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The Commercial Rent (Coronavirus) Act 2022

The UK Government's Answer to COVID-19 Rent Arrears?

UK – 4 April 2022

On 24 March 2022, Royal Assent was given to the Commercial Rent (Coronavirus) Act 2022 (Act). The main purpose of the Act is to bring certain rent arrears disputes to a conclusion through arbitration.

Since March 2020, the discussions between commercial landlords and tenants have been defined by delay, either by the parties themselves or by the moratoriums introduced by the government prohibiting landlords from exercising their usual remedies to recover unpaid rent. Although landlords and tenants have been encouraged to negotiate and reach agreement about unpaid arrears accrued during the pandemic, there remains a significant amount of outstanding rent debt.

This alert provides an overview of the new arbitration scheme.

Arbitrators are expected to follow principles similar to those set out in the Code of Practice for commercial property relationships following the COVID-19 pandemic. In essence, they are required to make an award that will preserve and restore the viability of the business of the tenant, provided that doing so is consistent with preserving the landlord's solvency.

When Will the Scheme Apply?

The rent arbitration scheme came into force on 24 March 2022 and a reference to arbitration may be made within six months (i.e. 23 September 2022), although this may be extended by the government.

Which Tenancies/Leases Does the Scheme Apply To?

The Act only applies to business tenancies under Part II of the Landlord and Tenant Act 1954, namely tenancies that are occupied by the tenant for the purposes of a business carried out by that tenant. The Act shall not apply where the party occupies the property under a licence or a tenancy at will, but landlords and tenants will still be able to negotiate having regard to the Code of Practice.

What Payments Does the Scheme Apply To?

Either a landlord or a tenant can make reference for arbitration in relation to any of the following unpaid sums:

- Annual rent
- Service charge
- Interest on an unpaid amount
- VAT
- Insurance rent

These sums will be ring-fenced and protected from other kinds of enforcement by the landlord (such as court proceedings) provided that the following apply:

1. The sums fell due between 2 p.m. on 21 March 2020 until the earlier of 11:55 p.m. on 18 July 2021 (in England) or 6 a.m. on 7 August 2021 (in Wales). These sums will be considered to be ring-fenced and will be treated separately to arrears accrued outside of the periods specified in the Act.
2. The tenant occupies the property for the purpose of operating a business, in accordance with Part II of the Landlord and Tenant Act 1954 (which provides a wide definition of a business tenancy).
3. The tenant was required, as a result of the COVID-19 restrictions, to close all or parts of the business/property (regardless of whether the tenant could carry out excepted, limited activities, such as "Click and Collect" in the case of retailers, or takeaway meals in the case of restaurants).
4. The tenant is not subject to a CVA, individual voluntary arrangement or a compromise or arrangement under Section 899 or 901F of the Companies Act 2006.
5. The reference is brought within six months of the Act becoming law (with the possibility of this period being extended by the government).

The Arbitration Process

Pre-action

Before a party makes a reference to arbitration, it must notify the other party that it intends to make a reference. The other party will then have the opportunity to submit a response within 14 days of receiving the notification (with the expectation being that the parties should try to reach an agreement before making a reference to arbitration).

If an agreement cannot be reached in the pre-action stages, a reference can be made after at least 28 days has lapsed from the date notification was first served on the other party (if they have not responded) or within 14 days of receipt of the other party's response (if they have).

Reference

The reference to arbitration must include the following:

