Talking Shop
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OLSWANG

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CVAs – on trend?

Rachael Davis

The term "CVA" (Company Voluntary Arrangement) has recently received increased exposure in the press, with high profile names in the retail sector such as Stylo, Miss Sixty and JJB Sports all associated with CVA proposals, approvals or rejections. This article briefly talks about what a CVA is, where it has been used recently in the retail sector and comments on the industry view.

Formal requirements

The CVA is an agreement between a debtor and its creditors which, once it has been agreed by the requisite majorities of unsecured creditors (75% in value of those present and voting) and shareholders (a simple majority in value), becomes binding on all unsecured creditors who were entitled to vote at the creditors' meeting to approve it – even if those creditors voted against the proposal, or did not attend the meeting.

However, should the outcome of the meeting of shareholders differ from the outcome of the meeting of creditors, the decision of the creditors shall prevail, subject to the right of any shareholder to apply to Court to challenge the approval. Also, under current law, eligible "small companies" have the option of a 28 day moratorium to allow them to put proposals for a CVA to their creditors without the threat of creditor action or enforcement.

Once binding, a CVA made by a company with its creditors and members under Part 1 of the Insolvency Act 1986 often involves a 'composition' in satisfaction of the company's debt, and proposals may include, for example, a rescheduling or reduction of the company's debt.

Use of CVAs by retailers

For retailers, getting landlords (usually the most significant unsecured creditor) on side can either make or break a CVA proposal. The CVA proposal can also highlight the fact that not all unsecured creditors (for example, landlords or suppliers) are equally as vital to the ongoing business as others.

Recent examples of the use of CVAs in the retail space demonstrate the mixed success of the process. The information contained in the case studies below reflects information and facts reported in the press and other publicly available information:

1. Stylo

Stylo plc, the owner of the Barratts and PriceLess store chains, was one of the first major retailers in recent times to make a CVA proposal.

It has been reported that the Stylo CVA proposed, among other things, to move rents on its shops from fixed passing rent to a reduced rent based on turnover, whilst agreeing to continue to trade from all properties for a period of six months and pay any arrears and ongoing liabilities on the properties.

However, creditors, and specifically the landlords of the various retail units, rejected the proposal at the creditors' meeting and the company went into administration in February 2009, resulting in many stores being closed that might have remained trading under the CVA.

Reasons for that rejection might have been that the landlords felt the rent reductions, which would have linked rents to future revenues at the stores, were unacceptable, and could set a dangerous precedent for retailers seeking to leave unprofitable sites. Further, the proposals were relatively complex and involved several options which may have led landlords with less experience of CVAs to vote against them.

2. Miss Sixty

Sixty U.K. Limited operated Miss Sixty, which went into administration, and the administrators subsequently made a CVA proposal that was approved by the creditors on 3 April 2009.

It has been reported that Miss Sixty, which had 12 UK retail store outlets, was able to make proposals dealing with landlords on an individual basis, with limited store closures. The CVA allowed all trade creditors to be paid in full immediately, with landlords separately agreeing differing terms going forward. This case illustrates that in order for a CVA to succeed, it is important to treat the company's key stakeholders (such as landlords) fairly to ensure they are on board.

3. JJB Sports

A very high profile CVA was recently approved in the case of JJB Sports. Two inter-conditional CVAs of JJB Sports plc and Blane Leisure Limited were approved under which the retail stores were categorised as either 'closed' or 'open', with the landlords of the closed stores (approximately 140 stores) able to make their claims against an aggregate fund of £10 million, and the landlords of the open retail stores (approximately 250 stores) agreeing to have their leases temporarily varied such that the rent would be paid on a monthly basis, rather than quarterly, for a period of 12 months from the next rental quarter date.

JJB Sports also additionally secured new financing arrangements, conditional on the CVA being approved with no subsequent challenge. Following a meeting of the creditors on 27 April 2009, and a meeting of the shareholders on 29 April 2009, the JJB Sports CVA was approved.

CVA – the cool kid in town?

As there is such a limited amount of Court involvement in a CVA, lower cost associated with it and an optional moratorium on creditor action available for eligible small companies, it had been thought that the CVA would be a popular option for restructuring struggling companies.

