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Covid Commercial Rent Arrears:

How will the arrears dispute be decided?

Introduction

Legislation is being introduced by the government in an attempt to resolve ongoing commercial rent arrears disputes between landlords and tenants following the coronavirus pandemic.

The Commercial Rent (Coronavirus) Bill is expected to become law at the end of March 2022 and will "ringfence" certain commercial rent arrears built up during the pandemic ('protected rent debts') and introduce a new arbitration scheme to resolve them.

If you missed our first two bulletins, click **HERE** for a summary of the new law and use our flowchart to assess if the new arbitration scheme will apply to your arrears and click **HERE** to find out more about the arbitration scheme procedure and timetable.

In this update, we look at what the arbitrator will need to consider in order to decide whether they should make an award about the protected rent debt, and if so what award should they make e.g. should they write off some or all of the arrears or allow the tenant to pay in instalments?

The Arbitrator's Decision

Green light/red light: the Viability assessment stage

When an arrears dispute is referred to arbitration, the arbitrator will first assess the viability of the tenant's business to decide whether they should make an award (green light) or dismiss the arbitration reference (red light).

If:

Tenant's business is viable, or would become viable if tenant was given relief, award can be made.

If:

Tenant's business not viable, and would not be viable even if tenant were given relief of any kind, then no award. Arbitration reference dismissed.

Draft guidance to arbitrators

Draft guidance about how to determine awards has been published, which includes guidance on how to approach the viability assessment.

Viability is deliberately not specifically defined, in order to take into account the vast array of different business models both within and between sectors.

The Code of Practice for commercial property relationships notes that **"when referring to viability, parties should consider whether ring-fenced debt aside the business has, or will in the foreseeable future have, the means and ability to meet its obligations and to continue trading".**

The new legislation aims to support landlords and tenants who cannot otherwise agree, in resolving disputes relating to the protected rent owed, and to facilitate a return to normal market operation. To do this, the bill aims to preserve the viability of the tenant's business. But this should only be to the extent that it allows the landlord to meet their ongoing obligations.

Viable business models will differ from party to party and across sectors. For example, the arbitrator may want to consider that profit margins can vary significantly between industries and sectors. However, guidance is provided on a range of tools and processes that will be useful for arbitrators to consider in assessing viability at the appropriate time.

Requirements for assessing viability

In assessing the **viability of the business of the tenant,** the arbitrator must, so far as known, have regard to the following:

(a) the assets and liabilities of the tenant, including any other tenancies to which the tenant is a party;

(b) the previous rental payments made under the business tenancy from the tenant to the landlord;

(c) the impact of coronavirus on the business of the tenant; and

(d) any other information relating to the financial position of the tenant that the arbitrator considers appropriate.

In making this assessment, the arbitrator must disregard the possibility of the tenant borrowing money or restructuring their business.

If a business took on more debt to become viable for the purposes of arbitration, they would likely be delaying the problem and risking their long-term viability.

Non-exhaustive list of evidence to demonstrate viability

When considering tenant viability, the arbitrator may wish to consider – and if not provided, consider requesting from the tenant – the following information:

(a) Bank account information, including savings accounts, current accounts and loan accounts from each financial year after March 2019

(b) Financial accounts for each financial year after March 2019

(c) Management accounts for each financial year after March 2019

(d) Gross profit margin and net profit margin.

(e) Details of dividends paid to shareholders for each financial year after March 2019

(f) Evidence of any financial grants and/or loans obtained for each financial year from March 2019 onwards

(g) Evidence of prior refusal of further credit, funding, or lending.

(h) Evidence of overdue invoices of tax demands, unpaid or returned cheques or electronic payments, exceeding overdraft limits, creditor demands, money judgements

(i) Liquidity Ratio

(j) Gearing Ratio

(k) Current Ratio

(l) Profit forecasting

This is a non-exhaustive list which should be applied flexibly on a case-by-case basis.

Arbitrators do not need to request all of the information in this list and may consider that some items above are not relevant in a particular case. However, if such information is provided by the parties the arbitrator should consider it.

Arbitrators may ask for additional information, including for items not featured in this list, if that would be helpful in determining viability.

It is the tenant's responsibility to provide evidence to support their proposal and to enable the arbitrator to determine the viability of the tenant's business.

Key principles of the arbitration scheme

- Any award should be aimed at preserving and / or restoring (as applicable) a tenant's business, provided this is consistent with preserving the landlord's solvency but where possible, a tenant should be required to meet its rent payment obligations in full and without delay.
- Anything done by either the landlord or tenant to manipulate the financial affairs in order to improve their position in the arbitration will be disregarded.

