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Developing Restructuring Law in Silos: Part 26A and Unexpired Leases

SARAH PATERSON AND ADRIAN WALTERS

I. Introduction

In her 2015 book, *The Silo Effect*, the financial journalist Gillian Tett set out to investigate how silos arise in organisations and what, if anything, ‘we can do to master our silos, before these silos master us.’¹ Tett describes what she calls ‘the silo effect’ as the fragmentation of modern life in terms of how people organise themselves, interact with each other, and even imagine the world.² We can observe the silo effect at work in the way in which law is developed, practised, taught, and judged in England and Wales. Civil service departments and their executive agencies are increasingly specialist, as are lawyers working in large law firms. Academics increasingly teach and research in narrower and narrower fields. And the judiciary responds to this specialisation by becoming increasingly specialist itself. Nowhere is this more visible than in corporate restructuring law, where large corporate restructuring cases are channelled to judges with relevant experience; most major law firms have an identifiable corporate restructuring law team (and barristers specialise in the field); a relatively small group of academics work on corporate restructuring law, who know each other well; and the Insolvency Service, an Executive Agency of the Department for Business and Trade, takes the lead on corporate restructuring law matters. As a result, corporate restructuring law frequently develops in what we might call a domain-specific silo.

Furthermore, corporate restructuring law develops in something of a geographical silo. For sure, lawyers, policy-makers, academics, and judges working in the law of England and Wales (henceforth ‘English law’) pay more attention to approaches in other jurisdictions when developing corporate restructuring law than they once did. The business of large law firms in London is increasingly international and US law firms with offices in London have become significant players in the London market. The Insolvency

¹ Gillian Tett, *The Silo Effect: Why Every Organisation Needs to Disrupt Itself to Survive* (Abacus 2015) xi.

² *ibid*, x.

Service demonstrates real interest in comparative analysis, and UK judges and academics frequently meet colleagues from other jurisdictions at international colloquia and the like. Nonetheless, it can be difficult for any of these actors in the domestic system to understand fully the approach in another, so that while the broad strokes of other systems may inspire change, the detail of English corporate restructuring law frequently develops in its own geographical silo. This is, of course, precisely what accounts of institutional path dependency might predict.

There are huge benefits that come with this siloed approach in increasingly complex modern markets. There are, however, dangers too. First, we know that we must pay some regard to the impact that the things we do in formal restructuring procedures have on the world outside them. How much regard we should have to this is a matter of debate.³ Scholars viewing corporate restructuring law through an economic lens typically consider that formal rules to facilitate restructuring should be developed with careful attention to the incentive effects they create for healthy companies. So-called progressive scholars are typically less concerned with this issue and countenance a more expansive role for corporate restructuring law, directed at achieving wider social goals.⁴ We regard it as incontestable that all corporate restructuring law scholars and policy-makers should pay *some* regard to corporate restructuring law's effects on corporate behaviour outside the relevant legal procedures and – of particular salience to this chapter – corporate restructuring law's impact on the decisions of debtors to opt for a formal corporate restructuring procedure rather than to address their financial troubles without recourse to one. Secondly, there are challenges with drawing inspiration from other jurisdictions in developing corporate restructuring law without considering the detail of the specific issues that arise.

An important aspect of corporate restructuring law in which we argue that both the domain-specific and geographical silo effects have become acute is the treatment of unexpired leases. A bundle of unexpired leases of serial sites from which a struggling debtor-tenant trades may present the debtor-tenant with an existential threat, so that renegotiating or surrendering unprofitable leases is essential to the survival of the debtor-tenant's entire business enterprise. The difficulties faced by many large retailers, casual dining operators, and hospitality businesses in meeting the terms of their existing leases in recent years are a case in point. Retailers have struggled with the size of their leasehold estate and the cost of their rental bill as customers have switched from the high street and the shopping centre to online shopping.⁵ Casual dining and other bricks-and-mortar businesses have seen their margins squeezed by increasing competition.⁶ The COVID-19 pandemic has only served to intensify these challenges with the consequence that, for many debtor-tenants, renegotiating their leases and

³For a particularly good discussion see Douglas G Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 *Yale Law Journal* 573, 578.

⁴*ibid* (noting that Baird uses the label 'traditionalist' to describe these scholars). For further discussion see Sarah Paterson, *Corporate Reorganisation Law and Forces of Change* (Oxford, OUP, 2020) 2–6.

⁵Carina Kaiser and Julia Freybote, 'Is E-commerce an Investment Risk Priced by Retail Real Estate Investors? An Investigation' (2022) 39(3) *Journal of Property Research* 197.

⁶Oliver Barnes, 'Jamie Oliver to steer clear of challenging mid-market in London return' *Financial Times* (London, 16 August 2023): <https://www.ft.com/content/7723babe-a93b-43d1-bf8c-e1f369022c78> (accessed 3 April 2024).

reducing the size of their leasehold estates has become central to their survival strategy.⁷ Moreover, the debtor-tenants we have in mind need *collective* resolution. As a result of changes in market conditions, their difficulties arise from a bundle of leases with multiple landlords rather than being confined to a single lease with an individual landlord. Against this backdrop, the debtor-tenant must seek to renegotiate those leases that have become unaffordable on sites that still have the potential to be profitable if the rent can be adjusted downwards. Furthermore, they must repudiate leases for sites that are no longer profitable, and that are unlikely to be profitable on any commercial terms as to the rent that could be negotiated.

English corporate restructuring law has developed on a trajectory in which scant attention has been paid to the increasingly dramatic differences between the way leases are treated inside and outside the procedures it offers, and with very little regard to the way in which unexpired leases are handled in other jurisdictions. These differences occur across four crucial dimensions: the right to surrender; bargaining power; cost; and information asymmetry. We are concerned about these specific issues for several reasons. First, we are concerned that debtor-tenants will be forced to resort to a formal corporate restructuring procedure exclusively or largely to deal with an overrented (priced above market-rate) lease portfolio, imposing both cost and risk on the business. There is a question as to whether, if law reform efforts focused on making changes to property law instead, the leases could be more efficiently renegotiated outside such a procedure. Secondly, we are concerned that the treatment of unexpired leases in the formal corporate restructuring procedure will have unintended consequences for the rental market outside it, driving the market rather than reflecting it, so that the tail ends up wagging the dog. And finally, we are concerned that the treatment of unexpired leases in formal corporate restructuring procedures raises foundational questions about the nature of a lease that are not being addressed by, and indeed may not even be visible to, those best able to tackle them – namely lawyers, academics, and policy-makers who specialise in real property. These are far from niche concerns and the principal contribution that we hope to make in this chapter is to bust the treatment of unexpired leases in English corporate restructuring law out of the corporate restructuring law silo.⁸

English corporate restructuring law tools to address unexpired leases have been developed comparatively recently by practitioners and courts exploiting open-ended legislative frameworks in the Insolvency Act 1986 and the Companies Act 2006.⁹ These developments have been noted, digested, and commented on as technical developments *within* corporate restructuring law¹⁰ but, to our knowledge, they have not been

⁷ Andrew Edgecliffe-Johnson, 'WeWork to renegotiate most of its leases amid viability concerns' *Financial Times* (New York, 6 September 2024): <https://www.ft.com/content/5b1e9325-86be-4faf-8f2f-3f142a8f472a#post-9a219486-fd32-4f0e-afb4-9cebde8349ec> (accessed 3 April 2024).

⁸ Tett uses the term 'silo-busting' to describe the process by which barriers between silos are broken down. See Tett (n 1) 304.

⁹ There are, of course, officeholder powers to disclaim onerous property including leaseholds in the Insolvency Act 1986, ss 178–182 and 315–321 that are of considerable vintage. But these are confined to corporate liquidation and individual bankruptcy. Our focus here is on corporate restructuring law tools that address unprofitable leases as part of a business enterprise continuation strategy.