However, CVAs are still rarely used in practice and reasons for this include the hurdles regarding implementation and the lack of an automatic statutory moratorium on creditor action.

In addition, no CVA can affect the rights of a secured creditor to enforce his security without his consent, and the rights of preferential creditors are protected such that any CVA proposal must allow for preferential debts to be paid in priority to other unsecured debts, and that they are to rank equally among themselves (unless otherwise agreed by the individual preferential creditors concerned).

Looking at figures released by the Insolvency Service, in 2008 there were only 587 CVAs compared to 4,822 administrations. The Chancellor of the Exchequer announced on 22 April 2009 in the budget speech

however that the Insolvency Service will be starting a consultation in June 2009, proposing changes to allow large and medium sized companies breathing space while they seek to reach legally binding agreements with their creditors without first having to place their companies in administration, and also proposals to allow money lent to companies in CVAs or administrations to be given priority.

If implemented, this may lead to an uptake in CVAs for struggling companies of all sizes – particularly if JJB Sports becomes something of a milestone for CVAs in the retail sector.

Ultimately, the success of a CVA will depend on the extent of financial difficulty the company is in, and the support of the company's key stakeholders as well as the ability of the company and its advisers to effectively communicate the proposal to the creditors. For many, the pre-pack administration sale will still be the route of choice to get the best deal, used as a quick and effective way of making a greater recovery.

In such a difficult economic environment, particularly in the retail sector, if a CVA proposal can throw a company a lifeline, and creditors are not unfairly prejudiced prompting them to challenge it, and it can be easily understood by the creditors involved, the future could be promising for voluntary arrangements, particularly if the proposals by the Insolvency Service come to fruition. However, until such time as the end result of a CVA can be proved to successfully breathe new and sustained life into a struggling company, the high street will continue to suffer, and the jury will still be out as far as the industry is concerned.

Avoiding competition law breaches when negotiating retail supply agreements

April Evans

In the current economic climate, retail suppliers and distributors are, more than ever, seeking ways to protect their revenue streams. Some may be tempted to do this by pressuring retailers to set minimum retail prices, however, competition law prohibits resale price maintenance ("RPM"). Businesses at all levels of the retail supply chain need to be aware that RPM is contrary to the competition rules and can potentially lead to the agreement being found to be void and substantial fines being imposed by the competition authorities.

How does competition law apply?

The Competition Act 1998 and Article 81 of the EC Treaty prohibit anti-competitive agreements. Agreements which fix the price at which a product must be sold are considered to be 'hard-core' restrictions that are presumed to infringe the competition rules. Businesses may also seek to enforce RPMs by indirect means which will similarly breach the competition rules. The key issue is determining whether the obligation in question has the effect of restricting the retailer's commercial activity and therefore competition between retailers in the downstream market. For example, a supplier or wholesaler would infringe the competition rules by seeking to enforce the following obligations on a retailer (each of which entails a form of RPM):

- fixing either the distribution margin or the maximum level of discount the distributor can grant from a prescribed price level;
- making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level;
- linking the prescribed resale price to the resale prices of competitors; or
- threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level.

If an investigation is opened into the commercial activity of a supplier and its distributors, competition authorities may also consider whether additional measures have been used to identify price-cutting e.g. price monitoring systems or obligations on retailers to alert the supplier to sellers who are not adhering to minimum price levels.

Suppliers may provide retailers with regularly updated lists of recommended retail prices during the term of the agreement without breaching the competition rules. However, if suppliers use pressure to enforce recommended prices, e.g. by refusing to supply further goods or threatening to terminate contracts if recommended prices are discounted, retailers may feel they have no choice but to comply with the suppliers' demands. By agreeing to adhere to recommended prices, retailers also breach the competition rules.

Understanding the risks

Competition authority action: The Office of Fair Trading ("OFT") or the European Commission may investigate an agreement following receipt of a complaint or under their own initiative. If a competition authority discovers that commercial parties have breached the competition rules, it may order that the parties bring the behaviour to an end and can impose financial penalties (up to 10% of annual worldwide turnover) depending on the seriousness of the infringement.

