A CRITICAL ANALYSIS OF THE EFFECTIVENESS OF CORPORATE RESCUE IN RETAIL SECTOR INSOLVENCY CASES

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DECLARATION

The candidate confirms that the work presented is her own and that appropriate credit has been given where reference has been made to the work of others.

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ABSTRACT

Over the years, there have been issues affecting the operational performance of companies operating in the United Kingdom (UK) retail sector leading to many well-known retail companies going bust. Corporate insolvency law provides rescue procedures aimed at ensuring the survival of a distressed company and/or its business as well as maximizing value in these companies for the benefit of creditors. However, it remains that most companies that undergo rescue procedures end up failing, resulting in suboptimal outcomes for stakeholders of the company. Thus, there is a constant struggle between the objectives of value maximization and survivability of rescued companies.

To this end, this thesis examines the effectiveness of corporate rescue procedures in achieving these objectives. The study begins by analyzing the drivers of financial distress and insolvency generally and in the retail sector. It proceeds to trace the development of the corporate rescue concept and examines the main rescue tools available to a distressed retail company in the UK mainly, schemes of arrangement, company voluntary arrangement (CVA), administration, pre-packaged administration(pre-pack) restructuring plan and the moratorium procedures.

Given the prominence of CVA in retail restructuring, this thesis has at its core an examination of this procedure. It explores the mechanics of this procedure and considers the operation of CVAs in retail restructuring cases. It attempts to understand the problems that hamper the effectiveness of CVAs and offer recommendations to this effect. Subsequently, it explores the pre-packaged administration (pre-pack) procedure which is often the alternative to CVAs in retail insolvency cases and considers the role of pre-packs in retail rescue whilst making some comparative analysis between CVAs and pre-packs.

This thesis finds that, while unsecured creditors fare better in a CVA in terms of outcomes, same is not the case in pre-packs as the procedure is attuned to lower realizations for these creditors. This project further examines whether the restructuring plan procedure offers a viable alternative to the problems identified in both CVAs and pre-packs. It finds

that the judicial involvement in the restructuring plan procedure may be helpful in addressing some of the problems identified in existing procedures.

Table of Contents

Chapter 1

Introduction

"Measurement is the first step that leads to control and eventually to improvement. If you can't measure something, you can't understand it. If you can't understand it, you can't control it. If you cannot control it, you cannot improve it."

Dr H James Harrington (American Businessman).[1]

1. Background

The retail sector is an important part of the UK economy contributing about 5.2% GDP in the year 2020 and 9.3% of all UK employees in 2019.[2] "It is a dominant force in the economy with an economic contribution of £97.0 billion in 2020, making a 5.0 percent of the UK's total economic output".[3] The UK has been regarded by Napoleon as "a nation of shopkeepers"[4] and the retail industry has been identified as one of the most competitive, diverse, and innovative business sectors in the UK.[5] Notwithstanding, many retailers operating in the UK continue to experience financial distress with some failing ultimately.

Recent years have witnessed a phenomenal decline in the performance of companies operating in the UK retail sector. This sector has been materially challenged with figures showing a total of approximately 16,000 store closures and 183,000 job losses in the year

[1] HJ Harrington, *Business Process Improvement: The Breakthrough Strategy for Total Quality, Productivity and Competitiveness* (McGraw-Hill, 1991) 112,118.

[2] L Croudace, 'Economic trends in the Retail Sector, Great Britain: 1989 to 2021' (*Office of National Statistics,* 27 July 2021) https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/articles/economictrendsintheretailsectorgreatbritain/1989to2021 accessed 1 October 2021.

[3] G Hutton, 'Retail Sector in the UK' (*House of commons Library,* 25 May 2021) https://researchbriefings.files.parliament.uk/documents/SN06186/SN06186.pdf accessed 1 June 2021 5.

[4] BE O'Meara, *Napoleon in Exile* (Cambridge University Press, 1822) 12.

[5] 'Department of Business Innovation & Skills, 'A Strategy for Future Retail' (2013) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/252383/bis-13-1204-a-strategy-for-future-retail-industry-and-government-delivering-in-partnership.pdf accessed 9 July 2018.

ended December 2020.[6] Factors responsible for these challenges include increased competition, online shopping which has led to reduced footfall, rental costs, increase in business rate, overly rapid expansions amongst others.[7] These problems have been further exacerbated by the 2019 coronavirus pandemic (COVID19) which had a pervasive impact on the UK economy.[8] Retailers have been hit hard on all fronts by the pandemic whose resultant effect was closure of physical stores across the UK and beyond.

The collapse of a retail company has adverse effects on the company, employees, creditors, customers, and the community. These stakeholders all suffer losses when a company cannot meet its obligations. The company will cease trading, the employees may lose their jobs, creditors may not recover monies owed to them, customers will have to look to other companies for goods, and communities may lose an important contributor to their quality of life.[9]

It must be acknowledged that the business environment globally has become volatile over the last two decades making it difficult for even the top performing retail companies to avoid financial difficulties.[10] Examples of UK retail companies that have experienced financial distress in recent years include Debenhams, JJB sports, Stylo plc, House of Fraser, New Look, British Home Stores, Carpetright, Mother care, Mamas & Papas, Toys R Us, amongst others.

Undeniably, failure will always be a possibility of a business venture as it is amongst a range of possible outcomes for the taking of risk. Since risk taking is part of human endeavor, it is impossible to avoid the occurrence of failure at least in some companies.

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[6] Centre for Retail Research, 'The Crisis in Retailing: Closures and Job Losses' https://www.retailresearch.org/retail-crisis.html accessed 1 July 2021. (Crisis in Retailing).

[7] Hutton (n 3); C Lamont, 'Re-structuring Leasehold Estates Under Chapter 11 of the US Bankruptcy Code and in England and Wales- a Comparison' (2018) 31 Insolvency Intelligence 69, 70.

[8] D David, 'Coronavirus: UK Worst Hit among Major Economies' *(BBC News,* 26 August 2020) https://www.bbc.com/news/business-53918568 accessed 1 September 2020.

[9] RK Rasmussen, 'A New Approach to Transnational Insolvencies' (1997) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=10380 accessed 1 July 2018.

[10] E Altman E Hotchkiss, 'Corporate Financial Distress and Bankruptcy: Predict and Avoid Bankruptcy Risk of Corporations' [2006] Journal of Banking & Finance 1, 30.

However, a distinction should be drawn between issues that are related to a company and affect its operations, and issues which are bound to occur during the lifetime of a company seeking to compete in an uneasy market.[11] Given a host of problems which it may encounter, it is pertinent to note that not all financial problems would lead to the end of a company.

In cases where the problems are significant, the company may be saved if certain measures are taken; for instance, the management of the company may seek help from the creditors to try to reach a compromise or arrangement with the aim of solving the company's problems before the situation becomes overly critical. This is the core of this thesis.

It examines the process which a distressed retail company undertakes to avert failure and continue trading as a going concern. This process in its literal meaning will be referred to as "corporate rescue/rehabilitation/restructuring" throughout this thesis. It entails helping a distressed but viable company to rise back to its feet and continue trading as a going concern. "As a perception, corporate rescue presents itself as a model designed to help distressed yet salvageable companies."[12]

When a retail company begins to struggle with its operational performance, the directors will usually respond to the difficulties in one of two ways: either they will attempt to restructure their finances and operations; or they will close their doors, sell their assets, and distribute the proceeds to their creditors. The former option may be regarded as a rehabilitation/rescue of the company while the latter may be classified as liquidation. Both options are opposing objectives of an insolvency regime.

On one hand, rescue aims to preserve the going concern value of a company by reducing or altering the claims of creditors. In most cases, the challenges facing a company is one

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[11] J Wood, 'Corporate Rescue: A Critical Analysis of its Fundamentals and Existence' (PhD thesis, University of Leeds 2013) 18.
[12] ibid 20.

that cannot be resolved without reorganizing the firm's structure or business.[13] Thus, the main purpose of a rescue regime is to maximize value in a financially distressed company by giving it a chance to restructure its business and continue trading as a going concern.[14]

On the other hand, liquidation seeks to put an end to an insolvent company. It is the process whereby the assets of a company are collected and realized, and the proceeds arising from the sale of the assets are used to discharge all the company's debts and liabilities and any outstanding balance after paying the costs and expenses of the process will be shared among the members according to their rights and interests, or as otherwise stated by the constitution of the company.[15]

From this analysis, it is evident that rescue will often be preferred to liquidation because the later diminishes or destroys the value in companies. The main rescue mechanisms that help retail companies alleviate the effect of financial distress and insolvency in the UK include the company voluntary arrangement (CVA), the pre-packaged administration (pre-pack) and the newly introduced restructuring plan procedure.

All the procedures are tailored around value maximization and survivability of rescued businesses. However, it appears that in CVA and prepack, little attention is paid to the latter as most companies/businesses end up in administration/liquidation. To further exacerbate the situation, returns to creditors under the procedures are either low or non-existent. The restructuring plan is still evolving, and it remains to be seen whether the same fate befalls this procedure as time goes on. Even though one of the goals of insolvency law is a restoration of a financially distressed company to solvency and allow it to carry on its business as a going concern,[16] this is often not the case and recidivism has been the norm in retail rescue context.

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[13] V Finch D Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, Cambridge University Press 2017) 209.
[14] ibid 117.
[15] A Keay, *Mcpherson's Law of Company Liquidation* (3rd edn, Sweet & Maxwell 2013).
[16] Finch and Milman (n 13) 25.

To this end, this thesis examines the main rescue procedures available to a distressed retail company in the UK to address financial distress and insolvency.

2. Research Objectives

Corporate rescue is a crucial aspect of any rescue law framework.[17] The UK government has always been concerned about the reformulation of its corporate rescue system to make the system fit for purpose. The promotion of entrepreneurship, investment and employment is at the heart of the UK government and policy.[18] At the crux of this research is the examination and assessment of the effectiveness of the rescue mechanisms available to a distressed retail company to restructure its debts on one hand, and the extent to which these companies survive as going concerns post-rescue on the other hand.

In this context, CVA, pre-pack and restructuring plan procedures are considered. This thesis focuses mainly on the CVA mechanism which has become the "go-to-procedure" for distressed retail companies seeking to restructure their debt and obligations. Furthermore, it is imperative to examine the role that pre-packs play in retail insolvency cases especially because directors often prefer to commence a pre-pack rather than a CVA,[19] coupled with the fact that more than half of the retail companies that undertake a CVA end up in a pre-pack.[20] The restructuring plan comes into play in this thesis due to its ability to restructure both financial and operational obligations of a retail company, something which is absent in CVAs as a standalone procedure.

With this in mind, 6 aims are produced:

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[17] TE Chan, 'Scheme of Arrangement as a Corporate Rescue Mechanism: The Singapore experience' (2009) 18 International Insolvency Review 37, 38.

[18] Insolvency Service, A Review of the Corporate Insolvency Framework: A consultation on option for reform (May 2016) www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework accessed 16 August 2018 para 2.1 (A consultation).

[19] P Walton C Umfreville L Jacobs, Company Voluntary Arrangements: Evaluating Success and Failure (R3, May 2018) https://www.icaew.com/-/media/corporate/files/technical/insolvency/publications/cvas-evaluating-success-and-failure.ashx accessed 24 July 2018 (Walton and others CVA) 51.

[20] A Hancock A Gross, 'More than Half of Groups Turning to CVAs still go under' *Financial Times* (London, 12 January 2020).

- To identify and assess the causes of financial distress and insolvency amongst companies generally, and in retail companies specifically.
- To consider the rescue options available to retail companies to ameliorate the effect of financial distress and insolvency.
- To specifically explore the mechanics of the CVA procedure.
- To illustrate through a series of case studies, the operation of CVAs in the retail industry, and identify factors that could impede successful retail rescue.
- To evaluate through comparative analysis the extent to which pre-packs offer a viable solution to retail insolvency cases.
- To examine the restructuring plan procedure and its consequence for corporate rescue

3. Research Questions.

This research project will seek to answer the following questions:

1. What are the causes of financial distress and insolvency in the UK and what are the drivers of distress and insolvency in the retail sector?
2. How does the UK insolvency framework ameliorate the issues facing retail companies in the UK?
3. What is the role of the CVA mechanism in the resolution of distress?
4. How do CVAs operate in retail restructuring cases? Given the continued use of CVAs by distressed retail companies, can the trend in retail CVAs be said to be changing the nature of the corporate rescue regime in the UK.
5. How does the pre-pack procedure compare with CVAs in the context of business rescue and future survival of retail companies?
6. What does the restructuring plan procedure mean for corporate rescue and what is the potential effect of the procedure on the use of CVA in retail restructuring?

4. Methodology

The research methodology adopted in this thesis is purely qualitative in nature. This is because this form of research supports the search for meanings and helps to better understand processes and procedures.[21] Likewise, qualitative research helps to uncover and understand processes that are deeply embedded within organizations.[22] To answer the research questions posed in this thesis, it is important to gain in-depth understanding of the processes used by retail companies to ameliorate financial distress and insolvency. Thus, a qualitative research design seems a step in the right direction.

This thesis aims to adopt a mix of doctrinal and descriptive qualitative research methods. Doctrinal analysis is the main methodology used in this thesis. The doctrinal method involves "a critical conceptual analysis of all relevant legislation and case law to reveal a statement of the law relevant to the matter under investigation."[23] This method examines a legal issue through an examination of the meaning of legal rules, principles, doctrines, and judicial statements relating to the issue.[24] It will principally involve a library-based approach to an examination of pre-existing literature and theoretical debates that have emerged in this field. The sources drawn upon will be cases, books, journal articles, reference books, government reports (white papers, consultations, and committee reports) and electronic sources.

Notably, the analysis canvassed using a doctrinal method is not merely an interpretation of the meaning of statutes and legal decisions, but it involves a logical and systematic examination of materials from these sources to identify the legal reasoning and rationales that controls the consistency and certainty of the law.[25]

This thesis adopts a doctrinal method because to improve the effectiveness of a law, it is important to understand the content of the law. A law has internal and external

[21] SL Jack AR Anderson, 'The Effects of Embeddedness on the Entrepreneurial Process' (2002) 17 Journal of Business Venturing 467.
[22] DJ Bluhm, 'Qualitative Research in Management: A Decade of Progress' (2011) 48 Journal of Management Studies 1866, 1870.
[23] T Hutchinson, 'Vale Bunny Watson? Law Librarians, Law Libraries and Legal Research in the Post-Internet Era' (2014) Law Library Journal 579, 580.
[24] K Vibhute F Aynalem, 'Legal Research Methods' (2011) https://chilot.files.wordpress.com/2011/06/legal-research-methods.pdf accessed 30 May 2022.
[25] Ibid 73.

effectiveness,[26] while the former refers to the coherence and consistency of legal rules, the latter deals with the effective operation of the law in real life context.[27] Before delving into the intricacies of the external effectiveness of a law, i.e. its practicalities, a legal researcher must “verify the authority and status of the legal doctrine being examined.”[28] This means that the researcher must understand and familiarize herself with the content and meaning of legal rules relating to the topic under examination. This thesis cannot examine the effectiveness of corporate rescue procedures in retail insolvency context without first examining and assessing the rules and legislation in this field.

Consequently, the doctrinal analysis is employed in this research project to provide an understanding of the laws and regulations that govern the current rescue framework in the UK. By so doing, this thesis will be able to answer questions on the causes of financial distress and insolvency amongst companies, as well as the role of rescue procedures in ameliorating the effect of financial distress and/or insolvency. The doctrinal analysis will be used in answering some of the research questions posed by the thesis. It will also offer a critique of the CVA and prepack procedure by comparing the outcomes of both procedures for the company and its creditors.

Despite the richness of a doctrinal analysis in providing a general overview of the operation of the law, it cannot fully assist the researcher in achieving the main objective of this thesis, which is to examine and assess the effectiveness of rescue procedures in retail insolvency cases and consider the extent to which retail companies survive as going concerns after being rescued. For example, a doctrinal analysis cannot provide answers to the questions of whether the trend in CVAs can be said to be changing the nature of the UK corporate regime, how CVAs and prepacks operate in retail restructuring context. This is because the doctrinal approach is limited to examination of legal rules, principles

[26] W Schrama, ‘How to Carry Out Interdisciplinary Legal research: Some Experiences with an Interdisciplinary Research Method’ (2011) 7 Utrecht Law Review 147, 148.
[27] Ibid.
[28] T Hutchinson, ‘Doctrinal Research: Researching the Jury’ in D Watkins, M Burton (eds) *Research Methods in Law* (Routledge 2013) 7.

and doctrines in law and does not touch on how the law operates in practice.[29] As a result of this, the doctrinal research method plays a supplementary role in legal research.

On the other hand, descriptive research methods as the name implies describe situations. A descriptive research method will be used to examine, describe, and identify the practical use of CVA, pre-packs and the restructuring plan procedures in the retail sector. This form of research method focuses on capturing the situation as they are present. It is "aimed at casting light on current issues or problems through a process of data collection that enables them to describe the situation more completely than was possible without employing this method."[30]

As part of the descriptive research methodology, this thesis will adopt a case study approach. This method of analysis enables the exploration and understanding of complex social issues. Case studies are used when there is need to gain deep insights beyond reliance on statistical results.[31] It involves a detailed and in-depth analysis of a particular event, phenomenon, situation, organization, or procedure within its real-life context. According to Yin, a case study is "a rich empirical description of particular instances of a phenomenon that is typically based on a variety of resources".[32] To be able to identify certain mechanisms or patterns amongst retail companies which experienced financial distress and insolvency, a multiple-case study approach was deemed appropriate as suggested by Yin.[33]

Suffice to say that the case study method seeks to test the aspect of a phenomenon through different means to comprehensively understand the subject at issue and offer a systematic based solution to problems found from such investigation. Moreover, the use of case study methodology is appropriate in this thesis given its effectiveness in

[29] M Salter J Mason, W*riting Law Dissertation: An Introduction and Guide to Conduct Legal Research* (Pearson Education 2008) 132.
[30] W Fox MS Bayat, *A Guide to Managing Research* (Juta & Company Ltd 2007) 45.
[31] J Feagin A Orum G Sjoberg, *A Case for Case Study* (University of North Carolina Press 1991).
[32] RK Yin, *Case Study Research: Design and Methods* (4th edn Sage 1984).
[33] Ibid.

answering how, why, and what questions,[34] which are the main types of research questions in this thesis.

A case study is particularly useful in a situation where the context is relevant to the phenomenon.[35] In this instance, investigating the effectiveness of rescue procedures (the phenomenon) within distressed retail companies (the context). It involves an analysis of processes taking place overtime in specific companies that have experienced financial distress, with multiple issues and actors. Because the boundaries between a phenomenon are somewhat blurred, case study design relies on multiple data sources for evidence.[36]

In Chapter 5, case studies of 10 retail companies that have used the CVA mechanism to tackle the effect of financial distress are presented. The companies in the sample are fashion, children, sports, home, stationery, and beauty retailers. Each case study evidences how CVA operate in retail insolvency cases and the consequences of this operation for the company and its creditors.

In Chapter 6, 7 case studies are examined. Each case illustrates how pre-packs are used in retail insolvency context and the effect of this on creditors of the company. Through this, a comparative analysis is drawn between the CVA and the prepack with the aim of considering which is of optimal benefit to the company and its creditors. case studies are also considered in the 7th chapter. Here, the focus is on exploring how the new restructuring plan operates generally and in retail restructuring context.

4.1. Sampling

A qualitative research inquiry typically focuses on information-rich sample of cases which are selected purposefully to illuminate the questions under study.[37] Based on Yin's suggestion on the pattern of case selection, multiple cases should adopt a replication

[34] Ibid.
[35] K Schoch, *Case Study Research* (Sage 2020) 245.
[36] Yin (n 32)15.
[37] MQ Patton, *Qualitative Evaluation and Research Methods* (Sage 1990).

logic and not sampling logic because multiple cases should be regarded as “multiple experiments” and not “multiple respondents in a survey”.[38]

There are no rules for sample size in qualitative research, the number of cases to include in a case study methodology is usually left for the researcher to decide.[39] It has been argued elsewhere that “the validity, meaningfulness and insights generated from qualitative inquiry have more to do with the information-richness of the cases selected and the observational/analytical capabilities of the researcher than with the sample size”.[40] This means that the criteria used in case selection is not “representativeness” rather the choice of each case should be made in a way that it either predicts similar results for predictable reasons (literal replication) or produces contrary results for predictable reasons (theoretical replication).[41]

This thesis concluded that 10 cases would be enough to justify the research design given that the number of cases included is not of utmost importance rather the information derived from these cases which can be used to generate meaningful insight into the subject of study. The sample size of 10 cases was determined based on the following criteria:

1. A base line approach adopting the approach of Creswell[42], who suggested that ten cases are acceptable number of case studies that a researcher should explore.
2. A review of similar qualitative case studies showed ten cases is an ideal number.[43]

[38] Ibid.
[39] C Romano, ‘Research Strategies for Small Business: A case Study” (1989) 7 International Small Business Journal 35, 36.
[40]Patton (n 37) 185
[41] RK Yin, *Application of Case Study Research* (Sage Publications, 2012) 46
[42] JW Creswell, *Qualitative Enquiry and Research Design: Choosing Among Five Approaches* (2nd edn Sage 2007)73.
[43] GI Hewapathirana, ‘Internationalization of Small Business: Multiple Case Studies of Successful Small Business Managers in Sri Lanka (PhD thesis University Digital Conservancy 2009) TJ Rzemy, ‘Faculty Experiences of Internet Filtering at A Proprietary Higher Education Institution (PhD thesis, Northcentral University 2011) 180-181.

3. Based on a predicted sufficiency point which has been defined as the saturation point in which the researcher realizes that no new substantial information that can add to the research questions can be found from any other case.[44]

To strengthen the case selection process, the researcher further adopted the criteria suggested by Stake.[45] According to him, "the first criterion [in case selection] should be to maximize what we can learn"[46] The other criteria as suggested by Stake include:

1. Do the cases provide diversity across contexts?
2. Do the cases provide good opportunities to learn about complexity and contexts?[47]

Further, other strategies have been identified in the literature for purposefully selecting information rich cases. One is criterion sampling which serves to "review and study all cases that meet some predetermined criterion of importance."[48] Another form of purposeful sampling as defined by Patton is intensity sampling which consists of "information-rich cases that manifest the phenomenon of interest intensely…"[49] These sampling methods were also chosen in this research because the researcher was seeking excellent or rich examples of the phenomenon under consideration that could mirror certain criteria.

Additionally, Creswell suggested the need to select cases that "show different perspectives on the problem, process, or event to be portrayed.[50]" He also stated that ordinary cases, accessible cases, or unusual cases may be selected.[51] The cases selected included successful and failed retail CVAs. An examination of successful and

[44] N Mack and others, 'Qualitative Research methods: A Data Collector's Field Guide' (2005) Research Triangle Park 252.
[45] RE Stake, *Multiple Case Study Analysis* (Guilford Press 2006) 4.
[46] Ibid.
[47] Ibid 23.
[48] ibid 238.
[49] Ibid.
[50] Creswell (n 42) 75.
[51] Ibid.

failed companies can strengthen and validate the case study by offering different and alternative perspectives on the subject under consideration.[52]

Based on the aforementioned perspectives on case selection approach, the following criteria was applied to case selection in this thesis.

1. Retail companies who experienced financial distress and/or insolvency and initiated a CVA.
2. Retail companies whose financial difficulties were caused by internal and external factors.
3. The CVA must have been either approved or rejected by creditors, if approved the CVA must have been implemented.
4. The CVA must have been completed, terminated or ongoing.
5. Retail CVAs which had been challenged by creditors in court.
6. Retail companies whose information were accessible and publicly available.

It is noteworthy that the second criteria used here for case selection was based on testing assumptions that had been generated from the wider literature and in the doctrinal analysis in Chapter 2 of this thesis. In chapter 2, it was submitted that no one factor is responsible for a company's financial problems, and it is important to construe the causes of distress/failure from identifying both factors which are internal and external to the company. Such internal factors include poor management skills and qualities, low productivity and improper management successions.

External factors include the rapid growth of e-commerce, store closures, high occupational cost, too much debt, changes in consumer preference and coronavirus lockdown. It has been argued that internal factors only affect a particular firm or a small number of firms within the same market while external factors are more pervasive and

[52] AE Kelly RK Yin, 'Strengthening Structured Abstracts for Education Research: The Need for Claim-based Structured Abstracts' (2007) 36 Educational Researcher 133.

affect all companies in the market.[53] To test the veracity of this argument, it was important to identify companies whose problems had been caused by both factors of distress.

Before selecting the 10 cases, a list of large retail companies that have entered these procedures and had filed statutory documents with Companies House in the UK were identified. One of the requirements for identifying these companies was media spotlight, and this was done by accessing online sources which was the most cost-effective means of doing so. Likewise, the researcher was able to access the Centre for Retail Research website.[54] This website provides "authoritative and expert research and analysis of the retail and service sectors in Britain, Europe and globally."[55] The sample does not claim to represent the situation of all retail companies in an insolvency situation. However, due to their large size, and the diverse nature of their creditors, these 10 cases provide comprehensive evidence of typical retail insolvency situations and its effect on the company and its creditors. The companies included in the case study include, JJB Sports plc, Stylo plc, Homebase, British Home Stores, Paperchase, Newlook, Mamas&Papas, Mother care, Toys R Us and Debenhams.

The cases identified in chapters 5 & 6 have been selected for evaluation in this thesis due to high-profile nature, media spotlight and accessibility of the documents filed by the insolvency practitioners. Also, even though these companies are retail companies, they operate different businesses which allowed the researcher to establish the impact of rescue procedures on companies operating different types of businesses. The wide availability of secondary data including the reporting requirements imposed on these companies, publicity created by formal announcements and media spotlight made the selection process less cumbersome.

Given the time and resources available to the researcher to complete this thesis, it was determined that 10 cases will be sufficient for this research. Looking at the data generated

[53] F Memba, 'Causes of Financial Distress: A Survey of firms Funded by Industrial and Commercial development' (2013) 12 Interdisciplinary Journal of Contemporary Research in Business 1171, 1176.
[54] Centre for Retail Research, https://www.retailresearch.org accessed 1 June 2022.
[55] Ibid.

from the cases, it is evident that this number is sufficient for the analysis that followed the case studies. Lastly, by analyzing different retail companies each with its own unique identity, operating different types of retail businesses, it may be possible to establish whether the impact of the CVA process is universal to unsecured creditors. Likewise, there will be potential to gain extensive knowledge on the operation of the procedure in retail insolvency cases. Each case provides the company background, the event leading to the company's financial distress and the causes of the financial distress. It then proceeds to examine the CVA process, the terms of the CVA proposal; the outcome of the CVA.

It must be pointed out that the cases examined in chapter 6 have been selected by this thesis for the same reasons. All were companies that initiated a CVA and thereafter entered a pre-pack procedure upon insolvency of the company. Although House of Fraser was not among the companies examined in chapter 5, but it was selected for examination in this chapter due to the media spotlight surrounding its pre-pack process.

Given that the pre-pack is usually a follow-on procedure for retail-CVAs, for sequential flow and to test and compare both outcomes and effect of both procedures (CVA and Prepack) on the company and its creditors, the researcher believed that rather than identify other companies that had initiated a pre-pack, it would be appropriate to consider some of those companies that had already been considered in the CVA chapter and identify comparable themes. Each case begins with an overview of the company, followed by the proposed sale agreements, and the outcome of the procedure.

It is noteworthy that the approach to case selection in the 7^{th} chapter which examines the restructuring plan procedure differs slightly from that of Chapters 5&6. Given that the restructuring plan procedure is still evolving, and at the time of writing this thesis only a handful of companies had initiated the procedure in response to financial distress, the researcher decided to examine 3 cases as an illustrative sample, required for a specific purpose: which is to understand the role of restructuring plans in corporate rescue and potential effect of the operation of restructuring plans in leasehold restructuring context.

This type of case study is descriptive in nature and the intent is to provide the reader with a general knowledge of the phenomenon and any other information that is important to support the research.[56] An illustrative case study aims to paint a wide picture about the topic. Due to its simplistic nature, it has been suggested by Davey[57] that only a small number of cases should be used. Consequently, of the 9 companies that had used the restructuring plan procedure, 3 were deemed adequate for the analysis in this research.

Notably, these companies differ from the retail companies that had been examined in the previous chapters. Virgin Active is a health club operator, Hurricane Energy plc, on the other hand is an oil-exploration and production company, while Pizza Express is a restaurant chain. Regardless, they were chosen based on certain considerations. The Virgin Active case is the first time that the court has considered the use of the restructuring plan in restructuring leasehold liabilities. It is the first true test of the cross-class cram-down mechanism and further affirms the usefulness of the restructuring plan as a comprehensive restructuring solution to tackle both financial and operational liabilities (such as those owed to landlords) with multiple creditors. It demonstrates the use of the procedure by debtor companies seeking to implement a major restructuring across their capital structure, and as an alternative to the CVA procedure.

The Hurricane case was chosen mainly because it is the first time that the court has refused to sanction a cross-class cramdown tool. The case represents an important test of the parameters of the restructuring plan procedure and the key considerations that the court will consider when attempting to exercise its cross-class cram-down powers. The Pizza Express was chosen to examine how the court will consider a restructuring plan which was used as part of a wider restructuring process and which the CVA which formed part of the rescue effort had been subjected to a challenge. The restructuring plan of Pizza Express is significant for being the second to be launched after the procedure was introduced in June 2020, involving a combination of debt-for-debt and debt for-equity

[56] A Baron K McNeal, Case Study methodology in Higher Education (Pam Epler 2019).
[57] L Davey, 'The Application of Case Study Evaluations' (1990) 2 Practical Assessment Research and Evaluation 9.

swaps. Likewise, of the three cases, it did not involve the use of the cross-class cram down facility.

Put together, these cases will provide insights into the practical operation of the restructuring plan procedure. Overall, the effect of studying a sample of cases all focused on the same issue i.e., “rescue in retail insolvency context” should create a more comprehensive “analytical strength” and lead to “all encompassing” conclusions, especially as the diversity of the cases increases.[58]

4.2. Data Collection Sources

To triangulate and enrich the overall picture, this research used multiple sources of information for its case study. The first source of data used is the reports available at the UK “Companies House” website[59] which holds details about the information of companies from inception up until insolvency. Upon entry into a CVA, mandatory disclosure continues to apply to the company directors and the supervisor of the CVA is obliged to file his own report with Companies House under the Insolvency Act 1986.[60] Once the company enters administration, the administrators are responsible for filing statutory information relating to proposals[61], progress reports,[62] and any extension of the process.[63] The administrator will also be required to disclose any information on the exit process from administration such as liquidation or dissolution. Likewise, entry into administration and by extension a pre-pack requires the administrator to document the progress of the administration.

[58]KM Eisenhardt ME Graebner, ‘Theory Building from Cases: Opportunities and Challenges’ (2007) 50 Academy of Management Journal 25, 27.

[59] Companies House, ‘Get Information about a Company’ https://www.gov.uk/get-information-about-a-company accessed 10 February 2019.

[60] Companies House, ‘Companies House Forms for Insolvency (1986).’ https://www.gov.uk/government/publications/give-notice-of-voluntary-arrangement-taking-effect-cva1 accessed 12 March 2019.

[61] Insolvency Act 1986, schedule B1, paragraph 41(4).

[62] Insolvency rules 1986, rule 2.47(4).

[63] Insolvency Act 1986, schedule B1, paragraph 78(5)(b).

All these filings are publicly available through Companies House and are a detailed source of secondary data which is used in this thesis to describe and examine financial distress and insolvency amongst companies operating in the UK retail sector. In addition, there were commentaries, analysis, interviews from a wider range of available online data sources.

Since the case studies includes a mix of public and private companies, for public companies the source of data used was the mandatory information that such companies are required to disclose under listing rules. This information is available through the Regulatory News Service (RNS) which is linked with the London Stock exchange (LSE) and records a variety of issues including the pre-rescue options adopted by the company.

Once a company becomes insolvent and is delisted from the LSE, it is no longer required to make announcements and any news which it makes are no longer available. However, there is an archive of previous news online. This is available via RNS-channelled company announcements through "FE Investegate" website that provides a sequential record of all company announcements online. This online archival data retrieval facility is controlled by Financial Express UK.

The second source of information was obtained from a wide range of online commentaries from commercial and financial media such as Financial Times, retail gazette, Estate gazette, the Guardian, Retail Week, Business Insider, and The Independent. This information can be found through Nexis and ProQuest websites.

Ethical review was not required for this study mainly because data collection and all other analysis are carried out by secondary means. Also, because primary data collection such as conducting semi structured interviews and other empirical research methods are not relevant to this study and may be cumbersome and expensive to undertake.

4.3. Data Analysis

There are different methods used to analyse qualitative data depending on the type of data, method of data collection, the subject matter and research design and objectives.[64] As submitted elsewhere, qualitative data can be analysed in 4 stages: data reduction, data display, conclusion drawing and verification, in which only when the volume of data has been organized in a manageable way will the analysis be completed.[65] In this thesis, two methods of qualitative data analysis were used: Thematic Analysis which is then following with a step wise analysis comprising of within case and cross case analysis which are used to isolate variables and draw conclusions. Starting with Thematic Analysis,[66] while there are different approaches to conducting thematic analysis, the most common approach in the literature includes[67]:

1. Familiarizing with derived data
2. Generating initial codes
3. Searching for themes
4. Reviewing the themes
5. Defining and naming themes
6. Producing the report.

Thematic analysis is an effective approach for determining processes, opinions, experiences and knowledge. Also, it helps to create value from a set of perspective data such as transcripts, case studies, interviews etc. I used this six-phase guide as a foundation in conducting thematic analysis in my study. In Phase one, “Familiarizing yourself with your data is focused on reading and re-reading the data, noting down initial ideas.[68]” In line with this phase of analysis, I delved into the data, I read each case thoroughly about three times over again to begin identifying patterns and meanings, I took notes as I went along. Further, I used “Excel Spreadsheet” as a tool of analysis. I created

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[64] NK Saunders and others, *Research Methods for Business Students* (Pearson 2009).
[65] MB Miles AM Huberman, *Qualitative Data Analysis: An Expanded Sourcebook* (Sage 1994).
[66] V Braun V Clarke, ‘Using Thematic Analysis in Psychology’ (2006) 3 Qualitative Research in Psychology 77, 79.
[67] Ibid.
[68] Ibid 87.

different columns for each case in excel and conducted an analysis to identify the main patterns and themes which had been handwritten during the data collection process.

The second phase of data analysis involved coding the material by generating initial codes.[69] The data was coded into "manageable and meaningful text segments, with the use of a coding framework…"[70] I devised a coding framework based on some pre-determined criteria and recurrent issues that arose from the text. 20 codes were derived based on for instance; causes of financial distress; categorization of leases; sales agreement; status of the process; relevant alternative; cross-class cramdown; outcome whether survival or dissolution amongst others. All these issues were combined and by going through the transcripts, the most salient points in the discussions were identified and turned into a definable set of codes that were meaningful and distinct. The transcripts were then scrutinized, grouped and organized according to these codes. For instance, the code "distress" included text segments such as "A company's problems may be caused by both internal and external factors." The code "trend and outcome" included text segments such as "More than half of distressed companies in the retail industry that have entered rescue procedures ended up in liquidation."

Ahead of the third phase, I focused on developing themes across the cases as this has been described as the first and most basic level of analysis that is used as an organizational tool.[71] In phase three, themes are searched, and codes are collated into potential themes and all data relevant to each theme will be gathered and matched.[72] I analyzed the sorted codes to identify significant or common themes across each code. This was done by re-reading the text segments which had been classified under each code.

[69] Ibid.
[70] J Attride-Stirling, *Thematic Network: AN Analytical Tool for Qualitative Research* (Sage Journal 2001) 391.
[71] V Braun V Clarke, 'Using Thematic Analysis in Psychology' (2006) 3 Qualitative Research in Psychology 77, 86.
[72] Ibid 87.

In phase four, the themes were reviewed to check if they are in line with the coded extracts and the entire data set thus generating a thematic map of the analysis.[73] In this phase, I used a two-level analysis of the codes to refine the draft themes identified in phase three. The first level involved reviewing the codes for each theme and determine if a coherent pattern exists. If positive, I moved on to the second level of analysis, if no coherent pattern was found, I had to determine whether it was the theme itself that had some issues or the codes and information for that theme. To finalize the second level analysis, I read through the entire data set to ensure there was a match between the theme and data. This enabled me to check if I had omitted any additional data that needed to be code.

Moving on to phase five which involved "defining and naming themes, ongoing analysis to refine the specifics of each theme, and the overall story the analysis tells, generating clear definition and names for each theme."[74] The aim of this phase was to be able to "…clearly define what your themes are and what they are not."[75] To achieve this objective, I focused on defining each theme, identifying the essence of the theme and determining what aspects of the data and research question the theme could fall under. The final phase involved "…selection of vivid completion extracts examples, final analyses of selected extracts, relating back of the analysis to the research questions and literature, producing a scholarly report of the analysis."[76] In this phase, my focus was on analyzing the data and writing an informative piece about the data. I related the principal themes and patterns that emerged in the analysis to the original research questions and interpreted these questions based on the context and exploration of the texts from the analysis and constructs supporting the research.

The second method of analysis used comprised of two parts: within case and cross-case analysis. Several variables both independent and dependent variables arose from the data that had been gathered from the case study analysis. I used a stepwise approach to

[73] Ibid.
[74] ibid 87.
[75] Ibid 92.
[76] Ibid 87

draw conclusions from the data following Eisenhardt's suggestion.[77] First, a within case analysis is conducted followed by a cross-case analysis. As part of the within-case analysis, a detailed description of each case was undertaken. These descriptive analyses were central to the generation of insights into the cases,[78] because I was able to manage the enormous volume of data that had been gotten from the data collection process. The descriptions of each case followed a chronological structure to allow a better overview of each case to be distilled. The descriptions enabled the researcher to become familiar with the cases. Subsequently, the researcher was able to identify possible similarities and differences between each case.

After this analysis, a cross-case analysis was done to "search for patterns."[79] During this phase, pattern-matching, data displays and explanation building analytical techniques[80] were used. This prevented the researcher from looking at the data from one angle and missing out on important findings. Thus, generalizing or reaching a conclusion based on initial impressions is eliminated. I began looking at the data in many ways. I selected categories within the cases and sought for within-group similarities as well as intergroup differences as suggested by Eisenhardt.[81] I grouped each company into categories based on the nature of their businesses and identified the companies whose problems were caused by either internal or external factors and grouped them together to identify patterns. Thereafter, I selected pairs of cases which are alike and then compared the different pairs among each other to be able to detect similarities and differences. By so doing, different variables and themes emerged, which enabled the researcher to draw novel findings.

Based on this, propositions, overall impressions, themes, concepts, and relationships between variables emerged. To manage this iterative process, I compared all the

[77] KM Eisenhardt, 'Building Theories from Case Study Research' (1989) 14 The Academy of Management Review 532, 539.
[78] C Gersick, 'Time and Transition in Work Teams: Toward a new Model of Group Development' (1988) 31 Academy of Management Journal 9.
[79]Eisenhardt (n 77) 540.
[80] Yin (n 32)
[81] KM Eisenhardt, 'Building Theories from Case Study Research' (1989) 14 The Academy of Management Review 532, 540.

information that emerged from the cross-case analysis with the evidence that emerged from each case to assess how well or poorly it fits with the data. As aptly described elsewhere, “the central idea is that researchers constantly compare theory and data iterating toward a theory which closely fits the data. A close fit is important to building good theory because it takes advantage of the new insights possible from the data and yields an empirically valid theory.”[82] This approach helped me in drawing conclusion by searching for patterns, themes and verifying them against the literature.[83]

4.4. Quality Criteria

There is need to establish if the approach taken in this study meets rigorous standards of reliability and trustworthiness. The conclusions made need to be verified in one way or the other. I am confident that this study is reliable and if carried out again, it would produce the same results. Moreover, the research uses secondary data, which makes it easier to describe the information obtained and is publicly available to anyone looking to conduct similar research. In terms of validity, as suggested elsewhere, validity means that the concept studied measures what it purports to measure.[84] With the detailed analysis that have been undertaken in this research, it is believed that it represents the content being studied. This means that the researcher has taken time to produce a work that is of high quality and therefore covered the area been researched.

4.5. Limitations.

While the case study has lots of benefits, it is important to acknowledge its disadvantages especially within the context of this research. The limitations to the case study methodology used in this research include the small sample size of retail companies used in the study which may raise questions of effectiveness in drawing wider reaching conclusions. Likewise, the focus on companies with media spotlight may pose a risk of inherent bias. A commonly acknowledged weakness of case study methodology is its lack

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[82] Ibid.
[83] Miles and Huberman (n 65).
[84] A Bryan E Bell, *Business Research Methods* (3rd edn, Oxford University Press 2011).

of rigor and validity in comparison with quantitative numeric studies for example.[85] Consequently, the conclusions reached from the case studies may somewhat present predominantly an "insider view" i.e., my personal bias which may lead to questions of whether the study encompassed an objective understanding and interpretation of the data. However, this weakness has a minor impact on the current study since the focus was on revealing a specific problem with an already identified population of retail companies.

Also, it is submitted that given the similarities in information across the cases, it could be argued that the sample is representative of general experiences of retail companies that have initiated rescue procedures in the UK. Moreover, it has been submitted elsewhere that even though the results from case studies cannot be generalized, it can be used as "springboard for further research or allow links to be forged with existing findings in the area."[86] Further training on research methods would have assisted the researcher however this posed a risk of high cost and would be time consuming. Notwithstanding, multiple case studies with focus groups, interviews, surveys, and observations could have assisted in enhancing the reliability and validity of the research.

5. Originality

This thesis contributes to the thin literature on corporate rescue in the UK retail insolvency cases. Research on the CVA mechanism has been low due to the notion that the procedure is rarely used. Some existing research focus on the reasons for the success or failure of CVAs[87] as well as a consideration of the outcomes of failed CVAs.[88] Little attention has been paid to the operation of CVAs in retail insolvency cases. This thesis attempts to bridge this gap.

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[85] RK Yin, Case Study Research: Design and methods (5th edn Sage 2014) 19-22; B Flyvberg, 'Case Study' in NK Denzin YS Lincoln (eds) The Sage Handbook of Qualitative Research (2011) 302,309-311.
[86] Bryman and bell, (n 84) 190.
[87] Walton and others CVA (n 19).
[88] S Frisby A Walters, '*Preliminary Report into Outcomes in Company Voluntary Arrangements'* March 2011 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792402 accessed 10 March 2018. (Frisby and Walters CVA).

Retail insolvency has become a reoccurring phenomenon amongst financially distressed companies operating in the UK retail sector. The retail industry plays an important role in the UK economy. Of major importance is the fact that the retail sector is closely linked to other sectors of the UK economy including manufacturing, construction and wholesale and as such, it has a multiplier effect on these industries.[89] Failure of a retail brand not only affects the company, but it also extends to the gamut of parties associated with it. Company failure has the potential of extremely disrupting an industry and may also cause significant ripple effects in an economy.

The increasing business deaths amongst retail companies entering rescue procedures calls for investigation into the causes of this recidivism rate and suggest solutions to the problems affecting successful retail rescue in UK insolvency law framework. Through series of retail case studies, I consider the extent to which the CVA and other rescue mechanisms facilitate rescue and survival of distressed retail companies and/or their businesses in the UK. The case studies are utilized to evidence the operation of the rescue procedures to enable the researcher to identify shortcomings of these procedures.

This research work on the operation of CVAs and other rescue mechanisms has implications for insolvency law policy generally and certain aspects of the UK corporate insolvency regime. First, whilst the CVA is infrequently used, this thesis delves into specific area in which the procedure is used i.e., in the retail industry. The thesis uses the retail industry as an important context to examine the sufficiency/efficiency level of rescue procedures used by distressed retail companies to avoid insolvency. It is the first project to consider the effectiveness of CVA as a rescue strategy for distressed retail companies through a series of case studies. Second, apart from the CVA, it also considers the effectiveness of the pre-pack and restructuring plan procedures which demonstrates an important contribution to knowledge of the actual functioning of the UK's

[89] Department For Business Innovation & Skills, 'A Strategy for Future Retail' (October 2013) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/252383/bis-13-1204-a-strategy-for-future-retail-industry-and-government-delivering-in-partnership.pdf accessed 12 January 2021, 6.

corporate insolvency regime and the impact that different types of rescue processes have on the debtor retail company and its stakeholders.

Third, through the analysis, the thesis shows that there is a tension between flexibility and fairness in both CVAs and pre-packs. Flexibility in rescue procedures means that the mechanisms can adapt to changing times and changing corporate structures. Fairness suggests that the process fully considers the privileges of all stakeholders, without preferences for a particular group of actors mostly insiders or repeat players when determining who should get paid amidst limited resources. Both flexibility and fairness do not coexist easily in corporate insolvency law.

On one hand, flexibility is amplified by reducing the number of voices that are important in a corporate rescue process. Such reduction however reduces fairness of the process. Flexibility inures to the advantage of large, repeat players who can adopt flexibility to suit their own interests. This no doubt may lead to self-maximizing pursuits at the expense of less sophisticated parties. Arguably, repeat players pursue flexibility because if it less fair.[90] As submitted elsewhere, … “flexibility and fairness will always represent inherent tradeoffs in this context”.[91]

A CVA is a flexible mechanism that allows retail companies to push through a compromise with creditors to achieve a retail restructuring and allow the company to continue trading as a going concern. However, whilst the flexibility of CVA is its greatest strength, it remains that the strategic use of this procedure has led to fairness issues. While secured creditors, preferential creditors and some trade creditors who are deemed “critical creditors” will usually be unaffected by a retail CVA, same cannot be said of landlord creditors who will usually have to deal with rental cuts and lease compromise. This is further exacerbated by the fact that most retail companies that initiate a CVA end

[90] SJ Lubben, ‘Fairness and Flexibility: Understanding Corporate Bankruptcy’s Arc’ (2020) 23 University of Pennsylvania Journal of business Law 129, 133.
[91] Ibid.

up in administration and ultimately liquidation,[92] leading to little returns for stakeholders. Nevertheless, this thesis shows that compared to existing rescue procedures, the CVA often provides beneficial outcomes for the creditors.

Secondly, the drift between flexibility and fairness is also inherent in pre-packs. The flexibility of the process allows the main actors to carry out an agreement for a sale before the formal process is initiated. The unsecured creditors only become aware of the process after it is completed thereby putting them in an unfair position. This is exacerbated by the fact that these creditors do not receive as much returns as it is in CVAs and these companies often are dissolved ultimately, which is a loss for creditors of the company.

Further, this tension extends to the very heart of rescue itself. The main objective of rescue is to maximize value in distressed entities for the benefit of the stakeholders of the company and give viable but distressed businesses the opportunity to attempt rescue and continue trading as a going concern (the so-called second chance culture). This thesis finds that in both CVAs and pre-packs there is a tension between value maximization in distressed companies and future survivability post-rescue. Value maximization means amplifying the net present value of future profits for the benefit of pre-distress stakeholders. In other words, maximizing the pie in the interests of stakeholders.

Future survivability means the ability of a company and/or its business to survive after undergoing a rescue procedure and continue trading as a going concern. Notably, this does not mean going back to the way the company used to be before distress, as expected minor alterations would have taken place during the rescue process. The tension between value maximization and post-rescue survival of retail companies suggests the presence of recidivism in rescue procedures. Consequently, there is need to ensure a balance between the quest for value-maximization with the need to have sustainable company/business rescues.

[92] A Hancock A Gross, 'More than Half of Groups Turning to CVAs still go under' *Financial Times* (London, 13 January 2020).

The restructuring plan procedure and its novel features can potentially address these imbalances. The procedure is all-encompassing due to its ability to holistically address operational and financial liabilities of retail companies. The court supervision and the sanction role may potentially have a role to play in addressing the problems with existing procedures. It is acknowledged that even though the procedure is still in its infancy and will take time to prove itself as a tried and tested tool in rescue cases, it remains that there is potential for the procedure to be an effective rescue tool given how it has been construed and applied in recent restructuring cases.

This thesis makes a significant contribution to knowledge by making certain recommendations targeted at recidivism reduction which can be helpful for policy makers, and insolvency practitioners to achieve a balanced system, improve the functioning of the rescue regime for distressed retail companies in the UK and enhance creditor and public confidence in the integrity and effectiveness of insolvency system.

6. Thesis Structure

This thesis contains 8 chapters which consists of the following:

Chapter one introduces the thesis. It provides an overview of the topic and the legal problem which the thesis seeks to answer. It gives an analysis of the research background, the research objectives, research questions, methodology, contribution to knowledge and the structure of the thesis.

Chapter two sets the scene for the thesis by examining the causes of financial distress and insolvency of companies generally and retail companies specifically. I introduce the reader to basic concepts of financial distress and insolvency and the causes of corporate failure from a legal and business perspective. Chapter three considers the development of insolvency law and corporate rescue in the UK. It identifies the rescue mechanisms available under the UK insolvency framework including schemes of arrangement, administration, pre-pack, CVA, restructuring plan procedure and the new moratorium procedure.

Chapter four considers the mechanics of the CVA procedure and its role in the UK corporate rescue framework. An analysis of the purpose, usage, and success of the procedure as a rescue mechanism is carried out in this chapter. Chapter five takes the discussion a step further by assessing the use of the CVA procedure in the retail sector. The retail sector was chosen because at the conception of this research project in 2018, there was an increase in retail insolvency and the use of CVAs, which made the year 2018 to be dubbed as "the year of the CVA".[93]

As such, analysis of certain retail sector companies that have used CVA to rescue their businesses will be evaluated to consider the feasibility of the procedure as a rescue device for retail companies. Some problems affecting the effectiveness of retail-CVAs are identified and recommendations are given to enhance the effectiveness of the procedure.

Chapter six assesses the use of pre-packs in retail insolvency cases and compares the outcomes of pre-packs and CVAs and what this means for the creditors of the company. Chapter seven examines the mechanics of the restructuring plan procedure. It also considers the effect of the restructuring plan on the operation of CVAs. Chapter eight closes the thesis; It provides a summary of research conducted, recommendation for improving the rescue regime for retail companies and identifies some considerations that might benefit from further research.

[93] S Clark G Moore, 'Could 2018 be the Year of the CVA?' (*Walker Morris,* 16 February 2018) https://www.walkermorris.co.uk/publications/2018-year-cva/ accessed 17 May 2018.

Chapter 2

Corporate Failure: Understanding the Causes of Financial Distress and Insolvency

Introduction

This chapter examines the concept of corporate failure. In this regard, it looks at the reasons why companies fail from a legal and business point of view. It is necessary to consider the nature and drivers of failure to understand how the law can step in to ameliorate some of these issues in a way that unsalvageable firms can be differentiated from salvageable ones and the right course of action can be pursued. It must be pointed out however that insolvency law does not aim to save all companies from failure.[1] "The economy is made up of a vast number of firms, each engaged in marketing and product innovations that are designed to improve competitive positions and each being challenged in the market by other firms."[2]

Business undertaking requires taking risks and dealing with problems, and the price paid for this is that only companies that are able to compete effectively will survive.[3] Thus, an efficient and competitive marketplace will drive unviable companies to the wall either because they are operating in an uncompetitive manner, or their products have become obsolete such that they are not in demand by consumers or it may be the case that the inability of directors to manage risk may leave creditor's susceptible to intolerable risk.[4]

In such cases, insolvency law does not step in to perform the market's selective functions, rather it aims to "give trouble companies the opportunity to turn their affairs around where it is probable that this will produce overall benefits or, where this is not probable, to end the life of the company efficiently, expertly, accountably and fairly."[5] Absent such aim,

[1] V Finch D Milman, Corporate Insolvency Law: Perspectives and Principles (3rd edn Cambridge University Press 2017)117.
[2] ibid
[3] M White, 'The Corporate Bankruptcy Decision' (1989) 3 Journal of Economic Perspectives 129.
[4] Finch and Milman (n 1).
[5] Ibid.

corporate failure may spread ripples that not only affects the firm but the gamut of parties associated with it. In essence, failure may lead to unemployment of staff, harm to customers and suppliers, hardship to communities and loss of confidence in the system.[6]

An examination of “distressed” or “failing” companies will mean talking about different companies encountering all kinds of problems and in different stages of decline or recovery. To bring clarity to the discussion requires distinguishing between companies that are in distress and those that are insolvent. Consequently, this chapter will explore the concepts of financial distress and insolvency. It will identify the general difference between both concepts and identify the causes of financial distress and insolvency from a legal and business perspective. Some issues affecting companies operating in the retail industry will also be considered.

It is divided into three sections. Section 1 provides an analysis of these concepts and proceeds to examine the causes of financial distress/decline and insolvency/business failure from a legal and business perspective. Section 2 provides a general background to understanding the UK retail industry. It explores the role it plays in national and local economies and attempt to define retail failure and the drivers of distress and failure in the UK retail industry. The last section concludes the chapter.

2.1. Analysis of Financial Distress and Insolvency

One of the most significant threats for many firms globally regardless of their nature and size is financial distress. It is a variable term that is applicable to many situations. It may be used to describe both internal and external events affecting a company or a series of ongoing problems that are yet to be resolved. Financial distress is a tentative term that is complicated. Realising that financial distress cannot be fixed but is something that takes on an evolving identity, choosing to reflect the diverse and complex nature of the market,

[6] Ibid.

it should be emphasised that distress is not a synonym for corporate death.[7] Financial distress suggests that a company is experiencing some problems especially with its cash flow while insolvency is an end result of that problem, which reflects what has happened to a company.[8] This thesis will examine both concepts simultaneously whilst distinguishing same where applicable.

A company has its own unique identity as such distress will affect each company in different ways leading to the value of the company to be reduced in a dissimilar manner. Consequently, attempting to provide a universal definition for distress would be an exercise in futility. It is important for each ailing company to assess its problems based on its individual circumstances, even if this leads to a variation of the accepted norm. A distressed company is one that requires a major rethink on how the firm's operations or structures are performed,[9] which may often involve a reorganisation of the company's operation.[10] Distress usually occurs from a default in honouring obligations such as failure to make a significant payment to the creditors of the company.[11]

Distress may also be confirmed through assessing calculations based on a company's accounts, which can provide a breakdown of the financial position of the company, generating models which can be used to predict a range of events, including how the company intends to enhance its solvency in the long term as well as its general financial position.[12] To provide some sort of solutions to the general issues arising, it may involve negotiating with some major creditors but depending on how the creditors and the company propose to deal with debt default within the provisions of the agreed contract, reaching a consensual outcome may be very difficult. Whilst this analysis attempts to

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[7] KH Wruck, 'Financial Distress, Reorganization and Organizational Efficiency' (1990) 27 Journal of Financial Economics 419, 420.
[8] J Wood, 'Corporate Rescue: A Critical Analysis of its Existence and Fundamentals' (Phd thesis, University of Leeds, 2014) 27-28.
[9] C Foster, *Financial Statement Analysis* (2nd edn, Englewood Cliffs 1986) 61; A Belcher, *Corporate Rescue* (Sweet & Maxwell 1997).
[10] Ibid.
[11] Finch and Milman (n 1)119.
[12] Wood (n 8); Belcher (n 9).

provide clarity on what financial distress means, it will be discovered that there is no universal consensus on its definition.[13]

A company in the UK may be regarded as insolvent if it is unable to pay its debts;[14] this presupposes that the distressed company has satisfied either the cash flow or balance sheet tests, these tests will be discussed in subsequent section. It should be highlighted here that there is a difference between both tests, and it is only with the cash flow test that a company is unable to fulfil its current monetary obligations. Examples of such obligations includes unpaid debts to suppliers and employees, missed principal or interest payments and actual or potential damages from litigation.[15]

These can all be regarded as signs of financial distress as there will usually be an obvious breach of contract. This should be contrasted with a company that has outstanding liabilities which are higher than the value of its assets, and as a result, is unable to discharge its liabilities. Whilst this scenario may render a company insolvent and unable to pay its debts,[16] unlike the cash flow test, it will often be the case that the creditors of the company will receive monies due to them since there will be no breach of contract.[17]

To clarify these technical assessments, the two tests which has been laid down by law is further examined.

2.1.1. Legal Perspective on Financial Distress and Insolvency

A). Cash Flow Test (Commercial Insolvency Test)

[13] For analysis on the potential indicators of distress see R Morris, 'Early Warning Indicators of Corporate Failure' (Ashgate/ICCA 1997); J Day P Taylor, 'Financial Distress in Small Firms: The Role Played by Debt Covenants and Other Monitoring Devices' Insolvency Lawyer [2001] 97.
[14] A Keay, P Walton, *Insolvency Law: Corporate and Personal* (3rd edn, LexisNexis 2017) ch.2.
[15] Wruck (n 7) 421.
[16] RM Goode, *Principles of Corporate Insolvency Law* (5th edn, Sweet & Maxwell, 2018) 130; J Boyle and others, *Boyle and Birds' Company Law* (4th edn, Jordans 2000) 638-640.
[17] EI Altman, *Corporate Financial Distress* (Wiley, 1983).

The cash flow insolvency test refers to a situation where a company cannot pay its debts as they fall due.[18] This means that the company has insufficient resources to pay creditors. This is the main reason why companies are liquidated. It does not matter if a company's assets exceed its liabilities, all that needs to be shown is that the company cannot pay its debt.

Once this has been established, the court will regard the company has been insolvent and the onus is then on the company to prove that it can pay its debts as they fall due.[19] On its face, the test appears simple and straightforward, however, its simplicity is bedeviled by the vagueness of the meaning of the term "debts", how the debts are to be paid and what can be included in the payment of the debts.[20]

The courts have examined the statutory definition of "inability to pay debts" and held that it includes both present debts and future debts.[21] In terms of the ability of the company to pay such debts, the court will consider both the money the company has readily at hand and money it can realize quickly from sale of assets or borrowing funds. Inability to pay debts is broad and covers any company that is unable to meet current demands,[22] regardless of whether the company had assets that can be sold to enable it to meet its liabilities in full. Same also applies to cases where an invoice has been sent to the company, and the amount has not been challenged but the sum is not paid within a stipulated timeframe, then this can be evidence to adduce the fact that the company cannot pay its debts.[23]

[18] Insolvency Act 1986, section 123.

[19] L Doyle, A Keay, Insolvency Legislation: Annotations and Commentary, (Jordans, 2021) 150.

[20] J Wood, 'Defining Corporate Failure: Addressing the "Financial Distress" Concept: Part 2' (2014) 27 Insolvency Intelligence 56.

[21] *Re Cheyne Finance Plc (In Receivership)* [2007] EWHC 2402 (Ch) [58]; *BNY Corporate Trustee Services Ltd v Eurosail-UK* 2007 -3BL plc [2013] UKSC 28, [2013] I WLR 1408.

[22] *Re Capital Annuities Ltd* [1979] 1 WLR 170.

[23] *Taylor Industrial Flooring Ltd v M & H Plant Hire (Manchester) Ltd* [1990] B.C.L.C. 216; [1990] B.C.C. 44, CA.

To show that a company is cash flow insolvent is a question of fact. If a company has a huge number of outstanding debts and unsatisfied judgments, the court may consider this as evidence that proves that a company is unable to pay its debts as they fall due,[24] after considering all the company's assets.[25]

It may also be the case that the company itself or its solicitors admit that they are unable to pay their due debts. If this occurs, then the court will take it as evidence,[26] together with the absence of assets on which execution can be imposed.[27] A company that meets the cash flow test is considered insolvent for the purpose of winding up, and this will trigger an administration order or winding up order to be made if sought for.

B*)* Balance Sheet Test (Absolute Insolvency Test)

A company is balance sheet insolvent if the value of its assets is less than the amount of its liabilities, thereby leaving the debtor with insufficient assets to discharge its liabilities.[28] The rationale behind this is that simply selling assets to satisfy a company's liabilities is not enough if the liabilities would not ultimately be met upon the sale of the company's assets. Unlike debts in the cash flow test, the term "liabilities" is much broader[29] and is defined with the context of winding up under rule 13.12(4) of the Insolvency Rules 1986.

Similar provision in the legislation provides that whether the liability is present or future, certain or contingent, fixed or liquidated, or whether it can be ascertained by fixed rules or as a matter of opinion are all immaterial.[30] The court may consider available assets

[24] *Re Tweeds Garages Ltd* [1962] Ch 406.
[25] *Re Lyric Club* (1982) 36 Sol Jo 801.
[26] *Re Great Northern Copper Co* (1869) 20 LT 264.
[27] *Re Flagstaff Silver Mining Co of Utah* (1975) 20 Eq. 268; *Re Yate Colleries Co* [1983] WN 171; *Re Douglas Griggs Engineering Ltd* [1963] Ch 19.
[28] Insolvency Act 1986, section 123(2).
[29] *Re Debtor* (No 17 of 1966) [1967] Ch 590, [1967] 1 All E.R. 668.
[30] Insolvency Rules 1986, rule 12.12(4).

held at the time, but will not consider assets which are expected to be received by the company in future or monies that it has on loan.[31]

Determining how the courts should establish whether a company can pay its debts has generated attention, especially in the wake of the *Cheyne* and *Eurosail* cases.[32] Both cases examined the scope of section 123(2) of the Insolvency Act 1986 and pointed out that the provision extended to situations where, even though it was not shown that a company was presently unable to pay its due debts, it was practically clear that it would not be able to meet its future or contingent liabilities.[33]

There is an interaction between the cash flow test and the balance sheet test in corporate insolvency. As described by Lord Walker in the *Eurosail* case, "once the court moves beyond the reasonably near future, the cash flow test can no longer be sensibly applied to any case. Instead, a comparison of present assets with present and future liabilities (discounted for contingencies and deferment) (the balance sheet test under section 123(2) takes over."[34]

In *Eurosail*, two different courts considered the exact point in time which a company should be assessed as being unable to pay its debts. The Court of Appeal held that it is when the company had reached a "point of no return"[35] while the Supreme Court disagreed and held that it went "beyond the need for a petitioner to satisfy the court, on the balance of probabilities, that a company has insufficient assets to be able to meet all its liabilities, including prospective and contingent liabilities."[36] The court further pointed

[31] *Re National Livestock Insurance Co* (1958) 26 Beav 153; 53 ER 855; *Byblos Bank SAL v Al-Khudhairy* (1986) 2 B.C.C. 99, 549 at [99], [562-99], [563].
[32] *Re Cheyne Finance Plc (In Receivership)* [2007] EWHC 2402 (Ch) [58]; *BNY Corporate Trustee Services Ltd v Eurosail-UK* 2007 -3BL plc [2013] UKSC 28, [2013] I WLR 1408 [110],[117].
[33] Ibid.
[34] Ibid*,* Keay and Walton (n 14) 19.
[35] *Re Cheyne Finance Plc (In Receivership)* [2007] EWHC 2402 (Ch) [58]; *BNY Corporate Trustee Services Ltd v Eurosail-UK* 2007 -3BL plc [2013] UKSC 28, [2013] I WLR 1408 [110],[117].
[36] Ibid.

out that “whether or not the test of balance-sheet insolvency is satisfied must depend on the available evidence as to the circumstances of the particular case.”[37]

Given the complexities associated with arriving at the decision of whether a company satisfies the balance sheet test, it has been submitted elsewhere that the focus should be on whether a company will be able to pay its contingent and prospective creditors.[38] However, it remains difficult to prove to the court’s satisfaction how a creditor should quantify contingent and prospective liabilities. As described by some commentators, if a company has contingent liabilities which are likely to be due in the future, it will seem difficult to show that the company cannot currently pay its debts on the balance sheet basis because of the uncertainty surrounding events which may occur or may not occur in the future.[39]

Thus, establishing inability to pay debt under both tests requires firstly, a consideration of whether the company has paid its current debts or will be able to pay its debts which are due in the foreseeable future. If this test is passed, the second approach is to look beyond the reasonably near future and consider if the company’s current asset are more than its present liabilities.

However, these two considerations discussed above may be unclear where the company’s insolvency touches on establishing a significant value for contingent liabilities.[40] Moving on it is worth considering the views from the business literature given that there has been an extensive debate on what financial distress and insolvency (regarded as decline and business failure respectively across the business literature) means in this field.

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[37] *BNY Corporate Trustee Services Ltd v Eurosail-UK* 2007 -3BL plc [2013] UKSC 28, [2013] I WLR 1408 [38] (Lord Walker).
[38] Wood (n 20).
[39] Keay and Walton (n 14) 19.
[40] See for example *Re Casa Estates (UK) Ltd* [2014] Civ 383, [2014] BCLC 49 and *Evans v Jones* [2016] EWCA Civ 660, [2016] 3 WLR 1480.