¹⁰ Sarah Paterson, 'A Fine Balance: Insolvency Practitioners and the Leveraging of Intermediary Power' in Paul S Davies and Tan Cheng-Han SC (eds), *Intermediaries in Commercial Law* (Oxford, Hart Publishing, 2022); Rodrigo Olivares-Caminal, Randall Guynn, Alan W Kornberg, Eric McLaughlin, Sarah Paterson, and Dalvinder Singh, *Debt Restructuring* (Oxford, OUP, 2022) 199–208; 267–73.

systematically analysed or theorised by academics across the pre and post-bankruptcy divide. In the US, section 365 of the Bankruptcy Code equips bankruptcy trustees – which include Chapter 11 debtors-in-possession – with explicit powers to reject or assume executory contracts and unexpired leases.¹¹ These powers represent some of the most invasive interventions in the private, non-bankruptcy rights of creditors found anywhere in US corporate restructuring law. As they have been on the statute book since 1978, we might expect them to have been subjected to intense scholarly focus. In fact, the scholarly treatment of the issue is remarkably thin, given the enormous literature on Chapter 11 more generally. George Triantis has noted some difficulties of statutory interpretation.¹² Kenneth Ayotte has reviewed the specific decisions debtors make within the options provided by Chapter 11 for unprofitable executory contracts and unexpired leases and the timing of those decisions.¹³ Thomas Jackson has expressed the view that ‘the ability to reject should depend on nonbankruptcy attributes’; has expressed some concern that this may not be the case; but has stopped short of any systematic analysis of the problem and what to do about it.¹⁴ Indeed, there appears to be virtually no comprehensive review of the regime in the scholarship, especially as it pertains to the rejection or renegotiation of unexpired leases. We attribute this gap in the literature to four scholarly tendencies: first, a tendency for scholars to focus on the restructuring of loan and bond debt;¹⁵ secondly, a tendency for scholars to apply their insights to other uses of US bankruptcy law besides the renegotiation or repudiation of executory contracts or unexpired leases;¹⁶ thirdly, even when scholars do consider the powers in section 365, a tendency to dwell more on the assumption and assignment of executory contracts or unexpired leases rather than on their renegotiation or repudiation;¹⁷ and finally, and significantly for us, a tendency for bankruptcy scholars to co-author with other bankruptcy scholars, or perhaps law and finance scholars, but not with other specialists such as real property scholars. We suspect that this gap may also explain why the US statutory regime for handling unexpired leases in bankruptcy was not considered in any detail in recent developments of English corporate restructuring legislation, notwithstanding that the reform decision was undoubtedly partly inspired more broadly by US Chapter 11. A second contribution that the chapter makes

¹¹ 11 USC § 365.

¹² George G Triantis, ‘Termination Rights in Bankruptcy (The Story of *Stephen Perlman v Catapult Entertainment, Inc*)’ in Robert K Rasmussen (ed), *Bankruptcy Law Stories* (New York, Foundation Press, 2007), 58.

¹³ Kenneth Ayotte, ‘Leases and Executory Contracts in Chapter 11’ (12 August 2014) available at SSRN: <https://ssrn.com/abstract=2462892> accessed 10 April 2024.

¹⁴ Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge MA, Harvard University Press, 1986) 109–21.

¹⁵ Kenneth Ayotte and David A Skeel, Jr, ‘Bankruptcy Law as a Liquidity Provider’ (2013) 80(4) *University of Chicago Law Review* 1557, 1589 whose purpose is specifically to focus on the problem of debt overhang and adverse selection problems and the related concern that addressing underinvestment by solving for these issues may result in overinvestment; Vincent SJ Buccola, ‘Bankruptcy’s Cathedral: Property Rules, Liability Rules, and Distress’ (2019) 114(3) *Northwestern University Law Review* 705 who focuses on methods of addressing excessive leverage.

¹⁶ Buccola (n 15) focuses on prepackaged plans in which he assumes that nonfinancial creditors will ‘ride through’ the case (at 727); concluding a going concern sale; and taking advantage of the automatic stay.

¹⁷ Buccola (n 15) 710. Among notable exceptions are Michael T Andrew, ‘Executory Contracts in Bankruptcy: Understanding “Rejection”’ (1988) 59 *University of Colorado Law Review* 845 and Jesse M Fried, ‘Executory Contracts and Performance Decisions in Bankruptcy’ (1996) 46 *Duke Law Journal* 517.

is to analyse and evaluate the differences between the treatment of unexpired leases in both regimes.

We start by comparing the treatment of unexpired leases inside English corporate restructuring law procedures with the position outside it. This enables us to draw out several crucial differences that illuminate the extent to which this treatment of unexpired leases has developed in its own domain-specific silo. First, we consider how it is possible for debtor-tenants to achieve something close to the functional equivalent of surrender inside the new Part 26A restructuring plan procedure (Part 26A) where it could not do so outside these procedures, and how this result developed from the Company Voluntary Arrangement (CVA). Secondly, we consider how Part 26A affects the distribution of bargaining power between the debtor-tenant and the landlord that exists outside a formal corporate restructuring procedure. Thirdly, we consider the debtor-tenant's cost of what we call functional surrender, and of modification, of unexpired leases inside Part 26A. Finally, we consider how information asymmetry is addressed outside Part 26A and the impact of Part 26A on information asymmetry. At each stage, we also compare the position with the position in US Chapter 11 to highlight that, notwithstanding the inspiration that Chapter 11 provided for the development of Part 26A generally, the treatment of unexpired leases has developed in a geographical as well as a domain-specific silo.

The differences we observe across the four dimensions of surrender; bargaining power; cost; and information asymmetry map onto the concerns we articulated above: that debtor-tenants will opt for Part 26A exclusively to address unprofitable leases; that Part 26A ends up driving the rental market for healthy firms; and, at a foundational level, that Part 26A brings about what amounts to an *ex post* re-characterisation of the nature of a lease without any apparent reference to property law. We also seek to show why these concerns are more acute in Part 26A than they are in Chapter 11. Our account provides a broader overview of the problem of unprofitable leases and enables us to reach some preliminary conclusions on the areas that real property lawyers, on the one hand, and bankruptcy lawyers, on the other, should be discussing across their respective domain-specific silos to inform law reform debate in each and to avoid them being, as Tett puts it, 'excessively rigid' or 'dangerously entrenched'.¹⁸ We hope that our analysis also demonstrates the value of studying specific issues in corporate restructuring law across geographical silos.

II. The Different Treatment of Leases Inside and Outside of Formal Corporate Restructuring Procedures

A. Outside Corporate Restructuring Law Procedures

Outside formal corporate restructuring procedures, we do not always hold contract counterparties to their bargain. In many circumstances, a party to a contract that has concluded that it does not wish to be bound by its bargain may seek to repudiate the

¹⁸Tett (n 1) 306.

contract, or to use the threat of repudiation to motivate renegotiation.¹⁹ In that event, if the parties to the contract cannot settle the matter among themselves, namely, one party seeks to repudiate the contract and the other party does not accept the repudiation, the non-assenting party has the right to apply to the court to seek compensation for the breach. It is possible that the counterparty may be successful in seeking an order for specific performance (to oblige the other party to perform the contract) or an injunction (to prevent the other party from repudiating the contract). Yet these are extraordinary equitable remedies, and a high hurdle must be cleared for the court to grant them.²⁰ The more usual remedy will be an award of monetary damages.²¹

Contract theorists interpret contract law's willingness to permit contractual breach, and the remedies which follow, in various ways. One such theoretical approach is the theory of efficient breach.²² There is a vast literature on the theory of efficient breach, which falls outside the scope of this chapter. For present purposes, it will suffice to focus on the argument that it is sometimes efficient to breach a contract: for example, because the value of performance has fallen, or the cost of performance has risen.²³ Contract law then provides the appropriate remedies to facilitate non-performance in these cases.²⁴

Leases are, however, a rather curious beast. In English law, outside Part 26A, the parties will ordinarily enter a contract for the grant of a lease. But the lease is not solely a creature of contract law. A lease also creates a tenancy: one party, the landlord, grants to the other party, the tenant, 'exclusive possession of identifiable premises for a definite period while retaining a reversion'.²⁵ As Garner and Frith put it, '[A] tenancy is an estate in land. The tenancy may be created by a contract, but once created it possesses qualities that run beyond the purely contractual'.²⁶ The implication is that leases are subject to property law rules as well as contract law rules. This is borne out by features of English property law that are designed to protect the landlord's reversionary interest such as the running of certain covenants with the land²⁷ and the landlord's ability to restrict alienability.²⁸ It also follows that, as a property law matter, the abandonment of the tenancy by the tenant of itself has no effect on the tenant's property rights or the corresponding duty of the tenant to pay rent.²⁹ A formal surrender is required to convey the tenant's estate to the landlord as owner of the reversionary interest. As a further consequence, the landlord has two options when their tenant abandons the tenancy and

¹⁹ Jack Beatson, Andrew Burrows, and John Cartwright, *Anson's Law of Contract*, 31st edn (Oxford, OUP, 2020) 503.

²⁰ *ibid.*, 578.

²¹ *ibid.*, 578–79.

²² Stephen A Smith, *Contract Theory* (Oxford, OUP, 2004) 115; Gregory Klass, 'Efficient Breach' in Gregory Klass et al (eds), *Philosophical Foundations of Contract Law* (Oxford, OUP, 2015) 362–87.

²³ Smith (n 22) 117.

²⁴ *ibid.*, 116.

²⁵ Simon Garner and Alexandra Frith, *A Practical Approach to Landlord and Tenant*, 8th edn (Oxford, OUP, 2017) 33. For the US, see Robert H Kelley, 'Any Reports of the Death of the Property Law Paradigm for Leases Have Been Greatly Exaggerated' (1995) 41 *Wayne Law Review* 1563.

²⁶ Garner and Frith (n 25) 36.

²⁷ *ibid.*, 138–39.

