Caffè Nero: High Court Rejects CVA Challenge

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Summary

On 29 September 2021, the English High Court rejected a challenge in respect of Caffè Nero's company voluntary arrangement ("**CVA**"), brought by a landlord on the grounds of material irregularity and unfair prejudice. The single disgruntled landlord, with the backing of the EG Group ("**EG**") (who were interested in acquiring Caffè Nero), argued that the directors of the company and the CVA nominees breached their respective duties in refusing to adjourn or postpone the electronic voting process to vote on the CVA, after EG had submitted an eleventh-hour offer for Caffè Nero.

The key takeaways arising from the unsuccessful challenge are:

- **Duties of directors and CVA nominees**: The directors and CVA nominees were found to have acted consistently with their respective duties and in the best interests of Caffè Nero's creditors in reaching the decision to not postpone the CVA vote. The time constraints and uncertainty surrounding EG's offer meant that their actions were reasonable as even a "*short postponement carried with it very great risk that the CVA would fail*", which would have likely resulted in a value-destructive administration.

- **Electronic voting**: The electronic voting process for CVAs, while less flexible than physical meetings in its ability to deal with last-minute offers and other unforeseen matters, is still accepted as being the norm for CVA voting. The Court accepted that the only feasible way in which an electronic voting process could be postponed or adjourned would be by way of a court application although, on the facts of this case, it is unclear precisely what relief would be sought.

- **Modification to CVA**: A modification to a CVA proposal is possible during an electronic voting procedure after the creditors have commenced voting, particularly where the modification is "*solely for the benefit of the creditors*". If such CVA proposal is ultimately approved, then "*the modification should be treated as having been approved, so long as the company has also consented*".

- **Last-minute offers**: The decision highlights that bidders seeking to acquire companies in financial distress must engage with the target company and its advisers at the earliest opportunity. Last-minute offers, even if they have the potential to offer a better return to creditors, are less likely to succeed if they are delayed and have any material execution risk as compared to any alternative transaction capable of being executed in the time available.

Background

The Caffè Nero group (the "**Group**") (together with the hospitality sector at large) was hit hard by the COVID-19 pandemic, rapidly shifting from profitable trading to impaired trading in a short space of time. Nero Holdings Ltd (the "**Company**") launched the CVA in November 2020, with a view to compromising its rent arrears, future rent, service charges and insurance. In particular, landlords in respect of outstanding rent arrears were to receive a return of 30% under the CVA proposal.

Separately, two levels of secured debt sat within the Group: a £155.5m senior facility and a £210.9m mezzanine facility. The Group had obtained waivers from both the senior and mezzanine lenders in respect of the defaults arising as a result of the CVA being launched, as well as breaches of certain financial covenants. The waivers were conditional on the CVA being approved within a certain timeframe.

In order to seek approval for the CVA, the CVA nominees opted for the electronic voting procedure, with the voting deadline being 11.59pm on Monday 30 November 2020. At 8.48pm on Sunday 29 November 2020, EG submitted a proposal to, amongst other things: (a) acquire 100% of the issued share capital of Nero Group Ltd, the Company's parent ("**NGL**"), and (b) pay all landlord rent arrears in full. Although the proposal was conditional upon the CVA being approved (in a modified form), the proposal also requested that the CVA meeting be adjourned for at least 14 days so as to enable the parties to agree terms. The Court noted that EG and its advisers prepared and submitted the offer on the assumption that the CVA creditors would vote on the CVA at a physical meeting, rather than electronically. Unlike for physical meetings, there is no express provision in the Insolvency Rules 2016 (the "**Rules**") which allows for electronic voting to be adjourned or postponed.

NGL rejected the offer on the morning of 30 November 2020, and the CVA nominees and directors of the Company decided to not postpone or adjourn the vote (with both parties having taken this decision without making further enquires to EG about the offer). At or around the same time, news of the offer was reported on Sky News and other media channels. During the course of that afternoon, the CVA nominees posted an announcement on the CVA portal setting out the details of EG's offer, and subsequently made a modification to the CVA later that evening (at which point, sufficient creditors had already cast their votes in favour to approve the CVA). The modification provided that if there was a sale of NGL within six months of the approval of the CVA, the Company would use its best endeavours to deliver the same deal to creditors as being offered by EG at that time (which included payment of all landlord arrears in full, less any payments already received under the CVA). The CVA was ultimately approved.

