

Restrictions on Rent Arrears Recovery During the Pandemic

At the start of the pandemic, the UK government moved quickly to introduce a range of measures severely restricting the ability of landlords under commercial leases to recover payment of rent arrears, forfeit leases and obtain possession of premises from tenants.

These measures have recently been extended.

- **Coronavirus Act 2020:** moratorium preventing eviction or forfeiture of commercial leases for non-payment of rent extended to 25 March 2022.
- **The Taking Control of Goods and Certification of Enforcement Agent (Amendment) (Coronavirus) Regulations 2020:** prevents the use of Commercial Rent Arrears Recovery (CRAR) unless 544 days' rent is outstanding from the tenant. Extended until 25 March 2022 (unless legislation is brought in ahead of that date that alters this).
- **Corporate Insolvency and Governance Act 2020:** prohibitions on presenting a winding-up petition unless the creditor has reasonable grounds for believing that COVID-19 has not had a financial impact on the debtor extended until 30 September 2021.

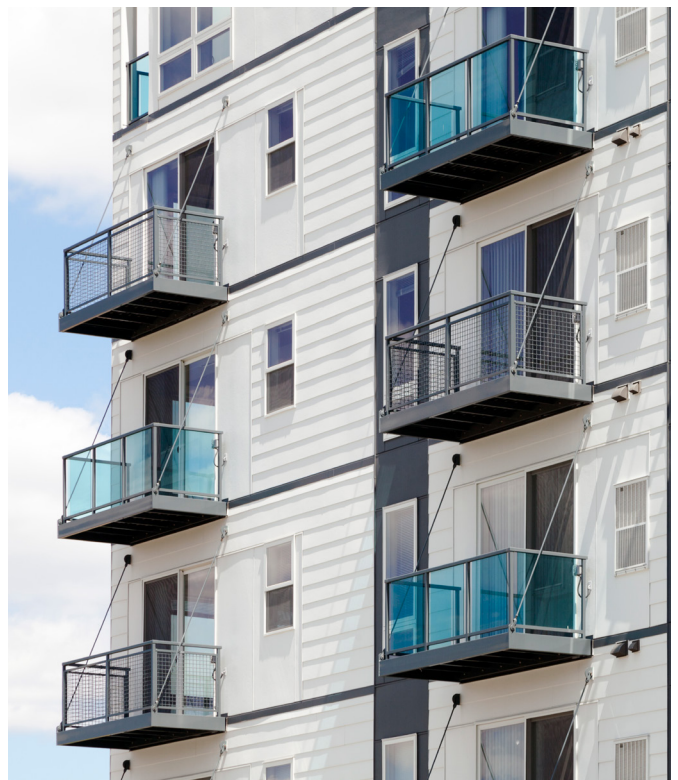
New legislation is set to be introduced for certain sectors to tackle rent arrears debt that has accrued during the pandemic, requiring landlords and tenants to engage in bilateral negotiations to resolve rent disputes or submit to a binding arbitration process if no agreement can be reached. If the legislation is passed before 25 March 2022, the restrictions on forfeiture currently in place will come to an end.

The government has now released further information ("Supporting businesses with commercial rent debts: policy statement") on who the rules will apply to and how the system will work in practice, the key points are:

- **Sector specific** – Not all commercial leases are covered. The new system will apply only to businesses that have been affected by business closure restrictions during the pandemic. Commercial tenants in sectors that were not required to close during the pandemic will not be covered. The message from the government is clear, for commercial tenants "...not affected by business closures who have the means to pay, should pay" and tenants will be expected to pay rents due in accordance with their lease terms or as otherwise agreed with their landlord, in full from the points that sector restrictions are lifted.
- **"Ringfenced Arrears"** – The new system will only apply to rent debt accrued from March 2020 for commercial tenants affected by business closure restrictions until sector restrictions are lifted. Any rents falling due before March 2020 or after restrictions have been lifted will not be covered.

- Two step process:
 - **Negotiation** – Parties are expected to negotiate compromise of ringfenced arrears and a new Code of Practice will set out key principles that parties are required to have regard to in negotiations.
 - **Arbitration** – To be used only as a "last resort"; after bilateral negotiations and only where landlords and tenants cannot resolve matters.
- **Evictions** – Landlords will be able to evict tenants for non-payment of rent prior to March 2020 and after the end of sector specific restrictions (e.g. trading restrictions on opening hours and social distancing measures, etc.), where not affected by enforced business closure under government measures and if the tenant breaches any other terms of their lease (i.e. by causing damage to the property).

The government is clearly aiming to strike a balance, requiring landlords to share the financial burden with tenants for rent debts and provide breathing space to pay or agree new terms, but expecting tenants who can pay, to pay.



What Are Landlords Doing and Why?

Many landlords now face substantial arrears on their rent rolls for all quarters since March 2020 and the expected rise in tenant insolvencies is likely to increase the amount of arrears that have to be written off as bad debts, although many landlords have already taken the decision to do that.

Despite the UK government introducing a voluntary Code of Practice in June 2020 promoting cooperation between landlords and tenants, many landlords report mixed results in agreeing meaningful rent concession agreements with tenants.

In the absence of the full range of pre-COVID-19 rent recovery options being available, landlords have resorted to pursuing debt claims for rent arrears in the civil courts and although the additional cost and time in doing that have to be factored into the process, there has been a string of successful summary judgment cases in favour of landlords, granting the landlord judgment for the arrears – the enforcement of which is not restricted.

