Simpson Thacher

Memorandum

UK Government Proposes New Code of Practice and Legislation to Address Remaining COVID-Related Commercial Rent Debts

16 November 2021

Since 26 June 2020, a broad moratorium has protected commercial tenants from many types of hostile action that might otherwise have been taken by landlords for non-payment of rent accrued during the COVID-19 pandemic. Having been extended a number of times, that moratorium is due to end on 25 March 2022.

The UK government has consistently urged landlords and tenants to discuss and negotiate a commercial agreement with respect to how such rent arrears should be dealt with (particularly in situations where the tenant is not in a position to pay them). It appears that the vast majority have now been resolved by agreement. However, the government announced on 16 June 2021 that rules would be introduced to address those arrears where this has not been, and cannot be, achieved consensually. Almost five months on, we now have further details of how this is proposed to work.

The draft legislation, the Commercial Rent (Coronavirus) Bill, will pass through parliament and is intended to come into force immediately upon the expiry of the existing moratorium. It will apply in England & Wales and Northern Ireland will have the power to also introduce similar legislation. The proposed legislation permits businesses that were forced to close (or whose trading was restricted by law) during the pandemic, such as pubs, gyms and salons, to ring-fence their unpaid rent debts accrued during the period of closures or restrictions, and provides a framework for a binding arbitration procedure to determine how the ring-fenced debt should be treated if the parties cannot otherwise agree between themselves. The legislation does not apply to other debts accrued at any other time.

The government also released a new code of practice for commercial property relationships following the COVID-19 pandemic intended to help commercial landlords and tenants navigate negotiations consensually and resolve disputes around rent debts in the period leading up to the expiry of the moratorium and, to the extent possible, to avoid resorting to the binding arbitration procedure under the new rules. The code replaces the code published on 19 June 2020 (subsequently revised on 6 April 2021) and is relevant for all commercial rent debts (including service charges and insurance charges) accrued since 21 March 2020. It applies in England & Wales, Northern Ireland and Scotland.

As well as introducing the new arbitration procedure, the proposed legislation is also significant in that it extends the existing moratorium on landlord remedies for recovering unpaid commercial rent arrears. In addition to

present restrictions on winding-up petitions and measures in relation to the Commercial Rent Arrears Recovery ("CRAR"), landlords will be prohibited from making a debt claim in civil proceedings and either drawing down on, or requesting top-ups in respect of, security deposits in respect of protected rent arrears. These protections will apply beyond 25 March 2022 (*see* "Relevant Timeframes" in the table below). Notably, the protection from civil debt claims is already effective (from 10 November 2021), thus closing a loophole that several commentators had criticised. In respect of any claims issued on or after 10 November 2021, either party may apply to the court to stay the proceedings and the court must do so.

Key Features of the Proposed Legislation

Objective	To permit viable tenants to keep trading without undermining the solvency of the landlord—and without either party having to borrow more money or restructure their business
Relevant Debts	The rules will apply to unpaid rent arrears (including service charges but excluding rates) accrued during the "protected period" in respect of tenancies: a) which were "adversely affected by coronavirus", meaning the whole or part of the business or premises was mandated by law to close pursuant to public health regulations; **and** b) to which Part 2 of the Landlord and Tenant Act 1954 applies. The "protected period" runs from **21 March 2020** to the last date restrictions were removed for a particular business (as summarised in Annex A to the code, reproduced in *Figure 1* below). Restrictions do not include guidance or generally applicable rules such as displaying signage about wearing face masks. As an example, a pharmacy would not fall under the scope of the proposed legislation because pharmacies were permitted to remain open at all times throughout the pandemic. However, a restaurant in England would likely be in scope for the period from 21 March 2021 to 18 July 2021 when the last restrictions on table booking sizes were lifted.
Relevant Timeframes	**Arbitration**: The window in which either party may apply to commence the arbitration process will last for **6 months** from the date on which the legislation is enacted (presumed to be **25 March 2022**). **Landlord action**: Landlords will be unable to take hostile action in respect of "protected rent debts" (*i.e.*, debts that fall within the above scope—but not other debts) until the earlier of (i) a settlement having been reached between the parties (through negotiation or arbitration, with the deadline for an appeal having passed) and (ii) the expiry of the 6-month period without an application having been made (presumed to be **25 September 2022**). **Deferral of rent payments**: Where the arbitration process applies and a viable tenant seeks to deviate from the terms of their lease, they will need to demonstrate why the payment is unaffordable and what payment or payment period might otherwise be affordable in the near future. The government expects that the debts will be paid as soon as practicable but, in any case, over a period of **no more than two years**.

