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FALCON CHAMBERS ARBITRATION

In the matter of an Arbitration under the Commercial Rent (Coronavirus) Act 2022

Between

KXDNA Limited

Applicant

and

60 SA Limited

Respondent

Final Award

1. COVID-19, and the restrictions placed on businesses and individuals during the pandemic, had a serious effect on many businesses. Many business tenants were unable to pay their rent as a result. Some landlords and tenants came to arrangements to enable tenants to continue to trade after the pandemic. But, some landlords and tenants were unable to agree terms. In a bid to resolve the impasse, Parliament enacted the Commercial Rent (Coronavirus) Act 2022 ("the Act"), which enables a landlord or a tenant to refer to arbitration the question of whether a business tenant should have any relief from its obligation to pay rent during the pandemic.

2. The Applicant is the Respondent's tenant under 2 leases, dated 23 March 2001 ("the First Lease") and 9 October 2007 ("the Second Lease"), of premises at 60 Sloane Avenue ("the Property"). The Applicant owes the Respondent a total of £1,805,820.30 in rent arrears and interest ("the Debt"), and, on 20 May 2022, referred the matter of whether it should have any relief under the Act to arbitration.

3. Neither party requested an oral hearing, but, following completion of the other steps required by the Act (which I explain in more detail below) both parties put in written submissions, in accordance with my directions, on 5 August 2022. The Applicant was represented throughout

by Steptoe & Johnson UK LLP and Ms Dacre of Mazars, and the Respondent was represented throughout by Stephenson Harwood LLP and Mr Osborne of FRP.

4. The Applicant invites me to write off most of the debt, and permit it to pay a sum of £407,000 by instalments.

5. The Respondent initially accepted that some relief should be given to the Applicant, but now says that no relief should be given; alternatively, I should require the Applicant to pay £1,023,284 in respect of the First Lease by instalments, but write off the rest of the debt.

The Issues

6. Section 13 of the Act provides:

(1) This section sets out the awards open to an arbitrator on a reference under this Part.

(2) If the arbitrator determines that-

(a) The parties have by agreement resolved the matter of relief from payment of a protected rent debt before the reference was made,

(b) the tenancy in question is not a business tenancy, or

(c) there is no protected rent debt,

the arbitrator must make an award dismissing the reference.

(3) If after assessing the viability of the tenant's business, the arbitrator determines that (at the time of the assessment) the business-

(a) Is not viable, and

(b) Would not be viable even if the tenant were to be given relief from payment of any kind,

The arbitrator must make an award dismissing the reference.

(4) Subsection (5) applies if, after making that assessment, the arbitrator determines that (at the time of the assessment) the business –

(a) Is viable, or

(b) Would become viable if the tenant were to be given relief from payment of any kind.

(5) In that case, the arbitrator must resolve the matter of relief from payment of a protected rent debt by

(a) Considering whether the tenant should receive any relief from payment and, if so, what relief, and

(b) Making an award in accordance with section 14.

7. The first question which I must determine is whether an arbitrator appointed under the Act is obliged to satisfy him/herself that the preconditions set out in section 13(2) are satisfied and the tenant's business is viable, even if both parties accept, as they did here,[1] that these hurdles were overcome by the Applicant and the only issue for determination by the arbitrator is the question of whether relief should be given, and if so what relief.

8. Arbitrations under the Act are statutory arbitrations, as defined in Arbitration Act 1996 section 94. Section 96 of the Arbitration Act 1996 provides that section 30(1) of the Arbitration Act 1996 applies, subject to the following modification:

   "Unless otherwise agreed by the parties, the arbitral tribunal may rule on its own substantive jurisdiction, that is; as to-

   (a) Whether the enactment [ie the Commercial Rent (Coronavirus) Act 2022] applies to the dispute or difference in question….."

   So, if the parties agree that the Act applies, the arbitrator cannot determine otherwise, and must determine the dispute as though the Act applies.

9. It might be argued that the only conclusion which this compels is that the Act, including section 13(2) and (3), must be applied. But, in my view, this would be to take too literal an approach. What section 13(2) and (3) are really saying is: *this part of this Act applies where …. there is protected rent debt and the tenant's business is viable*. If the parties have agreed these matters, they have agreed that the arbitrator should have power to grant relief. In these circumstances, the matter which has been referred to the arbitrator is simply the question of whether relief should be granted.

