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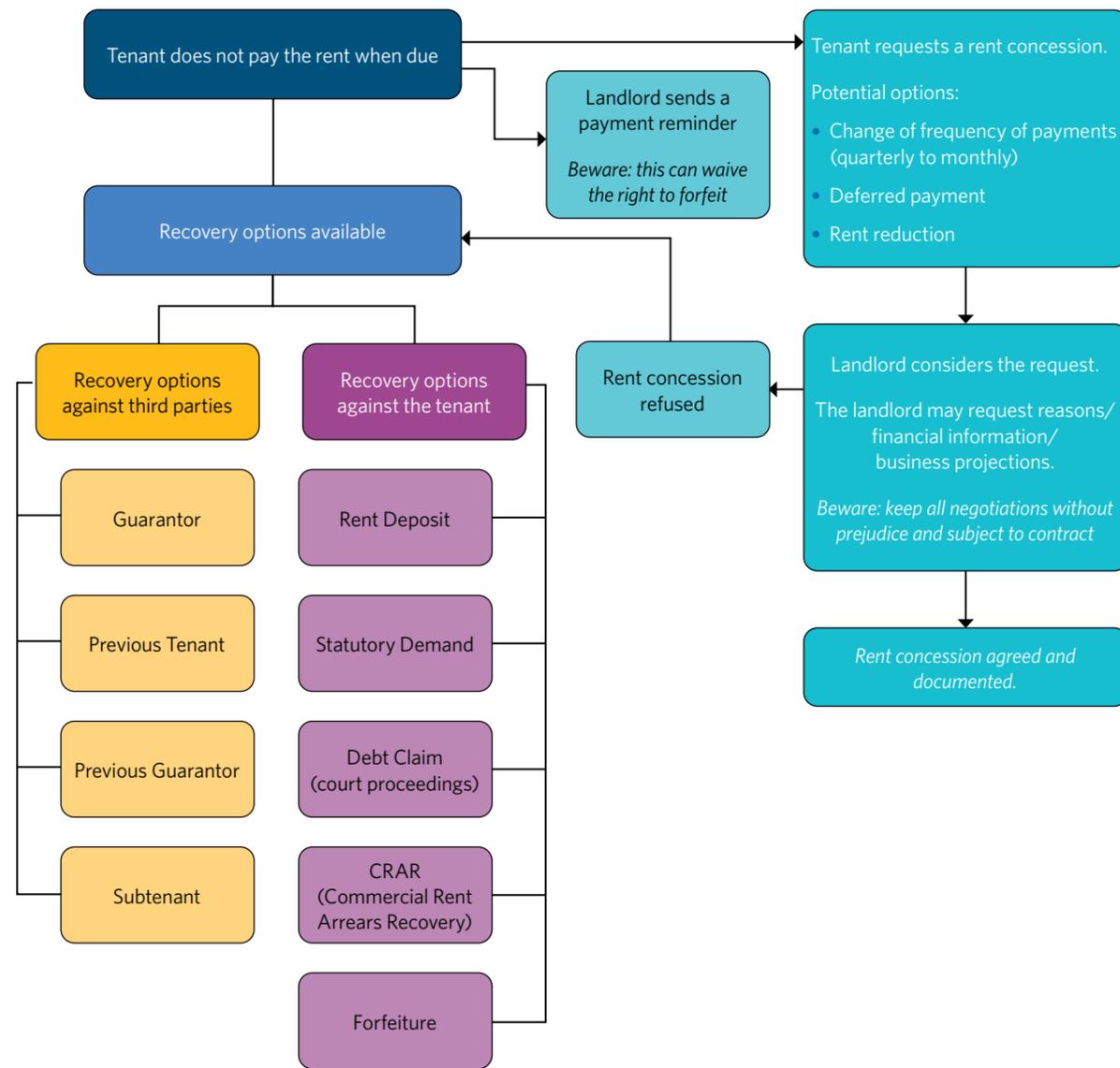
UK REAL ESTATE CLIENT GUIDE

A QUICK GUIDE TO A LANDLORD'S
REMEDIES FOR COMMERCIAL
RENT ARREARS



Landlords of commercial premises generally have one key overriding concern: to maintain their income stream by ensuring that their tenants pay and continue to pay all rents due under their leases. Landlords should act quickly if they see any delays in paying the full rent due, as they will stand a much better chance of maximising their return, possibly without incurring too many additional costs, if they act early.