2.1.2. Business Perspectives of Financial Distress and Business Failure

Corporate decline and Business failure research has its origins in the finance field when the establishment of commercial banks had a huge impact on the flow and spread of financial information in the nineteenth century.[41] From then onwards, business failure has piqued the interest of scholars across various disciplines including business and management disciplines, economists, accountants, entrepreneurs, and organization theorists. However, one major obstacle that is common to all these fields is the lack of a universally accepted definition of business failure. Scholars from various disciplines have failed to reach a consensus on the definition and even within these fields there is discord as "no two experts agree on a definition of business failure."[42]

The various interpretations of both concepts within the literature have differing goals in that the available data either contrasts or expands depending on the perspective in question.[43] The impact of this definitional shortfall is of twofold: first, the extent of the definition used in any given study will have a huge impact on the rate of failure identified, thus inhibiting comparisons across datasets.[44] Second, the choice of definition affects the outcomes and processes that are observed, as such, several definitions further expand the rift between studies.[45]

However, to shed light on the complex definition of failure, it is worth reviewing the definitions of "decline" and "failure" that have been propounded by scholars. From Whetten's perspective,[46] decline reflects the mismanagement of a company otherwise referred to as "Decline-As- Stagnation" or a consequence of scarcity of resources due to

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[41] JO Horrigan, 'A Short History of Financial Ratio Analysis' [1968] The Accounting Review 284-294.

[42] AV Bruno JK Leidecker, 'Causes of New Venture Failure 1960s v 1980s' (1988) 31 Business Horizons 51, 51.

[43] AB Cochran, 'Small Business Mortality Rates, A Review of the Literature' (1981) 19 Journal of Small Business Management 50, 53; T Bates, 'Analysis of Young, Small Firms that have closed: Delineating Successful from Unsuccessful Closures' (2005) 20 Journal of Business Venturing 324-358.

[44] Cochran (n 43), J Watson JE Everett, 'Do Small Businesses have High Failure Rates?' (1996) 34 Journal of Small Business Management 45.

[45] D Ucbasaran and others, 'Life After Business Failure: The Process and Consequences of business Failure for Entrepreneurs' (2013) 39 Journal of Management 163, 167.

[46] DA Whetten, 'Organizational Decline: A Neglected Topic in Organizational Science' (1980a) 5 Academy of Management Review 577, 878-580.

environmental threats, something he referred to as “Decline-As-Cutback”.[47] From another perspective, decline is a cutback from a firm’s market share, which results in the firm being unable to effectively compete.[48]

According to Ford, decline is perceived as a reduction in a firm’s performance which is caused by various factors linked to the management of the company.[49] Weitzel and Jonsson give a more thorough definition of decline; “failure to anticipate, recognize, avoid, neutralize or adapt to external or internal pressures that threaten the organization’s long-tern survival.”[50] Given a financial definition of decline, Sudarsanam and Lai define it as the potential risk of bankruptcy caused by weak performance indicators.[51] From these definitions, one thing is common, there is no single meaning of decline, however decline may be caused by both internal and external factors. Moving on, just like decline, the concept of failure is viewed from different perspectives.

Starting with Cochran’s perspective,[52] who drew attention to the various definitions expended on business failure ranging from “dysfunctional broad to acutely narrow.”[53] On one side of the argument is the definition of failure as bankruptcy. Entry into either voluntary or compulsory liquidation may result in a firm ceasing to exist as a legal entity. In some cases, dissolving the firm earlier through voluntary liquidation can cause further financial loss. However, firms may initiate voluntary liquidation for good reasons including acquisitions, mergers, or retirement.

Consequently, when considering the legal cessation of a firm from a business failure perspective, compulsory liquidation is a step in the right direction, as a court order forces

[47] Ibid.
[48] R Greenhaig CR Hinings, ‘Undertaking Radical Organizational Change: Bringing Together the Old and the New Institutionalism’ (1996) 21 Academy of Management Review 1022.
[49] JD Ford, ‘The Effects of Casual Attributions on Decision Makers’ Responses to performance Downturns’ (1985) 10 Academy of Management Review 770.
[50] WF Weitzel E Johnson, ‘Reversing the Downward Spiral: Lessons from WT Grant and Sears Roebuck’ (1991) 5 Academy of Management Executive 7, 12.
[51] S Sudarsanam J Lai, ‘Corporate Financial Distress and Turnaround Strategies: An Empirical Analysis’ (2001) 12 British Journal of Management 183.
[52] Cochran (n 43).
[53] Ibid.

the company to go into liquidation. As suggested elsewhere, insolvency is not the only ground for entry into compulsory liquidation, other grounds such as inequity and injustice also exist.[54] Insolvent firms can be easily identified since they have been subjected to a legal process that is on record; thus, this can be an attempt at defining business failure from the perspective of business failure studies.[55]

However, such definition is narrow in scope as it only accommodates a small subset of business failures. The definition does not take into consideration other signals of a failing business such as the business not providing returns to its owners and investors.[56] In addition, bankruptcy (insolvency) laws are not universally applicable thus limiting the ability to compare studies in various jurisdictions.

On the other end of the spectrum, the widest definition given by Cochran is discontinuance.[57] It has been submitted that discontinuance can be used as substitute for failure as it suggests that resources have been used elsewhere on a more profitable project.[58] However, discontinuance of ownership may be borne out of the fact that the firm is sold due to its owner wanting to retire, for profit purposes, and because the owner wants to move on to another business.[59] Therefore, assuming that discontinuance is a proxy for failure is narrow and unreasonable.[60] Further, inclusion of these entities in the definition of business failure inflate the failure statistics. This gives rise to additional difficulties which arise from the fact that there are different notions of discontinuance,

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[54] S Sheehan, 'Compulsory Liquidation' (CPA Ireland, 2013) https://www.cpaireland.ie/CPAIreland/media/Education-Training/Study%20Support%20Resources/P1%20Corp%20Laws%20and%20Governance/Relevant%20Articles/a-cuckoo-in-the-nest-the-role-of-a-receiver-in-irish-companies-p1cl.pdf accessed 12 January 2020.
[55] Cochran (n 43).
[56] Ucbasaran and others (n 45).
[57] Cochran (n 43).
[58] JE Fredland CE Morris, 'A Cross Section Analysis of Small Business Failure' (1976) 1 American Journal of Small Business 7.
[59] Watson and Everett (n 44).
[60] N Khelil, 'The Many Faces of Entrepreneurial Failure: Insights from an Empirical Taxonomy' (2016) 31 Journal of Business Venturing 72, 80; K Wennberg D DeTienne, 'What do we Really Mean When We Talk About Exit? A Critical Review on Entrepreneurial Exit' (2014) 32 International Small Business Journal 4; R Justo DR Detienne P Sieger, 'Failure or Voluntary Exit? Reassessing the female Underperformance Hypothesis' [2015] Journal of Business Venturing.

some view it as discontinuance of ownership while others classify it as discontinuance of business.[61]

Even though discontinuance is not clear-cut like insolvency, it is possible to easily identify through available data, discontinued entities. However, a complication arises in the way small firms are treated in transfer of ownership. The way transfers of ownerships are treated by corporations is different from that of partnerships or sole traders.[62]

When the latter sells his or her business or changes the format of the business, it is generally referred to as a discontinuance of a business and the start-up of another. Whereas in the case of the former, transfer of shares in a firm is not generally regarded as a business discontinuance.[63] Consequently, partnerships and sole traders are seen as likely to discontinue more frequently than corporations, thereby creating unbalanced statistics due to the inconsistency of treatment.

Discontinuance of a firm for any reason as well as formal insolvency proceedings are regarded as "surrogate measure of failure". [64] Despite being on opposing ends of the spectrum in terms of definitional scope, they are nevertheless both identifiable and specific, however, insolvency is excessively narrow while discontinuance is excessively broad; thus, many other definitions of business failure has been used and proposed over the years.

Even though these definitions may not offer the same ease of dataset identification, it remains that they offer an insight into business failure from a range of perspectives from researchers, from different disciplines who approach the concept from different areas of specialism, leading to a comprehensive definition of business failure. This has resulted in many compelling perspectives on business failure; however, a major drawback comes

[61] Watson and Everett (44) 272.
[62] Ibid.
[63] Ibid.
[64] Ibid 274.

from the fact that these studies are in many cases incomparable given that they involve different definitions and conceptualizations.[65]

From previous analysis, compulsory liquidation is regarded as the legal definition of business failure. It is a legal process that normally results in the end of a business. This is in contrast with the accounting perspective on failure which is described as "wanting or needing to sell or liquidate to avoid losses or to pay off creditors or general inability to make a profitable go of the business."[66] Whilst both definitions are feasible, the academic perspective the researchers examine the concept from, has a huge impact on each other.

Both perspectives involve selling assets and paying creditors where possible, however, the same process can be viewed from a completely legal perspective, or an entirely financial perspective. Thus, broadly speaking, the same process is under scrutiny, the arising results from the differing perspectives may be unparalleled. Even though evaluating business failure from diverse perspectives may enrich our understanding of the phenomena, it remains that it increases the complexity of integrating research on the subject as it subsumes many different aspects from different disciplines.

The economist perspective also offers a differing view of failure whereby it is regarded as a business whose rate of return on investment is insufficient to cover the opportunity costs.[67] The company need not dissolve to fall under this definition, it simply needs to be less fruitful than the available alternative opportunities at the time of the investment. However, from an entrepreneurial perspective, this definition is less compelling as many business owners exchange reduced profits for gaining market share, independence, and personal satisfaction.[68]

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[65] A Jenkins A McKelvie, 'What is Entrepreneurial Failure? Implications for Future Research' (2016) 34 International Small Business Journal 176.

[66] LR Gaskill HE Van Auken RA Manning, 'A Factor Analytical Study of the Perceived Causes of Small Business Failure' (1993) 31 Journal of Small Business Management 18.

[67] JE Fredland CE Morris, 'A Cross Section Analysis of Small Business Failure' (1976) 1 American Journal of Small Business 7.

[68] M Benz, 'Entrepreneurship as a Non-Profit-Seeking Activity' (2009) 5 International Entrepreneurship and Management Journal 23.

Given that entrepreneurship is not solely about profit making, the economists definition of failure is limited as it does not include the intangible benefits that arise from firm ownership. In line with the economist approach, Cardon and others provided another definition for failure: “a deviation from expected and desired results.”[69] This definition is broad and has the potential of incorporating almost every firm in existence.

The strategic management discipline has also expressed their views on business failure. According to Sheppard and Chowdhury, failure is “the misalignment of the organization to the environment’s realities.”[70] From this school of thought, Cochran defines failure as the inability “to make a go of it,”[71] irrespective of whether losses is inclusive of capital or not. This terminology can be regarded as a strategic response to curb the flow of loss following a period of difficulty. However, attempting to dissect the definition “requires further exploratory research in order to determine a dataset”.[72] It must however be pointed out that losses can arise from financial debt, reputational damage and the loss of time invested amongst other things. Thus, this definition of failure can pave way for different meanings from different perspectives.

From an organizational perspective discontinuance can be regarded as synonymous to failure as the firm is either discontinued from operating or the owner ceases to continue with the corporation. A broader organizational perspective considers the context within which the firm is operating. According to Freeman and others, failure occurs when a firm “ceases to carry out the routine actions that sustain its structure, maintain flows of resources, and retain the allegiance of its members”.[73] In a more general context, failure

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[69] MS Cardon and others, ‘A Tale of Passion: New Insights into Entrepreneurship from a Parenthood Metaphor’ (2005) 20 Journal of Business Venturing 23, 30.
[70] JP Sheppard SD Chowdhury, ‘Riding the Wrong Wave: Organizational failure as a Failed Turnaround’ (2005) 38 Long Range Planning 239, 240.
[71] Cochran (n 43) 52.
[72] MJ Ulmer A Nielsen, ‘Business Turn-over and Causes of Failure’ [1947] Survey of Current Business 10.
[73] JH Freeman GR Carroll MT Hannan, ‘The Liability of Newness: Age Dependence in organizational death Rates’ (1983) 48 American Sociological Review 692, 694.

has been regarded as a situation where a firm "cannot meet one or more of its responsibilities".[74]

In recent times, the discussion on business failure definitions has evolved and the debate has become more explicit. Coad[75] regarded the term "failure" as a derogatory word that considers the prior existence of a firm as a fruitless exercise because of its ultimate demise. Instead of failure, he refers to the word "death" as a more suitable term given that it consists of both involuntary exits such as bankruptcies (insolvency) and voluntary exits such as retirement liquidations.[76] Hoetker and Agarwal also share this perspective of the word death as meaning business exit.[77]

However, it must be pointed out that "exit and failure are two distinct concepts,"[78] yet despite their differences it is difficult to exclude voluntary closure from failure.[79] Based on representative samples from the US[80] and UK entrepreneurs,[81] some studies found that their firms were successful when exiting. According to Headd,[82] the lack of distinction between business closure and business failure is the reason for inflating failure statistics as some studies link business exits with failure irrespective of the underlying rationale behind discontinuance.[83] Due to the fluctuating nature of business failure definitions,

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[74] S Sharma V Mahajan, 'Early Warning Indicators of Business Failure' (1980) 44 Journal of Marketing 80,82.
[75] A Coad, 'Death is not a Success: Reflections on Business Exit' (2014) 32 International Small Business Journal 721, 722.
[76] Ibid.
[77] G Hoetker R Agarwal, 'Death Hurts, but it isn't Fatal: The Post exit Diffusion of Knowledge Created by Innovative Companies' (2007) 50 Academy of Management Journal 446, 465.
[78] K Wennberg D DeTienne , 'What do we Really Mean When we Talk About Exit? A Critical Review on Entrepreneurial Exit' (2014) 32 International Small Business Journal 4, 9.
[79] DA Shepherd J Wiklund, 'Successes and Failures at research on Business Failure and Learning from it' (2006)2 Foundations and Trends in Entrepreneurship 1.
[80] B Headd, 'Redefining Business Success: Distinguishing Between Closure and Failure' (2003) 21 Small Business Economics 51.
[81] Ucbasaran and others (n 45) 167.
[82] B Headd, 'Redefining Business Success: Distinguishing Between Closure and Failure' (2003) 21 Small Business Economics 51.
[83] T Bates, 'Entrepreneur Human Capital Inputs and Small Business Longevity' (1990) 25 The Review of Economics and Statistics 752; T Bates, 'A comparison of Franchise and Independent Small Business

voluntary exits tend to be linked with failure; the extent to which this happens depends on the nature of the definition used. Even though many studies have used exit as an alternative for failure,[84] it remains that an exit strategy that allows the owner of a business to close or sell it while it is still profitable can be regarded as positive and should not be included in any definition of failure.[85]

As research on business failure began to expand, the factors regarded as contributing to failure became complex; specifically, they are divided into external and internal factors. The debate majorly falls into two camps: The classical industrial organization school and the organization ecology school on one hand and the organizational studies and organizational psychology scholars on the other hand.

The industrial organization and organization ecology scholars who assume a deterministic role of the environment, argue that external factors play a major role in business failure. In their words, "managers are constrained by exogenous industrial and environmental constraints leaving them with little real strategic choice, and hence managers' role should be ignored."[86] On the other hand, the organizational studies and organizational psychology school form a voluntaristic perspective and posit that since managers oversee the affairs of the company, their actions and perceptions are the root cause of organizational failure.[87]

2.1.3. The deterministic approach

This school of thought consist of industrial organization and organizational ecology scholars who argue that the industry is more significant than the firm. Failure is "caused

Survival Rates (1995) 7 Small Business Economics 377, 380; T Astebro I Bernhardt, 'Start-up Financing, Owner Characteristics and Survival (2003) 55 Journal of Economics and Business 303.

[84] H Strotmann, 'Entrepreneurial Survival' (2007) 28 Small Business Economics 87.

[85] Headd (n 82).

[86] K Mellahi A Wilkinson, 'Organizational Failure: A Critique of Recent Research and a Proposed Integrative Framework' (2004) 5 International Journal of Management Reviews 21.

[87] ibid

by external factors over which management has little or no control".[88] The deterministic perspectives will be further explored below.

A). Industrial organization perspective

This perspective is grounded in economics. It mainly explores the environmental conditions within which firms operate and how firms interact and behave in the marketplace. It focuses on a particular industry as well as the interactions of competitors within an industry rather than individual outlooks. From the industrial organization perspective, changes in the external environment heighten the chances of organizational failure.[89] An example of such change is shift caused by revolutionary technological innovation such as internet, leading to exit from the market of businesses that are unable to predict and adapt to this change and entry of new businesses into the market. According to one scholar, when the environment is being transformed, new companies initiate processes that keep them in the market but overthrow existing companies.[90]

The industrial organization perspective consists of three assumptions: first, external factors put pressure on firms approaches and this could lead to failure, second, most firms operating in the same industry pursue similar strategies and thirdly management of a firm are rational actors who are committed to acting in the best interest of the company and as such their actions cannot be said solely to cause failure.[91] This perspective view the causes of business failure to include difficult demand structure because of changes in consumer tastes, strategic competition due to rivalry among present competitors or new entrants amongst others.[92]

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[88] Ibid 22.
[89] Ibid.
[90] M Tushman and P Anderson, 'Technological Discontinuities and Organizational Environments' (1986) 31 Administrative Science Quarterly 439, 442.
[91] Mellahi and Wilkinson (n 86) 22; JD Arthus and others, 'Managerial Agents Watching other Agents: Multiple Agency Conflicts Regarding Underpricing in IPO Firms' (2008) 51 Academy of Management Journal 277, 280.
[92] JAC Baum and J Singh, 'Organizational Niches and the Dynamics of Organizational Mortality (1994) 36 Administrative Science Quarterly 187; MZ Frank, 'An Intertemporal Model of Industrial Exit' (1988) 103

Other factors cited as affecting the lifespan of firms include technological change, economic change, regulatory change, and demographic change.[93] Technological uncertainty has become a major concern for many industries in recent times, it is further exacerbated by the replacement of one technological regime by another, yet it remains unclear which type of the new technology will be widely accepted by the industry.[94] Technological change can potentially change existing industry structures and in line with

Schumpeterian tradition "…interims of intensive change and technological progress alternate with periods of relative stability and incremental advance."[95] Schumpeterian approach mainly refers to economic growth that is controlled by innovation and governed by the process of creative destruction. From this perspective, technological change can overturn existing industry structure such that existing companies who are unable to adapt to new technological regimes will give way to new entrants with superior technological approaches, thereby leading to "shakeouts"[96] Thus, cyclical evolution of technology can threaten the environment/industry within which a company is operating especially because such technological regime are often unexpected and unpredictable.

Three factors explain the relationship between organisations and the environment: munificence, complexity, and dynamism.[97] Munificence has to do with the availability of resources, complexity refers to the complex linkages within a firm as well as between a

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Quarterly Journal of Economics 333; B Jovanovic and S Lach, 'Entry, Exit and Diffusion with Learning by Doing (1989) 79 American Economic Review 690.

93 Tushman and Anderson (n 90).

94 M Tushman L Rosenkopf, On the Organizational Determinants of Technological Change: Towards a Sociology of Technological Evolution. In B Staw L Cummings (eds), *Research in Organization Behaviour* (JAI press, 1992), P Anderson M Tushman, 'Organizational Environments and Industry Exit: The Effects of Uncertainty, Munifence and Complexity' (2001) 10 Industrial and Corporate Change 675.

95 Tushman and Anderson (93); GS Walsh JA Cunningham, 'Business Failure and Entrepreneurship: Emergence, Evolution and Future Research' (2016) 12 Foundations and Trends in Entrepreneurship 163, 196.

96 J Schumpter, Capitalism, Socialism and Democracy (Harper & Brothers 1942).

97 GG Dess and DW Beard, 'Dimensions of Organizational task Environments' (1984) 29 Administrative Science Quarterly 52.

firm and its external networks.[98] Dynamism pertains to unpredictability and an absence of pattern which creates an uncertainty that leads to "inability to predict or foresee."[99] Learning curves are deep and challenges may result in entrepreneurs revising their expectations which may then require individuals to unlearn past lessons.[100]

The arguments advanced by these scholars regard the marketplace where a firm operates as the major influencer of its chances of survival or success. Consequently, external factors such as cyclical demand declines and turbulent demand structures have more impact on a firm's wellbeing than the way the firm is managed.[101]

Another approach in the deterministic school of thought is the organizational ecology who also argue that external factors have a major role to play than internal factors when it comes to firm survival, however the arguments in support of their perspective is different from that of the industrial organisation perspective.

B) Organizational ecology perspective

They regard firms as entities that react slowly to changes in the environment and as a result are characterised by structural inertia.[102] Given that companies are required to be reliable and accountable for their actions the structures that guide the daily activities of organizations need to be highly consistent and dependable, consequently, the rules and regulations that ensure reliability and accountability must be in place and actions that showcase a stable process will be preferred over a less controllable action in an effort to ensure uniformity and stability.[103]

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[98] Ibid.

[99] Tushman and Anderson (n 90).

[100] Ibid, B Hedberg, How Organizations learn and unlearn? In PC Nystrom WH Starbuck (eds) *Handbook of Organizational Design* (Oxford University Press 1981)8.

[101] JP Sheppard, A Resource Dependence Approach to organizational Failure' (1995) 24 Social Science Research 28.

[102] MT Hannan JH Freeman, 'The Population Ecology of Organizations (1977) 82 American Journal of Sociology 929.

[103] C Boone A Van Witteloostuijn, 'Industrial organization and Organizational Ecology: The Potentials for Cross-Fertilization' (1995) 16 Organization Studies 265.

Based on this, organizational dissolution from the perspectives of organisational ecologists arises when a company "ceases to carry out the routine actions that sustain its structure, maintain flows of resources, and retain the allegiance of its members".[104] The organizational ecologists' perspective is based on the notion that organisations need a high level of structural inertia to be able to survive.[105] Structural inertia is borne out of internal structural arrangements and environmental limitations, yet it refers mainly to the core characteristics of an organisation.[106]

The main aim of organisational ecology is "to understand the mutual interactions within and among the populations and communities comprising organisational ecosystems and the mechanisms and processes underlying their growth, regulation and decline".[107] From their perspective on external causes of organizational failure, four components influence the chances of success or failure of companies. First, population density which refers to the number of firms operating within a given sector, with the argument that the greater the number of firms, the greater the competition which then means higher possibility of failure.[108] Second, industry life cycle, with the main argument being that failure is the natural and objective occurrence just as death follows birth.[109]

Third, age of the company, the argument here is that new companies are more likely to fail than well-established companies.[110] Lastly, the issue of size, with the argument that

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[104] JH Freeman GR Caroll MT Hannan, 'The Liability of Newness: Age Dependence in organizational Death Rates' (1983) 48 American Sociological Review 692, 694.
[105] Ibid.
[106] MT Hannan JH Freeman, 'The Population Ecology of Organizations' (1977) 82 American Journal of Sociology 929.
[107] Baum and Singh (n 92).
[108]J Delacroix and others, 'Density Dependence Versus Population Dynamics: An Ecology Study of Failings in the California Wine Industry (1989) 54 American Sociological Review 245; MT Hannan JH Freeman, 'The Ecology of Organizational Mortality: American Labor Unions (1988) 94 American Journal of Sociology 25.
[109] FE Balderston, Varieties of Financial Crisis, For Foundation Program for Research in university Administration. University of California, Berkeley (1972), KA Boulding, *A Reconstruction of Economics* (Wiley,1950).
[110] R Nelson and Winter S, *An Evolutionary Theory of Economic Change* (Harvard University Press, 1982) AL Stinchcombe, Social Structures and Organizations in JG March (ed), Handbook of Organizations. Chicago: Rand McNally, 142.

small firms are likely to fail than larger ones.[111] The reason is because small firms face challenges such as raising capital and finding the best employees which affects their ability to perform as well as large firms.

To summarize the arguments of the industrial organization and organizational ecology scholars, external factors go a long way in explaining the causes of firm failure and managers have no control over these factors and are often dependant on the economy and the decisions of policymakers. The main external factors include interest rates, market competition, wage costs, bad debts, late payments, inflation amongst others. Presently, the external factors inhibiting the success of firm operation arise mainly from inability to raise funds, low consumer confidence and global economy meltdown.

Critics of this approach however argue that the emphasis on external factor as the main cause of corporate failure neglects the fundamental issue of why companies operating in the same sector, facing the same environmental challenges, have differing levels of success and failure.[112]

2.1.4. The voluntaristic school of thought

The voluntaristic perspective which consist of organisational studies and organizational psychology scholars, reject the notion that external factors have more explanatory power on firm failure than internal factors.[113] It is premised on the belief that the main decision maker within a firm are the managers, therefore their decisions and perceptions have an huge impact on the firm and as such, management is the main cause of firm failure.[114] The main argument of scholars from this field is that the personnel at the helm of decision

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[111] JAC Baum C Oliver, 'The Institutional Ecology of Organizational Founding' (1996) 39 Academy of Management Journal 1378.
[112] CE Flamholtz Z Aksehirli, 'Organizational Success and Failure: Am Empirical Test of a Holistic Model (2000) 18 European Management Journal 488, K Mellahi P Jackson L Sparks, 'An Exploratory Study into Failure in Successful Organizations: The Case of Marks and Spenser' (2002) 13 British Journal of Management 15.
[113] N Khekil, 'The Many Faces of Entrepreneurial Failure: Insights from an Empirical Taxonomy' (2016) 31 Journal of Business Venturing.
[114] Mellahi and Wilkinson (86).

making is more important than the external environment within which the decision is made.[115] In the words of Barmash, “corporations are managed by men; and men, never forget, manage organizations to suit themselves. Thus, corporate calamities are calamities created by men.”[116]

The voluntaristic approach views internal factors as the main causes of business failure, and these inherent factors are unique to the firm and differs between companies. Examples of internal factors that affect a firm’s performance include management practices, accounting practices, marketing decisions and financial planning.[117] Some scholars have suggested that internal factors have a greater impact on the overall performance of a company.[118] According to Malone in his research findings, only about 18% of business failures were outside the control of their managers.[119] Much of the research on internal factors identify causes that collectively point to “bad management” as the major cause of business failure.[120] The voluntaristic school of thought is further examined.

A) Organisation studies and organisational psychology

Both perspectives regard failure as arising from internal adequacies in dealing with external problems.[121] Argenti uses a sinking ship to illustrate the collapse of a company at the hands of an ineffective manager:[122]

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115 CM Larson CR Clute, ‘The Failure Syndrome’ (1979) 4 American Journal of Small Business 35.
116 I Barmash, *Great Business Disasters* (Ballantine Books, 1973) 299.
117 GS Walsh JA Cunningham, ‘Business Failure and Entrepreneurship: Emergence, Evolution and Future Research’ (2016) 12 Foundations and Trends in Entrepreneurship 163, 201.
118 GS Hansen B Wernerfelt, ‘Determinants of Firm Performance: The Relative Importance of Economic and Organizational Factors’ (1989) 10 Strategic Management Journal 399; JE Fredland CE Morris, ‘A Cross Section Analysis of Small Business Failure’ (1976) 1 American Journal of Small Business.
119 M Malone, ‘The Small Business Ego Trap’ (2014) 47 Business Horizons 17, 18.
120 CR Kennedy, ‘Thinking of Opening your Own Business? Be Prepared’ (1985) 28 Business Horizons 38; S Haswell S Holes, ‘Estimating the Small Business Failure Rate: A Reappraisal’ [1989] Journal of Small Business Management 68; G Beaver P Jennings, ‘Competitive Advantage and Entrepreneurial Power’ (2005) 12 Journal of Small Business and Enterprise Development 9; H Ooghe S Deprijcker, ‘Failure Process and Causes of company Bankruptcy: A Typology’ (2008) 46 Management Decision 223.
121 Mellahi and Wilkinson (n 86); J Argenti, *Corporate Collapse* (McGraw-Hill 1976).
122 Ibid.

> If a ship is in good condition and the captain is competent it is almost impossible for it to be sunk by a wave or a succession of waves. Even if there is a storm, the competent captain will have heard the weather forecast and taken whatever measures are needed. Only a freak storm for which inadequate notice has been given will sink the ship.

This quote echoes the sentiments of other scholars who regard management as "the origin of most problems".[123] According to Dillon and Tinsley,[124] the actions of management amidst challenges are related to past experiences, if the firm has avoided failure in the past then management will be more likely to take riskier actions in the future regardless of any reasonable scepticism they may have.

This involves the arrogance and complacency which success can cause within a firm. Learning from repeated success can have a major impact on a company. A company could move from a once agile position to a structural and procedural stage.[125] Such complacency leads to poor decision making by management and the general literature suggests that poor decision making is the linchpin of managerial mistakes and by extension business failure.[126] One study relates the failure of many companies to the fault of the company's chief executive officer (CEO),[127] while another argues that ability to manage or reverse potential business failure lies majorly with the organisations top

[123] H Ooghe S Deprijcker, 'Failure Process and Causes of company Bankruptcy: A Typology' (2008) 46 Management Decision 223.
[124] RL Dillon CH Tinsley, 'How Near-Misses Influence Decision Making under Risk: A Missed Opportunity for Learning' (2008) 54 Management Science 1425.
[125] P Baumard WH Starbuck, 'Learning from failures: Why it may not Happen' (2005) 38 Long Range Planning 281.
[126] D Miller, 'The Icarus Paradox: How Exceptional Companies Bring about their own Downfall' (1992) 35 Business Horizons 24.
[127] S Finkelstein, 'When Bad things Happen to good Companies: Strategy Failure and Flawed Executives' (2005) 26 Journal of Business Strategy 19.

managers.[128] Further, Weisenfeld and others link failure with "hallmarks of mismanagement".[129]

To further illustrate the arguments on internal causes of failure, some theoretical stances have been identified. Groupthink theory argues that managers, specifically board level in many firms tend to make poor decisions which may result in failure.[130] Upper Echelon theory postulates that the characteristics of a company's major decision makers affect organizational performance and strategy.[131] It has been submitted that often, it is "strong-willed, dominating and egomaniacal executives that are at the helms of unsuccessful firms".[132]

Curse of success theories argue that successful companies are likely to fail for a range of reasons. One of the reasons for this is that 'success can breed over confidence and arrogance.'[133] Lastly, threat rigidity effect theory argues that "individuals, groups and organizations tend to behave rigidly in threatening situations and seek to maintain the existing status quo."[134] Such inaction may accelerate failure if it becomes the natural response to external threat and change that a firm may experience.

Critics however contend that despite the diversified nature of the internal approach to failure analysis, the reliance on different theories without an overall 'grand theory' is a major weakness of the approach. In comparison with the deterministic approach, the

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[128] B Richardson S Nwankwo S Richardson, 'Understanding the Causes of Business Type Failures: Generic Failure types: Boiled Frogs, Drowned Frogs, Bullfrogs and Tadpoles' (1994) 32 Management Decision 9.
[129] BM Wiesenfeld KA Wurthmann DC Hambrick, 'The Stigmatization and Devaluation of Elites Associated with Corporate Failures: A Process Model' (2008) 33 Academy of Management Review 231.
[130] IL Janis, *Victims of Groupthink* (Boston, 1972).
[131] D Hambrick and Mason P, 'Upper Echelons: The Organization as A Reflection of Top Managers' (1984) 9 Academy of Management Review 193.
[132] DC Hambrick RA D'Aveni, 'Top Team Deterioration as Part of the Downward Spiral of Large Corporate Bankruptcies' (1992) 38 Management Science 1445, 1450.
[133] D Miller, *The Icarus Paradox: How Exceptional Companies Bring About their Own Downfall: New Lessons in the Dynamics of Corporate Success, Decline and Renewal* (Harper Business, 1990).
[134] B Staw L Sandelands JE Dutton, 'Threat-Rigidity Cycles in Organizational Behavior: A Multi-level Analysis (1981) 26 Administrative Science Quarterly 501.

voluntaristic approach to organizational failure is too fragmented. Further, the over-reliance on internal factors as the causes of corporate failure limits the ability to decipher the context within which firms operate.[135] Overall the over-reliance on internal factors at the expense of external ones neglects the role that external factors play in corporate failure.

Consequently, an integrative framework was developed by Mellahi and Wilkinson to fill the lacuna in the ideologies of both approaches discussed above.[136] The framework illustrates the interplay between both internal and external causes of corporate failure and how a combination of both factors provides a comprehensive understanding of organizational failure. Also, from this perspective, different factors have their own separate effects on failure. These independent effects are however only important in serious situations; "such as major environmental disaster or economic crisis, or extreme cases of management misbehaviour, as in the cases of Enron and World.com."[137]

Further, the integrative framework argues that management actions alone hardly lead to corporate failure. Rather, such actions should be considered alongside industry dynamics and the general external environment within which the company functions.[138] In defining failure, Mellahi and Wilkinson stated that, "we propose that an organization fails when its ability to compete deteriorates as a consequence of actual or anticipated performance below a critical threshold that threatens its viability."[139] This definition of failure appears broad focusing on "inability to adapt" and "falling below a set threshold," as the tenets of failure.

[135] Mellahi and Wilkinson (n 86) 31.
[136] Ibid.
[137] Ibid, J Pal, D Medway J Byrom, 'Analysing Retail Failure from an Historical Perspective: A Case Study of A. Goldberg & Sons plc (2006) 26 The Services Industries Journal 513, 517.
[138] J Pal, D Medway J Byrom, 'Analysing Retail Failure from an Historical Perspective: A Case Study of A. Goldberg & Sons plc (2006) 26 The Services Industries Journal 513, 517.
[139] K Mellahi A Wilkinson, 'Managing and Coping with Organizational Failure: Introduction to the Special Issue (2010) 35 Group & Organization Management 531, 534.

Thus, it appears that what exactly amounts to failure remains unclear in the business literature, the broad agreement is that failure could include factors such as a general reduction in profit, turnover amongst other things. However, it is submitted that a deterioration in a company's fortunes does not necessarily mean that the company has failed. Where the company is viable i.e., it has a prospect of a going concern value, it may still be saved. Arguably, the real meaning of failure is a complete relapse such that the company ceases to exist.

Following the deterministic and voluntaristic approaches to business failure, the next section seeks to identify the causes of retail failure.

2.2. Understanding the UK Retail Industry

The retail sector can be regarded as any business or individual engaging in the sale of products directly to consumers. It includes shops, department stores, supermarkets, market stands, door to door sales and internet retailers. It plays a major role in the UK high streets and town centers. "It is the link between producer and consumer, influencing supply and demand, and is a valuable route to market for manufacturers."[140]

It is the largest private sector employer, with over 3 million people.[141] Likewise, the industry plays a major role in the communities as it provides employment, goods and services to individuals and is a force for social unity.[142] It is a major part of the UK economy which generated over a third (specifically 35% turnover) of all turnovers in

[140] Department For Business Innovation & Skills, 'A Strategy for Future Retail' (October 2013) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/252383/bis-13-1204-a-strategy-for-future-retail-industry-and-government-delivering-in-partnership.pdf accessed 12 January 2021.

[141] Office of National Statistics, 'Employees in the UK by Industry: 2018' (*ONS*, 26 September 2018) https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/employeesintheukbyindustry/2018 accessed 12 January 2021.

[142] Ibid.

2021.[143] In 2020, despite the effect of the pandemic, retail sales value amounted to approximately £437 billion.[144] It generated an economic output of £97.0 billion in 2020 which accounted for 5.2% of the UK's total economic output.[145]

The sector is diverse in size, structure, and operation. It serves "as the link between production and consumption and is also closely linked to other sectors of the UK economy."[146] Such sectors include manufacturing sector, construction, wholesale distribution, logistics sector and warehouse. The retail sector is very competitive and does not depend on government for financial support but majority of the government policy and regulation impact on retail than other sectors.[147] Retail has a "multiplier effect" on other industries, this is so because where there is retail there will be trade for other consumer-focused businesses such as tourism, food and drink, sports, and leisure amongst others.[148]

However, the sector has encountered difficulties over the years. The retail landscape in the UK has experienced a paradigm shift and there have been several retail companies in distress over the last fifteen years.[149] Examples of distressed retailers include Woolworths, Debenhams, JJB Sports, Stylo plc, British Home Stores, Toys R Us, Mamas & Papas, Mother care, New Look, Laura Ashley, Homebase amongst others. There has been changes in consumer shopping habits as well as a shift in spending patterns over

[143] G Hutton M Ward, 'Business Statistics' (House of Commons Library, 21 December 2021) https://researchbriefings.files.parliament.uk/documents/SN06152/SN06152.pdf accessed 12 January 2022, 16.
[144] Ibid.
[145] Ibid.
[146] Department For Business Innovation & Skills, 'A Strategy for Future Retail' (October 2013) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/252383/bis-13-1204-a-strategy-for-future-retail-industry-and-government-delivering-in-partnership.pdf accessed 12 January 2021, 6.
[147] ibid 2.
[148] ibid
[149] Centre for Retail Research, 'Who's Gone Bust in Retail' https://www.retailresearch.org/whos-gone-bust-retail.html accessed 12 April 2021.

the years.[150] Distress is universal to every sector of retail and no one sector is immune from distress.[151]

Over the years, researchers, organizations, entrepreneurs, investors, and policy makers have been concerned about organizational failure,[152] but less focus has been on the specific causes of retail failure. In 2019, there were 17,196 corporate insolvencies which has been regarded as the highest level of company insolvencies since 2013.[153] That same year, retail insolvencies in the UK hit a five-year high record which was reported as rising from 951 insolvencies in the year ending 2016 to 1252 in the year ending 2019.[154]

The Covid-19 pandemic and the lockdown measures imposed by government to curb the spread of the virus, which saw closure of non-essential stores in the UK for several months, has further exacerbated the issues of retail companies.[155] Most companies operating physical stores were deprived of their normal revenues during the lockdown restrictions, which led to a lot of high-profile companies going bust.

The increasing business deaths amongst companies in the UK retail sector with many ultimately failing shows that the retail sector is in crisis. This has a major implication for a

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150 'Retail Trends 2021' (Deloitte) https://www2.deloitte.com/uk/en/pages/consumer-business/articles/retail-trends.html accessed 10 January 2022

151 KS Cameroon RI Sutton DA Whetten, Issues in organizational Decline in KS Cameron RI Sutton DA Whetten (eds) *Readings in Organisational Decline: Frameworks, Research and Prescription*s (Massachusetts Ballinger Publishing Company, 1988); Mellahi and Wilkinson (n 140).

152J Pal, D Medway J Byrom, 'Analysing Retail Failure from an Historical Perspective: A Case Study of A Goldberg & Sons Plc' (2007) 26 The Service Industries Journal 513-535; N Alexander, 'Objects in the Rearview Mirror May Appear Closer than They Are' (1997) 7 The international Review of Retail Distribution and Consumer Research 383-403; S Kale D Arditi, 'Business Failures: Liabilities of Newness, Adolescence, and Smallness' (1998) 124 Journal of Construction Engineering and Management 458.

153 'UK Company Insolvency Statistics for 2019' (*The Gazette*, 31 January 2020) https://www.thegazette.co.uk/insolvency/content/103498 accessed 12 November 2021.

154 'Retail Insolvencies Hit Five-Year High' (*Retail Gazette*) https://www.retailgazette.co.uk/blog/2019/10/retail-insolvencies-hit-five-year-high-insolvency-service-statistics-rpc/insolvencies/ accessed 12 November 2021.

155 Centre for Retail Research, 'The Crisis in Retailing: Closures and Job Losses' https://www.retailresearch.org/retail-crisis.html accessed 1 July 2021. (Crisis in Retailing).

consumer-based economy, which requires an understanding of the main causes of financial distress and insolvency in the retail sector.

2.2.1. Attempting to define retail failure

Just like wider legal and business literature, it appears that there is no real consensus or exact definition of 'retail failure'. Retailers engage in different strategies that could shrink the assets of the company and ultimately cause failure. An example is retail internationalization activity which involves a retail company divesting part of its business in other to maximise value.[156]

The Marks and Spencers (M&S) retail internalization failed due to different reasons amongst which was misguided activities, inexperienced decentralized control of businesses and the systems required to develop these businesses.[157] It must however be pointed out that it is not in all cases that international expansion causes failure, it all depends on how the retail company can adapt to such strategy amidst competitive realities. Thus, a distinction needs to be drawn between a retailer failing due to internal and external factors such as British Home Stores and a failed strategy adopted by a retailer as in the case of Marks and Spenser in the early 2000s.[158]

Notwithstanding, determining when a retail company can be regarded as unable to trade as a going concern remains unclear. This thesis, however, supports the definition of organizational decline posited by Cameron and others,[159] where they stated that organizational decline involves "a two-stage phenomenon in which, first, an organization's

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[156] SL Burt K Mellahi TP Jackson L Sparks, 'Retail Internationalization and Retail Failure: Issues from the Case of Marks and Spencer' (2002) 12 International Review of Retail Distribution and Consumer Research 191.
[157] Ibid 214.
[158] Ibid 213.
[159] KS Cameron RI Sutton DA Whetten, 'Issues in Organizational Decline in KS Cameron RI Sutton DA Whetten (eds) *Readings in organizational Decline: Frameworks, Research, and Prescriptions.* (Massachusetts Ballinger Publishing, 1988).

adaptation to its domain, or micro niche deteriorates, and second, resources are reduced within the organisation."[160]

When a company's performance deteriorates, there will be insufficient resources available to meet its obligations, thereby leading to default. Thus, retail failure can be defined as a phenomenon which causes retail companies to reach a tipping point where there is a deterioration in their performance and ultimately unable to meet their obligations. Retail failure occurs when a retail company ceases to trade as a going concern and exit its market due to either micro or macro factors or a combination of both.[161]

An example of retail failure is the rise and fall of department store retailer British Home Stores (BHS). A major brand on the British high street which was formed in 1928 by American entrepreneurs with the aim of creating a UK version of Woolworths.[162] It was initially a profitable company which declared a dividend of £423 million in the period between 2002-2004, however, following years of declining sales and revenue, the company became unprofitable from 2009 upwards.[163] After various strategies to keep the company trading as a going concern the company was placed into administration in April 2016 and thereafter liquidation in December 2016.[164] This resulted in 11,000 employees losing their jobs[165] and huge outstanding debt being owed to its unsecured creditors.[166]

The BHS story is just one example of a UK retail landscape in the process of quick transition with many retail failures having been recorded over the years and the decline of the traditional high street shopping, especially following the 2008 financial crisis. There has been a roll call of retail failure amongst retail companies that enter an insolvency

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[160] Ibid.
[161] S Burt J Dawson L Sparks, 'Failure in International Retailing: Research Propositions' (2003) 13 The International Review of Retail Distribution and Consumer Research 355, 356.
[162] G Ruddick, 'BHS Battles to Stay on the High Street' *The Guardian* (London,19 March 2016)
[163] J Rankin N Fletcher, 'How Britain Fell Out of Love with BHS' *The Guardian* (London, 2 June 2016).
[164] House of Commons Work and Pensions, Innovation and Skills Committees, *BHS*, 20th July 2016 at 4.
[165] Ibid.
[166] Report to Creditors *BHS Limited (In Administration)*, 6th June 2016 at 9.15.

state in the UK.[167] This has a major implication for a consumer-based economy which represents about 5.2% of gross domestic product (GDP) in 2020.[168] Consequently, it is pertinent to examine the trends, paradigm shifts in the retail industry and the drivers of distress amongst companies in the retail industry. As one commentator describes elsewhere, "…it is always pleasing to come across proper objective research that examines how retail trends are affecting existing retail structures."[169]

2.2.2. Drivers of financial distress and insolvency in the UK retail industry

The issues facing retail companies in the UK include high costs of operating retail outlets including, rents, business rates and high labor costs, low profitability, the rapid growth of e-commerce, lack of preparation, store closures, changes in consumer preference and coronavirus lockdown, bad management[170] Amongst these problems, there are two main issues that have heightened the financial distress of many retail brands: the shift from brick-and-mortar stores to online stores and the level of debt arising from leasehold liabilities. These issues are discussed further.

1. Online Retailing

One aspect of technology that has been largely regarded as the main driver of crisis in retailing is online shopping. It has been described as the biggest retailing challenge in the UK, given that increase in competition from online retailers is a major threat to their high street counterparts.[171] Internet shopping has become very popular in the UK and is

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[167] Ibid.

[168] L Croudace, 'Economic trends in the Retail Sector, Great Britain: 1989 to 2021' (*ONS,* 27 July 2021) https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/articles/economictrendsintheretailsectorgreatbritain/1989to2021 accessed 1 October 2021.

[169] N Wringley, Evolving *High Streets: Resilience & Reinvention: Perspectives From Social Science* (Southampton, ESRC, 2014) Preface

[170]Crisis in Retailing (n 157) 9-15.

[171] House of Commons, 'Oral Evidence: High Streets and Town Centers in 2030' HC 1010 (2018b) https://gala.gre.ac.uk/id/eprint/21872/7/21872%20COCA-STEFANIAK_High_Streets_and_Town_Centres_in_2030_(2018).pdf accessed 19 January 2019, Q36

changing the retail sector. It has been submitted that the internet is arguably the most important retail innovation in recent times.[172]

In 2018, according to statistics provided by the Office of National statistics (ONS), online shopping increased by 15.9% in 2017, while store spending reduced to 4.7%.[173] further, such rapid growth has been a major occurrence throughout the decade, further demonstrating how much ground online retailing is gaining. Likewise, it has been reported that online shopping will form the crux of more than half (53%) of total retail sales in the next ten years.[174]

The reason for this is because many people find it easier to order their goods and services from a website through the comfort of their home rather than go to the physical shops to buy these items. This switch from offline to online shopping is not only peculiar to the UK, but it has also been reported that 1.92 billion people around the world are online shoppers.[175]

The implication of this is that online retailing has become a mainstream activity and companies need to integrate their on-line and off-line channels to enhance customer satisfaction. It is important for retail companies to understand their customers' needs and respond to the constant changing consumer preference. This is because "…the internet's power, scope and interactivity provide retailers with the potential to transform their

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[172] M Levy and others, 'Emerging Trends in Retail Pricing Practice: Implications for Research' (2004) 80 Journal of Retailing Xiii, xiv.

[173] 'Comparing "Bricks and Mortar" Store Sales with Online Retail Sales' (Office of National Statistics, 2018) https://www.ons.gov.uk/businessindustryandtrade/retailindustry/articles/comparingbricksandmortarstoresalestoonlineretailsales/previousReleases accessed 8 February 2021.

[174] G Satish, 'Online Shopping to Account for 53% of UK Retail Sales: WBD Study' (*Retail insight Network*, 9 July 2019) https://www.retail-insight-network.com/news/online-shopping-uk-retail-sales/ accessed 1 December 2021.

[175] D Coppola, 'Number of Digital Buyers Worldwide from 2014-2021' (*Statista*, 13 October 2021) https://www.statista.com/statistics/251666/number-of-digital-buyers-worldwide/ accessed 28 December 2021.

customers' shopping experience and in so doing strengthen their own competitive positions."[176]

For companies that generally rely on sales from their physical stores, they have had a threat to their market position and sales which has led to several store closures due to reduced footfall and weak trading performance which as will be seen in subsequent chapters is normally cited as a major cause of distress amongst companies operating in the retail industry

2. Burden of rental liabilities and High Debt

Retail companies are overburdened with lease liabilities arising from owning too many stores. Given the increase in online shopping and difficult trading conditions in the retail industry, retailers with underperforming shops are bearing the brunt.[177] Once a company with large leasehold portfolios starts encountering difficulties, one of the largest costs which it is likely to struggle with is usually rent. Most retailers are looking to reduce their rent bill because most of these rents were set several years ago when they entered long leases with upward only rent review clauses and during the period when online sales were not so popular. With changing patterns in the retail industry, many retailers are having to battle with high debt burdens arising from overexpansion. This had led to store closures.

The year 2020 recorded the highest number of store closures since the 2008/2009 financial crisis.[178] According to data by the Centre for Retail Research, 54 retail companies which had multiple stores ceased trading that year, which affected 5,214

[176] N F Doherty, F Ellis-Chadwick, 'Internet Retailing: The Past, the Present and the Future' (2010) 38 International Journal of Retail & Distribution Management 943,944.
[177] D Thomas, 'Six Reasons Behind the High Street Crisis' (*BBC*, 1 March 2018) https://www.bbc.com/news/business-43240996 accessed 12 July 2020.
[178] G Hutton, 'Retail Sector in the UK', (*House of commons Library,* 25 May 2021). https://researchbriefings.files.parliament.uk/documents/SN06186/SN06186.pdf accessed 1 June.

stores and 109,407 employees.[179] Consequently, the year 2020-2021 has been regarded as "one of the worst periods for bricks-and-mortar retailing since the 1970s."[180]

Store closures has been a major occurrence as far back as 2008 and the main reasons why store closures have been on the rise yearly include the high cost of running retail stores including rents, business rates and labor costs; low profitability arising from these high costs, the growth of online competition and lack of preparation.[181]

2.3. Conclusion

This chapter charts a general examination of financial distress and insolvency/business failure from a legal perspective through to business, accountancy, finance, and management perspectives. The reviewed literature illustrates the complexity of financial distress and insolvency. Failure is an existing threat for many businesses and a concept that warrants careful consideration.

Yet as seen, there is no universal definition of what it means. Despite the dissimilar nature of the different definitions of financial distress/decline and insolvency/ business failure, one thing is clear, these concepts could arise from both internal and external factors, and it is important not to attribute one factor as a major cause while leaving out the other factor. In the retail industry specifically, the most prevailing issues driving crisis on the high street include technology, and burden of rents and lease liabilities.

Given the negative consequences that failure brings to the company, stakeholders, community and even the economy, there are mechanisms that have been put in place to either avoid failure or ameliorate the potential effect of failure on a company, these mechanisms are regarded as corporate rescue procedures. The next chapter will

[179] Crisis in Retailing (n 155).
[180] Ibid.
[181] Ibid.

examine the development of the corporate rescue concept in the UK and provide an analysis of the different rescue mechanism available to distressed companies in the UK.

Chapter 3

CORPORATE RESCUE: THE UNITED KINGDOM APPROACH.

Introduction

Corporate insolvency law provides two avenues through which a distressed company can resolve its problems: liquidation and corporate rescue. Both routes provide a joint process of dealing with the company's problems when such problems cannot be resolved via the avenue of negotiating with creditors.[1] However these routes do not yield the same results when attempting to solve the problems.

The main objective of liquidation is realising the assets of the company and selling same for the benefit of the creditors when there is no possibility of rehabilitating/saving the company. The objective of corporate rescue on the other hand is to give the company somewhat a second chance to attempt restructuring by reaching compromises or arrangements with its creditors to enable the company to continue trading as a going concern.

A distressed company is likely to prefer a corporate rescue regime to the liquidation regime because the latter destroys the value in companies. However, what exactly does corporate rescue entail? How can it be achieved? How does the UK rescue framework ameliorate the issues facing retail companies in the UK?

To answer these questions, it will be necessary to examine the entirety of the corporate rescue concept. This chapter is divided into four sections. Section 1 examines the legal framework of corporate rescue, and the policy aims and ideologies behind a rescue culture. Section 2 explores the development of corporate rescue in the UK. Section 3

[1] B Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* (Edward Elgar Publishing Ltd 2016) 3.

examines the different rescue options available to a financially distressed company in the UK. The last section concludes the chapter.

3.1 The Legal Framework of Corporate Rescue

Corporate rescue models exist in almost every jurisdiction around the world, whilst there are different models depending on each country's identity, it remains that the concepts and principles of the rescue mechanisms that have been endorsed in different jurisdictions are similar.[2] To understand the heart of corporate rescue, there is the need to firstly comprehend how a legal system resolves the issues facing a distressed company.

Essentially, the substance of a rescue model is based mainly on the historical legal development that has occurred in a particular country.[3] As a result, it may be the case that the development of any model by legislative bodies is nothing more than recycling custom and practices that have long existed. This is evident in the UK's corporate insolvency and rescue regimes which is a product of the British environment shaped by different circumstances that have come to be.

It is heavily reliant on the ability of those actors (management, insolvency practitioners) who are involved with a distressed company and its operation to identify when action is required and what solution is best suited for the company given the situation. Rescue mechanisms tend to be involved with promoting a positive and dynamic role, as well as a corrective and punitive role. A system must be seen as easily accessible and quick to provide the requisite technical knowledge to those in charge of a company to inform and motivate them to seek help at the onset of distress and provide a level of confidence that they will not be penalised for identifying distress signals.

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[2] For instance, the United States of America has the Chapter 11 reorganization procedure under the US Bankruptcy Code 1978 which is often perceived as the "forerunner of corporate rescue" and the judicial settlement procedure in France under the Law of 1967. See generally J Franks W Torous, 'Lessons from a Comparison of US and UK insolvency Codes' (1992) 8 Oxford Review of Economic Policy 70, 73-75. A Sorensor P Omar, *Corporate Rescue Procedures in France* (Kluwer Law 1996) 24-26.

[3] See H Hansmann R Kraakman, 'The End of History for Corporate Law', in J. Gordan and M.Roe, (eds), *Convergence and persistence in Corporate Governance* (Cambridge University Press 2004) 33.

However, as noted in the previous chapter, identifying when a company is in financial distress is not an easy process, with some of the difficulty arising from how the initial assessment of the financial situation of a company is managed. The benchmarks often used to evaluate a company's solvency state typically referred to as cash flow and balance sheet tests are somewhat unclear.

Although it should be noted that the tests are not intended to be accurate models for determining the exact financial state of an ailing company rather, they are used as a statutory rule to determine for certain legal purposes whether a company is insolvent. In certain situations, these tests have presented a simple view of how distress is determined, when in fact such calculation of distress ought to be viewed in a wider context "constituted out of an assemblage of calculative technologies, expert claims and modes of judgment".[4]

Given how the point of insolvency is determined, it is possible for the actors who are charged with administering the affairs of the troubled company to exercise discretion to a large extent. This party in question who administers the affair of the distressed company (whether solely or in conjunction with the management team) is usually a qualified accountant who is trained as an insolvency practitioner. For the avoidance of doubt, it must be pointed out that in the UK it is accountants rather than legal professionals that are charged with the role of dealing with insolvency related issues and this may have an influence on the way distress and insolvency are determined.[5]

An insolvency practitioner (IP) is generally believed to have the requisite expertise to deal with financial distress and insolvency,[6] as such he/she may use his/her commercial judgment and may have available various data gotten from accounting spreadsheets

[4] P Miller M Power, 'Calculating Corporate Failure' in Y Dezalay and D Sugarman (eds). Professional Competition and Professional Power: *Lawyers, Accountants, and the Social Construction of Markets* (Routledge 1995) 51.
[5] V Finch D Milman, *Corporate Insolvency Law: Principles and Perspectives* (3rd edn Cambridge University Press 2017) 129.
[6] J Wood, 'Assessing the effectiveness of the UK's Insolvency Regulatory Framework at Deterring Insolvency Practitioners' Opportunistic Behavior' (2019) 19 Journal of Corporate Law Studies 333, 334.

amongst other things. The courts place so much reliance on the expertise of insolvency practitioners such that they have demonstrated a willingness not to interrupt with insolvency related decisions as well as opinions formed by insolvency practitioners and leave such decisions in their hands.[7]

Once an insolvency practitioner has been instructed to act in the best interests of the distressed company, he/she must determine what can be done to help the company. Notwithstanding the fact that the courts place so much reliance on the expertise of the insolvency practitioner and refrain from interfering with their duties, retrieving the essential information necessary for the performance of their duties has always been difficult in certain cases. Distress and insolvency are terms that can be construed widely. By allowing these actors to exercise discretion whilst conducting their duties, "it has left a legal space where a company's financial status can be negotiated."[8]

For instance it is possible for an insolvency practitioner to secure successfully data relating to the financial position of a company but in so doing he/she must bear in mind that it may be difficult to obtain accurate reports due to the possibility of doctoring data to suit the needs of the company.[9] Given this difficulty, the ultimate decision is based on the his/her opinion, in other words- does the insolvency practitioner think a company can survive as a going concern? Whilst this conclusion may lead to errors, it is submitted that no real alternative exists.

It is to be questioned whether the study of corporate insolvency law makes any meaningful contribution to the meaning and avoidance of failure. Legally speaking, the

[7] Re T & D Industries Plc [2000] 1 WLR 646, 657; Re MF Global UK Limited [2014] Business Law Review 1156 [41]; P Okoli, 'Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act' (2012) International Company and Commercial law Review 61, 63.
[8] J Wood, 'Corporate Rescue: A Critical Analysis of its Fundamentals and Existence' (Phd thesis, University of Leeds, May 2013) 30; P Miller M Power, 'Calculating Corporate Failure' in Y Dezalay and D Sugarman (eds). Professional Competition and Professional Power: *Lawyers, Accountants, and the Social Construction of Markets* (Routledge, 1995) 51.
[9] One weakness of accountants is the collection of financial data especially when evaluating the solvency of a company. See generally F Clarke G Dean K Oliver, *Corporate Collapse: Regulatory, Accounting and Ethical Failure* (Cambridge University Press 1997) Ch. 17.

interpretation of financial distress could be said to be irrelevant.[10] Merely focusing on the legal input will ignore other wider factors that have impacted this area of law. However, a thorough consideration of the nature of corporate insolvency proceedings could strengthen the knowledge to be gained in corporate rescue. Whilst the insolvency law may set out different rules and terms that should be followed, leading to a general acceptance on how a company should be dealt with, it remains that the legislation also gives incentives and penalties for certain actions.

Further, whilst such rules exist, total compliance is not always possible and it should not be expected that those who do not understand the intricacies of legal documents (such as directors) to follow same sternly.[11] Arguably, this reason may partly justify why directors do not recognise when to take action to help the company. "Whilst there are rules and tests in place to offer guidance and assistance it is often the knowledge that the law will be lenient with those who assist in promoting a proactive response, provided that they are not at fault for the demise of the company".[12]

It should however be noted that despite the assurance that the insolvency legislation provides, some companies will still end up failing and whilst it could be suggested that there is no definite proof that rescue prevents a company from eventual failure, it is perhaps right to propose a temporary measure that could ameliorate the challenges but only with the understanding that such temporary measures may not always amount to corporate rescue in actual sense. That said, it is important to explore the meaning of corporate rescue.

1.1.1. The Concept of Corporate Rescue

[10] Finch and Milman (n 5) 124.
[11] This assertion is more suited to managers of smaller companies. See generally V Finch D Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, Cambridge University Press, 2017) 145; V finch, 'Company Directors: Who Cares about Skill and Care?' (1992) 55 Modern Law Review 179.
[12] Wood (n 8) 43.

In market economies, companies are not static organizations, rather they are constantly in a state of change.[13] As noted in previous chapter, a company, in its business engagements may encounter financial distress from which it can either survive or fail depending on the extent of its challenges. As a matter of fact, in a capitalist society, a level of corporate demise has been accepted as both inevitable and necessary for the proper functioning of the market.[14]

However, despite the presence of financial difficulties, some companies may still be viable, such that drastic remedial action is resorted to at a time when the company is experiencing crisis, which may be necessary to protect the stakeholders of the company. Consequently, Belcher defines corporate rescue as a “major intervention necessary to avert eventual failure of the company.”[15] This definition suggests that any major action taken to prevent the ultimate failure of a company will amount to corporate rescue. This may include both formal and informal mechanisms designed to help an ailing company. The aim of a drastic intervention in a distressed company is to avoid failure and this does not mean that the company will be restored back to the way it was before the crisis struck.[16]

By contrast, a narrow definition of corporate rescue relates it to only the operation of legal proceedings offering facilitating mechanism for rescuing companies in financial distress. Furthermore, corporate rescue may be used to embody various outcomes of rescue activities. In the UK, the outcome of a rescue attempt may result in a range of rescue activities. Given the broad nature of the corporate rescue concept, it has been regarded as potentially misleading.[17] Essentially, corporate rescue may mean the restoration of a company to a healthy state, such that the company survives without change of its ownership, while at the same time, it can connote the preservation of the value in the

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[13] A Campbell, ‘Company Rescue: The legal Response to the Potential Rescue of Insolvent Companies.’ (1994) 5 International Company and Commercial Law Review 16.
[14] J Argenti, *Corporate Collapse: The Causes and Symptoms* (Wiley 1976) 170.
[15] A Belcher, *Corporate Rescue* (Sweet & maxwell, 1997) 12.
[16] A Campbell, ‘Company Rescue: The legal Response to the Potential Rescue of Insolvent Companies.’ (1994) 5 International Company and Commercial Law Review 16.
[17] R Parry, *Corporate Rescue* (Sweet & Maxwell, 2008) 2.

company in order to achieve a better result than the case in a winding-up.[18] In other words, rescue attempts may result in the rescue of the company or the rescue of the business of the company. The difference between both is critical to our understanding of corporate rescue.

A company rescue is aimed at keeping the corporate entity alive so that it can continue trading as a going concern after rehabilitation. It may be the case that the company has an underlying business idea that is sound but requires financial or structural reorganization.[19] Company rescue may result in a change in the management of the company through restructuring methods like "refinancing, debt composition or re-scheduling, refinancing downsizing activities and making redundant part of the workforce to offer temporary relief."[20]

In such circumstances, the stakeholders of the company may be better served if the company is preserved, as well as the business. Although Belcher argues that it may be impossible to save the entire company since it will usually be unable to pay some of its debt.[21] As a result, in practice, rescue entails preserving the interest and entitlements of some stakeholders which would typically involve some alterations.[22]

On the other hand, business rescue connotes the termination of the old company, but its business and activities will remain as a productive unit under new ownership. This occurs where a company is insolvent, but steps are taken to retain the operational part of the business, to save employees jobs and to ensure survival of some economic activity.[23]

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[18] Ibid.
[19] R Singh, 'KPMG Administrators Save 750 Jobs through Pre-pack' (*Accountancy Age*, 9 November 2012) https://www.accountancyage.com/2012/11/09/kpmg-administrators-save-750-jobs-through-pre-pack/ accessed 1 June 2019.
[20] J Armour A Hsu A Walters, The Impact of the Enterprise Act 2002 and Realizations and Costs in Corporate Rescue Proceedings (2006) Report to The Insolvency Service <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.96.6853&rep=rep1&type=pdf> accessed 1 November 2018.
[21] Belcher (n 15) 22-24.
[22] R Mokal, *Corporate Insolvency Law: Theory and Application* (Oxford University Press 2005) 11.
[23] Finch and Milman (n 5) 198.

The transfer to a financially healthy company may give the once distressed business another opportunity to succeed.

Likewise, such a sale may take away the business from the care of ineffective managers which led to the misfortune of the business into the care of more competent ones thereby giving the business an ultimate chance of future survival.[24] Business rescue is usually achieved via a sale of the company's assets and a business as a going concern which may result in maximizing the value of the company rather than the case with liquidation which merely sells the asset of the company piecemeal.[25]

It is submitted that both notions of corporate rescue are important, and both can be regarded as rescue because both perspectives seek to achieve a rescue outcome. The only difference is that company rescue involves a hypothetical sale while business rescue is an actual sale, as such, the idea of rescue has been regarded as "inherently vague".[26] However, regardless of what is being rescued, whether the company and/or its business, survivability ought to be at the crux of any rescue regime. It makes no sense saving a company or its business only to end up failing. Thus, it can be argued that both company rescue, and business rescue are inter-dependent of each other and both definitions cannot be ignored. Perhaps it can be said that rescue would have been achieved if the object of rescue continues to serve its purpose.

Thus, for the purpose of this thesis, the term "corporate rescue" refers to the legal procedures designed to facilitate either the preservation of the company itself or the rescue of the business within which the company operates by transferring same to a new owner. Corporate rescue seeks to preserve the going-concern surplus in corporate restructurings and insolvency in general. This going-concern surplus can be derived from

[24] N Pandit G Cook D Milman F Chittenden, 'Corporate Rescue: Empirical Evidence on Company Voluntary Arrangements and Small Firms' (2000) 7 Journal of Small Business and Enterprise Development 241,245.
[25] Xie (n 1) 5.
[26] B Adebola, 'A Few Shades of Rescue: Towards an Understanding of the Corporate Rescue Concept in England and Wales' (2014) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2524488 accessed 3 July 2019.

preserving the business and assets of the company as an operating unit. This can be achieved "either through a successful company turnaround or reorganization, or through a going-concern sale, where the whole or substantial business and assets of the ailing company are preserved."[27]

Capturing the surplus of the going-concern value of the assets of the distressed company is likely to yield more benefits than the piecemeal value of its assets.[28] As submitted elsewhere, "we have a going-concern surplus (the thing the law of corporate reorganizations exists to preserve) only to the extent that there are assets that are worth more if located within an existing firm. If all the assets can be used as well elsewhere, the firm has no value as a going concern."[29]

The "going concern value" can be measured by estimating the income stream that could be generated by assets if they are kept together, considering the risk of reorganization failure, and comparing same with "piecemeal liquidation value" which is the value realized when parts of the business and assets are broken off and sold separately, and the amount this would realize.[30]

However, a consideration of where this additional value is derived from is important. The orthodox view has been to place the source of going concern surplus in the intangibles linked with the running of the business, including goodwill and intellectual property.[31] However this notion has been questioned with the argument that if the only source of the going concern surplus is the intangible asset of the company, it remains that "most failed companies may be said to have no going-concern surplus, as their failure is usually due

[27]Xie (n 1).
[28] G McCormack, *Corporate Rescue Laws: An Anglo-American Perspective* (Edward Elgar 2008) 3.
[29] DG Baird TH Jackson, 'Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment of Adequate Protection of Secured Creditors in Bankruptcy' (1984) 5 University of Chicago Law Review 97, 109.
[30] ibid, TH Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986) 164.
[31] Xie (n 1) 56.

to their lack of valuable intangible assets, having neither a sound business strategy nor a good reputation."[32]

Changes in the fundamental forces at work in the economy has transformed this orthodoxy and it has been seen that "the most valuable resource may be human capital and relationship networks."[33] Thus, the going-concern value can be derived from various interconnected relationships "among people, among assets and between peoples and assets."[34] If the business is scattered through a piecemeal sale of assets, it will likely yield costs which will invariably affect these relationships and starting a business from the beginning is expensive and time consuming and involves a huge entrepreneurial risk.[35] This has been echoed by the legal department of the International Monetary Fund:[36]

> in the modern economy, the degree to which an enterprise's value can be maximized through liquidation of its assets has been significantly reduced. In circumstances where the value of a company is increasingly based on technical know-how and goodwill rather than on its physical assets, preservation of the enterprise's human resources, and business relations may be critical for creditors wishing to maximize the value of their claims.