10. After all, it must be remembered that the Act was intended to be a "last resort" for parties who were unable to agree how to deal with pandemic arrears. In its August 2021 Policy Paper, 'Supporting businesses with commercial rent debts: policy statement' the government stated:

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[1] This was of course the Applicant's case. Agreeing with this, in effect, paragraph 6.3 of the Respondent's submissions states:

"6.3.1 There is a protected rent debt. The rent arrears of £1,805,820.39 are a protected rent debt under section 3(2) of the Act because they relate to sums accruing due under the Leases in the relevance period from 21 March 2020 to 18 July 2021. That includes interest of £18.777.42. There is no dispute between the parties as to the amount of the protected rent debt owed….

6.3.2 There are no grounds for the Arbitrator to make a determination under section 13(2) of the Act to dismiss the reference.

6.3.3 The tenant's business is viable (as both experts conclude….

6.3.4 Accordingly the Arbitrator must resolve the matter of relief from payment as required by section 13(5) of the Act."

"*… This is to be used as a last resort, after bilateral negotiations have been undertaken and only where the landlords and tenants cannot otherwise come to a resolution…….*

…

We welcome negotiations between commercial landlords and their tenants to resolve any outstanding debts. ……

The Government will legislate ..and introduce a system of binding arbitration to be undertaken where agreement cannot be reached…..

Alongside this, to support negotiations between tenants and landlords further……

…….

The details of the process and how it works will be released in due course. We will aim to ensure that this is an impartial and manageable process which should only be used as a last resort when negotiations have failed and providing a faster and easier resolution than through the Courts. …..

… The Arbitration process should be seen as a last resort: our strong preference is for landlords and tenants to use the principles which we will set out in legislation… to reach agreement."

11. Given the aims of the Act, it would be odd if it did not preserve party autonomy to agree some of the issues even if they could not agree them all. Furthermore, I do not consider it likely that Parliament would have intended that the parties should have to demonstrate and an arbitrator have to consider these matters in every case, even where they were common ground. This scheme was supposed to provide a low cost and quick dispute resolution mechanism and it would have been quite inconsistent with that statutory purpose to require the arbitrator to investigate matters which were common ground between the parties.

12. In the circumstances, it therefore seems to me that I do not need to consider whether there was a protected rent debt, or whether the tenant's business was viable for the purposes of section 13(3). However, I should say (for the benefit of other parties similarly circumstanced) that, were it not for the parties' agreement, I would have had real doubts on both these points, because the Applicant is a dormant company and it is an associated company (KX Gym UK Limited) that carried on business from, and is in occupation of, the Property.

13. However, in light of the parties' agreement on these points, the only issue which I am to determine is the matter of relief from payment.

Relief

14. Section 14(6) states:

"An award under this section may –

(a) Give the tenant relief from payment of the debt as set out in the award, or

(b) State that the tenant is to be given no relief from payment of the debt.

15. Section 6(2) makes it clear that relief can be given in the following ways:

"(a) writing off the whole or any part of the debt;

(b) giving time to pay the whole or any part of the debt, including by allowing the whole or any part of the debt to be paid by instalments;

(c) reducing (including to zero) any interest otherwise payable by the tenant…..

16. This is supplemented by section 14(7) which states:

"Where an award under subsection (6)(a) gives the tenant time to pay an amount (including an instalment), the payment date must be within the period of 24 months beginning with the day after the day on which the award is made."

17. In determining what, if any relief, to award, the key principle I must apply is set out in section 15(1) as follows:

"15(1) The principles in this section are-

(a) That any award should be aimed at –

(i) Preserving (in a case falling within section 13(4)(a)), or

(ii) Restoring and preserving (in a case falling within section 13(4)(b)),

the viability of the business of the tenant, so far as that is consistent with preserving the landlord's solvency, and

(b) That the tenant should, so far as it is consistent with the principle in paragraph (a) to do so, be required to meet its obligations as regards the payment of protected rent in full and without delay.

18. It was common ground, in this case, that even if the protected rent debt were written off entirely, this would not impact the landlord's solvency.