This Guide summarises the options available to a landlord to recover rent arrears owed by a tenant and looks at the advantages and disadvantages of each. The options can be categorised into: (i) recovery against the tenant, and (ii) recovery against third parties such as guarantors, sub-tenants, former tenants and former guarantors.



What is the landlord hoping to achieve?

Before commencing any enforcement action to recover arrears, a landlord will need to consider its longer-term strategy. What is the landlord hoping to achieve? Much will depend on the landlord's view of the tenant and the prevailing market conditions, but a landlord should also be driven by the following considerations:

Is the aim to preserve an amicable, ongoing relationship with the tenant in occupation, and to allow the lease to continue?

Is the default a symptom of a temporary issue faced by the tenant, or is it indicative of something more serious?

Landlords should consider whether it is worth trying to negotiate repayment with the tenant, maybe by instalments, payment of a reduced rent or monthly rent. This would preserve at least some of the income stream from the premises.

Would the landlord prefer to regain possession of the premises to relet or occupy itself?

Landlords should consider whether they want to preserve the right to forfeit the lease at the outset, and take care not to waive the right to forfeit by acknowledging (either itself or by his agents) the continued existence of the lease eg by taking any action to recover the arrears. Once the forfeiture has taken place, the landlord can then pursue the tenant for the arrears.

Would the landlord consider accepting a surrender?

Where there is a substantial period of the term still to run on a lease, tenants may also consider agreeing to surrender all or part of the lease (possibly at a premium) to release them from their ongoing obligations. This would allow a landlord to market the premises free from encumbrances, possibly with the benefit of a cash lump sum.

Recovery directly against the tenant

Rent deposit

If the tenant provided a rent deposit by way of security at the time of taking the lease, a landlord will generally be able to call on the deposit and draw down the outstanding monies from the account in which the deposit is held. Prior to doing so, the landlord must check the rent deposit deed to ensure that its terms allow it to be drawn upon to discharge the type of arrears (plus interest) owed and whether any formalities eg requiring that landlords give prior notice to tenants of any withdrawals, must first be satisfied. Once a withdrawal has been made, the deed will usually require the tenant to top up the deposit sum, though a tenant experiencing even short-term financial difficulties may not be in a position to do so. Failure to top up the rent deposit sum within the requisite period may then, depending on the terms of the rent deposit deed and lease, give the landlord a fresh right to forfeit the lease.

Whilst the ease of drawing down on a rent deposit deed and receiving an immediate cash sum might seem attractive, a landlord should bear in mind that, if a shortfall in the deposit sum is to follow, there will be less money available to cover any future liabilities under the lease that may be less straightforward to pursue eg damages for dilapidations, wants of repair and reinstatement obligations.

Statutory demand

A statutory demand is a written demand for payment of an undisputed debt and can be served on an individual, partnership or a company. It is not in itself a method of debt recovery, but it is a popular and effective way of putting pressure on a tenant to pay what is owed. If the sums

specified in the demand are not paid within 21 days of service of the demand, the tenant is open to the very real risk that it could be (in the case of an individual) declared bankrupt or (in the case of a company) placed into liquidation.

A statutory demand can only be served if:

- the debt is liquidated, ie for a specific amount that has been fully and finally ascertained;
- the debt is undisputed; and
- the debt exceeds £750 (in the case of a company) or £5,000 (in the case of any individual).