Arbitration Process

Where a landlord and tenant have not yet been able to reach a commercial compromise with respect to the treatment of "protected rent debts", a party may apply for statutory arbitration. They will not be prevented from doing so even if an alternative dispute resolution process is required under the relevant lease, but must first follow a compulsory pre-arbitration stage.

The legislation prescribes a series of steps and time periods with respect to the arbitration process (*see Figure 2* below).

Appeals against an arbitrator's award are possible but only on a limited range of grounds.

Where parties have previously reached a legally binding agreement regarding a "protected rent debt", an arbitration process will not override this.

Arbitrator's Considerations and Decision

"**Viability**" of the tenant is a key concept in the arbitration process.

Firstly, it determines eligibility. If the arbitrator determines that the tenant business is not viable, and would not be viable even if the tenant were to be given relief, they must dismiss the application. If it is or would be viable, the arbitrator must then make an award.

Secondly, viability underpins the award; any award should be aimed at preserving, or restoring and preserving, the viability of the tenant—provided that this is not at the expense of the landlord's solvency.

In assessing viability, the arbitrator will have regard to the assets and liabilities of the tenant; previous rent paid by the tenant to the landlord; the impact of coronavirus on the tenant's business; and any other information on the tenant's financial position that is appropriate (which include a broad range of factors).

The other applicable principle, acting as a counterbalance to the above, is that the tenant should, so far as it is viable, pay its rent in full and without delay. Relief should be no greater than necessary for the tenant to afford the payments.

Generally, the arbitrator will consider all the relevant information to achieve a proportionate balance between the interests of the landlord and the tenant. On the whole, the arbitrator's mandate is less of a legal assessment of each party's rights and more of a commercial assessment of how much the tenant can afford to pay versus how much the landlord can afford to write off while remaining solvent.

As part of the arbitration process, each party may submit a final proposal as to how the matter should be resolved. It is notable that the arbitrator must adopt one of those proposals unless neither is consistent the key principles outlined above (in which case they will formulate their own award). If both are consistent, the arbitrator may choose the proposal that they consider most consistent.

The final award and reasoning will be public, but confidential information will be excluded.

Identity of Arbitrator	The Secretary of State will assess the competency of arbitration bodies that wish to arbitrate the disputes and will issue a list of "approved arbitration bodies" which will be authorised to do so. Arbitrators will be appointed from that list by the arbitration body. It appears that the landlord and tenant are unable to choose or dispute the assigned arbitrator but the arbitration body may remove the arbitrator in certain circumstances, including, amongst others, where there are justifiable doubts as to the impartiality or independence of the arbitrator or the arbitrator has failed to properly conduct the arbitration.
Restrictions on Compromise Proceedings in Respect of Arbitration Award	Tenants that have entered into the arbitration process (*i.e.*, in respect of which an arbitrator has been appointed) are prohibited from commencing a company voluntary arrangement, Part 26A restructuring plan or scheme of arrangement which would apply to the "protected rent debt" for a period of **12 months** commencing from the date of the arbitration award (unless the proceedings are dismissed).

As a general principle, the code and proposed legislation encourage landlords and tenants to negotiate in good faith with consideration for the viability of the respective businesses (with particular emphasis on the tenant's business) and the affordability for either party of any potential compromise. Any resolutions should not result in the tenant or landlord having to undergo a restructuring or to take on any further debt. The code and proposal legislation also make clear that any attempt by one of the parties to manipulate their financial position to gain an advantage will be disregarded.