Even though the rationale behind the existence of corporate rescue laws is to help restructure distressed entities, it does not suggest that all troubled companies can be rescued. "Corporate rescue mechanisms are not intended to maintain inefficient firms that are not economically viable."[37] There are two types of distress when considering whether the company can be rescued; financial distress and economic distress.

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[32] ibid, DG Baird RK Rasmussen, 'Chapter 11 at Twilight' (2003) 56 Stanford Law Review 673.
[33] McCormack (n 28).
[34] L Lopucki, 'The Nature of the Bankrupt Firm: A Reply to Baird and Rasmussen's The End of Bankruptcy' (2003) 56 Stanford Law Review 645, 652.
[35] H Miller S Waisman, 'Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?' (2004) 78 American Bankruptcy Law Journal 153, 192-193.
[36] Legal Department of International Monetary Fund, *Orderly & Effective Insolvency Procedures: Key Issues* (1999) https://www.imf.org/external/pubs/ft/orderly/ accessed 18 January 2020.
[37] The Insolvency Service, *A Review of Company Rescue and Business Reconstruction Mechanisms* (London: HMSO, 2000) para 24.

Financial distress as already discussed in the previous chapter, suggests that the company is facing cash flow problems i.e., it is unable to pay its debts as they fall due.[38] It has three underlying features: "only due debts are to be taken into account; insufficiency of liquid assets does not necessarily indicate inability to pay; and default in payment is sufficient evidence of inability to pay"[39]

The effect of cash-flow insolvency on the company does not mean that it is an eventual failure which is irredeemable. During the lifetime of a business, illiquidity of assets and repayment of huge debt can occur in the short term which could result in inability to pay debts as they fall due. Thus, there is a possibility that a financially distressed company is still economically viable, and its assets could be maximized to their full value. Winding up such a company could prove detrimental to the company and its stakeholders; it could lead to loss of job and assets which ought to be used for the benefit of the company would be moved to serve other goals.[40]

The most efficient and appropriate step to take for such a company is to allow the company to explore a corporate rescue regime to enable it attempt rehabilitation and perhaps it may because of this bounce back to its feet and continue trading as a going concern. Consequent upon this it can be argued that corporate rescue laws target financially distressed companies to enable them to survive corporate distress and avoid failure.

On the other hand, a company that is economically distressed suggests that "the net present worth of the troubled company's business as a going concern is less than the value of the assets broken up and sold separately,"[41] this means that the company cannot be saved. Winding up proceedings are designed to liquidate, and dissolve failed

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[38] Insolvency Act 1986, section 123(1).
[39] RM Goode, *Principles of Corporate Insolvency Law* (5th edn, Sweet & Maxwell, 2018) paras 4.15-4.23.
[40] RJ Mokal, 'Administrative Receivership and Administration- An Analysis' (2004) 57 *Current Legal Problems* 355, 357.
[41] E Ehlers, "Statutory Corporate Rescue Proceedings in Germany: the Insolvenzplan Procedure" in KG Broc R Parry (eds), *Corporate Rescue: An Overview of Recent Developments from Selected Countries* (2nd edn, Kluwer Law International 2006) 151.

companies and realize their assets via a going concern sale or breakup sale as applicable, to make a distribution among different classes of creditors under the order of priority.

The remaining resources of a hopeless insolvent company which cannot be saved will be used by the market to achieve more productive results.[42] This means that assets of a failed company will be released to other firms where they can be used to achieve profitable results and their employees who have been made redundant will be able to find jobs elsewhere.[43] Applying rescue laws to such companies will be a waste of resources instead such companies should be liquidated, delay will be detrimental as it could lead to further loss to creditors and the value of the assets of the company which could be deployed for optimal use in other firms could reduce. However, as mentioned earlier in this piece it is often practically difficult to differentiate between a financially distressed company and an economically distressed one.

Regardless, it is necessary that unviable companies do not abuse rescue regimes, also where a rescue regime does not lead to the rehabilitation of the company, there should be easy access from rescue regimes to a liquidation procedure.[44] As aptly described by Frisby "not all lame ducks can or should be rescued and the appropriate procedure for the genuinely doomed is immediate liquidation."[45] It is important to stand back and consider how the corporate rescue culture came to be in the UK.

1.2. The Development of the Corporate Rescue Culture in the UK

English insolvency law in its early years had a negative view about corporate rescue; it was considered a critical issue. The system existed for the benefit of creditors and the

[42] Finch and Milman (n 5) 189.
[43] G Lightman, 'Voluntary Administration: The new wave or the New Waif in Insolvency Law' (1994) 2 Insolvency Law Journal 59, 62.
[44] RM Goode, *Principles of Corporate Insolvency Law* (5th edn, Sweet & Maxwell, 2018) para 10.16
[45] S Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 67 Modern Law Review 247, 248.

law focused on distributing the remaining assets of the company amongst creditors. As such, English law was regarded as a creditor-oriented system.[46] It is often compared to the United States of America (USA) Chapter 11 reorganization procedure under the Bankruptcy Act 1978, which is a debtor in possession regime (DIP) aimed at giving the debtor a chance to attempt reorganization.[47]

There was no procedure in the UK aimed at corporate rescue or rehabilitation as existed in other jurisdictions like the judicial management in the South African Companies Act 1926,[48] or *redressement judiciaire* in the French decree of 20 May 1955,[49] which was later replaced by the law of 13 July 1967.[50] Little thought was given to the rescue of a distressed company in the UK before the last two decades. Even though the Companies Act for a couple of years[51] provided procedures for the reconstruction and arrangements of companies facing financial difficulties,[52] the usage of these procedures was very low.

The reasons for the low uptake were cost and delay involved in the process of getting the consent of creditors and the formality of court sanction. The cumbersome nature of the procedure was a major setback giving the fact that the law made no provision for a moratorium to keep creditors away from the company's assets during the period the arrangement has been put in place,[53] although the courts had the judicial discretion to protect the arrangement by not granting any enforcement order allowing creditors to

[46] Belcher (n 15) 13-14.
[47] For a discussion of the merits/demerits of a DIP regime; D Hahn, 'Concentrated Ownership and control of Corporate Reorganizations' [2004] 4 Journal of Corporate Law Studies 117; G McCormack, 'Control and Corporate Rescue- An Anglo- American Evaluation' (2007) 56 The International and Comparative Law Quarterly 515.
[48] Companies Act (Act no. 46 of 1926).
[49] Decree no 55-583 of 20 May 1955.
[50] Law no. 67-563 of 13 July 1967.
[51] Schemes of reconstruction emanated in the 19th century- Joint Stock Companies Arrangement Act 1870. It was a type of arrangement that was previously available to companies who were not considering a winding-up.
[52] Companies Act 1985, sections 425-427A
[53] A typical example was the case of *Booth v Walkden Spinning and Manufacturing Company Ltd* [1909] 2 KB 368.

enforce their rights against the company's assets during the period the scheme was being considered.[54]

A further problem was that where the scheme had been approved, any changes will require subsequent meetings to be requisitioned and the court would need to sanction the scheme again which made the process very rigid.[55] Moreover schemes were commonly used in the context of large restructurings; it was not a friendly procedure for small companies. The law did not pay attention to the needs of small companies who has greater chance of corporate failure than large companies. The alternative to the scheme of arrangement to help small companies in financial trouble was the procedure enshrined in the Deeds of Arrangements Act 1914, however in a turn of events the court ruled that the procedure could only be used by individuals who were insolvent and not companies.[56]

Likewise, before the 1980s, liquidation formed the crux of the English Insolvency Law system.[57] This procedure mainly facilitated the piecemeal sale of the company's assets thereby leaving the company as an empty shell. To curb this excess, there was the need to give the company an opportunity to attempt rehabilitation. However, at that time, the only process that was available to a company in financial distress was "administrative receivership".

This procedure is an "enforcement remedy"[58] available to a floating charge holder. A floating charge is a charge granted to a creditor by the company over the present and future assets of the company. Essentially, a floating charge allows the company to continue operating as a going concern pending when the floating charge holder seeks to enforce his security.[59] For example, where a debtor defaults on a secured loan or where

[54] *Hudson's Concrete Products v D.B. Evans (Bilston) Ltd* (1961) 105 SJ 281.
[55] *Srimati Premila Devi v Peoples Bank of Northern Ireland Indis Ltd* [1938] 4 All ER 337.
[56] *Re Rileys Ltd* [1903] 2 Ch 590.
[57] Goode (n 44).
[58] R Goode, *Commercial Law* (3rd edn, Penguin Books, 2004) 845.
[59] R Parry, 'United Kingdom: Administrative Receiverships and Administrations' in KG Broc R Parry, *Corporate Rescue in Europe: An Overview of Recent Developments from Selected Countries in Europe* (Kluwer Law International, 2004) 267.

it becomes obvious that the company will be unable to pay its debt at a due date, the floating charge "crystallizes", and the floating charge holder will be able to appoint a receiver.[60]

The receivership procedure is implemented by an administrative receiver who must be a qualified insolvency practitioner.[61] The receiver's primary responsibility is to take control of the assets subject to the security, realize them to fully pay off the creditor who appointed him. A receiver has been described as "an independent contractor whose primary responsibility is to protect the interests of his appointor,[62] but who also owes a duty to his deemed principal, the company,[63] to refrain from conduct which needlessly damages its business or goodwill, and a separate duty, by statute, to observe the priority given to preferential creditors[64] over the claims secured by a floating charge."[65]

Despite the abovementioned obligations, the receiver is not expected to take into consideration the interests of the unsecured creditors of the company at the expense of his appointor's interests.[66] It is often the case that even though the receiver is required to act in good faith in his appointor's interests, that does not stop him from dealing with the company or its assets in a way that adversely affects vulnerable junior creditors, who, even though are affected by the receiver's actions, cannot hold him responsible.[67] The

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[60] It should be noted that the power to appoint an administrative receiver must be expressly stipulated under the instrument creating the floating charge, since the Insolvency Act 1986 does not lay down circumstances in which an administrative receiver can be appointed.

[61] Insolvency Act 1986, section 230(2).

[62] See *Re B Johnson & co. (Builders) Ltd*. [1995] 1 Ch. 634; *Downsview Nominees v First City Corporation* [1993] AC 295.

[63] *Medforth v Blake* [1999] 3 All ER 97. See also S Frisby, 'Making a Silk Purse out of a Pig's Ear- Medforth v Blake & Ors' (2000) 63 Modern Law Review 413-423.

[64] See *IRC v Goldblatt* [1972] 1 Ch 498.

[65] Goode (n 44) 217.

[66] S Frisby, 'In Search of a Rescue Regime: The Enterprise Act 2002' (2004) 67 Modern Law Review, 247, 251.

[67] Mokal (n 22) 4-12; See also *Silven Properties Ltd v Royal Bank of Scotland* [2003] EWCA Civ 1409 (CA).

receiver was primarily accountable to his appointing creditor,[68] something which was incompatible with the ideologies of an ideal insolvency regime.[69]

The managers of the company are displaced for the duration of the receivership, leaving the receiver exercising all the powers of the managers. The receiver was deemed to be an agent of the company while carrying out his functions as receiver and manager. Based on this, liability for any actions of the receiver fell upon the company itself and not upon the creditor that appointed the receiver. Once the receiver had finished his task, the directors took over the control of the company in whatever state they found it. This procedure rarely resulted in the survival of companies, as its focus was to maximize returns to the floating charge holder.

Corporate rescue was not an objective of receivership. In cases where the business was sold as a going concern, the company itself would be stripped off its assets and the only option was to undergo an insolvent winding up. The prevalence of receivership daunted the image of rehabilitation and any attempt to make the procedure beneficial to all creditors proved abortive because the procedure was not designed to favor all the creditors as a whole and as such, "in most cases there was no alternative as it was often the case that the documents providing for security over a company's property demanded in return for finance by financial institutions such as banks were drafted to protect their own interests ahead of other creditors."[70]

Secured creditors (banks) were always quick to drive the company into receiverships with the end result of selling the assets of the company piecemeal and leaving the company as an empty shell. The downside of receivership prompted a review of the fairness of the

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[68] Department of Trade and Industry, *Insolvency- A Second Chance* (White paper, Cmnd 5234, 2001) paragraphs 2.2-2.3; *Re B Johnson & Co (Builders) Ltd* [1955] Ch 634

[69] It had been argued that administrative receivership should not be regarded as an insolvency procedure because it does not involve the exercise of class rights which is a requirement of a collective insolvency regime. See F Oditah, 'Assets and Treatments of Claims in insolvency' (1992) Law Quarterly Review 459, 460-461. This also justifies the reason for the exclusion of the procedure under the EU Regulation on Insolvency Proceedings (2015/848) and the UNCITRAL Cross-Border Insolvency Regulations (SI 2006/1030).

[70] Wood (n 8).

insolvency process mostly for viable companies. The above limitations affected the corporate insolvency landscape as it was in the 19th century; the English insolvency law sphere could not measure up to standard with similar jurisdictions as there was no mechanism to enhance corporate restructuring. As such, there was the need to rethink the English insolvency law system and introduce mechanisms which would help rehabilitate a financially distressed company. Although long before now the concept of rescue was in existence in the UK, but it was rarely explored because of the prevalence of receivership.[71]

The importance of having a framework that enables a company in financial distress to restructure their debt to avoid insolvency is recognized in almost every jurisdiction. This is because such a mechanism adds value to the company, saves jobs and is beneficial to the economy at large. The history of modern corporate rescue in the UK dates to 1977 when an interdisciplinary committee,[72] presided by Sir Kenneth Cork was formed. The Committee had the role of scrutinizing the system and in turn advocated for the "second chance" culture which had at its core the notion that in appropriate circumstances, viable business should be given an opportunity to attempt rescue and continue trading as a going concern. This notion brought about the introduction of the "rescue culture."[73]

1.2.1. The Role of the Cork Committee

Following a review of the English insolvency law and practice, and available insolvency procedures, the Cork Committee's findings was published.[74] The report frowned at the distribution of the debtor's assets among its creditors which formed the crux of insolvency law at that time and acknowledged that it would be beneficial both to the company and

[71] Ibid 21.
[72] Popularly known as the "Cork Committee"
[73] *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558 1982) (Cork Report).
[74] Ibid.

the creditors if there are mechanisms designed solely for facilitating corporate rescue as opposed to asset sales.[75]

Consequently, the Cork Committee embarked on a comparative analysis to draw virtues from other jurisdictions which had existing rescue mechanisms. The Chapter 11 reorganization procedure in the United States was the starting point since the procedure was seen as “the forerunner of corporate rescue.”[76] The Chapter 11 procedure was regarded as all encompassing, due to its broad and flexible nature and its ability to ultimately rescue the debtor company. It incorporated a debtor-in-possession (DIP) regime which allowed directors to remain in control of the affairs of the company during the reorganization process. A stay is in place to prevent individual creditor race to grab the assets of the company. The final objective of the procedure is the initiation and approval of a plan agreed with the debtor company’s creditors to reorganize the debtor’s obligations and if possible, to discharge the debtor.[77]

However, even though the Chapter 11 procedure was attractive to the reformers of the British insolvency law regime, the DIP feature was viewed cynically. Allowing the debtor to remain in charge of the business rather than an outside practitioner was something the UK did not wish to adopt. Critics of the DIP regime have likened it to “leaving an alcoholic in charge of a pub house”.[78]

The Committee considered other jurisdictions including France. The judicial settlement procedure in France provided for a composition with creditors that allowed the company to continue operating. This was however a court led procedure, a feature which makes it

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[75] D Milman C durrant, *Corporate Insolvency: Law and Practice* (3rd edn, Sweet & Maxwell 1999) 3-01.
[76] PJ Omar J Gant, ‘Corporate Rescue in the United Kingdom: Past, Present and Future Reforms’ (2016) 24 Australian Insolvency law Journal 40, 48.
[77] O Lobo (ed), *World Insolvency Systems: A Comparative Study* (Thompson Reuters, 2009) 693-800.
[78] G Moss, ‘Chapter 11: An English Lawyer’s Critique’ (1998) Insolvency intelligence 17, 18-19. For a general discussion on a comparison between chapter 11 and the UK corporate rescue regime see G McCormack, ‘Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK’ (2009) 18 International Insolvency Review, 109-134.

different from the US Chapter 11 procedure.[79] There were also existing reorganization procedures in South Africa under the Companies Act 1973 (which succeeded the 1926 Act). The procedure was used to compromise a company's debt with creditors coupled with a moratorium to prevent creditor claims. However, reflecting on the experience of these supposed rescue procedures in different jurisdictions, it was observed by the Cork Report that only few companies could be rescued.

The Cork Committee's Report advised the creation of "means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country."[80] Sequel to this, two new procedures: the company voluntary arrangement (CVA) and the administration procedures were introduced by the Insolvency Act 1986. The CVA was created for companies to explore prior to formal insolvency while the administration was for companies at the verge of insolvency.

The Cork Committee deliberated on the form that the corporate rescue procedures would take in the UK, although they considered existing procedures in other jurisdictions which could be emulated by the UK, nevertheless, they found inspiration for the two newly introduced procedures within the existing models within the UK law.[81] Arguably, "the structural foundations for the CVA and administration were found respectively in a simplified and stripped down version of the scheme of arrangement and receivership".[82] Nevertheless, both procedures were conceptually different: the aim of the CVA was to provide a framework that facilitated debtor-creditor negotiation similar to an informal workout, while the administration mechanism was more formal in nature and involved an administrator taking charge of the process under the supervision of the court. As submitted elsewhere, "both procedures lay on a path of increasing formality, with the CVA upstream and administration further downstream."[83]

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[79] A Sorenson P Omar, *Corporate Rescue Procedures in France* (Kluwer Law,1996) 24-26.
[80] Cork Report (n 73) 198(j).
[81] Omar and Gant (n 76).
[82] Ibid.
[83] Ibid.

Further, administration unlike receivership aimed to be a collective procedure with the interests of all creditors (both secured and unsecured) in mind rather than just the principal secured creditor. Both procedures had one thing in common: even though the debtor has the right to initiate the procedure, an insolvency practitioner is exclusively involved in managing and overseeing the process. The intention of the Cork report with regard to the CVA procedure was to create an inexpensive, quick and efficient method of resolving financial distress without entry into formal procedures.[84] The procedure was mainly targeted at companies dealing with creditors based on negotiations with them under the guidance of an insolvency practitioner, with such negotiation leading to an agreement or compromise through which debts could be settled and the company could continue trading as a going concern.

With the administration procedure on the other hand, the Cork Report had placed much emphasis on the need for a wholly new rescue procedure that would allow the business to continue, thereby saving jobs, allowing continued trading and generation of profits, alongside the satisfaction of debts owed to the company's creditors.[85] This led to the introduction of the administration procedure which was meant to be more formal than the CVA and allow a suspension of enforcement actions under the protection of a moratorium.

At inception, there were four possible outcomes expected of administration: survival of the company or a part of it as a going concern;[86] the approval of a CVA;[87] the sanctioning of a scheme of arrangement;[88] or some more advantageous realization of the company's assets than might be possible in a liquidation.[89] The administration was perceived as either leading to the rescue of the company or due to the involvement of the administrator, potentially some other form of rehabilitative procedure.3

[84] Cork Report (n 75) para 204.
[85] ibid chapter 9.
[86] Insolvency Act 1986, section 8(3)(a)
[87] Insolvency Act 1986, section 8(3)(b)
[88] Insolvency Act 1986, section 8(3)(c)
[89] Insolvency Act 1986, section 8(3)(d)

However, despite the good intentions of the law, the uptake rate of both procedures was "disappointingly low."[90] The annual statistics for corporate insolvency proceedings from 1997-2002 revealed the lack of usage of these procedures compared with the high levels of company liquidations and administrative receiverships in the same years.[91] The ideologies of the Cork Report which were to enhance a "rescue culture" with the ability to preserve the value of viable businesses as well as reducing the social and personal problems caused by liquidation were not achieved through the procedures. This was partly due to "…concerns that the large number of administrative receivership appointments in the early 1990s may have represented precipitate behavior on the part of lenders, causing companies to fail unnecessarily."[92] It is worth considering the main issues that scaled back uptake of the procedures.

1.2.2. Reasons for the Low Uptake of CVA

Starting with the CVA, it was intended to be a simple procedure offering an inexpensive and efficient means of achieving a compromise or an arrangement between a company and its creditors. It allowed the directors to retain control of the company albeit under the supervision of an insolvency practitioner. It was the closest model of the debtor-in-possession (DIP) mechanism under the US Chapter 11 procedure.

However, the involvement of an outside practitioner differentiates the DIP model enshrined in the CVA procedure from that of the Chapter 11 procedure. Under the CVA, creditors constituted a single class for voting purposes measured by the financial value of each creditor's claim. By contrast, under the Chapter 11 procedure, creditors are divided into different classes based on the features of their claims. "The financial weight of secured creditor's votes was reduced by the assessed value of their security, on the

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[90] *Productivity and Enterprise: Insolvency- A Second Chance* Cm 5234 (London: TSO, 2001)9. (Insolvency A Second Chance)

[91] See statistical tables of insolvency proceedings for the years 1987-2000 in IF Fletcher, *The Law of Insolvency* (3rd edn, Sweet and Maxwell 2002) Appendix III.

[92] Insolvency A Second Chance (90) 9.

principle that the size of the creditor's unsecured risk of loss should determine his or her influence on the final outcome of the vote."[93]

Despite the desire to make the CVA process simple, there were certain problems that arose in practice. The unclear nature of the rules guiding creditors' eligibility to vote especially in the case of disputed or unascertainable claims led to several contested litigation cases which targeted the viability of the CVA procedure. In this regard, "a ruling of ineligibility to vote would make it possible for the creditor concerned to escape being bound by the outcome, and so potentially the arrangement itself might be unraveled".[94]

Another major barrier to its usage was the lack of moratorium to stay away creditor actions which made the negotiation process difficult.[95] Likewise, the uncertainty surrounding the future viability of the company if it defaulted its obligations after the CVA has been implemented, as well as the notion that this could leave creditors in a worse off position, led to underutilization of the mechanism. Further it was important for secured creditors to lend their support to the CVA, because if their claims are affected, they could disrupt the entire process. These disadvantages made the new administration procedure more favorable to the CVA, however as will be seen this procedure also had its own shortcomings.

1.2.3. Reasons for the Low Uptake of Administration

The major advantages of the administration procedure over CVA were its collective nature, its rescue orientated nature and encouraged attempts to restructure a distressed company. The procedure was subject to court supervision and as such could be beneficial to all creditors as opposed to the case where a single secured creditor could solely pursue

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[93] IF Fletcher, 'UK Corporate Rescue: Recent Developments-Changes to Administrative Receivership Administration and Company Voluntary Arrangements- The Insolvency Act 2000 the White Paper 2001 and the Enterprise Act 2002' (2004) 5 European Business Organization Law Review 119,127.
[94] ibid; *Doorbar v Alltime Securities Ltd* [1994] BCC 994; *Re Cranley Mansions Ltd, Saigol v Goldstein* [1994] BCC 576.
[95] *Company Voluntary Arrangements and Administration orders: A Consultative Document* (Insolvency Service, October 1993).

recovery of assets. The procedure was debtor friendly and encourage a company to seek assistance timeously before becoming unsalvageable. “It also had the potential of avoiding the bad publicity associated with receiverships by promoting rescue as a joint effort between the debtor and its creditors, rather than forming a part of the reputational problem associated with banks and the lending culture that had become the subject of criticism.”[96]

Despite its attractive features, the mechanism suffered from major flaws that restricted its usage. First, the mode of entry was very daunting. The proceedings had to be initiated through a court order which could only be granted upon satisfying the court that at least one of the four statutory purposes could be achieved. This imposed an extreme and costly burden of proof at the early stage.[97] In the same vein, the low uptake of administration was linked to the ability of a secured creditor with relevant floating charge who could block a petition for an administration order by simply appointing an administrative receiver.[98]

Likewise, the administration procedure was perceived as a reflection of the administrative receivership procedure and since the latter gave secured creditors control of the process as well as access to the assets of the company, they preferred to use the receivership procedure rather than the administration procedure. This slowed down recourse to the administration procedure. Even though the appointment of an administrator effectively blocked the continuation of a receivership procedure, the opposite was also possible.

Once a principal creditor has concrete information that an administration order was imminent, the creditor could initiate a receivership procedure under a loan agreement with a floating charge which was typical of “business lending of any major amounts.”[99] Even though a moratorium was available upon presentation of the administrative order, this did not prevent the appointment of a receiver save where the main creditor had agreed to the

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[96] Omar and Gant (n 76) 48.
[97] The four statutory objectives were contained in section 8(3) of the original Insolvency Act 1986 which has now been repealed except for transitional cases.
[98] Insolvency-A Second Chance (n 90).
[99] Omar and Gant (n 76).

commencement of the administration procedure. Thus, in most cases, receivership took precedence over administration.

To further exacerbate the issues, a practice borrowed from receivership began to dominate the administration procedure. This consisted of selling the business and the debtor company's assets to a subsidiary of the company with the aim of selling the useful and liability-free subsidiary to a third company, commonly referred to as "hive down".[100] Such method defeated the purpose of the rescue ideology and left unsecured creditors and other weak stakeholders unprotected. Given that the business of the company or other profitable assets will be preserved, the process was favorable to only the company, administrator, and the third-party purchaser. This technique became the norm in administrations, and it led to concerns about "what advantage in terms of corporate rescue the procedure presented if practitioners merely sold the business to realize a sum distributable to creditors instead of saving the company."[101]

Another reason for the low uptake of the procedure was the loss of control of the affairs of the company by the management in favor of an administrator, coupled with the fact that administrators could remove and replace any director of the company made the procedure unfavorable to directors. As submitted elsewhere, "… many cases in which administration might have offered a solution to the company's predicament merely became additions to the statistics of failure, as directorial reluctance to venture into the unknown meant that administration was not even attempted or, if attempted, was resorted to only after the company had passed beyond the point of salvation."[102]

Other shortcomings that affected the uptake of the procedure included an obvious lack of hierarchy between the set objectives contained under section 8(3) of the Insolvency Act 1986, which meant that corporate rescue was set out equally among other objectives,

[100] Ibid 57.
[101] ibid.
[102] IF Fletcher, 'UK Corporate Rescue: Recent Developments-Changes to Administrative Receivership Administration and Company Voluntary Arrangements- The Insolvency Act 2000 the White Paper 2001 and the Enterprise Act 2002' (2004) 5 European Business Organization Law Review 119, 128.

leading to the conclusion that the procedure was not mainly attuned to rescue of the businesses. Further, the moratorium provisions contained loopholes which allowed some creditors to escape the binding effect of the stay.[103] Likewise, the lack of legislative clarity resulted in the absence of clear provisions setting out the exit process out of administration.[104]

These concerns discussed above were the major reasons for the disappointing usage of the rescue procedures and this led to increasing calls for reforms.[105] The insolvency service set up two working groups to look separately at the CVA and administration procedures, and they each came up with a report in 1955[106] and 2000.[107] The product of the two working groups led to two bills which were adopted rapidly by Parliament as the Insolvency Act 2000 which dealt essentially with the CVA, and the Enterprise Act 2002 (dealing mainly with reforms to administration). Both Acts revamped the Insolvency Act 1986 by replacing some of its provisions with new sections and schedules aimed at refining the rescue procedures, regarding efficiency, benefit, and practicability.[108]

1.2.4. The Insolvency Act 2000 and the Enterprise Act 2002 Reforms

Both reforms made important changes to the procedures under study. The Insolvency Act 2000 on its part varied the CVA by creating a moratorium for small and medium sized enterprises with certain criteria as specified under the then section 247(3) of the

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[103] For the provisions of the moratorium see sections 10 and 11 of the Insolvency Act 1986 (as originally enacted); For a description of the loopholes referred to see *Razzaq v. Pala* [1998] BCC 66 (landlord's rights) and *Air Ecosse Ltd v Civil Aviation Authority* (1987) SLT 751.
[104] *Re Mark One (Oxford Street) plc* [1998] BCC 984; *Re Norditrack (UK) Ltd* [2001] 1 All ER 369.
[105] S Hill, 'Company Voluntary Arrangements (1990) 6 Insolvency Law and Practice 47; J Gibson, 'Making Corporate Voluntary Arrangements Work' (1992) 5 Insolvency Intelligence 29; J Golding, 'Administrations-practical lessons of the First Two Years' (1989) 5 Insolvency Law and Practice 2; M Phillips, 'Administration orders- the First Few Months' (1987) 8 Company Lawyer 273.
[106] *Revised Proposals for a New Company Voluntary Arrangement Procedure: A Consultative Document* (Insolvency Service, April 1995).
[107] *Review of Company Rescue and Business Reconstruction Mechanisms: A Consultation Paper* (Insolvency Service, May 2000) which was followed by the White Paper titled Insolvency- A Second Chance (Insolvency Service, 2001) (Cm 5234) which contained provisions that later became the Enterprise Act 2002.
[108] Omar and Gant (n 76)58.

Companies Act 1985. It also amended the Company Directors Disqualification Act 1986 on the disqualification of directors who made false representations with a view of obtaining a CVA.[109] The framework of the CVA remained unchanged by the Insolvency Act 2000 save in some ways where there had been unclarity under the previous Insolvency Act 1986. One issue that previously arose was the effect of creditors who were unknown at the time of the approval of a proposal, and who had previously retained their rights of action. Following the reforms introduced by the Insolvency Act 2000, these creditors could be bound by the proposal if adopted.[110] In addition, the reforms brought clarity to the issue of which of the decisions of the meetings of creditors or shareholders took priority in the case of any disagreement. The creditors decision would have priority over that of shareholders.[111]

The Enterprise Act 2002 streamlined the administration procedure by creating a new hierarchy of objectives and an out-of-court appointments mode of appointing an administrator was also introduced. Both reforms reflected concerns about the position of the unsecured creditors, the need to simplify the administration procedure as a rescue tool and the importance of having collective insolvency procedures, in place of private recovery methods such as receivership which could be manipulated by floating charge holders.

Despite fierce opposition from those who benefitted most from the receivership process (mainly banks and other financial institutions, and primary market lenders), the government deemed it fit to promote administration and its rescue ideology over receivership. Consequently, receivership was subdued and only remains available for the insolvencies of certain large complex companies. There was also the abolition of Crown privilege, and a new regime was introduced in which a proportion of the distributions in liquidations were set aside mainly for unsecured creditors.[112]

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[109] Insolvency Act, Schedule A1, section 6A.
[110] Insolvency Act, Schedule A1, paragraph 37.
[111] Insolvency Act, Schedule A1, section 4A (3)-(6) subject to a right of challenge by the members.
[112] Insolvency Act 1986, section 176A. Although it should be pointed out the Crown preference has been reintroduced by the Finance Act 202o on 1 December 2020, ranking as secondary preferential debts after

The old administration procedure was costly due to the burden and expense of a compulsory application to the court for an administration order, as the long duration of the administration procedure which could run for years without the administrator having any real incentives to terminate the process. Likewise, the procedure was rigid, due to the barriers to entry and exit.[113] Thus, the Act also streamlined the administration procedure inserting a new Schedule B1 to the 1986 Insolvency Act.

The result of which is a hybrid of old administration procedure and receivership. It became possible to appoint an administrator out of court thereby introducing flexibility into the process (ease of entry) and removing the costs of court application and hearing.[114] Floating charge holders, and the company and/or its directors were given rights to appoint an administrator out of court. Besides, the legislation is structured in a way that allows floating charge-holder to exercise veto rights over the choice of administrator where the company and/or its directors appoint the administrator.[115]

Greater emphasis was also placed on exit from administration. The appointment of an administrator is now limited to a period of one year commencing on the date on which such appointment took effect unless the period is extended by the court or with the consent of the creditors (for a period which must not exceed six months).[116] The court cannot extend the one-year period if the application is made after the one year has lapsed.

There are other exit routes designed to increase flexibility and certainty. Specifically, the previous hurdles associated with exiting administration into creditors' voluntary

the preferential claims of employees. For a discussion of what this reintroduction means see AJ Knight, S Olufunwa, 'The Reintroduction of Crown Preference: What Does this Mean for Secured lending' (Lexology, 4 August 2020) https://www.lexology.com/library/detail.aspx?g=d1e1ff84-db31-4b74-b506-a3a13e1a061a accessed 22 January 2021.

[113] The requirement for a court order to commence the procedure and the lack of any defined mode of exiting the procedure. See J Armour RK Mokal, 'Reforming the Governance of Corporate Rescue: The Enterprise Act 2002' (2005) Lloyd's Maritime and Commercial Law Quarterly 28

[114] Insolvency Act 1986, schedule B1, paragraphs 14 and 22.

[115] Insolvency Act 1986, schedule B1, paragraphs 26(1).

[116] Insolvency Act 1986, schedule B1, paragraphs 76 &78.

arrangement has been defeated.[117] It should also be noted that where appropriate the administrator can avoid incurring the additional costs of a liquidation and instead make distributions in administrations[118] and exit directly through a dissolution.[119]

The new administration procedure also seeks to promote accountability in addition to enhancing flexibility and reducing costs. This accountability is achieved by giving the administrator new duties.[120] The administrator must seek to implement a hierarchy of objectives: a rescue of the company as a going concern; if not possible, achieving a better result for the creditors as a whole than in liquidation should be considered; if not possible, a realization of the assets of the company for the benefit of secured or preferential creditors must be carried out.[121]

Arguably, “this is intended to correct the perceived incentive problem under receivership by requiring the administrator to seek to achieve a ‘rescue’ either of the company or the business if he can.”[122] There is a further overarching objective requiring the administrator to perform his duties in the interests of the company’s creditors as a whole.[123] The administrator is also required to act “quickly and efficiently” in order to minimize costs of the process.[124]

It can be argued that where the Insolvency Act 1986 failed in its paradigm shift, the Insolvency Act 2000 and the Enterprise Act 2002 had at their core: “a change in focus of insolvency from wealth maximization for the privileged few towards a true collective

[117] Insolvency Act 1986, schedule B1, paragraph 83.
[118] Insolvency Act 1986, schedule B1, paragraph 65, distributions to unsecured creditors however require the court’s permission
[119] Insolvency Act 1986, schedule B1, para 84. See also Re GHE Realizations Ltd [2005] EWHC 2400 (Ch).
[120] Armour and Mokal, (n 113).
[121] Insolvency Act 1986, schedule B1, paragraph 3(1).
[122] Armour and Mokal (n 113); the rationale behind this was that it was felt that allowing rescue of the company to top the hierarchical objections would serve as an incentive for directors to take timeous actions to address the problems of financial distress since this will not threaten their position as managers.
[123] Insolvency Act 1986, Schedule B1, paragraph 3(2).
[124] Insolvency Act 1986, Schedule B1, paragraph 4.

approach in the form of administration and other rescue-oriented procedures, incidentally, supporting the further development of the rescue culture sweeping legal systems globally."[125]

Despite the reforms introduced by the Enterprise Act 2002 and additional revisions to insolvency law framework in succeeding years, there remained uncertainties within the law, and it could be argued that corporate rescue in the UK until recent reforms in 2020 remained a difficult objective to achieve. This is partly due to the evolving and complex business world and the attitudes of those charged with the duty of managing the company. The recent passing of the Corporate Insolvency and Governance Act 2020 further changed the rescue regime in the UK, introducing a new standalone moratorium process, restrictions on certain termination rights of contractual counterparties (including a ban on ipso-facto clauses) and importantly the introduction of the restructuring plan procedure with its attractive cross-class cram down facility.

The Act was introduced due to the global outbreak of the coronavirus pandemic, with many economically viable businesses experiencing difficulties and ultimately entering insolvency.[126] There had been a consultation by the Department for Business, Energy & Industrial Strategy (BEIS) on how to improve the UK's governance and insolvency laws in 2016[127], which led to proposals[128] to improve the system in 2018. The consultation sought to consider potential insolvency reforms intended to help struggling businesses to continue trading through a rescue process. The proposals included creating a company moratorium as well as developing a flexible restructuring procedure. At the end of the consultation process, the summary received showed wide support for the principles

[125] Omar and Gant (n 76) 59.
[126] A Shalchi, 'Corporate Insolvency and Governance Act 2020' (5 October 2021, House of Commons Library) https://researchbriefings.files.parliament.uk/documents/CBP-8971/CBP-8971.pdf accessed 21 January 2022.
[127] The Insolvency Service, 'A Review of the Corporate Insolvency Framework- A Consultation on Options for Reform' (May 2016) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf accessed 12 July 2021.
[128] Ibid.

behind the proposals and the Insolvency Service committed to further liaising with stakeholders to refine the proposals.

In 2018, the Department for Business, Energy & Industrial Strategy (BEIS) consulted again amidst several company failures including that of Carillion.[129] Views were sought from stakeholders on proposals to reduce the risk of major company failures, strengthen directors' responsibilities when they are in or at the verge of insolvency and ensure a fair balance of interests for all stakeholders amongst other things. Following the closure of the consultation, the Government published its response[130] to both the 2016 and 2018 consultations.

The government in its response announced plans to make changes to the insolvency regime by introducing new rescue procedures. This was left until when "parliamentary time permits."[131] However, due to the adverse effect of the 2019 novel coronavirus disease crisis, (generally referred to as the COVID-19 pandemic), the government signaled the urgent need to introduce both temporary and permanent measures to support continued trading through the crisis to prevent companies from entering insolvency.[132] Sequel to this, the Corporate Insolvency and Governance Act 2020 (CIGA) was born.

According to the Explanatory Notes following CIGA, the aim of the legislation is "to provide businesses with the flexibility and breathing space they need to continue trading, and to help them avoid insolvency during this period of economic uncertainty. The measures are designed to help UK companies and other similar entities by easing the burden on businesses and helping them avoid insolvency during this period of economic

[129] Department of Business, Energy & Industrial Strategy, Insolvency and Corporate Governance (March) 2018 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/691857/Condoc_-_Insolvency_and_Corporate_Governance_FINAL_.pdf accessed 21 April 2021.
[130] Ibid.
[131] Ibid.
[132] Shalchi (n 126).

uncertainty."[133] The inclusion of more flexible, debtor-friendly mechanism is partly due to the "growing complexity of corporate capital structures, the growth of secondary debt markets and divergent views among stakeholders, requiring a shift from the traditional approach of achieving purely consensual restructuring solutions."[134]

The permanent measures introduced by CIGA include first, the introduction of a new free standalone moratorium designed to give companies a breathing space from creditor actions while they explore the possibility of rescuing and restructuring the company's business. Second, a new restructuring plan mechanism with the inclusion of a cross-class cramdown facility and third, a prohibition of termination clauses (*ipso facto* clauses) that would otherwise be used by suppliers to terminate the supply of goods and services upon a counterparty's entry into relevant insolvency procedures.

The temporary measures are a prohibition of creditors from filing statutory demands and winding up petitions except in certain limited circumstances and lastly, a suspension of wrongful trading provisions to reduce the pressure on directors during the COVID-19 emergency response. Likewise, a ban on forfeiture for non-payment of rent was introduced in the Coronavirus Act 2020 which has since become law. While the permanent measures have remained in place, the temporary ones have ceased to apply as they expired at the end of June 2021.[135]

It has been submitted elsewhere that the UK corporate rescue regime consists of three connected processes; the formal, informal, and quasi-formal processes.[136] The formal legal regime centers on several mechanisms which are provided for by the Insolvency

[133] 'Corporate Insolvency and Governance Bill Explanatory Notes' https://publications.parliament.uk/pa/bills/cbill/58-01/0128/en/20128en.pdf accessed 22 June 2021 Part 1

[134] K McMaster and Others, 'The Insolvency Review: United Kingdom- England and Wales' (The Law reviews, 17 October 2021) https://thelawreviews.co.uk/title/the-insolvency-review/united-kingdom-england--wales accessed 17 December 2021.

[135] The Insolvency Service, 'End of Temporary Insolvency Measures' https://www.gov.uk/government/news/end-of-temporary-insolvency-measures accessed 17 November 2021.

[136] V Finch, 'Corporate Rescue: A Game of three Halves' (2012) 32 Legal Studies 302, 303.

Act 1986 and other applicable legislation. The informal regime consists of procedures that exist without resort to the formal procedures as well as the court. The quasi-formal regime somewhat “straddles’ both formal and informal processes as shown by the pre-packaged administration (which has been developed in practice as a pragmatic approach to corporate rescue) such that it commences with informal negotiations which often leads to formal procedures and is thereafter concluded as part of the formal procedure.

According to Finch; “these regimes blur into each other to a degree but they nevertheless have distinct features and the problem is that these three ‘halves’ do not add up to a single whole.”[137] The aforementioned regimes all have their own separate characteristic which makes them distinct but they do not combine arbitrarily to produce a systematic corporate rescue regime and this can bring negative consequences for parties involved with the ailing company as well as deterring the objectives of public policy.

What needs to be considered is the variety of rescue procedures available to distressed companies in the UK.

1.3. Overview of the Corporate Rescue Mechanisms in the UK

Due to the incessant recognition of the perceived benefits of a rescue system as opposed to liquidation, several rescue mechanisms have been developed both within and outside the insolvency legislation. These mechanisms can be classified into two categories: informal and formal rescue mechanisms.

Informal mechanisms as the name implies are ‘informal’ in nature in that they are agreements between the debtor and its creditors attempting to restructure or reduce the obligations of the company without resorting to court. Formal mechanisms on the other hand involve the company reaching a compromise or arrangement with creditors via legally designed statutory procedures which may be subject to court supervision or may involve an outside practitioner.

[137] Ibid.

Often, a troubled company is likely to prefer informal procedures to the complicated formal procedures. Major creditors may prefer the same route because of the informality involved which may help prevent negative consequences that arise from initiating a formal process.[138] Such consequences may include but not limited to "the precipitation of contractual breaches across financing arrangements; liquidations of collateral; rating agency devaluations; shocks to market confidence; reductions in employee morale; and reputational harms to brands and directors as individuals."[139]

Likewise informal processes may be more flexible than legal procedures; as such they can be used to pursue an early and pro-active course and can help curb the excesses of certain creditors.[140] They usually involve firstly the company coming to a realization of the fact that it is unable to pay debts immediately.[141] After which the company's major financial creditors will be informed and consequently an assessment of the problems facing the company will be carried out with a view to finding out if there is a possibility of helping the company.[142]

This will usually involve finding sources of financing to sort out the cash flow problems of the company as well as attempting to get the support of creditors. However, for a turnaround to be feasible, all affected creditors need to give their consent[143] which is often difficult to obtain. "Major creditors will usually have to be brought together in an attempt to coordinate actions, financial reviews will be undertaken, and the managers' business

[138] J Armour, 'Should we redistribute in insolvency? In J Getzler J Payne (eds), *Company Charges: Spectrum and Beyond* (Oxford University Press, 2006) 219.
[139] Armour and Mokal (n 113) 9.
[140] P Omar 'The Convergence of Creditor-driven and formal insolvency models' (2005) 2 International Corporate Rescue 251.
[141] N Segal, 'Rehabilitation and Approaches other than Formal Insolvency Procedures' in R Cranston (ed) *Banks and Remedies* (Oxford University Press, 1992) 147.
[142] Ibid 148-149.
[143] Belcher (n 15) 116.

plans will be scrutinized."[144] Once there is a reasonable prospect of rescue, plans will be drawn up by the directors and the creditors approval will be sought on certain matters.[145]

However, there are downsides to an informal rescue approach. A formal rescue has values which the decision maker seeks to pursue during the process, one of which is the protection of the creditors' interests as a whole. This is not the case with an informal rescue. All creditors will often seek to pursue their own individual self-interests and not all will be involved in the process which may result in further complications to the problems of the company.

Likewise, since it is only an informal contractual agreement, there is no moratorium i.e., stay of actions, to shield the company from its creditors. As between creditors, they must agree to such an arrangement. "Standstill agreements will therefore be needed to bind the major creditors of the company, including banks, the bondholders' representatives and the major trade suppliers."[146] The nature of such agreements could prove very difficult in large restructurings.

A second limitation is that before such an arrangement can come to fruition, all creditors must agree to it. A cram-down of any type is not possible here and this could lead to some potential problems; mainly that it will be impossible to identify all the parties with a stake and get them to agree to the arrangement.

The debt market has changed in such a way that companies now get their finance from different sources including hedge funds, investment funds, investment banks etc. as opposed to the situation previously about ten years ago where the main creditor of a company would usually be a single bank.[147] As a result of these difficulties, the only option

[144] V Finch, 'Corporate Rescue: A Game of Three Halves (2012) 32 Legal Studies 307.
[145] For a discussion of what it entails, see J Willman, 'Rescuers armed with new ideas' *Financial Times* (19 March 2007).
[146] J Payne, *Schemes of Arrangement: Theory Structure and Operation* (Cambridge University Press 2014) 192.
[147] Ibid 193.

available to the company may be to resort to a formal restructuring procedure which is the focus of this thesis.

Currently, there are five main legal mechanisms backed by statute for effecting corporate rescue in the UK; Scheme of Arrangement, CVA, Administration, Restructuring Plan procedure and the new Moratorium procedure. Each of these mechanisms will now be examined in turn.

1.3.1. Scheme of Arrangement

The Scheme of Arrangement which is provided for under Part 26 of Companies Act 2006 has a long legislative history which dates to the 19th century.[148] Despite the unavailability of corporate rescue procedures in English insolvency law during that period, a scheme offered a rescue-friendly approach which existed outside insolvency law, providing the ailing company an opportunity to reach an agreement with its creditors for reorganization to prevent liquidation.

Previously, it was not valued as a debt restructuring mechanism as it was criticized as highly complicated, costly and cumbersome.[149] However in recent times, schemes have emerged as a useful mechanism for restructuring the debts of ailing companies most especially in the aftermath of the global financial crises.[150] A typical example of its use was to effect debt restructuring in the reorganization of large companies like British Energy plc and Cape plc.[151] Most significantly, it has been consistently used in the reorganization of insurance companies.[152]

[148] It dates to the Joint Stock Companies Act 1870.
[149] Goode (n 44) 120-136.
[150] J Payne, ‘Debt Restructuring in the UK’ (2018) 15 European Company and Financial law Review 449, 453-454.
[151] S Phillips, ‘Shareholders Rights in the UK Public Companies Restructurings- The case of British Energy plc (2006) 3 International Corporate Rescue 22; *Re Cape plc* [2007] Business Law Review 109; J Townsend, ‘Scheme of Arrangement and Asbestos Litigation: In Re Cape plc’ (2007) 70 Modern Law Review 837.
[152] *Re Hawk Insurance Co ltd* [2002] BCC 300; *Re Anglo American Insurance Co Ltd* [2001] 1 BCLC 755.

One very peculiar advantage of a scheme is that it is not an insolvency procedure. As a matter of fact, they are provided for under the Companies Act and not the Insolvency Act.[153] It can be used to tackle the company's problems at an early stage. It is a procedure that involves the court considering the interest of all parties with a stake in the company.[154]

In other to protect minority interests and to avoid exploitation of schemes by majority, creditors and members are divided into distinct classes to consider and approve the schemes and such approval requires a majority in number and three-quarters in values of every class of members or creditors.[155] Before the scheme can be perfected, the scheme needs to be sanctioned by the court. Once this happens the scheme will be binding on the company and all parties affected including dissenters.

One distinct feature of a scheme which can be an advantage as well as a disadvantage is the level of court involvement in the procedure. Firstly, there is an application to court to convene the meetings of creditors and members.[156] Likewise there is a requirement that the court should take into consideration the interests of dissenting creditors to ensure that the process is fair to all parties and caters for their legitimate interests.[157]

However, scheme is not a rubber-stamping exercise and where appropriate the court has a wide discretion in sanctioning a scheme and can refuse to do so despite approval of the scheme by the requisite majority in every class where there is a case of unfairness.[158]

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[153] Companies Act 2006, Part 26.

[154] *A Review of Company Rescue and Business Reconstruction Mechanisms, The Insolvency Service* (London: HMSO, 1999) (hereinafter "IS 1999) para 6(1). Creditors and members are not required by statute to compulsorily attend the meeting of their class and vote. Thus, when it comes to the process of approving a scheme, a low turnout in the meeting is possible. However, the court must take into consideration both the proportion of creditors and members who vote by person or proxy and the value of their claims. See *Re British Aviation Insurance Co Ltd* [2006] BCC 14.

[155] Companies Act 2006, section 899 (1).

[156] ibid, section 896 (1).

[157] *Re NFU Development Trust Ltd* [1972] 1 WLR 1548; see generally V Finch D Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, Cambridge University Press, 2017) 325.

[158] D Milman 'Schemes of Arrangement: Their continuing Role' [2001] Insolvency Law 145.

The court can also render a scheme that has previously been sanctioned null and void where a case of fraud is proved.[159]

The court involvement is an advantage because it safeguards the interests of all parties involved since the court has the discretion in sanctioning the scheme, no party's interest will be jeopardized. However, the disadvantage is that the involvement of the court especially the requirement of two court hearings makes the process cumbersome, time consuming and costly.

A second positive feature of scheme is that it does not involve an insolvency practitioner (IP) in this regard, it is a debtor in possession procedure (DIP) which allows directors to remain in control and agree a compromise with the creditors. This could encourage timely initiation of rescue where the company is approaching insolvency. Thirdly, scheme may be tailored around the company's needs and there are no statutory objectives which need to be followed, as a result, the procedure is flexible and where appropriate can be used together with liquidation or administration or as an alternative to liquidation.[160]

Previously, the downside of scheme was the absence of a moratorium to prevent individual creditors from grabbing the assets of the company and enforcing their claims during the period where directors try to attempt restructuring. The court is also not required to provide an informal moratorium to protect the company during this period.[161] In order to seek the benefits of a moratorium, schemes are usually twinned with administration which makes the process slow, cumbersome, and costly. However, the lack of a moratorium in schemes has been remedied by the introduction of the standalone moratorium which can be used by UK companies to pursue a rescue.[162]

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[159] This is very rare as fraud is generally presumed to be very difficult to establish in a commercial relationship. See *Fletcher v RAC Ltd* [2000] 1 BCLC 331.

[160] Finch and Milman (n 5) 325-326.

[161] Cork Report (n 75) 406.

[162] A Shalchi L Conway, 'New Business Support Measures: Corporate Insolvency and Governance Act 2020' (*House of Commons Library*, 05 October, 2021) https://commonslibrary.parliament.uk/research-briefings/cbp-8971/ accessed 16 October 2021.

Notwithstanding, the Cork Report already pointed out that the procedure is complex, costly and time consuming and as such is not suitable for all companies' especially small companies.[163] Consequently, the scheme of arrangement was not suitable as a main corporate rescue procedure thereby paving way for the introduction of other rescue regimes. Thus, a scheme is a sophisticated procedure which is mostly employed by large companies with complex financial structures who require a long-term settlement.[164]

1.3.2. Company Voluntary Arrangement (CVA)

The CVA procedure was introduced by Part I of the Insolvency Act 1986. The Cork Committee recommended a procedure that is "quick, user-friendly and inexpensive" and could afford distressed companies an avenue to put in place a reorganization plan and reach a composition or arrangement of its debt with its creditors without engaging in formal procedures.[165]

It allows the directors of a company to make a proposal to the company and its creditors "for a composition in satisfaction of its debts or a scheme of arrangement of its affairs."[166] The CVA can be initiated by the directors of a company in financial distress but not necessarily insolvent. Likewise, the procedure can be initiated by an administrator or liquidator if the company is in either administration or liquidation.[167] The justification for initiating a CVA is that even though this arrangement allows creditors to receive less returns than they are owed by the company, this is likely to be higher than they will receive in liquidation. Once approved, the company will continue trading under its management team subject to compliance with the terms of the CVA which operates as a contract between the company and its creditors.

[163] Cork Report (n 73) 406.
[164] D Milman, 'Reforming Corporate Rescue Mechanisms' in J Lacy (ed), *Reform of United Kingdom Company Law* (Cavendish, 2002), 415.
[165] Cork Report (n 73) 428-430; A Smith M Neill, 'The Insolvency Act 2000' (2001) 17 Insolvency Law and Practice 84.
[166] Insolvency Act 1986, section 1(1).
[167] Insolvency Act 1986, section 1(3)

The process is overseen by an IP who will firstly act as nominee and give an opinion on whether the proposal has "a reasonable prospect of being approved and implemented,"[168] and subsequently as a supervisor upon approval of the CVA proposal by the creditors.[169] Where the company is in administration or liquidation, it is the duty of the administrator and liquidator respectively to make the proposal.[170]

The CVA requires the votes of 75% by value of the unsecured creditors of the company to be approved, after which the CVA becomes legally binding on all unsecured creditors and parties who had notice of the meeting and were entitled to vote regardless of whether they were present or not.[171] However the caveat is that it cannot bind secured or preferential creditors except they agree to be bound.[172]The CVA mechanics will be discussed in detail in the next chapter.

1.3.3. **Administration**

The administration procedure was introduced alongside the CVA by the Insolvency Act 1986. The Enterprise Act 2002 refashioned the original administration procedure. Section 248 replaced the old part II of the Insolvency Act 1986 and revamped the administration regime as Schedule B1 of the 1986 Act. The aim of the reform was to introduce a more inclusive rescue culture in other to give distressed companies a second chance, preserve jobs, avoid corporate failure, and introduce an environment which is favorable towards entrepreneurial risk taking.[173]

Most importantly, the reforms were meant to "strengthen the foundations of the enterprise economy, change the traditional director blaming attitudes and offer honest but unfortunate or unsuccessful entrepreneurs a second chance in order to avert

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[168] Insolvency Rules 2016, rule 2.9(2).
[169] Insolvency Act 1986, section 7(2). See also, A Wilkinson and others, "Creditors Scheme of Arrangement and Company Voluntary Arrangement" in H Rajak (ed) *Insolvency Law: Theory and Practice* (Sweet and Maxwell 1993) 338.
[170] Insolvency Act 1986, section 1(1), 1(3).
[171] Insolvency Act 1986, section 5(2); Insolvency Rules 2016, rule 15.34(3).
[172] Insolvency Act 1986, sections 4(2) and (3).
[173] V Finch, 'Re-invigorating Corporate Rescue' [2003] Journal of Business Law 527, 529.

unnecessary loss."[174] The new administration regime replaced the administrative receivership procedure.

It also introduced an out of court appointment procedure which makes the administration procedure quicker and easily accessible. Furthermore, unsecured creditors' weak position was improved by the abolition of crown preference and the establishment of a ring fence fund to enable more assets to be available to the unsecured creditors.[175] Likewise more streamlined exit routes was introduced which made the procedure less costly and more time effective.[176]

The company or its directors can appoint an administrator out of court,[177] which gives them the motivation to commence the proceeding early enough and seek outside advice from experts instead of pursuing opportunistic and risky activities.[178] The out of court appointment by the company or its directors is a laudable innovation in the new administration regime because it curbs the veto power which the floating charge holder enjoyed in the old regime. However, this mode of appointment has certain limitations this is necessary to estop the company or its creditors from abusing the out of court appointment. Before any of such appointment can be made, the company needs to be insolvent or likely to be insolvent.[179]

Also, the company or its directors must give a written notice to the floating charge holder before applying for an administration and such holder of floating charge has four choices to make concerning such notice; first the party can agree to the appointment; second can decide to appoint his own administrator; third if allowed, he can stop the appointment by

[174] HC Deb. April 10, 2002, Col.44.
[175] Enterprise Act 2002, section 251 (1) provides that 'the crown preference shall cease to have effect.'
[176] S Davies Qc (ed) *Insolvency and the Enterprise Act 2002* (Jordans, 2003) 171.
[177] Insolvency Act 1986, Schedule B1 paragraph 22.
[178] Finch and Milman (n 5) 118.
[179] Insolvency Act 1986, schedule B1 paragraph 27(2)(a).

appointing an administrative receiver; fourth he can apply for a court-based administration.[180]

Theoretically, it was envisaged that since the holder of the floating charge's veto power in the old regime has been abolished by the Enterprise Act 2002, he would in turn use the out of court appointment regime to gain back the veto power through the back door and would normally be the first to appoint an administrator. However, the practice has been that most often than not, the most frequent mode of entering administration is by out of court appointment by the company or its directors.[181]

The reason for this may be that the floating charge holders are no longer dominant as in the old regime. According to Frisby in her survey, "in 30% of cases where a paragraph 22 appointment was made there was no floating charge holder who could have appointed."[182]Also banks who are often the secured creditors may not be willing to appoint an administrator because of reputational reasons. One of the concerns may be that they do not want to make such antagonistic appointments and thereafter be blamed by other creditors.[183]

Although this doesn't suggest that banks do not appoint administrators, rather most times instead of appointing directly they can encourage their directors to make such appointments and directors being aware of the wrongful trading liability provision would be willing to appoint an administrator to avoid been potentially liable.[184]

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[180] Insolvency Act 1986, Schedule B1, Paragraph 26; S Foster, 'Enterprise Act 2002: Changes to Corporate Insolvency' [2003] Insolvency Law 174. However, see the recent court decision in *Re Tokenhouse VB Limited* [2020] EWHC 3171 (Ch) Where the court held that the appointment of an administrator may be valid even if notice of intention is not served.

[181] A Katz M Mumford, Study of Administration Cases, Report to the Insolvency Service in October 2006, 33

[182] S Frisby A Walters, '*Preliminary Report into Outcomes in Company Voluntary Arrangements'* March 2011 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792402 accessed 10 March 2018,12.

[183] Armour and others (n 20)13.

[184] Ibid.

In addition, the directors often seek the advice of the bank before making such appointment and this means that the banks can influence who the directors appoint as administrator.[185] In sum even though the floating charge holder are no longer rampant, secured creditors are at the forefront of administrator appointments and they often recommend IPs or their firms to directors. The upshot of this is that even the IPs may in a bid to maintain a cordial relationship with the banks be swayed to act in the interests of the banks so they can be recommended for future appointments.

One great feature of the new administration regime is the wide statutory moratorium which stays off creditors' actions in administration. During this period all legal actions are suspended, and no debt enforcement can be made save with the consent of the administrator or an order of court.[186] Of great importance is the fact that the company can agree with its creditors to commence a voluntary arrangement whilst the company is in administration. This is so that the company by using both CVA and Administration can benefit from the peculiar features of both procedures and attempt to rescue the company during the moratorium period. The combination of these procedures has been regarded as representing a true corporate rescue model which could help solve the company's problems.[187]

At the heart of administration are three statutory objectives which the administrator is expected to go down the ladder one after the other and determine which best suits the circumstances of the company. The administrator must in carrying out his duties consider:
"1) rescuing the company as a going concern or.
2) Achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration) or.
3) Realizing property in order to make a distribution to one or more secured or preferential creditors."[188]

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[185] Ibid.
[186] Insolvency Act 1986, schedule B1, paragraphs 42 and 43.
[187] Frisby and Walters (n 182).
[188] Insolvency Act 1986, schedule B1, paragraph 3(1).

The new administration regime places so much focus on rescuing the company as a going concern and the administrator has the duty to primarily explore this objective before considering the next objective. The real meaning of “rescuing the company as a going concern” is the preservation of the company itself as a legal entity with a large part of its business or undertakings where possible.[189]

The administrator is to decide based on his opinion whether rescuing the company as a going concern is reasonably practicable.[190] How his/her judgment is reached is not to be questioned by the court and the court places so much reliance on such judgment reached in good faith. The administrator cannot explore the second objective except the first objective cannot be achieved.[191]

In certain cases, the administrator may think that the sale of the company’s assets as a going concern rather than a piecemeal sale in liquidation is more beneficial to the company. For example, in a case where new finance is not readily available to the company to continue trading in a moratorium leaving the company unable to fulfil its existing liabilities.

If the first two objectives are not feasible, the last will be explored by the administrator and this objective enables the administrator to make a distribution to one or more secured or preferential creditors. This is somewhat like the previous administrative receivership regime because it involves a quick sale of the property of the company to satisfy the claims of the creditor who appointed the administrative receiver. Nevertheless, the underlying aim of the third objective and administrative receivership is quite different because the new regime places emphasis on collectivity and the administrator has a duty to cater for the interests of creditors as a whole.

[189] S Davies Qc (ed) *Insolvency and the Enterprise Act 2002* (Jordans, 2003) 180.
[190] Ibid 136.
[191] *Re British American Racing (Holdings) Ltd* [2005] BCC 110.

The hierarchy of the objectives shows that corporate rescue is at the heart of the new regime and more company's would be rescued as a going concern however the extent to which this is justifiable is to be questioned because study shows that only in rare cases is the primary objective of company rescue usually achieved.[192] Moving on, in practice, a form of administration has been developed in dealing with distress and has become a commonly used procedure under the administration regime.

1.3.4. Pre-packaged Administration

Pre-pack is not a new phenomenon; it has been widely accepted in many jurisdictions including the United States of America (US) where it is thought to have originated from in the 1980s following the Chrystal Oil case.[193] In the US, companies are increasingly using the Chapter 11 reorganization procedure to sell substantially all their assets through a 363 sale.[194] Likewise, it has been used to a large extent in the United Kingdom (UK), Australia, Canada, some parts of Asia and Europe.[195]

A pre-pack is a process whereby the sale of the business and the assets of an insolvent company is arranged prior to the commencement of formal insolvency and effected immediately, or very soon after, the appointment of an administrator.[196] It is an informal process that emanated from legal practice and developed within the context of the administration procedure. In actual sense, the starting point of the administration procedure is the last stage of the pre-pack process because the pre-pack operations are effectively a "done deal" before the insolvency procedure is initiated and the sale effected

[192] Armour and others (n 20).
[193] D Palmer J fink, *Prepaid Bankruptcy and Prearranged Bankruptcy Process* (PLI's course Handbook, 2008).
[194] See Section 363 of the US Bankruptcy Code 1978; 'B Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue'* (ElgarOnline 2016) Chapter 2.
[195] M Wellard P Walton, 'A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means Be Made to Justify the Ends?' (2012) 21 International Insolvency Review 143,144; S Phillips A Kaczor, 'The Benefits of UK-Style Pre-packs and Comparisons with other Jurisdictions' (2010) 7 International Corporate Rescue 328; A Sorenson A Tetley, 'French Pre-packs: Key Stages and their Related Issues' (2010) 7 International Corporate Rescue 7.
[196] M Haywood, 'Pre-pack Administrations' (2010) 23 Insolvency Intelligence, 17. Paragraph 1 of Statement of Insolvency Practice 16 (SIP16).

shortly after the administrator's appointment.[197] The legality of pre-packs has been settled by the courts,[198] and it appears that the reason behind their usage is premised on the notion that insolvency is sometimes value stripping rather than value enhancing, and as a result it may be difficult to preserve value through the rescue of a company or its business within a formal insolvency procedure.[199]

Through this "anticipatory action,"[200] the distressed company with the assistance of the insolvency practitioner (IP), negotiates with its main creditors and arrange the sale of all or part of the company's assets to a purchaser to rescue the business as a going concern. It may be the case that the purchaser is a third party who may be new to the company or may be a competitor of the company but in majority of the cases, the purchaser is usually the management team or other connected party.[201]

Pre-packs have been around for some time, particularly in the context of receiverships and pre-enterprise act administration procedure. The process has grown in prominence since the introduction of the Enterprise Act 2002 reforms to the administration process. Arguably, the Enterprise Act can be regarded as the catalyst for the growing popularity of prepacks in the UK.[202] The reason for this is not far-fetched; the Enterprise Act 2002 (EA) made significant changes to the rescue culture in the UK by revamping the administration procedure and effectively making it a major restructuring mechanism. However, it should be noted that the EA does not specifically refer to prepacks. Rather, prepacks developed as a market strategy to promote corporate rescue, but there is no specific statutory provision governing them.[203]

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[197] L Qi, 'The rise of Pre-packaged Corporate Rescue on Both Sides of the Atlantic' (2007) Insolvency Intelligence 129, 129; S Harris, 'The Decision to Pre-pack' [2004] *Recovery* (Winter) 26.