If these criteria are not met, or if the tenant has a valid counterclaim against the landlord, the tenant may apply for the statutory demand to be set aside.

Non-payment of the sum sought in the statutory demand is treated as evidence of the tenant's "inability to pay the debt" and entitles the landlord to present a bankruptcy or winding up petition to the court. A landlord will have to consider the tenant's financial position before deciding whether this option is worth pursuing. If the tenant simply does not have any money, the landlord will have incurred costs in petitioning the insolvency, only to rank as an unsecured creditor and recover only a small percentage, if any, of the debt owed. However, where a tenant has the money, a statutory demand in itself may be sufficient to prompt payment.

Court proceedings

As an alternative to serving a statutory demand, a landlord can sue a tenant for rent arrears as a debt. Pursuing a tenant using the court system should be considered as a two-stage process:

- Issuing and serving proceedings on the tenant and pursuing the claim to judgment or settlement; and
- Enforcing the judgment or settlement so that the tenant pays what is due.

The conduct of litigation in England and Wales is governed by the requirements of the Civil Procedure Rules ("CPR"). Before proceedings are commenced, the CPR requires that the parties take reasonable and proportionate steps to identify, narrow and resolve the legal or factual issues between them. Arrears cases should be relatively straightforward, so the landlord should engage with the tenant to put forward its requirement that the rent arrears which fall due under the lease should be paid. A letter before action must be sent, which must clearly set out all relevant details relating to the type of arrears, the date(s) on which they fell due, the amounts and any interest owed (and how this has been calculated), with supporting documentation. The tenant must be allowed a reasonable time to consider this. If this does not trigger payment and the landlord issues proceedings, the parties will remain subject to the detailed procedural requirements and timeframes set out in the CPR.

Once proceedings are issued and served on the tenant, they must file an Acknowledgment of Service or a Defence. If they do not, the landlord will be able to seek judgment in default. Alternatively, in relatively straightforward arrears claims, the landlord may be able to apply for summary judgment. Summary judgment is a procedure by which the court may decide a claim at an early stage, so without a full trial or many of the procedural steps that would ordinarily lead up to trial. The aim of the procedure is to determine straightforward cases quickly, avoid long running disputes and to minimise costs.

Early judgment in either instance would resolve the matter with minimal cost and delay, subject to the landlord being able to enforce the judgment. If neither judgment in default or summary judgment is granted, the court will order directions for the conduct of the litigation through to trial, which can be time consuming and costly.

However, obtaining judgment against a tenant is only the first step. Landlords will have to take further steps to enforce any judgment against a tenant, which will only be worthwhile if the tenant has sufficient assets to make it worth pursuing. If the tenant's assets are minimal (save for his interest in the premises), the landlord should consider whether other less costly or time-consuming avenues of recovery might be more appropriate.

Various enforcement options include:

- Writs of control (High Court) and warrants of control (County Court) (bailiffs)
- Third party debt order (banks)
- Charging order (property)
- Attachment of earnings (individual)

Commercial Rent Arrears Recovery (CRAR)

CRAR was brought into force in 2014, replacing the ancient common law remedy of distress or distraint for rent arrears. It allows a commercial landlord to enter the demised premises and seize goods belonging to the tenant to the value of the arrears due, and sell them to cover the arrears and the landlord's costs.

CRAR is available to landlords where at least seven days' principal rent is due under the lease (it is not available for service charge, rates, council tax, repairs, maintenance or insurance arrears even if these are reserved as rent under the lease). The landlord must engage an enforcement agent to exercise CRAR on its behalf, and the enforcement agent must give the tenant at least seven days' written notice that it will enter the demised premises to exercise CRAR, though it is possible to apply to court so that a shorter notice period is allowed to the tenant. Following service of the notice, a tenant will often enter into a "controlled goods agreement" to allow goods to remain on the premises whilst the tenant negotiates and performs a repayment agreement with the landlord. This allows the tenant to continue to trade and run its business, thus not causing it further financial difficulties. Alternatively, the goods belonging to the tenant at the premises may be seized and sold by the enforcement agent on notice to the tenant.