Prior to the commencement of the CVA challenge, the applicant landlord (who voted in favour of the CVA) entered into an agreement with EG, under which he would receive £100,000 in return for undertaking to not accept any settlement offer from the Company and to not withdraw the challenge application without EG's consent.

The CVA was challenged primarily on the basis of there being multiple material irregularities, most notably: (a) failure by the CVA nominees and the directors of the Company to adjourn or postpone the vote to approve the CVA; and (b) the CVA creditors' votes counting towards the modified CVA proposal despite having voted before the modification was made.

The Court's decision and key takeaways

Ground for Challenge	Decision
The failure to postpone or adjourn the CVA vote was a material irregularity, as well as a breach of duty	The Court acknowledged that there is no express provision in the Rules enabling a CVA nominee or director to postpone an electric voting procedure (unlike a physical meeting) and failure to do so therefore could not be an irregularity, let alone a material one. The Court did note that this discrepancy in the Rules was a "lacuna" and may have been a legislative oversight for the Insolvency Rules Committee to consider in the future. While it was possible in theory for the CVA nominees or directors to apply to Court to seek a postponement, it is unclear what relief could have been granted, given that the Rules prevent creditors from changing their votes once they have already been submitted. In any event, the CVA nominees and directors were considered to have acted in good faith and in accordance with their respective duties in choosing not to postpone the vote. This is because a postponement to engage with EG's offer carried a real risk of the statutory deadline for the completion of the creditors' decision procedure (10 December 2020) being missed, causing the CVA to fail and the Company going into administration. Furthermore, the continued support from the Group's senior and mezzanine lenders could not be guaranteed as the waivers provided by the lenders were subject to the CVA being approved within a set timeframe.
The modification to the proposal was invalid as most of the CVA creditors had already cast their votes before the modification was made	As the Rules are clear that electronic votes cannot be changed once submitted, the Court took the view that modifications to a proposal may be made after voting has commenced and any such modification should be treated as forming part of the approved CVA and not requiring a separate vote. This is particularly relevant for cases where the modification is solely for the benefit of the creditors (i.e., the terms of the compromise were not changing but the Company was agreeing to procure improved payment terms for creditors), such that it would be difficult for a challenging creditor to demonstrate that the modification was an irregularity that was also material. The Court strongly rejected the applicant's argument that the CVA procedure intended that votes on a proposal should be distinct from votes on a modification, especially considering that the CVA nominees were unable to adjourn the proposal vote to allow for the modification to be voted upon. If any creditor objected to any modifications made to a CVA, they retained the right to subsequently challenge the CVA on the grounds of either material irregularity or unfair prejudice.

The applicant also brought a challenge on the grounds of unfair prejudice, alleging that EG's offer meant that the "relevant alternative" to the CVA had shifted from a value-destroying administration with minimal creditor returns, to a commercial transaction where the landlords' rent arrears would be paid in full. However, the Court dismissed this challenge as "*half-hearted*" and being dependent on "*vague and speculative scenarios of what might have happened*". The Court was not convinced that a similar offer would have been made by EG had the CVA failed, and the Company entered administration. Pursuing such an offer rather than buying parts of the Group at a discount following the Company's administration would have been inconsistent with EG's own commercial interests.

Comment

The facts of this case are rather unique compared to recent CVA challenges, in that the focus was on the receipt of a last-minute offer and the inability of the CVA nominees or directors to consider the offer due to the constraints associated with the electronic voting procedure. However, this decision should be welcomed by insolvency practitioners, as the decision to not engage with last-minute bidders due to time constraints, deal uncertainty and the potential risks will likely be considered as reasonable where the insolvency practitioner has acted in good faith and in the best interests of the company's creditors.

From the perspective of potential third-party purchasers intending to exert pressure on directors and insolvency practitioners by making last-minute offers (especially in "burning platform" scenarios), any such strategies are unlikely to succeed where putting a restructuring process on hold to consider such an offer could lead to the debtor's insolvency if such a transaction is not consummated, and the original restructuring ultimately fails. Potential bidders will therefore need to ensure timely communication with distressed targets and insolvency practitioners if they are intent on seeking any meaningful engagement.

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