[198] *Re DKLL Solicitors* [2007] EWHC 2067 (Ch); *Re Johnson Machine and Tool Co Ltd* [2010] EWHC 582 (Ch).

[199] S Frisby, 'Insolvency law and Insolvency Practice: Principles and Pragmatism Diverge? (2011) 64 Current Legal Problems 349, 378.

[200] Finch and Milman (n 3)25. J Klein, 'Pre-pack Administration: A Comparison between Germany and the United Kingdom: Part 1' [2012] Company Lawyer 261, 262.

[201] Haywood (n 196).

[202] Wellard and Walton (n 195) 144.

[203] A Kastrinou S Vullings, 'No Evil is Without Good': A Comparative Analysis of Pre-pack Sales in the UK and the Netherlands' [2018] 27 International Insolvency Review 320, 325.

Recall that Schedule B1 of the Insolvency Act 1986 allows an administrator to be appointed by court order and out of court. In a pre-pack, the administrator is appointed out of court and then proceeds to implement the pre-arranged rescue deal. By so doing, the pre-pack is perceived as an alternative to full, formal administration process, in other words, "it is an abridged process".[204]

Secured creditors exert "a high level of control and certainty"[205] over the process. They are the only parties involved in negotiating the pre-pack with the debtor company and appointing the administrator. This is so because it is impossible to implement a pre-pack sale without the secured creditors' support, as they will be required to release their security. Likewise, they possess more information about the debtor company than any other stakeholder of the company.

Advocates of pre-packs argue that the procedure has "some compelling merits" over other procedures because pre-packs reduce the time spent in formal proceedings and provide certainty, thereby preserving value in the insolvent debtor's business and increasing the possibility of reaching a going concern solution.[206] Likewise, pre-packs helps in streamlining the administration process, allowing a fast and more flexible mode of achieving rescue and thus achieving "the goals of speed and transaction-cost economization."[207] It has also been submitted elsewhere that pre-packs can facilitate "a discreet and quick sale of the business" and thus preserve value in the insolvent company.[208]

[204] AS Nocilla, 'Corporate Rescue at the Crossroads: An Empirical and Comparative Examination of pre-packaged Administration in the UK' (PhD thesis, 2019, University of Leeds)55.
[205] V Finch, *Corporate Insolvency law: Perspectives and Principles* (3rd edn, Cambridge University Press, 2017) 44.
[206] B Xie, Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue (Edward Elgar, 2016) 90.
[207] Ibid.
[208] Kastrinou and Vullings (n 203).

However, despite all of these benefits, it remains that pre-packs raise issues of transparency, accountability and fairness given that are susceptible to abusive use.[209] The lack of transparency in pre-packs stems from the fact that not all creditors are involved in the pre-arranged negotiation stage which makes it difficult for most creditors to determine how the deal was struck and whether the practitioner has carried out his duties in line with the legislation and bearing in mind the interests of all the creditors.[210]

Sequel to this, the lack of transparency may have invariably resulted in a lack of accountability especially since creditors have a right to challenge the practitioners conduct but are unable to do so because of the inability to retrieve the information necessary to mount the challenge in the first place.[211]

There have been safeguarding measures including the introduction of the Statement of Insolvency Practice 16 (SIP 16) in 2009 which requires IPs to provide key information about the pre-pack sale transaction to creditors within seven days of conducting the sale. Likewise, a comprehensive independent review of the process was undertaken in 2013 by Teresa Graham CBE, leading to the publication of the Graham Review in 2014. The aim of the review was to assess the impact of pre-packs on stakeholders and the economy.[212] The Graham Review found that pre-packs indeed have an important place in the UK's insolvency framework. It facilitates the preservation of employment and businesses.[213] It also found that it was common for prepacks to result in connected-party sales which helped to give a second chance to entrepreneurs.[214]

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[209] E Vaccari, 'English Pre-packaged Corporate Rescue Procedures: Is there a Case for Propping Industry Self-Regulation and Industry-Led Measures such as the Pre-pack Pool?' (2020) 31 International Company and Commercial law review 170.
[210] Ibid.
[211] Ibid.
[212] T Graham, "Graham Review into Pre-pack Administration', available at https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration accessed 30 January 2020, p4. (Graham Review)
[213] ibid 23-28.
[214] P Walton C Umfrielle P Wilson, 'Pre-pack Empirical Research: Characteristics and Outcome Analysis of Pre-pack Administration' http://data.parliament.uk/DepositedPapers/Files/DEP2014-0860/Report_to_the_Graham_review_by_the_Univers....pdf accessed 18 February 2020, accessed 1 December 2019, A.2.1.

However, there were issues related to its governance, such as insufficient marketing, poor valuation strategies being used to determine the value of the distressed business. The review also identified issues surrounding lack of transparency and poor oversight.[215] Lastly, the review observed that particular focus on post-rescue viability was being neglected, which resulted in pre-pack sales to parties previously connected to the company failing twice as often as sales to other unconnected purchasers.[216] It concluded that because of these practices, unsecured creditors have felt unfairly treated.[217]

Consequently, several industry-led reforms were introduced to remedy these defects: including guidance on marketing and valuation of the pre-packaged sale transactions which were later incorporated into SIP 16.[218] Likewise, targeting mainly pre-pack sales to connected persons, the Review recommended the requirement that previously connected persons obtain a business viability statement whenever there was a sale of a business via a Pre-pack. Further, a layer of independent oversight was added to pre-pack sales to connected parties in form of a Pre-pack Pool,[219]

The Pool is an independent body and a limited liability company comprising of experienced businesspeople who are selected from different industries to handle cases strictly by rotation.[220] The main function of the pre-pack pool is to make an independent assessment for a fee,[221] as to whether the deal is reasonable or not. The pre-packaged sale must be proposed within the context of the main administration procedure to fall under the Pool's scrutiny. The availability of the Pool is to be made known by the insolvency practitioner to the potential purchaser who then approaches the Pool on a

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[215] Graham Review (n 216) 51.
[216] Ibid.
[217] ibid 29-51.
[218] ibid 64-66.
[219] Ibid 62.
[220] G Hindle, 'Pre-packs- The Latest Attempt at Transparency' (*Lexology*, 7 December 2015) https://www.lexology.com/library/detail.aspx?g=54275706-e962-452e-8dba-3aeb9fb68c08 accessed 18 June 2021, 1.
[221] The application fee is £1500.00 + VAT See Pre-Pack Pool, 'Questions & Answers About the PrePack Pool https://www.prepackpool.co.uk/questions-answers accessed 1 November 2021.

voluntary basis.[222] The greatest challenge of the Pool has been the low record of referrals. This may be because reference to the Pool is voluntary. In 2019, there were 473 pre-packs, 260 were connected party sales whilst referrals to the Pool was made in 23 cases (9%).[223] Consequently, there have been calls for statutory intervention to mandate referral of any pre-pack sales involving a connected party to the Pool.[224]

More recently, the government introduced the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 (hereinafter the Regulations) to address the concerns of creditors and improve stakeholder confidence in the process. The regulation was introduced as an additional mandatory requirement on connected party sales through an administration.

The Regulation is applicable to all companies initiating administration on or after 30 April 2021. The Regulation is applicable to all the companies regardless of size. It applies in respect of any disposal (hiring out or sale) in administration of all or a substantial part of a company's business or assets.[225] An administrator cannot make a substantial disposal of property of a company to a person connected with the company within the first 8 weeks of the administration unless either the approval of creditors or an independent written "qualifying" report has been obtained.

[222] Statement of Insolvency Practice 16, 'Pre-packaged Administrations' https://www.r3.org.uk/technical-library/england-wales/sips/more/29131/page/1/sip-16-pre-packaged-sales-in-administrations/ accessed 15 August 2021, 9.
[223] Pre-pack Sales in Administration Report https://www.gov.uk/government/publications/pre-pack-sales-in-administration/pre-pack-sales-in-administration-report accessed 1 November 2020.
[224] E Vaccari (n 209); B Adebola, 'The Case for Mandatory Referrals to the Pre-pack Pool' (2019) 32 Insolvency Intelligence, 74.
[225] The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021. (Pre-pack Regulations) part 2,

1.3.5. The Restructuring Plan Procedure

The new restructuring plan procedure also known as "Super Scheme"[226] is a significant change to the corporate rescue framework that exists in the UK. In essence, it has the potential of changing the face of corporate restructurings in the UK by moving the UK rescue framework closer to a US Chapter 11 model. The restructuring plan is modelled on the existing scheme of arrangement procedure under part 26 of the Companies Act 2006 albeit with certain differences. Similarly, the restructuring plan does not carry any insolvency stigma as it sits in the Companies Act 2006 rather than the Insolvency Act 1986.[227]

The restructuring plan allows a company encountering financial distress to propose a compromise or arrangement with its creditors and members to restructure its affairs. To access the procedure, a company needs to satisfy two eligibility criteria: the company must have encountered or be likely to encounter, financial difficulties which will affect its ability to continue trading as a going concern and the purpose of the plan proposed must be to eliminate, reduce, prevent, or mitigate the effect of those financial difficulties. Any type of company can use the restructuring plan procedure provided the eligibility criteria is met. Both English and foreign companies can use the plan, although in the case of foreign companies, the company must have a sufficient connection with the UK.

To initiate a restructuring plan, directors will apply to court for approval to convene meetings of the creditors and members. Creditors and shareholders can also apply to court to commence the procedure; however, this is highly unlikely due to the "significant resourcing requirements that typically need debtor/shareholder input to put together a realistic and credible restructuring plan modelled on the existing business performance."[228]

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[226] D Ampaw D Manson, "The New UK Restructuring Plan- The Super-Scheme" (*DLA Piper*, 6 October 2020) available https://www.dlapiper.com/en/uk/insights/publications/2020/10/restructuring-global-insight/restructuring-plan/ accessed 12 February 2021

[227] It takes effect by way of the introduction of a new Part 26A of the UK Companies Act 2006.

[228] Ampaw and Manson (n 226).

Similar with schemes of arrangement, the process will require at least two court hearings. The first hearing is held to decide whether to convene the meetings at which each class of creditor and member will vote. To approve the convening of the meetings, the court will consider whether the company meets the eligibility criteria, the classes have been formulated correctly, any creditors or members should be excluded from voting because they have no genuine economic interest in the outcome and the court itself has jurisdiction to consider the plan. If the court consents to the convening of the meetings, notice of such meeting must be sent to the relevant members and creditors, together with a document outlining the restructuring plans and its effects.

The meetings are convened for the relevant parties to vote. If the required thresholds are met, a second court hearing will take place. If none of the classes meet the required voting thresholds, the process automatically comes to an end. At the second court hearing the court will decide to sanction the plan. Like the scheme of arrangement, the court does not simply rubber stamp its approval, rather the court has an absolute discretion on whether to approve the plan.

Even though the restructuring plan shares many similarities with the scheme of arrangement, there are some major differences. First, the procedure is intended to be a flexible procedure just like the scheme, however, it must be used with the purpose of eliminating, reducing, preventing, or mitigating the company’s financial difficulties. Second, a restructuring plan requires 75% in value of the creditors or voting members within each class to approve the plan. Unlike a scheme, there is no additional numerosity requirement for 50% of the class members voting to approve the arrangement.

Likewise, a company can apply to court to exclude certain class of creditors or shareholders, or multiple classes of creditors who have no genuine economic interest in the company from voting, but still bind those classes into the restructuring plan. This contrasts with a scheme of arrangement where “out of the money” classes can be excluded from voting but will not be bound by the plan if so excluded.

Third, the restructuring plan consists of a significant mechanism which is absent in the scheme of arrangement procedure- "Cross-class cram down." This allows a company with the approval of the court to impose the plan on dissenting classes of creditors and members. The court can approve such plan if it is satisfied that in a case whereby the plan is sanctioned, no member of the dissenting classes would be any worse off than they would be in the event of a relevant alternative and at least one class of creditors or members that would receive a payment or have a genuine economic interest in the company in the event of a relevant alternative has voted in favour of the plan. Once these conditions are met, the cross-class cram-down mechanism can be imposed to bind dissenting classes of creditors.

The effect of the cross-class cram down is that junior or senior stakeholders can be bound into a restructuring plan without their consent thereby moving the UK restructuring model towards that of the US Chapter 11 model and providing distressed companies with a more extensive mechanism to address their financial difficulties. Arguably, the cram down tool could be used by companies "to propose multiple smaller classes to try to ensure its Restructuring Plan succeeds…"[229]

However, the court may view this strongly and prevent companies from duplicating classes to exploit the new cram down tool, especially in situations where the numbers of dissenting creditors would have been sufficiently able to vote down the scheme if they were in the same class as those creditors who are in support of the scheme.[230] Recent restructurings have featured the procedure as an innovative tool used in facilitating both financial and operation restructuring via a single process, which demonstrates the flexibility of the process.[231] The restructuring plan procedure has been welcomed as a

[229] A Plainer M Benson, 'The New Restructuring Plan- In Depth' (*Lexology*, June 19, 2020) https://www.lexology.com/library/detail.aspx?g=75de1559-3667-4261-bcd5-aca229f2d45f accessed 20 January 2021.
[230] Ibid.
[231] See *Re Virgin Active Holdings Ltd & Ors,* [2021] EWHC 1246 (Ch) (Virgin Active); *Re Amicus Finance Plc* [2021] EWHC 2255 (Ch) (Amicus Finance).

step in the right direction and it remains to be seen whether it will take on its own identity and tip the balance firmly towards a true rescue culture in the UK.

1.3.6. Moratorium

Alongside the restructuring plan procedure, the Corporate Insolvency and Governance Act 2020 (CIGA) introduced a new standalone moratorium procedure for companies in financial difficulties.[232] Arguably, the new procedure has elements of both CVA and administration but differs from both procedures.[233] Before the introduction of CIGA, the UK lacked a wide "debtor-in-possession" process that allowed directors to remain in control to implement a rescue plan with the benefit of a moratorium. The previously available moratorium available to distressed companies in the UK were the CVA moratorium available to small, eligible companies pursuant to Section 1A and Schedule A1 of the Insolvency Act 1986 which was limitedly used and has now been repealed by CIGA and the moratorium available under the administration procedure further to Schedule B1 of the Insolvency Act 1986. This new regime is a major change to the UK rescue framework.

It is a standalone mechanism which does not lead to any insolvency procedure. The moratorium can be used by any company undergoing any of the insolvency/rescue processes available under the UK insolvency regime albeit with some exceptions.[234] It prevents creditors from taking enforcement actions against the company during the period in which the directors of the company together with a monitor (who must be an insolvency practitioner and oversees the process) attempt to save the company as a going concern.

The moratorium is available to "eligible" UK companies that fall outside one of the 14 excluded categories listed under the new Schedule ZA1 of the Insolvency Act 1986. These categories include companies subject to or recently subject to a moratorium or

[232] Insolvency Act 1986, Part A1.
[233] L Linklater J Wildridge, 'Changing Times: Aspects of Creditor Enforcement in Administration and in the New Moratorium' (2020) 33 Insolvency Intelligence 96.
[234] For an analysis of the Moratorium provisions see E Sanderson, 'The CIGA Moratorium: A Lifeline for UK Companies?' (2020) 17 International Corporate Rescue 342.

insolvency procedure, insurance companies, banks, electronic money institutions, capital market transactions and certain overseas companies. Essentially, it covers any company registered under the Companies Act 2006 as well as overseas companies.[235] The rationale behind excluding financial services companies is because these companies are subject to their own rules and procedures regarding insolvency.[236]

A company registered in the UK can apply by merely filing relevant documents at the court[237] to initiate a moratorium, whereas eligible overseas company will need to make an application to the court to initiate the process. There are three routes to a moratorium: first, if a company is eligible and not subject to a winding-up petition and not an overseas company, the directors may obtain a moratorium by simply fining the relevant documents in court.[238] Second, if a company is eligible but is subject to an outstanding winding-up petition, the directors may apply to court for a moratorium, and such application may be granted by the court only if it is satisfied that it would achieve a better result for the company's creditors as a whole than would be likely if it was wound up without first being subject to a moratorium.[239] Third, if a company is eligible and not subject to an outstanding winding-up petition and is an overseas company, the directors may apply to the court for a moratorium.[240]

Regardless, all three routes require the directors to submit "relevant documents" to the court. The relevant documents include a notice that the directors want to obtain a moratorium and in their view the company is or is likely to become unable to pay its debts; a statement from the proposed monitor that he/she is a qualified person and consents to act as monitor, that the company is eligible and in his or her view, it is likely that a moratorium would result in the rescue of the company as a going concern.[241]

[235] Insolvency Act 1986, Part A2 and A3.
[236] Sanderson (n 237).
[237] Insolvency Act 1986, part A3.
[238] Insolvency Act 1986, part A3.
[239] Insolvency Act 1986, part A4.
[240] Insolvency Act 1986, part A5.
[241] Insolvency Act 1986, part A6.

The main objective of the moratorium which can be inferred from the role of the monitor is to rescue the company. The monitor is an officer of the court and is required to monitor the company's affairs throughout the moratorium period and form an opinion as to whether it will be likely that the moratorium will result in the rescue of the company as a going concern.[242] To form an informed opinion, the directors who remain as debtor in possession during the moratorium must provide the necessary information that will guide the monitor's decision in the performance of his functions. If the monitor believes that it is no longer likely that the aim of the moratorium will be achieved, he must immediately terminate the moratorium.[243]

The moratorium runs for an initial 20-day beginning from the date of the filing of the documents at the court. It may be extended by the directors for up to an aggregate period of 40 business days or with the consent of creditors, for up to an aggregate period of one year, or by making an application to court. The monitor is not required to give consent for any extension, but he must continue to believe that it is likely that the moratorium will result in the rescue of the company as a going concern.

During the moratorium process, the creditors cannot petition for the winding up of the company, no winding up or administration proceedings can be progressed, no right of forfeiture can be exercised by landlords in relation to premises occupied by the company, no enforcement of security over the company's property can be carried out, albeit subject to some exceptions, no repossession of goods and no legal process can be issued or continued against the company. Additionally, the company is required to pay its moratorium debts.

The actions of the monitor and/or the directors may be challenged by creditors, directors or company members,[244] and there are certain offences set out under CIGA that can be brought in respect of the behavior of the company directors and/or monitor prior to

[242] Insolvency Act 1986, part A35.
[243] Insolvency Act 1986, part A38.
[244] Insolvency Act 1986, sections 42-43.

obtaining a moratorium and concerning the way the moratorium is obtained.[245] In Minor Hotel Group MEA DMCC v Dymant & Anor,[246] a secured creditor brought an action against the monitors for refusal to terminate a moratorium that prevented the creditor from taking enforcement action in relation to an unpaid loan due to the creditor, and as such had unfairly harmed the creditor. The court held that the monitors duty with overseeing the moratorium had been justified since the monitor believed the company will be able to pay the unsecured creditor's loan. The court examined whether the monitors decision was reached in bad faith or was irrational such that no reasonable monitor could not have reached such decision and was therefore irrational and found that this was not the case. In deciding whether the company was able to pay its debt, the court stated that a monitor should be allowed to adopt a "flexible and commercially realistic approach taking into account the circumstances as a whole".[247]

This suggests that the court will not interfere with the commercial judgment of a monitor and will give a degree of latitude to the decision reached by a monitor. This case is instructive for monitors in considering how they should exercise their judgment in situations where a lender seeks to bring a moratorium to an end, but the monitor is of the opinion that there is a prospect of payment of the pre-moratorium debt in the short term.

The procedure is likely to face many limitations in practice. First, it is possible that recourse to the moratorium may be low due to the limited window available (20-40 business days) for the application to be made, this timeframe "may not be enough to prepare an "oven ready" restructuring and rescue…"[248] Second, the exclusion of bank debts from the payment holiday may affect the usefulness of the moratorium save where the company can get its lenders on board prior to obtaining the moratorium. Third, it could be expensive for a company already in financial troubles given the monitor's costs and

[245] Insolvency Act 1986, sections A46-47.
[246] [2022] EWHC 340 (Ch).
[247] Ibid.
[248] 'Is the Corporate Insolvency and Governance Act Moratorium Working?' (Osborneclarke, 31 May 2021) https://www.osborneclarke.com/insights/corporate-insolvency-governance-act-moratorium-working accessed 22 January 2022.

the costs that will be generated from submitting documents to court. It is more likely that the moratorium will be a useful tool when a rescue plan has been agreed with a company's major creditors and a further short period is required to get the other creditors on board.

Critics argue that the new pre-insolvency moratorium is not needed,[249] and the constraints and limitations placed on the moratorium to protect creditors amongst other reasons can significantly inhibit the effectiveness of the mechanism, and it is likely that companies will not make use of the moratorium and seek alternative measures.[250] Till date, recourse to the moratorium has been low mainly; according to the statistics published by the Insolvency Service between June and December 2021, only 15 moratoriums were initiated in England and Wales.[251] This may be because companies did not have to use the procedure given the significant restrictions that were placed on creditors because of the COVID-19 pandemic. Given that these restrictions have now been lifted, it remains to be seen if there will be increase in the use of the moratorium.

1.4. Conclusion

The Cork Committee set in motion wide reaching review of the UK insolvency legislation and sought to change the negative perception of insolvency in the UK. The outcome of the review led to the overhaul of the insolvency system giving rise to what is now known as a "rescue culture." However, rescue remained a difficult objective to achieve in the years following the reform given the low usage of the CVA and administration procedures.

[249] C Umfreville, 'A Review of the Corporate Insolvency Framework: A New Moratorium to Help Business Rescue?' (2016) Company Law Newsletter 385, 1-4.

[250] J Payne, 'The UK Restructuring Moratorium (*Oxford law blog*, 26 January 2021) https://www.law.ox.ac.uk/business-law-blog/blog/2021/01/uk-restructuring-moratorium accessed 10 November 2021.

[251] Insolvency Service, 'Commentary-Company Insolvency Statistics October to December 2021' https://www.gov.uk/government/statistics/company-insolvency-statistics-october-to-december-2021/commentary-company-insolvency-statistics-october-to-december-2021 accessed 12 March 2022.

To ameliorate some of the problems affecting the uptake of the procedures, the Insolvency Act 2000 and the Enterprise Act 2002 revamped the procedures. Notably, the legislation sought to promote collectivity and accountability in line with the policy aims of corporate rescue. Notwithstanding, rescue was still an objective difficult to achieve. Given the need to enhance the rescue culture in the UK, the CIGA introduced a new restructuring plan procedure and the wide availability of the moratorium procedure to companies in distress irrespective of the rescue procedure entered. This is based on the notion that an effective debt restructuring mechanism is key to the success of any rescue regime. Given the wide endorsement of the rescue culture, the UK adopts a very diverse approach to corporate rescue, with different rescue procedures each with its own unique features all aimed at allowing a company a second chance to continue trading as a going concern.

These procedures can be explored individually or combined where appropriate to settle a company's affairs. The restructuring plan and the new moratorium procedures, offer a new dimension to the rescue culture with the availability of the cross-class cram down facility and the availability of the new moratorium procedure to companies regardless of any insolvency procedure that is being commenced. It however remains to be seen the extent to which these procedures offer viable solutions to the problems of a company.

Having laid a background, the next chapter will consider the main procedure used by distressed retail companies in the UK to restructure their debt and what the operation of this procedure means for retail insolvency.

Chapter 4

An Examination of the Company Voluntary Arrangement Framework

Introduction

This chapter purports to gain insight into the mechanics of the CVA. Recall that the focus of this thesis is on the CVA mechanism and its operation in retail insolvency. Consequently, it is important to examine the mechanics of the procedure and its role in the UK corporate rescue framework ahead of the discussion that will follow in subsequent chapters. Whilst the previous chapter had earlier touched on CVAs alongside other corporate restructuring mechanisms, this chapter seeks to elaborate on the discussion on CVAs. Using the foundation laid in the previous chapter, this chapter aims to examine the role of the CVA mechanism in the resolution of financial distress in the UK.

To this end, this chapter is divided into five sections: section 1 examines the background to the CVA procedure. It discusses the development that led to the introduction of the procedure. Section 2 considers the purpose of the CVA to explore the various ways a CVA can be used within the corporate rescue framework. Section 3 examines the legal and procedural rules which govern a CVA as well the challenges that may arise from a CVA process. Section 4 considers the crucial elements necessary to achieve a successful CVA. Section 5 provides the conclusion to the chapter.

2.1. The Development of Company Voluntary Arrangement

The CVA procedure at inception was modelled after the individual voluntary arrangement (IVA) which is a parallel mechanism used by natural persons to avoid bankruptcy and its effect.[1] The CVA on the other hand was introduced to enable insolvent companies avoid liquidation and its consequences.[2] Recall that it was proposed by the Cork Committee

[1] *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558, 1982) paras 428- 429 (Cork Report).

[2] Insolvency Act 1986, section 1(4). Although a company needs not be insolvent to initiate the procedure.

which was responsible for reviewing the rules regulating personal and corporate insolvency at that time in the UK.[3] The Cork Committee suggested CVAs for companies as an addendum to complement the existing scheme of arrangement procedure under the Companies Act.[4]

Before the CVA was introduced, the scheme of arrangement procedure was the go-to mechanism for companies to propose arrangements to creditors; however, this procedure was widely regarded as problematic.[5] According to the Cork Committee, the procedure was too formal and cumbersome due to the heavy court involvement.[6]

To convene meetings of classes of creditors, an order of court was required.[7] The court will not assess the proposed scheme at the convening stage, rather this is left till the sanctioning stage.[8] Issues relating to the class composition could also be heard at the sanctioning stage.[9] The effect of this was that even where the scheme was approved at the meetings, it could still be defeated at the sanction stage.[10] The committee also noted the effect of a lack of moratorium during the period of initiating the scheme, which meant that during the time when the proposal was to be sanctioned by court (which usually takes 8 weeks as stated by the committee)[11], any creditor could forestall the plan by instituting legal actions against the company.[12]

It was observed by the committee that this problem "makes it extremely difficult for even the most uncomplicated scheme of arrangement to be launched."[13] Thus, it was submitted

[3] Cork Report (n 1) chapter 7.
[4] Ibid, paras 400-403.
[5] Companies Act 1948, sections 206, 287, 306, Cork Report (n 1) paragraphs 97-103.
[6] Cork Report (n 1) paragraphs 99, 409-415.
[7] *Re Hawk Insurance Company Limited* [2001] EWCA Civ 241; [2001] 2 BCLC 480.
[8] Ibid.
[9] Practice Statement (Companies: Schemes of Arrangement) 2002 WL 347191; [2002] 1 W.L.R 1345; S Bristoll, 'Schemes of Arrangement: A Question of Class' (2002) 18 Insolvency Law & Practice, 216.
[10] *Re BTR Plc*, 1999 WL 1953241; [2000] 1 BCLC 740.
[11] *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558, 1982) paragraph 406.
[12] J Tribe: 'Company Voluntary Arrangement and Rescue: A new Hope and a Tudor Orthodoxy' (2009) 5 Journal of Business Law 454, 458.
[13] Cork Report (n 1) paragraph 408.

that this procedure could inhibit effective reconstruction.[14] The committee noted that the lack-luster attitudes of some mangers could also inhibit the success of the scheme procedure because these managers may have either lost interest in the business or lost the will to fight for its survival.[15]

Even though the Cork committee pointed out that the reform of the scheme procedure was outside its scope of consideration because the procedure was not an insolvency procedure and can be used to achieve many objectives,[16] nevertheless, the committee suggested two pathways for reforms to "facilitate the effecting of fair and reasonable schemes".[17] The first possible avenue was the administration procedure.

The second was borrowed from the committee's proposals on personal insolvency which in turn was borrowed from creditors' voluntary liquidation.[18] As there were no improvements that could be immediately made to the schemes of arrangement process for insolvent companies, the committee opined that, "the procedure for individual debtors described in Pt I of this chapter may be adapted for use by corporate debtors."[19]

The procedure described therein is "voluntary arrangement". This voluntary arrangement for companies as proposed would take two forms: first, arrangements which would be followed by the appointment of an administrator, second, voluntary arrangements without court order. It was anticipated that the first form of voluntary arrangement which would be implemented under administration would benefit from the proposed moratorium for the administration procedure.

The Cork Committee considered whether the second form of voluntary arrangement which is the voluntary arrangement without court order could mirror the personal

[14] Ibid 409.
[15] Ibid 417.
[16] Ibid 419.
[17] Ibid 422.
[18] Ibid 363.
[19] Ibid 422.

insolvency voluntary arrangements recommendation such that it will be possible for corporate entities to also reach a formal and binding arrangement with creditors.

After many deliberations on whether this should be implemented in the recommendations, the committee decided that there was nothing to preclude them from applying the same treatment to a company.[20] However, the procedure would be adjusted slightly to mirror certain features; directors will be in control, a trustee would be involved, and meetings of creditors would take place to approve the arrangement.[21]

The committee predicted that the voluntary arrangement mechanisms could be used by companies when the administration procedure was inadequate and would allow small companies reach an arrangement with creditors as quickly as possible.[22] This was to be used by both solvent and insolvent companies.

The government responded to the committees' proposals on a voluntary procedure focusing on the corporate aspect of the proposals at paras 20 and 126 of the document.[23] Although when compared to the wide content of the Cork Report, the document in response to the report is relatively short. Nevertheless, the Government's response was quite promising which makes one wonder why the subsequent take-up rate of the CVA procedure has been very low. In the White Paper, it was observed that:

"The Government wishes to see voluntary procedures used to their fullest potential and to achieve this there must be public confidence that such procedures cannot be abused to represent for those concerned, an easy means of evading their responsibilities"[24] However, the CVA procedure was not specifically addressed in the revised framework. What then is the purpose of a CVA?

[20] Cork Report (n 1) paragraph 428.
[21] Ibid 429.
[22] Ibid 430.
[23] A Revised Framework for Insolvency Law, Cmnd 9175 London, HMSO, 1984. (Revised framework).
[24] ibid 21.

2.2. Purpose of CVA

As earlier mentioned, the CVA was created by the Insolvency Act 1986 based on the recommendations of the Cork Committee. The CVA mechanism was intended to give companies the opportunity to attempt rescue at an early stage before insolvency comes knocking on the door. Easy access and uptake were meant to be the attractive features of the procedure, which was intended to be less formal than the scheme of arrangement procedure.[25]

Unlike administration, there are no statutory guidelines determining the purpose of a CVA. Although the CVA may constitute one of the reasons for entering administration,[26] notwithstanding there is no statutory guidance on the purpose of CVAs. A perusal of Part I of the Act and Part 2 of the Insolvency Rules will show that there is no detailed explanation of what exactly a CVA should contain or what it should do.[27] Notwithstanding the addition to some parts of the legislation, there is still a lack of detail on CVA when compared to the amount of legislation devoted to liquidation.[28]

Generally, under Section 1 of the Insolvency Act 1986, the forms which a CVA may take are: to reach a composition of debts i.e. the company agrees with its creditors to pay a certain amount of the money it owes, for example 50 pence in the pound; or to formulate a scheme of aarrangement i.e. the company agrees to pay its creditors in full but not immediately.[29] However, some practical guidance on the purpose of CVA can be found in case law, as described by Keay and Walton, "in order to obtain a clear understanding

[25] According to Doyle and others, the binding nature of a CVA on dissenting creditors makes the procedure "more than a passing resemblance to a scheme of arrangement" L Doyle and A Keay J Curl QC, Annotated Insolvency Legislation 2021 (10th edn, LexisNexis 2021) 51.
[26] Insolvency Act 1986, section 8(3); as part of Insolvency Act 1986, Schedule B1 paragraph 3(1)(a) one of the purposes of administration is 'rescuing the company as a going concern'. See also *Re Sunbow Ltd* [2005] EWHC 3066 (ch) the judge stated at [4] that 'it is submitted by Mr Papi that the administration order was for the single purpose of the approval of the CVA…'
[27] A Keay P Walton, *Insolvency Law Corporate and Personal* (4th edn, Lexis Nexis 2017)19.
[28] Ibid.
[29]*March Estates plc v Gunmark Ltd* [1996] 2 BCLC 1; *Commissioners of Inland Revenue v Adam & Partners Ltd* [2001] 1 BCLC 222.

of CVAs, much depends on judicial interpretations."[30] It must be pointed out that the main idea behind initiating a CVA is to prevent the creditors from pushing the company into liquidation. This is usually done by suggesting a better deal to the creditors than they would receive in the case of liquidation.[31]

The main purpose of a CVA is to enable a company to enter a binding arrangement or compromise with some of its creditors, usually unsecured creditors. Once the arrangement has been agreed upon, it has a binding effect on all unsecured creditors that were entitled to vote at the meeting where the arrangement was deliberated upon and approved, even if they did not vote or voted against the proposal.[32]

Contextually, it may be argued that the CVA indeed is meant to be a device that can be used in addition to other mechanisms to facilitate the rehabilitation of an ailing company. This is made evident in the case of *Commissioners of Inland Revenue v The Wimbledon Football Club Ltd and others* where Neuberger LJ (as he then was) stated; '…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'[33]

Similarly in *Simpson v Bowker (sued in the capacity of a CVA relating to Vevos Ltd)*, the CVA allowed directors to remain as debtor in possession and conduct the business of the company, the directors were to use their commercial and professional judgment to decipher how the purpose of the CVA could be fulfilled. In their opinion, the directors reached a conclusion that the purpose of the CVA was "…to pursue the claim and to obtain judgment against Anadarko, or a settlement by negotiation or mediation. The officers of the company were empowered to enter into agreements for goods and services

[30] Keay and Walton (n 27).
[31] ibid.
[32] Insolvency Act 1986, Part I.
[33] *Commissioners of Inland Revenue v The Wimbledon Football Club Ltd and others* [2004] EWCA Civ 655 at para 53.

required for the purposes of the trading permitted under the CVA i.e., to pursue the claim and to avoid liquidation of the company".[34]

Another reason why a company may choose to initiate a CVA procedure is to enable the company to continue trading.[35] It was stated that "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) he should normally as it currently appears to me, expect to pay the full rent to which the landlord is contractually entitled."[36] Likewise in *Re NT Gallagher and son Ltd*, it was noted that "the primary purpose of the CVA was to enable Gallagher to continue trading."[37]

Lastly, a CVA may be used because of situations arising from a rescue activity. A typical example is the use of a CVA to reduce liability from rental obligations.[38] Recent trend has seen an increase in the use of CVAs to restructure high street retail companies in financial distress. Even though most of these companies usually end up in administration.[39]

Despite the rescue objective inherent in CVAs, it remains that not all CVAs are intended to pursue a rescue outcome.[40] A CVA can be used to effect "an orderly winding down of a business where contracts can be completed without an immediate formal winding up and its restrictions."[41] The reason why a CVA is used in this manner is because an orderly wind down leads to a better result for stakeholders than an immediate liquidation. In the same vein, a company may use a CVA to enable a distribution to creditors. This happened

[34] [2004] EWCA Civ 655 at para 53 per Mummery LJ.
[35] *Thomas v Ken Thomas Ltd* [2006] EWCA Civ 1504 [2007] BPIR 959 [34] [Neuberger LJ] (as he then was).
[36] Ibid.
[37] [2002] BPIR 565, [2002] EWCA Civ 404 [49] (per Peter Gibson LJ).
[38] *Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2007] EWHC 1002 (ch); [2007] BUS LR 1771 (Ch D).
[39] As seen in BHS, JJB Sports, Stylo plc, Debenhams, Mothercare etc.
[40] S Frisby A Walters, '*Preliminary Report into Outcomes in Company Voluntary Arrangements'* March 2011 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792402 accessed 10 March 2018. (Frisby and Walters CVA).
[41] Ibid 42.

in the Nortel case,[42] where the administrators sought the court's sanction to propose a CVA as a distribution mechanism which would allow them to distribute the proceeds of sale of the company's assets.[43]

From the following analysis, it can be argued that the CVA can be used to achieve a wide variety of purposes depending on individual circumstances of the company. An analysis of the procedure leading to a CVA is explored further.

2.3. The Mechanicscs of a CVA

The Cork committee recommended a procedure that is "quick, user-friendly and inexpensive" and could afford distressed companies an avenue to put in place a reorganization plan and reach a composition or arrangement of its debt with its creditors which will be binding.[44] The CVA procedure can be found under part I of the Insolvency Act 1986; Sections 1 and 7 and in Schedule A1.

The Insolvency Act 2000 reforms had the effect of constituting two types of CVA: CVAs without Moratorium (PT 1 of the IA 1986 and IA 2000) and CVAs with a moratorium (IA 1986 Schedule A1, and IA 2000).[45] According to Fletcher, "the guiding principle of this procedure [i.e., the moratorium based CVA] would be that only viable businesses, adequately financed should be accorded access to this mode of rescue".[46] It should be pointed out at this point that the CVA without a moratorium i.e., the standalone CVA is usually the preferred option rather than the CVA with a moratorium.[47]

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[42] *Re Nortel Networks UK Ltd and Ors* [207] EWCH 3299.

[43] Ibid; A Gallagher, K Crinson J Shepherd, 'The Resurgence of the Company Voluntary Arrangement' (2018) 37 American Bankruptcy Institute 32, 38.

[44] A Smith M Neill, 'The Insolvency Act 2000' (2001) 17 Insolvency Law and Practice 84; Cork Report (n 1) 428-430.

[45] Although the CVA with moratorium has now been repealed by the Corporate Insolvency and Governance Act 2020 which introduced a new standalone moratorium.

[46] IF Fletcher, *The law of Insolvency* (3rd edn, Sweet & Maxwell 2003) 15-005. The CVA with a moratorium has been repealed following the introduction of the new standalone moratorium introduced by the CIGA 2020.

[47] According to S Frisby and A Walters in their report to the Insolvency Service, they found that only 1% of companies that had commenced a CVA made use of the Sch A1 moratorium. Frisby and Walters CVA (n 40) 22.

2.3.1. Standalone CVA

By virtue of section 1(1) of the Insolvency Act 1986, those who may initiate the procedure leading to a CVA are often the directors of the company save where the company is in administration or liquidation, in which case it is the duty of the administrator or liquidator respectively to commence the procedure.[48] If the directors commence the procedure under section 2, they must identify an authorized person to act as 'Nominee.' This individual, according to the Act must be a fully authorized Insolvency Practitioner (IP).

The directors will submit a proposal for a CVA along with a statement of the company's affairs (i.e., details of the company's assets and liabilities) to the nominee. Although in practice the directors will first approach an IP for guidance, who will in turn advise on the propriety or otherwise of a CVA and if appropriate, he will assist with the drafting of the proposal.

The nominee must prepare a report to the court on the suitability of a CVA for the company within 28 days or longer subject to the permission of the court. If he/she is of the opinion that a CVA is suitable for the company and that the proposal has a reasonable prospect of being approved and implemented, the nominee must call a meeting of the company's members and seek a decision from the company's creditors. The proposal needs to be "serious and viable."[49]

He/she must send copies of the proposal, his/her comments on the proposal and the statement of affairs to the members and creditors whom he is aware of.[50] He/she must call a meeting of the company's members and seek a decision from the company's creditors regarding the approval of the proposal. The details of the meeting including the time, place and venue must be included in the report made to the court.[51]

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[48] Insolvency Act 1986, section 1(3).
[49] *Cooper v Fearnley* [1997] BPIR 20, *Hook v Jewson Ltd* [1997] 1 BCLC 664, *Davidson v Stanley* [2005] BPIR 279.
[50] Insolvency Act 1986, section 3(3), Insolvency rules 2016 rules 2.25, 2.28.
[51] Insolvency Rules 2016, rules 2.26.

Since the nominee would usually have been involved in drafting the proposal, it is very unlikely that he/she would give a negative report to the court. It should however be pointed out that the court is not usually involved in a CVA even though a report is made to the court. The report is only kept for record purposes and does not bestow upon the court any judicial role except where a problem arises.

If the company is in administration or liquidation this formality is not required of the administrator or liquidator who acts as the nominee. This means that there is no need to report to the court or to call the meeting of the company and seek a decision from the creditors.[52] All that needs to be done is for copies of the proposal to be sent out to members and creditors including a copy of the statement of affairs which would have been submitted to the liquidator or administrator by the directors.

For the CVA to become effective, the proposal must be approved by 75per cent of the creditors voting in person or by proxy by reference to the value of their claims and 50 per cent in value of members/shareholders present at a shareholders' meeting also need to approve it.[53]

Once the requisite majority has approved the proposal, it becomes binding on the company and all creditors who were entitled to vote at the meeting or would have been so entitled if they had notice of it.[54] Even if the creditor did not receive notice of the meeting, or if the creditor received notice but was not present at the meeting and did not vote, or was present and voted against the CVA, such a creditor regardless of the aforementioned circumstances will be bound by the CVA.[55] For these purposes, a creditor is one whose claim is future[56] or contingent.[57]

[52] Insolvency Act, section 3(2).
[53] Insolvency Rules 2016, rule 2.36, Insolvency Act 1986, sections 4 and 4(A).
[54] Insolvency Act 1986, section 5.
[55] Insolvency Act 1986, section 5 (2).
[56] *Re Cancol Ltd* [1996] 1 All ER 37.
[57] *Re T & N Ltd (No 3)* [2006] EWHC 1447 (Ch); [2007] 1 All ER 851.

By virtue of section 6 of the Act, decisions made at the meetings can give rise to challenges. Any creditor who feels strongly about the CVA can apply to the court on grounds that the CVA terms are unfairly prejudicial to the interest of the creditors or that there were some material irregularities in the procedure. This will be elaborated upon subsequently.

After approval, the CVA is then administered by a supervisor usually the same person who has been nominee from inception now becomes supervisor.[58] The terms of the CVA are carried out just like other commercial contracts.[59] Under section 7(3) of the Act, any of the company's creditors or any other person dissatisfied by an act, omission or decision of the supervisor can apply to the court for an order. The court may proceed to "confirm, reverse, or modify any act or decision of the supervisor… give him directions, or… make such other order as it thinks fit".[60] This section also applies where the supervisor of the CVA requires guidance on any matter arising under the arrangement; he/she can apply to the court for directions.

One thing that the CVA does not do under section 4(3) and (4) of the Insolvency Act 1986 is affect without consent, the rights of secured creditors of the company to enforce their securities; "meetings shall not approve any proposals or modifications that interfere with such enforcement rights except with the concurrence of the creditor concerned."[61] Likewise, the CVA cannot treat preferential creditors in such a way that their rights to be paid rateably before a non-preferential creditor is unrecognized except the preferential creditors give their consent.

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[58] Insolvency Act 1986, section 7(2).

[59] It should be noted that even though the CVA has contractual effect, it remains that not every contractual principle is applicable to a CVA. The Insolvency Act creates a "statutory hypothesis" or a "deeming provision" which allows the court to apply a contractual analysis to the true construction of the CVA. However, it is not expected that the usual principles of contract formation should be applied to a CVA. See generally, *Wright v Prudential Assurance Company Limited* [2018] EWHC 402 (ch); *Re Brelec Installations Ltd* [2001] BCC 421 [423E-F] (Per Blackburne J); *Sea Voyager Maritime Inc v Bielecki* (1999) BCC 924.

[60] Insolvency Act 1986, section 7(3).

[61] Insolvency Act 1986, section 4(3)

There was a perceived weakness with the CVA procedure in that as soon as the meetings of creditors is called, the creditors will become wary that the company is facing financial distress and the company stood the chance of having its rescue plans thwarted by impatient creditors. Although the creditors may not take any steps immediately and wait for the meeting to see what the company has proposed in the terms of the CVA, it may however be the case that some of the creditors will immediately take steps to protect their position.

Aggressive creditors could obstruct the CVA by proceeding to enforce their claims via a winding-up petition during the period between the initial notification to creditors of the situation of the company and the creditors meeting.[62] A successful petition for winding-up brought in anticipation of the creditors meeting had the effect of wasting the "up-front investment in time, money and organizational effort."[63] Likewise, as a result of the lack of moratorium to prevent such actions being taken, creditors may proceed to achieve a better return for themselves rather than wait on the outcome of the meeting and be bound by the CVA.

The only way a moratorium could be achieved under the Act was to combine a proposal for a CVA with a court application for the appointment of an administrator.[64] The moratorium available under administration could prove beneficial to the company such that its assets would be safeguarded until the time when creditors exercise their votes on the CVA proposal.

The long process of acquiring an administration order prior to the Enterprise Act 2002 regime coupled with the costs involved in having an administrator in place who will oversee the running of the company made the procedure non-beneficial especially for

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[62] G Cook N Pandit D Milman C Mason, *Small Firm Rescue: A Multi-method Empirical Study of CVAs* (London: Institute of Chartered Accountants in England and Wales, 2003) 32.
[63] G McCormack, 'Rescuing Small Businesses: Designing an Efficient Legal Regime' (2009) 4 Journal of Business Law 299,302.
[64] Insolvency Act 1986, Schedule B1.

small companies. As a result, there was the need for the CVA to have its own moratorium. According to Sir Kenneth Cork, "a company needed a period when the dogs were called off and they were able to recover a degree of equilibrium. They needed in other words, a moratorium for which existing law made no provision."[65]

Consequently, to give the company a breathing space from its creditors during the period in which the proposal was being devised, the Insolvency Act 2000 introduced a moratorium based CVA which was expected to make company rescue simpler, cheaper, and more accessible, particularly for a smaller company.

2.3.2. The Previous Schedule A1 Moratorium CVA

The directors of "small companies" ccould apply for a short moratorium to keep creditors away from the company during the period when the CVA proposal is put to creditors. The definition of small companies for this purpose was provided under section 382(3) of the companies Act 2006 which states that for a company to be eligible, it must satisfy at least two of the following three requirements:

a) Its annual turnover does not exceed £10.2 million.
b) Its balance sheet total does not exceed £5.1 million; and
c) It has no more than 50 employees.

The Schedule A1 moratorium was not available to a company that is in administration, liquidation, administrative receivership or is already undergoing a CVA or has benefitted from a CVA previously within a period of 12 months but which the CVA was not approved or where the CVA ended prematurely.[66] Where the company is eligible, the directors must submit a CVA proposal to the nominee together with a statement of the company's affairs.

The nominee shall opine on the report and reply the directors stating whether in his opinion; the proposal has a reasonable prospect of being approved and implemented; the company is likely to have sufficient funds available during the moratorium period to enable it to carry on its business; and the proposal should be considered by a meeting of the

[65] Sir Kenneth Cork, Cork on Cork: Sir Kenneth Cork Takes Stock (Macmillan, 1988) 145.
[66] Insolvency Act 2000, Schedule A1, paragraph 4.

company's members and by the company's creditors.[67] The nominee is required to base his opinion on the information supplied to him by the directors unless there is a reason to doubt the accuracy of the information.[68]

To obtain a moratorium, the directors were required to file in court a copy of the proposal, a statement of affairs of the company, a statement containing the eligibility of the company and a statement from the nominee containing his opinion as earlier mentioned and his willingness to act as nominee.[69] Upon filing the necessary documents, the moratorium comes into effect and terminates after 28 days or on an earlier date depending on when decisions are taken by the members meeting and the creditors.[70] The moratorium may further be extended for a two-month period subject to the agreement of both the members and creditors.[71]

Research shows that most CVAs operate on a standalone basis without the benefit of a moratorium.[72] According to Walton and his colleagues, of the 534 companies that entered a CVA in 2013, only 8 made use of the Schedule A1 moratorium.[73] As such, it has been submitted elsewhere that the moratorium is a "dead letter in practice."[74]

Given the infrequent use of the moratorium, it has been effectively replaced by the new moratorium introduced by the Corporate Insolvency and Governance Act (CIGA) 2020.[75] As discussed in the previous chapter, this moratorium is not embedded in any procedure. Rather, it is a self-standing pre-insolvency debtor-in-possession process which is subject

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[67] Insolvency Act 1986, Schedule A1, paragraph 6(2).
[68] Ibid 6(3); see also the comments of Lindsay J in *Greystoke v Hamiltoon-smith* [1997] BPIR at [28]-[29].
[69] Ibid 7.
[70] Ibid 8.
[71] Ibid 32.
[72] P Walton C Umfreville L Jacobs, Company Voluntary Arrangements: Evaluating Success and Failure (R3, May 2018) https://www.icaew.com/-/media/corporate/files/technical/insolvency/publications/cvas-evaluating-success-and-failure.ashx accessed 24 July 2018 (Walton and others CVA); Frisby and Walters CVA (n 40) .
[73] Walton and others CVA (n 72) 272.
[74] Keay and Walton (n 27) 139.
[75] CIGA introduced a new Part A1 of the Insolvency Act 1986.

to the supervision of an insolvency practitioner known as a "monitor."[76] The main objective of the moratorium is to rescue the company.[77]

On the challenge to the nominee's actions, a director or member, creditor or any third party whose rights is affected by the moratorium can institute an action against the nominee challenging his act, omission or any decision made by him.[78] The court has the power to confirm, reverse or modify any decision made by the nominee, give directions to the nominee, or make such order as it deems fit.

Once a CVA has been approved, the only challenge to it is one brought within 28 days of the creditors meeting on grounds of "unfair prejudice and material irregularity". Any party including a creditor, member, nominee or where the company is in liquidation or administrator, the liquidator or administrator respectively may apply to the court to challenge the CVA on the grounds that the CVA unfairly prejudices the interests of a creditor, member, or contributory of the company or that there has been some material irregularity at or in relation to the members' meeting or in relation to the relevant qualifying decision procedure.[79]

If the court is satisfied that the ground for making the application has been proved, it may revoke or suspend any decision approving the CVA and/or order the requisitioning of another meeting and a further decision of the company's creditors be sought to either consider the original proposal or a revised one. These two grounds of challenging a CVA prevents other forms of challenge and any party wishing to challenge under section 6 of the Act must do so within 28 days from the date of the report to the court of the decisions

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[76] 'Insolvency and Corporate Governance: Government Response' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf accessed 12 July 2019 5.65 and 5.59. (Government Response 2016).

[77] For an analysis of the Moratorium provisions see E Sanderson, "The CIGA Moratorium: A Lifeline for UK Companies? (2020) 17 International Corporate Rescue 342.

[78] Insolvency Act 1986, schedule A1, paragraph 26.

[79] Insolvency Act 1986, Section 6.

reached by the members and creditors. Once this time limit has lapsed, no challenge can be made thereafter. This is discussed in the following subsection.

2.3.3. Grounds for Challenging a CVA

As stated by the Cork Report; "unless it can be shown that the treatment of the general body of creditors under the voluntary arrangement is likely to be at least as advantageous as that obtainable by court proceedings, then a dissatisfied creditor will have reasonable grounds for complaint and will normally be entitled to have the debtor's affairs administered by the court, otherwise he would be bound by the wishes of the majority voting in favour of the voluntary arrangement."[80]

There is no guidance under the Act as to what 'unfair prejudice' means, however case law has established some principles, most of which relates to unfair prejudice to creditors as they are most likely to be the party who brings a claim of unfair prejudice. For the purposes of section 6 of the Insolvency Act 1986, there is usually no difficulty in determining whether there is "prejudice". A CVA which leaves the creditor worse off than before the CVA considering both the present and future will be deemed prejudicial.[81] In the Individual voluntary arrangement (IVA) case of Sea *Voyager Maritime Inc v Bielecki*[82]*,* which involved a variation of the terms of the IVA on grounds of unfair prejudice, the court opined that the prejudice complained of must affect the creditor in the capacity as creditor of the debtor company and not in any other capacity.

The difficulty is usually the need to prove that the prejudice complained of is "unfair".[83] The court must satisfy itself that the provisions of the statute have been met. The unfair prejudice complained of may be done to a particular creditor, or a specific class of creditors or it may even be towards all the creditors. It should be noted that only an act

[80] *Insolvency law and Practice*: Report of the Review Committee (Cmnd 8558, 1982) 364 (4).
[81] *Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2007] BPIR 839.
[82] [1999] 1 BCLC 133.
[83] *Prudential Assurance* (n 81).

done with regards to the terms of the arrangement constituting the CVA can be regarded as unfair prejudice and not one which relates to an external agreement.[84]

It must involve some discriminatory treatment of some sort done to a creditor or creditors. It may be the case that there is a reason for treating members of a class differently from others, but the reason for such treatment needs to be explained.[85] It is trite that there is no single and universal test for determining unfair prejudice. It is necessary to examine all the circumstances, especially the available options apart from a CVA and the practical consequences that will arise out of a decision to either confirm or reject the arrangement.[86] The determination of whether a CVA unfairly prejudices a creditor's interests is dependent on the information available during the period the CVA was approved.[87]

The court uses two tests to establish unfair prejudice: the vertical comparison test and the horizontal comparison test.[88] Vertical angle means that the court needs to compare the creditor's position under the CVA to the position the creditor would have been under a winding up.[89] Horizontal comparison suggests that the creditor or creditors has been treated differently from other creditors under the terms of the CVA. It may also include comparing the position of the creditor under the CVA with the creditor's position under a Scheme of Arrangement under Part 26 of the Companies Act 2006.[90]

Turning to the second ground of challenge; a material irregularity that occurred at or in relation to either the company meeting or involved the relevant qualifying decision-making

[84] *Somji v Cadbury Schweppes plc* [2001] 1 BCLC 498.
[85] See the CVA cases of *Re Primlaks (UK) Ltd (no2)* [1990] BCLC 234; *IRC v Wimbledon Football Club Ltd* [2004] 1 BCLC 638; *Sea Voyager Maritime Inc v Bielecki* [1999] 1 BCLC 133.
[86] *Prudential Assurance* (n 81); *Re a debtor (No. 101 of 1999)* [2001] 1 BCLC 54 [63d] (Ferris J); *SISU Capital Fund Ltd v Tucker* [2005] EWHC 2170 (Ch) [71].
[87] ibid.
[88] ibid 75.
[89] For example, *Re T & N Ltd* [2005] 2 BCLC 488.
[90] See the discussion of David Richards J on both Schemes and CVAs in *Re T & N Ltd (No 2)* [2006] 2 BCLC 374.

procedure requires an irregularity that would or could have substantially affected the way the CVA was assessed by those voting upon it.[91]

There are recent court challenges to a CVA that clarifies some aspects of the procedure. This will now be discussed one after the other.

a) The Debenhams Challenge

This case was instituted by some landlords of the company who felt that the CVA was unfairly prejudicial to them amongst other grounds of challenge.[92] The specific grounds of challenge were:

1. Landlords do not constitute 'creditors' for future rent and it was beyond the scope of the CVA under the Insolvency Act 1986 to compromise claims for future rent.
2. The CVA was automatically unfairly prejudicial to the landlords because it sought to reduce rent payable under the lease.
3. It was beyond the scope of the CVA to remove landlord's right to forfeiture because of the CVA or because of a CVA related event.
4. Landlords were treated less favorably than other unsecured creditors without any proper justification.
5. The directors of Debenhams failed to disclose certain security granted by Debenhams and this amounted to a material irregularity.

The court rejected the challenge on 4 out of 5 grounds. On the first issue, the court held that as a matter of jurisdiction, future rent can be included within a CVA. Even though the debt in question was not 'presently provable', it is a financial liability of the tenant company during the term of the lease. On the second issue, the reduction of rent payable under the lease does not automatically unfairly prejudice landlords. It was infact fair to the landlords because they were allowed to terminate the lease if they wished to do so and the CVA did not impose any new obligations on them, it only varied existing obligations.

[91] *Somji v Cadbury Schweppes plc* [2001] 1 BCLC 498.
[92] *Discovery (Northampton) Limited v Debenhams Retail Limited* [2019] EWHC 2441 (Ch).

On the third issue, the court found that a CVA cannot vary the right of a landlord to re-enter its premises. Even though the CVA can vary the conditions under which the landlord can exercise the right to re-enter, the CVA cannot by itself vary the right of re-entry itself. Based on this, the court ordered a deletion of the clause purporting to remove the landlords right to forfeiture.

On the fourth ground, the treatment of landlords compared to other unsecured creditors especially suppliers were properly justified. The landlords were providing long term accommodation at above market rates while suppliers were providing goods and services on an order basis and were paid in full, which was justified based on business continuity. The court was satisfied that on the evidence adduced, there was nothing to show that the rent being paid to landlords was below the market rate. On the last ground, the court did not find the lack of disclosure as material since it would not have had any effect in how creditors voted on the CVA.[93]

b) New Look CVA Challenge

This case is instructive on the legality and fairness of the use of retail CVAs. The company had entered a CVA because of difficult trading conditions arising from the effect of the Covid-19 pandemic. The challenge was brought by landlords of the company on the following grounds:

1. The CVA proposal did not constitute a composition or arrangement within the meaning of section 1(1) of the 1986 Insolvency Act. (Jurisdictional challenge)
2. The landlords were unfairly prejudiced
3. There were material irregularities.[94]

On the first ground, it was argued that firstly, the CVA could not be regarded as a CVA because there were different classes of creditors who receive different treatment and who

[93] Ibid.

[94] Lazari Properties 2 Limited and others v New Look Retailers Limited, Butters and Another [2021] EWHC 1209 (Ch).

ought to be treated as separate classes. The court held that a CVA can provide for differential treatment of creditors and there is nothing unfairly prejudicial in doing so and such arrangement was within the scope of the Insolvency Act 1986. Secondly, it was argued that there was insufficient "give and take" between the company and various groups of creditors.

The court held that an arrangement which "takes" the contractual rights of creditors and "gives" them a return which is at least better than that which they will receive in an alternative insolvency process such as administration, constitutes a sufficient give and take. Likewise, the CVA did not compromise proprietary rights by reducing rent to zero, and the lease itself remained in place unless terminated by the landlord. The court also held that the fact that some creditors are paid in full on grounds of commercially justified business continuity does not mean that the CVA did not constitute sufficient "give and take."

Thirdly, it was argued that the termination right proposed by New Look interfered with property rights of those landlords. The court held that there was no interference with landlord's proprietary rights since the release of the company from paying rent and other sums did not operate as a surrender of the leases because the obligation to pay rent is not an essential requirement of a lease.[95] Even though the CVA proposal offered certain landlords the rights to agree to a surrender of the lease, they were not mandated to do so.

On the second ground for challenge, it was argued that firstly, the votes of unimpaired creditors were used to secure the requisite majorities. The court held that this did not constitute unfair prejudice, however this will be a material relevant factor to be considered in any given case, in determining whether there has been unfair prejudice.

[95] ibid [281]-[282].

Secondly, creditors whose claims were compromised were treated differently from those who were not compromised. The court held that the CVA is intended to be a flexible procedure which facilitates the rescue of a company. Even though differential treatment of different groups of creditors is a cause for enquiry, which must be justified, this is not inherently unfairly prejudicial. What needs to be considered is the nature and extent of the different treatment, the reasons justifying the treatment and the impact of this on the outcome of the creditors' meeting. While the votes of compromised creditors if they voted separately would not have achieved the statutory majorities, these creditors voted in favor of the CVA.

Thirdly, it was argued that the modification to the terms of the leases which involved a switch to turnover rent was unfair to the landlords. The court held that the CVA offered landlords a termination right in return for the lease modifications and this sufficiently addressed any potential prejudice. The court further stated that any rent reduction and modification must be fair, otherwise landlords would exercise their termination rights and the company would cease trading from the premises.

On the third ground, it was contended that there was a material irregularity due to omissions and inaccuracies in the CVA proposal, and the calculation of landlords voting rights. The court held that the formula used in calculating the value of the landlords claims for voting purposes ensured transparency to all landlords and this did not affect the chairman's discretion.

c) Regis CVA Challenge

Like the previous cases, the applicants in this CVA challenge were also landlords of various properties occupied by the company. The grounds of challenge include:

1. Material irregularity: The landlords claimed that there was material irregularity in the approval process of the CVA due to firstly, the application of an unpopular discount on landlord votes as is customary in retail CVAs. Secondly, it was suggested under the CVA proposal that if the CVA was not approved, the likely alternative and outcome for creditors was a shutdown of the business. The

landlords argued that the right comparison should have been a pre-pack or a trading administration. Thirdly, it was contended that the company did not disclose the history of various transactions entered in the years before the CVA was launched. Lastly, some creditors should not have been allowed to vote at the meeting because their debts were not valid, and the statement of affairs and estimated outcome statements did not reflect this.

2. On grounds of unfair prejudice based on claims that modifications to some lease terms including the reduction of future rent amongst other things were unfairly prejudicial. Also, two creditors were treated as critical with their debts unimpaired and the differential treatment was not justified.

The court rejected all grounds of challenge except the one about the treatment of a creditor as critical. The material irregularity challenge was rejected on the basis that there was no irregularity, or such was not material. The unfair prejudice claim was also rejected on grounds that the landlords were given a termination right and they did not exercise it.

The court considered the treatment of some creditors as critical and held that the treatment was unjustified. Consequently, the CVA was deemed unfairly prejudicial to landlords. The court considered whether the nominee had breached its duty by recommending the proposal to creditors when one party was treated as a critical creditor and thus unfairly prejudicial to other creditors. The court found that the nominee had breached its duty. However, the court found that in the absence of bad faith or fraud, it was not appropriate to make an order requiring the nominees to repay fees. In this respect, the CVA was revoked.

2.3.4. Termination of a CVA

The routes and outcomes out of a CVA are wide and varied just like its purposes. It is possible for the CVA route to be chosen instead of another exit procedure from administration.[96] The CVA agreement will contain the outcomes of the CVA and the routes out of it.

In terms of termination of the CVA, a CVA may be successful or may be a failure. It may be the case that the CVA may progress, and the company will be able to fulfil all the terms stated in the arrangement and pay all the creditors and even continue trading as a going concern. On the other hand, the company may struggle to keep up with the terms of the arrangement may be because of funding issues and as a result, the company may be unable to fulfil its obligations as at when due. Where the latter occurs, the supervisor may proceed to put the company into liquidation on grounds that the terms of the CVA have been breached. Whereas if the CVA is successful, the supervisor will make the final distributions and the CVA will be terminated.

As mentioned earlier, the CVA regime was designed after Individual Voluntary Arrangements (IVAs), however despite the two procedures having emerged in similar fashions, in personal insolvencies, IVAs receive considerable attention compared to corporate insolvencies where the CVA process is not often used.

The CVA is meant to be somewhat a debtor in possession (DIP) regime as in the US.[97] However, given the English cynical view of a DIP regime, the legislature made it a pre-requisite for the directors to involve an insolvency practitioner (IP) who is to monitor the affairs of the company throughout the CVA process. Yet, research has shown that the uptake of CVA over the years has been relatively low.[98]

[96] P Wallace S Berwick TXU-CVAs v S 425 Schemes [2006] 3 International Corporate Rescue 2006 69.
[97] On the benefits of a DIP regime and that of a practitioner in possession regime see D Hahn, 'Concentrated Ownership and Control of Corporate Reorganizations (2004) 4 Journal of Corporate Law Studies 117; G McCormack, 'Control and Corporate Rescue- An Anglo-American Evaluation' (2007) *56* International Corporate Law Quarterly 515.
[98] Walton and others CVA (n 72); Frisby and Walters CVA (n 40).

It has not enjoyed much popularity as other rescue procedures. In 2020 there were 259 CVAs compared to 1,526 administrations in the same year.[99] This has been the case from year to year. As a result, the CVA has been referred to as "a blunt tool for those wishing to rescue distressed businesses."[100] The reasons for the low usage of the procedure have already been discussed in the previous chapter.

This does not however suggest that there is no use of CVA, infact, it has been used to a large extent by retail companies to restructure their leasehold liabilities.[101] The reason for the popularity of CVA in the retail sector is due to the ability of the process to structure the CVA in such a way that the company can restructure its ongoing obligations, especially its rent for the duration of the CVA and continue trading as a going concern. The use of the CVA in the retail sector will be considered in the next chapter, what now needs to be examined is the efficacy of the CVA as a rescue model.

2.4. The Success of CVA as a Rescue Mechanism

CVAs enjoy certain benefits over other rescue procedures, especially administration. The key features that the CVA regime brought to the rescue scene is its voluntaries and its flexibility. Given its DIP feature, directors are incentivized to tackle financial difficulty early enough; they remain in control of the business of the company and commence the restructuring procedure although under the supervision of a nominee. Even though a DIP regime may also be a disadvantage depending on the view one takes about allowing directors to remain in control. Nevertheless, it preserves jobs and existing contracts as opposed to administration or liquidation.

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[99] 'UK Company Insolvency Statistics' https://www.thegazette.co.uk/insolvency/content/103888 accessed 11 July 2021.

[100] B Adebola, 'Conflated Arrangements: A Comment on the Company Voluntary Arrangements in the Proposed Nigerian Insolvency Act 2014' (2015) available https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2565491 accessed 21 July 2019.

[101] J Chetwood, 'Retail CVAs: Trends and Future Direction' (*Herbert Smith Freehills*, 2018) https://www.herbertsmithfreehills.com/insight/retail-cvas-trends-and-future-direction accessed 13 February 2019.