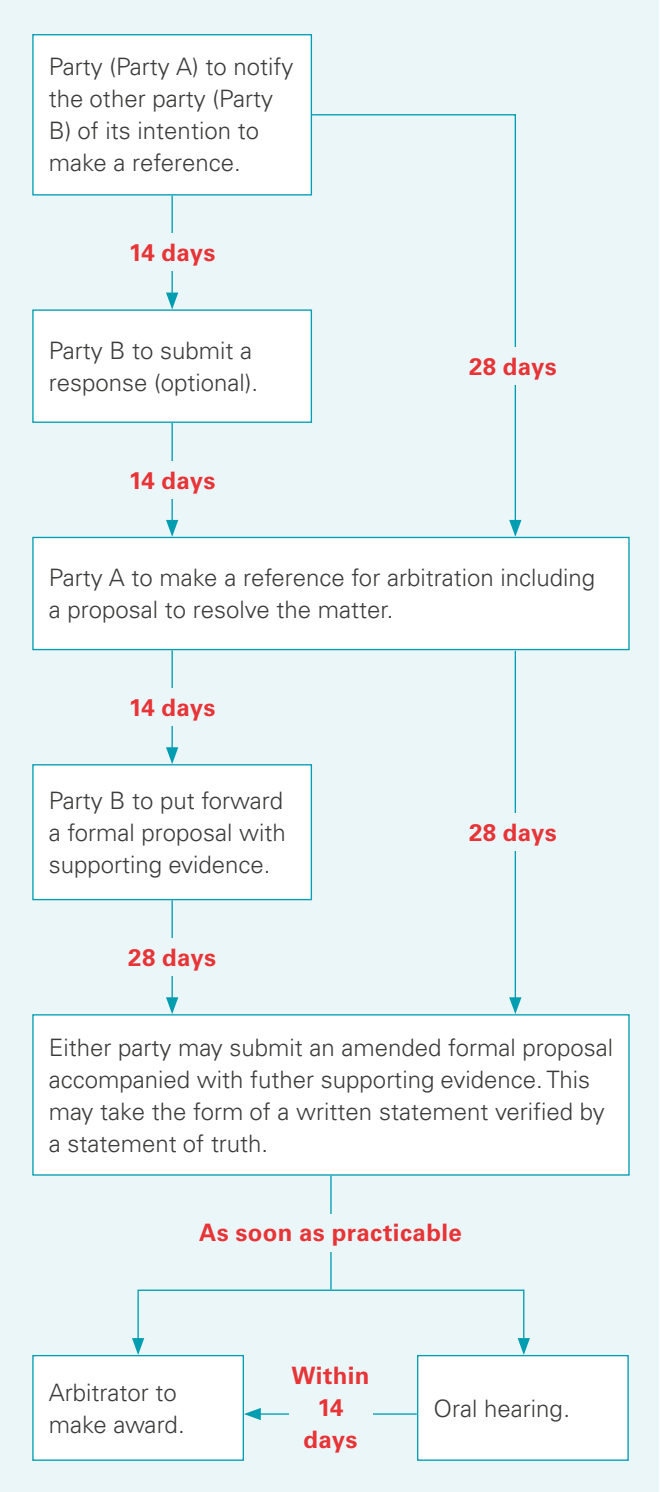
1. A formal proposal for resolving the matter (for example, a repayment proposal)
2. Supporting evidence

Once a reference has been made, the other side has 14 days to submit a formal proposal in response, along with supporting evidence. In most cases, it is likely to be the case that a tenant will provide the majority of the supporting evidence in order to show why a concession or payment plan is required.

Once each party has submitted a formal proposal, they are given a further 28 days to submit a final proposal. The proposals made will be considered by the arbitrator.

Oral Hearing

Either or both parties can request an oral hearing, but this is not strictly necessary; an arbitrator can reach a decision based on the written proposals and evidence provided by the parties. The parties will be jointly liable for the hearing costs, but if one party requests the hearing, it will be expected to pay the hearing fees in full in advance. The arbitrator's award will include a requirement for half of those fees to be reimbursed by the other party, but the arbitrator does have the discretion to make another cost award if appropriate. If this is treated in the same way as the court's discretion to award costs, this means parties who have frustrated the process or acted unreasonably may find themselves liable for more than 50% of the arbitration costs.



Evidence of Viability and Solvency

When making an award, the arbitrator must consider the following:

- Assets and liabilities of the tenant (including other tenancies)
- Rent payments previously made by the tenant under the business tenancy (for example, if the tenant has consistently paid rent, it is more likely that their inability to pay rent is because of the COVID-19 pandemic)
- Impact of the COVID-19 pandemic on the tenant's business
- Any other appropriate information about the financial position of the tenant

Tenants should, therefore, consider providing supporting documentation that assists the arbitrator with considering this, such as company accounts and trading figures. Likewise, landlords should request this information as early as possible in order to consider whether their proposals are likely to be successful when making a reference to arbitration.