The code includes guidance on what type of evidence or supporting documentation could be exchanged between parties in negotiations and failing that, in arbitration proceedings, in order to reach a settlement. In particular, the parties and/or the arbitrator should consider the following (non-exhaustive) list of factors:

- the impact of COVID-19 on the business of the tenant;
- the assets of the tenant (noting that certain assets such as machinery may be necessary to running of the business) and the landlord;
- the liabilities of the tenant and landlord;
- dividend and bonus payments to shareholders and/or directors;
- expert evidence as to the tenant's trading position;
- loss of important contracts, loss of key staff or insolvency of a major customer; and
- any other information relating to the financial position of the tenant and/or landlord.

Initial Reflections

The code and proposed legislation clearly favour the tenant to the extent that it has a viable business (insofar as they anticipate a departure from the tenant's contractual obligations, whether as to time and/or amount of payments). However, they are more balanced than COVID-19 relief measures to date in that they make clear that

the tenant has an obligation to discharge its debt as quickly and fully as possible, and that saving the tenant's business should not tip the landlord itself into insolvency. This reflects the tricky balancing act that the government is seeking to achieve in preserving (viable) trading businesses while not inflicting undue harm on commercial landlords, who may have their own debts to service as well as investment from pension schemes and similar. From a landlord perspective, however, it is perhaps unfortunate that well-capitalised and stable entities may be penalised relative to more highly leveraged or less profitable peers in the context of assessing affordability of any proposal.

The emphasis in both the code and the proposed legislation rightly remains on encouraging landlords and tenants to come to a mutually agreed resolution, with the arbitration procedure very much a last resort. It remains to be seen whether it is widely taken up or whether the uncertainty as to what the final award could be will drive compromise outside the process. It will also be interesting to see the extent to which the inability of a tenant to compromise an amount awarded in the arbitration process for 12 months will play into the strategic thinking of landlords, tenants and their advisers.

Landlords will generally have to wait for almost a year before being able to take action against tenants for "protected rent debts", even if tenants make no attempt to engage in negotiations (or commence an arbitration). However, it is worth noting that the proposed legislation does not prevent a landlord from taking action against lease guarantors (which may include former tenants under authorised guarantee agreements) in respect of the relevant debt, or those lease guarantors taking action in turn against the tenant. Time will tell whether this point is addressed as the draft legislation makes its way through Parliament—but it is otherwise a potentially significant trapdoor in the intended protections.

Finally, "protected rent debts" only include rent arrears accrued during periods in which businesses were legally required to close, in whole or in part. Of course, it was during these periods that commercial tenants generally suffered the heaviest losses. However, the pandemic has obviously cast a longer shadow over the economy than this, in terms of its impact on consumer—and human—behaviour. Even when businesses were able to trade again without restriction, footfall generally was (and in some cases remains) materially down on the position prior to the pandemic, as people continued to work from home or were less inclined to resume their previous behaviours. It therefore made economic sense for some businesses to remain closed, in whole or in part, even when they were not legally required to do so. The government had to draw the line somewhere, and in a way that was both concrete and which balanced tenant and landlord interests, but the new code and legislation is therefore far from a free pass for commercial tenants.