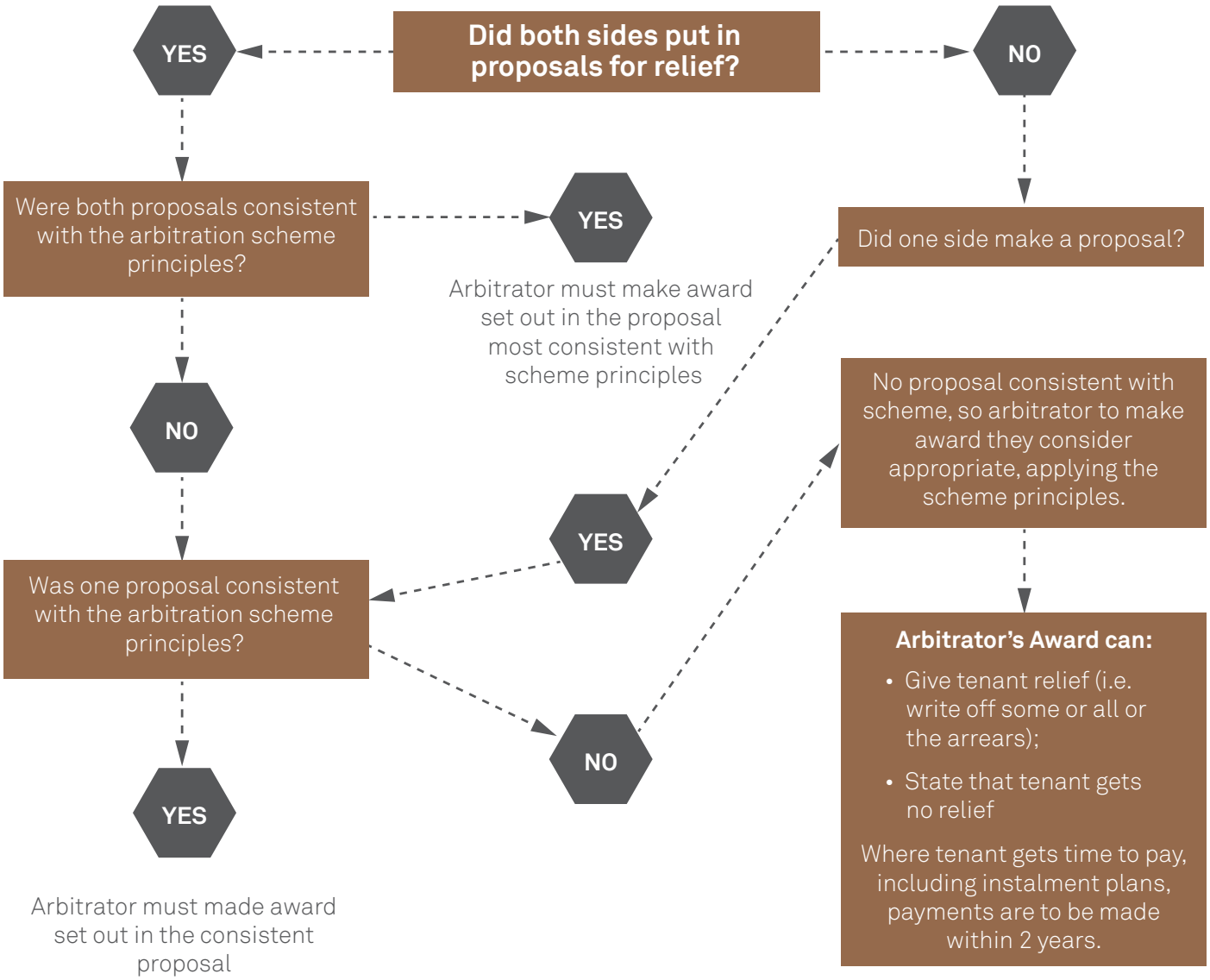
If the viability assessment is passed, what award will the arbitrator make?

Where both parties have made final proposals to deal with the protected rent debt, the arbitrator must consider which proposal is consistent or most consistent with the key principles and make an award as set out in that proposal. Alternatively, the arbitrator must make whatever award it considers appropriate, applying those key principles.

Similarly, where only the party that referred the matter to arbitration has made a final proposal to deal with the protected rent debt, the arbitrator must make an award as set out in that proposal, provided it is consistent with the key principles. Alternatively, the arbitrator must make whatever award it considers appropriate, applying the key principles.

The flowchart below explains this process.

What will the arbitrator award?



How we can help

We can help you to prepare for the viability assessment stage under the Statutory Arbitration Scheme and explain what this may mean for you in practice. We can also help you navigate your options in relation to timings, risk and strategy to assist you in resolving your commercial rent arrears dispute, whether you are caught by the new legislation or not.

Want to know more?

Look out for future updates on what options you may have if you can't use the new scheme but still have an unresolved rent arrears dispute, as well as landlord's enforcement options for non-payment of rent post 25 March 2022.

Contact the team if you would like to discuss.

This note is based on the Bill as it's currently drafted. The guidance for arbitrators in relation to the viability assessment is also based on the published working draft which subject to change. The completed guidance will be published after the Bill becomes law.

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