The CVA procedure is an efficient, quick, cheap way of rescuing companies in financial distress as opposed to schemes.[102] It appears that the expectations of the Cork Committee have not been met since it is common for a company to enter a subsequent insolvency procedure after the CVA has been implemented.[103] However, it has been argued based on empirical study that the CVA is a flexible mechanism that produces effective results for creditors.[104]

Thus, "If the circumstances are right and the CVA is executed properly, it can provide a good outcome."[105] This assertion leads to the question: what are the essential elements necessary for a CVA to generate a positive outcome for a company and its stakeholder? These are discussed further.

1. Early Commencement of the CVA

As previously mentioned, the CVA incorporates a DIP model which allows directors to remain in charge of the affairs of the company, however, this is subject to the supervision of a nominee who later becomes supervisor of the CVA after approval. One major advantage of a DIP regime is that it "encourages timely filings for reorganization, thus mitigating the obvious tendency of firms and their managers to postpone the commencement of corporate bankruptcy proceedings".[106]

A major reason why rescue procedures fail to achieve the aim of saving the company is because directors wait until it is too late to seek assistance. Even though the directors have the incentives to prevent late intervention owing to the wrongful trading rules, yet they fail to tackle the problems of the company early because they are either reluctant to

[102] I Fletcher, 'UK Corporate Rescue: Recent Developments- Changes to Administrative Receivership, Administration and Company Voluntary Arrangements- The Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002', (2004) 5 European Business organization Law and Review 119, 133.
[103] S Frisby A Walters, '*Preliminary Report into Outcomes in Company Voluntary Arrangements'* March 2011 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792402 accessed 10 March 2018. (Frisby and Walters CVA) 29.
[104] Walton and others CVA (n 72).
[105] Ibid.
[106] DA Skeel Jr, 'Markets, courts, and the Brave New World of Bankruptcy Theory' [1993] Wisconsin Law Review 465,517.

admit that there are problems that needs addressing or they fail to understand that the company is in financial distress.[107]

Similarly, directors have been accused of not acting quickly, and failing to understand, identify and properly address the issues facing the company.[108] Arguably, late initiation of a CVA may have a significant impact on the success of CVAs as a corporate rescue mechanism. Early intervention is an important aspect of a corporate rescue model, and it is essential that directors act early to avoid failure. It is suggested that there should be an incorporation into legislation, a principle that broadens directors' duty of care to include an initiation of timely rescue in the face of an impending distress.[109] Where such principle is not complied with, there should be legislative sanctions for erring directors.

2. Expertise in CVAs

The issue of expertise of the nominee and all the parties involved in CVAs also need to be considered. Prior to the development of the rescue culture, the expertise of IPs in the CVA process were limited. According to Flood and his colleagues,[110] only few IPs had full knowledge of the procedure.

Their expertise revolved around administrations and liquidations, and these procedures tend to be more remunerative for them than CVAs.[111] However this assertion may have been discredited by the development of the rescue culture; IPs knowledge and orientation

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[107] T Mocroft, 'Companies cannot do it alone: An Investigation into UK Management Attitudes to Company Voluntary Arrangements' (Centre for the Study of Financial Innovation (CSFI), 2004) https://www.companyrescue.co.uk/fileadmin/uploads/cr/docs-pdf/Tim_Mocroft_report.pdf accessed 23 October 2019.

[108] Walton and others CVA (n 72).

[109] Such a principle exists under the South African Business Rescue Regime. See generally, E Synman-van Deventer L Jacobs, 'Corporate Rescue: The South African Business Rescue Plan Examined' (2011) Nottingham Insolvency and Business Law E-Journal 103.

[110] J Flood and others, 'The Professional Restructuring of Corporate Rescue: Company Voluntary Arrangements and the London Approach' ACCA Research Report 45 (Certified Accountants Educational Trust, London, 1995) 17.

[111] Ibid.

regarding the CVA process and its rescue potential can be said to have increased significantly.[112]

In terms of the relationship between the CVA process and its ability to facilitate/encourage expert decision, it should be noted that the IP is not fully in control of the decision-making process in a CVA, he does not sit as a judge of the process. The CVA involves a wide negotiation process between the IP, directors, secured and unsecured creditors. It follows therefore that this negotiation process may be fraught with a lot of uncertainties.

One question that comes to mind is whether the relevant information is being disseminated during the negotiation process and whether based on the information on the table, there is a possibility of generating sound decisions relating to rescue. A further difficulty may revolve around trust amongst various participants within the CVA process. This is where the role of the IP comes in handy. The IP is required to build trust between the different creditors and the directors of the company. Without trust and confidence in the process, "even the best informed, most astute commercial judgments will come to nothing."[113] Of major importance here is faith in the competence of the directors and their ability to turn around the situation of the company positively.[114] The expertise required in a CVA procedure is dependent not just on the skills that IPs possesses but also on that of the management team. Likewise, the major creditors have a role to play on the issue of expertise.

Moreover, if a CVA is to succeed in the first place, they are the major parties that need to be convinced. It follows that the main creditors of the company need to have a high standard of expertise in rescue for them to be able to identify the difference between good and bad CVA proposals.[115] Thus it has been argued that the CVA requires a "co-ordination of expertise. It is a procedure that might be thought to conduce to such co-

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[112] V Finch D Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn, Cambridge University Press 2017) 432.
[113] Ibid.
[114] Flood and others (n 110) 19.
[115] Finch and Milman (n 112) 433.

ordination since the CVA provides a forum for discussion of the rescue scheme's strength and weaknesses."[116] However, the aforementioned discussion may not necessarily generate the desired results due to some reasons.

Firstly, the issue of conflict of interest between different creditor groups will come to play. These creditors have different level of risk and will also perceive rescue differently. This conflict will lead to disagreements and may affect the process. Secondly, company directors will also have differing views and interest from other parties since they have their own interests to protect. For instance, where the IPs and creditors wants to bring in new directors, the directors will often not agree to their wishes because of their own self-maximising interests: "the director's estimations of their own value to the company may be higher than those of the IPs and creditors."[117]

Thirdly, all these differing interests may affect the levels of trust which will also influence the flow of information; in which case directors may limit the information they make available to IPs because of the fear that they could be replaced if certain facts are disclosed. Lastly, the quality of participation in the negotiation process may be below standard because the major players are not fully trained in CVA procedures or are not completely aware of the situation of the company.

How can the issue of expertise be improved? Since a CVA is viewed as a process that encourages a wide variety of negotiation, it then means that solely improving the knowledge of IPs regarding CVAs is insufficient. Directors, banks, unsecured creditors, and other participants in the process need to also be fully aware of the process. Certain measures need to be put in place to improve performance; one of such measure could be training company directors, bankers, and other creditors in basic insolvency mechanisms.

[116] Ibid.
[117] Ibid.

As suggested by Finch and Milman, “within the banking industry, attention might also be given to the provision of a continuing expertise in insolvency at the appropriate organizational level.”[118] Apart from such measures relating to training, it may also be necessary to introduce ‘interdisciplinary skills’ so that all the actors involved in a CVA can work together to achieve rescue. As aptly described by Flood et al: “It is worth reflecting those professional relationships across jurisdictional boundaries are crucial to the satisfactory resolution of something like the CVA.”[119]

3. Rescue Funding

According to turnaround specialists, for a business to survive, a distressed company must resolve its initial cash flow problems first, after which it should focus on refinancing to sustain its future growth.[120] This means that the success of rescue is dependent on resolving both short and long-term funding challenges. Research has shown that cash flow problems are amongst the reasons for the early termination of CVAs.[121] Even though new lending could reduce these challenges, it has been noted that providing security to new lenders would not be feasible because the property of the company would already be subject to fixed charges.[122]

As such, the company would not have enough resources to raise new funding during the CVA process. Due to this, it is important to provide measures by which a distressed company can raise credit during the rescue procedure. Lenders who provide such credit may however require greater protection for them to agree to investing in the business.[123]

However, according to Walton and colleagues in their research on CVAs, where they pointed out the view of one interviewee thus: “…any super priority of new funding would not be workable in the UK. The interviewee’s view was that if banks see a future for the

[118] Ibid.
[119] Flood and others (n 110) i.
[120] M Blayney, *Turning a Business Around* (2nd edn, How To Books 2002)112-115.
[121] Walton and others (n 72) 58.
[122] ibid, K Ayotte E Morrison, ‘Creditor Control and Conflict in Chapter 11 Bankruptcy’ (2009) 1 Journal of Legal Analysis 511.
[123] Ibid.

company, they will put money in. If they do not wish to support such a company and a new funder had priority over the bank this would “blow a hole in the bank’s security and future lending policies”.[124]

Consequently, a major challenge for distressed companies is how to secure new funds to finance the company’s activities while the CVA is being negotiated and to enable the company carry on its business in the long term. The success or failure of the CVA is dependent on the availability of longer-term financing since it is unlikely for creditors to agree to a CVA proposal without the possibility of some funding in place.[125]

Banks are often keen to protect their own shareholders’ interests and are conscious of “throwing good money after bad”.[126] Also rather than commit to a procedure like CVA, secured creditors may be willing to provide such funding in other procedure that does not allow managers to remain in place like administration. Even though asset-based lenders may be willing to provide these funding, it has been submitted that “…such assistance usually came at a high cost in terms of termination fees if the CVA failed.”[127] Although rescue finance plays a pivotal role in the rescue process, the UK rescue laws do not provide for incentives to encourage fresh lending as it is in other jurisdictions like the US and Canada.[128]

It remains that the only avenue available to support rescue funding in the UK is new secured finance which is applicable only “…where existing secured creditors agree, and/or if the company has uncharged assets (or charged assets with sufficient equity) that can be offered as fresh security”.[129] Rescue finance is currently not regarded as essential in the UK because due to the inherent flexibility of the rescue procedures funding

[124] Walton and others (n 72) 58.
[125] On the importance of funding see Insolvency Service, A Review of Company Rescue and Business Reconstruction Mechanisms, Interim Report (DTI, September 1999) (IS 1999) 33-5.
[126] Ibid, 15.
[127] Walton and others (n 72) 58.
[128] A Aruoriwo, ‘Financing Corporate Rescues, Where Does the UK Stand’ (2014) 1 Institute of Advanced Legal Studies Student Law Review 12,13; American Bankruptcy Code 11 U.S.C., s 364.
[129] Ibid.

can be secured by a company in the right circumstance.[130] Further, debt factoring has been suggested as a solution to ameliorate cash flow problems.[131]

This facility is an external short-term source of funding for a business to unlock working capital by selling receivables to a third-party firm called a "factor".[132] The factor provides funds required to turn the business around. This could be beneficial to a company given the wide nature of this facility coupled with the fact that there is no security required. However, this may come at such a high cost for a company which is already in distress, which can in turn reduce overall profit for businesses.

This thesis argues that given the importance of rescue funding in alleviating cash flow problems in distressed companies, it is time for the UK to embrace rescue finance as an avenue to relieve financial pressure from a distressed company. However, the appropriate balance should be struck between provision of fresh funds and the rights of existing secured creditors to avoid the challenges faced in the US.

4. Length of CVA

A typical duration of CVAs is 5years, this has been criticized as overly long.[133] At conception, the Cork Committee stated that "the duration of a voluntary arrangement will normally be for a maximum period of three years, but there will be power to extend the period in special circumstances."[134] Walton and his colleagues noted in their research on CVAs that a significant number of CVAs commenced in 2013 were still ongoing towards the end of 2017.[135] Such long duration could potentially make the process expensive, lead to increase pressure on a struggling company and could be cumbersome. As a result, there has been calls for a reduction of the CVA process to no more than 3 years

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[130] Walton and others (n 72) 82.
[131] Ibid.
[132] 'The Role of Factoring in the Business Rescue Process' https://www.mfactors.co.za/insights_factoring_business_rescue_process.php accessed 1 July 2021
[133] Walton and others (n 72) 79.
[134] Cork Report (n 1) 387.
[135] Walton and others (n 72) 79.

except for good reasons.[136] Such a reduction could alleviate issues regarding high cost and complexity of the procedure which is an essential element that goes to the crux of the success of the procedure.

4.5. Conclusion

This chapter has attempted to examine the mechanics of the CVA procedure. The flexibility of the procedure is its most attractive and beneficial feature. The purpose of the procedure is wide-ranging, it may be used to pursue rescue related goals as well as purposes that go beyond rescue such as achieving a better result for creditors via an orderly wind down process or distribution process.

The chapter examined the legal and procedural rules governing CVAs, the issues that often arise from the process and factors that facilitate the success of the procedure. It has been argued that a CVA can only achieve its desired results if there is a committed management team who will initiate the CVA early enough, if the CVA is sufficiently planned and the process is no longer than 3 years, introduction of rescue funding to relieve the financial pressure from the distressed company, healthy cooperation between the main actors involved in the process.

Despite the presence of the elements that could enhance the efficacy of the procedure, it remains that there is no one size fits all approach to a CVA. Based on individual circumstances of each company, the management team needs to identify the causes of distress/insolvency and consider whether the CVA is a potential fit for the company. The next section will consider the operation of CVAs in retail insolvency context.

[136] Ibid.

Chapter 5

<u>Company Voluntary Arrangement in the UK retail sector.</u>

Introduction

The previous chapter examined broadly the mechanics of the CVA mechanism and provided a procedural analysis of the CVA procedure. Based on the analysis given, it is evident that the main feature that differentiates the CVA from other restructuring and insolvency mechanisms is its flexibility. It can be used to carry out a wide range of restructuring activities aimed at ensuring the survival of a company.

Moreover, the survival of the company will preserve jobs, encourage the spirit of enterprise, and make valuable contribution to the economy because firms are generally worth more as going concerns than if liquidated.[1] However, since its introduction, rather than become a mainstream rescue procedure, it has become more of a niche mechanism and has been used to a large extent by companies in the retail industry as a means of restructuring their leasehold liabilities.

The gale blowing through the UK high street has adversely affected the retail sector which has brought about the resurgence of CVAs as a preferred restructuring mechanism by distressed retailers. The list of companies in this sector that have gone bust and those in distress looking for ways to restructure their businesses is endless.[2] In most cases, to survive, compete more effectively and improve the longer-term prospects of the business, the distressed company needs to reduce its property portfolio and propose rent reductions to landlords of these properties. This potentially creates a fuss between the company and

[1] P Okoli, 'Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act' (2012) 23 International Company and Commercial Law Review, 61, 62; AC Davies, 'Compromise or Fudge? Reflections on the Law of the UK as it Affects the Taxation of Insolvent Companies' (2010) 2 British Tax Review 149.

[2] For example, large retail brands including Debenhams, House of Fraser, Mothercare, Homebase have all initiated a CVA in response to financial distress/insolvency.

certain unsecured creditors (landlords). As will be seen, these stakeholders are usually the most affected parties in a retail CVA context.

Despite the flexibility of the procedure, coupled with the inherent rescue features that it is meant to offer to these companies, it will be seen that the CVA often precedes a terminal insolvency procedure.[3] Likewise, since the introduction of the procedure in 1986, more than half of retail CVAs have failed to save the company.[4] Notwithstanding, it remains that the procedure produces better financial returns for stakeholders when used in appropriate circumstances.

Consequently, there will be an assessment of the effectiveness of CVAs in achieving successful retail sector rescue. The key questions which this chapter seeks to address is whether a CVA is sufficient as a standalone mechanism to return a retail business to viability. Second, can the trend in retail CVAs be said to be changing the nature of the corporate rescue regime in the UK? Third, what can be done to address the concerns arising from the use of CVAs in restructuring leasehold liabilities?

To this end, the chapter is divided into 4 sections: Section 1 will examine how the law in the UK addresses the restructuring of leasehold liabilities through the CVA mechanism. The second section will draw a case study of ten retail companies that have initiated a CVA to illustrate the positions of the company and its creditors under the CVA process. Section 3 will consider issues affecting the success of retail-CVA and identify possible recommendations to ameliorate these problems. Section 4 will provide some concluding analysis.

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[3] According to the Centre for Retail Research, from 2015 onwards, the number of retail businesses entering administration has increased by 30 per cent. See Centre for Retail Research, 'The Crisis in Retailing: Closures and Job Losses' https://www.retailresearch.org/retail-crisis.html accessed 1 July 2021. (Crisis in Retailing).

[4] A Hancock A Gross, 'More than Half of Groups Turning to CVAs still go under' *Financial Times* (London, 13 January 2020).

5.1. Evolution of CVAs in the retail sector: How do CVAs operate in restructuring leasehold liabilities?

The UK high street has been affected by certain disruptive factors and those bearing the brunt are businesses in the retail and casual dining sectors. The year 2018 was a watershed year for retail insolvencies; according to the centre for retail research, 43 retail companies ceased trading which resulted in about 2,595 store closures and 46,000 job loss.[5]

The causes behind each individual business problems differ, yet there are certain similarities including too much debt, increased competition, increase in business rates, change in customer behavior and spending amidst economic uncertainty, rental costs, overly rapid expansions, online shopping which has led to reduced footfall.[6] This development has led to some companies falling by the wayside. Examples of such companies include Toys R Us, British Home Stores, Debenhams, Maplin, Kleeneze, Feather & Black which have all fallen into administration/liquidation.[7]

As a result of the current situation many retailers are seeking measures to shield themselves from the challenging trading environment. To survive and ease the burden of increased rents and business rates aggravated by a history of upwards-only rent review clauses under long-term leases, distressed retailers are increasingly turning to the CVA as a restructuring option. Several high-profile brands have initiated the procedure over the years, including New Look, House of Fraser, Home Base, Mother Care, Paper Chase, Mamas & Papas, Debenhams, Toys R US, Carpet Right, Prezzo.[8]

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[5] Centre for Retail Research, 'Whose Gone Bust' (2020) https://www.retailresearch.org/whos-gone-bust-retail.html accessed 1 October 2021.
[6] C Lamont 'Re-structuring Leasehold Estates under Chapter 11 of the US Bankruptcy Code and in England and Wales- a comparison' (2018) 31 Insolvency Intelligence 69, 70.
[7] Hancock and Gross (n 4).
[8] E Jonathan, 'Landlords hit out at high street restructurings' *Financial Times* (28 May 2018) 1.

The CVA has been one of the biggest issues in retail over the years with many high street brands and large retail department chains using the mechanism to consolidate, reduce and restructure their rental obligations. But what was the intention of the legislation in respect of CVAs generally and leasehold obligations specifically? Has there been a divergence between its main objective in theory and the way it is been used in practice? It is important to consider how CVA is used in the retail sector and the common trends in the usage.

When one considers the CVA statutory framework, it is evident that there are no provisions dealing with leasehold obligation or a format for retail CVAs. What has in fact happened is that market practice has been developed overtime with innovations here and there to fit the circumstance of each company. For instance, the JJB Sports CVA has been regarded as the hallmark that laid down the basic legal structure for retail CVAs.[9]

Recall that in the White Paper that followed the Cork Report's Revised Framework document, it was submitted that "the Government wishes to see voluntary procedures used to their fullest potential and to achieve this there must be public confidence that such procedures cannot be abused so as to represent, for those concerned, an easy means of evading their responsibilities."[10]

The Cork Report may have been unknowingly describing the current operation of CVAs in the retail sector. CVAs have been used by companies as a quick means of avoiding their leasehold liabilities to allow the continued operation of the business. The operation of CVA could however have a detrimental effect on landlords of the company. The reason for this will be considered later in this piece.

[9] Herbert Smith Freehills, 'Retail CVAs: Trends and Future Direction' (2018) https://www.herbertsmithfreehills.com/insight/retail-cvas-trends-and-future-direction accessed 18 January 2019.

[10] *Insolvency law and Practice*: Report of the Review Committee (Cmnd 8558, 1982). *A Revised Framework for Insolvency Law* (Cmnd 9175, 1984) para 21.

Based on the provisions of Section 1 of the Insolvency Act 1986, it was expected that the CVA would become a major restructuring mechanism available to companies in English insolvency law, specifically allowing a debtor and its unsecured creditors to execute an efficient restructuring solution outside of formal insolvency proceedings. However, this turned out not to be so due to reasons already discussed in the previous chapter.

Despite the low usage of this procedure by companies, compared to other rescue procedures, it has nevertheless gained some spotlight in the retail sector. The reason for its incessant usage in this sector may be because of the flexible format of CVAs alongside the ability to focus on one type of creditor (landlord creditors). Likewise, the retail sector lends itself to CVAs because retail businesses are heavily reliant on leased properties.[11] A lease is a fixed cost for a tenant which is generally paid for a long period of time with upwards only rent review clauses usually inserted. This arrangement will usually prove beneficial to the landlord because of the certainty in the long-term commitment that comes with it.

On the other hand, retail tenants agree to this form of arrangement because they are generally optimistic that they can continue trading profitably from the store and the terms of the arrangement are market standard. Once a company with large leasehold portfolios starts encountering difficulties, one of the largest costs which it is likely to struggle with is usually rent.

Most retailers are looking to reduce their rent bill because most of these rents were set several years ago when they entered long leases with upward only rent review clauses and during the period when online sales were not so popular. Moreover, 'the reason [a CVA] is used largely around rents is that [a business] can adjust its rent for a much longer period compared with the one-off reduction in the cost of stock…'[12]

[11] CK Wong, 'Will Company Voluntary Arrangement Play a Significant Role in the UK's Corporate Rescue Culture?' (2017) 38 Company Lawyer 122.
[12] A Turner A Gross 'Struggling UK Retailers Turn to the CVA Escape Route' *Financial Times* (London, 21 April 2019).

Given the timeframe available to the company to sort out its problems before the situation becomes critical, reducing such cost in a consensual manner by way of coming to certain terms with landlords across a large portfolio is usually not practicable since this is likely to yield different levels of success. In this instance, the CVA presents the most favourable statutory mechanism for the retail company such that by initiating a CVA, the company can apply a compromise to some of its leases or even all of it within a fixed period.

This is usually achieved by shutting down stores and cutting down on rental obligations owed to landlords without the need to meet and negotiate with them individually, thereby making the process easy and cost-effective.[13] According to one commentator; "The principal advantage of going the CVA route is that it allows … the 'multi-tract' amendment of lease terms rather than necessitating the entry into bilateral negotiation with individual landlords."[14]

Moreover, unlike a scheme of arrangement where creditors are separated into classes for voting purposes, under a CVA all unsecured creditors vote together.[15] Consequently, it is possible for a company to propose a CVA which will legitimately affect only a group of creditors and all creditors will be required to vote on the proposal. However, for the rights of these creditors to be affected by the CVA, there must be good and objective reasons for wanting to single them out as those to be affected, and these creditors must be offered a better deal than they would receive in administration or liquidation.[16]

Due to the flexibility of CVAs, a retail CVA is always selective; not all creditors are treated the same way. Unlike other sectors where their key creditors are usually banks, the major creditors of retail businesses are unsecured trade creditors and the landlords of the

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[13] S Clark G Moore, 'Could 2018 be the year of the CVA?' (Walker Morris, 16 February 2018) https://www.walkermorris.co.uk/publications/2018-year-cva/ accessed 10 May 2019.
[14] 'Retail Insolvency' (Norton Rose Fulbright, June 2018) https://www.nortonrosefulbright.com/en/knowledge/publications/8c449f65/retail-insolvency accessed 5 July 2019.
[15] Lazari Properties 2 Limited and others v New Look Retailers Limited, Butters and Another [2021] EWHC 1209 (Ch). (New Look Case).
[16] Discovery (Northampton) Limited v Debenhams Retail Limited [2019] EWHC 2441 (Ch).

leased premises. Moreover, landlords do not hold any major security for the obligations owed to them by their tenants save where rent deposits are charged.[17]

As a result, their claims can be varied or cancelled under the terms of a CVA. A retail CVA will typically treat landlord claims differently based on the financial performance of the store as well as the strategic importance of the property portfolio.[18] Essentially, the directors of the company and their advisors will conduct a review of the company's property portfolio to determine the past, present, and future performance of each store. This information will be used to divide the company's premises into different categories based on each site's strategic performance and financial performance.

To illustrate further, the common approach has been to split the properties into three categories: profitable stores (green), marginal stores (amber), and unprofitable stores (red). Leases of green stores are usually left unchanged because they are deemed viable except in certain cases where the rent may be moved from quarterly to monthly to aid cash flow. Regardless, the landlords of these premises will be paid rent in full. Amber stores leases are amenable to cater for sizable rent deductions and an option of renegotiation of the lease. For red stores, the stores are closed, and the premises will be returned to the landlords because they are not likely to be viable and the lease obligations will be terminated. Although there may be some agreement in terms of compensation/retention of rent by the landlords.[19]

This approach has worked over the years due to the contractual nature of a CVA and its ability to single out certain group of creditors (usually landlords) of stores that share similar characteristics, although such differential treatment must be justified. While this legal

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[17] R Aspinwall T Dawson, 'Tenant Insolvency- How Landlords Should Approve a CVA' (23 September 2016) https://www.dlapiper.com/sv/global/insights/publications/2016/09/real-estate-gazette-25/how-landlords-should-approach-a-cva/ accessed 18 June 2019

[18] 'The changing landscape of retail CVAs- are landlords taking back control?' (*Lexology*, 19 June 2019) https://www.lexology.com/library/detail.aspx?g=81c7455e-426f-45f0-b3c0-51b88c13f7a6 accessed 21 June 2019.

[19] I Wallace, 'CVA: A Revival' (*White & Case*, 26 January 2018) https://www.whitecase.com/publications/alert/cvas-2018-revival accessed 3 October 2019.

structure has remained the same, it however remains that in addressing problems specific to each company, the CVA has been used in a strategic fashion something which was not envisaged by legislation when the procedure was introduced. This has led to complexity of the process than would otherwise have been the case. CVAs have evolved overtime and it has now been used in a dynamic fashion rather than the traditional ‘one size fits all’ approach.

It is often the case that CVAs will include: “more complex proposals with different compromises being applied to more categories of leasehold premises requiring the company to make increasingly fine distinctions between various leases as a justification for the different treatment; imposing haircuts on all ‘non-critical’ creditors (rather than landlords) principally as a way in which to compromise accrued rates; and introducing a break clause or a requirement for landlords to accept a surrender, both of which appear designed to have the effect of passing liability, for future rates to the landlord.”[20]

Also, apart from targeting the claims of landlords, the terms of a CVA can also reflect the past performance and expected future trading of individual stores.[21] As seen in the Paperchase CVA, landlords were separated into six different categories and rent was compromised on different terms based on the category.[22]

Landlords are often furious and critical of CVAs because they are the ones who are singled out to bear the brunt of a failing business model.[23] Due to the flexible nature of CVAs, specifically its ability to compromise unsecured debts of the company, it presents a tenant company with greater scope of flexibility when attempting to renegotiate the terms of the lease with the landlord creditors. As a result, the landlord is faced with a

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[20] P Chases, K Pullen J Chetwood ‘High Street CVAs: Has the right balance been struck? (2019) Estate Gazette. 52, 54.

[21] D Singh, ‘The changing landscape of retail CVAs- are landlords taking back control?’ (*Lexology*, 19 June 2019) available at https://www.lexology.com/library/detail.aspx?g=81c7455e-426f-45f0-b3c0-51b88c13f7a6 accessed 21 June 2019.

[22] Ibid.

[23] M Brown and others ‘The World of High Street CVAs’ (2019) *Estate Gazzette* 13, 14.

restriction of its own flexibility when reacting to the tenant's breach of the covenant in the lease or when attempting to bring the lease to an end.[24]

The continued use of CVA in this manner has raised concerns that CVAs are being exploited as "nice to have" instead of being a last resort, or that they are being proposed without considering similar arrangements from stakeholders which could enable the survivability of companies. For instance, providing new funds, making operational changes etc.[25] These factors have led to increasing challenge of the CVA proposals by landlords.[26]

Arguably, this pragmatic approach is contrary to the heart of the UK legal system which is supportive of the traditional sanctity of contract.[27] The arguments of supporters and opponents of this process are well rehearsed. From the retailers' perspective, the mechanism serves as a lifeline for the company during a difficult period and can be used as a catalyst for rescuing a good business. Moreover, rescuing the firm has the potential benefit of saving jobs and reducing potential losses. Most importantly, the structural shifts from the traditional brick and mortar stores to online shopping coupled with other factors has shown that the space occupied by businesses on the high street is overvalued. Consequently, to strike a balance between the competing interests of the company and that of certain creditors, a CVA is used as a fair process which recognises that different categories of leases yield different value.[28]

Opponents on the other hand are more critical of CVAs with the argument that it is used to 'delay the inevitable' and allows the business to continue trading for a while, plunging into more debts, and eventually folding up. As seen in the case of BHS which initiated a

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[24] H Sladen. 'Tenant Insolvency: CVAs and Landlords' (2009) 15 Landlord and Tenant Review 9,11.
[25] Chases and others (n 20).
[26] Typical examples include the Debenhams CVA challenge, New Look CVA challenge, Regis CVA challenge amongst others.
[27] I White, Clifford Chance, 'Death on the high street? The Impact of CVAs' (*Clifford Chance,* 9 May 2019) https://www.cliffordchance.com/briefings/2019/05/death_on_the_highstreettheimpactofcvas.html accessed 1 October 2019.
[28]M Brown and others 'The World of High Street CVAs' (2019) *Estate Gazzette* 13, 14.

CVA in March 2016 and subsequently entered administration seven weeks after and ended up in liquidation in November 2016.[29]

These divergent views no doubt create a lot of uncertainty which is likely to impact upon the optimum outcome which the CVA seeks to deliver. On one hand there is an imbalance of interests between the retailer and the landlord creditors, on the other hand it can be argued that both the company and the landlords are trying to exploit their different positions and do what is convenient for them without considering the wider picture.

Retailers wants to get rid of as much properties as they can to remain viable and continue trading as a going concern, landlords on the other hand wants to reap the fruit of their investment in these properties. Although this may not be a bad thing, however, a balance needs to be struck for the CVA to deliver the optimum outcome for the parties. The next section examines series of case studies that illustrates how retail CVAs are used to address the leasehold liabilities of the company.

5.2. CASE STUDY

5.2.1. Case Study 1: Stylo plc.

Stylo was a large public company established in 1936. The company had approximately 380 stores and 5,300 staff.[30] It operated in two different industries: retailing and property investment. The company had generated a huge cost base because of high rent obligations. At the end of 2007 financial year, the parent company was adversely affected by a £12.5m decrease in revenue (before tax) which resulted in a £12m loss before tax, falling share price and inability to pay shareholders dividend.[31]

[29] A Milson, 'When a Company Voluntary Arrangement Fails: Goodbye BHS' (20 June 2016) https://leasingsolutions.bnpparibas.co.uk/british-home-stores-the-process-behind-the-headlines/ accessed 2 August 2019.

[30] Stylo Plc, 'Statement of Administrator's Approval' (Companies House, 5 February 2009) https://beta.companieshouse.gov.uk/company/00657595/filing-history?page=2 accessed 20 July 2019

[31] Ibid.

The internal causes of the problem were caused by closure of some concessionary stores run by Dorothy Perkins, amidst competition between companies within the same retail shoe market.[32] The stock and brand of an insolvent company Dolicis[33] were acquired by the company in February 2008 which resulted in a huge cost that were written off at the time of acquiring the company.[34]

On the other hand, external causes of financial distress according to the company was a difficult trading position caused by "increasing costs in the form of rents, business rates, minimum wage and power costs."[35] Concerns were also raised about risks related to borrowing such as interest rates, decrease in foreign currency values, credit, and liquidity risks. The crash of financial markets also affected the company's properties which led to a reduction in their value.[36]

The company had attempted to reduce costs through an operational turnaround plan which entailed cost reduction, store closure, sale of some of its businesses such as Shellys, reduction in stock level, changes in management team amongst others.[37] However, trading conditions in the retail sector towards the end of 2008 resulted in the company needing an urgent and substantial solution to address the challenges facing the business.

The companies and their advisers appointed three joint administrators to propose the CVA and give the companies breathing space during the period the proposals were considered by creditors. The CVA proposal mainly focused on landlords and rent obligations which were the major cost for the company. The key terms of the CVA include

[32] Stylo Plc, 'Final Result' (27 May 2008) https://www.investegate.co.uk/stylo-plc--styl-/rns/final-results/200805270800002338V/ accessed 21 July 2019.
[33] Stylo Plc 'Acquisition' (14 February 2008) https://www.investegate.co.uk/stylo-plc--styl-/rns/acquisition/200802140900039827N/ accessed 21 July 2019.
[34] Stylo Plc, 'Final Result' (27 May 2008) https://www.investegate.co.uk/stylo-plc--styl-/rns/final-results/200805270800002338V/ accessed 21 July 2019.
[35] Ibid.
[36] Ibid.
[37] Stylo plc, 'Proposed CVA and Appointment' (26 January 2009) https://www.investegate.co.uk/stylo-plc--styl-/rns/proposed-cvas-and-appointment/200901261238412428M/ accessed 15 July 2019.

landlords moving from the rent payable to a reduced turn-over based rent.[38] This would increase cash flow for the operating companies. All ongoing liabilities for rates, service charges and insurance would all be paid in full when due.

The companies agreed to continue trading from all their stores for six months during which time landlords would have the right to market the premises and find replacement tenants. If a potential tenant is found and is prepared to pay more than the turnover rent, the company will have the right of first refusal. If the company does not take up this right i.e., right to match the rent, the landlord will be entitled to terminate the lease for nil premium which will result in both the landlord and the company releasing each other from any future liabilities relating to the lease.[39]

From August 2009 till January 2010, the company was entitled to terminate any of its leases to enable them to reduce their store portfolio. Before terminating the lease, the landlord would be given the option of finding another tenant instead of just giving notice to the existing tenant, if not the CVAs may fail. Rent reviews could still take place during the CVA period, but any resulting increased rent would not be paid until the end of the CVA term. The landlords who were still being paid a turnover rent would change to the pre-CVA rent at the end of the CVAs.

Even though unsecured creditors would be paid in full, they were required to defer and reschedule their pre-existing debts. To protect employees, the claims of employees and the defined benefit pension scheme were excluded expressly from the CVA. The creditors rejected the CVA proposal. According to landlords, the potential effect of the proposal could place them in an unsuitable position such that other creditors would be paid with the money that landlords would concede to.[40] Specifically the company proposed a reduction to the rent payable to landlords based on the turnover at each of the premises.

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[38] Ibid.

[39] J Morris, 'Stylo CVA: The Shoe that Didn't Fit' (2009) https://uk.practicallaw.thomsonreuters.com/8-385-4049?__lrTS=20211110145451289&transitionType=Default&contextData=(sc.Default)&firstPage=true accessed 1 July 2018

[40] Ibid.

"The uncertainty inherent in turn-over based rent can bring with it a reduction in income for a landlord and may cause damage to the value of the reversion if the turnover lease is capable of being assigned."[41]

The terms of the proposal were regarded as tilting towards the tenant company, and this caused discomfort amongst landlords, aggravated by the fact that landlords were given a condition to find another tenant to replace the operating company if the landlords wanted to terminate the lease.

This created a lack of flexibility and certainty which arguably deviates from the overall ideology and policy behind the introduction of CVAs.[42] Consequently, the proposal did not constitute a real compromise and was insufficient to gain the support of landlords. Likewise, landlords were of the view that if they consented to the Stylo proposals, it could lead to a precedent for similar CVAs to follow which will possibly affect their investment values.[43]

It was argued that the proposal had been presented as a *fait accompli* failing to engage with landlords.[44] To sum it up, the Stylo proposal was regarded as not constituting a good compromise. Following the rejection of the CVA, the company was placed into administration. In 2009, the administrator announced the sale of 160 stores (70 fewer than would have continued trading under the CVAs) and 165 concessions to the existing management team led by Michael Ziff.[45] The core profitable parts of the business were

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[41] H Sladen, 'Tenant Insolvency: CVAs and Landlords: Part 1' (2011) 9 Landlord and Tenant Review, 15, 17.

[42] In the White Paper that followed the Cork Report it was stated that: "the Government wishes to see voluntary procedures used to their fullest potential and to achieve this there must be public confidence that such procedures cannot be abused to represent for those concerned, an easy means of evading their responsibilities" See generally A Revised Framework for Insolvency Law, Cmnd 9175 London, HMSO, 1984. (Revised framework).

[43] W Parker, 'What is the Future of Company Voluntary Arrangements (CVAs)' (*Gordons,* 5 May 2010) https://www.gordonsllp.com/whats-the-future-for-company-voluntary-arrangements-cvas/ accessed 1 July 2019.

[44] A Gallagher M Rhodes, 'Restructuring UK Landlord Liabilities: Company Voluntary Arrangement.' (2012) 31 American Bankruptcy Institute Journal 103, 109.

[45] Stylo Plc, 'Store Sale' (19 February 2009) https://www.investegate.co.uk/stylo-plc--styl-/rns/store-sale/200902191343395961N/ accessed 18 July 2019.

sold via a pre-packaged deal to a new entity owned by the chairman of the company, leaving unprofitable stores to close.[46] The company subsequently entered liquidation and was dissolved in 2012.[47]

According to the supervisor's receipts filed in Companies House, the company owed £47million approximately to its secured creditors and the administrators made distribution totalling £550.2m to the secured creditor and £1.3m to the floating charge holder.[48] There were no preferential creditors because of the pre-pack sales, these creditors had been transferred to the Newco.

The unsecured creditors of the company were owed approximately £33m and received nil returns and nil dividends.[49] The prescribed part which by virtue of Section 176A of the Insolvency Act 1986 contains proceeds realised from the sale of assets covered by a floating charge (created after 15 September 2003) which is set aside to satisfy unsecured debts, was unavailable in this case because the floating charge was registered before 15 September 2003.[50]

5.2.2. Case Study 2: JJB sports plc

JJB Sports was a public limited company formed in September 1971. By late 1990s, it was the largest footwear retailer in the UK and operated as a parent company with two major trading companies: Blane Leisure Limited and Sports Division (Eireann) Limited. From 1999 up until 2008, JJB had maintained a portfolio of about 420 stores, but moved

[46] Ibid.
[47] Stylo Plc, 'Notice of Move from Administration to Dissolution' (Companies House, 6 January 2012) https://find-and-update.company-information.service.gov.uk/company/00657595/filing-history?page=2 accessed 19 July 2019.
[48] Stylo Plc, 'Notice of Move from Administration to Dissolution' (Companies House, 6 January 2012) https://find-and-update.company-information.service.gov.uk/company/00657595/filing-history?page=2 accessed 19 July 2019, 5.
[49] Ibid.
[50] It is worthy of mention that the prescribed part was previously capped at £600,000 but has recently been increased to £800,000. See The Insolvency Act 1986 (Prescribed Part) (Amendment) Order 2020. https://www.legislation.gov.uk/uksi/2020/211/made accessed 1 July 2021.

gradually from small high street stores to bigger high street store and subsequently out of town superstores.[51]

From late 2007, the company had experienced a gradual decrease in profitability on a yearly basis.[52] An internal cause of its problems was a hostile business expansion strategy adopted by a major shareholder/new chief executive who acquired two companies; the Original Shoe Company Limited OSC) and insolvent Qube Footwear Limited which were both financially distressed.[53] External causes were due to general loss of consumer confidence after the global financial crisis of 2008 which led to reduction in turnover.

Consequently, JJB plc was in dire need of financing and working capital; the company attempted to ameliorate some of its problems with a short-term loan and sought to raise cash through a placing of new shares and the sale of some of its retail stores.[54] As the date of the repayment of the short-term loan approached, JJB entered a standstill arrangement with its lenders.[55]

This helped the company to have continued access to its existing working capital facilities as well as the short-term loan, whilst its directors considered the best option to secure the viability of the company. Similarly, a major competitor (Sports Direct International)

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[51]'Sports Direct International PLC and JJB Sports PLC: A report on the acquisition by Sports Direct International PLC of 31 Stores of JJB Sports PLC' https://assets.publishing.service.gov.uk/media/551947dee5274a142e0000eb/554final_report_excised.pdf accessed 19 July 2019.

[52] JJB Sports Plc, 'Interim Results' (28 September 2007) https://www.investegate.co.uk/jjb-sports-plc--jjb-/rns/interim-results/200709280704486885E/ accessed 19 July 2019.

[53] MM Parkinson, *Corporate Governance in Transition: An Empirical Approach* (Palgrave Macmillan, 2018) 165.

[54] JJB Sports Plc, 'Cash Placing' (20 October 2008) https://www.investegate.co.uk/Index.aspx?searchtype=2&words=jjb+sports&pno=6 accessed 19 July 2018.

[55] JJB Sports Plc, 'Interim Management Statement' (10 December 2008) https://www.investegate.co.uk/jjb-sports-plc--jjb-/rns/interim-management-statement/200812101043328688J/ accessed 19 July 2018; Will Pearce Gawain Moore, 'Restructuring JJB Sports: New Enthusiasm for the CVA' (2009) https://uk.practicallaw.thomsonreuters.com/1-386-1802?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1 accessed July 1 2019.

targeted the core business of the company (Sports goods) by moving quickly into online retailing selling the same markets with a lower price and meeting consumer demands effectively.[56] The company struggled with these challenges for a long time and its management team were unable to respond and handle the challenge quickly.

It was the first "modern" leasehold CVA to compromise landlords and was regarded as 'groundbreaking' due to its ability to effect a solvent restructuring of a listed company without resorting to administration and a suspension of trading in its shares.[57] The CVA entailed splitting the lease portfolio of the company into two: 250 stores were categorised as profitable stores i.e., they were to continue trading and 140 stores were designated as under-performing stores which were to be closed. The claims of landlords of under-performing stores were to be compromised alongside certain related contingent claims of former tenants and guarantors.

Those landlords of closed stores were however given the choice of being claimants in a £10 million aggregate fund with two instalment payments from the fund, which will equal to receiving payment of approximately six months' rent.[58] Landlords did not have to take back their properties immediately: the company was left to remain in occupancy of the leases which meant that JJB was liable for business rates, a huge cost once a temporary relief for vacant property expired. Landlords had an option to take back their properties at any time. Most importantly, the CVA package delivered to the landlords at least what they would likely receive in administration, the directors could not have offered less than that.

Both creditors and members voted overwhelmingly in support of the proposals; this presented a contrasting fortune with the Stylo CVA. JJB sports plc seems to have received the support of secured creditors already since the company expected that the

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[56] JJB Sports Plc, 'Interim Management Statement' (10 December 2008) https://www.investegate.co.uk/jjb-sports-plc--jjb-/rns/interim-management-statement/200812101043328688J/ accessed 19 July 2018.
[57] A Gallagher M Rhodes, 'Restructuring UK Landlord Liabilities: Company Voluntary Arrangement.' (2012) 31 American Bankruptcy Institute Journal 103, 109.
[58] JJB Sports plc 'Update re CVA Proposal' (7 April 2009) https://www.investegate.co.uk/jjb-sports-plc--jjb-/rns/update-re-cva-proposal/200904070702452495Q/ accessed 20 July 2019.

CVA would be funded through different amounts and types of loan.[59] The CVA was completed within one year. Based on the reports submitted to Companies House by the supervisors of the CVA, the company continued to pay secured creditors, preferential creditors, and trade creditors in the ordinary course of Business.[60] Of the £59.3m owed to landlords of closed stores, they received on a pro rata basis 10% of the sum due which equalled £7.3m.[61]

The CVA was successfully completed. Nevertheless, the measures put in place after the first CVA did not result in restoring the company to profitable trading and its competitive position worsened following the completion of the CVA. A subsequent CVA was initiated and put in place in 2011, a year after the first.

According to the company, the new proposal was based on constructive discussions with major creditors.[62] The CVA proposed closure of 43 stores by April 2012 and a subsequent 46 stores by April 2013. The rents owed were modified to 50% of contractual values. It also proposed to landlords of closed stores a reduction of contractual rent value of 50.[63] A compromised lease fund was set up for compromised landlords to share in the gain of the business if its situation improves. The proposal was approved by creditors.

A year after the implementation of the CVA, based on the report filed by the supervisors of the CVA, no payment had been made to compromised landlords for pre-CVA arrears

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[59] Parkinson (n 57) 183.

[60] JJB Sports plc 'Annual Report and Accounts' (23 May 2008) https://www.investegate.co.uk/jjb-sports-plc--jjb-/rns/annual-report-and-accounts/200805231529272044V/ accessed 17 July 2019. JJB Sports plc, 'Notice to Completion of Voluntary Arrangement' (Companies House) (16 June 2010) https://beta.companieshouse.gov.uk/company/01024895/filing-history?page=5 accessed 1 July 2019. Para 3.

[61] JJB Sports plc 'Annual Report and Accounts' (23 May 2008) https://www.investegate.co.uk/jjb-sports-plc--jjb-/rns/annual-report-and-accounts/200805231529272044V/ accessed 17 July 2019, 3.

[62] JJB Sports plc 'Update re Proposed Company Voluntary Arrangements. (25 February 2011) https://www.investegate.co.uk/jjb-sports-plc--jjb-/rns/update-re-proposed-company-voluntary-arrangements/201102251255288923B/ accessed 21 August 2019.

[63] JJB Sports plc, 'Notice to Registrar of Companies Voluntary Arrangement Taking Effect' (20 April 2011) https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history?page=3 accessed 21 July 2019.

of rent.[64] In October 2012, the parent company entered administration and the CVA was terminated. As contained in the CVA proposal, the landlords of the closed stores were not entitled to any dividend, as the fund was subject to the sale of assets. The prescribed part was unapplicable because the company had no assets for realisation under the CVA.[65]

There were no receipts or payments to compromised creditors in respect of the CVA.[66] The failure of the CVA and the subsequent entry into administration led to more than 2,000 job loss. A rival company Sports Direct acquired only 20 stores as part of the business in a pre-packaged administration.[67] The company entered liquidation in 2015 and was dissolved shortly after.[68]

5.2.3. Case Study 3- British Home Stores (BHS)

BHS was founded by American entrepreneurs in London in 1928. It was modelled after the retail chain Woolworths but at a lower price point to avoid direct competition with Woolworths.[69] The business expanded rapidly, and it began selling a variety of goods and additionally café and grocery services. BHS sought to expand its stores by focusing less on price and more on quality and value for money in the 1960s.[70]

By the end of the 1960s BHS had more than 12,000 employees and 94 stores nationwide. The company was bought by Sir Philip Green in May 2000 for £200 million. He changed

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[64] JJB Sports plc,'Voluntary Arrangement Supervisor's Abstract of Receipts and Payments' (23 May 2012. https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history?page=2 page 2 accessed 21 July 2019.

[65] Ibid.

[66] Ibid.

[67] Office of Fair-Trading press release. 'OFT considers divestments in Sports Direct's acquisition of JJB stores.' (1 May 2009) http://www.oft.gov.uk/news/press/2009/50-09 accessed 21 July 2019.

[68] JJB Sports Plc, 'Notice of Move from Administration to Dissolution' (6 October 2015) https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history?page=1 accessed 22 July 2019.

[69] 'What happened with BHS' (*AFP blog,* May 2016) https://afpservices.co.uk/afp-blog/what-happened-with-bhs accessed 12 July 2019.

[70] A Foster, 'BHS collapse: look back at the departmental store's history' (*Express UK* , 25 April 2016) https://www.express.co.uk/news/uk/664161/BHS-Collapse-British-Home-Stores-History-Department-Store-Rise-Fall-Timeline accessed 12 July 2019.

BHS into a private company and further acquired other high street retailers including Topshop, Burton, Evans, Dorothy Perkins and Wallis, making BHS the second largest retailer in the UK after Marks and Spencer. In March 2015, Sir Philip sold the company to Dominic Chappell for £1, a development which attracted lots of criticisms since Chappell had been bankrupt twice in 2005 and 2009.[71]

The internal causes of its financial distress have been attributed to huge pension deficit of £571 million, property costs, prolonged mismanagement, poor business strategies and importantly the inferior nature of the BHS brand when compared with other brands.[72] Its external problems were mainly poor trading conditions.

The losses incurred by the company in the year ending 30 August 2014 was £69 million.[73] This loss was due to withdrawal of credit cover by trade credit insurers for most of BHS's group's major supplies.[74] This had an adverse effect on the cash flow of the group.

A CVA was needed to address the large amount of property costs that the company had accrued. In the current retail landscape, most of the company's stores were enormous and most of them had upward-only rent reviews which were entered into a long time ago. The company had been unable to sell or surrender several properties or to renegotiate

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[71] S Goodley 'Dominic Chappell and the BHS take over that alarmed Retail watchers' *The Guardian* (25 April 2016).

[72] E Curwen, 'Five Issues at the Heart of the BHS Story' (*BBC*, 29 April 2016) https://www.bbc.co.uk/news/business-36175250 accessed 12 August 2019; 'House of Commons Work and Pensions and Business, Innovation and Skills Committees, BHS' (2016) HC https://publications.parliament.uk/pa/cm201617/cmselect/cmworpen/54/5402.htm accessed 18 July 2019, 54.

[73] SHB Realisations Limited, 'Statement of Administrator's Proposal' (Companies House, 22 June 2016) https://find-and-update.company-information.service.gov.uk/company/00229606/filing-history?page=8 accessed 22 July 2019, 3.3

[74] Trade credit insurance is an insurance policy that ensures that in the event of insolvency of a customer, a supplier will still be paid. Upon becoming aware of any adverse information affecting a company or imminent insolvency, suppliers may begin to withdraw their insurance because they risk losing out and having their invoices uninsured upon insolvency. For a discussion of withdrawal of credit cover, see S Njobeni, 'Credit Insurers 'Step Up Withdrawal of Cover' as Economic Weakness Persists' (BusinessDay, 8 April 2019) https://www.businesslive.co.za/bd/companies/financial-services/2019-04-08-credit-insurers-step-up-withdrawal-of-cover-as-economic-weakness-persists/ accessed 12 January 2021.

the rent payable to reduce its cost base. After many years of increasing losses, the company appointed joint administrators to propose a CVA in March 2016 which was focused on revitalising the business of the group.

The CVA focused on three major areas: “align rents with market levels and exit loss making stores, reduce central overheads and reduce the store cost base.”[75] The proposed terms of the CVA included dividing the company’s premises into three categories and imposing restrictions on the different landlords’ rights.

BHS had 164 stores, for 77 stores all rent and other lease liabilities were to be paid in full; rent reductions of between 50% and 75% were sought for 47 stores; for the remaining stores, BHS proposed rent reductions of 75%.[76] Without landlord approval, the stores were to be shut down, leaving landlords to find new tenants.

The rights of other unsecured creditors were to be paid in full under the terms of the CVA. The CVA was approved by the creditors. Even though the company secured the support of creditors for rent reductions of up to 75% at 87 stores, the proposal was dependent upon the company raising £100m for continued trading through different means.

However, it became clear that the company had insufficient funds to continue to trade in the short-medium term and it was impossible to rescue the company as a going concern. Consequently, a month after proposing the CVA, the company went into administration in April 2016.

The CVA continued during the administration process because the administration order did not lead to a breach of the CVA terms or a termination event. Eight months into

[75] Ibid.
[76] Ibid.

administration, the company moved to creditors' voluntary liquidation (CVL) which also did not constitute a breach of the terms of the CVA or a termination event.[77]

Clause 25.8 of the CVA entitled any landlord creditor to send a notice demanding payment within 14 days of sums due within the categories set out and if payment were not made, a further notice could lead to the termination of the CVA once the company receives it. The company had failed to make payment in respect of the rental amount due to landlords.

Consequently, Prudential Assurance one of the landlord creditors served the relevant notices on the company and the CVA terminated accordingly in November 2016. The CVA contained a provision with the effect that if the company ended up in liquidation, any landlord was entitled to send a notice demanding payment with 14 days of sums due within the categories set out in the CVA and if payment were not made, a further notice could be sent to terminate the CVA upon receipt of the notice by the company.

Upon termination, Clause 25.9 took effect which stated that: [78]

"…compromises and releases effected under the terms of the CVA shall be deemed never to have happened such that all landlords and other compromised CVA creditors shall have claims against BHS limited that they would have had if the CVA proposal had never been approved."

Prudential Assurance had leased two properties to BHS and was one of the landlords who had their leases compromised under the CVA. The rent payable to prudential was to be paid at a reduced rate for the period set out in the CVA. Prudential claimed that since the CVA had been terminated, they were entitled to claim the full pre-CVA rent, and as

[77]SHB Realisations Limited, 'Notice of Completion of Voluntary Arrangement' (Companies House 20 January 2017) https://find-and-update.company-information.service.gov.uk/company/00229606/filing-history?page=7 accessed 22 July 2019.

[78] *SHB Realisations Limited (Formerly BHS Limited) (In Liquidation) v. The Prudential Assurance Company Limited* [2018] Bus L.R 1173, [2018] B.C.C 712.

the administrators had occupied the premises for the advancement of the purpose of administration following their appointment, the rent which had been incurred during that period ought to be paid as an administration expense.

As a result of this, the liquidators approached the court for clarifications contending that: the said clause 25.9 was a penalty and thus not enforceable; the clause was in violation of the *parri passu* principle on liquidation and since it only took effect after the administration had ended, the claim for the pre-CVA rent should not be paid as an administration expense.[79]

The court held that the clause was not a penalty clause. It simply reinstated the landlord's right to full rent. Also, the clause did not breach the *parri passu* principle since the rationale behind the CVA terms was to ensure that landlords would not be in a disadvantaged position if the CVA was terminated. Thus, the reduced rent only continued when the CVA was in force.

Lastly, the court held that the full rent due was rightly payable as an administration expense, it was always a contingent liability whilst the CVA continued. The court clearly stated that for any period during which the administrators used the leaseholds premises, they were liable to pay as an expense of administration. This case demonstrates that landlords who agree to a rent reduction as part of the CVA with tenants who continue to trade under the CVA will be entitled to the full amount of rent due upon failure of the CVA.[80]

During the CVA, secured creditors and preferential creditors were paid in full.[81] The prescribed part provisions was applicable here since the company granted a floating

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[79] Ibid.

[80] *SHB Realisations Limited (Formerly BHS Limited) (In Liquidation) v. The Prudential Assurance Company Limited* [2018] Bus L.R 1173, [2018] B.C.C 712 [44].

[81] SHB Realisations Limited, 'Administration Progress Report' (Companies House, 11 January 2017) https://find-and-update.company-information.service.gov.uk/company/00229606/filing-history?page=7 accessed 12 August 2019, 5.1-5.4

charge to one of its creditors. No returns were made to unsecured creditors of the company.[82]

5.2.4. **Case Study 4- New Look**

New look was established in 1969. It is a British global fashion retailer with a chain that sells womenswear, menswear, and clothing for teens.[83] The group's operations are located mainly in the UK, but it has international reach in major global markets.[84] The company is one of the largest operators of the UK high street and has 606 stores with a staff of over 18,000 and three distribution centres.[85]

The internal cause of its distress was a shift in the commercial strategy adopted by the company. "Not only did the Group shift focus from its proven, traditional customer to a "younger" and "edgier" profile, but it also over-committed to stock ahead of the season."[86]

This development led to a loss of flexibility in trading into trends which resulted in commitment to products that did not attract the right customer. In other to be able to sell the products, the company required a significant discounting to enable the company to commence the new financial year and launch new products in spring and summer.

External causes of financial distress include the challenging retail environment exacerbated by a decline in consumer confidence, macro-economic conditions, increase in business rates which affected the occupancy costs of the company, increasing competition from online retailers amongst others affected the trading performance of the company and the financial position of the business.

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[82]SHB Realisations Limited, 'Notice of Completion of Voluntary Arrangement' Companies House Dated 20 January 2017) https://find-and-update.company-information.service.gov.uk/company/00229606/filing-history?page=7 accessed 12 August 2019.

[83] 'Over 40 Years off New Look' https://www.newlookgroup.com/who-are-we/our-history accessed 29 August 2019.

[84] New Look Retail Group Limited, 'Annual Report' (7 June 2018) https://www.newlookgroup.com/system/files/uploads/financialdocs/fy18-annual-report-12-06-2018.pdf accessed 1 February 2019, 3-5.

[85] Ibid.

[86] Ibid.

The rent payable to landlords under the lease portfolio was a significant fixed cost that was a burden for the company. The company had significantly over rented store portfolio compared to comparable market rates. Consequently, to maintain the solvency of the group, there was need to address the rental payments which had become unsustainable.

The company pursued both financial and operational restructuring strategies. In terms of its financial strategy, it announced a debt-for-equity deal with a group of major stakeholders that saw a slash in its debt from £1.35million to £350million.[87] This was needed to secure the future of the company. The operational initiative which focused on the CVA was used to re-align the property portfolio of the company to market rents. This enabled the company to shut underperforming stores and avoid going into administration or ultimately liquidation.

The proposal identified 60 out of its total 593 stores in the UK for potential closure as well as a further 6 sites which are sub-let to third parties. It sought rent reductions ranging between 15% to 55% across 393 stores over a 3-year period.[88] Furthermore, it provided for a compromised lease fund of £600,000 to enable compromised landlords share in the upside of the company. The CVA received 98% creditor approval. The company however failed to comply with its obligations under the CVA, consequently the supervisors terminated the process.[89] Secured creditors and preferential creditors were not affected under the CVA, and they were paid in full. However, it was reported that no distribution was made to unsecured creditors because of this termination.[90]

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[87] E Jahshan, 'New Look Pursues Debt-for-Equity Swap After Lacklustre Christmas *Retail Gazette* (*Retail Gazette*, 14 January 2019) https://www.retailgazette.co.uk/blog/2019/01/new-look-pursues-debt-equity-swap-lacklustre-christmas/ assessed 1 July 2020.

[88] Ibid.

[89] New Look Retailers Ltd, 'Notice of Completion of Voluntary Arrangement' (Companies House, 15 September 2020) https://find-and-update.company-information.service.gov.uk/company/01618428/filing-history accessed 14 September 2021, 8

[90] Ibid 3.

Due to the impact of the pandemic on the retail industry specifically and the UK economy generally, a second CVA was launched a year after, as part of a wider restructuring exercise which involved a scheme of arrangement of its finance creditors.
The aim of the second CVA was to reset 402 UK stores to a turnover rent model and propose a 3-year rent holiday for 68 of its stores.[91] Landlords were given enhanced break rights to terminate the lease if a potential tenant that could offer better terms is found. Importantly, the proposal did not include any store closures or job losses.

The turn-over based model was heavily criticized by the British Property Federation. They argued that the proposal was inaccurate and the CVA was used to rewrite leases rather than being used as a temporary measure and as part of a rescue plan to enable the business to continue trading as a going concern.[92] Even though the CVA was approved by creditors, it was subsequently challenged by some landlords on grounds of jurisdiction, unfair prejudice, and material irregularity, all of which were dismissed by the court.[93]

The CVA is still ongoing at the time of writing. Secured and preferential creditors received full payment of their claims and were not affected by the CVA, while it was reported by the supervisors of the CVA that a dividend will be paid to unsecured creditors, it has not been paid up until November 2021 as shown in the latest supervisor's progress report filed in Companies House.[94]

5.2.5. Case Study 5. Debenhams

[91] 'New Look Announces Company Voluntary Arrangement Proposal '(26 August 2020) https://www.newlookgroup.com/pressreleases/new-look-announces-company-voluntary-arrangement-proposal-0 accessed 20th September 2020.
[92] S Wood, 'New Look's CVA Proposal Criticized' (27 August 2020) https://www.punchline-gloucester.com/articles/aanews/new-look-cva-proposal-criticised-by-british-property-federation-has-store-in-cheltenham- accessed 1 September 2021.
[93] Lazari Properties 2 Limited and others v New Look Retailers Limited, Butters and Another [2021] EWHC 1209 (Ch). [330]. This has already been discussed in Chapter 3 of this thesis.
[94] New Look Retailers Ltd, 'Notice of Supervisor's Progress Report in Voluntary Arrangement' (17 November 2021) https://find-and-update.company-information.service.gov.uk/company/01618428/filing-history accessed 29 November 2021.

The history of Debenhams dates to 1778. The company was one of the UK's clothing and goods retailers. Following several years of business acquisitions from retail to manufacturing, Debenhams ltd was incorporated.[95] By 1950, the business was classified as the largest department store in the UK, owning 84 companies and 110 outlets. However, after decades of success, sales began to drop, and the company announced a profit warning of about 26% plunge and a share drop of 12% in 2013.[96] This was attributed to poor weather which affected its sales.[97]

Analyst argue that the company's problem dates back to the early 2000s when its former private equity owners sold off the freeholds of the stores in order to raise money.[98] In addition to this, an outdated fashion style which has left its store portfolios very dull has also been attributed to its financial woes.[99] As described by the veteran retail analyst Richard Hyman; "About 25 years ago the company came up with designers at Debenhams then they didn't change it, to the extent that some of the designers are still same now. For a long time, they have failed to apply the general retail principles of innovating and constant change."[100]

The company secured a short-term loan of £40million from its lenders to secure the future of the business.[101] This was dependent on the company meeting certain covenants and

[95] 'The rise and decline of Debenhams' (25 October 2018) https://www.insider.co.uk/news/debenhams-shares-dividend-history-loss-13477002 accessed 29 August 2020.
[96] ibid
[97] Debenhams Plc. 'Interim Management' Statement' '(31 December 2013) https://www.investegate.co.uk/debenhams-plc--deb-/rns/interim-management-statement/201312311021286436W/ accessed 12 July 2020.
[98] B Chapman 'What went wrong for Debenhams and how can the department chain turn things around?' *The Independent* (10 September 2018).
[99] S Butler 'The Problem with Debenhams-it's not just indebted, it's dull.' *The Guardian* (13 April 2019).
[100] Ibid.
[101] Debenhmas PLC. 'Update on Refinancing Discussions' (12 February 2019) https://www.investegate.co.uk/debenhams-plc--deb-/rns/update-on-refinancing-discussions/201902120700076977P/ accessed 10 July 2019.

milestones such as ‘the possible provision of equity or debt financing to Sports Direct International plc (“SDI”) one of its major shareholders.[102]

The company was unable to fulfil the conditions of its loan agreement and consequently, Debenhams was put into administration, wiping out its shareholders.[103] The company through a pre-packaged administration was sold to a newly incorporated company controlled by its secured lenders. It announced its CVA plan to restructure its store portfolio and balance sheet to secure the future of the company in the long term.[104] Two CVAs were proposed- one for the main trading entity (Debenhams Retail Limited) and the other for Debenhams Properties Limited a subsidiary of the company.[105]

The main terms of the CVAs include reducing 166 UK store portfolio by closing 50 stores. A CVA fund of £25 million was made available to compromised creditors upon implementation of the CVA. The CVA was approved by 94.7% of Debenhams creditors. On 11 June, Sports Direct and Combine Property Control (CPC) a group of landlords challenged the CVAs.[106] The ground of challenge has already been considered in the previous chapter.

5.2.6. Case Study 6. Home Base

Home base is a British home improvement retailer and garden centres which was founded in 1979. It was sold to an Australian company in 2016 after which the owner divested its stake to Hilco Capital a restructuring firm for £1.[107] The company had hoped to turn

[102] Debenhams Plc, ‘Administrators Appointed to Debenhmas PLC’ (09 April 2019) https://www.investegate.co.uk/debenhams-plc--deb-/rns/administrators-appointed-to-debenhams-plc/201904091140036359V/ accessed 19 August 2020.
[103] Ibid.
[104] Debenhams PIC. ‘Debenhams CVA Plan to Restructure Store Portolio’ (26 April 2009) https://www.investegate.co.uk/Index.aspx?searchtype=2&words=debenhams&pno=1 accessed 12 June 2020.
[105] Ibid.
[106] Debenhams PLC ‘Challenge to CVAs’ (11 June 2019) https://www.investegate.co.uk/debenhams-plc--irsh-/rns/challenge-to-cvas/201906111558148702B/ accessed 12 July 2020..
[107] A Woodhouse, ‘Wesfarmers Agrees Sale of Homebase’ *Financial Times* (London, 25 May 2018).

around its business within three years by going back to its former lines of product such as soft furnishings to address the extremely difficult market conditions and huge store portfolio.[108]

However, over 70% of its stores were losing money which led to more than 10% fall in sales in the year to June 2018.[109] The internal cause of its problem was bad strategy adopted by its former management who in an attempt to grow its international expansion strategy, tried to rebrand the stores as Bunnings which was a successful DIY chain in Australia. They scaled back on some of its products including curtains, cushion, and other homeware sales, focusing instead on building materials which did not resonate with consumers.[110]

This lack of knowledge of the UK market coupled with the decision to abandon certain products led to a loss of between £300million to £230million and closure of some of its stores.[111] External causes of financial distress has been attributed to weak consumer confidence, reduced consumer spending and inability to keep up with competition, which had an adverse effect on its trading position.[112] As a result, the company launched a CVA in 2018. The purpose of the CVA was to rationalise the company's lease portfolio and other onerous liabilities. The terms of the Homebase CVA proposal include closure of 42 of its 241 stores and payment of between 25-90% reduced rents on 70 other stores.[113]

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[108] A Szajna-Hopgood '11,000 Jobs at Risk as Homebase Votes on CVA' (Retail Gazette, 31 August 2018) https://www.retailgazette.co.uk/blog/2018/08/homebase-faces-make-break-vote/ accessed 12 November 2020.
[109] J Eley, 'Creditor Agreemement Shows 70% of Homebase Stores in the Red' *Financial Times* (London, 24 August 2018).
[110] Ibid.
[111] Szajna-Hopgood (n 112); J Smyth, 'Wesfarmers Admits to Botched Homebase Takeover as it Closes Stores' *Financial Times* (London, 5 February 2018).
[112] C Morrsion 'Homebase Faces Mak-0r-Break Vote on Rescue Plans' *The Independent* (London, 31 August 2018) https://www.independent.co.uk/news/business/news/homebase-store-closures-job-losses-rescue-plan-vote-cva-a8516086.html accessed 18 July 2019.
[113] Szajna-Hopgood (n 112).