Landlords must consider the type and value of the goods belonging to the tenant at the premises when deciding whether CRAR is the most suitable remedy to recover arrears. CRAR places restrictions on the type and value of the equipment, stock etc that can be seized. If the landlord intends to remove goods from the premises (rather than enter into a controlled goods agreement under which the goods would remain at the premises so that they could still be used for the benefit of the tenant's business), they will have to arrange for suitable storage and insurance. Landlords should also consider whether, having entered into a controlled goods agreement, there is any possibility that the tenant might still remove its goods from the premises. In such cases, the landlord should consider the practicalities and logistics of arranging for the goods to be relocated to a suitable storage facility.

CRAR is still seen as a relatively quick, easy and cheap means of recovering principal rent arrears plus VAT and interest on these sums, particularly if the tenant settles the debt following the initial notice from the enforcement agent to avoid them seizing control of their goods.

Written tenancy	Commercial premises	Tenant possession	Rent arrears
Includes tenancies at will but not licenses	Not dwellings	Where the tenant is still in possession of at least part of the demised premises	The amount payable for possession and use. Not service charge, rates, insurance etc., even if these are reserved as "rent" in the lease. Equal to at least 7 days

Forfeiture

The strongest action that a landlord can take when faced with a tenant not paying the rent due is to forfeit the lease.

Most leases will contain a clause allowing a landlord to forfeit the lease if rent is unpaid for a certain length of time. This is typically 14 or 21 days, but the landlord's ability to forfeit will wholly depend on the terms of the forfeiture (also known as the right of re-entry) provisions in the lease. The landlord may effect the forfeiture in one of two ways:

- By peaceable re-entry, whereby the landlord takes back physical possession of the premises, usually by changing the locks to secure the premises. Enforcement agents should be used to avoid inadvertently committing a criminal offence; or
- By the issue and service of proceedings against the tenant (also known as forfeiture by action), claiming possession of the premises because a right to forfeit has arisen under the lease. The proceedings can include a claim for the unpaid rent.

If the landlord's overriding objective is to recover possession of the premises, forfeiture by peaceable re-entry is much cheaper and speedier than forfeiture by action. However the forfeiture is effected, the tenant will have the right to apply to court for relief from forfeiture, which would have the effect of setting aside the forfeiture and the lease would continue on the same terms. Relief for forfeiture for non-payment of rent will automatically be granted if the tenant pays all of the arrears and the landlord's costs.

It is important that, when the rent falls due, the landlord makes a decision to either preserve its right to determine the lease or allow the lease to continue. The landlord will lose its right to forfeit the lease if they or their agent does anything which acknowledges the continued existence of the lease after becoming aware of the tenant's breach. This includes demanding or accepting rent or reduced rent, discussing an arrears repayment plan, negotiating a revised schedule for the payment of future rents (except on an entirely without prejudice to the landlord's position that the lease is forfeit basis) and serving notices pursuant to other provisions in the lease eg notice to reinstate.

Once the lease is forfeit, it is at an end. The landlord therefore regains possession of the premises. Unless the landlord has its own immediate plans for the premises eg to redevelop or occupy them itself, whether forfeiture is an appropriate action will depend on the landlord's ability and willingness to pay likely void costs such as non-domestic business rates and other outgoings until they can secure an incoming tenant, and the market conditions for reletting. Following forfeiture, CRAR will not be available even for rent which had accrued prior to the forfeiture. Also, after forfeiture, the future income stream for the remainder of the lease term is lost against third parties and any guarantor (see below), so the landlord will also want to consider the existence and covenant strength of these entities. For these reasons, it can sometimes be preferable to keep the lease alive, and use the threat of forfeiture as a strong negotiating tool to prompt the tenant to pay the arrears or negotiate a repayment plan. It could also be an incentive for a tenant to agree a (documented) revised rent payment agreement for future rents.

