FRIED FRANK

Restructuring and Insolvency
Alert

Finding Balance for Landlords and Tenants - A Challenge for Government in Withdrawing COVID-19 Measures

Last week was a bad week for landlords, with challenges to the restructuring plan proposed by the Virgin Active Group and the company voluntary arrangement ("CVA") implemented by New Look both being unsuccessful in the courts. Whilst the recent revocation by the court of the Regis CVA may provide a glimmer of hope, the general outlook is not optimistic.

Since the implementation of the new measures introduced to help occupiers who have been impacted by the Covid-19 pandemic, the British Property Federation ("BPF") estimates that the total rent unpaid for UK commercial property between late March 2020 and the end of June 2021 will be up to £7 billion if the current rate of rent non-payment continues. This figure covers all commercial property, including offices and warehouses, but the vast majority of the rent unpaid is from the retail and hospitality sectors. The recent Virgin and New Look court decisions will no doubt exacerbate the concerns of landlords about how they might be treated by tenants who seek to rightsize their balance sheets and restructure their business

In response to the Covid-19 pandemic, the government has implemented various measures which restrict the ability of landlords to exercise rights against tenants. The measures, which have been in place since March 2020, are briefly as follows:

- **Forfeiture**: landlords' ability to forfeit a commercial lease for non-payment of rent has been suspended by the Coronavirus Act 2020 ("CA") from 26 March 2020 until 30 June 2021, or such later date as may be specified. This means that, whilst the moratorium is in place, a landlord will not be able to evict a tenant for non-payment of rent;
- **Commercial Rent Arrears Recovery ("CRAR")**: restrictions on the use of CRAR, which is a statutory process where tenants are given seven days' notice before bailiffs can enter the premises and seize goods equal to the value of the outstanding debt. Under the rules enacted by the Taking Control of Goods and Certification of Enforcement Agents (Amendment) (Coronavirus) Regulations 2020, the use of CRAR may currently only be exercised: (i) between 25 March 2021 and 23 June 2021, if at least 457 days' rent (i.e. five quarters' rent) is outstanding when the notice is given and when the goods are taken control of for the first time, or (ii) on or after 23 June 2021, if at least 554 days' rent (i.e. six quarters' rent) is outstanding when the notice is given and when the goods are taken control of for the first time;
- **Statutory demands**: statutory demands served between 1 March 2020 and 30 June 2021 cannot form the basis of a winding-up petition presented at any point after 27 April 2020 as a consequence of the Corporate Insolvency and Governance Act 2020 ("CIGA");

- **Winding-up petitions**: under CIGA, from 27 April 2020, creditors are prohibited from presenting a winding-up petition against a company on the grounds that it is unable to pay its debts unless the creditor has reasonable grounds for believing that (i) Covid-19 has not had a "financial effect" on the company or (ii) the company would be unable to pay its debts regardless of the effects of Covid-19;

- **New moratorium**: CIGA also introduced a new permanent moratorium to provide companies "with breathing space" to implement a rescue. The moratorium is not an insolvency or restructuring procedure in its own right, but comes into force upon the filing of prescribed documents by the directors (or upon the order of the court). The moratorium can be used by companies which are, or are likely to become, unable to pay their debts and provided that a "monitor" provides a statement that in the monitor's view,it is likely that the moratorium would result in the rescue of the company as a going concern.

- The restrictions against the right of forfeiture, use of CRAR, and use of statutory demands and winding-up proceedings have been extended since first implemented, and are now due to expire on 30 June 2021. The government recently issued a "call for evidence" to inform the approach that it takes in relation to the withdrawal of these measures: https://www.gov.uk/government/consultations/commercial-rents-and-covid-19-call-for-evidence/commercial-rents-and-covid-19-call-for-evidence--2.

The measures introduced by the government do not waive the arrears which have accrued, nor do they permanently adjust the remedies of landlords. There has therefore been an expectation that a number of tenants will face a "cliff edge" once the measures are withdrawn. Landsec and British Land, in association with the BPF, have responded to the government's call for evidence with their own proposals, urging that the current restrictions be allowed to expire in June 2021. Their solution to the moratorium includes:

- A **phased approach** designed to give occupiers breathing space to resume operation before paying arrears or to negotiate payment plans with their landlords by bringing arrears within the enforcement regime only once they have been open and trading for a considerable period, in particular:

  - Ending the moratorium on 30 June 2021 and resuming normal market operation from this date;

  - Arrears of rent in respect of the period between March 2020 and May 2021 to be ring-fenced, with the moratorium remaining in place with respect to those arrears in order to allow more time for occupiers and owners to agree to any necessary concessions. Any outstanding payments for the 15-month period would then be due by December 2021. Payments could be deferred until after this date if an agreement can be reached; and

  - Where an occupier and property owner are unable to reach a settlement, they would then submit to binding arbitration.

- **Managing rent arrears**: rejecting proposals for a blanket write-off of a proportion of debt accrued through the lockdown period, as this will penalise businesses who have paid in full throughout the pandemic. Instead, proposing the creation of clear guidelines for negotiation that would penalise those who did not engage in good faith.

- **Arbitration backstop**: recommending that the government should set out clear guidelines for negotiation, meaning that arbitration can be provided by an expert in arbitration rather than a real estate specialist. This would allow for a compromise solution to be reached by the arbitrator rather than a binary outcome, as currently envisaged under the government's call for evidence.

- A **statutory limit on compromising arrears** through CVAs or restructuring plans.

Given the long line of company voluntary arrangements which have imposed compromises upon landlords, and now the use of the "cross class cram down" to bind dissident landlords by Virgin Active's restructuring plan, landlords are understandably concerned about the measures that could be deployed by tenants to deal with rent arrears. That being said, a proposition that tenants are forced into arbitration with individual landlords in order to come to settlement terms, and are prevented from using a CVA or restructuring plan to restructure their lease liabilities, is unlikely to be welcome - particularly given the positive steps taken by the government with CIGA to encourage restructuring with the new moratorium and restructuring plan.

Clearly there is a balance to be struck between ensuring fair treatment of landlords who have been uniquely affected by the government's intervention during the pandemic (as demonstrated by the sheer volume of arrears) and allowing businesses to use available tools to restructure themselves for the benefit of creditors as a whole.

The approach of the Australian government could offer some inspiration as to how to best strike an appropriate balance between these competing interests. Whilst the volume of rent arrears attributed to COVID in Australia is much lower than in the UK, Australia adopted the approach of introducing a mandatory rent proportion of business lost during the pandemic and then required landlords to permanently waive 50% of this overall reduction, with the remaining 50% to be repaid in instalments based upon the remaining term of a tenant's lease. Whilst the interplay between such arrangements and the existing rights of a tenant to implement a CVA or restructuring plan would need to be carefully considered, it is possible that statutory intervention of this sort could set an appropriate balance between helping companies deal with the significant rental liabilities on their balance sheets and helping cauterize the pain being felt by landlords as a result of their inability to recover any of the pandemic arrears.

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