Arbitrators are specifically required to discount any actions taken by landlords/tenants to manipulate their financial position and the possibility of the landlord/tenant borrowing money or restructuring its business.

What Can the Arbitrator Award?

There are a number of awards that can be awarded by the arbitrator and these awards are legally binding.

1. Dismissal of the reference where the following apply:
   - The parties have reached an agreement to resolve the dispute
   - The tenancy is not a business tenancy
   - There is no protected rent
   - The tenant's business is not viable, or would not be viable even if relief was granted
2. Make an award for relief

   The arbitrator can either award one of the proposals submitted by the parties or they can make any other award they consider to be appropriate. The award will either:
   - Grant relief to the tenant (such as a repayment arrangement, provided the sums are paid within two years, or a waiver of some or all of the rent)
   - Require the tenant to pay all of the outstanding sums with no relief

The award made by an arbitrator will be published (although confidential information must be redacted). For parties with large property portfolios, this is likely to affect their negotiations with other landlords/tenants. For example, if a tenant has been unsuccessful in obtaining relief, their other landlords are likely to point to this as a reason for why they will not agree relief.

Considerations When Deciding Whether to Make a Reference to Arbitration

1. **Costs**

   Under the Act, the parties will be expected to bear their own legal costs and to share the cost of making a reference and (if relevant) the hearing fees. This means that both parties will need to consider the potential cost of instructing legal representatives and paying the arbitration fees (which are yet to be determined). However, given the anticipated speed of the arbitration process, it is likely to be a more cost-effective option than issuing court proceedings to recover arrears.

2. **Limited scope of arbitration award**

   The purpose of the arbitration scheme is to consider the arrears relating to the protected period only. This means that the award made by the arbitrator will not take into account other arrears incurred by the tenant. It may be more beneficial for parties to negotiate on a commercial basis, which would give them the scope to explore other commercial agreements, such as lease renewals and re-gears.

3. **Rights of appeal**

   The decision of the arbitrator will be binding and the parties will be able to appeal an award on limited grounds (e.g. jurisdiction, serious irregularity or on a point of law).

4. **Court process**

   The Act prevents landlords from issuing court proceedings against tenants in respect of the ring-fenced sums. However, if the arrears have not been dealt with by the time the Act comes to an end, landlords will once again be able to sue tenants for outstanding debts, interest and their legal costs. Tenants should, therefore, try to resolve disputes sooner rather than later or potentially face high legal bills and court claims.

5. **Timing**

   On average, the arbitration process should take approximately two months from the pre-action stage up to the point when the arbitrator makes an award. This is significantly quicker than the court process, when it can take more than two months for the court to list a cost and case management conference.

6. **Landlords with multiple tenancies**

   The Act does not contain provisions for consolidation, meaning a landlord with multiple tenancies with the same tenant should initiate a reference for each lease, which is unlikely to be a cost-effective or easy process to manage.

Will the Arbitration Scheme Work?

The Act is aimed at preserving or restoring viable businesses while at the same time ensuring that any award will not impact the solvency of a landlord, but the costs of arbitrating a dispute may outweigh the benefit to either party of referring the matter to arbitration.

In most cases, it is likely that a tenant will initiate the process rather than a landlord, who could feasibly wait for the six-month moratorium on rent recovery actions to expire in September 2022 and then take action against the tenant to recover rent arrears in full. For tenants, the risk of the process is that the arbitrator can decide that the tenant is not viable. Faced with such a finding, a tenant's directors must immediately consider the risks of wrongful trading and whether the company should be placed into an insolvency process.

It is questionable whether landlords will want to initiate the process, if since July (when all restrictions in England were lifted) tenants should have been paying rent on time. If a landlord is now receiving a steady income stream, will they wish to risk that to recover unpaid pandemic rent arrears?

These are considerations that, in light of the Code of Practice and the Act, may encourage commercial landlords and tenants to come to the table to agree a consensual way forward, rather than deal with matters formally through an arbitration process.

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