For a breach other than non-payment of rent, the landlord would first need to serve a section 146 notice and give the tenant a reasonable period to remedy the breach (if capable of remedy) before proceeding to forfeit.

Recovery against sureties (guarantors)

A landlord can also consider pursuing any surety to the lease. At the outset, the landlord will need to identify whether the security provided is, in law, a guarantee or an indemnity (or both), as its position will differ depending on the nature of the security.

Guarantee

Under a guarantee, the guarantor usually agrees with the landlord to be responsible for the tenant's performance of its obligations if the tenant defaults. Therefore the guarantor is only liable if the tenant breaches its covenants. Leases sometimes require that guarantors be served with a demand for payment before becoming liable. Landlords must also satisfy themselves that a guarantor has not inadvertently been wholly or partially released from its obligations. An oral or written modification or variation to the original lease, such as an increase in the demise, will discharge the guarantor from all further liability under the lease from the date of the variation, unless the variation is not prejudicial to the guarantor, or the guarantor gives its consent to the variation.

A strong guarantor is very valuable, so a landlord should always check the status and covenant strength of the guarantor and their relationship to the tenant. Often guarantors are parent companies of the tenant, and so where a tenant is facing financial difficulties, the guarantor could well be experiencing the same problems. If a guarantor fails to repay the tenant's arrears, the landlord can consider serving a statutory demand or issuing proceedings against them.

Indemnity

Under an indemnity, the surety's obligation to comply with the tenant's obligations is not dependent on the tenant being in default. However, where a tenant has not paid its rent, the landlord's right to recover against a surety under an indemnity will be the same as against a guarantor.

Recovery against third parties

Subtenants

In the event of a tenant failing to pay its rent, but the tenant has granted an underlease, a landlord may be able to pursue the subtenant for its rent. Where the landlord would be able to exercise CRAR against its defaulting tenant (the intermediate landlord) and there is an identifiable subtenant in place, the superior landlord may itself serve a prescribed notice on the subtenant requiring the subtenant to pay its rent directly to the superior landlord until the sums are paid or the notice is replaced or withdrawn. The notice takes effect 14 days after it has been served. The subtenant can then deduct the sums that it pays to the superior landlord from those sums owed to the intermediate landlord. If the subtenant fails to pay its rent to the superior landlord, the superior landlord can:

- exercise CRAR against the subtenant, following the same procedure as where CRAR is being exercised on a direct tenant;
- serve a statutory demand; or
- issue court proceedings for the amounts due.

Serving a notice against a subtenant is a simple and straightforward procedure and gives a landlord another route towards recovery. However, the notice can only relate to arrears due at the time the notice is served. Additional notices will need to be served when further rents become due under the lease. Also the level of rent payable by the subtenant to the superior landlord is the amount that it covenanted to pay under the sublease. This may be an amount less than the rent payable under the headlease. The landlord would need to recover any shortfall by other means. Furthermore, the landlord should also consider that the effect of the subtenant paying its rent direct to the superior landlord will be to reduce the income received by the tenant, which may cause it further longer-term financial problems.

Former tenants

If the current tenant was not the contracting tenant party when the lease was granted, the original tenant or any intermediate assignees could potentially be liable for the current tenant's rent arrears.

When considering whether a former tenant could remain liable for a current tenant's arrears, a landlord must look to the date on which the lease was granted.

In the case of a lease granted prior to 1 January 1996 or pursuant to an agreement, court order or option granted before this date (commonly known as "old" leases for these purposes), the original tenant under the lease remains liable for performance of the tenant covenants for the entire term of the lease. This is the doctrine of privity of contract. Liability for performance of the current tenant's covenants also falls on any intermediate tenants provided that they also entered into a covenant with the landlord to observe and perform the tenant covenants for the duration of the term of the lease. Such a covenant is commonly found in the licence to assign granted by the landlord prior to the assignment taking place.