In recent years, the OFT has investigated a number of high profile cases involving distribution agreements which breach the competition rules by containing RPM clauses. These agreements have involved the supply of a variety of consumer goods in a wide number of retail outlets from the sale of Oakley sunglasses in department stores to the supply of Lladro figurines in specialist shops. In some cases these investigations have resulted in substantial fines for the parties involved. For example, the OFT imposed a fine of £18.6 million on ten suppliers of replica football kits (including JJB Sports) for having agreed to set the price of kit manufactured under licence by Umbro. It also imposed a fine of almost £5 million on Hasbro, the toy and games manufacturer, for actively enforcing RPM clauses on its distributors.

The European Commission also takes RPM seriously and is willing to penalise companies infringing competition rules with substantial fines. For example, the Commission imposed fines of €2.56 million on Yamaha, the musical instruments manufacturer, for forcing its distributors to enter into agreements containing anti-competitive elements including RPM obligations.

Unenforceability: Another important point to note is that if a competition authority or a court finds that a contractual term breaches the competition rules it will be automatically void and unenforceable. If a supplier launched a claim for contractual breach because, for example, a retailer had not complied with an RPM obligation, a retailer could therefore argue in its defence that the agreement is in breach of the competition rules and unenforceable.

Third party damages actions: It has been established under EC law that third parties can bring private damages actions in the courts where they can establish that they have been adversely affected by an anti-competitive agreement. Pursuant to provisions of the Competition Act, where the OFT or the Commission has found an infringement of the competition rules, follow-on claims for damages can be brought before the UK Competition Appeal Tribunal (the "CAT") either directly by interested parties or by specified bodies on behalf of groups of affected consumers. Further to the OFT's decision against suppliers of replica football kits, the Consumers' Association commenced legal proceedings against JJB Sports on behalf of consumers who had paid more for replica shirts as a result of the price-fixing agreements. JJB subsequently settled the case out of court and agreed to pay damages to affected consumers.

The Price of Loyalty

Aliya Young

Retailers hit by the credit crunch are employing imaginative ways to get people through their doors. Vouchers, gifts, discounts and other promotions are all being used to stimulate trade.

An immediate question which should be asked in relation to any promotion is whether it results in a VAT cost to the retailer.

Discounts and gifts

If the promotion consists of a discount then the answer should be no – the general rule is that a retailer charges VAT on the discounted price where the discount is freely available. This normally applies in respect of discounts in store, as well as discount vouchers available online or through magazines.

The position is more difficult in relation to gifts.

Where the cost to the retailer of the item is £50 or less and does not form a series or succession of such gifts to the same person, then the gift will not attract VAT. If this condition is not satisfied then VAT is payable by the retailer calculated by reference to the cost of the gift. As a result promotions tend to comprise goods of low value and are often stated to be 'one per customer'.

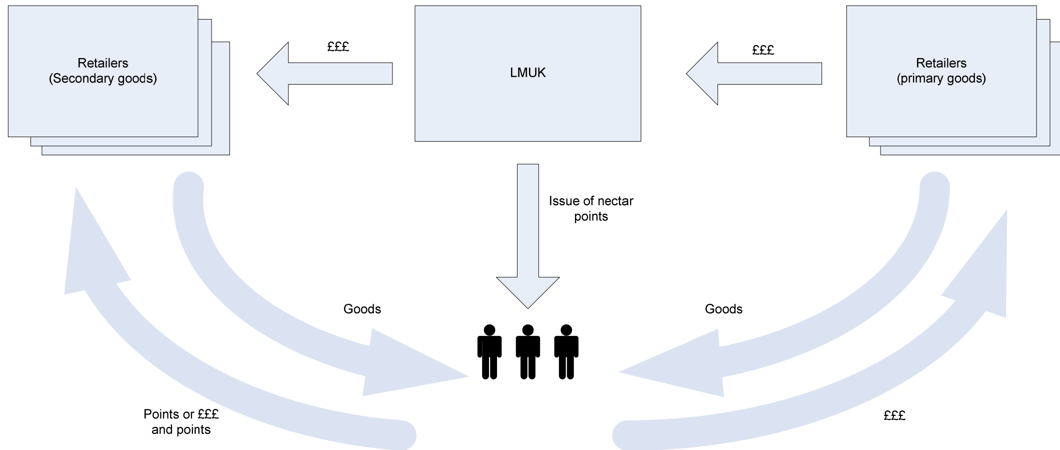
In the case of face-value vouchers (meaning, vouchers having a cash value stated on them) then, if they are given away for free, they are treated in the same way as goods which are gifted to customers.