The changes to its store portfolio automatically put 1,500 jobs at risk. The CVA did not affect the rights of secured, preferential, and ordinary unsecured creditors. The creditors affected by the proposal were mainly landlord creditors. The proposal however included a ring-fenced fund for compromised creditors to the tune of £3million. In addition to the CVA, the company implemented a turnaround plan which focused on improving and stabilising the financial performance of the company over a period of 3 years.[114]

The owners of the company agreed to add £25million to the deal if the CVA is approved by creditors. If creditors reject the CVA, the likely alternative was administration which would put 11,000jobs at risk.[115] Some of its landlords had purported to challenge the CVA terms claiming that the proposal was too aggressive.[116] However, the CVA received overwhelming support of 95.92% of its creditors.[117]

The CVA as proposed was to last for 3years however, it was terminated 18months after implementation of the CVA. The company had renegotiated most of its leases and improved profitability. Compared to 70% of its stores which were loss making before the CVA was initiated, it was reported that "more than half of its stores were now profitable".[118] Compared to a loss of £114.5million in 2018, the company recorded £3.2m overall financial performance for the year ended 29 December 2019.[119]

During the operation of the CVA and the turnaround plan, the company executed some key initiatives including "rebuilding ranges, strong cost control, margin management and

[114] HHGL Limited, 'Notice of Completion of Voluntary Arrangement' (Companies House, 02 July 2020) https://find-and-update.company-information.service.gov.uk/company/00533033/filing-history accessed 3rd July 2021.
[115] Szajna-Hopgood (n 112).
[116] Ibid.
[117] Ibid.
[118]J Eley, 'Homebase to Exit CVA Early After Returning to Profit' Financial Times (London, February 27 2020).
[119] HHGL Limited, 'Notice of Completion of Voluntary Arrangement' (Companies House, 02 July 2020) https://find-and-update.company-information.service.gov.uk/company/00533033/filing-history accessed 3rd July 2021

expanding its digital platform."[120] From the approval date till it was terminated, the CVA and turnaround plan achieved: move from monthly to quarterly rents across the portfolio, rent reductions across unviable stores, downsizing of stores that were too large for the current market, reduction in business rates amongst other things.[121] As seen, the improvement in the financial performance of the company coupled with the key initiatives that was borne as a result of the success of the CVA led to early conclusion of the CVA.

5.2.7. Case Study 7: Mother care Plc

The company is an international retailer that sells products for expectant mothers and generally merchandise for children of up to 8 years merchandise.[122] It was founded in 1961 by two entrepreneurs.[123] Over the years, the main internal cause of its problems was frequent changes in its management team. Changes in management began from 2011 up until 2017 and this meant that when one chief executive implemented a turnaround plan, upon replacement, their successor would have to complete it.[124]

External causes of its financial distress include rising costs, failure to adapt to modern market due to underinvestment in online business and its inability to differentiate itself from its competitors.[125] Kids wear is ubiquitous, and the company failed to differentiate its brands from that of other retailers.

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[120] ibid 2.

[121] Ibid.

[122] PWC, 'Information Regarding the sale of Specific Assets of Mothercare UK Ltd ("MUK or the "Company") on 5 November 2019 as Required by Statement of Insolvency Practice No. 16 (SIP 16). https://www.pwc.co.uk/business-recovery/administrations/assets/Mothercare/mothercare_sip16.pdf%20accessed%2021%20November%202021 accessed 21 November 2021.

[123] N Cope, 'Mothercare Chief Executive Ousted after Fourth Profits Warning in Under a Year' *The Independent* (16 July 2002) https://web.archive.org/web/20080422164758/http://www.independent.co.uk/news/business/analysis-and-features/mothercare-chief-executive-ousted-after-fourth-profits-warning-in-under-a-year-648407.html accessed 12 November 2021.

[124] Ibid.

[125] ibid

Following a period of declining sales,[126] the company sought measures to stabilize the business and maintain its going concern value. Sequel to this, a financial restructuring via a debt and equity refinancing of the company, and an operational restructuring through the initiation of a CVA to reduce its store portfolio were proposed.[127]

The former will provide funding of up to £113.5m to the company via different means including equity capital raising of £28m by way of firm placing and new equity issue, shareholder loans to the tune of £8m were to be gotten from some of the company's largest shareholders among other things.[128]

The later involved "an accelerated reduction of the UK store estate to reduce losses and rent liabilities and will be effected through the CVA proposals."[129] The CVA proposals was tailored around closing 50 of its store portfolios and seeking rent reductions on 21 others.[130] The CVA proposals will not affect other creditors save for landlords and some intra-group creditors. It was envisaged that if approved, these creditors will have a greater return than will be the case in an alternative insolvency procedure such as administration.[131] A compromised lease fund of £1m was set up to be paid to landlord creditors falling under Category 3 premises.[132] The CVA was approved by creditors of the company in June 2018.

[126] Mothercare Plc, 'Trading Update' (12 April 2018) https://www.investegate.co.uk/mothercare-plc/rns/trading-update/201804120700036413K/ accessed 12 November 2021.
[127] Mothercare Plc, 'Refinancing and Restructuring'(17 May 2018) https://www.investegate.co.uk/mothercare-plc/rns/refinancing-and-restructuring/201805170700023594O/ accessed 13 November 2021.
[128] Ibid.
[129] Ibid.
[130] Ibid.
[131] Mothercare Plc, 'Comprehensive Debt and Equity Refinancing of the Company' https://www.mothercareplc.com/~/media/Files/M/Mother-Care/documents/annual-reports/refinancing-and-restructuring-17-05-18.pdf accessed 17 November 2020.
[132] ibid

During its operation, according to the receipts filed by supervisors in Companies House,[133] the company continued to fulfill its ongoing rental payments to category 1,2 and 3 landlords, some landlords of categories 2 and 3 leases exercised their proprietary rights to terminate their leases and recover possession.[134] The CVA was fully implemented and completed in September 2018. This means that the duration of the CVA was 4months.

The CVA did not result in the improvement in the company's performance. Even though the international franchise business remained profitable, the UK arm continued to be loss making. As a result, two months after the CVA was completed, the company entered administration and was sold via a pre-pack administration to Mothercare Global Brands Ltd. In 2019, the company announced that its products will now be sold in Boots stores across the UK.[135]

5.2.8. Case Study 8: Mamas and Papas

The company was a mother and baby retailer established in 1981 in Huddersfield.[136] By 2011, it was regarded as the UK's best-selling nursery brand.[137] However, the company recorded pre-tax losses of £12.1m for the year to March 2014.[138] According to accounts filed at Companies House, the company recorded sales falling from 6.35% over the year

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[133] Mothercare UK Limited, 'Notice of Termination or Full Implementation of Voluntary Arrangement' (Companies House 28 September 2018) https://find-and-update.company-information.service.gov.uk/company/01950509/filing-history accessed 12 December 2021.

[134] Ibid 2-4.

[135] Mothercare PLC, 'Mothercare's New UK Franchise Partner' (13 December 2019) https://www.investegate.co.uk/mothercare-plc/gnw/mothercare-s-new-uk-franchise-partner/20191213131532H9104/ accessed 10 November 2020.

[136] Mamas & Papas, Wikipedia https://en.wikipedia.org/wiki/Mamas_%26_Papas accessed 17 November 2021.

[137] 'Yorkshire Determination and Italian Design & Ndash; It's a Winning Combination' *The independent* (10 July 2011).

[138] G Goldfingle, 'Mamas &amp: Papas Landlords Approve CVA Safeguarding its Future' (Retail Week, September 10, 2014) https://www.proquest.com/docview/1561151431?accountid=14664 accessed 6 November 2020.

to £91.5m from £97.7m in the previous year.[139] It also recorded an earnings before interest, taxes, depreciation and amortization (EBITDA) loss of £8.6m.[140]

In 2013, the company secured loans of £5 and £4m to enable it to ameliorate its losses and continue trading, however, it breached its banking covenants in March and sought third party investment.[141] Similar with other retailers, the company experienced several financial pressures which affected its trading performance.

Internal cause of its problems was inappropriate strategies. External causes were attributed to “general economic conditions in the UK” including decline in consumer confidence and spending, competition from online retailers and supermarkets who are selling the same line of products, rising costs, rising business rates.[142]

The company commenced a CVA in 2014 to reduce its store portfolio from 60 to 28. Its private equity owner (BlueGem) injected £20m in exchange of a majority stake in the business.[143] Under the terms of the CVA proposal, creditors were divided into three categories based on the financial performance of each store.

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[139] M Petah, ‘Mamas &amp: Papas losses Widened TO [POUNDS] 12.1m in the Year Before CVA’ Retail Week (January 20, 2015) https://www.proquest.com/docview/1646878616?accountid=14664 accessed 1 July 2020.

[140] T Holland, ‘Mams & amp: Papas Demands up to 50% Rent Reductions as Part of CVA’ Retail Week (27 August 2014) https://www.proquest.com/docview/1556659694?accountid=14664 accessed 13 August 2020. EBITDA loss is used to gauge a company’s long-term growth potential. Analysts use this formula to make comparisons between companies and to project a company’s long-term profitability and decipher its ability to pay off future financing.

[141]Holland (n 144)

[142] Mamas and Papas Retail Limited, ‘Notice of Administrator’s Proposals’ (Companies House, 15 November 2019) https://find-and-update.company-information.service.gov.uk/company/01950509/filing-history accessed 21 November 2021; M Petah, ‘Mamas &amp: Papas losses Widened to [pounds] 12.1m in the Year Before CVA’ (*Retail Week*, January 20, 2015) https://www.proquest.com/docview/1646878616?accountid=14664 accessed 1 July 2020.

[143]‘Mamas & Papas CVA Approved’ (7 July 2014) https://www.companyrescue.co.uk/guides-knowledge/news/mamas-and-papas-cva-approved-3517/ accessed 12 May 2019‘Mamas & Papas Landlords Face Rent Cuts’ The Estates Gazette (August 23, 2014) 26.

25 stores were classified as "adequately performing" (green stores) had their rent payment moved from quarterly to monthly and were largely left unaffected under the proposal. 25 stores were classified as "unviable" and a 50% rent reduction was sought from landlords of these stores.[144] Rent payment on 10 stores were to be cut by 25%.[145] Landlords would receive between £150,000- £450,000 from a compromised lease fund set up for affected landlords to share.[146]

It was envisaged that if creditors approve the proposal, they will receive 19p to 21p at the lowest estimation compared to nil returns if the company fell into administration.[147] The proposal was voted through by creditors in 2014. During the pendency of the CVA, unsecured creditors claim amounted to £2.8m approximately, and of this they received a dividend of £150,000 (being 5.4p in the pound) which was funds paid from the compromised lease fund set up for category 2 & 3 landlords.[148] All other creditors were unaffected by the CVA. The CVA was successfully completed in 2017.

However, the company's trading position worsened after the completion of the CVA because of the challenging retail environment. Ultimately, it entered administration in 2019 and was sold via a pre-pack to its owners.[149] Ultimately, the company was dissolved in 2021.[150]

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[144] Goldfingle (n 142).
[145] Ibid.
[146] T Holland, 'Mamas & amp: Papas Demands up to 50% Rent Reductions as Part of CVA' Retail Week (27 August 2014) https://www.proquest.com/docview/1556659694?accountid=14664 accessed 13 August 2020.
[147]Ibid.
[148] Mamas & Papas Limited, 'Notice of Termination or Full Implementation of Voluntary Arrangement (Companies House, 14 November 2017) https://find-and-update.company-information.service.gov.uk/company/04992387 accesed 19 March 2019, 11.
[149] Mamas and Papas Limited, 'Notice of Administrator's Proposals' (Companies House, 15th November 2019) https://find-and-update.company-information.service.gov.uk/company/04992387 accesed 22 July 2020.
[150] Mamas & Papas limited, Final Gazette Notice Companies House (Dated 7 August 2021) https://find-and-update.company-information.service.gov.uk/company/04992387 accessed 18 July 2020.

5.2.9. Case Study 9- Toys R Us

The company was a children toy retailer founded in 1984 in the USA. It was known for its out-of-town retail park super-store format, something which is known for "low cost and extensive choice."[151] This format paved way for the company to expand to become the main multinational toy retailer in the US.[152] By 1998, the business had 1,452 stores. However, it was soon overtaken by Walmart to become the US biggest toy retailer. What paved the way for Walmart was the incorporation of on-line retailing in its business operation.[153]

Toys R Us began online retailing in 1988. It experienced some implementation problems which led to a new competitor entering the market with a larger market capitalization than the company.[154] In response to this the company partnered with Amazon to become its sole supplier of Toys. However, amazon began offering the products of competitors claiming that the inventory of the company was not exhaustive.[155] While Amazon continued to expand, Toys R Us was tied into Amazon and this ultimately weakened its brand and sales, which led to a reduction in its share price.[156]

It was purchased by private equity firms in 2005, and they changed its status to a private company.[157] The aim was to increase the company's sale position for a stock offering

[151] A Nicolaou K Scannell, 'Toys r Us Buckled Under Private Equity Pressure'. *Financial times* (London, 20 September 2017); J Spross; How Vulture Capitalists ate Toys R Us' *The Week* (London, 16 March 2018).
[152] J Morgan M A Nasir, 'Financialized Private Equity Finance and the debt Gamble: The Case of Toys R Us' (2021) 26 New Political Economy, 455, 463.
[153] Ibid.
[154] Ibid.
[155] Ibid.
[156] T Rozhon A Sorkin, 'Three Firms are said to buy Toys R Us for $6 billion' *The New York Times*, (New York, 17 March 2005).
[157] B Biron E McDowell 'Inside the Wild and Tumultuous History of Toys R Us, A Once Beloved Children's Brand that Just Closed its Last 2 Stores in the US (Insider, 2 February 2021) https://www.businessinsider.com/the-tumultuous-history-of-toys-r-us-photos-2020-8?r=US&IR=T#in-2005-a-conglomerate-of-private-equity-firms-including-bain-capital-kohlberg-kravis-roberts-and-vornado-realty-trust-purchased-toys-r-us-for-66-billion-taking-the-company-private-in-the-process-15 accessed 19 September 2021.

which would provide money for investors. To compete more effectively in online retailing the company purchased two online retailers (Etoys.com and Toys.com) in 2009.[158]

Despite this acquisition, the chain continued to struggle with its trading performance;[159] its full year financial statement for 2016 recorded a loss of £673million down from a profit of £2.6million the previous year,[160] which led to the company filing for bankruptcy protection under Chapter 11 in 2017.[161] The company was unable to control its debt and operate its 1,600 stores worldwide and subsequently entered liquidation in 2018.

It's UK arm started experiencing difficulties as many suppliers stopped deliveries in the UK.[162] The internal causes of its problems were too much debt, failure to adapt to changing consumer behaviors, poor management, poor store merchandise, failure to adapt to digital transformation.[163] External factors include intense competition from rival retailers and macro-economic conditions.[164]

The company filed for a CVA in 2017 to improve cash flow and sustain the store portfolio of the company. It proposed closure of 26 of 105 stores which were loss making and sought a reduction of rent on other stores. One of its main creditors- the Pension Protection Fund (PPF) had threatened to vote against the CVA due to the huge pension deficit owed by the company. It was requested that the company pay £9.8 million a year

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[158] Ibid.

[159] S Halzack 'Why Toys R Us is Still Struggling Even As The Wider Toy Industry Booms' (*Washington Post*, April 14, 2017) https://www.washingtonpost.com/news/business/wp/2017/04/14/why-toys-r-us-is-still-struggling-even-as-the-wider-toy-industry-booms/ accessed 12 November 2021

[160] B Stevens, 'Toys R Us: What Went Wrong? (Part I)' (*Retail Gazette*, 20 March 2018) https://www.retailgazette.co.uk/blog/2018/03/toys-r-us-went-wrong-part-1/ accessed 1 November 2020.

[161] TM Andrews, 'Toys R Us Files for Bankruptcy, The Latest Victim of the Retail Apocalypse' (*Washington Post*, September 19, 2017) https://www.washingtonpost.com/news/morning-mix/wp/2017/09/19/toys-r-u-s-files-for-bankruptcy/ accessed 18 November 2021.

[162] Stevens (n 164).

[163] A Harting, 'Toys R Us: How Bad Assumptions Fed Bad Financial Planning Creating failure' *Forbes* (20 September 2017); A Nicolaou K Scannell, Toys r Us Buckled Under Private Equity Pressure. *Financial times* (London, 20 September 2017).

[164] Toys "R" Us Limited, 'Notice of Administrator's Proposal' (Companies House, 12 April 2018), p5.

into its pension's deficit.[165] The company agreed to the PPF's demand and the CVA was subsequently approved in December 2018.

However, the CVA was insufficient to turn around the fortunes of the company and the company experienced liquidity constraints.[166] It was unable to meet its continued obligations under the CVA. The company incurred £15millom in value added tax (VAT) debt, which ultimately led to entry into administration.[167]

5.2.10. Case study 10: Paperchase Products Ltd

The company is an international stationary and greeting cards retailer founded by 2 art students in the UK in 1968.[168] The company has over 130 stores in the UK and 30 sites abroad with 2000 employees.[169] The company recorded pre-tax loss of £6.3m in the year ending February 2018.[170]

The causes of its problem have been attributed to the structural changes affecting the retail sector, reduced footfall, rising costs.[171] As a result, the company launched a CVA to reduce the store portfolio by exiting unprofitable stores, secure rent reductions on non-viable stores and switch to turn-over based rental agreements to reduce the fixed cost base of the business.[172]

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165 B Stevens, 'Toys R Us: What Went Wrong? (Part II)' (*Retail Gazette,* March 22, 2018) https://www.retailgazette.co.uk/blog/2018/03/toys-r-us-went-wrong-part-2/ accessed 12 November 2021

166 Toys "R" Us Limited 'Notice of Termination or Full Implementation of Voluntary Arrangement' (Companies House, 28 February 2018).

167 Stevens (n 169).

168 https://en.wikipedia.org/wiki/Paperchase

169 Paperchase, 'About Paperchase' https://www.paperchase.com/the-journal/about/ accessed 12 November 2021.

170 E Jahshan, 'Creditors Greenlight Paperchase's CVA' (*Retail Gazette*, March 22, 2019) https://www.retailgazette.co.uk/blog/2019/03/creditors-greenlight-paperchases-cva/ accessed 1 August 2019.

171 J Eley, 'Paperchase uses CVA to Seek Sales-Based Rents' *Financial Times* (London, March 4, 2019).

172 Paperchase Products Limited, Notice of Administrators Proposal' (Companies House, 4 February, 2020) p9.

Under the terms of the CVA, rent reduction was sought at 100 of its stores. Of these, 28 were to pay 50% rent for three months after which the company will decide whether to close the stores or seek a rent-free period.[173] The company closed some loss-making stores as part of the process and 70 stores moved to turn-over based rent i.e., rent payment based on the company's trading turnover. 45 stores were to remain largely unaffected by the terms of the CVA.

Landlords were separated into six different categories and rent was compromised on different terms based on the financial performance of each category. Landlords were offered a "guaranteed base rental income of between 35% to 80% (payable regardless of sales) which is then "topped up" based on the performance of individual stores."[174]

The creditors approved the CVA in March 2019. During the pendency of the CVA, one of its lenders provided £16million to support the running of the daily affairs of the company.[175] The CVA was completed in August 2019 in line with the terms of the proposal. According to the supervisor's receipt filed in companies house, the company made payment to some landlords as set out in the proposal.[176]

The company continued to trade as a going concern until March 2020, when the UK economy was affected by the pandemic. The company was able to rely only on its e-commerce business as all shops were closed for a period of three months to curb the adverse effect of the pandemic.[177] Due to inability to secure funding from its lenders, the company entered administration in January 2021, after which the business was sold through a pre-pack to one of its lenders.[178]

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[173] Jahshan (n 174).
[174] D Singh, 'The changing landscape of retail CVAs- are landlords taking back control?' (*lexology*, 19 June 2019) available at https://www.lexology.com/library/detail.aspx?g=81c7455e-426f-45f0-b3c0-51b88c13f7a6 accessed 21 June 2019.
[175] Paperchase Products Limited, Notice of Administrators Proposal' (Companies House, 4 February, 2020)p9.
[176] Paperchase Products Limited, 'Notice of Termination or Full implementation of Voluntary Arrangement' (Companies House, 20 August 2019) 3-4.
[177] ibid 9.
[178] Ibid 8.

Key Findings

1. **CVA Commencement and Issues Arising.**

Starting with the commencement of the CVA, all the cases entailed altering the terms of profitable stores, exiting underperforming stores and restructuring rental obligations altogether, depending on the individual circumstance of each company. This suggests that a company can propose terms that suit the individual circumstance of the business to guarantee the viability and survivability of the business.

Recall that it was submitted earlier that the division of leases into categories followed a basic legal structure of division into 3 categories. Majority of the companies in the case study had their leases divided into up to 7 categories. This demonstrates the flexibility of the CVA process and clarifies that there is no one size approach to lease categorization in retail CVAs. Although, it can be argued that more lease categorization could make the process complex which stands the risk of subjecting the CVA to a court challenge.[179]

In terms of the use of a moratorium, since all the companies in the study are large companies, they did not qualify for the Schedule A1 moratorium introduced by the Insolvency Act 2000. The alternative moratorium available to these companies is the moratorium available under the administration procedure. To further justify the fact that the uptake of the CVA moratorium was low when it existed, none of the companies under study except Stylo made use of a moratorium. Only Stylo entered a CVA having first been in administration, thus benefiting from the moratorium available under that procedure.[180] All the other companies initiated the CVA as a standalone process.

[179]Herbert Smith Freehills, 'Retail CVAs: Trends and Future Direction' (2018) https://www.herbertsmithfreehills.com/insight/retail-cvas-trends-and-future-direction accessed 18 January 2019.

[180] Insolvency Act 1986, schedule B1, paragraph 42.

As demonstrated by some of the case studies, majority of businesses that undergo a CVA do not achieve what they set out to do at the onset of the process. In all the cases, the JJB's first CVA, Mothercare, Mamas & Papas, Paperchase, and the Home Base CVA were successfully implemented according to the terms of the proposal, this presents a contrasting fortune with the other companies in the case study.

The Stylo CVA did not make it to the approval stage as its proposal was not approved by creditors, the New Look's first CVA saw some slight fulfilment of its CVA terms but the lifespan of the CVA was cut short because of the adverse effect of the COVID-19 pandemic on trading, Toys R Us, BHS, and Debenhams CVA were both terminated without achieving the terms of the proposal. This explains the reasons for the outburst of landlords over the CVA process.

They are regarded as the creditors often compromised in a CVA proposal and their investments have been severely affected by their use over the years. Likewise, they can sometimes be voted through by other less affected creditors. In a loan restructuring for example, the major creditors who are compromised by the process would usually insist on receiving an equity stake in the business as part of the restructuring, however, this is usually not the case in a leasehold CVA.

As a result, landlords are becoming critical of the CVA process and are seeking to "share the gain" with the tenant company as part of any retail CVA which requires them to "share the pain." Due to this, CVA provisions including upside sharing clauses, (as seen in JJB, Home Base, Debenhams, Paperchase, Mothercare, Mamas & Papas and New Look), termination clauses with landlord break rights, (as seen in Stylo, JJB, New Look) reinstatement of landlord claims to pre-CVA rent if the CVA fails, (as seen in BHS), have all been part of CVA proposals to remedy the imbalance of interests between the company and its landlords.

The "upside sharing" mechanism is one way of getting creditor support on the proposal. This tool serves as a profit share mechanism which involves an increased return to a landlord if certain profits/turnover thresholds are met. The whole idea behind upside sharing is that in exchange for rent reduction and support for the CVA, landlords would receive incentives such as a guaranteed base rental income which could increase based on the performance of individual premises. Upside sharing could also take the form of an equity stake in the business where a landlord could receive a share in the equity value of the company when a sale is conducted in the future. This mechanism is not a compulsory element in CVAs, although its absence in a CVA proposal nay raise questions of fairness but this will be considered by examining the proposal as a whole.[181]

However, as seen, not all the companies in the case study included "upside sharing" in their CVA proposals. A typical example is the Stylo, BHS and Toys R US CVA proposals. Although in the Stylo CVA, landlords commented that they felt more pain than gain given the nature of the CVA proposal. It is perhaps unsurprising that the proposal was rejected by creditors. This does not however suggest that the inclusion of "upside sharing" is a pre-requisite to receiving creditor approval. In cases where no such factor was included in the proposal, the CVA still gathered enough creditor support as seen in BHS and Toys R Us cases.

It must however be pointed out that the BHS CVA included similar provisions to upside sharing in form of a provision allowing the landlord to claim the full amount of rent due if the CVA fails. This suggests that simply allowing landlords to bear the brunt of the CVA is not enough, there must be a sufficient "give and take."

Whilst landlords are required to take the pain in form of compromised leases and rents, this has led to landlords receiving Nil or little returns for these reductions. To further exacerbate this issue, other creditors are paid in full, and their interests are usually not affected by the CVA. The upside sharing approach on the flipside allows landlords to be rewarded by a higher return if the CVA is successful and allows the company to continue

[181] 'Company Voluntary Arrangements Challenges' (Squire Patton Boggs, 30 June 2021) https://www.squirepattonboggs.com/-/media/files/insights/publications/2021/08/company-voluntary-arrangements-cvas-support-for-the-retail-and-hospitality-sector-and-considerations-for-landlords/cva_challenges_quick_guide.pdf accessed 1 June 2022.

trading profitably. Thus, this thesis advocates for the inclusion of upside sharing or similar provisions in retail CVA proposals as an incentive to help strike the much-needed balance between compromised creditors and the company.

A somewhat similar approach to "upside sharing" identified in three of the cases (Stylo, New Look and Paperchase) and is increasingly becoming a trend in retail CVAs, is a "turnover rent arrangement". This is a major departure from the traditional open market contractually agreed rates with upwards only rent review clauses. The turn-over based rental model is a form of rent which is calculated in part or whole by reference to the trading turnover which the tenant company generates from the premises.[182]

The traditional open market rental calculation method which has been widely accepted by landlords and their tenants provides predictable tenant costs and landlord returns and allows clarity for valuation purposes.[183] However, it is inflexible and often unsustainable in a market downturn.

As aptly described by one commentator, "the fixed nature of rental payments leaves tenants with little room to maneuver to adapt to changing market pressures, even when central balance sheet costs are aggressively reduced."[184] Changes in the retail landscape especially the move from bricks to clicks coupled with the impact of the COVID-19 pandemic have led to the choice of turnover based rents as landlords and tenant companies seek to find a workable compromise amidst the challenging economic conditions. The inclusion of this mechanism into lease agreements has emerged as a tool in alleviating financial difficulties for retailers wishing to restructure their leases.

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182 Baker McKenzie 'Turnover Rents as a Tool in CVAs: Sharing the Risk and Reward' https://insightplus.bakermckenzie.com/bm/attachment_dw.action?attkey=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQJsWJiCH2WAXW59W9rh3JQWRFq5vwNmVN&nav=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQbuwypnpZjc4%3D&attdocparam=pB7HEsg%2FZ312Bk8OIuOIH1c%2BY4beLEAeHXuMC4YCCH4%3D&fromContentView=1 accessed 1 August 2021

183 S Walker, 'The Return of Turnover Rents? Lessons from CVAs in the retail and Casual Dining Sector' (*Travers Smith blog*, 2020) https://www.traverssmith.com/knowledge/knowledge-container/2020-the-return-of-turnover-rents-lessons-from-cvas-in-the-retail-and-casual-dining-sector/ accessed 1 November 2021.

184 Ibid.

Where a retailer's sales are seasonal, a turn-over based rent allows the business some sort of breathing space to trade profitably outside its peak season by reducing rent to a sustainable fixed figure or a percentage of the market rental value. Such rent model creates a business relationship between the landlord and the tenant and could in turn be beneficial to both parties.

It requires both parties to ensure that the business in question is successful. Where a tenant business generates a high turnover, the landlord will receive a higher rent. If the business struggles, the landlord will receive a considerable amount, but the tenant is not required to pay rent that is unsustainable to the landlord.[185] Nevertheless, there is usually a form of "guaranteed base rent" payments to landlords where turn-over based rent model is adopted.[186]

On the flipside however, "the uncertainty inherent in turn-over based rent can bring with it a reduction in income for a landlord and may cause damage to the value of the reversion if the turnover lease is capable of being assigned."[187] In the Stylo CVA, the CVA was rejected by landlord creditors because of the deemed uncertainty that a turnover based rental arrangement would have on their investment. In the Paperchase CVA on the other hand, the turnover rent component formed part of the arrangement proposed to landlords. The turnover rent feature allowed the company and the landlords to equitably share risk

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[185] S Richards, 'What is Turnover Rent and Who Does it Benefit' (*Lexology*, January 7 2021) https://www.lexology.com/library/detail.aspx?g=ab0d902d-9af8-4f8a-99f5-6c434dc514f8 accessed 12 December 2020.

[186] Baker McKenzie 'Turnover Rents as a Tool in CVAs: Sharing the Risk and Reward' https://insightplus.bakermckenzie.com/bm/attachment_dw.action?attkey=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQJsWJiCH2WAXW59W9rh3JQWRFq5vwNmVN&nav=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQbuwypnpZjc4%3D&attdocparam=pB7HEsg%2FZ312Bk8OIuOIH1c%2BY4beLEAeHXuMC4YCCH4%3D&fromContentView=1 accessed 1 August 2021.

[187] H Sladen, 'Tenant Insolvency: CVAs and Landlords: Part 1' (2011) 9 Landlord and Tenant Review, 15, 17.

between each other and reduce the pressure of cashflow amongst other benefits.[188] The CVA was successfully implemented with no court challenge brought by creditors.

However, landlords are increasingly becoming critical of turnover based rents, and it is common for them to require that “at the end of the CVA “rent concession period” (typically 2-3years), rents revert to the previous contractual rates.”[189] A challenge was raised by some landlords to the New Look CVA, where they claimed that the modifications to the terms of the leases including a switch to turnover rent was unfair to them, the court held that the CVA presented landlords with a choice between terminating their leases and accepting a financial return better than administration or remaining in the leases but on reduced rent and modified terms.[190] Since the landlords had not elected to choose the former option, they could not claim that they were unfairly prejudiced by the terms of the CVA. Consequently, the challenge failed on this ground. Thus, it remains that the court will deal with this issue on a case-by-case basis.

Even though this type of rent model creates a business relationship between a landlord and the tenant company, it remains that the optimal benefit which it seeks to achieve is often lost since most of these companies end up in an alternative insolvency procedure.

2. CVA Outcomes

From the series of cases in this study, there were three possible outcomes for retail CVAs. They were either implemented in accordance with the original or modified proposals, terminated early, or were ongoing at the time of conducting this research. Both JJB and New look present a contrasting fortune.

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[188] ‘CVA Market Update’ (*Kirkland & Ellis International LLP*, 31 October 2019) https://tma-uk.org/uploads/site-files/nextGen_London_CVA_Presentation_31_October_2019_(002).pdf accessed 12 September 2021.

[189] Baker McKenzie ‘Turnover Rents as a Tool in CVAs: Sharing the Risk and Reward’ https://insightplus.bakermckenzie.com/bm/attachment_dw.action?attkey=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQJsWJiCH2WAXW59W9rh3JQWRFq5vwNmVN&nav=FRbANEucS95NMLRN47z%2BeeOgEFCt8EGQbuwypnpZjc4%3D&attdocparam=pB7HEsg%2FZ312Bk8OIuOIH1c%2BY4beLEAeHXuMC4YCCH4%3D&fromContentView=1 accessed 1 August 2021.

[190] Lazari Properties 2 Limited and others v New Look Retailers Limited, Butters and Another [2021] EWHC 1209 (Ch).

The companies initiated the CVA twice, which may have been because of issues with the financial position of the companies. While JJB 's 1st CVA was successfully implemented with returns made to creditors according to the terms of the CVA, the New Look's 1st CVA was terminated early due to its inability to comply with its obligations under the terms of the CVA. Upon termination, no returns were made to unsecured creditors. The second CVA of JJB was also terminated due to same challenges in New Look. The 2nd CVA of New look is still ongoing at the time of writing this thesis.

Of the other companies which initiated a CVA once, Home Base, Mothercare, Mamas & Papas and Paperchase had their CVA implemented in accordance with the terms of the proposal, others including BHS, Toys R Us, Debenhams and Stylo had theirs terminated early due to the same reasons given for the termination of New Look's 1st and JJB's 2nd CVAs respectively, save in Stylo where its CVA was rejected by creditors for being insufficient to create a real compromise between creditors and the company. The numbers of CVAs terminated early is significant. The reasons given for early termination include inability to meet obligations under the CVA, non-payment of rental amount due and difficulty in trading after the CVA was implemented.

On its face, early termination of a CVA will mean that the CVA has not achieved its aims and thus unsuccessful. However, this assertion should be carefully examined as it has been argued that early termination does not necessarily mean that the CVA has failed.[191] Of the 10 cases examined, 4 had their CVA terminated between 12-36months after commencement.[192] In these 4 cases, some contributions which had accrued were distributed to unsecured creditors which were monies held on trust for them.[193]

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[191] P Walton C Umfreville L Jacobs, Company Voluntary Arrangements: Evaluating Success and Failure (R3, May 2018) https://www.icaew.com/-/media/corporate/files/technical/insolvency/publications/cvas-evaluating-success-and-failure.ashx accessed 24 July 2018, 3. (Walton and Others CVA).
[192] JJB's first CVA lasted for 1year and 2months, New Look's first CVA duration was 1year 6months, Mamas and Papas- 3years 2months, Home Base; 18months.
[193] *Re NT Gallagher & Sons ltd* [2002] BCLC 13.

Of the CVA's which were implemented, all but Home Base moved into an insolvency process shortly after the completion of the CVA. It has been submitted elsewhere that in this circumstance, the CVA operated as a distribution mechanism rather than a company rescue procedure.[194] It should be noted that the reason why most companies end up in administration after implementation of the CVA is due to difficulty in trading post-CVA. However, where a CVA is fully implemented and not followed by an immediate insolvency process, the company appears to perform reasonably well. This was the case in Home Base where the full implementation of the CVA resulted in improvement in the company's financial performance, the company has continued to trade as a going concern whilst meeting its obligations under the terms of the CVA.[195]

As recorded by the company, its turnaround plan had a positive effect on its financial performance compared to a loss of £3.2m overall financial profit for the year ended 29 December 2019.[196] The robustness of a company post CVA without entry into a follow-up immediate insolvency process was also reported in the R3 research project.[197]

The high termination rate leading to the failure of CVAs amongst the cases examined casts doubt on the suitability of the CVA for these companies in the first place. A CVA is only a part of the solution and in isolation may not generate an expected outcome for a company which has failed to make underlying changes to its business. As noted by Walton and colleagues, "often directors do not implement necessary changes or fail to identify and tackle fully the problems identified in the CVA".[198] Thus, it is submitted that for a CVA to generate optimal benefits for the company and its stakeholders, the first step is for the directors of the company to identify whether its problems can be ameliorated by initiating a CVA.

[194] Walton and Others CVA (n 191).
[195] Home Base, 'Notice of Termination or Full Implementation of Voluntary Arrangement' (Companies House, 23 June 2020) 2.
[196] Ibid
[197] Walton and Others CVA (n 191).
[198] ibid

3. CVAs and Impact on Creditors

CVAs are generally accepted by creditors because it offers them a better result than they would realize in an alternative insolvency procedure. Trade creditors will be supportive of CVAs because they might be able to retain a customer in the near future.

Creditors have little to lose by agreeing to a CVA proposal which will deliver a better return to them than in administration or liquidation: payments made into the CVA post implementation will be held on trust for them by the supervisor of the CVA,[199] and where the CVA falls short of expectations, they are entitled to prove for the balance in a subsequent insolvency procedure.[200] Therefore, "the CVA would appear to offer, firstly, a share in any payments made into the arrangements and, if it fails, the possibility of a dividend through the subsequent realization of the assets of the insolvency company."[201]

Most of the cases recorded little or no payments being made into the CVA post implementation. The premature termination of CVAs means that the company has depleted assets which would have been available where the company enters liquidation or administration. This means that creditors are infact placed in a worse off position.

Considering the position of creditors in retail CVAs, generally, secured creditors are often not affected by a CVA as it is impossible for the CVA to affect the rights of secured creditors without their consent. The information available on the level of secured debts in each of the company was scarce or non-existent. Where information was available, it was expressly stated that these creditors were not affected by the CVA proposal or there were no secured creditors.

Arguably, this further confirms the submission that the level of secured debt is usually low in CVAs, and it is possible that CVAs are being used by companies where there is little

[199] S Frisby, *Report on Insolvency Outcomes: Presented to the Insolvency Service* (26 June 2006), 55-56.
[200] Ibid.
[201] S Frisby A Walters, '*Preliminary Report into Outcomes in Company Voluntary Arrangements'* March 2011 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792402 accessed 10 March 2018,19.

or no secured debt owed.[202] However, the presence of secured creditors will not in any way affect the success or implementation of a CVA. This is because they are "well-insulated as regards the procedure and might be content to allow the company to proceed in the knowledge that if matters deteriorate, they will still be able to have recourse to their security".[203]

Like secured creditors, there was also little information available on the position of preferential creditors. The reason may be borne out of the fact that the implementation of a CVA proposal would have secured the employment of these creditors.[204] Where information was available, it was shown that they received their returns in full. The case is different for unsecured creditors as they are the major creditors in a retail CVA context.

The CVA proposals contained information on the expected returns and dividends for these creditors under the CVA. Of the 10 cases examined, these creditors received their payments in 5 cases, no returns were made to them in the remaining 5. Suffice to say that the procedure does not regularly result in high levels of returns for unsecured creditors. This point was also noted by Walton and his colleagues where they stated that the average dividend paid to unsecured creditors was often not substantial and was typically between 10 and 20 pence in the pound.[205]

4. Length of CVAs

In terms of duration of CVAs, retail CVAs are typically proposed to run for 3years, this is contrary to perceived norm of the 5-year duration of most CVAs as noted elsewhere.[206] as seen in all the cases, based on the reports filed by the supervisors at Companies House, the CVAs as proposed were to last for 3years, although it is open to the directors and nominee to propose any length for the arrangement as they deem fit. In the case

[202] Ibid.
[203] ibid 22.
[204] Ibid.
[205] P Walton C Umfreville L Jacobs, 'A Snapshot of Company Voluntary Arrangements: Success, Failure and Proposals for Reform' (2020) 29 International Insolvency Review 267, 274. (A Snapshot of CVA).
[206] Ibid 275.

studies, only one company had its CVA run for more than 36months. (Mamas & Papas). The other nine companies had a duration of between 2months-24months.

On this basis, it appears that where a CVA terminates, it tends to occur very early. Given that most of the CVAs in the case study ended in administration and some liquidation with an insolvent outcome recorded in some cases where creditors were paid nothing, it is not surprising that the duration of these CVAs was relatively short, since they would have been terminated prematurely due to failure of the CVA.

5.3. Factors Affecting the Success of Retail CVAs and Proposed Recommendations

There are factors that have been identified as the root causes of the problems in retail CVAs.[207] The first main factor inhibiting the success of CVA stems from the lack of legislative clarity, this is because the present legislation governing CVAs has not kept pace with their innovation.[208] Essentially, the legislation governing CVAs are brief and lacking in detail. There is no guidance under the Act detailing how a debtor should approach its leasehold obligations, and instead market practice has been developed in this regard.

This lack of legislative clarity has led to CVAs been used by debtor companies to tailor the CVA proposals to suit the circumstances of the company even where this could come at the detriment of the landlord. For instance, a CVA has been used to re-write contracts, vary the terms of the lease beyond the CVA period, remove the company's obligation to give an authorised guaranteed agreement on assignment; (AGA), trigger rent reviews at the end of the CVA, amongst other things.[209]

[207] British Property federation, 'Company Voluntary Arrangement (CVA) Briefing' (2018) https://bpf.org.uk/media/3474/bpf-cva-briefing-2020.pdf accessed 12 January 2021. (BPF CVA Briefing).
[208] ibid 14.2.
[209] ibid paragraphs 46-48.

Given that there is no clarification on the extent to which this can be allowed, it is possible for the process to be abused. Moreover, retail CVAs undermine a major principle in insolvency law which is equality amongst creditors. This is so because under the CVA, similarly situated creditors (in this case, unsecured creditors) are treated differently and the present legislation does nothing to prevent this. In fact, debtors find it very easy to evade this principle. To further exacerbate the issue, as seen across the series of CVA challenges that have come before the courts, judges rarely require the debtor company to present any meaningful evidence that a creditor, for example a supplier, is critical to the business and would cease doing business with the company unless it is paid in full. It is thus suggested that legislation should provide expressly clear boundaries within which the CVA can operate.

To prevent any further abuse of the procedure, a case is made for an urgent review of CVAs which should lead to potential reforms of the process. Such reforms should aim to ensure that retail-CVAs operate for the purpose of rehabilitating the company and not simply used for cost-cutting purposes as is the case. Likewise, with regards to the treatment of similarly situated creditors, such reforms to the CVA procedure should include debtors demonstrating in their CVA proposals records that show the prospect of benefit to other creditors not considered as "essential to business continuity." This could be in form of strengthening the "upside sharing method" and making it a mandatory inclusion in CVA proposals.

The second reason for the ineffectiveness of retail CVAs is that the CVA does not require the company or IPs to adequately review the reasons for the decline in the company's operational performance.[210] Arguably, this explains why many companies that have initiated the CVA ended up in administration.[211] A successful CVA is a blend of the CVA itself, adequate restructuring exercise, refinancing and implementation of an effective turnaround plan.[212] Most companies identify the problems affecting their trading

[210] ibid paragraph 18.
[211] ibid paragraph 33.
[212] Ibid paragraph 34.

performance but fail to set out how these problems will be rectified to turn around the fortunes of the company. Instead, the focus has been on compromising creditors and cutting costs which only serve as a quick fix in the short term, and which is unviable in the long term.

It must be pointed out that most of the companies examined in the case study highlighted the internal and external factors affecting their profitability including over-expansion, poor-marketing, competition from rivals etc. These companies however failed to identify modes of addressing these problems. Even though some of the companies had their turnaround plans set out in full as part of the CVA proposals, what they did not do was identify how these measures was a potential fit for the company's situation.

This thesis therefore suggests that any potential reform to the process should contain a requirement for firms to highlight the yardsticks for measuring the effectiveness of turnaround plans identified in their CVA proposals. In other words, there should be greater legislative specificity on the content of CVA proposals. Further, it has been suggested that for a CVA to maximise its potentials, there should be adequate restructuring exercises that consider every aspect of the business, including the capabilities of the management of the company.[213]

Thirdly, the process suffers from a lack of proper oversight. Research has shown that directors do not act timeously when a company is in distress, and they fail to properly understand and assess what is needed to turn around the fortunes of the business.[214] The role of the IP is critical in this regard. He/she is required to scrutinize the proposals and assess its fairness. However, it has been submitted that majority of IPs do not carry out this responsibility efficiently and leave it in the hands of the directors since according to IPs the CVA is a company-led process, and it is not for them to perform the role of directors.[215]

[213] Ibid paragraph 20.
[214] A Snapshot of CVA (n 205) 276.
[215] ibid paragraph 38; B Adebola, 'The Case for Mandatory Referrals to the Pre-pack Pool' (2019) 32 Insolvency Intelligence, 74.

Given the antecedents of directors, leaving the crucial decision of rescuing the company solely in their hands is counterproductive. Even though IPs are not expected to perform the role of the directors since they are not involved in the day-to-day activities of the company and would only come into the picture when they are consulted by directors, it remains that creditors place so much reliance on the expertise of IPs to act as an intermediary between them and the company and assess the proposals for feasibility. The CVA proposals are often "overly optimistic" with some "setting out ambitious cash flow or collectibles predictions."[216] Regardless, IPs most often give these proposals a pass mark to go ahead, and creditors do not hesitate to approve the proposals knowing that an expert practitioner has reviewed it. Subsequent failure of the company typically few months after implementation leads to the conclusion that IPs are not performing their duties effectively.

As a result, it is easy for the process to be abused. If unsatisfied, creditors are left with no choice than to challenge the CVAs in court but as seen, a CVA challenge rarely inures to the advantage of a landlord. To further exacerbate this, the challenge is often costly and time consuming which is likely to further deteriorate the company's position. Also, the publicity such challenge gains especially in the media usually results in damage to the landlord's reputation. Consequently, it has been suggested that to boost confidence in CVAs, there should be an alternative means of assessing CVA proposals.[217]

One of such mode of assessment could be referral to an independent body such as the pre-pack Pool. This would solve the issue of transparency in CVAs without creditors having to resort to the judicial system and would provide additional level of scrutiny of the proposals. However, given the abysmal rate of referrals to the Pool,[218] due to its voluntary nature, the propriety of extending its scope to CVAs is questionable.

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[216] A Snapshot of CVA (n 205) 276.

[217] BPF CVA Briefing (n 207). paragraph 40.

[218] Pre-pack Pool Annual reports 2020 https://www.prepackpool.co.uk/uploads/files/files/PPP%20Annual%20Review%202020.pdf accessed 18 October 2021.

Also given that members of the Pool are themselves insolvency practitioners and retired accountants, it could be that having them give an opinion on the fairness of a proposal would be tantamount to doing the same thing that IPs who act as nominees and supervisors do, which would be recycling the same old problems. This thesis argues that in theory, extending the remit of the Pool to CVAs could be beneficial but may not be obtainable in practice.

Whilst the Pool can help foster creditor confidence in the process by thoroughly reviewing the terms of CVAs to sieve out unrealistic proposals, recourse to the Pool is voluntary and this accounts for the reason behind the low record of referrals to the Pool. There has been calls to make referral to the Pool compulsory,[219] and it remains that at present, the future of the Pool itself is bleak.[220]

Even though there has been a recent statutory instrument on the pre-pack Pool,[221] seeking to further increase transparency and unsecured creditors confidence in the process. It remains that here has been concerns on whether this Regulation will make any difference to the existing problems.[222]

Thus, this author opines that due to the voluntary nature of the Pool, until it is made mandatory, extending its remit to CVAs would make no difference. Rather, strengthening the role of the IP in assessing the CVA proposal could improve the process. This thesis advocates for the separation of the multiple roles played by IP in a CVA process. A case is made for a turnaround professional to oversee the CVA prior to approval in place of a nominee, whilst the IP should be left to supervise the CVA post approval.

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219 Adebola (n 215).

220 C Umfreville, "Taking the DIP into the Pool: Should the Pre-pack Pool Be Extended to CVAs" (2018) 11 Corporate Rescue & Insolvency 158.

221 The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021. (Pre-pack Regulations).

222 D Ampaw J Green, 'The New Pre-pack Regulations- Controls on Transactions to connected Parties' (*Lexology*, 14 April 2021) https://www.dlapiper.com/en/uk/insights/publications/2020/11/the-new-pre-pack-regulations/ accessed 1 September 2021.

Research has shown that turnaround specialists "offer a range of services that are rescue relevant".[223] These include "conducting independent business reviews, advising on financial, operational and managerial restructurings,"[224] amongst others. Their duty is mainly to make the critical decision of whether a distressed business can be reorganised.

They "review strategy, business operations and bring recommendations quickly and with certainty, often in days where cash is running out."[225] IPs are more attuned to commencing insolvency proceedings and recovery of assets for creditors,[226] as such they should not be involved in determining the decision to reorganise the company. Rather, their expertise can be brought in after such critical decision has been made.

Further, turnaround specialists are independent of the major creditors, and this means that the directors are less threatened by them which will yield more co-operation. Such independence by extension may also produce higher level of trust, especially in the minds of creditors. This allows more effective negotiations to be achieved on the rescue proposals something which IPs have battled with in the CVA process. In addition, another benefit of the nature of independence that turnaround professionals have is that such independence allows the free flow of information within the distressed company. Directors will have no reason to limit information since they know that the specialists have no biased interest of any party.

Even though such independence may be exaggerated since these professionals are mainly appointed by banks, it has been argued that nevertheless, it is the company and not the bank that pays these professionals, and as such they are obliged to act in the interests of their paymaster i.e., the company.[227]

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[223] V Finch, 'Doctoring in the Shadows of Insolvency' [2005] Journal of Business Law, 690, 703.
[224] Ibid.
[225] TMA, 'What is Turnaround' https://tma-uk.org/about/what-is-turnaround accessed 12 November 2021.
[226] J Flood and others, 'The Professional Restructuring of Corporate Rescue: Company Voluntary Arrangements and the London Approach' ACCA Research Report 45 (Certified Accountants Educational Trust, London, 1995) i.
[227] Finch (n 223).

Additionally, these professionals are repeat players in rescue-related activities and they have their reputation to protect, thus if their reputation is in doubt, this would affect any future work that may be available for them since "their success in achieving turnaround will in no small part turn on trust they are able to generate amongst stakeholders and on the authority with which they can deliver business reviews and proposals for reorganization, refinancing and so on."[228] Thus, for all these reasons, it is submitted that turnaround professionals can contribute to rescue and their rescue outputs may be valued in overseeing the CVA proposal in the period before it is put to creditors for approval.

The fourth factor affecting CVAs is the use of the procedure to target a particular class of creditors and manipulate votes. Even though there is no justification for it, CVAs are tailored around compromising debts owed to landlord creditors, yet their voting rights are hugely discounted by the IPs to secure votes on the plan. Critics argue that the voting discount is decided by the IP, and this is a clear conflict of interest.[229]

This affects the content of the CVA and the chances of approval as these creditors whose votes are discounted can be compromised heavily without the chance of voting retaliation.[230] Even where all affected landlords vote against a CVA, they would still be unable to block the CVA from going ahead due to the way the votes are manipulated. Arguably, targeting landlords in this way amounts to an abusive use of the CVA process for the promotion of individual, rather than collective goals, something which the law should prohibit.

It has been suggested that a statutory requirement should be introduced requiring the votes of unaffected creditors or those slightly affected under a CVA not to be counted "on

[228] Ibid.
[229] BPF CVA Briefing (n 207)14.8.
[230] Ibid.

the basis of their inherent conflict of interest with those creditors who are, in effect, funding the turnaround of the business."[231]

The fifth factor affecting the success of CVAs is the lack of transparency. Unsecured creditors are often not given adequate information on which to make an informed decision on, which is not the case for their secured counterparts. This is further exacerbated by the fact that with little knowledge of the CVA proposal, unsecured creditors are required to vote and support the turnaround.

It is submitted that in this scenario, these creditors will be unable to identify properly whether the CVA is the most appropriate course of action and whether they are treated fairly. Thus, this leaves the creditors sceptical about the process and require more information before they can give their support.

A further problem for creditors is the failure of many CVAs. Despite relying on the IPs judgment who in each case admits to the chances of success of the CVA proposed, only for the CVA to fail shortly after. This further casts doubt on the role of IPs in CVAs. It has been submitted that "either IPs and the firm make poor judgments on CVAs or perverse incentives are at play."[232] Similar point was also noted in recent research conducted by Walton and his colleagues,[233] where an interviewee questioned the veracity of the opinion given by IPs on the viability of the company.[234] It is submitted that all creditors should be given the relevant information necessary to make an informed decision on whether a CVA is the right course of action for them.

Lastly, lack of engagement prior to the launch of the procedure. Landlords are generally open to accept the differential treatment they get in a CVA as they recognise that CVAs are a necessity even though they cause short term pressure.[235] However, there is need

[231] ibid 30.
[232] ibid 35.
[233] Walton and others CVA (n 191) 57.
[234] Ibid.
[235] Ibid 59.

to engage them in the process, but this is usually uncommon, rather IPs prefer to engage with secured creditors and share information with these creditors but leave out unsecured creditors such as landlords. It is suggested that early stakeholder engagement in the process will facilitate cooperation and coordination amongst the company, IPs and creditors which is critical to the success of CVAs.

5.4. Conclusion

This chapter has attempted to examine the effectiveness of CVAs as a rescue mechanism for distressed retail companies. It finds that whilst CVAs can be a helpful restructuring mechanism, the strategic use of this rescue tool by distressed retail companies raises a lot of questions on its propriety especially considering the treatment of similarly placed creditors which has formed the crux of the issues in retail CVAs.

As seen in majority of the cases identified, whilst creditors enjoy beneficial outcomes (even though minimal) in the process in form of payment of funds due to them, it remains that majority of retail CVAs do not result in the rescue of the company. The simplicity envisaged by legislation when it was introduced has been overridden by its flexibility such that it has been used to a large extent to restructure leasehold obligations of retail companies. It remains that, this flexibility inherent in the procedure, deals a great blow on fairness. This is so due to the ability of the procedure to undermine the principle of equal treatment amongst creditors.

Majority of retail companies that undergo a CVA end up in administration and ultimately liquidation. The landlords bear the price of such failure: they suffer a loss of rental income, their investment value is significantly impacted by the process, they bear increased liabilities and benefit little from the CVA arrangement if it fails to rescue the company.

Consequently, this thesis argues that a CVA will not always be appropriate for every distressed retail company as evidenced by how quickly they fail. The underlying causes of a retail company’s problems cannot be solely addressed by a CVA. A business that has no prospect of generating profit or evolving in the challenging retail environment will often not survive under a CVA. Thus, retailers need to innovate and address the underlying challenges facing the business. This may involve making structural changes to the business where appropriate as well as pairing the CVA with a wider financial and operational restructuring.

However, there will be circumstances where the CVA will be the best course of action for the company. In this regard, certain recommendations have been made to enhance the effectiveness of the process. The first being legislative reforms to provide guidance on the operation of retail-CVAs. Such reforms should aim to ensure that retail-CVAs do not operate outside the province of rescue. In other words, they should not simply be used as cost-cutting exercises but as rescue procedure aimed at enhancing the going concern surplus in a distressed company. Likewise, with regards to the treatment of similarly situated creditors, debtor companies should be required to strike a balance between critical creditors and non-critical ones such that those identified as non-critical should also receive beneficial outcomes from the process.

The dual roles played by IPs in overseeing the pre-approval and supervising the post-approval process has been questioned. It has been suggested in this thesis that there is a potential role for turnaround professionals in performing the duties of the nominee and leaving the supervisory role for insolvency practitioners to perform. Likewise, it has been suggested that more transparency and engagement is needed in the process as this will facilitate cooperation and coordination amongst the main actors involved in the process, which is critical to the success of CVAs. The CVA remains an important rescue mechanism yet to achieve its optimal objective, it is important to scale back elements that block its effectiveness.

Given that the pre-pack is often the follow-on procedure for retail companies that go through a CVA, the next chapter will examine the role of pre-packs in retail insolvency cases.

CHAPTER 6

PREPACKAGED ADMINISTRATION: AN ALTERNATIVE APPROACH TO RETAIL INSOLVENCY

Introduction

In the previous chapter company voluntary arrangement (CVA) was examined to determine its effectiveness as a restructuring tool for financially distressed companies in the retail sector. It has been seen that the use of CVAs in retail insolvency cases rarely results in rescue of a financially distressed company. However, it remains that the CVA does generate beneficial outcomes for creditors.

Next to CVA, the pre-packaged administration (pre-pack) is the most prominent insolvency procedure in the UK retail industry.[1] As seen across the cases examined in the previous chapter, most CVAs that were implemented or terminated early ended in a pre-pack administration. With the rising number of retailers entering administration, the pre-pack which as discussed in Chapter 3 is a variant of the administration procedure, has become a popular method of selling the viable part a failing retail brand. Both CVA and prepacks allow the continuation of a business by the existing management although in different ways.

Likewise, it has been echoed by scholars and previous research on CVAs and prepacks that directors often prefer to pursue a pre-pack instead of a CVA due to the trading issues that often arise in CVAs and the effect of this process on the cash flow of the business.[2] It is thus imperative to consider the role that pre-packs play in retail restructuring cases. Given that CVAs do not ultimately lead to the rescue of the company, and most retail companies that exit a CVA end up in a pre-pack administration, the questions remain: to

[1] I Wallace C Edgington, 'House of Fraser Pre-pack: Still a viable option? (*White & Case*, 31 August 2018) https://www.whitecase.com/publications/article/house-fraser-pre-pack-still-viable-option accessed 1 November 2019.

[2] P Walton C Umfreville L Jacobs, Company Voluntary Arrangements: Evaluating Success and Failure (R3, May 2018) https://www.icaew.com/-/media/corporate/files/technical/insolvency/publications/cvas-evaluating-success-and-failure.ashx accessed 24 July 2018, 51 (Walton and others CVA).

what extent does the pre-pack mechanism facilitate rescue in retail insolvency cases? Do creditors fare better in a pre-pack than a CVA?

To this end, this chapter is divided into four sections. Section 1 gives an overview of the operation of pre-packs in retail insolvency cases. Section 2 provides a case study analysis of retail-prepacks. It identifies cases from retail CVAs examined in the previous chapter that ended in administration/liquidation and considers the impact and outcomes of the process on stakeholders. Section 3 examines the interplay between the CVA and pre-packs in the retail industry and finally, the chapter ends with some concluding analysis.

6.1. Operation of pre-packs in retail Insolvency.

Recall that, pre-packs refer to an agreement to sell all or part of an insolvent company's business and/or assets to a buyer, negotiated before the commencement of the administration, the transaction is then completed upon the appointment of the administrator. The use of pre-packs in administrations has been on the rise over the years. For instance, it accounted for 30% of all administrations in 2018.[3] Likewise, it has been regarded as the most used utilized business rescue procedure in England and Wales.[4] There have been several high-profile retail pre-packs over the years including JJB Sports, Stylo Plc, Debenhams, House of Fraser, Mother Care, Paperchase, Laura Ashley, Mamas & Papas to mention just a few.[5] A retail pre-pack involves a transfer of the viable parts of the business to a Newco as well as the brand, stock, and employees of the company.[6]

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[3] C Umfreville 'Pre-packaged Administrations and Company Voluntary Arrangements: The Case for a Holistic Approach to reform' (2019) 30 International Company and Commercial Law Review 581, 581.

[4] P Walton C Umfrielle P Wilson, 'Pre-pack Empirical Research: Characteristics and Outcome Analysis of Pre-pack Administration' http://data.parliament.uk/DepositedPapers/Files/DEP2014-0860/Report_to_the_Graham_review_by_the_Univers....pdf accessed 18 February 2020, accessed 1 December 2019, para 5.

[5] Centre for Retail Research, 'Whose Gone Bust' (2020) https://www.retailresearch.org/whos-gone-bust-retail.html accessed 1 October 2021.

[6] C Pikington I Wallance B Davies M Radlow C Draper, 'Pre-pack Rules Repackaged' (*White& Case*, 6 May 2021) https://www.whitecase.com/publications/alert/pre-pack-rules-repackaged accessed 1 July 2021.

A pre-pack can be problematic for unsecured creditors especially landlords. As already indicated, the key concern is their lack of involvement in the process. The pre-pack is effectively a done deal before they become aware of the sale. The purchaser will want to take on leases of profitable stores and leave behind unprofitable ones. This approach appears not to conform with the structure and drafting of modern commercial lease. Such lease will have restrictions on alienation in some form or other and a proviso for re-entry where rent is left unpaid, other breaches of tenant covenants and insolvency events such as administration.[7]

The purchaser of the business is often granted a license usually by administrators to occupy premises pending an application to the landlord for license to assign all the leases of the premises to the Newco. Majority of covenants in leases will contain information on a tenant's ability to assign or underlet which will also prevent a tenant from parting with or sharing possession or occupation of the premises.[8] The license to occupy premises often amounts to a breach of this covenant. The newco is effectively in occupation of the premises without the landlord's consent.

However, this is permissible because of the wide moratorium in force upon entry into administration which prevents landlords from forfeiting a lease, either by court proceedings or peaceable re-entry without seeking the permission of the administrators or the consent of the court.[9] A landlord's security contained in the proviso for re-entry will be unenforceable in so far as its enforcement is contrary to the purpose of administration and where the overall balancing exercise is in favor of the administration.[10] Thus, the

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[7] R Thomas, G Tolmie H Close, 'Forfeiture: The Right of Re-entry' (*Lexology*, 2 January 2019) https://www.lexology.com/library/detail.aspx?g=25b166c5-239a-4e9b-acd7-523c8652ab79 accessed 18 July 2021.

[8] D Drummond-Brassington C Peter, 'What is the Meaning of "Parting eith Possession"? (*Lexology*, 8 January 2013) https://www.lexology.com/library/detail.aspx?g=4d7c3842-6a88-49a7-a691-08aa47fb0351 accessed 17 July 2019.

[9] Insolvency Act 1986, Schedule B1, paragraph 43(4); C Lamont 'Pre-Pack Administrations and CVAs "Game On'- Landlords Fight Back (Landmark Chambers, 2009).

[10] C Lamont 'Pre-Pack Administrations and CVAs "Game On'- Landlords Fight Back (Landmark Chambers, 2009).

moratorium restricts the landlord's options. Many of the enforcement actions that can be taken would not be possible because of the moratorium.

If a landlord applies to court to take any of the enforcement actions which would lift the moratorium, it is unlikely that the court would give permission. In exercising its discretion, the court will balance the rights of the landlord against the rights of other creditors. *In Sunberry Properties Ltd v Innovate Logistics Ltd (in Administration),*[11] considering the impact of the moratorium on landlords, a landlord of a company in administration had been given permission to initiate court proceedings seeking the termination of a license to occupy premises, which was given to another company by the insolvent tenant company. On appeal however, the court overturned the decision because of the potential effect that such termination would have on the administration process.[12]

The outcomes for landlords under a pre-pack are; landlord of unprofitable leases will be left with an insolvent tenant, a likely empty store which they need to fill by finding a new tenant. Landlords of profitable stores which the company intends to take on, will find themselves in a better position albeit with a new unlawful occupier. Although the administrator may be paying rent to the landlord during the period the purchaser is occupying the premises, nevertheless the landlord is placed in a different position with an occupier it has no direct relationship with. This is because "such occupation is often unexpected and the landlord is frequently "left in the dark" regarding the terms or intended duration of the purchaser's occupation, making it difficult to plan ahead."[13]

In a buoyant market, landlord may proceed to forfeit the lease due to the tenant's insolvency, however, in the current market conditions, landlords will consider such arrangement as beneficial since the newco will assume the tenant covenants in the lease and pay rent. Thus, the landlord will not have to pay any money for empty premises.

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[11] [2008] EWCA Civ 1321.

[12] M Bonye, G Moore O Boehner, 'Tenants in Administration- What Landlords Need to know' (*Lexology*, 29 January 2013) https://www.lexology.com/library/detail.aspx?g=0d33aed5-8bce-42e1-8776-4bf49d14d1db accessed 12 July 2019.

[13] Ibid.

However, for this to be feasible, the lease will be assigned to the Newco with the landlord's consent. This will give the landlord an opportunity to negotiate a deal for payment of outstanding rent arrears with the Newco. It is still possible for the landlord to insist on the current terms of the lease such as provision of a rent deposit if it is permissible under the lease. The landlord may not accept a tenant covenant which is not sufficient to fulfill the obligations under the lease. Although, given the situation, the landlord may nevertheless accept such lesser covenant rather than accept an empty portfolio.[14]

In the past, where the Newco takes on the lease or part of it, the Newco would then be required under contractual arrangements with Administrators to seek the landlord's consent to assign all of the leases of the property to Newco.The challenge with such arrangement is that the Newco has to accept the lease the way it is i.e. together with all its debts and liabilities, which presumably will be over-rented, leaving the Newco with the same issue that led the company into administration.

However, there has been an increasing trend in recent pre-packs whereby Newco chooses not to be bound to seek the landlord's consent and take on all of the leases rather, Newco then elects to freely negotiate reduced rental terms with the landlord on the condition that the Newco could exit the premises thus leaving landlords with the option of looking for a new tenant.[15] Such approach is the reason why Newco pays a lower purchase price for the business.[16] The benefit of this approach from a landlord's perspective is that the landlord is more in control of the process and can choose not to accept new terms and seek a new tenant instead. Having established how pre-packs operate in retail insolvency, it is worth examining some real-life cases of prepack usage in the retail industry.

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[14] 'Tenant "pre-packs" The Impact on Landlords' (9 February 2009) https://www.cms-lawnow.com/ealerts/2009/02/tenant-prepacks-the-impact-on-landlords?cc_lang=de accessed 19 July 2021.

[15] A Spiers J Duffy J Middlemass A Bates, 'Tenant Insolvency- The Landlord's Position' (*Lexology*, 17 September 2020) https://www.lexology.com/library/detail.aspx?g=f92c5796-0cd9-4f25-bf3e-34e3f869f117 accessed 19 November 2021.