Under leases granted on or after 1 January 1996 (commonly known as "new" leases), the options are more limited. A former tenant will only be liable for performance of the current tenant's obligations if, on assignment, it entered into an authorised guarantee agreement ("AGA"), guaranteeing the assignee's obligations under the lease. An AGA will last as long as the incoming assignee remains the tenant under the lease. A former tenant is normally released from its AGA obligations on any subsequent lawful assignment.

Whether the lease is an old or a new lease, a landlord cannot recover arrears from a former tenant unless it has first served a prescribed form of notice. The notice must be served within six months of the date on which the monies owed fall due. Where a tenant falls into further arrears (and rent is due every quarter under most modern leases), to preserve his right to recover the arrears from the former tenant(s), the landlord may need to serve a second notice, which may go on to form part of a series of notices. Therefore the landlord will need to stay on top of when the next notice is due to be served. If the landlord fails to serve the notice, they will lose the right to pursue the former tenant for these arrears.

If the former tenant does pay the sums demanded under the notice, they can call on the landlord to grant them an overriding lease. The former tenant will then become the current tenant's direct landlord. When considering whether to pursue a former tenant for arrears, the landlord will again have to consider its overall strategy. Whilst service of a notice is a simple and efficient

procedure, the former tenant's right to an overriding lease may frustrate a landlord's plans to redevelop the premises or occupy the premises itself. On the other hand, if the landlord is open to having a direct relationship with the former tenant, its covenant strength may prove a better option than the current tenant who is in arrears.

Following service of the notice(s), if the former tenant(s) fails to pay the sums due, the landlord may serve a statutory demand or issue proceedings to recover the monies.

Former guarantors

Similarly, guarantors of former tenants may continue to be liable for the arrears of the current tenant.

If the lease is an old lease, and (as one might expect) the former tenant has entered into a direct covenant with the landlord to remain liable to comply with future tenants' covenants, the guarantor of the former tenant will remain liable. In the absence of a direct covenant, the guarantor is off the hook.

If the lease is a new lease, the landlord will need to discover whether the former tenant gave an AGA on assignment. If the former tenant has not given an AGA, then both the tenant and the guarantor are released from their liabilities, and so the landlord has no course of action against either of them. If there is an AGA in place, the former tenant's guarantor may, depending on the terms of the guarantee initially given, have also given a guarantee of the AGA (a "GAGA"). The landlord will need to analyse the title deeds to the premises to discern whether a GAGA is in place.

As is the case in relation to former tenants, whether a former guarantor remains liable under a direct covenant or a GAGA, a landlord cannot recover arrears from them unless they have first served the prescribed form of notice within six months of the date on which the monies fall due. Further subsequent notices will need to be served if the tenant persistently fails to pay further rents due. Again, if the former guarantor pays the arrears owed, they have the right to call for an overriding lease of the premises, and the same considerations will apply. If the lease has been varied in a way that is prejudicial to the former guarantor without them giving consent to the variation, they will not be liable for any further liability under the lease from the date of the variation.

Conclusion

In this Guide, we have set out the options available to a landlord when faced with a tenant who is unwilling or unable to pay all rents due under its lease. Unfortunately, despite the best landlord/tenant relations, tenant default is sometimes inevitable. Only the financial affairs of large, better known tenant entities are publicised in the press, and Companies House filings and credit scores are backwards looking and add little current value. Whilst a landlord cannot prevent a tenant from getting into financial difficulties, well advised landlords will do all they can to spot any early signs that tenants are struggling financially. Selecting the most appropriate remedy for each situation will save both time and costs for the landlord in the long term and help to preserve the landlord's rights and interests.

This Guide assumes that the tenant is not insolvent or the subject of any insolvency procedure that might prevent or restrict the landlord's ability to use the recovery options otherwise available to it. The issues that arise in such cases are beyond the scope of this Guide and the landlord's position in these circumstances will depend on the type of insolvency faced by the tenant.

