Commercial Rent (Coronavirus) Act 2022: Interaction with Insolvency

By Arnold Ayoo

Those advising commercial landlords and tenants were no doubt aware of the Government's introduction of the Commercial Rent (Coronavirus) Bill 2021 ("the Bill") and revised Code of Practice. The Bill has received Royal Assent today ("the Act"). Given its passage, this alerter considers 5 implications for insolvency lawyers and practitioners.

The Act

1. The Act received Royal Assent on 25 March 2022. The headline feature of the Act is an arbitration procedure whereby commercial tenants can have their commercial rent debts reduced, or even extinguished, depending on the viability of their business as against the solvency of the landlord. It is aimed at preventing a glut of tenant insolvencies amongst otherwise viable businesses.

2. Section 3 of the Act defines a 'protected rent debt' as a debt under a business tenancy adversely affected by coronavirus, and consisting of rent attributable to a period of occupation between 21 March 2020 and 18 July 2021 (during which a tenant was obliged under Covid regulations to close the whole or part of its business). The aim is to provide a level of rent relief that will 'preserve' or 'restore and preserve' the viability of the business tenant so far as that is 'consistent with preserving the landlords solvency'.

(1) Interaction between CVAs, IVAs, compromises/arrangements (sanctioned under section 899 or 901F of the Companies Act 2006) and the arbitration

3. The Act makes it clear that, where a relevant insolvency arrangement has already been proposed and is pending, or has already been approved, that insolvency process will take priority over the arbitration (and prevent a reference to arbitration from being made, or if a reference has already been made, prevent it from continuing). If such an arrangement has not been proposed or applied for, and a reference to arbitration is made, the statutory arbitration will take priority and prevent the tenant from proposing such an insolvency arrangement.

4. Practical advice: if you act for a commercial tenant, make an assessment about whether the CVA, IVA or arrangement would produce a better outcome than the arbitration. Such an analysis will mean assessing the viability of your client's business, in line with the arbitrator's principles. Depending on the answer, you may want to move first to propose the CVA/IVA/arrangement.

(2) Bankruptcy and winding up

5. Schedule 3 prevents the presentation of winding-up or bankruptcy petitions against tenants, or guarantors, in respect of protected rent debts during the Moratorium (a six month window beginning on the day the Act becomes law). Three things are notable:

   (i) **Protection for the individual**: It extends the statutory protection to business tenants who are individuals (as opposed to merely companies).

   (ii) **Protection for guarantors/sureties**: 'Tenant' includes a guarantor - i.e. a person who has guaranteed the obligations of the tenant under a business tenancy, a person other than the tenant who is liable on an

indemnity basis for payment of rent, and a former tenant who is liable for the payment of rent.

(iii) **Retrospective invalidation of bankruptcy orders**: If the court has made a bankruptcy order on or after 10 November 2021, but before the day on which the Act comes into force, and the order was not one which it would have made had the Act been in force at the time, the order is void.

(3) Assessment of viability and solvency

6. Relief can be granted if the business is (a) viable or (b) would become viable if the tenant were to be given relief from payment. The Act does not define viability, but the Draft Guidance[1] issued to arbitrators in February 2022 includes a list of 'non exhaustive' indicators. Notably, it goes on to say that gross profit margin and/or net profit margin may "be the most useful indicators as to whether the tenant's business is viable", which suggests that viability is really a test of profitability. The skillset required in assessing business performance for this purpose will be most familiar to IPs and those advising them.

7. The Draft Guidance also sets out that for the purpose of assessing the landlord's solvency, a landlord is "solvent" unless the landlord is, or is likely to become, unable to pay their debts as they fall due. The parallels with the cash flow solvency test in s.123(1)(e) Insolvency Act 1986 are clear, again making IPs and insolvency solicitors best placed to advise on this. Although landlords are not required to provide evidence of their solvency, it is patently useful for the landlord to establish a threshold past which any further reduction will push it towards insolvency.

[1] The Department for Business, Energy & Industrial Strategy (BEIS) has published draft statutory guidance on how arbitrators should exercise their functions under Part 2 of the Commercial Rent (Coronavirus) Act. https://www.gov.uk/government/publications/arbitration-on-rent-debt-relief-for-businesses-affected-by-coronavirus The government will publish a final version of the draft guidance once the Act receives Royal Assent.

(4) Pre-arbitration attempts to alter the financial position

8. The Act and Draft Guidance make clear that, when considering the viability of the business of the tenant and the landlord's solvency, the arbitrator must disregard anything that the landlord or tenant has done with a view to manipulating their financial affairs so as to improve their position regarding an award for relief from payment of protected rent. "Manipulating" is said to have "its usual meaning for this purpose".

9. Practical advice: This will be one of the more contested elements of the arbitration and something particularly suited to insolvency lawyers. It is likely that 10 November 2021, being the date that the Act was published (thereby fixing the parties with notice that an arbitration procedure was in the pipeline), will be the date from which any act that has improved a party's respective position (in respect of an award) is 'reviewable'. In other words, any act of financial manipulation undertaken from 10 November 2021 can be scrutinised to determine if it was done with a view to improving the position in the arbitration[2]:

   - The debate will likely be whether a particular act had a legitimate business purpose or was done to obtain an advantage.

   - It may be that the law in respect of intent, taken from preference claims under s.239(5) Insolvency Act 1986, becomes a useful guide (insofar as for a transaction to constitute a preference, a company must have been influenced in deciding to give the preference by a desire to prefer the party). The question may become whether a party intended to obtain the advantage, notwithstanding the fact that a particular transaction has *in fact* given a party an 'advantage' in the arbitration. Where this is in issue, an oral hearing is the most appropriate forum.

[2] Excessive dividend payments to a corporate tenant is an example from the Draft Guidance.

(5) Commercial implications outside of the arbitration

10. The Act and Draft Guidance state that the award must be published (save for any confidential information). Further, the Draft Guidance explicitly states that, whilst the determination of viability is specifically for the purposes of the Act and not intended to have broader application, arbitrators should be mindful that a determination of non-viability may have other implications for a tenant business. Arbitrators are therefore asked to ensure that any determination of non-viability is justifiable and the reasonings for such must be set out in the award dismissing the reference to arbitration.

11. The implications of an arbitrator publicly declaring, with reasons, that a tenant's business is not viable, are clear. In effect, it is stating that the business is so far from profitability that even complete extinguishing of its rental debts would not assist it. It is not hard to imagine the commercial implications and the effect on, for example, creditworthiness (from the perspective of a financial institution). A declaration of non-viability may be the precursor to actual insolvency.

ARNOLD AYOO

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