²⁸ *ibid.*, 79–80, discussing some developments. For a discussion of similar developments in the US, see Alex M Johnson, Jr, 'Correctly Interpreting Long-Term Leases Pursuant to Modern Contract Law: Toward a Theory of Relational Leases' (1988) 74 *Virginia Law Review* 751, 751–52.

²⁹ Garner and Frith (n 25) 495. For the US, subject to the discussion that follows, see Kelley (n 25) 1582.

stops paying rent. First, the landlord can accept the surrender of the lease by re-entering the premises, terminating both the lease and the tenant's duty to pay rent. Secondly, the landlord can do nothing and continue to pursue the tenant for the rent for the remainder of the lease.

It is immediately apparent that as a matter of English law, outside a formal restructuring procedure, the tenant cannot compel the landlord to accept surrender without a continuing liability for the full amount of the rent for the remainder of the lease. Thus, surrender will only be effective to release the tenant from the lease if the landlord agrees.³⁰ Multiple rationales have been offered to explain this legal position under which the landlord holds most of the cards, but it is immediately clear that it does not sit comfortably with efficient breach theories in contract law. By contrast, some US States have imposed a duty on the landlord to mitigate damages, in line with the contract law concept of mitigation.³¹ This more modern, contract-based approach is only available in some US States³² and even where it does apply, if the market has deteriorated to such an extent that the premises cannot be re-let or can only be re-let at an exceptionally low rent, the distressed debtor-tenant is largely held to its bargain.³³ Nonetheless, as we will develop further below, the difference between the treatment of unexpired leases inside a formal restructuring procedure and outside it is undeniably starker in England than the difference between the treatment of unexpired leases inside the US's corporate restructuring procedure, Chapter 11, and outside it in those US States that have moved towards a more contract-orientated approach to lease surrender.

B. Inside Corporate Law Restructuring Procedures

English corporate restructuring law has no explicit statutory regime permitting the repudiation of unexpired leases but has arrived at approximate functional equivalence through ingenious lawyering and judicial acquiescence. The story of this development

³⁰ Garner and Frith (n 25) 495. The effect outside bankruptcy is illustrated by the efforts in 2023 of Meta to break a 20-year lease on two buildings in a London development. The lease had no break clause and Meta reportedly had to pay the equivalent of around seven years of rent to surrender it. See Helen Thomas, 'The London office market is becoming harder work' *Financial Times* (London, 4 October 2023). Thomas's article points out that inflexible, long-term commercial leases are 'starting to feel like a relic from another era'. Nonetheless, as this kind of lease was common in the UK's pre-pandemic commercial real estate market, there are still plenty of leases on such terms in existence.

³¹ *Schneider v Gordon* 843 P 2d 1378 (Colo 1993) cited in Dawn R Barker, 'Commercial Landlords' Duty Upon Tenants' Abandonment – To Mitigate' (1995) 20 *Journal of Corporate Law* 627, 635; Ian Davis, 'Better Late Than Never: Texas Landlords Owe A Duty to Mitigate Damages When A Tenant Abandons Leased Property' (1997) 28 *Texas Tech Law Review* 1281, 1283–85.

³² In New York and Pennsylvania, for example, a commercial real estate tenant has no unilateral right outside of bankruptcy to terminate the lease in the absence of a break clause, and the landlord has no duty to mitigate damages by seeking to re-let after repudiation – see David Crump, 'Should The Commercial Landlord Have A Duty to Mitigate Damages After The Tenant Abandons? A Legal and Economic Analysis' (2014) 49 *Wake Forest Law Review* 187; *Holy Properties Limited, LP v Kenneth Cole Productions, Inc* 661 NE 2d 694 (NY 1995); *Stonehedge Square Limited Partnership v Movie Merchants, Inc* 715 A 2d 1082 (Pa 1998).

³³ Moreover, in some of the 'landlord-mitigation' states the duty to mitigate can be expressly waived in the lease – see Jacqueline Sandler, 'Waiving the Duty to Mitigate in Commercial Leases' (2014) 5 *William & Mary Business Law Review* 647.

starts with the CVA.³⁴ The contours of the CVA are set out in some rather skinny provisions in the Insolvency Act 1986,³⁵ somewhat fleshed out by the Insolvency Rules.³⁶ The CVA is available for a company to make a proposal to its shareholders and its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs.³⁷ All creditors receive notice of, and are entitled to vote on, the CVA proposal,³⁸ although secured creditors only vote for the unsecured portion of their debt.³⁹ There is no provision in the statute for creditors to vote in classes or in separate meetings. The Insolvency Rules provide simply that if a majority of 75 per cent of creditors (present and voting) support the CVA, of whom at least 50 per cent are unconnected creditors, the CVA is approved.⁴⁰ The court is not involved in reviewing the terms of the CVA unless there is a challenge. The CVA can be challenged on two grounds: that the proposal unfairly prejudices the interests of a creditor or member, or that there was a material irregularity in the way approval of the CVA was obtained.⁴¹

Starting with the case of *Powerhouse* in 2007, enterprising corporate restructuring professionals developed a method of mobilising the CVA to address their client's problem of an overrented leasehold estate.⁴² In the early cases, leases that the debtor wished to surrender were simply terminated pursuant to the terms of the CVA. However, in the *Instant Cash Loans* case Zacaroli J decided that it was not possible for a tenant to compel a landlord to accept a surrender in an English law scheme of arrangement, because surrender relates to a property right and the scheme of arrangement jurisdiction only extends to contractual matters between the debtor and its creditors.⁴³ This reasoning would also apply to CVAs because a CVA, like a scheme, involves a compromise or arrangement between the company and its creditors or members.⁴⁴ However, rent is not strictly a requirement of a lease.⁴⁵ And the obligation to pay rent is generally regarded as a contractual matter.⁴⁶ Thus, Zacaroli J decided in *Instant Cash Loans* that it was possible to write the rent sum down to zero in the arrangement. This creates something that is very close to a functional surrender, notwithstanding that it would not have been possible for the tenant to surrender the lease unilaterally outside of a formal proceeding, because a landlord is unlikely to wish to leave the unoccupied premises with the tenant while receiving no rent.⁴⁷

³⁴ Insolvency Act 1986, ss 1–7B.

³⁵ *ibid.*

³⁶ The Insolvency (England and Wales) Rules 2016 (2016 No 1024).

³⁷ Insolvency Act 1986, s 1.

³⁸ Insolvency Rules (n 36), r 15.28(5).

³⁹ *ibid.*, r 15.31(4) and (5).

⁴⁰ *ibid.*, r 15.34.

⁴¹ Insolvency Act 1986, s 6.

⁴² *Prudential Assurance Co Ltd v PRG Powerhouse Limited* [2007] BCC 500.

⁴³ *Re Instant Cash Loans Limited* [2019] EWHC 2795 (Ch).

⁴⁴ Compare the Companies Act 2006, s 895 and Insolvency Act 1986, s 1.

⁴⁵ Garner and Frith (n 25) para 1.26, 14.

⁴⁶ *ibid.*, para 6.14, 66.

⁴⁷ The landlord may do so for a time in order to avoid paying rates on unoccupied premises to the relevant local authority – see <https://www.gov.uk/apply-for-business-rate-relief/empty-property-relief>. However, landlords will worry about the risk of squatters and illegal use of the premises, the premises falling into disrepair, and the risk of lapsed insurance, and so are likely to prefer to take the empty premises back in most cases.

A crucial feature of many of these CVAs is that only landlords were compromised. Typically, leases were divided into several ‘buckets’: leases that the debtor-tenant wished to keep; leases in respect of which it wished to get as close to surrender as possible; and leases in the middle that it preferred to retain but only if it could renegotiate terms.⁴⁸ In most cases all other unsecured creditors were paid in full. And equally crucially, the CVA compromised future rent as well as any outstanding but unpaid rental instalments. Thus, the success of these CVAs turned on three legal issues. First, the CVA jurisdiction had to be broad enough to compromise future rental payments. Secondly, the CVA jurisdiction had to permit differential treatment of creditors. And finally, the CVA proposal had to be able to withstand a challenge on the grounds of unfair prejudice or material irregularity.

The first of these issues had been tested as early as 1995 in debtors’ favour. In *Cancol*, Knox J held that a CVA could compromise future rent.⁴⁹ There was a bit of a hiccup in 2006 when Neuberger LJ seemed to suggest, *obiter*, that it would be unfairly prejudicial to pay a landlord a reduced rent for the period after the CVA had been approved,⁵⁰ but when the position was finally reviewed after a slew of unchallenged CVAs compromising landlords in the 2000s, Norris J followed *Cancol*.⁵¹ And when Zacaroli J was invited to overrule *Cancol* on the point in *New Look* he declined to do so.⁵² It now appears settled that a CVA can compromise future rent, absent intervention from a higher court.