19. It was also common ground that "the business of the tenant" whose viability was to be considered was the business of "KX Group", which includes the Applicant, KX Gym UK Limited, KX Holdings Limited and KX Group Holding Limited. I believe that the basis for this agreement was that the only business operated by any of the companies within the KX Group is the business operated by KX Gym UK Limited from the Property, the rent has in fact been paid by KX Gym UK Limited to the Respondent, and the parties considered it appropriate to

ignore the group structure in those circumstances. Again, I should make clear that but for the parties' agreement on this matter, I could see real scope for argument as to whether it was appropriate to pierce the corporate veil / construe the Act so as to permit or require an arbitrator to consider anything other than the business of the actual tenant.

20. The debate between the parties was whether it was consistent with the viability of the business for the Applicant to be required to pay the protected rent debt in full forthwith, and, if not, what amount it could pay and when, consistently with the viability of the business.

21. The Act provides some guidance as to how viability is to be approached:

(1) In section 15(2): "*the arbitrator must disregard anything done by the tenant… with a view to manipulating their financial affairs so as to improve their position in relation to an award to be made under section 14.*

(2) In section 16(1): "*the arbitrator must, so far as known, have regard to –*

(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.

(3) In section 16(3): *in making an assessment under subsection (1)…, the arbitrator must disregard the possibility of the tenant… -*

(a) Borrowing money, or

(b) Restructuring its business.

Further guidance is also provided in the DBEIS Commercial Rent (Coronavirus) Act 2022 Guidance dated April 2022, which is statutory guidance issued pursuant to the power in section 21 of the Act. The Guidance indicates that viability is "deliberately not defined in the Act…. [but] In making the assessment of viability, a key question is whether protected rent debt aside, the tenant's business has, or will in the foreseeable future have, the means and ability to meet its obligations and to continue trading." (paragraph 6.3), but that it is distinct from an assessment as to whether the business is solvent (paragraph 6.6). The arbitrator is to assess the viability of the business "in a holistic and common-sense way" (paragraph 6.10).

22. Before I consider the evidence as to viability of the KX Group, there is one peculiarity of the Act which I must explain. The Act requires (in section 11) the tenant to make "a formal proposal" for resolving the matter when it makes the reference to arbitration – ie to set out what relief it says ought to be given. Section 11 also gives the Respondent the right to file a formal proposal, and each party the right to file one revised proposal. Section 14 requires the

arbitrator to "consider" the parties' final proposals before determining what award to make, and provides:

"*(3) Where both parties put forward final proposals under section 11 –*

(a) If the arbitrator considers that both proposals are consistent with the principles in section 15, the arbitrator must make the award set out in whichever of them the arbitrator consider to be the most consistent;

(b) If the arbitrator considers that one proposal is consistent with the principles set out in section 15 but the other is not, the arbitrator must make the award set out in the proposal that is consistent.

……

(4) *Otherwise, the arbitrator must make whatever award the arbitrator considers appropriate (applying the principles in section 15).*

23. It seems clear from this provision that (a) Parliament envisaged that there could (in at least some cases) be more than one figure which was consistent with the principles in section 15; and (b) the arbitrator is not entitled to substitute his/her own figure if one or more of the proposals made by the parties fall within the range of figures which are consistent with the principles set out in section 15. The purpose of this provision is obvious: it is to encourage parties to make sensible proposals.

24. In my view, the approach which is mandated by the Act is for the arbitrator to begin by ascertaining a range of figures that would be consistent with the principles set out in section 15. If only one of the parties' proposals falls within that range, then the award must be in accordance with that proposal. If both parties' proposals fall within the range, then the arbitrator must consider in more detail which proposal is more consistent with the principles in section 15.

25. If, however, neither party's proposal is within the range, the arbitrator must determine what award is appropriate.

26. The Applicant says that its formal proposal (in which it sought release from all of the Debt apart from £407,000 and an instalment plan) is consistent with the principles, and the Respondent's is not. Somewhat unusually, the Respondent's primary position seems to be that neither party's proposal is consistent with the principles, on the basis that the KX Group would be viable within the meaning of the statute even if it paid the Debt in full and immediately, because :

(a) Sums totalling £861,000 were lent, between April 2020 and 31 December 2021, to a company called KX U Limited (which is outside the KX Group, notwithstanding its

name). The fact this loan has been made must (so the Respondent contends) be disregarded under section 15(2);[2]

(b) Even without those sums being added back, the KX Group can afford to pay the Debt because it can call in at least part of the substantial loans (totalling £3.4 million) which it has made to KX U Limited, and if it did that, KX U Limited's shareholders (who are known to be wealthy) would inject more money into KX U Limited in order to enable it keep it afloat; and

(c) The shareholders in the various KX Group companies could inject additional capital to enable it to pay the Debt.

