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Client Alert Commentary

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COVID-19 Commercial Rent Arrears: UK Government Publishes Draft Arbitration Rules

The rules provide an arbitration procedure to determine the amount of affordable rent arrears for a commercial tenant where landlord and tenant have been unable to reach a consensual agreement.

On 9 November 2021, the UK government published the Commercial Rent (Coronavirus) Bill (the Bill), which will implement an arbitration process for determining the amount of rent arrears payable by commercial tenants affected by COVID-19 restrictions if landlords and tenants are unable to reach an agreement bilaterally. The Bill, which is subject to parliamentary passage, is expected to become law and enter into force on or prior to 25 March 2022, which is the date on which the current moratorium on forfeiture and restrictions on use of the commercial rent arrears recovery (CRAR) regime expire. The government also published a new accompanying Code of Practice, which takes effect immediately.

The Code of Practice aims to encourage dialogue between landlords and tenants to find resolution without the need to resort to the arbitration process. Survey data from the British Property Federation indicates that landlords and tenants have reached agreement on the treatment of rent arrears in more than 80% of cases, and so arbitration is likely to be required in only a minority of cases. For those, the Bill sets out a process under which an arbitrator will hear evidence and make a ruling on the amount of rent arrears to be paid by the tenant and the timeframe for payment, taking into account a number of factors, including the ongoing viability of the tenant's business and the solvency of the landlord. This *Client Alert* considers the scope of the draft arbitration rules and highlights some areas of uncertainty for landlords and tenants.

Key Provisions

Under the Bill:

- Only "protected rent" will qualify for arbitration; this is defined narrowly as rent relating to a business tenancy adversely affected by COVID-19 restrictions attributable to the period between 21 March 2020 and 18 July 2021 (for England) or 7 August 2021 (for Wales) or, in each case, any earlier date on which the tenant's business sector became unrestricted in its ability to carry out its business (the periods for each sector are set out in the Code of Practice).

- Landlords and tenants will have up to six months from the passing of the Bill into law to refer a matter to arbitration; the government expects the Bill (as amended through the parliamentary process) to become law by 25 March 2022 to coincide with the expiry of the current moratorium on forfeiture and

restrictions on the use of the CRAR regime. These protections will be extended for the duration of the arbitration referral period, together with a prohibition on a landlord making a debt claim with respect to protected rent and using a tenant's deposit.

- Any referral to arbitration must be preceded by an exchange of formal proposals between the parties (or a proposal delivered by one party to which the other fails to respond within 28 days).

- If the arbitrator determines the tenant's business is viable or would become viable if the tenant were given relief from payment of protected rent, the arbitrator may make an award based on whichever proposal best balances the viability of the business of the tenant with preserving the landlord's solvency. If an award gives the tenant relief from payment and time to pay a reduced amount of protected debt, the total payment must be made within 24 months of the award.

- If, on the other hand, the arbitrator determines that, notwithstanding the award of any relief, the business would still not be viable, the arbitrator will dismiss the referral, and, logically, the directors of the tenant will need to pay close attention to potential wrongful trading liability.

- Retrospective provisions allow the tenant to apply to the court to stay proceedings relating to a protected rent claim commenced on or after 10 November 2020 pending its resolution either consensually or through arbitration; the landlord must also apply any non-protected rental payments received for the period following the ending of restrictions (i.e., on or after 19 July 2021 in England) against unprotected rent before it is applied against protected rent.

- If a relief award has been made, the tenant may not propose a CVA, scheme of arrangement, or restructuring plan that would affect the protected rent for a period of 12 months following the award or, if an arbitration is requested but then abandoned or withdrawn, the date of such abandonment or withdrawal.

Discussion Points

Excluded arrears and commercial leverage

The decision to restrict the scope of arbitration to only protected rent raises interesting questions around the treatment of pre-March 2020 rental arrears. Following expiry of the current restrictions at the end of March 2022, a landlord would be free to present a winding-up petition on the basis of any unpaid non-protected rent arrears, potentially using it as leverage in its negotiations and arbitration with respect to the protected rent. This action would introduce a dynamic seemingly at odds with the purpose of the Bill.

Limited grounds for appeal

The Bill includes passing references to appealing an arbitration award. However, because the arbitration does not determine legal rights but rather seeks to apportion losses between the landlord and tenant in an equitable way, the circumstances under which an award could be appealed on a point of law are unclear. A challenge on the grounds of serious irregularity (within the meaning of the Arbitration Act 1996, which in modified form applies to an arbitration under the Bill) might be envisaged, but the circumstances would need to be exceptional and in breach of the detailed parameters set out for the arbitration in the Bill. The Code of Practice gives the example of the tenancy being out of scope, but that is something that should be established by the parties and arbitrator at the outset.

Third party releases

It is commonplace for a commercial lease to be guaranteed by a third party or for an assignor of the leasehold interest to remain liable to the landlord under an authorised guarantee agreement (AGA) in the event that the assignee tenant fails to perform. The Bill offers no guidance on how a "ricochet" claim arising from a third party's counterindemnity right against the tenant might be treated in an arbitration. Most likely, any award given by an arbitrator that seeks to compromise landlord claims against third parties would be beyond the scope of its powers. This may need to be addressed during the Bill's passage in order for the outcome of the arbitration to reflect the clear policy intention to compromise the arrears (whoever might be liable for them) if such an award is made.

Affordability and viability

Assessing a tenant's viability will be a challenging task. The consequences of an adverse finding by the arbitrator may be terminal for the tenant. Much focus will be placed on the affordability of the protected rent to the tenant in addition to its ability to meet ordinary course rental payments. The purpose of the arbitration process is not to renegotiate future rent, but the burden of this will be factored into the affordability assessment in determining what proportion of the protected rent to write off. Viability will therefore be based on the assumption that existing rent terms will be preserved.

When making a proposal or counter-proposal, the tenant will need to provide a considerable amount of evidence to the arbitrator to assist with determining what amount of rent is affordable and whether that amount is viable. Whether that information should relate only to the finances attributable to the premises in question or to the tenant's financial position overall, if that differs, is unclear. Rent payable in respect of a property occupied by a tenant that was not subject to COVID-19 restrictions is not protected. As such, whether affordability should relate only to the business operated premises under the relevant lease, where that is possible, is a valid question. Given that the outcome may be substantially different for a tenant, it would be helpful for that to be clarified in the Bill before it becomes law.

Multiple leases and efficiency of process

The Bill does not address multiple leases with multiple landlords, so if a tenant has multiple premises on which it has not reached an agreement with the landlord, the tenant could be drawn into multiple arbitrations, each with their own fees. Further, the Bill does not require an arbitrator to follow other decisions relating to that tenant, though the awards must be published (subject to confidential information being withheld). As such, arbitrators are likely to consider previous decisions.

An Effective Deterrent?

The government's stated preference is that landlords and tenants negotiate to reach a consensual solution without resorting to arbitration. The novelty and unpredictability of the arbitration regime may well be a sufficient deterrent to deliver this outcome.

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