[16] Ibid.

6.2. Case Study

The cases that will be examined in this chapter are Stylo, JJB sports, Debenhams, Mamas &Papas, Mothercare, Paperchase and House of Fraser. Some of these companies have already been examined in the previous chapter, although the analysis only focused on the CVA process, it is important to examine the pre-pack process and identify comparable themes.

6.2.1. Background

The companies in the sample are fashion, children, home, greeting cards, stationery, and beauty retailers, which had initiated a CVA to restructure their property portfolios and reduce rents on some of these premises. However, the CVA was insufficient to turn around the fortunes of these companies and all experienced trading difficulties after initiating the process and ultimately led to their insolvency.

The insolvency of the companies led the companies in their different capacities to appoint administrators to assist with the management of the sale of the businesses. In all the companies except Debenhams, appointment of administrators was done out of court by the directors pursuant to paragraph 22 Schedule B1 of the Insolvency Act 1986, while it was the major lenders that appointed the administrators in Debenhams on the invitation of the directors.

In all the companies, the insolvency practitioners had prior professional relationship with the companies prior to their appointment as administrators. In some of the companies, the proposed administrators considered various courses of actions alongside a pre-packaged administration. For example, in JJB plc, prior to the appointment of the joint administrators, several courses of actions were considered by the joint administrators including seeking further money to avoid insolvency, winding down through a trading administration, sale of the business through a trading administration.[17]

All these options when reviewed were insufficient to return the company to a sustainable footing. Moreover, trading the company through administration was likely to pose significant commercial risk especially challenges in relation to stock, which will not be the case in a pre-packaged sale.[18] After due consideration, the pre-pack was regarded as the best option that would produce the best anticipated return to creditors. Likewise, in House of Fraser, amidst its financial problems, it was expected that a Chinese company (C banner) would rescue the company by injecting funds into the business. However, the deal fell through at the last minute because of C Banner's share price declining remarkably on the Hong Kong stock exchange.[19]

The company began an accelerated marketing process to identify potential investors who could acquire or invest in the group. However, all the offers proposed by the investors were evaluated and assessed and none could generate higher recovery for the creditors.[20]

In Debenhams, alternative options considered include seeking to rescue the company as a going concern, marketing the company's interests following administrator's appointment and liquidation. After weighing all the options, the administrators concluded that a pre-pack was the most viable for both the company and its creditors.

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[17] JJB Sports Plc 'Statement of Administrators Proposal' (Companies House, 21 November 2012. https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history?page=2 accessed 12 January 2020, 4.

[18] ibid 5.2.

[19] HFL Realizations Limited, 'Statement of Administrators' Proposal' (Companies Act, 20 August 2018) https://find-and-update.company-information.service.gov.uk/company/SC021928/filing-history 1.3.3

[20] HFL Realizations Limited, 'Statement of Administrators' Proposal' (Companies House, 20 August 2018) https://find-and-update.company-information.service.gov.uk/company/SC021928/filing-history Accessed 7 June 2020, Appendix B (SIP 16 Report)

In Mothercare, the company sought to initiate another CVA to restructure its operations, however, this option was ultimately not implemented.[21] In Paperchase, the company considered a continuance of trading the business in administration, however the lack of sufficient funds and unwillingness of stakeholders to provide further funding truncated this option. Other options considered include refinancing, a second CVA, liquidation and trading administration with a sale pursued during administration.[22] In Mamas & Papas, alongside the pre-pack, the company considered consensual negotiations with landlords, CVA feasibility review of the company and trading administration.[23] The pre-pack was identified as the most feasible option of the alternatives considered.

6.2.2. Sale Agreements

In Stylo plc, upon failure of the CVA to gain approval of creditors, the administrators of the company concluded that a sale of the business and assets of the company as a going concern was the best option that would produce return for the creditors of the company. The sale was completed for a consideration of £5.2m to the company's directors.[24] The consideration for the sale was paid upon completion save for some amount in relation to stock delivered during the administration.[25] This sum due was expected to be paid in instalments later. It was indicated in the administrator's report filed on Companies House that the transactions were carried out at a fair value and an extensive marketing exercise was conducted.[26] There was no specific timeframe given as to the duration of the marketing process.

[21] Mothercare UK Limited, 'Notice of Administrator's Proposals' (Companies House, 20 December 2019) 8.
[22] Paperchase Products Limited, 'Notice of Administrator's Proposals' (Companies House, 4 February 2021) (SIP 16) Appendix D.
[23] Mamas & Papas, 'Notice of Administrator's Proposals' (Companies House, 15 November 2019) SIP 16
[24] Stylo plc, 'Administrators' Progress Report' (Companies House, 10 March 2010) 8.
[25] Stylo plc, 'Statement of Administrator's Proposals' (Companies House, 31 March 2009) 8.
[26] Stylo plc, 'Administrators' Progress Report' (Companies House, 10 March 2010) 8. There was no specific timeframe given as to the duration of the marketing process.

In JJB plc, the directors instructed KPMG in 2012 to assist in seeking a buyer for the business. During the marketing process, 100 potential bidders were contacted, 25 signed a non-disclosure agreement (NDA). The deadline for indicative bids was 7th September 2012 which means that the business was marketed for about a week.

The offers received were analyzed by the administrators and was discussed with directors and the secured creditors who determined that the offer from Sports Direct International (SDI) a major competitor of the company, was the best offer because it offered certainty of outcome given that consideration will be paid upon completion. It also offered higher returns to creditors and mitigated preferential liabilities. The sale of majority of the business and assets of the company was completed for £23.8m.[27]

In House of Fraser, a major financial advisory company was instructed to carry out the marketing process and they identified potential investors in 2 August 2018. The advisors invited offers for the business in the form of acquisition of the group, further funding investment in the group or an acquisition of the whole or part of the group's assets or business. These interested parties included both trade parties and specialist financial investors.

The interested parties were required to provide confirmation of their interest alongside initial commercial proposals for any acquisition by 5 August 2018. This means that the marketing process was conducted within a three days' timeframe. Arguably, it is to be questioned whether the interested parties can be said to make an incisive decision within this short timeframe. However, the justification for the short timeframe may have been needed to protect further deterioration of value of the company's business or assets. It

[27] JJB Sports Plc 'Statement of Administrators Proposal' (Companies House, 27 November 2012) https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history?page=2 accessed 12 January 2020, Appendix 6 (SIP 16) report

was noted that “this accelerated timetable was necessary due to the deteriorating liquidity position of the Group.”[28]

Six parties made formal offers some outside the stipulated timeframe. The offers were assessed based on some metric including value, timing, and deliverability. Of the offers received, that of Sport Direct International (SDI) a major competitor of the company was regarded as offering the best possible deal for the business. It was regarded as a significantly better outcome when compared with other approaches.[29]

The administrators considered alternative options to the offer received from SDI. This included trading the companies as a going concern during administration. This was not suitable to the circumstance of the company because of the likely significant risks involved in securing continued support from major trading suppliers, possibility of these key parties seeking potential ransom demands, erosion of brand value, loss of employees and additional professional expenses.[30] All these factors would impact on the value of returns payable to creditors and could lead to lower returns compared to the offer from Sports Direct International. On 10 August 2018, the Joint Administrators completed a sale of substantially all the Companies’ business and assets to Sports Direct group for a consideration of £90 million.

In Debenhams, the proposed administrators marketed the business “to determine for the company’s benefit whether there was a bidder that would buy the group for a price that would repay the financial debt and secured liabilities in full and potentially yield a return

[28] HFL Realizations Limited, ‘Statement of Administrators’ Proposal’ (Companies House, 20 August 2018) https://find-and-update.company-information.service.gov.uk/company/SC021928/filing-history accessed 12 January 2020, 6.
[29] ibid 15.
[30] ibid 18.

for shareholders."[31] 70 potential interested parties were identified, which included both financial investment purchasers and strategic partners.[32]

A set threshold value was provided in the process letter sent to potential interested parties. If bids received were more than the threshold value and fully funded the administrator would require that Newco accept the offer and account for sums received in excess of the threshold value, if otherwise, it would be within the discretion of the Newco to accept the transaction. The first-round deadline for indicative bids in the sale process was 2 May 2019. Two offers were received. Both offers could not satisfy the threshold value and were rejected by the Newco. The company was sold to an entity owned my some of its secured creditors. The consideration paid for the transaction was £101.8m and was settled by the purchaser on completion. The form of consideration made was a discharge of the New Money Facilities Agreement which the company had entered to secure financing.[33]

In Mamas & Papas, the sale arrangement involved a sale of the assets and trade of the company. There was no marketing exercise conducted due to some reasons, one of which was the costly nature of the process.[34] The sale consideration paid comprised of cash paid to cover the estimated costs of administration and distributions to preferential and unsecured creditors, and credit bid being a release of BlueGem's secured debt; a major secured lender of the company.[35] The consideration of £1,693k approximately was paid in full on completion. The pre-pack pool was approached in this case given that the sale was made to a connected party. The Pool found that the evidence provided in some areas were limited, nevertheless a case of not unreasonable was made.[36]

[31] Debenhams plc, 'Statement of Administrators' Proposal' (Companies House, 13 June 2019) https://find-and-update.company-information.service.gov.uk/company/05448421/filing-history accessed 12 January 2020, 1.1
[32] ibid 1.1.
[33] Debenhams Plc, 'Notice of Administrator's Proposals' (Companies House, 28th May 2019) 41.
[34] Mamas & Papas Retail Limited, 'Statement of Administrator's Proposals' (Companies House, 15 November 2019) https://find-and-update.company-information.service.gov.uk/company/01529849/filing-history accessed 12 January 2020 accessed 12 January 2020. SIP 16 report, p13.
[35] Ibid.
[36] Ibid.

In Mothercare, the sale agreement involved the sale of the international franchise contracts and intellectual property of the company.[37] The company was sold to a company owned by the owners of the company. The consideration for the purchase was non-cash and it involved the assumption of certain liabilities of the UK company including the pension schemes and certain trade creditors.[38] A marketing exercise was conducted pre-appointment of the administrators which involved a sale process of the UK business mainly, but also afforded potential buyers the opportunity to bid for the whole Group.[39]

The process lasted from July-September 2019. 35 parties showed interest in the sale. Of this, two parties made indicative offers, but the offers did not progress to the final offer stage of buying either the business or the brand. Given that the sale was undertaken to a connected party, the purchaser had the option of approaching the Pre-pack Pool but did not approach the Pool given the time constraints involved.[40]

In Paperchase, the sale of some parts of the company's business and assets were undertaken. This included sale of the E-commerce business and associated infrastructure, intellectual property including brand, website, and customer lists amongst others.[41] Independent valuations of the business were conducted, and it was concluded that no other party would make an offer higher than that of the Purchaser. Instead of marketing the business for sale, a call option was carried out. This allows the transaction to be unwound if an alternative bidder is found within 28 days of the transaction, and the alternative bidder submits a viable and higher consideration.

[37] Mothercare UK Limited, 'Notice of Administrator's Proposals' Companies House (20 December 2019) 9.

[38] 'Information Regarding the Sale of Specific Assets of Mothercare UK Ltd ("MUK" or the "Company") on 5 Novemeber 2019 as Required by Statement of Insolvency Practice No 16 ("SIP16")' https://www.pwc.co.uk/business-recovery/administrations/assets/Mothercare/mothercare_sip16.pdf accessed 22 January 2020.

[39] Ibid.

[40] Ibid.

[41] Paperchase Products Limited, 'Notice of Administrators Proposals' (Companies House, 4 February 2021)5.

This alternative option to marketing process was said to provide additional comfort to the creditors that even though a formal pre-appointment marketing process did not take place, there is still an opportunity to unwind the transaction if this would result in enhanced recoveries to the creditors.[42] The business and assets of the company was sold to Permira Debt Managers Ltd (PDM), a main secured creditor of the company. The consideration for the sale was #40m structured by way of a credit bid, which facilitated an immediate distribution to PDM thereby reducing the company's indebtedness to PDM.[43] The sum of £32m was payable on completion of the sale and another £8m was to be paid after five weeks.[44]

6.2.3. Pre-pack outcomes

Of the 7 companies in the case study, only in House of Fraser, Mothercare and Paperchase is the Newco (Purchaser) still trading. As a result, it may be impossible to ascertain whether the purchaser will indeed survive ultimately for a long period of time. In the other 4 cases, the purchaser had gone into a subsequent insolvency process or struck off the register of companies as shown in the filings of the administrators with Companies House. This means that the company had failed. In Debenhams, three months after its pre-pack administration, the company entered another administration to prevent its collapse into liquidation.[45]

The process was a "light touch administration" which allowed the directors of the company to run the business rather than the administrators.[46] The company sought to protect itself from the threat of legal action from suppliers who were submitting winding-up petitions over unpaid debts of £600 owed to them.[47] Through its light-touch administration, the

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[42] Ibid 6.
[43] Ibid 5.
[44] Ibid.
[45] P Sweet, 'Debenhams in Second Administration in a Year' (*Accountancy Daily,* 7 April 2020) https://www.accountancydaily.co/debenhams-second-administration-year accessed 117 November 2021.
[46] J Kollewe, 'Debenhams up for Sale in Last-Ditch Bid to Avoid Liquidation' *The Guardian* (London, 26 July 2020).
[47] Sweet (n 45).

company sought ways for the business to exit the administration including a sale to a third party, a new joint venture agreement and the current owners retaining the business.[48]

In the absence of this, the likely outcome for the company was liquidation. At the end of the administration, the company entered liquidation pursuant to Para 84 of Schedule B1, Insolvency Act 1986.[49] This was since the company had no property which could be distributed to its creditors. The liquidation of the company occurred almost a year after its pre-pack transaction was completed. The dissolution of the company means the pre-pack resulted in a failure of the company and its business. Likewise, in Stylo, JJB and Mamas & Papas, the companies moved from administration to dissolution within 24-36months after the pre-pack was completed and were dissolved following liquidation.[50]

6.2.4. Pre-pack stakeholder outcomes

All the companies had secured, preferential and unsecured creditors. The administrators considered that the proposed pre-packaged sale of the business represented the best deal available for creditors compared to other options.

Starting with secured creditors, in JJB sports, Lloyds TSB was a secured creditor who had provided working capital facilities and associated ancillary facilities of £25m and

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[48] Ibid.

[49] Debenhams Plc, 'Notice of Move from Administration to Dissolution' (Companies house, 17 March 2020) https://find-and-update.company-information.service.gov.uk/company/05448421/filing-history accessed 12 December 2020.

[50] Stylo plc, 'Notice of Move from Administration to Dissolution' (Companies House, 6 January 2012) https://find-and-update.company-information.service.gov.uk/company/00314740/filing-history accessed 18 May 2019. JJB Plc, 'Notice of Move from Administration to Dissolution' (Companies House, 25 September 2015) https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history accessed 10 January 2021; Mamas & Papas (Retail) Limited 'Notice of Move from Administration to Dissolution' (Companies House, 27 April 2021) https://find-and-update.company-information.service.gov.uk/company/01529849/filing-history accessed 12 May 2021.

£13m to the group respectively.[51] These total sum and facilities of £38m were subject to cross guarantees between the group and other subsidiary which are secured by debenture.[52]

According to the last administrator's progress report filed at Companies House, a payment of approximately £21m was made to the bank.[53] The second priority secured creditor DSGI and Adidas had provided additional funding of approximately £18.5m and £15m respectively which are secured by a guarantee and debenture.[54] DSGI received £2.5m approximately, while there was no funds available to pay Adidas.[55]

In House of Fraser, the company's secured creditors consisted mainly of banks and bondholders.[56] Some of the bank creditors had super senior secured working facility and as such their claims were prioritized. All other secured claims falling outside the category were to rank pari passu.[57] Till date, no returns had been made to these creditors.[58]

In Stylo, the secured creditors were owed approximately £47m and they received £550, 241 and £1, 300,000 under the fixed charge and floating charge respectively.[59] In Mothercare, secured creditors were owed a total of £58m and according to the last report filed by the administrator, it was indicated therein that secured creditors may not be fully repaid. However, the purchaser of the business had agreed to pay an additional sum as

[51] JJB Sports Plc 'Statement of Administrators Proposal' (Companies House, 27 November 2012) https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history?page=2 accessed 12 January 2020, 18-19.
[52] Ibid.
[53] JJB Sports plc, 'Administrators progress report' (Companies House, 3 May 2019) https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history?page=1 accessed 12 January 2020, 5.
[54] Ibid.
[55] Ibid.
[56] HFL Realisations Limited, 'Notice of Administrator's Progress Report' (Companies House, 17 September 2021) https://find-and-update.company-information.service.gov.uk/company/SC021928/filing-history accessed 12 December 2021, 3.1
[57] Ibid.
[58] Ibid 4.
[59] Stylo plc, 'The Administrator's Report' (Companies House, 13 January 2012) p5.

consideration to ensure that secured creditors are paid in full.[60] In Paperchase, as previously noted, the consideration paid for the transaction was made by way of a credit bid which involved an immediate distribution following the sale of the business. The consideration which totaled £40m was meant to reduce the indebtedness of the company to its main secured lender from £55.2m to £15.2m.[61] It was anticipated that further recoveries from asset sales will be used to pay the outstanding sum due to PDM, however, it was unlikely that PDM will be repaid in full.[62] For Lloyds bank, another secured creditor of the company, it was anticipated that Lloyds will be paid in full[63]

In Debenhams, there was no secured debt in the company because it was fully repaid from the transaction. At the commencement of the administration, the secured liability inclusive of interest was £101.81m. The form of consideration paid by Newco for the transaction was a discharge of £101.8m of the new money facilities agreement.[64] Similarly, in Mamas & Papas, secured creditors (HSBC and BlueGem Capital Partners LLP) were not paid in full. Bluegem received part of its distribution by way of credit bid which was the consideration for the transaction.[65]

In all the cases, preferential creditors were paid in full as they transferred to the purchaser, although some were made redundant. For instance, in Mothercare, the company had 2,992 employees and 156 of these immediately transferred to newco upon completion of

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[60] Mother care UK Limited, 'Notice of Administrator's Progress Report' (Companies House, 2 December 2021) 5.

[61] Paperchase Products Limited, 'Notice of Administrator's Progress Report' (Companies House, 25 August 2021)5.

[62] Ibid.

[63] Ibid.

[64] Debenhams plc, 'Notice of Administrators Proposal' (Companies House, 13 June 2019) https://find-and-update.company-information.service.gov.uk/company/05448421/filing-history accessed 12 January 2020, 1.3.

[65] Mamas & Papas (Retail) Limited, 'Notice of Move from Administration to Dissolution' Companies House Dated 27th April 2021. A credit bid is a "self-help" choice available to a secured lender. It allows such creditor to bid its debt in a sale of its collateral. In other words, it involves a creditor swapping all or part of its debt for some or all the debtor's business. For a general discussion, see F Hyman, 'Credit Bidding Part I: An Important Tool for Lenders' (*Lexology*, 21 April 2020) https://www.lexology.com/library/detail.aspx?g=ddd869b4-0d92-47d2-bb6e-b988860fb782 accessed 16 May 2020.

the pre-pack transaction, a further 23 employees were transferred under a subsequent deal with Boots via a joint venture, while others were made redundant.[66] It was stated in the last administrators report filed in Companies House that preferential creditors were paid in full.[67]

The range of returns to unsecured creditors in the 7 cases was very low. In all the cases, no distribution was made to unsecured creditors other than by virtue of the prescribed part as provided for under Section 176A of the Insolvency Act 1986. Even where dividend was paid to unsecured creditors, such payment was small compared to the overall unsecured debt figures.

For example, in JJB sports, unsecured creditors were owed a total sum of £212.2m and the administrators at the end of the administration made a payment of £450,012 under the prescribed part.[68] In Mamas & Papas, unsecured creditors received 0.7p in the pound£ from the prescribed part distribution.[69] In Mothercare, of the £74m (approximately) owed to unsecured creditors, they received a dividend of 0.65% from the prescribed part.[70] In Paperchase, it was anticipated that unsecured creditors will receive a dividend in the range of between 1% and 4% under the prescribed part.[71] However, as at the time of writing, no dividends had been paid to unsecured creditors. In Stylo plc, no

[66] Mother care UK Limited, 'Notice of Administrator's Progress Report' (Companies House, 2 December 2021)
[67] Ibid 5.
[68]JJB Sports plc, 'Administrators progress report' (Companies House, 03 May 2019) https://find-and-update.company-information.service.gov.uk/company/01024895/filing-history?page=1 accessed 12 January 2020, 5.
[69] Mamas & Papas (Retail) Limited 'Notice of Move from Administration to Dissolution' (Companies House, 27 April 2021) https://find-and-update.company-information.service.gov.uk/company/01529849/filing-history accessed 12 May 2021, 3.
[70] Mother care UK Limited, 'Notice of Administrator's Progress Report' (Companies House, 2 December 2021) 5.
[71] Paperchase Products Limited, 'Notice of Administrator's Progress Report' (Companies House, 25 August, 2021)6.

dividend was paid to unsecured creditors despite being owed £29m approximately.[72] In Debenhams and House of Fraser also, no dividends were paid to unsecured creditors.[73]

6.3. CVA and Pre-packs: Comparable themes

Both CVAs and pre-packs share some comparable metrics including business survival and impact on stakeholders. This section will attempt to identify some comparable themes from CVA case studies and that of pre-packs.

It appears that both CVAs and pre-packs facilitate corporate rescue although in different ways and to a varying degree. CVAs aim to preserve the trading company while pre-pack focuses on the continuation of the business of the company through a new company.[74] The difference between them is that in a pre-pack process, the debt of the insolvent company is left behind and the viable part of the business is transmitted to a new company, which can be regarded as 'business rescue' and not corporate rescue per say. On the other hand, the CVA seeks to preserve the life of the trading company by maintaining the going concern value in the company, which is what is regarded as corporate rescue. However, in a CVA the debt of the company remains with the company and arguably, "the debt continues to burden the company, although on renegotiated terms."[75]

Thus, while a CVA can ease cash flow problems, it will not be a remedy in cases of a lack of business model or inherent financial management issues. In such cases, a pre-pack may be the only feasible way of dealing with the problems of the company; such that the business or assets of the company can be preserved by selling them to a new company with the hope of achieving beneficial outcomes for creditors of the company. However, as

[72] Stylo Plc, 'Administrator's Progress Report' (Companies House, 10 March 2010) 7.
[73] Debenhams plc, 'Notice of Move from Administration to Dissolution' (Companies House, 17 March 2020). 9; HFL Realisations Limited, 'Notice of Administrator's Progress Report' (Companies House, 16 September 2021)6.
[74] Umfreville (n 3) 582.
[75] Ibid.

will be seen later this is often not the case. It however remains that the legislative frameworks governing the outcomes of either business rescue or corporate rescue are "inherently creditor-centric".[76]

To secure approval of creditors on the CVA proposal, the CVA needs the consent of three-quarters of unsecured creditor for it to go ahead,[77] while in a pre-pack, the administrator can choose to forgo the primary aim of rescuing a company as a going concern in favor of the second objective of administration if this would achieve a better result for creditors as a whole.[78] Consequently, it is worth questioning whether the outcomes of these procedures are beneficial to both the company and its creditors.

From a starting point, it was observed in the retail CVA cases that majority of companies that entered a CVA had their CVA terminated early, and the company entered a further insolvency process- in most cases, administration. By contrast, in a pre-pack, and consistent with the findings of other studies, there is no such clear pattern in the period before the purchaser fails. One thing that stood out is that the failure of the purchaser did not occur early as is common in CVAs where early termination occurred between 2months-24months. Most of the purchaser failure recorded in the case study occurred between 24-36months. One reason for this as submitted elsewhere is that "… the CVA will fail almost immediately if opening statement cannot be met, whereas the lack of immediate debt repayment in a pre-pack provides a buffer against the impact of financial difficulties becoming apparent."[79]

In addition, similar studies on pre-pack outcomes noted that some failed purchasers had entered a voluntary arrangement or administration following failure of the pre-pack, which may have facilitated further business rescue.[80] My findings showed otherwise. Upon failure of the pre-pack, the purchaser moved straight into dissolution, save in Debenhams

[76] Umfreville (n 3) 598.
[77] Insolvency Act 1986, section 4; Insolvency Rules 2016 r.15.34(3).
[78] Insolvency Act 1986, Schedule B1, Paragraph 26.
[79] Umfreville (n 3) 582.
[80] ibid 592.

where the company entered a further administration procedure and moved into dissolution 9 months after.

The subsequent failure of these companies may be surprising because unlike a CVA, the purchaser in a pre-pack will be operating free from the shackles of liabilities facing companies operating under a CVA.[81] This suggests that just like CVAs, the problems of most companies is failure to properly identify and tackle underlying problems. Thus, rescue procedures will not be an appropriate remedy for financial distress/insolvency where a company has failed to understand its underlying problems.

Moving on to outcomes for stakeholders, it was observed in the series of CVA case studies examined in the previous chapter that after the CVA was implemented, the supervisors continued to make payments to the unsecured creditors before the CVAs ultimately terminated and secured and preferential creditors' claims were intact under the CVA. Likewise, according to the research conducted by Walton and his colleagues,[82] "it was observed that where CVAs are completed, or continue for a period of at least six quarters, there are positive outcomes for unsecured creditors, while the position of secured and preferential creditors will only have been varied with consent."[83]

Even in cases where the CVA was terminated, unsecured creditors still received more from the CVA than would have been the case in liquidation or a pre-pack based on the pre-pack outcomes examined in the precious section. In a prepack, the comparable benchmark to the outcome of a CVA is survival of the purchaser.[84] Even though there is hope for survival of the purchaser as opposed to the case where a CVA is implemented, yet such survival does not automatically result in a positive outcome for the creditors of the insolvent company. This is because the debt remains behind with the insolvent company.

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[81] Ibid.
[82] Walton and others CVA (n 2) 3.
[83] Ibid.
[84] Umfreville (n 3) 591.

Nevertheless, the purchaser's survival can be beneficial to suppliers and customers although this argument is "purely anecdotal,"[85] given that these stakeholders can still count their losses from debts owed by the insolvent company. A laudable benefit that inures to the advantage of pre-packs is the ability of the process to preserve jobs of employees, as they will transfer to the Newco under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE).[86] However, this benefit is short-lived as majority of these purchasers (as shown in the case study) subsequently entered a terminal insolvency process which resulted in their failure.[87] This means that jobs were only preserved for a short timeframe.

Of the 7 pre-pack cases examined, there were secured creditors in all the cases. Their debt ranged from between £23 to more than £100million, of which only in 1 of the case (Debenhams) was the secured creditor paid in full. This payment was consideration paid for the pre-pack transaction. Likewise, in the 7 cases employees were transferred under TUPE to the newco, and they received monies due to them in all 7 cases, although in some of the cases, they did not receive their payment in full. This contrasts with a CVA where secured and preferential creditors will often be unaffected by the process and will be paid in full. Given that a CVA is unlikely to proceed without the support of secured creditors, these creditors are usually paid in full under a CVA. Despite the involvement of secured creditors in a pre-pack, compared to a CVA, returns to these creditors were not always paid in full.

Unsecured creditors appear to suffer a material shortfall in a pre-pack. This point was also noted by Umfreville who observed that unsecured creditors receive little from a pre-pack compared to CVA.[88] The situation appears worse when the newco enters a further terminal insolvency process. In the 7 cases, unsecured creditors were present in all the cases, and they received distributions in form of low dividends paid out of the prescribed

[85] ibid 582.
[86] Transfer of Undertakings (Protection of Employment) Regulations (SI 2006/246)
[87] As seen in Debenhams and JJB.
[88] Umfreville (n 3) 582.

part only in 3 cases, they received NIL returns in the other 4 cases. Thus, it can be argued that creditors fare better in a CVA than in a pre-pack.

The general aims of insolvency law include:[89]

1. The preservation and maximization of the value of insolvent enterprises.
2. The fair treatment of all stakeholders, including especially the fair distribution of assets among them.
3. The investigation of the causes of insolvency to minimize harm & abuse in the future.

The analysis given in this thesis shows that both CVAs and Pre-packs have the potential to undermine all these goals although in different ways. Starting with the CVA procedure, even though creditors receive beneficial outcomes in a retail CVA, such returns are usually small compared to the actual amount these creditors are owed. This means that the first goal of value preservation and maximization is only minimally achieved. In terms of the second goal, not all creditors are treated fairly under a CVA. Secured and Preferential creditors are usually unaffected by the process and will be paid in full while same cannot be said of their secured counterparts.

Some unsecured creditors are usually treated better than other unsecured creditors, for example suppliers and trade creditors are deemed "critical creditors" and will usually be paid in full while landlord creditors are often singled out to bear the brunt. Even though landlords are the ones majorly compromised under a CVA, it remains that these creditors receive little returns in a CVA. Lastly, turning to the 3rd goal of insolvency law, doubts have been raised as to whether directors thoroughly investigated the reasons behind the company's problems. This is evidenced by how quickly CVAs fail, and it has been argued that majority of CVAs fail because the directors failed to tackle the underlying problems of the company. Addressing the underlying problems of the company mean an initial assessment of the causes of distress in the company, something which is not usually conducted.

[89] See Chapter 3 for a discussion of the aims of insolvency law.

Moving on to Pre-packs and how the procedure furthers the goals of insolvency law, arguably, the prepack procedure tends to undermine all the 3 goals identified above. Starting with the first goal, even though value is preserved by selling the viable assets and business of a failed company to a new co, it remains that retail pre-packs are attuned to huge lower realizations than CVAs. With respect to fair treatment of stakeholders, even though secured creditors are not always paid in full, it remains that on average, this class of creditors receive better returns in pre-packs than the CVA while preferential and unsecured creditors obtained lower returns due to the significant lower realizations that pre-packs generate. As described elsewhere, "… average returns for creditors as a whole were only marginally lower in pre-packs than other procedures, suggesting that the value lost by preferential and unsecured creditors flowed to secured creditors."[90]

Lastly, due to the quick nature of pre-packs, it can perhaps be argued that there will be no incentives to immediately investigate the causes of insolvency once the signs become evident, since the main attention will be the preservation of value in the company by selling the viable parts of the business. Even though the pre-pack Pool exercise oversight functions, a company is not required to identify or give reasons for the causes of insolvency when approaching the Pool. Moreover, the Pool has no investigative powers and as such, "… it strains credulity to suggest that current pre-pack practices facilitate the investigation of the causes of insolvency in most cases."[91]

Thus, the extent to which both procedures enhance the goal of insolvency law is questionable. To exacerbate the issue, most retail companies that undergo these procedures end up in liquidation. This echoes Adebola's concerns about the existing conflict between value maximisation and the survivability of rescued businesses.[92] The rational for rescue given by proponents of rescue as early as 1970s was "… to provide

[90] AS Nocilla, 'Corporate Rescue at the Crossroads: An Empirical and Comparative Examination of Pre-packaged Administration in the UK' (Ph.D. thesis, University College London 2019) 168-169.
[91] Ibid.
[92] B Adebola, 'An Invitation to Encourage Due Consideration for the Survivability of Rescued Businesses in the Business Rescue System of England and Wales' (2017) 26 International insolvency Review 129.

the means by which an insolvent business could be continued and disposed of as a going concern so as best to preserve jobs for employees and preserve the nation's assets".[93] There are two objectives in this statement; first continuation of an insolvent business and second, disposal of same as a going concern, both of which can be carried out under either of the two procedures under study. It was not expected that the company/business is saved from complete failure only to fail again shortly after; something which has been referred to as recidivism in the context of pre-packs.[94] However, it appears that recidivism is also inherent in CVAs.

Recidivism destroys the economic and social benefits of allowing a company to continue trading as a going concern. Stakeholders bear a huge cost arising from it since they are the ones who stand to lose out if a business fails; entrepreneurs will not be afforded the opportunity to try again, jobs will be lost;[95] suppliers will receive little or nothing from failure and they also lose a trading partner; the economy is also affected by the loss of a potentially valuable contributor.[96] Overall, "recidivism erodes trust in the rescue system."[97] Thus, an effective rescue regime ought to strike a balance between value maximisation and potential future survival, as this will enhance creditor confidence as well as wider stakeholder confidence in the system.

6.4. Conclusion

This chapter has examined the role of pre-packs in retail insolvency cases. As seen, a pre-pack by virtue of its flexibility, helps to preserve value in a distressed company by transmitting the valuable part of the business to a new entity and leaving the debt of the company behind in the old company. It helps to further the notion that the value in

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[93] K Cork, *Cork on Cork.* (Macmillan 1988)189 (Cork on Cork).
[94] Adebola (n 92) 132.
[95] The Insolvency Service, *Productivity and Enterprise: Insolvency- A Second Chance* Cmnd 5234 (2001).
[96] Adebola (n 92).
[97] Ibid; J Guthrie, 'Debt Dodgers Revel in Return of the Phoenix' *Financial Times* (London, January 21, 2009).

financially distressed businesses ought to be maximized for the benefit of all stakeholders. However, its benefits are often exaggerated, especially when one considers the potential harms of pre-packs which are often downplayed.

As seen in the analysis provided in this chapter, in terms of outcomes, unsecured creditors appear to suffer a material shortfall in prepacks. Majority of the cases examined saw unsecured creditors receive low or Nil returns compared to their secured and preferential counterparts, even though these creditors do not often receive their monies in full in all cases. Suffice to say that retail pre-packs are correlated with lower overall realizations than retail CVAs. Whilst a pre-pack allows for the quick continuation of the business with little or no interruption, it may in the long run not be beneficial to all creditors. However, both procedures tend to undermine the goals of insolvency law although in different ways.

Nevertheless, both procedures do not encourage the ultimate survival of the rescued company and/or business. Most retail companies that initiate a CVA end up in administration or liquidation which often leads to a failure of these companies. Likewise, whilst the purchaser survives under a pre-pack, it often enters a terminal insolvency process such as liquidation few months/years after being rescued. Thus, it appears there is a conflict between value maximization and survivability of rescued businesses.

The next chapter will focus on the restructuring plan and its approach to rescue.

CHAPTER 7

The Role of the Restructuring Plan Procedure in Corporate Rescue

Introduction

The previous chapters of this thesis have analysed the CVA and pre-pack procedures, and the extent to which these procedures have established themselves as effective solutions to the problems of distressed retail companies, in terms of rescuing these companies/businesses and providing the best outcomes for creditors and other stakeholders. As seen, the flexibility of these procedures has raised issues of fairness amongst creditors on the company. Likewise, the procedures are inherently suited for value maximization, but little attention is given to future survivability of the rescued company.

As a result, there has been calls from stakeholders including professional advisers, professional associations, academic scholars amongst others, for the introduction of a wholly new rescue procedure in the UK.[1] This need was further exacerbated by the recent COVID-19 pandemic which had a pervasive impact on the UK economy.[2] Retailers were hit hard on all fronts by the pandemic whose resultant effect was closure of physical stores across the UK and beyond. Consequently, a new restructuring plan procedure was introduced by the Corporate Insolvency and Governance Act (CIGA) on the 26th of June 2020, thereby making a significant reform to the UK's restructuring and insolvency framework.

This chapter takes into consideration the discussions and analysis in previous chapters and evaluates how the restructuring plan provides a basis for addressing the deficiencies of existing restructuring mechanisms especially the CVA procedure. This chapter

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[1] Insolvency Service, Summary of Responses: A Review of the Corporate Insolvency Framework (September 2016) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/578524/Summary_of_responses_26-10-16_Redacted.pdf accessed 10 January 2021, Annex B (Summary of Responses).

[2] D David "Coronavirus: UK Worst Hit among Major Economies" (*BBC News*, 26 August 2020) https://www.bbc.com/news/business-53918568 accessed 1 September 2020.

addresses the following questions: does the restructuring plan provide a panacea to the inadequacies identified in the current corporate rescue landscape? given the all-encompassing nature of the new procedure, coupled with its similarities with the CVA, to what extent does the restructuring plan provide an effective alternative to CVAs in retail insolvency cases? will the restructuring plan replace CVAs as a rescue mechanism in the retail industry?

The roadmap of this chapter is as follows: Section 1 examines the legal framework of the restructuring plan procedure in detail and its operationality. Given that the procedure is built upon the architecture of schemes of arrangement, both procedures will be discussed simultaneously. Section 2 examines the practicalities of the procedure by examining multiple case studies of companies that have initiated the process. Section 3 provides a comparative analysis between the CVA, pre-pack and restructuring plan. Section 4 considers whether the restructuring plan will replace the CVA as a rescue device in the retail sector. Thereafter, a conclusion follows.

6.1. The Legal Framework of the Restructuring Plan Procedure

The new restructuring plan procedure also known as "Super Scheme"[3] is a significant change to the corporate rescue framework in the UK. Essentially, it has the potential of expanding the scope of corporate restructurings in the UK by allowing the combination of both financial and operational restructurings in one procedure, something which was previously unavailable as a standalone process under any of the existing rescue procedures.

The restructuring plan is modelled on the existing scheme of arrangement procedure under part 26 of the Companies Act 2006 albeit with certain differences. In fact, due to the commonality between both procedures, legislation suggests that when dealing with cases bordering on restructuring plans, courts will be allowed to draw on existing body of

[3] D Ampaw D Manson, "The New UK Restructuring Plan- The Super-Scheme" (*Lexology*, 6 October, 2020) https://www.dlapiper.com/en/uk/insights/publications/2020/10/restructuring-global-insight/restructuring-plan/ accessed 12 February 2021.

case law relating to schemes of arrangement where appropriate.[4] As a result, the mechanics of both procedures will be discussed in tandem.

Both procedures are situated under the companies Act 2006, (Part 26 sections 895-901 for schemes) and (Part 26A, sections 901A-901L for restructuring plans). The implication of this is that both procedures do not carry any insolvency stigma as they sit in the Companies Act rather than the Insolvency Act 1986. Although it must be pointed out that a company must have encountered, or be likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern before a restructuring plan can be initiated.

Like schemes of arrangement, the restructuring plan allows a company encountering financial distress to propose a "compromise or arrangement" with its creditors and/or shareholders to restructure its affairs. Due to the flexibility of the mechanism, it can contain any proposal as the company sees fit to secure the long-term viability of the company provided it offers a "compromise or arrangement."[5]

Given the speed at which the new legislation took off, the take up rate was initially low. Following its introduction in June 2020, only 2 restructuring plans were sanctioned in the second half of 2020 compared with 12 schemes of arrangement initiated in the same period.[6] The usage of the restructuring plan in its first year has been poor compared to the government's "high scenario estimate" of 50-100 restructuring plans per year as stipulated in its impact assessment[7] that followed the Bill.

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[4] See *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch) and [2020] EWHC 2376 (Ch); HL explanatory notes https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf. accessed 12 July 2021, 6.
[5] Ampaw and Manson (n 3).
[6] A Rogan, 'Over a Year On- The New Restructuring Plan in Action' (October 2021) https://www.financierworldwide.com/over-a-year-on-the-new-restructuring-plan-in-action#.YZ-BSy8w2fU accessed 12 November 2021.
[7] Corporate Governance and Insolvency Bill Impact Assessment https://publications.parliament.uk/pa/bills/cbill/58-01/0146/SIGNED%20-%20IA%20Insolvency%20and%20Corporate%20Governance%20Enactment%20Stage.pdf accessed 30 August 2021, paragraph 6.93.

Similarly, comparing its usage in its first year with that of CVA between 1986-1987 when it was first introduced, there were 21 CVAs that year,[8] while between June 2020- August 2021, nine companies had used the restructuring plan. It is unlikely that the number of companies using the procedure after then would match the number of companies that used CVA in the first year of its introduction.

Arguably, the reason for the low uptake may have been borne out of the fact that there is an inclination to choose the well tried and tested approach of schemes rather than risk exploring an unknown process.[9] However, there has been a gradual increase in its usage as the legal landscape has developed. Overall, it is submitted that the use of the procedure is fair for a relatively newly adopted mechanism,[10] coupled with the circumstances surrounding its introduction.[11]

It has been used to pursue a solvent recapitalization,[12] implement a restructuring via a debt-for-debt and debt-for-equity swap,[13] compromise liabilities under bonds governed by swiss law[14], effect a solvent wind-down,[15] effect a restructuring of its debt and injection of new money,[16] to restructure leasehold liabilities,[17] undertake an extended wind-down,[18] and pursue a solvent exit from administration and a cramdown on secured creditors.[19]

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[8] J Tribe, 'Company Voluntary Arrangement and Rescue: A New Hope and a Tudor Orthodoxy' (2009) Journal of Business Law 454, 480.

[9] PWC, 'Restructuring Plans- What a Difference a Year Makes.' (2021) https://www.pwc.co.uk/services/business-restructuring/insights/restructuring-plans-what-difference-year-makes.html accessed 2 November 2021.

[10] I West, "Reflections on a Year of Restructuring Plans" (2021) 34 Insolvency Intelligence 62.

[11] Recall that it was introduced amongst other mechanisms as a response to the effect of the COVID-19 pandemic on businesses.

[12] *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch) and [2020] EWHC 2376 (Ch) (Virgin Atlantic).

[13] *Re Pizza Express Financing 2 Plc* [2020] EWHC 2873 (Ch) (Pizza Express).

[14] *Re Gategroup Guarantee Limited* [2021] EWHC 304 (Ch) (Gategroup)

[15] Re DeepOcean 1 UK Ltd & Ors [2020] EWHC 3549 (Ch) [4] (DeepOcean)

[16] *Re Smile Telecoms Holdings Ltd* [2021] EWHC 685 (Ch) (Smile Telecoms)

[17] *Re Virgin Active Holdings Ltd & Ors,* [2021] EWHC 1246 (Ch) (Virgin Active).

[18] *Hurricane Energy* [2021] EWHC 1759 (Ch). (Hurricane Energy) although whose restructuring plan was not sanctioned by the court.

[19] *Re Amicus Finance Plc* [2021] EWHC 2255 (Ch) (Amicus Finance).

The restructuring plan is wide in scope but does have a threshold entry criterion. Unlike a scheme of arrangement which can be proposed by the company in financial distress, as earlier stated, to be eligible to commence the restructuring plan procedure, the company must have encountered or be likely to encounter, financial difficulties which will affect its ability to continue trading as a going concern. Likewise, the plan must involve a compromise or arrangement proposed between a company and its creditors or members or any class of them which purpose is to eliminate, reduce, prevent, or mitigate the effect of those financial difficulties facing the company.[20]

The financial difficulty threshold identified above is one that would affect the company’s ability to meet its financial obligations as they fall due on one hand and/or one that presents a threat of liquidation in the foreseeable future. It could be extended to include using the process to facilitate a solvent wind down as seen in the DeepOcean case.[21]

Likewise, “a terminal financial state counts as “financial difficulties”, and a plan that is designed to promote a solvent wind-down of the company by injecting additional group funds in order to give creditors an uplift above the dividend they would receive in an insolvent liquidation, counts as mitigation of those financial difficulties.”[22] Arguably, the intended benefit of this low threshold is to serve as an incentive for a distressed company to address its financial difficulties timeously via the restructuring plan framework.

6.1.1. Process

The court is an integral part of both schemes and the restructuring plan process. To commence a restructuring plan, the directors will apply to the court for approval to convene the meetings of creditors and members. Creditors and shareholders can also apply to the court to initiate the procedures; however, this is highly unlikely due to the “significant resourcing requirements that typically need debtor/shareholder input to put

[20] Companies Act 2006, section 901A.
[21] Re DeepOcean 1 UK Ltd & Ors [2020] EWHC 3549 (Ch) [4].
[22] West (n 10) 63.

together a realistic and credible restructuring plan modelled on the existing business performance."[23] Arguably, directors are best suited to perform this role since they are the ones in charge of the day to day activities of the company and will usually have encompassing knowledge about the business of the company.

Like schemes of arrangement, the restructuring plan involves a three-stage process. First, the debtor makes an application to the court to convene the meeting of creditors (convening hearing). In order to approve the convening of the meetings, the court will consider whether the company meets the eligibility criteria and whether the classes have been formulated correctly; in this context, the same body of law and practice applicable to schemes in respect of class composition will also apply to Restructuring plans,[24] i.e. whether in relation to any given group or creditors or members, their rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.[25] In essence, creditors or members whose rights are similar should be placed in one class for meeting and voting purposes of the scheme or restructuring plan, while those whose rights are dissimilar ought to be placed in separate classes.

The court will also consider jurisdictional issues at the first hearing. The test for establishing jurisdiction for both procedures is whether there is a "sufficient connection" between the company and England and Wales.[26] This can be established in many ways; for instance it could be shown that the company has assets in England and Wales, or it has an establishment, a place of business or its centre of main interests in England and Wales, it could even be the case that English law governs any obligations to be compromised by the scheme or restructuring plan or that the parties have submitted to the jurisdiction of the courts of England and Wales under the relevant contractual arrangements.

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[23] Ampaw and Manson (n 3).

[24] See *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch) and [2020] EWHC 2376 (Ch); HL explanatory notes at para 16 and available at https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf.

[25] *Re Hawk Insurance Co Ltd* [2001] EWCA civ 241.

[26] See Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006); Virgin Atlantic (n 939).

To give creditors an opportunity to appear at the convening hearing to contest the proposed class composition for the scheme or plan, the company will usually send a document known as the “practice statement letter” to all affected parties usually 14 days before the proposed convening hearing. Likewise for the court to properly consider the issue of jurisdiction and class composition, it will require information on the existing rights of creditors and/or members and how these rights will be affected by the scheme or restructuring plan.

The company will draft the scheme or plan document and an accompanying explanatory statement which will explain the effect of the proposal on the relevant parties thereby allowing the creditors and/or members to make an informed decision about whether the proposal is in their interests. The court has emphasised the importance of full and extensive disclosure of the documentation being submitted by the company to the court and to the creditors/members.[27]

If the court agrees to the convening of the meetings, notice of each meeting must be sent to all parties who are required to vote and participate in the plan together with a document that looks like an explanatory statement used in schemes outlining the restructuring plans and its effects.

Second, the meetings are thereafter convened for the relevant parties to vote. There is a material difference between the voting and approval requirements in schemes and restructuring plans. In schemes, the proposal requires 75% by value of claims and a majority in number i.e., more than 50% in number of the creditors in each class voting on the scheme to vote in favour for it to be approved[28]- the so-called “numerosity test.” While in a restructuring plan, the approval threshold is 75% in value of creditors voting within

[27] *Re Virgin Active Holdings Ltd & Ors,* [2021] EWHC 1246 (Ch).

[28] Companies Act 2006, Section 899.

each class.[29] Thus, the majority in number threshold as in the case with schemes does not apply to restructuring plans.

The creditors/members that are required to vote under a restructuring plan include every creditor or member of the company whose rights are affected. An application may be made to the court to exclude classes or members from voting which will be granted if the court is satisfied that none of the creditors or members of that class has a genuine economic interest in the company.[30] In essence, the "out of the money" creditors are not required, or not allowed to vote on the plan. Nevertheless, these creditors can still be bound to the plan. This contrasts with schemes where the "out of the money" creditors can be excluded from voting but will not be bound if so excluded.

Third, if the required thresholds are met, the debtor applies to the court for sanction of the scheme or restructuring plan (sanction hearing). At this hearing, the court will decide whether to sanction the plan and bind creditors and shareholders to the plan. Like the scheme of arrangement, the court does not simply rubber stamp its approval, rather the court has an absolute discretion on whether to sanction the restructuring plan.[31]

According to the explanatory notes, the court will sanction the plan if it is just and equitable to do so.[32] The court will consider whether the scheme or the restructuring plan is a fair one which a creditor could reasonably approve and whether the majority was not coercing the minority in order to advance interests which are contrary to the class that they purported to represent.[33] Once the plan has been sanctioned, it will become binding on all creditors/members affected, including those who voted against or did not vote and those who did not receive notice to vote on the plan.

[29] Companies Act 2006, Section 901F (1).
[30] Companies Act 2006, section 901C (4).
[31] Companies Act 2006, Section 901F (5); *Re British Aviation Insurance Co ltd* (2006) I BCLC 665 at [69]; *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2376 (Ch) [51-52].
[32] See HL Explatory Notes at para 15 available at https://publications.parliament.uk/pa/bills/lbill/58-01/113/5801113en.pdf.
[33] *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2376 (Ch) [51-52].

The restructuring plan consists of a significant mechanism which is absent in the scheme of arrangement procedure but is a prominent feature of the US Chapter 11 reorganization procedure: - a "cross-class cram down." This allows a company with the approval of the court to impose the plan on dissenting classes of creditors and members. This is a departure from the scheme procedure where every class must vote in favour of the proposal for it to be sanctioned.

The aim of the cram down tool is to prevent hold-out creditors blocking viable restructuring plans. It must be pointed out that the cram-down mechanism is not a rubber-stamping exercise, and it will only be available where:

-the court is satisfied that no member of the dissenting class(es) would be any worse off under the plan than they would be in the event of the 'relevant alternative' (Condition A) and.

-at least one class that would benefit from the 'relevant alternative' has voted in favour of the restructuring plan. (Condition B)

The relevant alternative will be whatever the court considers the most likely to happen to the company should the restructuring plan not be sanctioned by the court i.e., a formal insolvency process such as administration or liquidation. Once these conditions are met, the cross-class cram-down mechanism can be imposed to bind dissenting classes of creditors.

This facility adds a flexibility to restructurings in the UK which was previously unavailable. Although it was possible to achieve a "de facto cram down" of dissenting creditors under the UK rescue framework by combining schemes and administration as has happened in the Bluebrook Case.[34] However, there were some disadvantages. First, to do this, the business of the company or group need to be transferred to a new company, which could

[34] *Re Bluebrook Ltd [*2009] EWHC 2114 (Ch); [2010] 1 B.C.L.C 338.

be costly and cumbersome, may have tax implications and can be difficult to achieve if the creditor agreements impose restrictions on the ability of the company to transfer.[35]

The effect of the de jure cross-class cram down under the restructuring plan is that junior or senior creditors can be bound by a restructuring plan without their consent thereby moving the UK restructuring model towards that of the US Chapter 11 model and providing distressed companies with a more extensive mechanism to address their financial difficulties.

Arguably, the cram down tool could be used by companies "to propose multiple smaller classes to try to ensure its restructuring plan succeeds…"[36] However, the court may view this strongly and prevent companies from duplicating classes in order to exploit the new cram down tool, especially in situations where the numbers of dissenting creditors would have been sufficiently able to vote down the scheme if they were in the same class as those creditors who are in support of the scheme.[37]

Amidst all this process, it is possible for creditors to attempt to disrupt the process by laying claims to the assets of the company. A company can apply for the moratorium procedure under Part A1 of the Insolvency Act 1986 whilst the restructuring plan process is being progressed to approval.

As discussed earlier in Chapter three, the moratorium is a self-standing pre-insolvency debtor-in-possession process which is subject to the supervision of an insolvency practitioner known as a "monitor."[38] To be eligible, the directors are required to make a statement to the court that the company is, or is likely to become, unable to pay its debts to access the moratorium. The main objective of the moratorium is to rescue the company.

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[35] J Payne, "The Role of the Court in Debt Restructuring" (2018) 77 Cambridge Law Journal 120, 140.
[36] A Plainer M Benson, "The New Restructuring Plan- In Depth" (*Lexology*, June 19, 2020) https://www.lexology.com/library/detail.aspx?g=75de1559-3667-4261-bcd5-aca229f2d45f accessed 20 January 2021.
[37] ibid
[38] Summary of Responses (n 1) paragraph 5.65 and 5.59

The monitor is required to oversee the process on an ongoing basis and provide an objective assessment of whether the company can be rescued as a going concern. If the monitor thinks that this is no longer possible, he/she must immediately terminate the moratorium.

6.1.2. The Absolute Priority Rule.

The absolute priority rule (APR) concept is used in the context of the cross-class cram-down under the Chapter 11 reorganisation procedure. It serves as a form of creditor protection under Chapter 11, and it seeks to prevent shareholders of the company from gaining priority to the detriment of other creditors.[39] The principle simply provides that under a restructuring process, senior creditors should be paid in full or receive sufficient value for their claims before any junior creditor receives anything under the plan.[40]

During the consultation phase leading up to the introduction of the restructuring plan, a modified version of the absolute priority rule(APR) was sought to be introduced by legislation, which would give the court a discretion to approve a plan even where such plan was not in conformity with the absolute priority rule but where such deviation was necessary to achieve the objectives of the restructuring and it was just and equitable in the circumstances.[41] The reason why the legislation deviated from the absolute priority rule was because it has been described as “inflexible and often a barrier to a debtor’s successful reorganization.”[42] Also, the rule may be abused due to potential holdout problems by “predatory market players.”[43]

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[39] See American Bankruptcy Institute Commission to Study the Reform of Chapter 11, ‘Final Report and Recommendations’ (2014) (‘ABI Commission Report’) 229-30.
[40] SJ Lubben, ‘The Overstated Absolute Priority Rule’ (2016) 21 Fordham Journal of Corporate & Financial Law 581, 582.
[41] Summary of Responses (n 1) paragraph 5.134.
[42] ibid 5.160, See RJ Landry III, ‘Enhancing Rescue in Chapter 11: Lessons from Reform Efforts in the United Kingdom’ (2020) 57 American Business Law Journal, 227, 267.
[43] Summary of Responses (n 1) 5.162.

The absence of the APR principle gives the restructuring plan an added flexibility which may arguably make the procedure appealing to some stakeholders. Moreover, flexibility has always been at the crux of the UK's restructuring market. However, the downside to the absence of this principle or its equivalent is uncertainty given the fact that at the outset, it was unclear how the courts will choose to exercise their discretion.[44]

The court must "adjudicate on the fairness of the restructuring proposal as a whole in determining whether or not to exercise its discretionary power to sanction the restructuring plan." [45]Although there have been some guidelines set out by the court on this issue especially for out of the money creditor classes yet there are still uncertainties awaiting further judicial guidance especially around the treatment of shareholders.[46]

The UK Government introduced a 'best interests' in place of the absolute priority rule to determine whether a cross-class cramdown should be allowed. By virtue of Section 901G (3) of CIGA, before a restructuring plan may be crammed down on dissenting creditors, the court must be satisfied that none of the members of the dissenting class(es) of creditors will be worse off under the plan than in the relevant alternative. Both the absolute priority rule and the best interests test are forms of creditor protection, although they function differently.

It has been submitted that "the best interests test under section 901G (3) protects the value of the entitlements of the creditors under the relevant alternative scenario while the APR serves as a 'baseline' for determining the fairness of the distributions contemplated under the proposed plan."[47] It however remains that both principles will require a valuation of the debtor to determine whether the relevant test or rule is met.

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[44] West (n 10).
[45] Ibid.
[46] See generally Re Virgin Active Holdings Ltd, Virgin Active Ltd and Virgin Active Health Clubs Ltd [2021] EWHC 1246 (Ch); Re DeepOcean [2020] EWHC 3549 (Ch).
[47] See S Madaus, "Is the Relative Priority Rule Right for your Jurisdiction." (2020) https://stephanmadaus.de/wp-content/uploads/2020/01/Is-the-Relative-Priority-Rule-right-for-your-jurisdiction-—-Madaus-WP-2020-1-1.pdf accessed 30 August 2021, 1.

6.1.3. Valuation issues

At the heart of every restructuring procedure is the issue of valuation of a debtor.[48] The cross-class cramdown mechanism alongside the assessment of genuine economic interest will potentially raise issues of valuation. The court not only has the duty to determine the relevant alternative, but it must also consider what value to be placed on a creditor's interest.[49]

Basically, "a debtor's enterprise value determines the size of the asset pie that may be available for distribution to all creditors and other stakeholders."[50] The debtors' enterprise value under a restructuring plan is important for two purposes: firstly, in determining whether creditors have a genuine economic interest in the company. Secondly, in determining whether the cross-class cram down mechanism can be initiated. However, it has been shown that valuation is not a straightforward process.[51]

The restructuring plan is intended to be an extension of the valuation method used in schemes as developed by case law. However, 'valuation is not salient in schemes, as the court's focus in these procedures is on ensuring that parties behave in good faith.'[52] Consequently, the courts have generally adopted the current market value approach in valuation as opposed to the complex valuation method in the US which requires a debtor to be valued based on the post-organisation value determined by discounted cash-flow methods.[53]

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[48] A EU, "Valuation Issues in the UK Restructuring Plan" (2021) Working Paper EW Barker Centre for law and Business Working Paper NUS Law Working Paper No.2021/001, 5 ahttps://law.nus.edu.sg/ewbclb/wp-content/uploads/sites/6/2021/02/001_2021_Alfino.pdf accessed

[49] Bluebrook Ltd, Re [2009] EWHC 2114 (Ch); [2010] B.C.C 209 (Ch D).

[50] Ibid.

[51] For a discussion of the importance of valuation evidence see Re Smile Telecoms Holdings Limited [2022] EWHC 740 (Ch) [53]; E Vaccari, "Broken Companies or Broken System? Charting the English Insolvency Valuation Framework in Search for Fairness" (2020) 35 Journal of International Banking Law and Regulation. 135; E Vaccari, "Promoting Fairness in English Insolvency Valuation Cases" (2020) 29 International Insolvency Review 1.

[52] E Vaccari, "Corporate Insolvency Reforms in England: Rescuing a "Broken Bench"? A Critical Analysis of Light Touch Administrations and New Restructuring Plans" (2020) 31 International Company and Commercial Law Review 645, 665.

[53] Ibid.

The court is wary of the valuation disputes that may arise in restructuring cases especially due to the cross-class cram down mechanism. In cases where the company is at the brink of financial distress, the courts will seek to avoid lengthy valuation issues which due to the time involved in determining such challenges, could affect the viability of any given restructuring plan and by extension, lead to the insolvency of the company.[54] To minimize such challenges, it has been held that the use of restructuring plans should not be undermined by lengthy valuation disputes, and it is for the court to ensure that the protection for dissenting creditors laid down by the "no worse off" criteria and the court's general discretion is guaranteed.[55]

Moving on, it is important to consider the practical application of the procedure in restructuring leasehold liabilities since it came into force. The next section will reflect on the use of the procedure by reference to two case studies.

6.2. Case Studies on the Practical Operation of Restructuring Plans.

Case Study 1: Virgin Active

1. Background

Virgin Active operates a chain of health clubs and like most businesses in the leisure, retail, and hospitality industry, it was forced to close for a long period from 2020-2021 following the COVID-19 pandemic restrictions. Likewise, it struggled with the loss or suspension of its main source of revenue and the company took actions to preserve cash.[56] Consequently, the company experienced financial difficulties that affected its cash flow. It resorted to negotiating with landlords to "seek agreement with them to alleviate the financial difficulties facing the Group."[57] This resulted in limited success and alternative options were considered to save the company. With that burning platform, it

[54] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch); *Hurricane Energy* [2021] EWHC 1759 (Ch) [88]- [100]
[55] Ibid [95].
[56] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch) [18].
[57] Ibid [19].

became clear that absent a financial restructuring, the company would fall into a formal insolvency process.[58]

The restructuring plan was used to restructure the financial and operational liabilities of the company. The plan involved seven groups of creditors; secured creditors, unsecured creditors of property liabilities (i.e., those creditors who were not current landlords of the company but had claims derived from present or past occupation of certain properties) and landlords of 67 leasehold premises who were split into five categories based on the operational performance and profitability of each premises, like a typical retail CVA structure. The aim was to restructure the plan companies' leasehold portfolio into a more sustainable one. The operational restructuring was paired with a financial restructuring which involved a provision of funds by the shareholders of the company.

2. Proposed Restructuring Plans

The company initiated the plan to facilitate the injection of new money into the group, extend the maturity date of its senior secured debt, and effect a restructuring of its lease portfolio to reduce its rental liabilities that had accrued as well as future rental liabilities. The company divided its creditors into seven separate classes, with each to be treated differently under the proposals.

All the secured creditors were placed within a class. There debts were to remain in place with certain amendments to the facilities agreement which included an extension of the maturity by 3 years, deferment of interest payments amongst other things.[59] Landlords were divided into five classes (categories A-E). Category A landlords would receive 100% of their future rent and arrears which had accrued, while landlords in other categories would have their unpaid arrears of rent released in exchange for a payment of 120% of the estimated return in a hypothetical administration.[60] Category B landlords would

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[58] Ibid [20].
[59] Ibid [57].
[60] D Shah B Ward H Davies, 'Developments in Restructuring Plans and Cross-class Cram Down: Virgin Active' (*Mayer Brown*, 28 may 2021) https://www.mayerbrown.com/en/perspectives-

receive their contractual rent in full for a period of up to three years after the plan has been sanctioned. The payment was to be made monthly in advance. Category C landlords would receive 50% and the landlords of the last two categories will be paid nothing. However, Categories C, D and E landlords would be given break rights, allowing them to terminate their leases and re-let their premises. These compromises were also extended to the guarantees of these leases.

3. Convening Hearing

Certain issues arose at the convening hearing that is worth identifying. There were issues surrounding inadequate information provided to stakeholders. A group of landlords had opposed the convening of relevant creditors meetings because according to them they were not given sufficient information by the company to enable them vote on the plan.[61]

Likewise, they argued that the two weeks' notice they were given prior to the convening hearing was unreasonable and they needed more time to consider the proposals. Taking into consideration the interests of landlords, the court suggested that Virgin Active should disclose certain information including the company's categorisation of their various sites and the relevant alternative against which the outcome to creditors should be evaluated, to the landlord's professional advisers. The landlords and their advisers in turn were required to provide a confidentiality undertaking to the court to receive these information and other creditors could also apply to the court to receive same.[62]

If the company failed to voluntarily provide the above information, the landlords were entitled to apply for an order for specific disclosure. The implication of this perhaps is that companies especially tenant companies who may want to compromise their rental

events/publications/2021/05/developments-in-restructuring-plans-and-cross-class-cram-down-virgin-active accessed 1 July 2021.

[61] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch) [76].

[62] Ibid [77]; D Manson and others, "Super Scheme or Super CVA" (*DLA Piper*, 31 March 2021) https://www.lexology.com/library/detail.aspx?g=1901d300-74a3-44fe-99e9-5bf9f69adf6f accessed 10 April 2021.

liabilities could be required to provide some information for transparency purposes albeit on a confidential basis to landlords or other creditors objecting to the plan. The court mindful of the financial pressure currently affecting the group and the need to balance a company's need to restructure vis a vis a creditor's right to vote on an informed basis, ruled that the meetings of creditors should proceed as planned.[63]

The plans were approved by the senior secured creditors and landlords of category A, premises but was rejected by landlords of other categories thereby failing to achieve the statutory majority of 75% in value of creditors in a class.[64]

4. Sanction Hearing

At the sanction hearing, given that the statutory majority vote required for the plan to proceed was not met, the court was called upon to invoke the cross-class cram down tool on dissenting creditors and exercise its discretion to sanction the plan. Under Part 26A of the Companies Act 2006, a court can sanction a restructuring plan even though one or more classes of the plan company's creditors reject the plan (something which is referred to as the cross-class cram facility). This may only happen if Conditions A and B are met and the court is willing to exercise its discretion. For emphasis, Condition A and B are explained further.

a. Condition A: The "no worse off" test i.e., would any members of the dissenting class be any worse off in the 'relevant alternative' if the restructuring plans were sanctioned.
b. Condition B: Were the restructuring plan approved by 75% of those voting in any class that would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative? And,
c. whether the court should exercise its discretion to sanction the Plans in all the circumstances.

[63] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch) [78].
[64] Ibid [81].

Condition B was met swiftly and was not in dispute since the most senior class of creditor had approved the plan i.e., Virgin Active secured creditors and Class A Landlords in Virgin Active. These creditors would receive a payment or had genuine economic interest in the company, in the event of the relevant alternative.

The crux of the issue was with Condition A and whether the court should exercise its discretion to impose the plan on a dissenting class of creditors. As anticipated the relevant alternative formed the crux of the arguments from both supporters and opponents of the plan.

5. The relevant alternative & the court's discretion

In Virgin Active, the company argued that the most relevant alternative to the plans was a trading administration involving an accelerated sale of the most viable parts of the companies' businesses. This was on the basis that should the plans not be sanctioned by the court; the company would run out of cash shortly after. Thereby leaving unsecured creditors with no return other than the prescribed part which was estimated to be one penny in the pound (p/£). Opponents of the plan which were a group of landlords argued that the company should have pursued other options to the plans that may have resulted in a better return for unsecured creditors.

The Court however accepted the plan companies' evidence and pointed out that the Court is not to consider what would have occurred if other alternatives had been sought in place of the relevant alternative or whether the plans were negotiated in a way that would affect certain creditors. Instead, the Court will consider what the relevant alternative was at the time of sanctioning the plan.[65]

The landlords further raised some points relating to the discretion of the court to sanction the plan. First, they sought to challenge the company's valuation evidence on the grounds

[65] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch) [91].

that the valuations used by the companies was not subjected to market testing. It was submitted that the valuations used here were “desktop” valuations that primarily used discounted cashflow methodology.[66] Second, creditors were not provided with adequate information to make an informed decision. Third, whether it was appropriate for the court to sanction the plan in cases where more junior stakeholders (the existing shareholders) were retaining their interests in the group at the expense of more senior stakeholder (the dissenting landlords).[67] The landlords argued that based on the above, the Court could not conclude outrightly that no member of a dissenting class would not be worse off under the relevant alternative.