The Respondent's fall-back position is that its revised formal proposal (in which it sought payment of £1,023,284 by instalments) is consistent with the principles in section 15.

27. I will deal first with the argument about section 15(2), but I will deal with the Respondent's other points when considering viability generally.

Section 15(2)

28. The Respondent invites me to infer, without having heard any live evidence, that additional sums were advanced to KX U Limited after the pandemic began "with a view to manipulating [KX Group's] financial affairs so as to improve their position in relation to an award to be made under section 14".

29. I have a number of comments. Firstly, if parties wish to make an allegation that section 15 applies, they should generally request a hearing, unless the amounts at stake would make this wholly disproportionate. It is not satisfactory for an arbitrator to be asked to make a finding about whether a party has acted with a view to doing something without having heard any evidence, for this requires a conclusion to be drawn about the intention with which something was done.

30. Secondly, whilst I can see the argument that steps taken after August 2021 (when the intention to legislate for a binding arbitration scheme that focused on whether the tenant could pay was announced) could be taken with a view to improving a tenant's position in relation to an award to be made, it seems much less obvious to me that steps taken prior to August 2021 could have been taken with this intention.

[2] In fact, if I accepted this point and added back £861,000 onto the figure which the Applicant accepts that it could pay, this would not result in a figure which matched or exceeded the Debt.

31. Thirdly, if a party wants to make an allegation that section 15(2) is engaged, evidence in support should be produced at the appropriate time. Here the Respondent is relying on mere speculation that the payments must have been made in order to evade its rent obligations.

32. In fact, the Applicant's evidence makes it clear that the KX Group had guaranteed KX U Limited's borrowings with Metro Bank ("the Metro Loan") in 2017, long prior to the pandemic. The Metro Loan was originally of £2.8 million, though it might have increased (or indeed decreased) since. The guarantee meant that KX Group had an interest in ensuring that KX U Limited continued to meet its payments due on the Metro Loan, and otherwise complied with the terms of that loan, to avoid that loan being called in. The Metro Loan documentation is not in evidence, but I am willing to infer that the insolvency of KX U Limited would have been an Event of Default under the Metro Loan. Thus KX U Limited's financial position was of direct relevance to the KX Group. Further, the evidence does not suggest that the KX Group's behaviour as regards lending money to KX U Limited changed during the pandemic: even prior to the pandemic, KX Group had loaned substantial sums to KX U Limited in order to allow it to meet its obligations: it advanced £1 million in 2017, a further £1 million in 2019 and a further £880,000 during the pandemic. In these circumstances, I cannot infer that the reason payments were made to KX U Limited during the pandemic was "with a view to manipulating [KX Group's] financial affairs so as to improve their position in relation to an award to be made under section 14".

33. That does not mean, however, that the fact that monies were advanced to KX U Limited rather than making payments of rent is not information relating to the financial position of the tenant which I could take into account under section 16(1)(d). I consider this below.

Viability

34. I must consider the following points:

    (a) What assets and liabilities the KX Group has;

    (b) The previous rental payments made under the business tenancy;

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

    (d) Any other information relating to the financial position of the tenant:

        i. The fact that KX Group paid monies to KX U Limited to enable it to meet its obligations in preference to meeting its own obligation to pay the rent;

        ii. The relevance of the possibility that shareholders could inject additional funds into either KX Group or KX U Limited (and, if relevant, whether this would be possible); and

        iii. How the profit of the KX Group could be expected to grow over the next 24 months.

Assets and Liabilities

35. The KX Group balance sheet as at 31 March 2022 reveals:

    (a) Fixed assets worth £1,739,791;

    (b) Current assets of £5,878,662, including trade debtors of £1,519,218 and the KX U Loan of £3.4 million;

    (c) Current liabilities of £5,534,177 including the Debt; and

    (d) On this basis, net current assets are £344,485, and total assets less total liabilities are £838,026.