The second issue was also decided by a series of cases in the debtor’s favour. Indeed, the cases now firmly establish that a CVA will not be automatically unfairly prejudicial because creditors are treated differently in the proposal.⁵³ In *Powerhouse*, Etherton J set out a two-stage approach to the question of whether a differential proposal was unfairly prejudicial to a complaining creditor or group of creditors. The first stage was what he called a ‘vertical’ comparison: a comparison of what the complaining creditor or creditors receive under the CVA proposal with what they would receive in the event of a winding up.⁵⁴ Over time, judges have moved the vertical comparison away from a comparison with liquidation and towards a comparison with whatever the court considers would be most likely to happen if the CVA were not approved.⁵⁵ Assuming that this is an insolvent sale of the business and assets or assets, and the landlord cannot show that a purchaser of the business and assets or assets would want to assume the relevant lease, this is unlikely to provide a ground for complaint for a landlord whose lease is being written down to zero in the CVA. The second stage is what Etherton J called a ‘horizontal’ comparison, in which the treatment of the complaining creditor or class of creditor is compared with the treatment of other creditors who would rank equally with

⁴⁸ See, for example, the categorisation of leases in *Discovery (Northampton) Ltd v Debenhams Retail Ltd* [2019] EWHC 2441 (Ch), [16]–[19].

⁴⁹ *Re Cancol Ltd* [1995] BCC 1133.

⁵⁰ *Thomas v Ken Thomas Ltd* [2006] EWCA Civ 1504, [39].

⁵¹ *Debenhams* (n 48) [23]–[61].

⁵² *Lazari Properties 2 Limited v New Look Retailers Limited* [2021] EWHC 1209 (Ch), [212] (*New Look*).

⁵³ *Powerhouse* (n 42) 88; *Inland Revenue Commissioners v Wimbledon Football Club* [2004] EWCA Civ 655 at [18]; *New Look* (n 52) [155]–[159].

⁵⁴ *Powerhouse* (n 42) [71].

⁵⁵ Known as the ‘relevant alternative’ in Part 26A restructuring plans – see Companies Act 2006, s 901G(4).

the complainant in the counterfactual.⁵⁶ However, and as noted above, uneven treatment has not necessarily been found to be prejudicial. Indeed, judges have found that differential treatment may be necessary to ensure fairness;⁵⁷ or that it may be necessary to treat trade creditors more favourably in order to secure their continued support of the business for the purpose of the CVA;⁵⁸ or that the risks of sorting out creditors who can be compromised without risking the stability of the company from those that cannot outweigh the benefits.⁵⁹

So far so good for a debtor wishing to mobilise the CVA to achieve something functionally similar to a surrender of a lease that could not be surrendered outside it. There is, however, a further fly in the ointment. We can assume that a landlord whose lease is to be written down to zero or whose lease is to be very heavily modified is highly unlikely to support the CVA. At this point, recall that for the CVA to be approved the proposal must be supported by the vote of 75 per cent by value of creditors present and voting. These so-called 'landlord CVAs' have relied on two sleights of hand to secure the majority vote, notwithstanding landlord opposition. The first move is to dilute the landlords' vote in determining the denominator for the 75 per cent calculation. This move relies on the fact that under the Insolvency Rules a debt of an unliquidated or unascertained amount is valued at £1 unless the chairman puts a higher value on it.⁶⁰ Debtors have not been so bold as to suggest that landlords' claim for future rent, which is unliquidated because the lease might be terminated early, should be admitted for £1. Instead, they have initially discounted the future rental stream to produce a net present value using a formula developed in a different context in *Re Park Air Services*,⁶¹ and then applied a further, somewhat arbitrary, discount of 75 per cent to that discounted claim.⁶² The second move is to admit all other unsecured creditors with outstanding claims to vote on the CVA, notwithstanding that if the CVA is approved these claims will be paid in full. These creditors can expect to vote for the CVA proposal, given that they are unaffected by it. And assuming they have a relatively large aggregate claim and the landlords' claims have been sufficiently discounted, they may be able to 'swamp' the landlords' claims and force the CVA through.

As CVAs became more frequently challenged, however, both techniques came under fire. The discount applied to the landlords' claims steadily decreased as debtors began to worry about the risk of a successful challenge. Thus, by the time the *New Look* case was heard in 2021 a straightforward discount of a mere 25 per cent was applied to the landlords' claims.⁶³ And even more crucially, while Zacaroli J found on the facts of *New Look* that it was not a case in which the statutory majority had been secured by the votes of unaffected creditors, in an important passage he stated:

[I]f assets that would, in the relevant alternative, have been available for all unsecured creditors are allocated in a greater proportion to other creditors (e.g. where critical creditors are

⁵⁶ *ibid.*

⁵⁷ *Sea Voyager Maritime Inc v Bielecki* [1999] 1 BCLC 133, 149; *Wimbledon Football Club* (n 53) [18].

⁵⁸ *Wimbledon Football Club* (n 53) [18].

⁵⁹ *Debenhams* (n 48) [107].

⁶⁰ Insolvency Rules (n 36) r 15.31(3).

⁶¹ *Re Park Air Services Plc* (also known as *Christopher Moran Holdings Ltd v Bairstow*) [2000] 2 AC 172.

⁶² Inga West, 'The Evolution of Landlord CVAs: at a Tipping Point?' Presentation at the Annual Insolvency Lawyers' Association Conference, 23 April 2021, on file with the author.

⁶³ *New Look* (n 52) [287]–[298].

paid in full), then the fact that the requisite majority was reached by reason of the votes of those creditors may point towards the CVA being unfairly prejudicial, even if there was an objective justification for their payment in full.⁶⁴

These *obiter* remarks strongly suggest that the practice of ‘vote swamping’ in CVAs may not pass the unfair prejudice test in a future challenge. And challenges to landlord CVAs have become more frequent now that the British Property Federation is taking a leadership role in guiding landlords on what to look out for.⁶⁵ Overall, there is a question mark about whether the legal analysis crucial to the success of landlord CVAs will stand up to scrutiny going forwards.

Debtor-tenants may, therefore, increasingly turn to the new Part 26A restructuring plan procedure as the principal tool for cherry-picking among their unexpired leases. Part 26A was introduced into the Insolvency Act 1986 by the Corporate Insolvency and Governance Act 2020. It is adapted from the existing scheme of arrangement process, in which creditors vote in classes determined by their rights going into the scheme and the rights that they are granted under it. However, crucially, and unlike schemes of arrangement, the court has the power to impose the plan over the objection of an entire dissenting class (a so-called ‘cross-class cram-down power’).⁶⁶ This means that landlords whose leases are being written down to zero can be placed in a separate class and if, as we would expect, they vote against the plan, the debtor can ask the court to impose it on them against their wishes. Indeed, debtor-tenants have taken some of the technology developed in the CVA context and adapted it for use with Part 26A, now that vote swamping in CVAs is questionable.

Importantly, for our purposes, there was no explicit discussion of how to address unexpired leases in the two Insolvency Service consultations that preceded the introduction of Part 26A. Specifically, there was no comparison of the approach that was developing in CVAs with the position outside them. And while the introduction of a new scheme-like procedure with a cross-class cram-down power was heavily influenced by US Chapter 11, there was no explicit comparison of how unexpired leases were treated in the US regime with the incrementally developing position in England and Wales. Instead, Part 26A has been developed to address unexpired leases in a domain-specific, geographical silo.

This is significant because US federal corporate restructuring law deals *explicitly* with unexpired leases. Section 365 of the US Bankruptcy Code permits a Chapter 11 debtor-in-possession⁶⁷ to ‘assume’, ‘assign’ or ‘reject’ unexpired leases. If the debtor-in-possession assumes the lease, then all outstanding defaults must be cured, adequate assurance that the debtor will continue to perform must be forthcoming, and ongoing liabilities are payable with administrative priority. The power to assign raises some difficult issues where there is a non-bankruptcy law prohibition on assignment,⁶⁸ but otherwise enables the debtor to assign the unexpired lease to a third party. Rejection is treated as a breach of the lease immediately preceding the commencement of the

⁶⁴ *ibid* [195].

⁶⁵ <https://bpf.org.uk/media/company-voluntary-arrangements-cvas/>.

⁶⁶ Companies Act 2006, s 901G.

⁶⁷ On filing a voluntary Chapter 11 case, the debtor becomes a debtor-in-possession: see 11 USC §§ 1101(1), 1107(a).

⁶⁸ Ayotte and Skeel (n 15) 1609 fn 124.

Chapter 11 case:⁶⁹ the counterparty has a general unsecured claim for damages, the face value of which is capped in the case of a real estate lease.⁷⁰ Crucially for our purposes, in all cases the capped damages claim can be further compromised in the reorganisation plan. This is subject only to an administrative expense claim for certain benefits which the estate received under the unexpired lease after commencement of the case and before rejection.⁷¹ The express powers in section 365 apply to unexpired leases in broadly the same way as they do to executory contracts. In other words, the default approach under US federal law is to equate unexpired leases with contracts.