Dismissing these arguments, the court held that the use of restructuring plans should not be undermined by lengthy valuation disputes, and it is for the court to ensure that the protection for dissenting creditors laid down by the “no worse off” criteria and the court’s general discretion is guaranteed.[68]

The court also pointed out that it is not compulsory to conduct a full market testing process, especially where it was unclear how the companies would fund such process and whether given the uncertainty of the market, it was reasonable to subject the business to a thorough market testing. Given the effect of the pandemic, “the market into which such testing would have been done could hardly have been less favorable.”[69] On this basis, the court held that the valuation evidence was reasonable and there was “no basis upon which to impugn it.”[70]

Further, the court held that to challenge the valuation exercise, the party challenging must adduce their own evidence and demonstrate that a better deal could be obtained in the relevant alternative. In the present case, no member of any dissenting class would be worse off under the plans than in the relevant alternative of an administration. Under the

[66] Ibid.
[67] Ibid.
[68] ibid [130].
[69] ibid [145]
[70] ibid [184].

restructuring plan, they would receive a return up to 20% more than they would have received in an administration.[71] Additionally, the return would likely be paid sooner than the administration dividend.

On the issue of whether the Court should exercise its discretion upon the satisfaction of Conditions A & B, there is little guidance under the legislation on the factors that should be considered by the court when exercising its discretion to sanction a restructuring plan using the cross-class cramdown. Case law also provides little guidance in this regard due to the novel features of the restructuring plan; specifically, the “cross-class cram down” provision.

The court examined the use of the cram down tool in the DeepOcean case[72] and held that a plan should be sanctioned if it is “just and equitable”, and that while a company may have a “fair wind behind it” if the cross-class cram-down conditions are satisfied, the court must notwithstanding consider all the facts and circumstances of the case.

According to the companies, under the relevant alternative, the value would “break” in the class of secured creditors (i.e., the value would the insufficient to repay their debt) and they would be entitled to the full value of the business to the exclusion of the dissenting creditors, who would only benefit from the prescribed part. Based on this, a distinction was made between “in the money” creditors and “out of the money” creditors.

The opposing landlords had argued that the plan was designed to enable the companies to eventually continue trading as a going concern and this could result in an increase in value of shares in those companies, thereby giving shareholders substantial benefit since they were to receive new equity. However, if it were to be the relevant alternative, the shareholders would rank behind the landlords and their shares would be worthless.

[71] ibid [200].
[72] *Re DeepOcean* [2021] EWHC 138 (Ch) [48].

It was contended by the opposing landlords that it would not be fair, just, or equitable if the restructuring surplus is divided in this way, because the unsecured creditors had enabled the survival of the companies by releasing their claims under the plan. As such, any treatment that allows shareholders to obtain value to the detriment of unsecured creditors that rank above them in the insolvency distribution ranking is contrary to the principles of insolvency law.

The court held whilst referring to the Deep Ocean case that a restructuring plan may allow different treatment and substantial value to be given to some but not all, creditors who are out of the money. By virtue of Section 901C (4) of the Companies Act 2006, creditors who are out of the money in the relevant alternative can be bound by a plan that compromises their claims without being allowed to vote.

In cases where out of the money creditors are allowed to vote, little reliance should be given to their votes in the court's determination of whether to sanction the plan and bind them to the plan. Their votes will only count if they adduce evidence that they are not out of the money in the relevant alternative. In this case, it was evident that the opposing landlords would be out of the money in the relevant alternative. Consequently, their votes were given little or no weight.

Importantly, it was pointed out by the court that it is the creditors who are in the money (i.e., those with genuine economic interest) that will determine the division of value that a business may generate after the restructuring process and as such, more weight should be attached to their votes. There may however be exceptions to this principle. In this case, there were justifiable commercial reasons for allowing the shareholders to retain their equity since they were providing new money on better terms than would have been available in the market. The court proceeded to sanction the plan.

Case Study 2: Hurricane Energy

1. Background

Hurricane Energy PLC is an Alternative Investment Market (AIM) listed company that deals with oil extraction and production. The company proposed a restructuring plan as it considered that it would be unable to repay in full its $230m unsecured bonds owed to its bondholders who are the main creditors of the company, on its maturity date. This was due to “reduced production from its well and reduced current and forecast oil prices...”[73] Even though the company was likely to continue trading as a going concern in the short term, it forecasted that it would be unable to repay the bondholders in full at maturity.

The purpose of the plan was to extend the maturity date for the bonds, get bondholders to agree a reduction to the amount due to them ($50m) and issue the bondholders with shares providing them with 95% of the equity in the company, with the existing shareholders’ interests being reduced from 100% to 5%.[74] If sanctioned by the court, the company was expected to undertake an extended wind-down allowing it to continue its oil production business until 2024. Likewise, “this would allow sufficient cash generation to enable full repayment of the Bonds with a small surplus to generate some value in the equity, although this was expected to be “less than a meaningful return”.[75]

Shareholders of the company had kicked against the plan after the plan was launched. One of the shareholders (Crystal Amber) of the company requisitioned an emergency extraordinary general meeting with the purpose of replacing some directors on the company’s board. Likewise, this shareholder and other individual shareholders opposed the plan in court.

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[73] ‘The Hurricane Energy Restructuring Plan: An in-depth inside View from Dentons’ (Dentons, 23 September 2021) https://www.dentons.com/en/insights/articles/2021/september/30/the-hurricane-energy-restructuring-plan accessed 3 March 2022.
[74] *Hurricane Energy PLC, Re* [2021] EWHC 1759 (Ch) [17] [Zarcoli J)
[75] Ibid.

2. Convening Hearing

At the convening hearing of Hurricane Energy, the company proposed holding a meeting of a single class of Bondholders to vote on the plan. The court disallowed this and ordered that the rights of shareholders were affected under the plan by virtue of section 901C(3) of the Act, (since the plan sought to effect a debt-for-equity swap which would dilute the shareholders' equity in the company), and as such should be involved in the process and form a separate voting class.[76] Even though an application can be made to exclude a meeting of shareholders under section 901(C)(4) of the Companies Act 2006, where the shareholders do not have a genuine economic interest in the company. This provision was not invoked by Hurricane Energy because of the difficulties in identifying and serving the application on all the shareholders of the company. However, for companies with a small shareholder base, it has been submitted that, this provision may be an attractive option for these companies, and this could potentially allow the disputes around the relevant alternative to be resolved at the convening hearing.[77]

Two classes of meetings were formed for voting purposes under the plan: one of the shareholders and the other for Bondholders. At the meetings, 100% of bondholders present voted in favour and 92.34% of shareholders attending voted against the plan.[78] The reasons given by shareholders for not supporting the plan include: "…premature market conditions were improving, the business was currently cash generative, and alternatives to the plan were available."[79]

[76] Ibid [29].

[77] 'The Hurricane Energy Restructuring Plan: An in-depth inside View from Dentons' (Dentons, 23 September 2021) https://www.dentons.com/en/insights/articles/2021/september/30/the-hurricane-energy-restructuring-plan accessed 3 March 2022.

[78] L Jennings, 'Hurricane Energy- The First UK Court Refusal to Sanction a Restructuring Plan' (*Taylor Wessing*, 2 August 2021) https://www.taylorwessing.com/en/insights-and-events/insights/2021/08/riu-hurricane-energy-the-first-uk-court-refusal-to-sanction-a-restructuring-plan accessed 10 August 2021.

[79] 'The Hurricane Energy Restructuring Plan: An in-depth inside View from Dentons' (Dentons, 23 September 2021) https://www.dentons.com/en/insights/articles/2021/september/30/the-hurricane-energy-restructuring-plan accessed 3 March 2022.

3. Sanction Hearing

At the sanction hearing, since at least one class of creditor voted against the plan, the voting threshold of 75% in value of creditors was not met. Consequently, like the Virgin Active case, the court was called upon to invoke the cross-class cram down tool on dissenting creditors and exercise its discretion to sanction the plan.

Like Virgin Active, in this case, Condition B was met swiftly and was not in dispute since in the most senior class of creditor had approved the plan i.e., Bondholders. These creditors would receive a payment or had genuine economic interest in the company, in the event of the relevant alternative. The crux of the issue was with Condition A and whether the court should exercise its discretion to impose the plan on a dissenting class of creditors. As anticipated the relevant alternative formed the crux of the arguments from both supporters and opponents of the plan.

4. The Relevant Alternative

In the Hurricane Energy Case, from the company's perspective, shareholders would not be worse off under the restructuring plan than would happen in the relevant alternative. The company considered that the relevant alternative would be a controlled wind-down. This would see the company continue trading for a further year after which it would cease to trade two months before the final maturity date of the company's unsecured bonds after which the company will commence decommissioning process of the oil field.[80]

Likewise, the company also argued that if the restructuring plan was not sanctioned and the board of the company was replaced at the extraordinary general meeting requisitioned by one of its shareholders, the new board may delve into risky strategies which could result in the insolvent liquidation of the company.

The opposing stakeholders contested that the relevant alternative identified by the company (controlled wind-down) was flawed. From this perspective, it was likely that the

[80] *Hurricane Energy PLC, Re* [2021] EWHC 1759 (Ch) [36].

company will continue to trade profitably in the short and medium term, and there were realistic possibilities of some options including refinancing, rights issue, buy-back of the bonds, open to the company to sort out the unsecured bonds by their maturity date.[81]

The court accepted the argument of the company to the extent that in the relevant alternative, the company will continue trading for a short period of time before the maturity date of the bonds. However, the court did not agree with the company on its submission that it would cease production of oil and comply with its decommissioning obligations. The court also disagreed with the company that in the absence of the plan, the replacement of the current board by a new board could lead to a near-term, insolvent liquidation of the company.

There was no burning platform as in the Virgin Active case where the company was facing an impending liquidity crisis and as such the relevant alternative was not an immediate cash flow crisis or insolvency. Given the likelihood that the company had a prospect of continuing to trade as a going concern coupled with the time available to the company before the maturity of the unsecured bonds, the court was willing to consider other available strategies to the plan that could be pursued by the company to resolve its expected financial challenges. The Judge identified “realistic” possibilities such as continuing to trade profitably in the short to medium term, and a bond buy-back, which could in the meantime allow Hurricane to meet its obligations to its bondholders.[82]

The court was of the view that the burden of proof lies with the company to show that the shareholders would not be any better off if they retained their existing rights and the company continued to trade for at least a further year. The court held that based on available evidence, the company had failed to discharge this evidential burden.[83] The shareholders will be better off without the plan since they would retain their shares in a company that continues to trade profitably and has a prospect of repaying the bonds in

[81] Ibid [35].
[82] ibid [102]-[104].
[83] Ibid.

due course, rather than give up 95% of their shares with the prospect of a "less than meaningful return".[84]

Given the lack of any 'meaningful return' under the plan, the court held that there was a realistic prospect of shareholders obtaining a better outcome through the alternative strategies identified and as such Condition A of the threshold conditions for the application of cross-class cram-down was not satisfied.[85]

In considering whether a plan fairly allocates value between the different stakeholders, the court will consider the potential upside from future trading as well as the possible steps been undertaken to address the repayment of debt when due and absent a 'burning platform', and where the restructuring was not important until a later stage, the court may conclude that junior stakeholders should not be deprived of their interests immediately, rather they should wait and see if actual performance improves overtime.

In contrast to the Virgin Active case where the plan was sanctioned by the court, the court refused to sanction the plan on the basis that Condition A (no worse off test) had not been satisfied. Consequently, there was no need for the court to exercise its general discretion to sanction the plan, although the court pointed out that it would have still refused to exercise that discretion in this case.

Case Study 3. Pizza Express

1. **Background**

Pizzaexpress is a multinational restaurant chain founded in 1965. The company had incurred a loss of £345million in the 2019 financial period.[86] This financial position was further exacerbated by the restricted trading measures and temporary closures of stores

[84] ibid [126].
[85] ibid [28].
[86] PizzaExpress Financing Plc, Re [2020] EWHC 2873 (Ch); Rob Davies, "Pizza Express Lining Up for Painful Debt Restructuring" (7 October 2019) https://www.theguardian.com/business/2019/oct/07/pizza-express-lining-up-for-painful-debt-restructuring accessed 22 January 2021.

due to the COVID-19 pandemic lockdown restrictions.[87] Due to the unsustainability of the level of debt which the company had incurred, a financial and operational restructuring became imminent. The company initiated the restructuring plan to restructure its financial obligations using a combination of debt for debt and debt for equity swaps.

The Pizza Express restructuring plan was part of a wider effort comprising three options: a disposal of the China group, restructuring plan under Part 26A of the Companies Act 2006 which was tailored around restructuring the group's debts and a CVA which was used to effect an operational restructuring of its leasehold liabilities.[88] This case is significant because it is the first time a CVA and restructuring plan will be used together, and the successful implementation of the CVA was dependent on availability of funds being made available to the group under the terms of the restructuring plan.

2. Convening Hearing

At the convening hearing, the court was satisfied that it had jurisdiction to consider the application of the company to convene the meetings of creditors. In terms of class constitution, there were three main classes of creditors comprising of a plan member who was a shareholder, senior secured notes holder and senior unsecured notes holder. It was necessary for the shareholder to be separated from the other group of creditors due to the existence of dissimilar rights between the creditors which necessitated the need for separate meetings to be held.

Further, it was also identified that the senior unsecured notes holders were subordinated to the existing senior secured notes holders and were out of the money, as such it was necessary to separate them into different classes.[89] Class composition was based on the principles used in schemes of arrangement which has been extended to restructuring plans which provides that a class must be confined to those persons whose rights were not so dissimilar so that it would make it impossible for them to consult together with a

[87] PizzaExpress Financing Plc, Re [2020] EWHC 2873 (Ch) [1]-[4]
[88] https://www.bakermckenzie.com/en/newsroom/2020/11/bm-advises-glas-on-pizzaexpress-restructuring
[89] PizzaExpress Financing Plc, Re [2020] EWHC 2873 (Ch) [37].

view to a common interest.[90] The court found that having met the required pre-requisites, it was appropriate for the meetings to be convened.[91]

3. Sanction Hearing

The plan had been devised in contemplation of a possibility of invoking the cross-class cramdown tool on dissenting classes of junior creditors, but it was not used in this case even due to receiving overwhelming creditor approval from all the three classes of creditors. Recall that the plan was part of an operational restructuring that involved a CVA, the CVA had been challenged by some landlords. However, the court held that even though such challenge had a risk of adding uncertainty to the process, nevertheless, the restructuring plan could still achieve its aims and the fact that a challenge exists need not prevent the court from sanctioning a plan even where the processes were inter-dependent of each other. The court is only required to consider whether a restructuring plan has a commercially real prospect of success and not whether the plan's success is guaranteed.[92] The court proceeded to sanction the scheme. An application was also brought for the plan to be recognised under Chapter 15 of the US bankruptcy code proceedings.

Summary

The practical implications of these cases demonstrate the flexibility of the restructuring plan procedure. As seen, the procedure can be used either as a standalone process or in combination with existing rescue mechanisms such as the CVA as seen in the Pizza express case. The novel feature of the plan allows the possibility of cramming down dissenting operational creditors vis a vis effecting a compromise of financial liabilities thereby solving the problems encountered in CVAs between retail debtors and their creditors with regards to financial and operational restructurings.[93]

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[90] Re Sovereign Life [1892] 2 QB 573, [583].
[91] PizzaExpress Financing Plc, Re [2020] EWHC 2873 (Ch) [61] (Alastair Norris).
[92] PizzaExpress Financing Plc, Re [2020] EWHC 3933 (Ch) [21]-[22].
[93] B Metcalfe P Usmani N Butchart "United Kingdom: Leisure and Retail Restructuring- A landlord's Lament" (*Lexology*, 28 May 2021,) https://www.lexology.com/library/detail.aspx?g=436c1767-f0e3-4450-b3d3-bbcd9235fb76&utm_source=Lexology+Daily+Newsfeed&utm_medium=HTML+email+-+Body+-

However, it is evident that the cross-class cram down tool under the procedure has boundaries and the court will not allow the strategic use of a restructuring plan to disenfranchise a particular stakeholder group. The court will be careful in its application of the restructuring plan specifically the cross-class cram down tool especially in cases where the relevant alternative is not immediate insolvency and must ensure that it is only used in appropriate circumstances and in the absence of realistic alternatives.

Where the relevant alternative is an impending insolvency and the dissenting class is out of the money, the application of the cross-class cram down tool is relatively straightforward. In such circumstance, if it can be shown that the dissenting creditors who are out of the money are no worse off under the plan i.e., they would receive a better financial outcome under the plan than if the company were placed in insolvency, the courts have held that it is for the in the money creditors to decide how the restructuring surplus should be shared amongst the relevant parties.

By contrast, where the relevant alternative is not an imminent insolvency but a prospect of profitable trading, application of the cross-class class down facility is more cumbersome. This is because the dissenting class of creditors may be in the money and would be required to vote on the plan.

It will be impossible to cram down in the money creditors as seen in the Hurricane Energy case where the shareholder challenging the plan was able to show that there was at least a realistic prospect that they would be better off in the relevant alternative than under the plan. In such circumstance, the cram down tool was not applicable. According to the court, “in other words, to retain 100% of the equity in a company that is continuing to trade, with a realistic prospect of being able to repay the Bonds in due course, is to my mind a better

+General+section&utm_campaign=Lexology+subscriber+daily+feed&utm_content=Lexology+Daily+Newsfeed+2021-06-01&utm_term= accessed 1 June 2021.

position than immediately giving up 95% of the equity with a prospect of a less than meaningful return as to the remaining 5%”.[94]

The issue of differential treatment of creditors is one of the major issues that arise in retail-CVA. The type of differential treatment that has consistently occurred is the treatment of landlord creditors as opposed to other creditors such as trade creditors. Landlords feel they are the ones singled out to bear the brunt of a failing business model, whilst other creditors are paid in full. It has however been held that such treatment will be permissible if it is essential to the rescue of the business such that payment in full of other creditors is needed to ensure business continuity.[95]

Interestingly, such treatment is also permissible under the restructuring plan procedure. A restructuring plan allows creditors to be treated differently irrespective of the class they belong to. Such differential treatment of creditors could be justified by reference to factors such as commercial importance and profitability. This case provides a helpful guidance on the treatment of differing interests of creditors who are “in the money” such as secured creditors compared with those creditors who are “out of the money” such as landlords and other unsecured creditors in this case, when considering how to distribute the benefits of the restructuring. It is however suggested that a balance should be struck between such differing interests. This is so that the rescue ideal is not promoted too strenuously such that it overly affects the rights of creditors.

Overall, the policy intention behind the introduction of restructuring plans was to promote timely restructurings, minimize value dissipation and to prevent companies from approaching the court at the last minute when the company is almost at the edge of collapsing. However, it has been submitted that “the appropriate timing for the launch of any restructuring plan will likely remain driven by the specific circumstances relating to the plan company’s business”.[96]

[94] Hurricane Energy PLC, Re [2021] EWHC 1759 (Ch) [17] [Zarcoli J).
[95] Discovery (Northampton) Limited v Debenhams Retail Limited [2019] EWHC 2441 (Ch).
[96] I West, “Reflections on a Year of Restructuring Plans” (2021) 34 Insolvency Intelligence 62, 65.

Given the encompassing nature of the procedure and its potential for rescue, it must be placed side by side the other rescue mechanisms examined in this thesis, i.e. CVA and pre-packs.

6.3. A Comparative Analysis Between the Restructuring Plan, CVAs and Pre-packs

At present, under the UK legal regime, a financially distressed company wishing to facilitate some form of restructuring or rescue will have the option of commencing either the restructuring plan or CVA or pre-packs. Much analysis has been given on these procedures in this thesis, this section will pinpoint some key aspects of the procedures for the analysis that will follow.

Recall that the CVA was introduced by the Insolvency Act 1986 following the recommendations of the Cork Report.[97] It is used by a financially distressed but economically viable company to reach a compromise or arrangement with its creditors with the aim of reducing or rescheduling the company's liabilities. It has become the preferable tool of choice for retail businesses who are overburdened with leasehold liabilities and seeking to reduce and restructure the liabilities owed to landlords. This is usually achieved by shutting down stores and cutting down on rental obligations owed to landlords without the need to meet and negotiate with them individually, thereby making the process easy and cost-effective.[98]

Next to the CVA is the pre-pack which is the variant of the administration procedure which involves the sale of the business or assets of an insolvent company, which is concluded almost immediately after the appointment of the administrator. Both the CVA and restructuring plan share more similarities than the pre-pack. This is because both procedures are corporate rescue procedures aimed at keeping the corporate entity intact,

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[97] *Insolvency law and Practice*: Report of the Review Committee (Cmnd 8558, 1982) "Cork Report", Chapter 7.

[98] S Clark G Moore, 'Could 2018 be the year of the CVA?' (*Walker Morris*, 16 February 2018) https://www.walkermorris.co.uk/publications/2018-year-cva/ accessed 10 May 2019.

whereas the pre-pack is a business rescue procedures targeted mainly at saving the business of the company. Nevertheless, some similarities between the three procedures will be considered.

First, both CVA and restructuring plans are debtor in possession (DIP) mechanisms such that the directors of the company remain in control of the business and affairs of the company during the process and most importantly, the directors will usually commence the rescue process. Even though the directors of the company would usually be involved in the decision to sell the business of the company to a new co, it is not normally a debtor in possession mechanism. Second, all three procedures can achieve the same broad outcome namely business continuity. Third, both the CVA and restructuring plan procedures enable a company to reach compromise with its creditors without the need for all creditors to support the process. This is perhaps where the similarities end with pre-packs.

Moving on to the similarities between CVA and the restructuring plan, the approval threshold for both procedures require the support of 75% in value of creditors or voting members within each class. Even though the CVA also requires 50% in value of unconnected creditors to support the proposal, something which is absent in restructuring plans, nevertheless, both procedures do not require the additional numerosity requirement as in schemes of arrangement.

Both procedures are flexible, and the company can propose anything if it offers a compromise or arrangement to its creditors. Both procedures involve an element of “give and take” to amount to a composition or arrangement. The restructuring plan and CVA procedures cannot affect proprietary rights without consent. Specifically, the right to forfeiture which can be triggered by a landlord on the occurrence of an insolvency-related event may not be altered by either a CVA or a restructuring plan.[99] Despite these similarities, there are however, fundamental differences between these mechanisms.

[99] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch).

First, the CVA provision is contained in the Insolvency Act 1986 which could arguably mean that there is an insolvency stigma on CVAs even though the procedure was created to facilitate rescue of a distressed but viable company. On the other hand, the restructuring plan procedure is a procedure based on company law rather than insolvency law as it is situated under the Companies Act which may mean that its absence from the Insolvency Act may have been intentional in an attempt to make the procedure more rescue friendly. Although, it was held in the Gategroup case[100] that the restructuring plan is an insolvency procedure and could have been listed under the European Union (EU) Insolvency Regulation 2015/848 were the UK still an EU member. The pre-pack has no formal legislation governing its application.

Second, as previously highlighted, even though the procedures are debtor-in-possession mechanisms, yet the extent of the debtor-in-possession model adopted in these procedures differ. The restructuring plan is essentially an agreement between a company and its creditors and requires no expertise of an insolvency practitioner in formulating or implementing the plan. This allows the directors to remain fully in control of the process.

By contrast, the CVA incorporates a hybrid model of debtor in possession and practitioner in possession (PIP). Even though directors are allowed to stay in control of the day-to day affairs of the business, the insolvency practitioner will oversee the process first as nominee and subsequently as supervisor who implements the arrangement after approval and distribute the dividends to creditors.[101] Similarly, pre-packs also incorporate a hybrid model of DIP which involves the administrator working alongside directors and secured creditors of the company to carry out the sale of the business before his/her formal appointment as administrator of the company.

[100] [2021] EWHC 304 (Ch); K Stephenson, 'Gategroup: UK Restructuring Plans are Insolvency Proceedings; Classes Split' (*Kirkland*, 26 February 2021) https://www.kirkland.com/publications/kirkland-alert/2021/02/gategroup-restructuring-plan-insolvency-proceeding accessed 22 July 2021.
[101] Insolvency Act 1986, section 7(2).

Third, the types of liabilities that can be compromised in all procedures are different. In a CVA, secured creditors and preferential creditors cannot be bound by a CVA except they consent.[102] In pre-packs, secured creditors are usually unaffected by the process as it is usually impossible for the sale to be conducted without the involvement of the secured lenders. For preferential creditors, majority often see their rights usually unaffected by the pre-pack sale, as they will be transferred to the new company upon completion of the sale.

Whereas a restructuring plan can modify the rights of these creditors with the consent of creditors within the same class and alternatively if the cross-class cram down conditions is met, secured creditors can be crammed down in a restructuring plan.[103] This potentially makes the restructuring plan more useful for restructuring liabilities owed to financial creditors than the CVA mechanism. Although a CVA can be twinned with a scheme to restructure and compromise debt owed to secured creditors. It remains that this is a cumbersome process.

Fourth, a critical question for a company seeking to propose any of the procedures is whether creditors will support the process and vote in favour of it. In a CVA, all unsecured creditors are required to meet as a single class for voting purposes.[104] As emphasised in the New look case, all unsecured creditors vote together and no separate class exists for voting purposes.[105] Even where the statutory majority is achieved by the votes of unimpaired creditors, this does not necessarily mean that the CVA is unfair, although depending on each individual circumstance, this will be a highly relevant factor to be considered in any given case of unfair prejudice.[106]

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[102] Insolvency Act 1986, section 4(2) (3).
[103] *Re Amicus Finance Plc* [2021] EWHC 2255 (Ch) (Amicus Finance).
[104] Insolvency Act 1986, section 3.
[105] Lazari Properties 2 Limited and others v New Look Retailers Limited, Butters and Another [2021] EWHC 1209 (Ch). [84].
[106] ibid 147.

A CVA proposal requires the approval of majority of at least three-quarters in value of those voting in favour of the CVA. This approval criterion is however subject to the condition that not more than half of the total value of “unconnected creditors” vote against it.[107] This voting threshold can be difficult to achieve where the CVA approval is highly dependent on landlord creditors approval of the process. As previously indicated in Chapter four of this thesis, landlords constitute major creditors who are mostly affected by the CVA. Landlords in general and institutional landlords in particular are inherently not approving of CVAs due to the loss of control around amendments of lease and as a result, they often strike back against the proposals.[108]

By contrast, in a restructuring plan, creditors are divided into separate classes for voting purposes and subject to the cross-class cram-down power, each class must vote in favour of the restructuring plan. Borrowing from the case law that has been developed in schemes, the class constitution is usually formed by reference to whether the interests of the members of a class are not so dissimilar as to mean that they cannot consult together with a common view to their common interest.[109]

With the restructuring plan procedure, the voting process is quite straightforward; only 75% by value of each relevant class of creditors must vote in favour of the plan for it to be sanctioned.[110] When compromising lease liabilities via a restructuring plan, the application of the class composition test will result in creation of different classes as seen in Virgin Active’s plan which consisted of seven classes of creditors.[111]

Due to the voting rules under the restructuring plan, it may be easier to impose the plan on dissenting landlords. The votes of secured and connected creditors count in full in a restructuring plan. Using the cross-class cram down tool, these votes can be used to cram

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[107] Insolvency Act 1986, section 3.

[108] A Szajna-Hopgood, ‘Landlords Strike Back Against Arcadia Proposals’ (*Retail Gazette*, 10 June 2019) https://www.retailgazette.co.uk/blog/2019/06/landlords-strike-back-arcadia-proposals/ accessed 27 August 2019.

[109] *Re T& N Ltd* [2005] 2 BCLC 488.

[110] Companies Act 2006, section. 901F (1).

[111] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch).

down dissenting landlords if the qualifying conditions are met, and the court is willing to exercise its discretion to invoke the cross-class cram down tool on dissenting creditors. Once the conditions are satisfied, dissenting creditors will be bound to a restructuring plan with a lower overall supporting vote than would have been the case in a CVA.

A pre-pack does not generally include a voting process. The procedure is carried out in secret with only the main actors involved i.e., the directors of the company, the administrator, and the secured lenders. Unsecured creditors are not given an opportunity to consider or vote on the proposed sale of the business. The only time a pre-pack is subjected to creditors voting is when the sale is to be made to parties previously connected to the company.[112]

Fifth, an additional flexibility offered to a debtor company wishing to initiate a restructuring procedure is that by virtue of section 901C (4) Companies Act 2006, a company can exclude a particular class from participating in the voting exercise on the grounds that the class is out-of-the-money or has no genuine economic interest in the relevant alternative.

This suggests that the out-of-the-money creditors are excluded from having any real influence on the way assets of the company should be distributed. The effect of this is that in terms of voting, a restructuring plan may be preferable to a CVA because of the ability to exclude certain out of the money creditors and cram-down dissenting creditors.

Sixth, an important point of consideration for debtor companies when making a choice between any of the procedures is the point in time at which a creditor can challenge the processes and what this means for the processes. Starting with a restructuring plan, challenges usually arise at the early stage of the process. Any disgruntled creditor may voice their concerns at the convening or sanctioning hearings without having to commence a separate process for challenge purpose.

[112] See the Pre-pack regulations discussed in Chapter 6.

On the other hand, in a CVA, the court is not involved in the process save where a CVA is challenged by disgruntled creditors. As such, there is little opportunity for these creditors to air their objections until after the proposal is approved. A CVA can only be challenged within 28 days of the supervisor's report to the court of the creditors and shareholder's meetings.[113] Consequently, the time of challenge is short and requires parties seeking to pursue such challenge (e.g., landlord) to coordinate themselves quickly and initiate proceedings, as well as bear the costs of pursuing the challenge proceedings.

Thus, the major difference between both processes is that the CVA is challenged after the procedure has come into effect. This means that the company will be operating within the terms of the CVA, thereby paying reduced rent during the period of the challenge. Conversely, if the restructuring plan is used, the challenge occurs before the plan is sanctioned. By so doing, the restructuring plan achieves certainty whereas a CVA leaves open the possibility of subsequent challenge.

Furthermore, the scope of challenge is wider in a CVA than a restructuring plan. The CVA can be challenged based on two grounds- unfair prejudice and material irregularity.[114] Whilst there is no laid down rules for challenging a restructuring plan, the oversight role that the court plays in the process means that the court will scrutinize the restructuring plan even where there is no formal application for challenge.

Conversely, this is not the case in a CVA since the court does not involve itself with the process which means absent a challenge process, the CVA may never get to court. Moreover, a company may settle a CVA challenge outside the court as was the case in House of Fraser.[115] Therefore, the mode of challenge, timing consideration could have a role to play in the choice of whether to pursue a CVA or restructuring plan.

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[113] Insolvency Act 1986, section 6.
[114] Ibid.
[115] E Jahshan, "House of Fraser Settles Landlords ' Legal Challenge" (August 6 2018, Retail Gazette) available https://www.retailgazette.co.uk/blog/2018/08/house-of-fraser-landlords-legal-challenge-cva-settled/ accessed 1 August 2021.

In the case of pre-packs, an action can be brought against the administrator under the Insolvency Act 1986[116]. The grounds for bringing such action may include that the administrator causes unfair harm to the interests of the creditor, or he/she failed to perform his duties sufficiently, timeously, and efficiently. However, the courts are unwilling to question the actions and decisions of the administrators. Thus, the scope of challenging a pre-pack is very limited.

Seventh, valuation plays an important role in CVA, pre-pack and restructuring plan. In both CVA and restructuring plan, a company will need to include in its proposal process, evidence as to the valuation of available assets and the relevant alternative to persuade creditors and the court that some creditors are out of the money or that insolvency is the appropriate comparator. As stated by the court in Virgin Active,[117] it is not compulsory to conduct a market testing process, but such a process is likely to be the best way of valuing an asset. The debtor company will also need to show that creditors will not be worse off under the restructuring plan than they would be in the relevant alternative.

Where the relevant alternative is not an imminent insolvency, it may be difficult to persuade the court that the test is satisfied as seen in Hurricane Energy.[118] Valuation and restructuring alternative also have a role to play in a CVA if a challenge is raised, the company must be prepared to face extensive court scrutiny. Valuation in pre-packs is often the most contentious part of the process.[119]

Eighth, the CVA and pre-packs have been regarded as cost effective when compared to a restructuring plan, however, the cost of initiating any of the process will depend on the circumstances of each case. If a restructuring plan is proposed, automatically, the proposer knows that it will involve a substantial court scrutiny (two court hearings) and

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[116] Insolvency Act 1986, Schedule B1, Paragraph 74, 75.
[117] Virgin Active Holdings Ltd & Ors, Re [2021] EWHC 1246 (Ch).
[118] Hurricane Energy [2021] EWHC 1759 (Ch).
[119] A Goldrein, "Unwrapping English Pre-packaged Administrations: A Guide to "Pre-packs" in England' (*Lexology*, 23 May 2011) https://www.lexology.com/library/detail.aspx?g=da1945a8-be91-4557-9028-48c5e8993a39 accessed 1 January 2021

would be expected to have factored in the cost so it is expected that the costs of a restructuring plan will be relatively certain.

A CVA will only be cost effective if a challenge is not raised against the process. A contested CVA may be costly as a restructuring plan. Pre-packs are often lauded for their cost-effective nature compared to the main administration procedure. Given that the control of the business, risks and costs involved are transferred to the purchaser immediately or shortly after the appointment. This can save trading costs. Thus, cost depends on the nature of the process and the circumstances of each case. Ninth, of the three procedures, pre-packs preserve the jobs of employees compared to CVAs where cost-cutting and reduced trading operations associated with the process will result in job losses.

Lastly, in terms of foreign recognition, Brexit has affected to a large extent cross-border recognition of rescue processes. The UK ceased to be a part of the European Union on December 31, 2020. The effect of this is that the rescue processes will no longer be automatically recognized under the EU's Recast Insolvency Regulation.[120] However, plans are more likely to be internationally recognized since they are approved by the court, unlike CVAs which do not necessarily come before the court.[121]

Haven identified the similarities and differences of these procedures as well as the advantages and disadvantages of each, given that the restructuring plan and CVAs share more similarities than any other procedure, it is pertinent to examine whether the restructuring plan will herald the decline of CVAs.

[120] For a general discussion see DEA Nolan, 'Recognition of Restructurings in Europe' (*Lexology*, 2 June 2021) https://www.lexology.com/library/detail.aspx?g=4f3d1852-07ba-42de-b8ea-940512d5e677 accessed 1 December 2020.
[121] Ibid.

6.3.1. Will the Restructuring Plan replace the CVA mechanism as a rescue device in the retail industry?

As submitted by Snowden J in the Virgin Active case, there is nothing "inappropriate in the Plan companies choosing to utilize Part 26A rather than a CVA if that appeared more likely to achieve the desired result of rescuing the companies in the interest of their stakeholders generally."[122] This confirms that distressed companies have a choice between both procedures.

However, given the similarities between the two procedures, coupled with the fact that they are both corporate rescue procedures, the question remains: To what extent will the operation of the restructuring plan restrict the use of CVAs as a rescue device in the retail sector? In other words, will the restructuring plan become the preferable tool of choice thereby leading to the end of CVAs as a rescue device?

The starting point will be to place both procedures within the context of different usage to which they can be subjected to. Firstly, both procedures allow directors of the company to remain at the helm of affairs and propose the plan or CVA to the creditors. However, a restructuring plan differs from the CVA in this regard, and this may have a potential effect on the use of CVAs. The plan does not involve an insolvency practitioner to oversee the process alongside the directors as it is the case in CVAs.

The reason why an insolvency practitioner is required in CVAs to oversee the process alongside directors is because even though the CVA allows directors to remain in control and tackle the problems of the company, concerns have been raised about the inability of directors to act timeously when the company is approaching distress, coupled with the fact that directors have been accused of not properly identifying what is required for the company to continue trading as a going concern or failed to make underlying changes to the business.[123] This makes the role of the IP important in CVAs.

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[122] *Virgin Active Holdings Ltd (and others)* [2021] EWHC 1246 (Ch) [276].

[123] P Walton C Umfreville L Jacobs, 'A Snapshot of Company Voluntary Arrangements: Success, Failure and Proposals for Reform (2020) 29 International Insolvency Review 267, 276.

Nevertheless, despite the presence of an IP in CVA, the nature of the role played by the IP both as nominee and supervisor of the CVA has also been questioned. It has been commented that the assessment of the proposal by the nominee is often overly optimistic, which brings into question the effectiveness of the proposal from the onset.[124] Such arguments have also included that a nominee may be driven my self-interest in recommending a CVA, which would result in the same nominee being appointed subsequently as supervisor of the CVA.[125] These concerns have led to a lack of confidence in CVAs, with creditors opining that their interests are not fully catered for in a CVA.[126]

This is further exacerbated by the allegations of abuse levelled against CVAs from the perspective of landlord creditors who stand the chance to lose out the most in retail CVAs. As recognized by Finch, "there are risks attached to restructuring, however, with the possibility of abuse and oppression of some parties by others during the process of restructuring."[127] The rights of other creditors such as suppliers for example are often protected in CVA, on grounds of business continuity.

Given the involvement of the court in the restructuring plan procedure, the court can act as a mediator between the different creditors during the approval process, since by law the creditors are required to meet in classes comprising of those with similar rights. This is unlike the case in a CVA where creditors vote as a single class, and it is possible for dissenting creditors to be bound to the plan even where they did not approve it.

Even though the involvement of the nominee in CVA is to enhance minority protection and reduce court involvement in the process, the roles played by the court in a restructuring plan and nominee in a CVA are not the same. It has been argued elsewhere

[124] Ibid.
[125] ibid
[126] ibid
[127] J Payne, "The Role of the Court in Debt Restructuring" (2018) 77 Cambridge Law Journal 120, 140.

that "there may be differences in the extent of the role and costs connected with these choices."[128]

The court being an integral part of the restructuring plan will ensure that the process is thoroughly scrutinized, and each party's interest will be considered in the court hearings. Likewise, the final sanctioning of the restructuring plan by the court even where the requisite creditor approval has been received is an important feature which is tailored around ensuring that the plans are thoroughly scrutinized.

It is however noteworthy that huge court involvement in the restructuring plan procedure may make the process cumbersome and expensive which will likely mean that only large companies can use the procedure, since small companies may find the costs prohibitive. This may potentially make the CVA a better course of action for small companies. Although the recent use of the restructuring plan by Amicus Finance Plc[129] by a mid-market company may set the path for more restructuring plans to be used by such businesses.

Further, CVAs may not always be quick, non-costly and timely as the literature suggests. The role of the nominee in a CVA includes assessing the prospects for success of the CVA and identifying proposals that are non-viable. However, the source of the information needed for the nominee to perform this function is derived from the directors of the company.[130] A party not satisfied with the actions or inactions of the nominee can apply to the court under Section 6 of the Insolvency Act 1986. As such, the nominee will want to take precaution and do his own due diligence. Moreover, it has been commented that in some cases, it may be dangerous for a nominee to rely solely on information supplied by directors.[131] The effect of this due diligence is that a procedure that ought to be cheap

[128] J Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press, 2014) 212.
[129] *Re Amicus Finance plc (in administration)* [2021] EWHC 2340 (Ch).
[130] Although directors will refrain from making false representations to the nominee to avoid being personally liable. Insolvency Act 1986, sections 6A (4) and 7A.
[131] Law Society Company Law Committee, Comments on the Insolvency Bill (London: March 2000) No. 396, at 5.

and quick may become more expensive and cumbersome. Consequently, the CVA procedure may not be quick and cheap in practice as may have been expected.

Secondly, the restructuring plan is wider in scope than a CVA. It can be used for various types of restructurings and can involve a combination of different stakeholders including financial creditors, landlords, trade creditors and shareholders unlike a scheme which mainly involves "companies with numerous tiers of financial creditors, often with international operations and complicated financial arrangements."[132] As previously pointed out, unlike the CVA, the restructuring plan can be used as a single process to compromise multiple creditors both secured and unsecured; it can be used to achieve both improvements to the operational structure of the company as well the company's balance sheet.[133]

While a CVA can be used to address leasehold liabilities in similar fashion with the restructuring plan, there are certain issues with the procedure that affects its viability, such as the inability to bind secured creditors, voting and classification issues given that all unsecured creditors vote as a single class. The restructuring plan can ameliorate these issues since both secured and unsecured creditors can be bound to the plan, creditors are divided into different classes for voting purposes, the cross-class cram down can be used to bind dissenting creditors to the plan and the plan can be launched swiftly in the face of real, imminent, or anticipated financial difficulties. Moreover, it has been held that from the creditor's perspectives, a restructuring plan is more beneficial than a CVA because it allows more time for negotiation and consultation than is possible in a CVA.[134]

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[132] P Keddie J Bains S Beale, 'Planning a way out of Lockdown- The UK's New Restructuring Plan Procedure and its Applicability to the Mid-Market' (*Macfarlanes*, 24 May 2021) https://www.macfarlanes.com/what-we-think/in-depth/2021/planning-a-way-out-of-lockdown-the-uk-s-new-restructuring-procedure-and-its-applicability-to-the-mid-market/ accessed 12 December 2021.

[133] D Manson and Others, 'UK restructuring Plan Update: One Further Sanctioned Case, One Giant Step Forward' (*Lexology*, May 19 2021) https://www.lexology.com/library/detail.aspx?g=575edfbc-455c-427c-b6f4-485381bdff51&utm_source=Lexology+Daily+Newsfeed&utm_medium=HTML+email+-+Body+-+General+section&utm_campaign=Lexology+subscriber+daily+feed&utm_content=Lexology+Daily+Newsfeed+2021-05-21&utm_term= accessed 2 June 2021.

[134] Lazari Properties 2 Ltd v New Look Retailers Ltd [2021] EWHC 1209 (Ch) [199] (per Zarcoli J).

The restructuring plan unlike a CVA does not require the approval of 75% of creditors and 50% of unconnected creditors to go ahead. All that is required is 75% of each class of creditor to vote in support of the plan. Where the required threshold is not met in a class, the plan may still be sanctioned by the court (the power of cross-class cram-down), provided the two conditions already discussed in previous sections are met.

Bringing the restructuring plan procedure to retail restructuring context will mean that landlords will be divided into classes in similar way as in a CVA, based on the proposed outcome for the landlord as seen in the Virgin Active case.[135] This means that companies will benefit more from the increased flexibility on the plans they present to their landlords. In a CVA, a company will have to place landlords of less performing sites in a favorable category to secure their approval in the CVA. This will no longer be the case if a restructuring plan is used as the cross-class cram down can be used to bind dissenting creditors to the plan.

Importantly, a company can disenfranchise a class of creditors or shareholders who have no genuine economic interest in the company and are therefore “out of the money,” yet still bind those classes into the restructuring plan, something which is absent in CVAs. The court has gone a step further to rule that out of the money creditors should not determine how the restructuring surplus should be shared and their votes will carry little or no weight at all in the sanction process.[136] This demonstrates the all-encompassing nature of the new procedure, and it is likely to be a preferable tool of choice for distressed but viable businesses in the retail sector who have struggled with balancing the interest of the company with that of its creditors.

Thirdly, it has been submitted that “the overall treatment of creditors in a restructuring plan has not changed as the relative bargaining position of creditors is dependent upon

[135] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch) [149].
[136] Ibid.

their relative priority positions."[137] The safeguards enshrined in the restructuring plan is designed to protect the interests of creditors. They can raise any challenge to the restructuring plan proposal at an early stage before it is implemented.

Whereas in a CVA, challenges can only be made after implementation of the CVA and must be done within a limited timeframe. In fact, it can take several months before the challenge is heard in the court as in the New Look case,[138] thereby undermining the finality of the CVA. However, in certain cases, "challenges can be settled after the event, without undermining the finality of the CVA."[139] Nevertheless, the certainty inherent in restructuring plans is a major advantage over a CVA procedure and may inform the decision of which of the procedures a debtor company should initiate to restructure its obligations.

One of the challenges that can be brought against restructuring plans as experience has shown in the scheme of arrangement procedure is one that relates to class composition. In the Virgin Active case, even though no such challenge was brought, the judge gave an indication that such challenge may be successfully instigated in future cases. In the words of the court: [140]

"Nor did the [opposing landlords] seek to challenge the differing treatment accorded to each of the classes of Class B-E landlords and the General property Creditors…. There may, in principle, be reasons for the court to decline to exercise its discretion to sanction a plan that discriminated arbitrarily or capriciously between different classes of unsecured creditors who were all equally "out of the money", but I do not need to explore the boundaries of any such principle on the facts of this case."

[137] 'Virgin Active Restructuring Plan Approved by the English Court' (*Clifford Chance*, May 2021) https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/05/virgin-active-restructuring-plan-approved-by-the-english-court.pdf accessed 4 January 2022.

[138] *Lazari Properties 2 Limited and others v New Look Retailers Limited Butters and another* [2021] EWHC 1209 (Ch).

[139] *Nero Holding Ltd v Young* [2021] EWHC 1453 (ch) [107].

[140] *Virgin Active Holdings Ltd & Ors, Re* [2021] EWHC 1246 (Ch).

Thus, there is scope for landlord challenges to oppose future restructuring plans on grounds of unequal treatment of similarly situated creditors. Furthermore, despite the flexibility of CVAs, an inherent weakness of the procedure is that unless the company can show that no creditor is worse off under the CVA than in administration or liquidation, the CVA will be susceptible to a court challenge by aggrieved creditors. Due to the difficulties involved in meeting the no worse off criterion, the company will often address this problem by "over-paying" creditors under the CVA. On the plus side, this approach minimizes the risk of court challenge to the CVA. However, on the negative side, the over-payment approach reduces the economic upside for the business under the CVA.

Additionally, despite initial criticism of the lack of a debtor-in-possession financing as is the case in a US Chapter 11,[141] there has been some form of rescue financing under a restructuring plan. New money has been advanced alongside restructuring plans for example in Smile Telecoms where it was used to fund capital requirements[142] and in Virgin Active where new money was used to pay creditors more than their estimated recoveries in the relevant alternative.[143]

Lastly, the restructuring plan indeed aims to facilitate the going concern surplus. The legislation is clear on the aim of the procedure; it seeks to eliminate, reduce, prevent, or mitigate the effect of financial difficulties in a company. This suggests that the procedure is mainly tailored around preventing a company from entering insolvency. Whereas the purpose of a CVA remains uncertain due to the little guidance given by legislation.

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[141] DIP financing is a form of financing in the US which is available to firms in Chapter 11 bankruptcy which allows the company to continue operating. It allows the company to raise capital to fund its operations during the bankruptcy process. For a general discussion see S Dahiya K Ray, 'A Theoretical Framework for Evaluating Debtor-in-possession Financing' (2017) 34 Emory Bankruptcy Developments Journal 57.

[142] *Re Smile Telecoms Holdings Ltd* [2021] EWHC 685 (Ch) (Smile Telecoms).

[143] *Re Virgin Active Holdings Ltd & Ors,* [2021] EWHC 1246 (Ch).

The restructuring plan can be said to promote corporate rescue over other goals.[144] Even though the courts are involved in the process, their involvement is limited to examining class composition and sanctioning the plan provided the statutory conditions are met and if it is just and equitable to do so. Even though the twin benefits of the cross-class cram-down and the court approval can make the restructuring plan a restructuring tool of choice, notwithstanding, a balance needs to be struck between ensuring the fair treatment of creditors who have been affected by the restructuring process and helping companies deal with financial difficulties via the restructuring process.

It is evident that the restructuring plan encompasses certain distinctive features which makes it attractive than CVAs. However, it is submitted that the restructuring plan does not mark the end of CVAs, indeed, CVAs will still have a role to play in leasehold liabilities restructuring especially that of small and medium-sized companies. The process remains less expensive than the plan procedure because the courts are not involved, and unsecured creditors vote as a single class thus making the process less cumbersome.

However, in large cases especially one that involves secured creditors, it is likely that the restructuring plan will be preferred to CVAs. Overall, it has been submitted elsewhere that the choice of either of the procedures will depend on certain considerations including voting analysis, process and timing considerations and the willingness of the court to apply the cross-class cram down facility when dealing with restructurings focusing on landlords.[145]

6.4. Conclusion

The restructuring plan procedure indeed has a beneficial role to play in the UK restructuring landscape. It is the first step towards a genuine debtor-friendly regime in the UK and a step towards an effective rescue model in the restructuring framework aimed

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[144] E Vaccari, "Corporate Insolvency Reforms in England: Rescuing a "Broken Bench"? A Critical Analysis of Light Touch Administrations and New Restructuring Plans" (2020) 31 International Company and Commercial Law Review 645, 665.

[145] N Cooper, "The Death of the CVA? Landlord Compromises and the Restructuring Plan" (2020) 17 International Corporate Rescue.

at maximising the survival of distressed but viable companies. It is emerging as a viable tool to facilitate both financial and operational restructurings via a single procedure, which is not possible in a CVA except it is twinned with schemes.

The CVA is often hailed for its flexibility in that the company can propose any arrangement as it deems fit to protect the trading concern value in the company. However, the case studies examined in this chapter has demonstrated the inherent flexibility of restructuring plans which arguable is wider in scope than the CVA.

The decision as to whether the plan is a better restructuring alternative to CVAs will depend on the facts and circumstances of each case. The cross-class cram down mechanism is an innovative and beneficial feature under the new regime and it is likely to make the restructuring plan procedure more appealing than the CVA. This is because dissenting creditors who are out of the money can be crammed down under the plan and do not determine how the restructuring surplus should be allocated, this is for the in the money creditors to determine. Thereby, preventing undue delay to the sanctioning of the process.

Likewise, the decision of the court in the Virgin Active case is very instrumental to the choice of whether to pursue a restructuring plan or a CVA. The court stated that where the restructuring plan is more likely to achieve the result of rescuing the companies in the interest of their stakeholder generally, the company can choose to initiate a restructuring plan rather than a CVA. Consequently, it is highly likely that more distressed large companies in the retail sector will choose the new regime over the CVA process.

This may not be surprising due to the recent trend in retail CVAs; most companies that undertake a CVA as a rescue device often end up in administration/liquidation months after and this casts doubt on whether the CVA was the appropriate procedure to save the businesses in the first place. Thus, the flexible and innovative feature of the restructuring plan when used in the right circumstances is likely to facilitate an effective corporate rescue regime in the UK. Likewise, there is a potential role for the courts in addressing the imbalance between flexibility and fairness in rescue scenarios. This is something which has been a constant struggle in both CVA and prepacks.

It however remains that the complexity and cost of the restructuring plan process may mean that the CVA remains the preferred choice for small to mid-size companies. Thus, the CVA will continue to have a role to play in retail restructuring albeit on a reduced basis. Even though the restructuring plan procedure can be said to tip the balance firmly towards an effective corporate rescue regime, it however remains to be seen the extent to which the new procedure will balance value-maximization with the prospect of future survival.

Chapter 8

Conclusion

This chapter concludes the thesis, it seeks to give an overview of how each research questions has been answered in each chapter of the thesis. The thesis in Chapter 1, highlighted the host of problems affecting the operational performance of companies operating in the UK retail sector. Given the constant disappearance of retail brands from the high street, the thesis sought to examine the effectiveness of the rescue mechanisms available to a distressed retail company in the UK. To examine the issue in detail, the chapter posed and answered in the subsequent chapters, the following research questions:

1. What are the causes of financial distress and insolvency in the UK and what are the drivers of distress and insolvency in the retail sector?
2. How does the UK insolvency framework ameliorate the issues facing retail companies in the UK?
3. What is the role of the CVA mechanism in the resolution of distress?
4. Given the continued use of CVAs by distressed retail companies, can the trend in retail CVAs be said to be changing the nature of the corporate rescue regime in the UK.
5. How does the pre-pack procedure compare with CVAs in the context of business rescue and future survival of retail companies?
6. What does the restructuring plan procedure mean for corporate rescue and what is the potential effect of the procedure on the use of CVA in retail restructuring?

Question 1: The Causes of Financial Distress and Insolvency in the UK Retail Sector

In answering this question, Chapter 2 examined the concept of financial distress and insolvency from a legal and business perspective. The causes of financial distress and insolvency is not clear cut with different disciplines ascribing different meanings to both concepts. From a legal perspective, financial distress refers to the inability of a company to pay its debts, which could result in the company been placed into a formal insolvency procedure. The law uses the cash flow test and balance sheet test to determine when a company to determine when a company is in financial distress or approaching insolvency, however, establishing inability to pay debt under both tests requires several considerations which may be unclear depending on individual circumstance of the company. The chapter considered the causes of decline and business failure from a business perspective. It was found that just like the legal definition, there is no universal consensus on what these concepts mean.

The interpretation of business failure within the literature have differing goals since the available data either contrasts or expands depending on the perspective of failure under consideration. This definitional shortfall impacts on how failure is measured and failure from the business literature. As seen, both factors need to be taken together to better understand the reason why companies fail. It went on to consider the importance of the retail industry to the UK economy. As seen, the sector is the largest private sector employer in the UK and its turnover forms a major part of the UK's total economic output. Regardless of this, companies continue to go bust year in year out. The drivers of retail failure were identified as- internet online retailing which has seen the shift from physical stores to online shopping and burden of rental liabilities.

<u>Question 2: Corporate Rescue in the UK and the Role of the CVA</u>

The third chapter of this thesis examined the corporate rescue concept and its development in the UK. The Cork Report has significantly shaped the UK's rescue model by defining the characteristics of a good modern insolvency system. As seen corporate rescue is any intervention taken to prevent the company from failing. English insolvency law has transitioned from a liquidation culture which involved the sale of the assets of the company to satisfy the claims of creditors, to a rescue culture which aims to maximize the going-concern value in the company. There is a plethora of rescue procedures (both informal and formal) aimed at pursuing the goals of insolvency law and corporate rescue.

The thesis focus is on the company voluntary arrangement procedure, given its increasing role in the retail industry. Chapter 4 considered the mechanics of the procedure and identified the success factors required for the procedure to be effective. It was identified that for a CVA to yield beneficial results for stakeholders, first, the process must be commenced early. In this regard, a case has been made for the inclusion of a principle that widens the director's duty of care to include early commencement of rescue when financial distress is imminent. To back this up, there needs to be legislative sanction for erring directors for non-compliance.

Second, availability of rescue finance to enable the company to resolve its cash flow issues is critical to the success of a CVA. It was suggested that the UK should make steps towards incorporation of rescue funding in its insolvency system to ease financial pressure from a distressed company. However, any adoption of this facility should be balanced with the rights of existing creditors to avoid the challenges faced in the US. Third, the length of the CVA is also important to its success, a reduction of length to three years could alleviate issues of cost and complexity which will make the process effective. Lastly, the CVA requires a coordination of expertise of the main actors involved in the process if it is to be successful. Regardless of these factors, it remains that there is no one size fits all approach, and each company ought to be treated based on its individual circumstance.

Question 4: The Operation of CVA in Retail Restructuring Cases

Chapter 5 of the thesis went on to assess the practicalities of CVA in retail restructuring cases. It found that CVAs are correlated with better outcomes for creditors but most of the companies that undergo a CVA do not ultimately continue trading as a going concern, thereby leading to conclusions that the CVA does not ultimately fulfil the goal of corporate rescue. The simplicity of the CVA procedure has been overridden by its flexibility; leading to issues of fairness for some stakeholders. Thus, this thesis argues that a CVA will not always be the best course of action for every distressed retail company, this is evidenced by how quickly they fail. Consequently, retailers need to make structural changes to their business as well as adopt both financial and operational restructuring measures alongside the CVA.

In cases where the CVA is the best option for the company, some recommendations have been given to enhance the effectiveness of the process for both the company and its creditors. This includes first more legislative clarity and specificity on CVAs, such legislative reforms should aim to ensure that retail-CVAs do not continue to be used simply as cost-cutting exercises but there should be genuine intention to save the company where it is viable. Likewise, with regards to the treatment of similarly situated creditors which is a major issue in retail-CVAs, it has been suggested that debtor companies should be required to strike a balance between critical creditors and non-critical ones such that those identified as non-critical should also benefit from the process. A way of incorporating this is to make the "upside sharing mechanism" an important part of the CVA proposal.

Secondly, a case has been made for more transparency, and engagement in the process as this will facilitate cooperation and coordination amongst the company, IPs and creditors which is critical to the success of CVAs. Third, it has also been suggested that the dual roles played by IPs in CVAs should be separated. In this regard, it was suggested that turnaround specialists should take over the pre-approval role played by nominees', given their expertise in assessing the propriety of reorganization for a distressed company amongst other pre-rescue considerations, as well as their independence. The post-approval role should be left for the IPs to perform i.e., IPs should be involved in the supervisory role post implementation.

Question 5: The Role of Pre-packs in Retail Restructuring: Comparing Pre-packs with CVAs

The sixth chapter in the thesis examined the role of pre-packs in retail restructuring. Pre-packs are the most used business rescue procedure in England and Wales and the common alternative to CVAs for retail companies. The benefits and shortfalls of pre-packs were identified. It was found that compared to CVAs, pre-packs are attuned to lower overall realizations than CVA, even though there is hope for survival of the Purchaser. However, the ultimate survival of the purchaser is often short-lived even though it doesn't occur as early as the termination rate in CVAs. It was also found that these procedures tend to undermine the goals of insolvency law.

Whilst the CVA preserves value to a minimal extent, it remains that not all creditors are treated the same under the process. Likewise, directors do not fully investigate the reason why their companies ended up in financial distress. In a pre-pack, value is preserved by selling the assets and business of the company to a newco, nevertheless, the procedure is attuned to lower realizations compared to a CVA. Likewise, while secured creditors often benefit from the process, same cannot be said of their unsecured and preferential counterparts who are usually left with Little or no returns. Given the nature of pre-packs, investigating the causes of insolvency is often not considered. To further exacerbate these problems, most companies that commence a CVA or pre-pack end up in liquidation. This leads to conclusions that there is an imbalance between value maximization and future survivability of rescued business. Likewise, the flexibility of these procedures, often affect the fair outcomes they are supposed to provide for stakeholders.

Question 6: Restructuring Plan, CVA and the Corporate Rescue Ideology

The 7th chapter explored the extent to which the restructuring plan procedure provides a panacea to the problems identified in both CVAs and pre-packs, i.e., how to resolve recidivism and how to balance flexibility and fairness of rescue procedures on one hand, and whether the operation of the restructuring plan will herald the decline of the CVA on the other hand.

In considering the first issue, the thesis argues that the role played by the court in overseeing the process will help address the imbalance. Thus, there must be a tectonic shift in the way rescue procedures are used to pursue the going concern values in companies. On the second issue, it was submitted that due to the cost and complexity of the procedure, given the role of the courts in the process, small and medium sized companies may prefer to use the CVA for obvious reasons, while large companies may result to the restructuring plan due to its ability to compromise both financial and operational liabilities. However, it remains that the choice of either of the procedures will be dependent on several considerations.

Way Forward

Without a doubt, the present rescue system in the UK has undergone a massive change than would have been envisaged when the rescue culture was advanced many years ago. The way the goals of rescue has been furthered through the rescue procedures leaves the rescue ideology at a crossroad. As described by Finch, "…it is often hard to state whether any rescue successes or failures are due to the properties of the "rescue process" or are a product of other related factors that may or may not be included within the notion of a rescue regime."[1]

The rescue framework exhibits a pattern that demonstrates a drift between flexibility and fairness. Flexibility as seen in a CVA means that a restructuring can take any form. The process allows the company to explore rescue options which will allow it to continue trading as a going concern. In other words, options that will enhance the survival of the company. Through flexibility, the company can adapt to the constantly evolving market landscape and changing corporate structures. Fairness on the other hand means that the process considers the privileges of all stakeholders without treating one party favorably than others.

As seen throughout this thesis, both features of flexibility and fairness co-exist uneasily in corporate rescue. Flexibility is enhanced in a retail rescue context by allowing a company to tailor the CVA around its leasehold obligations such that the company can

[1] V Finch, 'Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve' (2010) 6 Journal of Business Law 502, 505.

continue trading from its leasehold estate. Flexibility also allows the company to propose various options to its landlord creditors which may include a reduction to the payment due to them in form of rent, whilst other creditors will be paid in full. Thus, as described elsewhere, "flexibility is enhanced by reducing the number of voices that matter in a corporate restructuring."[2]

Such reduction adversely affects the notion of fairness. Flexibility allows repeat players such as directors and the insolvency practitioners to take advantage of the tool and pursue self-serving interests which will result in more recoveries for these players but less recoveries for less sophisticated creditors like the unsecured ones.

To further exacerbate the situation, in a retail restructuring context, some unsecured creditors like landlords are treated less favorably than other trade creditors on the often-cited ground of business continuity. Even though landlords agree to a CVA because it offers them a better restructuring outcome than would be the case in an alternative procedure like administration or liquidation, it remains that most companies that enter a CVA end up in administration and ultimately liquidation. Flexibility comes into play in the inception of the pre-pack process where the directors, IP and the main creditors conclude a deal to sell the viable parts of the business before the formal process is initiated. Unsecured creditors become aware of the process when it is completed leaving them in an unfair advantage, hence, this is where the battle between flexibility and unfairness comes in. The use of pre-packs in retail restructuring is also not beneficial as most of these companies end up in liquidation with unsecured creditors receiving less from the process.

Arguably, the repeat players seek flexibility because it is less fair.[3] Thus, "on some level, flexibility and fairness will always represent inherent tradeoffs in this context."[4] To put it

[2] SJ Lubben, 'Fairness and Flexibility: Understanding Corporate Bankruptcy's Arc' (2020) 23 University of Pennsylvania Journal of business Law 139, 166.
[3] Ibid.
[4] Ibid.

in another way, flexibility reigns supreme at the expense of fairness, and it means there will be continuous deviation from fairness.

Notwithstanding, it is submitted that greater fairness and less flexibility may render the process rigid and unusable. This is because “fairness is often promoted by more rules, more oversight and more process, the reorganization system loses its ability to be useful.”[5] Thus, extreme fairness may not be an effective solution. The most appropriate solution is therefore balance. The question then is how can a balance be struck between flexibility and fairness?

The present flexibility inherent in the system is beneficial, yet it could be streamlined by judicial involvement in form of limitations and cautions. For instance, the fact that trade creditors are critical to the business of the company and should be paid in full does not mean that all trade creditors are important for business continuity. Consequently, judicial skepticism could begin from there. Secondly, not every proposal for restructuring needs to be approved. A company needs to set out how its turnaround and restructuring strategies will be achieved, and the prospect for survivability post-rescue.

Also, it is important for the court to recognize that not all rescue plans need to be approved, as some companies are better off in liquidation than rescue. Thus, “judicial discretion needs to be harnessed to preserve the flexibility of the present system.”[6] The court must carefully access whether flexibility is always required. In this regard, judicial oversight in restructuring plans, may make the procedure an important mechanism to achieve this balance.

Research Limitations

While this thesis contributes to the corporate rescue literature in respect to retail insolvency cases, the study has some limitations. The case studies allowed the

[5] Ibid 144.
[6] SJ Lubben, ‘Fairness and Flexibility: Understanding Corporate Bankruptcy’s Arc’ (2020) 23 University of Pennsylvania Journal of business Law 139, 166.

researcher to provide comprehensive description, however, the small sample size, and results are limited in that they cannot be generalized, but they do provide insights into how financial distress affects retail companies, the operation of CVAs and other rescue mechanisms in ameliorating financial distress and the extent of the sufficiency of these procedures in balancing the rescue objectives with post-rescue survival of these companies. As seen, the rescue procedures can be improved based on the recommendations that has been made, this research can assist other researchers in looking more closely at how rescue mechanisms operate across multiple industries using the case study methodology.

Likewise, as mentioned earlier, the risk associated with focusing on companies with media spotlight is another limitation. However, due to time and money constraints, it was simply beyond the scope of this study to select a sample through other means. The use of multiple data sources including identifying companies through the Centre for Retail Research website helped to minimize the risk. It was more practical to access other sources via secondary data collection means in order to develop a detailed and rich description of the events.

Potential Future Research

This thesis has examined the effectiveness of the rescue mechanisms that can be used to achieve retail restructuring. The focus is on the CVA procedure, however, the pre-pack and restructuring plan procedures were also considered. The empirical research conducted in this thesis used different case studies to examine the effectiveness of these procedures. Further research could extend the empirical research to the US and identify comparable themes across retail rescue in both jurisdictions, given that the retail apocalypse in the US is also one of the major challenges that the reorganization procedure under Chapter 11 has had to grapple with.

Additionally, this thesis only examined the effectiveness of CVAs in rescuing distressed retail companies, further research could be conducted to examine the effectiveness of CVA in rescuing distressed companies in other industries for instance the construction industry as well as hospitality sector. This could take the form of case studies as well as comparative analysis of CVAs across sectors.

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