    It has not been suggested to me that it would be possible to liquidate any of the fixed assets to discharge the Debt. However, even looking at the net current assets, it appears that the KX Group are able to pay the Debt.

36. However, the balance sheet includes the loan to KX U Limited as a current asset, and the evidence is that KX U Limited is loss-making and (absent any injection of shareholder funds, which I consider below) is unlikely to be able to make any payment of this loan within the next 2 years, given its existing commitments to secured creditors and HMRC. If the balance sheet figures are adjusted to exclude the KX U Limited loan, current liabilities exceed current assets by over £3 million, and total liabilities exceed total assets by over £2.5 million. That being the case, the Applicant's position that KX Group would be viable if relief is given in respect of the Debt is difficult to understand, at first sight. Even if the Debt is written off completely, which neither party advocates, current liabilities will still exceed current assets by over £1 million, if the KX U Loan is ignored. In its evidence, the Applicant attached considerable weight to the profits that it anticipated making in the next 2 years, rather than its present balance sheet position. Given the Applicant's position, I do not therefore attach much weight to the balance sheet.

37. The KX Group are only party to one other tenancy, relating to the administrative offices of KX Gym UK Limited. There is very little evidence about this before me, save that there are no arrears under this tenancy.

Previous Rental Payments

38. There is nothing to suggest that the rent has not been paid by the KX Group punctually in the previous 20 years of the tenancy. This is evidence that the KX Group is, in ordinary trading conditions, viable and able to pay the rent.

Impact of Coronavirus

39. The business which is run from the Property is a private members health club, including, in the Applicant's words, a state-of-the-art gym, luxury spa and restaurant. The business itself and the part of the Property in which the restaurant is found were subject to numerous closure requirements and other restrictions, and I have no doubt that the coronavirus and the closure requirements that resulted from it impacted the KX Group's business. The revenue generated by the business was in excess of £9 million for each year from 2013 – 2019. In 2020, revenue was £4.5 million and in 2021, it was £5.6 million. Revenue of £8.4 million is forecast for 2022, but by 2023, it is forecast that revenue will again be above £9 million. No other reason for this temporary fall in revenue has been suggested, and it seems to me entirely appropriate to conclude, as the Applicant invites me to do, that this was as a result of the coronavirus. Furthermore, the figures for KX Gym UK Limited's earnings before interest, tax, depreciation and amortisation ("EBITDA") show a similar picture: they were over £1 million for each year up until 2018, in 2019 they dropped somewhat to £880,000 and then in 2020, they dropped to a loss of over £1million and a loss of over £500,000 in 2021. A profit was made in the first quarter of 2022. I do not know why the EBITDA dropped in 2019 when revenues were still high, but I cannot help but conclude that the dramatic shift from a profitable business to one running at a loss of over £1million the following year was caused, at least in large part, by the coronavirus. I would therefore expect that the business would now return to profitability, as the results from Q1 2022 suggest has in fact occurred.

Other matters (1) – the KX U Loan

40. Although I accept that the fact that the KX Group has paid out a substantial sum to a third party rather than paying its landlord the protected rent calls for investigation, particularly when the payee is a connected entity, once it is clear that section 15(2) is not engaged, the main question is whether there is any prospect of the KX Group recovering the money. The evidence demonstrated that, absent any further shareholder funds being injected, KX U Limited will not be in a position to make repayments on the KX U Loan within the next 2 years. I therefore consider that it would not be consistent with the principles to assess the KX Group's viability on the basis that it will be able to obtain repayment of this loan, subject to the point about shareholder support.

Other matters (2) - Shareholder support

41. The final preliminary matter raised by the Respondent is the fact that the evidence shows that both the KX Group and KX U Limited have, in the past, been supported by shareholder injection of funds when necessary. In the case of KX U Limited, shareholder funds were introduced in February 2022. Further, the accounts of KX Gym UK Limited for the year end 31 December 2020, but which were prepared much more recently and signed on 26 February 2022 state (on page 4):

"The shareholders continue to support the business and it is expected that, depending on the outcome of the Covid 19-related rent arrear arbitration process, further cash injections of between £150,000 and £1,850,000 will be made in the twelve months from the date of approval of these financial statements. At the date of the approval of these financial

statements this additional funding had not been committed, however, following conversations with the shareholders, the directors are confident that the additional funding will be provided as required."