In contrast, and as we have already noted, Part 26A contains no express provisions addressing unexpired leases at all. Moreover, Part 26A is customarily brief on what the court must consider in deciding whether to impose, or ‘cram down’, the plan on the dissenting class. It provides merely that the court must be satisfied that, if the compromise or arrangement were to be sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative.⁷² We have already met this requirement in a CVA context, and the comments made above about the position of the landlord apply equally here. The second condition is that the statutory majority has been achieved in at least one class ‘who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative.’⁷³ This second requirement may be relatively easily navigated if, for example, there is a class of leases which is being modified, rather than written down to zero, with amendments that are acceptable to a majority of landlords in that class.

This is not, however, the end of the matter. This is because the legislation is expressed in permissive and not mandatory terms, providing that if the two conditions are met the fact that the dissenting class has not agreed to the compromise or arrangement does not *prevent* the court from sanctioning it.⁷⁴ Furthermore, section 901F provides that if the statutory majority agrees the compromise or arrangement, the court ‘may’ sanction it. Thus, the legislation leaves a discretion for the judge in deciding whether to sanction the plan or not, even if the statutory conditions are met. Perhaps unsurprisingly, given the total absence of guidance in the legislation, the courts have been struggling to put in place a structured decision-making framework for the exercise of this discretion. This raises questions far beyond the scope of this chapter. For the moment, two points are made. First, the courts have shown themselves willing to impose a Part 26A restructuring plan on an entire class of dissenting landlords whose leases are being written down to zero, provided they are satisfied that those landlords are no worse off than they would be in the relevant alternative.⁷⁵ Secondly, although courts have paid some attention to whether proposed plans unfairly transfer value from the affected landlords to those that

⁶⁹ 11 USC § 365(g) ([‘T]he rejection of an executory contract or unexpired lease of the debtor constitutes a breach ...).

⁷⁰ 11 USC § 502(b)(6).

⁷¹ 11 USC § 365(d)(3). See further American Bankruptcy Institute, ‘Commission to Study the Reform of Chapter 11 2012-2014: Final Report and Recommendations’, 117.

⁷² Insolvency Act 1986, s 901G(3).

⁷³ *ibid*, s 901G(5).

⁷⁴ *ibid*, s 901G(2).

⁷⁵ *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch).

will end up owning the equity in the firm, where they conclude that the landlords would not recover anything in the relevant alternative, such concerns have been given little weight.⁷⁶ We return to the issue of allocative fairness below. For now, we observe that the cross-class cram-down power in Part 26A may become the primary mechanism in UK law for targeting unprofitable leases if vote swamping, as we anticipate, does become more difficult in CVAs. We now turn to draw out the important differences that arise compared to the position in English law outside Part 26A and compared to US Chapter 11.

C. Dimensions of Difference: Right to Surrender; Bargaining Power; Cost; Information Asymmetry

(i) Right to Surrender

The first crucial difference between the treatment of leases inside and outside Part 26A is that outside Part 26A the debtor-tenant may have no ability to surrender the lease, while inside Part 26A it may be able to achieve something functionally close to surrender. As we have seen, the technology to achieve this arises in part from Part 26A itself and in part as an incremental development from innovation in CVAs. Nonetheless, the differential treatment inside and outside Part 26A is rather stark and it seems remarkable, with the benefit of hindsight, that there was little to no consideration of it when Part 26A was introduced. Moreover, while the cross-class cram-down provision in Chapter 11 was explicitly examined when Part 26A was developed, there was no explicit comparison between the impact of Part 26A on unexpired leases and the US section 365 regime. Overall, the ability functionally to surrender an unexpired lease in Part 26A has developed in a domain-specific, geographical silo.

(ii) Bargaining Power

In Part 26A, the debtor-tenant can bundle together the leases it wishes to modify in a specific way; put the proposal to the landlords as a group; and ask the court to impose the modification via the cross-class cram-down power if the statutory majority of landlords do not agree. Of course, the debtor will have to convince the court that the landlords as a class will be no worse off than they would be in the event of the relevant alternative. And at least one impaired class must have supported the plan. Furthermore, the courts have made it very clear that they expect the landlord to have a right to terminate the lease if they do object to the terms.⁷⁷ Thus, Part 26A enables the debtor-tenant to change the bargaining structure, from a series of individual bargains struck with individual landlords to a collective offer available for acceptance. And Part 26A requires the landlord to force the debtor-tenant to put its threat of rejection into action if the landlord holds firm. Once again, it seems remarkable that no explicit consideration was given to

⁷⁶ *ibid.*

⁷⁷ *Virgin Active* (n 75) at [64].

this dramatic shift in relative bargaining power inside and outside Part 26A when the new statutory regime was introduced. Moreover, the English law regime shifts bargaining power in ways that are different from, and arguably more dramatic than, the shift in bargaining power in Chapter 11.

Under the US Bankruptcy Code, the debtor-tenant does have more bargaining power in bankruptcy, by virtue of its power to assume and assign or reject the unexpired lease, than it does outside bankruptcy in those States that have no unilateral right of surrender. Moreover, the Chapter 11 regime consolidates the bargaining process and changes the bargaining dynamics. Where the debtor is seeking to renegotiate a bundle of leases outside bankruptcy, if terms cannot be agreed with individual landlords, each landlord may start its own legal action, and each of these legal actions may be in a different State. Under section 365, if terms cannot be agreed with any landlord, the landlord has a claim for damages in common with all other landlords in the same position, and any challenges are addressed together by the federal bankruptcy court within strict boundaries established by the Bankruptcy Code. In this way, the Chapter 11 regime reduces the hold-out problem. While there is no statutory right to modify an unexpired lease without the landlord's consent, debtor-tenants can use the threat of rejection to motivate bargaining.⁷⁸ In other words, section 365 provides the credible threat that the debtor-tenant needs to get the landlord to the table. This also addresses the free rider problem. If the landlord refuses to renegotiate, it may find that other landlords agree terms with the debtor so that the debtor-tenant becomes confident it can live without the lease in question. Thus, the landlord who sits tight and refuses to negotiate risks having its lease rejected and being left with an unsecured claim for damages paid at cents in the dollar.

Nonetheless, it is considerably more difficult for the debtor to bundle leases that it wishes to modify (as opposed to reject) in an omnibus motion in US Chapter 11 because modification requires landlord consent and cannot be addressed through mobilisation of the cross-class cram-down power. Moreover, in the US context it is the debtor that must ultimately make the assume/reject decision if modifications cannot be agreed while, in the English law context, it is ultimately the landlord who must make that decision. It is very interesting that notwithstanding the significant influence Chapter 11 had on the decision to implement Part 26A, and the careful attention that was paid to some of its provisions in developing the new procedure, no explicit regard was had to section 365.

(iii) Cost

The third significant difference in the treatment of unexpired leases inside and outside of a formal corporate restructuring procedure relates to the debtor-tenant's cost of surrender or modification. CVAs can be a relatively low-cost procedure, particularly

⁷⁸ Josiah M Daniel III, 'Lawyering on Behalf of the Non-Debtor Party in Anticipation, and During the Course, of an Executory Contract Counterparty's Chapter 11 Bankruptcy Case' (2014) 14 *Houston Business & Tax Law Journal* 230, 251.

as court involvement is kept to a minimum and only seriously engaged in the event of a challenge. And the courts have held that the normal ‘loser pays’ principle applies to challenges to CVAs, so that there is a serious risk of an adverse costs order for an unsuccessful claimant and thus a serious disincentive to raising a challenge.⁷⁹ However, as we have seen, doubts around the technology that practitioners have used to promote landlord CVAs may mean that they fall out of favour. Part 26A restructuring plans are more expensive, not least because the court is more involved. Moreover, it is considerably more likely that a dissenting creditor could raise a challenge to a Part 26A restructuring plan without suffering an adverse costs order and may even have their costs covered by the company. This is because the court may take the view that the dissent served a purpose in ventilating the issues before the court and, hence, in helping the court to decide whether to sanction the plan or not.⁸⁰ There is, therefore, considerable risk of an expensive challenge to a Part 26A restructuring plan.

As we have already explained, in those US States that do permit surrender outside Chapter 11 the landlord has a duty to mitigate damages.⁸¹ As we have also seen, however, while the counterparty has a general unsecured claim for damages for breach of the unexpired lease under Chapter 11, that damages claim is capped in the case of a commercial real estate lease: section 502 provides that damages are capped at the greater of one year’s rent or the rent for 15 per cent – not to exceed three years of the remaining term – of the lease.⁸² Indeed, the position is even more favourable because the debtor can compromise the damages claim at the dividend rate in the Chapter 11 plan. This recently led the *Financial Times* to comment that WeWork’s Chapter 11 filing would allow the company, ‘at least in the US, to rationalise its portfolio by terminating scores of leases with little financial penalty’.⁸³ This means that it may also be considerably cheaper to address an overrented leasehold estate in Chapter 11 than outside it. Nonetheless, Chapter 11 is a considerably more expensive procedure than Part 26A. This means that on a cost-benefit analysis, the benefit of addressing unexpired leases within Part 26A may be considerably greater than the benefit of addressing them in Chapter 11.