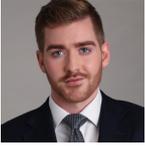
At a glance: Comparison of remedies

REMEDY	PROS	CONS
Rent Deposit	<ul style="list-style-type: none"> ✓ Immediate drawdown of cash ✓ Easy to use ✓ Usually must be topped up ✓ Can usually trigger right to forfeit if not topped up 	<ul style="list-style-type: none"> X Limited funds may not cover the whole arrears X Tenant may not top up the deposit X Reduces funds for future claims
Statutory Demand	<ul style="list-style-type: none"> ✓ Strong pressure ✓ Low cost and quick ✓ Can lead to insolvency action ✓ Very effective for undisputed debts 	<ul style="list-style-type: none"> X Only for undisputed debts X Insolvency may reduce recovery X Costs if insolvency petition needed X Risk that other creditors will "piggyback" on any winding up proceedings
Court proceedings	<ul style="list-style-type: none"> ✓ Pre-action letter can be enough to prompt payment ✓ Unlikely to be defended (if pure rent arrears claim) ✓ Multiple enforcement options ✓ Quick default/summary judgment possible ✓ Useful where tenant is solvent but uncooperative 	<ul style="list-style-type: none"> X Slow and costly X Judgment only useful if tenant has assets X May damage relationship X Requires pre action steps
CRAR	<ul style="list-style-type: none"> ✓ Initial stages are fast and cheap ✓ Often prompts payment ✓ Controlled Goods Agreement allows continued trading 	<ul style="list-style-type: none"> X Only available for principal rent X Needs 7+ days' arrears X Only for commercial premises X Depends on available goods to seize - only beneficial if tenant is still in occupation and has goods available/which are valuable
Forfeiture	<ul style="list-style-type: none"> ✓ Regains possession ✓ Peaceable re-entry is quick ✓ Useful if landlord wants to relet/occupy 	<ul style="list-style-type: none"> X Tenant may get relief - risk if you want to re-let X Right can be easily waived X Leads to void costs X Ends income
Guarantor	<ul style="list-style-type: none"> ✓ Strong fallback payer ✓ Often better covenant strength ✓ Can use statutory demand/court/insolvency routes ✓ Sometimes must take new lease 	<ul style="list-style-type: none"> X Released if lease varied without consent May require demand first X Guarantor may be struggling if there are wider group insolvency issues X Enforcement may be needed - check where the Guarantor is located
Subtenant (Rent Diversion)	<ul style="list-style-type: none"> ✓ Simple notice process ✓ Provides direct income ✓ Can enforce using CRAR or court ✓ Useful when subtenant is solvent 	<ul style="list-style-type: none"> X Applies only to existing arrears X Subtenant rent may be lower X Reduces main tenant's income X Requires repeated notices
Former Tenant (Old Leases)	<ul style="list-style-type: none"> ✓ Original tenant usually liable for whole term ✓ Intermediate assignees may also be liable ✓ May be financially stronger than current tenant 	<ul style="list-style-type: none"> X Strict notice deadlines X Former tenant may request overriding lease X Requires repeated notices X Can disrupt landlord's future plans
Former Tenant (New Leases)	<ul style="list-style-type: none"> ✓ Former tenant liable if AGA given ✓ Liability lasts while assignee remains tenant ✓ Useful fallback 	<ul style="list-style-type: none"> X Ends on next assignment X AGA must be validly given X Overriding lease can be demanded X Requires prompt notices for each arrears period
Former Guarantor	<ul style="list-style-type: none"> ✓ Extra party to pursue ✓ Liability may continue under old lease or GAGA ✓ Same enforcement options as guarantor 	<ul style="list-style-type: none"> X Strict notice rules X Can request overriding lease X Released if lease varied without consent

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