42. I bear in mind that the shareholders of KX Gym UK Limited is another group company, and the question is whether funds would be injected into the KX Group rather than moved between group companies. However, since it is clear that none of the other group companies has any way of earning money, if funds are to be injected into KX Gym UK Limited, this can only be from the ultimate shareholders of the holding company. Thus, it is clear from this statement that the ultimate shareholders would, if necessary, inject further funds in order to keep the KX Group afloat if it were ordered to pay the full protected rent debt. In these circumstances, I can well understand the Respondent's frustration with the request to accept a rent concession.

43. However, the "cash injection" terminology obscures the legal mechanism by which this would be done. Section 16(3) mandates that I disregard the possibility of the KX Group borrowing money or restructuring its business. I cannot envisage how a "cash injection" could be made by the shareholders without either it appearing in the KX Holdings Limited accounts as a loan from these individuals (and I note that there are already loan accounts within the KX Holdings Limited accounts, for Peter Dubens and Jon Wood), or by way of some share issue or similar equity restructure. In my view, I cannot consider this possibility. Although there may be room for argument about the meaning of the words "restructure the business", I do not consider that Parliament would have intended that the corporate veil should be disregarded in these arbitrations. This is a fundamental principle of company law. It therefore seems to me that section 16(3) should be construed so as to require the arbitrator to ignore any possibility of a "cash injection" into the KX Group by the shareholders.

44. The Respondent's point, though, is that section 16(3) does not mandate me to disregard the prospect of additional shareholder investment into KX U Limited, and I should take this into account when assessing the likelihood of the KX Group being able to call in the KX U Loan. I do not consider that I can attach much weight to this prospect when assessing the viability of the KX Group. The legal position is that the KX Group cannot enforce repayment by KX U Limited without triggering a demand against itself for the Metro Loan, which would have a serious impact on its viability. It seems to me that I must therefore approach the matter on the basis that the KX Group would not be able to enforce the KX U Loan whilst remaining viable, so, given the poor financial position of KX U Limited, I must attach very little weight to the prospect that the KX U Loan will be repaid when assessing the viability of the KX Group.

Other Matters - (3) Forecasts

45. Both parties proceeded on the basis that forecasts as to the likely profitability of the KX Group during the 2 year period are material. I agree. Although this is not a matter to which arbitrators are specifically directed, in most cases, it will be necessary to look at what the tenant's financial position is forecast to be during the 2 years after the date of the award,

because it is necessary to consider what the tenant will be able to pay during that period consistently with the business remaining viable.

46. The Applicant's evidence was as follows:

    (a) Net profits of £122,000 and £367,000 were forecast for KX Gym UK Limited for 2022 and 2023 respectively, with a further £268,000 forecast for Q1 and Q2 2024;

    (b) A quarterly cash-flow forecast for KX Gym UK Limited. This shows that any surplus generated in the first half of 2022 is used up by the end of Q3 (presumably as revenues are considerably lower in the summer), so that there is only £17,000 in cash at the end of Q3. A similar pattern is shown for 2023.

    (c) A £20,000 "float" is on the low side. However, adopting that float, based on the Applicant's cash-flow forecast, it would be possible to pay £4,000 in October 2022, £22,000 in October 2023, £90,000 in January 2024 and £291,000 in April 2024 without dropping below that figure in any given month.

    (d) Forecasting following Covid-19 is difficult to do with any significant degree of accuracy.

47. The Respondent challenges the assumptions in the forecast. It says:

    (a) The revenues forecast are unduly pessimistic; and

    (b) The amount allowed in respect of capital expenditure should be reduced.

    I must therefore consider these issues.

48. As regards revenue forecasts, initially the Respondent relied on the fact that the April 2022 Forecast suggested a much lower growth rate than the growth forecast in a report by IBISWorld relating to Gyms and Fitness Centres in the UK dated January 2022. That report suggests that significant growth in revenue is expected during the year 2022-23 (17%) whereas the April 2022 Forecast predicts lower growth. (The Respondent's expert thought it showed growth of 3-4% per annum, but the Applicant's expert demonstrated that the figures actually showed a forecast growth rate of 7.6% in 2023). I am not persuaded that this provides a good reason to doubt the April 2022 Forecast. The Applicant is running a single luxury gym whose growth may well be different from a portfolio of "run-of-the-mill" gyms. Indeed, the Respondent's expert resiled from this report in his supplemental report. I therefore consider it no further.