(iv) Information Asymmetry

Finally, no account of the differences in the treatment of unexpired leases inside and outside formal corporate restructuring procedures would be complete without an examination of the renegotiation mechanism itself. Outside corporate restructuring a tenant

⁷⁹ *Discovery (Northampton) Limited and others v Debenhams Retail Ltd* [2020] EWHC 1430 (Ch), [13].

⁸⁰ *Virgin Active Holdings Limited* [2021] EWHC 911 (Ch), [29].

⁸¹ See n 31 and accompanying text.

⁸² 11 USC § 502(b)(6). 11 USC § 365 already federally pre-empts any right the landlord has under State law to refuse to accept the tenant’s surrender of a commercial real estate lease. 11 USC § 502 represents a further erosion of landlords’ rights outside bankruptcy especially in those States that adhere to the traditional common law rules on tenant abandonment and surrender. For a short account of the history and rationale of 11 USC § 502 see Blake Rohrbacher, ‘More Equal Than Others: Defending Property-Contract Parity in Bankruptcy’ (2005) 114 *Yale Law Journal* 1099, 1121–23.

⁸³ Stephen Gandel and Joshua Franklin, ‘Overdue Commercial Property Loans hit 10-year High at US Banks’ *Financial Times* (New York, 9 November 2023).

can, of course, attempt to reach a negotiated settlement with its landlord. As Szumilo and Wiegmann identify, the bargaining dynamics may vary because different types of property investor may have different incentives.⁸⁴ Thus, a pension fund that relies on income will be incentivised to prefer partial rent to no rent, whereas an investment fund that periodically reports the value of assets and income return may prefer a rent deferment.⁸⁵ Szumilo and Wiegmann also note the possibility of an income-sharing arrangement, where rent is a percentage of the debtor-tenant's revenue. But, overall, outside a formal corporate restructuring procedure, the negotiating process reduces information asymmetry. The tenant learns what is motivating the landlord and where the landlord's red lines are. At the same time, the landlord is likely to demand significant information from the tenant about the debtor-tenant's financial position, to ensure that it obtains what it can accept as a fair deal in the renegotiation.⁸⁶

The dynamics are fundamentally different in Part 26A because the debtor-tenant can ultimately functionally surrender the lease at a low financial cost without having to engage extensively with the landlords – or even at all. At the sanction hearing for the Part 26A restructuring plan for the UK gym group Fitness First, the judge noted:

Even though the Company had clearly decided by January 2023 and, indeed, Teneo had been instructed by May 2022 to prepare for a restructuring, there was no engagement with Landlord Creditors until the Practice Statement Letter ... was sent to all creditors on 17th April 2023.⁸⁷

This seems remarkable when we consider the information that a tenant would need to share with a landlord to reach a consensual renegotiation outside Part 26A. In any commercial negotiation, the landlord is likely to demand sufficient financial information about the debtor's underlying operating performance to be able to consider other demands to compensate it for the benefit that other creditors may receive through the renegotiation. For example, where the debtor-tenant leases more than one property from the landlord, the landlord may be able to strike a better bargain on some of the better properties. This may not even require a cash payment – the landlord might extend the lease of some of the better properties to give it greater confidence in the long-term value of its overall portfolio with the debtor-tenant. Similarly, the landlord may be able to alter covenants in these leases to reduce risk. More dramatic options are also available: taking equity in the debtor-tenant; sharing intellectual property rights; or even entering a partnership arrangement.⁸⁸ And, crucially, if there is to be any type of deferred rent or income-sharing arrangement, the landlord will be in possession of the financial information to strike a deal. The risk is that, by contrast, in Part 26A the landlord is not in possession of any, or at least not enough, of the relevant information.

⁸⁴ Nikodem Szumilo and Thomas Wiegmann, 'How Struggling Businesses Can Renegotiate Rent' *Harvard Business Review* (5 May 2020): <https://hbr.org/2020/05/how-struggling-businesses-can-renegotiate-rent> (accessed 10 April 2024).

⁸⁵ *ibid.*

⁸⁶ *ibid.*

⁸⁷ *Fitness First Clubs Ltd* [2023] EWHC 1699 (Ch), [27].

⁸⁸ Szumilo and Wiegmann (n 84).

Levels of engagement were at the centre of the *Virgin Active* dispute,⁸⁹ and landlords continue to press the information asymmetry issue. In the recent Part 26A restructuring plan for the retailer Superdry, one of the landlords, Prudential, sought additional disclosure after the plan had been launched.⁹⁰ However, while Prudential was successful in obtaining sight of further financial information, it failed in some of its disclosure requests. Notably, it was denied sight of cash-flow forecasts for individual group companies and financial detail that had been used to construct the target post-reorganisation operating model for the group.⁹¹ The question remains as to whether the level of disclosure that the landlord is able to demand in a Part 26A restructuring plan is equivalent to the disclosure it would demand in order to achieve a consensual plan outside it.

The British Property Federation has complained bitterly about information asymmetry between debtor-tenants and landlords, and many of their best practice guidelines relate to levels of engagement.⁹² The risk of information asymmetry is considerably heightened in the UK compared to the US because leases can be bundled together into different baskets and a collective deal put to the landlords as part of the cross-class cram-down request. This ability to bundle leases together into different categories with different treatment and to impose the plan centrally is a powerful tool in the Part 26A toolbox. It enables the debtor to negotiate with enough creditors to secure support but potentially to shut out others. It is clear that the courts are increasingly alive to this risk – as the judgments referred to above and in *Sunbird* show.⁹³ Nonetheless, we would suggest that there is a greater risk that the debtor-tenant will exploit information asymmetry in Part 26A than in US Chapter 11.

III. Does it Matter?

Thus far, we have identified four explicit dimensions to the differences between the treatment of unexpired leases inside and outside Part 26A: the right of surrender; bargaining power; cost; and information asymmetry. We have suggested that none of these received extensive consideration in the consultations that preceded Part 26A, which was largely developed in a corporate restructuring law silo. And we have suggested that each of them is more significant in Part 26A than it is in Chapter 11, so that the UK would have benefitted from explicitly considering Chapter 11's approach rather than developing this aspect of Part 26A in a geographical silo. In this section, we put a bit more flesh on the bones of why this analysis matters. We have already explained why the CVA may be seen as a less attractive proceeding for compromising unexpired leases in the immediate future and so, in this section, we will focus on Part 26A restructuring plans.

⁸⁹ *Virgin Active* (n 75).

⁹⁰ *In the matter of C-Retail Limited* [2024] EWHC 1194 (Ch).

⁹¹ *ibid*, [11] and [14]–[17].

⁹² British Property Federation, 'Insolvency Engagement Document' available at: <https://bpf.org.uk/media/2448/bpf-cva-engagement-document-v3-2407.pdf> (accessed 1 December 2023).

⁹³ A scheme case but applicable on this point – *Re Sunbird Business Services Ltd* [2020] EWHC 2493 (Ch).

A. Entering Part 26A to Deal with Unexpired Leases

Thomas Jackson most famously offered a justification for, ‘the time-honored proposition that non-bankruptcy entitlements ... should be recognized in bankruptcy’.⁹⁴ Jackson does spend some time considering the specific example of unexpired leases, although his focus is not on surrender or modification. His general concern is that if specific consequences follow from filing for a formal corporate restructuring procedure that do not apply outside of it under ordinary private law, incentives will become distorted to such an extent that formal corporate restructuring procedures are instigated even when this is not in the creditors’ collective interest.⁹⁵ Jackson is focused on decision-making by creditors, but we can apply his analysis equally to debtors. The risk is that if a loss-making lease can be surrendered in a formal corporate restructuring procedure but not outside it, or if a lease can be more readily heavily modified in a corporate restructuring procedure than outside it, the debtor-tenant may be incentivised to resort to bankruptcy too easily, with all the direct and indirect costs that that entails but more crucially with all the uncertainties it entails about the robustness of the business to survive the formal process.

Our first concern, then, is that a debtor-tenant who is in only moderate financial difficulty may resort to Part 26A too readily because of the advantages it offers in addressing unexpired leases. Part 26A restructuring plans are distinctive in two important ways. First, it is not necessary to compromise all liabilities: trade creditors can relatively easily ride through the case unaffected. Secondly, the debtor-tenant can impose lease modifications through the plan, provided that the landlord retains the right to terminate the lease if it does not accept the modifications. These additional features potentially render the Part 26A restructuring plan a very attractive proposition for terminating or modifying unexpired leases and bring into stark relief our concern that debtors will resort to the procedure too readily. Judges have several levers they can pull to ensure that this is not the result and, given the relative ease with which debtor-tenants can deploy Part 26A to surrender or modify leases, they should be willing to use them.