In the first few months of 2021, the High Court gave judgment in a number of cases confirming that landlords are, in most circumstances, entitled to recover rent and service charges owed to them by tenants whose premises have been closed as a result of COVID-19 restrictions. The first such case was *Commerz Real Investmentgesellschaft mbH v TFS Stores Ltd*, where the court held that while the current government measures restrict some of the remedies available to a landlord, such as forfeiture for non-payment of rent, they do not prevent a landlord from bringing a claim before the court. Since then, there have been more cases following this precedent.

Tenants have failed with a range of pandemic-related defences, including failed arguments for implied rent suspension terms and termination of leases under the doctrine of frustration due to the pandemic.



While obtaining summary judgment is only a first step and does not guarantee payment nor entitle a landlord to recover possession of the premises, it does give a landlord more enforcement options that may put them in a more advantageous position, including:

- **Charging Orders** – if the tenant owns freehold property, it could get a charging order against that property to secure the judgment debt, or, if the tenant is a corporate, apply for a charge over the tenant’s shares, which might give them some control over an insolvency process.
- **Third-party Debt Orders** – if the landlord knows the tenant’s bank details and believes the tenant has funds (it may be that the tenant is just refusing to pay), the judgment could be enforced by obtaining a court order compelling the tenant’s bank to pay the money to the landlord.
- **Winding-up Proceedings** – obtaining early judgment may also place landlords in a stronger position to issue a winding-up petition when current restrictions on doing so come to an end in September 2021 (assuming the new arbitration process does not prohibit this – see further below) because the judgment can be used as evidence in support of inability to pay. Presenting a winding-up petition may increase the likelihood of landlords getting paid (if the tenant has funds), or, alternatively, if a tenant company becomes insolvent, it may increase the chance of getting the property back sooner than March 2022, when the prohibition on forfeiture proceedings ends (assuming that the landlord wants the property back). Although it is worth noting that further measures on the ability of landlords to use insolvency measures to recover rent arrears will be announced in due course.

There are a number of options available to landlords to recover rent arrears now, or which might put the landlord in a better position when restrictions on winding-up petitions lift, that are certainly worth considering in light of the current restrictions on forfeiture and the proposed legislation that could compel a landlord to submit to arbitration proceedings.

Arbitration: The Future of Rent Arrears Recovery?

The UK government has recently announced that new legislation will be introduced to tackle rent arrears under commercial leases accrued by reason of COVID-19, that will “ringfence rent debt accrued during the pandemic by businesses affected by enforced closures and set out a process of binding arbitration to be undertaken between landlords and tenants.”

In summary, the new system will apply to commercial tenants in sectors that have been forced to close during the pandemic and to rent debts falling due between March 2020 and the point at which any sector restrictions are finally lifted.

The government has made clear that under the new system, parties will be expected to negotiate first and resort to binding arbitration only as a last resort. It has also signalled its intention to revise the existing voluntary Code of Practice that sets out key principles to structure arrears negotiations. If the parties cannot reach agreement, the new legislation will require both lease parties to enter an arbitration process.

Once the new system is in place, the landlord will be able to:

- Evict any tenant for the non-payment of rent debt incurred prior to March 2020 and from the end of the period that restrictions in a particular sector have been lifted, known as the “ringfenced period”
- Evict any tenant who is not caught by the new arbitration systems, which includes tenants who were not impacted by business closure restrictions during the pandemic
- Charge interest on rent incurred from the end of the ringfenced period onwards, if the terms of the lease permit interest to be charged

The introduction of a scheme that will require qualifying parties to negotiate and submit to arbitration, a process that is usually entirely consensual, marks a shift away from the government’s entirely voluntary Code of Practice.

The move is perhaps not unsurprising and, in part, driven by concerns to avert the risk of the courts being inundated with COVID-19 rent arrears claims and a potential cliff edge of insolvencies given the estimated £6billion of rent arrears. On a positive note, arbitration will help avoid protracted court proceedings and result in faster outcomes. However, this cannot be guaranteed, as the scheme could simply result in delays in dealing with arbitration cases outside of the court system.

Arbitration is also not necessarily cheaper either, typically requiring the parties to pay for the arbitrator and make private arrangements for hearings. The government has committed to putting in place “clear rules which will help ensure impartiality and to manage the cost of the process to both landlords and tenants” and that it expects the parties to “...contribute to the cost of arbitration if both are found to have negotiated in good faith. However, if any party is found not to have negotiated in the spirit of the legislative principles, arbitrators may be empowered to grant the cost of arbitration as part of their decision.”

At this stage, the details of the new legislation are awaited, including the extent to which arbitrators will be given discretion to make awards compromising the amount of “ringfenced” rent payable by a tenant, beyond the powers of the court having regard to the circumstances of individual cases. Landlords may be concerned that arbitration could lead to sums that are lawfully payable by tenants under lease arrangements being reduced through the arbitration process due solely to the financial circumstances of a tenant, for example.

It remains to be seen how the new rules will strike fair balance and whether provision will be made for existing rent arrears cases currently in court proceedings to be transitioned into the new arbitration regime.

An important point to note, for both landlords and tenants, is that the new law will only apply to COVID-arrears. Therefore, any rent that falls due following the restrictions on a business being lifted (whether this is monthly or on the usual quarter day) will have to be paid when it falls due and will not be dealt with under this new arbitration regime, although the restrictions on winding up and forfeiture will continue to apply until the end of September 2021 and the end of March 2022, respectively.

Summary

Many landlords have faced significant financial pressure as a result of the protective measures designed to assist tenants during the pandemic. While the UK government has made it clear that tenant businesses that are able to pay rent must do so, landlords will be concerned that a system that actively encourages and promotes compromise may lead them to having to write off debts they are legitimately owed.

Although the latest government information provides greater clarity on how the new arbitration regime will work once introduced, for now at least, many landlords are likely to remain of the view that acting quickly and taking a proactive approach to rent arrears recovery through the courts remains the best option.

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