49. However, the Respondent has another point: an alternative forecast was disclosed by the Applicant pursuant to Procedural Order number 1 ("the February 2022 Forecast"). The February 2022 Forecast contains higher estimates for EBITDA than the forecast annexed to the Applicant's evidence, which is titled "KX Gym – P&L and Cash Flow Workings (slow growth in membership)" ("the April 2022 Forecast"). The February 2022 Forecast requires careful examination. It was evidently prepared before the actual figures for Q1 2022 were available. The April 2022 forecast has replaced the actual Q1 figures for the estimated Q1 figures used in the February 2022 Forecast. The figures were as follows:

Period	February 2022 Forecast	Actual	Difference
Jan 2022	(29)	22	51
Feb 2022	34	37	3
March 2022	81	76	(5)

50. Although January was under-estimated in the February 2022 Forecast, February and March appear to have been good estimates.

51. Notwithstanding that, the figures forecast for subsequent months in the February 2022 Forecast were revised downwards in the April 2022 Forecast:

Period	February 2022 Forecast	April 2022 Forecast	Difference
April 2022	61	56	(5)
May 2022	94	75	(19)
June 2022	77	70	(7)
July 2022	30	29	(1)
August 2022	(35)	(30)	5
September 2022	88	65	(23)
October 2022	120	90	(30)
November 2022	104	76	(28)
December 2022	38	7	(31)
January 2023	51	85	34
February 2023	102	72	(30)
March 2023	134	99	(35)
April 2023	106	70	(36)
May 2023	137	89	(48)
June 2023	117	82	(35)
July 2023	68	37	(29)
August 2023	1	(27)	(28)
September 2023	124	72	(52)

October 2023	153	117	(36)
November 2023	134	100	(34)
December 2023	62	24	(40)
TOTAL	1766	1258	(508)

52. In summary, the EBITDA has been revised downwards by over half a million pounds over the period April 2022-December 2023 in the forecast produced in evidence as compared with what management were forecasting just 2 months before. I can only infer, given the title of the April 2022 Forecast, that it was prepared on a more conservative basis than management had previously seen fit to adopt. Inevitably that leads to suspicion that the April 2022 Forecast was pessimistic precisely because it was prepared after the Applicant had resolved to refer the dispute to arbitration.[3] This calls for some explanation. No specific explanation is given in the evidence about they way in which the EBITDA figures were calculated for the April 2022 forecast as against those in the February 2022 Forecast. That means that care must be taken in attaching weight to the April 2022 Forecast. The Respondent's expert, Mr Osborne, suggested that it was appropriate to take a median between the February 2022 Forecast and the April 2022 Forecast. I can understand Mr Osborne's logic (though I might myself have attached more weight to the forecast produced before the arbitration was in prospect), but, given the absence of explanation for these specific changes in the April 2022 forecast, my own view is that it would be better to use the February 2022 Forecast as the starting point.

53. In submissions, the Applicant stressed that historically its EBITDA estimates have been overestimates. That is true. EBITDA was overestimated by 16% in 2017, 15% in 2018 and 16% in 2019. In 2021, the loss was underestimated by 33% (ie the forecast was optimistic by 33%). There is no evidence as to how this was, or was not, factored in by management when creating the February 2022 Forecast. However, it seems to me that, ignoring 2021 which was a particularly difficult year to forecast, the evidence suggests that management's forecasts are likely to be accurate +/- 15% in an ordinary year. However, given the continued uncertainties about the "new normal" post Covid-19 and the risk of inflation affecting fixed costs and customer spending more than may have been anticipated in February 2022, I am prepared to increase that figure to 25%.

54. As regards capital expenditure, the Respondent challenges the decision to estimate spend at £117,000 for 2022, £205,000 for 2023 and £205,000 for 2024. The Respondent's point is that actual expenditure in the pre-pandemic years was £184,000 (2017), £224,000 (2018) and £130,000 (2019). In 2017 and 2019 this was significantly less than had been budgeted. Furthermore, the February 2022 Forecast reveals that the actual spend in 2021 was £117,000, and the Applicant was estimating spending £100,000 per annum in each of 2022 and 2023.