If a class of landlords whose leases are either functionally surrendered or significantly modified in the Part 26A restructuring plan rejects the plan, recall that for the court to be willing to impose the plan over the landlords’ dissent, the landlords must be no worse off under it than they would be in the relevant alternative. The first lever the court has is to put the debtors’ feet to the fire over their analysis of the relevant alternative and the treatment of landlords within it. In considering whether the landlord is worse off than it would be in the relevant alternative, in our view courts should consider not just the distribution that the landlord would receive as an unsecured creditor but also – where the relevant alternative is a sale of all or part of the business as a going concern – the possibility that the landlord would receive better, modified terms from the purchaser.⁹⁶ The core issue here is that the premises may be worth

⁹⁴ Thomas H Jackson, ‘Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors’ Bargain’ (1982) 91(5) *Yale Law Journal* 857, 858.

⁹⁵ *ibid*, 890.

⁹⁶ Sarah Paterson, ‘Judicial Discretion in Part 26A Restructuring Plan Procedures’: <https://ssrn.com/abstract=4016519> (accessed 10 April 2024).

more to a purchaser in a specific sector than they would be worth on the open market. For example, if the premises are adapted for a specific use, such as a gym, and have an established clientele of gym members, the premises may be worth considerably more for a purchaser who wishes to buy the chain of gyms than they would be worth as a single lot on the open market. This becomes much more obvious when we break out of the corporate restructuring silo and consider how leases are treated under ordinary private law.

Secondly, the court must be alive to the question of whether unaffected creditors are getting too good a deal. A holistic review is essential: the court must demand that the debtor provides evidence for why trade creditors have been excluded and why this does not make a material difference to the landlords. It seems to us that it will rarely be justifiable to compromise leases but not unsecured debt. And the court must also be alive to the question of whether the plan results in an 'unfair' transfer of value to other creditors and to those who will retain equity in the group after the restructuring. To unpack this, we must start with the financial treatment of a lease. In his fabulous new book, *The Financial Restructuring Tool Set*, Mike Harmon identifies the ambiguity over whether an operating lease in a lease-heavy business, such as a retailer or a casual dining operator, ought to be treated as debt or as an operating expense on the firm's balance sheet.⁹⁷ Harmon prefers to treat the leases as debt in a lease-heavy business because 'a lease is just a different way of financing productive long-term assets used in the business'.⁹⁸ This leads Harmon to view an improvement in EBITDAR (earnings for the business before not only interest, tax, depreciation and amortisation (EBITDA) but also rent) as a signal that the total enterprise value of the firm has increased. If EBITDAR increases after rejection of leases in a Chapter 11 case, then Harmon identifies that there may have been a transfer of value from the landlords to other stakeholders. He admits that his treatment is not universally accepted. Indeed, when we asked him, Harmon pointed out that the financial services company Lazard had valued clothing retailer J Crew on an EBITDA, rather than EBITDAR, basis when it ran both a multiples valuation and a discounted cash-flow valuation of the business. Nonetheless, we find Harmon's approach extremely useful for our analysis.

This is because, by focusing on changes in EBITDAR, Harmon draws out whether lease rejection has improved the fundamental operating performance of the debtor. If a debtor-tenant's EBITDAR goes up when a lease is effectively rejected in a Part 26A plan, then value is transferred from the landlord to those that will end up owning the firm. We should be very concerned if the issues with surrender; bargaining power; cost; and information asymmetry make it possible for other stakeholders to capture value from landlords by seeking to reshape leasehold estates inside Part 26A rather than outside it. If this were to become a widespread feature of Part 26A plans, then there would undoubtedly be a strong incentive to use it to achieve a restructuring of an over-rented leasehold estate rather than making any attempt to negotiate consensually.

⁹⁷ Mike Harmon, *The Financial Restructuring Tool Set* (New York, Columbia University Press, 2025) 148 fn j.

⁹⁸ *ibid.*

We consider that our analysis acquires even more force when we bust Part 26A not only out of its corporate restructuring law silo but also out of its geographical silo. This is because the risk that debtors will be tempted to resort to a formal corporate restructuring tool solely to address unexpired leases may be somewhat moderated in a US context because of an issue that we have addressed in earlier work. The issue is that there are challenges with selecting specific liabilities to compromise in Chapter 11.⁹⁹ A specific issue arises in so-called non-consensual plans, in which the court is asked to impose a plan of reorganisation over the wishes of a dissenting class. This is because two rules, known informally as the cram-down rules, are engaged: a rule that states that a non-consensual plan must not discriminate unfairly with respect to non-accepting impaired classes,¹⁰⁰ and the absolute priority rule, which provides that no junior class shall recover until a more senior class has recovered in full.¹⁰¹ The overall result of these rules is that it may prove especially difficult to confirm a plan over the objections of dissenting landlords in which a substantial number of unsecured trade creditors ride through the plan unscathed.

In our earlier work, we exposed (and criticised) a technique developed in the Mattress Firm bed store bankruptcy for rejecting leases while leaving a substantial number of other creditors unimpaired. We called this technique ‘target claim unimpairment’ because it relies on an interpretation of unimpaired claims adopted by the Courts of Appeal in the Second, Third and Fifth Circuits. This interpretation is that a claim is unimpaired if the debtor proposes to pay the full amount of an allowed claim in bankruptcy even if that allowed claim is less than the amount the creditor would have been entitled to under non-bankruptcy law. And recall that the landlord’s claim for damages on rejection is capped at the greater of one year, or 15 per cent not to exceed three years, of rent for the remaining term of the lease. However, this technique is not for the faint-hearted debtor-tenant. While in the face of mounting problems in meeting the terms of leases negotiated in an entirely different market, and the serious obstacles to surrender outside bankruptcy, tenants may have little choice but to resort to this type of expensive, uncertain, aggressive use of the US Bankruptcy Code, it is undoubtedly a narrow and rocky path to navigate. Overall, Chapter 11 probably remains more of a last resort for addressing an overrented estate than Part 26A.

B. Market Implications

Our second concern is that the compromise of leases within Part 26A will lead the commercial real property market rather than reflect it. To put this another way, we see less objection to the use of Part 26A to reduce a landlord’s hold-out power to realign the lease terms with the current market so that the debtor can survive, than with the use of Part 26A to force terms on landlords that other, perfectly healthy leaseholders

⁹⁹ Sarah Paterson and Adrian Walters, ‘Chapter 11’s Inclusivity Problem’ (2023) 55 *Arizona State Law Journal* 1227.

¹⁰⁰ 11 USC § 1129(b)(1).

¹⁰¹ *ibid.*

subsequently demand. To unpack this concern, it is helpful to set out reasonably extensively some observations of Norris J relating to the Debenhams CVA:

Normally, it would seem wrong in principle that a tenant should be able to trade under a CVA for the benefit of past creditors at the present and future expense of its landlord. But suppose that past creditors consisted of suppliers who provided goods under ‘one-off’ contracts of ‘short-term supply’ deals that would naturally reflect the current market price for such supplies; and suppose the landlord could under the lease charge a rent fixed at an historic high or which automatically escalated by a fixed percentage unrelated to the value of money ... Would it not be ‘unfair’ for the suppliers to be unable to receive the market price for their goods in order that the landlord should receive a 100% premium over the market price for his supply? What would be ‘unfair’ about a scheme the object of which was to ensure that everybody got the market price for what they supplied? As a matter of *principle* I would not have thought it ‘unfair’ that a landlord might receive less than his contracted-for rent in such circumstances.¹⁰²

Norris J is referring here to the long-term, upward-only rent review commercial leases that were very common in the UK but that are rapidly becoming a thing of the past. In today’s highly challenging environment, tenants are increasingly able to negotiate for either-way rent reviews (where the rent can go up, down, or stay the same); turnover rent reviews (linked to trading success) or stepped rents (fixed increases at defined points in time). The objective is for the rent to reflect the market value of the premises or the tenant’s trading success.¹⁰³ Yet a problem arises if that market value is artificially impacted by the dramatically reduced rents that debtor-tenants can impose on landlords in a Part 26A restructuring plan. Healthy tenants who are suffering no financial difficulty at all may push for ‘most-favoured tenant’ clauses that promise the tenant they will receive terms at least as favourable as the landlord’s other tenants. If those other tenants have imposed dramatically low rents through a Part 26A restructuring plan, the results may be drastic for the landlord.

We have seen that in the US context the landlord’s damages claim for rejection is capped in Chapter 11. This was originally intended to prevent short-term ‘claim swamping’ by long-term claims but was presumably sized as a proxy for the damage that the landlord would suffer based on the assumption that the landlord would be able to re-let the premises in question within the time-frame envisaged.¹⁰⁴ Thus, the cap was designed to prevent landlords from swamping the vote of other unsecured creditors¹⁰⁵ (the very reverse of the vote swamping issue we explored in a UK context) while representing a realistic assessment of their economic loss. But this may be very far from the truth today in the highly challenging retail environment.¹⁰⁶ And, as we have seen, in the target unimpairment cases the landlord is denied any vote, so that no cap is

¹⁰² *Debenhams* (n 48) [66].