Points schemes

The VAT treatment of points schemes is more complex and, in the case of the Nectar scheme, is the subject of litigation.

The Nectar scheme is operated by Loyalty Management (UK) Limited ("LMUK"). Customers who purchase goods (primary goods) from participating retailers are credited with Nectar points. These points can be redeemed to acquire discounted or free goods (secondary goods) from participating retailers. The retailers of primary goods pay a price per point to LMUK. When points are redeemed by customers then LMUK pays the retailers of the secondary goods.

The scheme can be illustrated as set out below:



The current VAT litigation relates to LMUK's claim to recover input tax incurred in relation to its payments to the suppliers of secondary goods. Essentially, the question is this – do the suppliers of secondary goods simply make a supply to nectar customers, in which case LMUK has no right to recover input tax, or do such suppliers also make supplies to LMUK?

This is a key issue; an adverse decision might threaten the scheme itself.

To date, the good news for retailers is that the courts have agreed with LMUK. The Court of Appeal has held that the retailers of secondary goods have made two supplies - a supply of goods to customers and a supply of services (namely, the redemption of Nectar points) to LMUK (Revenue and Customs Commissioners v Loyalty Management UK Ltd – [2007] EWCA Civ 938).

However, a referral has been made to the European Court of Justice to consider the decision of the Court of Appeal that the secondary retailers make two supplies. HM Revenue & Customs have warned operators of similar points schemes that, until the LMUK case is decided, it will disallow input VAT claims and invite loyalty scheme promoters to appeal to the VAT tribunal (see Revenue & Customs Brief 46/08). As a result the VAT treatment of these schemes is likely to remain contentious for some time.

Expanding your dot horizons

Sarah Wright

A recent announcement by ICANN (the Internet Corporation for Assigned Names and Numbers) in October 2008 indicated an expansion of the pool of top level domains (TLDs) captured the attention of the world's media. Most front pages hailed the news as a complete overhaul of the internet system, and ICANN itself described the proposals as "a whole new way for people to express themselves on the net".

A top level domain is the final word coming after the dot in your domain name, the most popular being .com, .net, and .org. From 2010, ICANN will invite applications from around the world for up to 200 new top level domains to be added to the pool. Applicants will be able to propose their own, entirely new, top level domain, which might be a generic word like .fashion or .shopping, or a brand name like .gucci.

How will it work?

Applications for new TLDs are expected to begin in Q1 of 2010. ICANN is hoping that this will see a rush of some 500 or more applications, of which somewhere between 50 and 200 will be accepted.

The plan is that a successful applicant will negotiate with ICANN the basis on which they agree to act as the registrar of the new domain. This will mean the applicant has the freedom to set and monitor the eligibility criteria for domain names.

Theoretically the registrar of the new domain might apply the eligibility criteria extremely widely (or even not at all) so that anyone may apply. More likely, however, is that the new TLDs will be restricted to specific individuals or groups.

If the registrar of the new domain is a trade body, for example, the domain might be reserved for its members. If the registrar of the new domain is a government body, the domain would be only be available for those deemed appropriate, such as those performing other governmental functions.

Equally, an applicant may want to create a "private island" on the internet: large brand-owners might want their entire brand to be shifted to the new .brand domain. In this scenario the domain names would only be available for use by the business, and would never be open to registration by the public.

ICANN has already published its RFP and two draft versions of the Applicant Guidebook. A third version is expected in Q3 of 2009 and the final version is due in Q4. ICANN is proposing an upfront evaluation fee of US$185,000 in order to ward off speculative applicants. If the application fails or is withdrawn, part or all this will be refunded, depending on the stage at which the application is stopped. However, this does not take into consideration the applicant's costs in preparing the bid, which are likely to be very substantial.