Figure 1

MANDATED CLOSURES DUE TO COVID-19

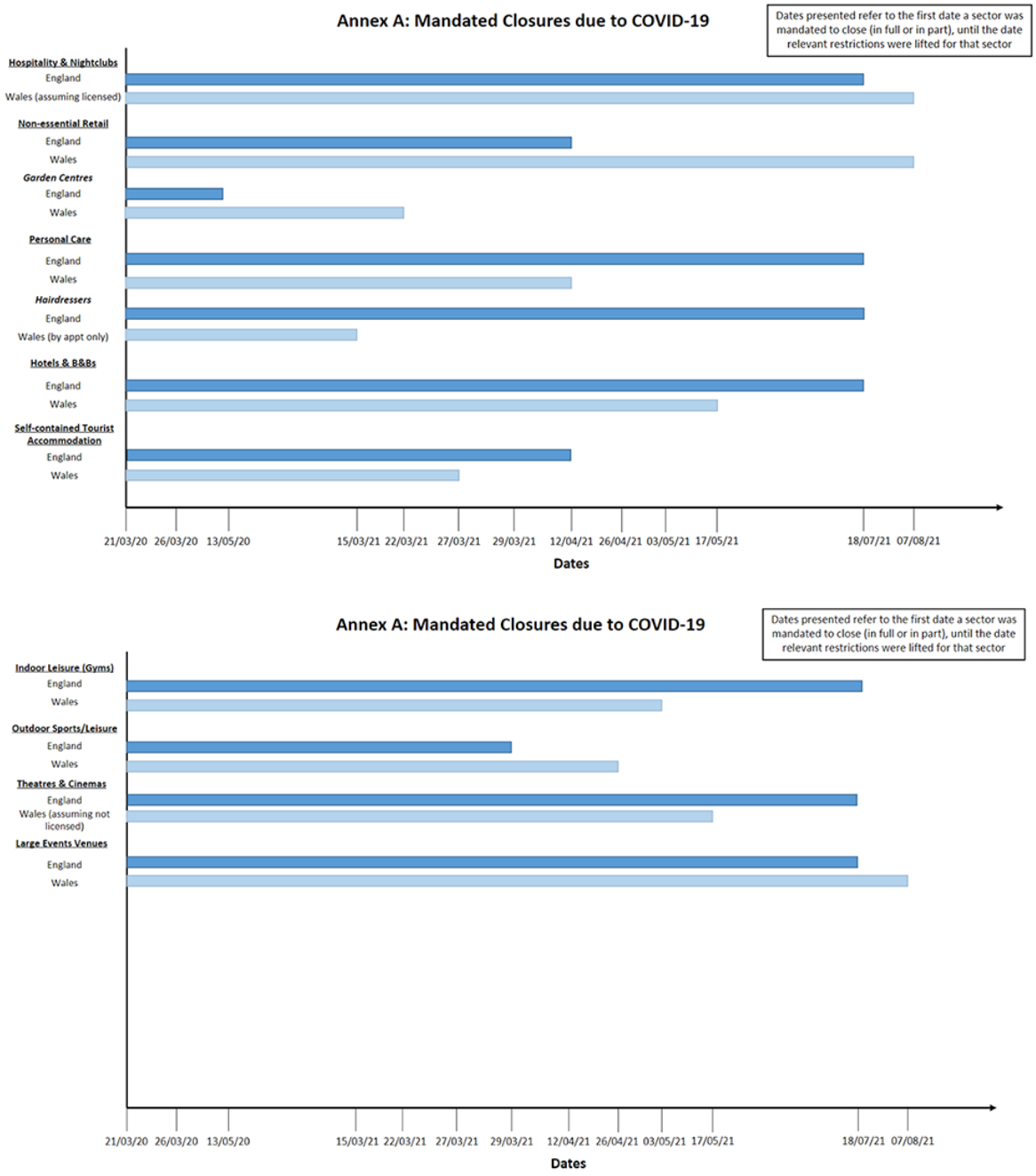
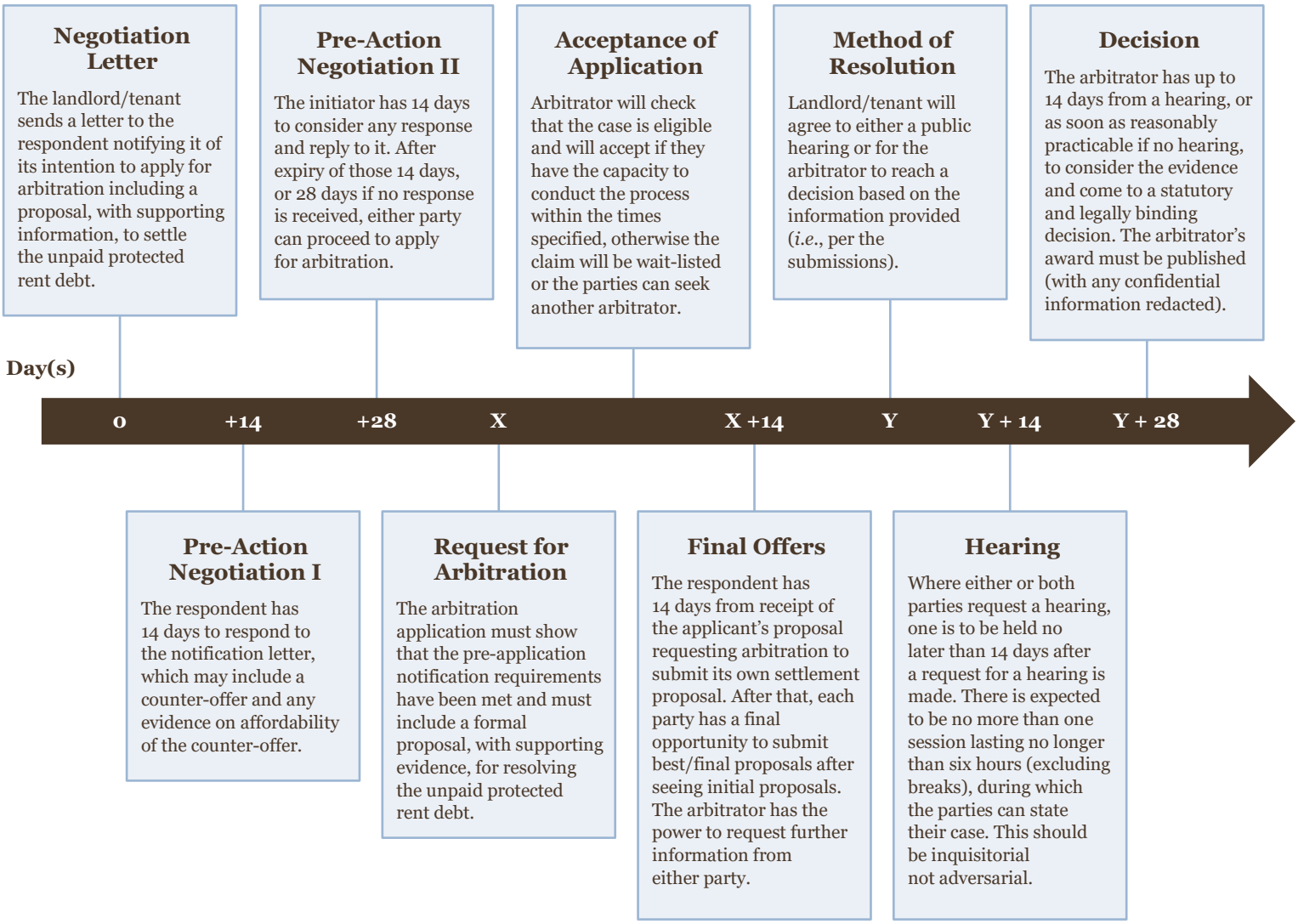


Figure 1: From "Code of practice for commercial property relationships following the COVID-19 pandemic," Department for Levelling Up, Housing & Communities, Government of the United Kingdom (9 Nov., 2021), https://www.gov.uk/government/publications/commercial-rents-code-of-practice-november-2021/code-of-practice-for-commercial-property-relationships-following-the-covid-19-pandemic

Figure 2

ARBITRATION PROCESS



For further information regarding this memorandum, please contact one of the following:

LONDON

Adam Gallagher
+44-(0)20-7275-6358
adam.gallagher@stblaw.com

James Watson
+44-(0)20-7275-6419
james.watson@stblaw.com

Dasha Chirkov
+44-(0)20-7275-6480
dasha.chirkov@stblaw.com

Matteo Clarkson-Maciel
+44-(0)20-7275-6516
matteo.clarkson-maciel@stblaw.com