¹⁰³ DMH Stallard, ‘Is the end in sight for upward-only rent reviews?’ 20 September 2021: <https://www.dmhstallard.com/news-insights/blog/is-the-end-in-sight-for-upward-only-rent-reviews-1> accessed 10 April 2024.

¹⁰⁴ John T Baxter, ‘Bankruptcy 101: Lease Assumption, Assignment, and Rejection’ (2023) XIII (335) *The National Law Review*.

¹⁰⁵ *ibid.*

¹⁰⁶ Ethan Rothstein, ‘Even Developers Agree the US has Way too Much Retail Space’ (*Forbes*, 5 April 2017): <https://www.forbes.com/sites/bisnow/2017/04/05/even-developers-agree-the-u-s-has-way-too-much-retail-space/> (accessed 10 April 2024).

needed for the purposes of ensuring that the landlord's vote does not disproportionately determine the vote of an unsecured class. Similarly, the stipulation that the debtor must decide whether to reject a non-residential lease within 120 days of petition (extended to 210 days under the CARES Act¹⁰⁷), unless it manages to extend the period for an additional 90 days, was developed in a very different era when commercial landlords considered it unfair for debtors to have the time to determine what they would like to do – assume, assign or reject the lease – while the landlord could re-let with relative ease. Nonetheless, all the other limitations with the Chapter 11 regime that we have highlighted also apply to the extent to which the regime impacts on the ordinary rental market.

C. Foundational Questions

Our final concern is that the sophisticated and complex treatment of unexpired leases in Part 26A raises foundational questions about the nature and treatment of leases more generally that have not been asked, still less answered. For us, there are two relevant issues: the first is the implications of the no surrender rule outside Part 26A for the ability to reject or compromise an unexpired lease within it; the second is the question of whether a lease is properly treated as a financial liability or an operating expense.

As we have seen, Zacaroli J has held that a debtor-tenant cannot impose a surrender in Part 26A but can write the rent down to zero.¹⁰⁸ The rationale is that surrender implicates a property right while the obligation to pay rent is merely contractual. Yet we cannot help but feel that this issue merits further consideration. The question of the relationship between property law and contract strikes right at the heart of landlord and tenant law. For example, the lease will contain multiple covenants, besides the covenant to pay rent. However, a covenant in a lease does not necessarily just bind the parties to it: it can 'run with the land'. In other words, it is more than a mere contractual term. In our view, the partially contractual approach that Zacaroli J adopts would merit more consideration by property lawyers.

Similarly, we have drawn on Mike Harmon's analysis of the lease as a financial liability rather than an operating expense. This has important implications for how we think about potential transfers of value between landlords and those who would own the business after the restructuring. We suggest that this issue would also benefit from discussion between finance professionals specialising in real estate finance and those working in financial restructuring.

Once again, we consider that our analysis is strengthened when we reach outside our geographical silo. US landlord and tenant law already appears to be moving in the direction of a contractual approach to lease surrender, making the foundational question considerably less pressing. Indeed, peering over the edge of the geographical silo suggests that England should also, perhaps, be revisiting the common law rules on surrender.

¹⁰⁷ Coronavirus Aid, Relief, and Economic Security Act (2020).

¹⁰⁸ *Instant Cash Loans* (n 43).

IV. Silo-Busting

All of this leads us to suggest that it is time to bust leases out of the corporate restructuring and English law silos in considering how we hope to address holistically the dislocations that have been caused by the changing shape of the high street. In June 2021 Sarah Olney MP introduced a Private Members' Bill in the UK Parliament that sought not only to prohibit the use of upward-only rent review clauses in future commercial leases, but also to extinguish existing upward-only clauses.¹⁰⁹ This Bill appears to have ground to a halt with very little comment, but indicates that it is perhaps time to consider reform of leasehold renegotiation outside Part 26A, while being informed by it.

Crucially, we wonder if the experience of lease modification and rejection in restructuring indicates that the time has come to reconsider whether contract doctrines such as repudiation and mitigation should have a place in landlord and tenant law in the UK and in those US States that have not already moved in this direction. In our view, developments within Part 26A and in Chapter 11 undermine the 'property' aspect of the lease, adopting what Jason Brock and Jim Phillips call (in a different context) a 'partial contractualization' of the commercial lease.¹¹⁰ It seems to us profoundly unsatisfactory to have, drawing on Brock and Phillips again, 'an inconsistent patchwork of approaches'.¹¹¹ Brock and Phillips' work is part of a body of literature suggesting that the time has come to abandon commercial landlord and tenant law as part of property law and to fully assimilate it within contract law. We suggest that the analysis in this chapter provides more grist for that mill and, at the very least, suggests that the time has come to re-evaluate the common law of surrender.

More radical options outside corporate restructuring law might also fruitfully be considered. In the UK, the Commercial Rent (Coronavirus) Act 2022 introduced an arbitration process to resolve disputes regarding Covid rent arrears. The deadline for making reference to the arbitration process was 23 September 2022 and it was not subsequently extended. The arbitration process introduced considerable uncertainty for both landlord and tenant and, therefore, shifted bargaining power quite dramatically. The arbitration process was accompanied by a code of practice issued by the Government to help parties in the process of negotiation,¹¹² and anecdotal reports suggest that many parties decided to avoid the scheme and reach commercial settlements.¹¹³ Yet there has been very little analysis of the lessons learnt from this process for the ongoing efforts to move rents onto a sustainable footing in a very different environment.

¹⁰⁹ Commercial Rent (Prohibition of Upward-Only Reviews) Bill, Private Members' Bill (2021-22) 54.

¹¹⁰ Jason Brock and Jim Phillips, 'The Commercial Lease: Property or Contract' (2000-2001) 38 *Alberta Law Review* 989, 991.

¹¹¹ *ibid.*

¹¹² *Commercial Rent Code of Practice following the COVID-19 Pandemic*, 7 April 2022: <https://www.gov.uk/government/publications/commercial-rent-code-of-practice> (accessed 31 March 2025).

¹¹³ Clyde & Co, 'Covid rent arrears arbitration service closes: What now?': <https://www.clydeco.com/en/insights/2022/09/covid-rent-arrears-arbitration-service-closes-what> (accessed 31 March 2025).

Silo busting is not, however, unidirectional. Just as we consider the time has come to analyse the implications of the treatment of leases within Part 26A for landlord and tenant law, so too we think the time has come to reconsider what landlord and tenant law has to say about the treatment of leases within Part 26A. Moreover, just as we consider that English lawyers should bust out of their geographical silo in considering the treatment of unexpired leases in Part 26A, so we believe that US lawyers would benefit from understanding how they are treated in Part 26A. Specifically, we consider that the treatment of a capped damages claim by a landlord under Chapter 11 as an unimpaired claim requires some interrogation. We are also of the view that the cap of the damages claim in Chapter 11 needs a fresh look in the new market environment. And we consider that the possibility of a transfer of value from one group of unsecured financial creditors, the landlords, to the shareholders via the rejection process requires serious consideration. Similarly, in our opinion, the English courts must take into account all payments that a landlord may receive in the event of the relevant alternative; should be cautious about treating a termination right as an end to the landlord's concerns; and should take very seriously indeed the risk of a transfer of value from the landlords to those owning the firm after the restructuring. In both jurisdictions we are concerned about transparency. In our view, a debtor should always be required to show that it has attempted to bargain with the landlord, and shared relevant information with them, before resorting to a cram-down technique.

Finally, we advocate for a more radical approach to busting the geographical silo. We hope that our unpacking of the Anglo-American position already provides some useful insights. We suspect, however, that much more could be learned by understanding the process of lease negotiation in other jurisdictions. For example, in the *Virgin Active* litigation the court heard that the company's clubs outside the UK had generally been able to reach consensual agreements with landlords. Experience of renegotiation in Italy, Thailand, Singapore, and Australia had been more positive than in the UK.¹¹⁴ It would be very interesting to understand what was different about the negotiating dynamics in those jurisdictions and what lessons the UK and the US could learn.

V. Conclusion

Part 26A and real property law are misaligned. There is not the room here for us to work out fully how they could be better aligned. Rather, our purpose has been to demonstrate that corporate restructuring law's more contract-based approach has developed in the corporate restructuring law silo with apparent disregard for debates in property law about the nature of the lease and the relative rights of landlord and tenant outside a formal corporate restructuring procedure. By the same token, property lawyers are also seemingly often oblivious to the misalignment. As corporate restructuring lawyers, we doubt that this state of affairs is healthy. Moreover, in our view, a proper understanding

¹¹⁴ *Virgin Active* (n 75) [8].

of the stakes outside formal corporate restructuring procedures, and the impact of corporate restructuring law on landlords' rights, is essential to the resolution of questions of allocative fairness between landlords and other stakeholders in the corporate restructuring law process. And finally, we consider that lawyers, policy-makers, scholars and judges would all do well to look beyond their geographical silo in addressing the detail of how corporate restructuring law interferes in the important area of long-term leases.