ICANN will have the unenviable task of selecting the most promising applications based on a range of factors including the nature of the applicant, their financing and security and their trade mark rights. Applications to register third party trade marks as generic TLDs will not be prohibited outright but there will be an "objection process". This is obviously of serious concern to rights holders – particularly where two unrelated parties hold equally valid registered trade mark rights in different jurisdictions. Such rights clashes would also raise a number of interesting questions of intellectual property law.

Who are the likely applicants?

In 2000, ICANN engaged in a similar exercise and invited recommendations for new TLDs. Over 150 top level domains were proposed by industry bodies, private individuals and existing registrars, including .movie, .nyc, .kids, .church, .africa., .travel and .news. We anticipate that many of these early proposals will now be re-submitted. The main contenders are expected to be trade bodies and brand owners applying for generic terms rather than brand names.

There are a number of reasons why someone would be interested in making an application. The first and most important is where a solid business case exists for doing so. This might be because a particular trade body wants to regulate an area of business on the internet (for example, the adult or travel industries). Or, it might be based on belief that a domain registrar can be run at a profit and that a particular domain will be popular enough to be worth the initial investment in filing the application.

However, there is concern that the process will result in a plethora of blocking applications. Whilst ICANN will include an objection process, rights holders are understandably concerned to ensure that they will be able to prevent a third party successfully applying to be the registrar of their ".brand". Similarly, even for generic words like .shoes or .shopping, ICANN may find itself adjudicating over hard-fought battles between key players in the relevant industry.

We believe that, for the majority of brand-owners, the business case is unlikely to be strong enough to arouse serious interest in their own right. Many marketing teams will not be prepared to take the risk of having to re-educate the public that their brand has shifted from a .com space to a .brand space. The prohibitive financial cost and prospect of having to act as the registrar is also likely to disincentivise participation.

There will undoubtedly be some applicants who will be prepared to test the waters. However, we anticipate that for many, the threat of someone else acquiring their .brand legitimately may prove to be a motivating factor. The big question therefore is whether, in addition to the serious "business case" applications, brand-owners will be prepared to pay up to £1 million in application fees and legal costs at the submission stage, just so that their competitors don't get there first. Whether or not it will lead to ICANN's predicted sea change in internet usage is yet to be seen.

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About Olswang

Olswang is a leading business law firm with a distinctive approach. Our pioneering and problem-solving ethos has established a commanding reputation in the technology, media and real estate sectors, as well as a wide range of other industries.

Founded in 1981, our Firm has grown to a team of over 650, including over 100 partners, across four European offices. In addition, Olswang has a formal alliance with a major US firm Greenberg Traurig LLP and a long-established best friends network of leading independent law firms throughout the world.

Our Firm continues to be acknowledged as a leading practice in many of our core areas: Olswang was voted TMT Team of the Year 2008 at the annual Legal Business Awards; Olswang's Corporate Group won M&A Law Firm of the Year at the M&A Awards 2008 in conjunction with M&A Magazine, and was named Corporate Team of the Year – Mid markets at The Lawyer Awards 2008.

Resourceful drive and a climate of shared knowledge and empowerment are the hallmarks of our meritocratic, unstuffy culture. For the last four years Olswang has been ranked in The Sunday Times 100 Best Companies to Work For and our strong management team is dedicated to the personal and professional development of our people.

We are committed to encouraging every member of staff to engage in lasting and meaningful pro bono and volunteering activities, both legal and non legal. The time invested by our people through the Firm's HELP Programme to assist those in need is a positive contribution to the community which is reflected in the values and culture of Olswang.

We recruit personalities with a genuine fascination and notable reputation in the sectors they focus on, which is reflected in the quality of our advice. We also understand the importance of achieving our clients' goals and ensure that our advice is, above all else, practical.

From world-class businesses to entrepreneurial startups, the rich diversity of our client base ensures a broader perspective and, as a result, deeper commercial insight. Transactional work is the most obvious feature of the role we perform. However, ongoing non-transactional support is an integral part of our business, and we focus on creating long-term relationships with our clients. We employ a range of proactive initiatives such as client care programmes, secondments, client training and feedback sessions to ensure our client relationships are strong.

At Olswang the passion of our lawyers, the confidence of our approach and the commercial edge to our advice provide a unique and compelling service.

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