[3] The Applicant served its notice under section 10 of the Act on 13 April 2022. The evidence is that this forecast was prepared on 22 April 2022. The forecast period is until the middle of 2024, which matches the period that was, at that time, thought would be relevant in the arbitration.

55. The Applicant has explained in its evidence that the £100,000 figure in the February 2022 Forecast is a place-holder, and the estimates provided in the April 2022 Forecast reflect a considered estimate of the minimum capital expenditure that will actually be required, bearing in mind the significant underspend on capital items over recent years. The Applicant has produced detailed evidence explaining that much of the gym equipment purchased in 2012-2019 is now coming to the end of its life and requires replacement and that new equipment is required for the spa for it to maintain its top of the range offering. In addition, specific items of facilities management spend, such as new air-conditioning units, have been identified and have been factored in to these assessments.

56. I am satisfied that the Applicant's estimates in relation to capital expenditure are appropriate, given the nature of the business, and given the pre-pandemic levels of investment.

57. However, I must bear in mind that the question I must consider is not whether the Applicant's assessment as to capital expenditure is reasonable, but rather whether it is reasonable to allow the KX Group to make all of this capital expenditure within the next 2 years, at the expense of paying the rent owed to the Respondent, rather than deferring some of the spend until the second half of 2024. Although the Applicant has asserted that this is the minimum figure which could be spent consistently with the business remaining viable, I consider that it is appropriate to expect the KX Group to tighten its belt as regards capital expenditure from pre-pandemic levels, if it is asking the Respondent landlord to bear a rent concession. I accept the figure of £117,000 for 2022 since this seems low compared with pre-pandemic levels, but adjust the Applicant's figures for projected capex spending in 2023 and January – August 2024 by just over 10%, to £185,000 per annum. (The forecasts have been prepared on the basis that this expenditure will be largely linear. I think it most unlikely that this will be the case, but since I have not been provided with any details as to when the capital expenditure projects are to take place, I cannot do otherwise than follow the forecasts).

58. In the circumstances, I consider that it is appropriate to use the February 2022 figures - 25% for EBIDTA when considering the minimum it is likely the KX Group can afford, adjusted:

    (a) to take account of the detailed estimate of capital expenditure included in the April 2022 Forecast, adjusted as set out above; and

    (b) the fact that it is now clear that the amount which must be paid to HMLR in respect of deferred taxes is £51,000 per month not £50,000 per month as had been estimated in February 2022.

59. The February 2022 Forecast does not extend to 2024. The Applicant's estimate for EBITDA for the first 6 months of 2024 in the April 2022 Forecast is 593. This is almost exactly half of the February 2022 estimate for 2023, and is only slightly below half of the historic EBITDA

figures for 2017 (1,209) and 2018 (1,223). I am therefore prepared to use this estimate as the minimum likely for the first 6 months of 2024.

60. It is necessary to extend the period until August 2024. It is evident from the figures provided for 2022 and 2023 that the summer months are not expected to generate as much profit as other months, no doubt because of holidays. I would therefore suggest carrying forward the figures for July and August 2023 (68 and 1, in each case +/- 25%) into July and August 2024 for the purposes of the calculation. However, it is necessary to model into September 2024 as well in order to establish how much could be drawn in July and August 2024 without impacting the ability to pay the rent on the September 2024 quarter day.

61. On this basis, the amount which KX Group can afford to pay is (by my calculations which are summarised on app 1 attached) £625,000 in the following instalments:

October 2022	£25,000
April 2023	£95,000
October 2023	£50,000
January 2024	£100,000
April 2024	£295,000
July 2024	£60,000

This is about a third of what the Applicant owes. I must consider whether this is the minimum which would be consistent with the principles in section 15. In addition to the cash flow analysis, I bear in mind that

(i) The net profit figures produced by the Applicant would suggest that £857,000 should be available for payment towards the Debt without impacting the KX Group's viability.

(ii) The Applicant was obliged to close for substantial periods during the pandemic and even when it was able to open, trading will have been much reduced. These factors resulted in it making a considerable loss.

(iii) However, it was able to maintain about half of its revenue during the pandemic and it seems from the Q1 2022 results and management's forecasts that it should now be able to return to profit.

In my view a payment of £625,000 by instalments as set out above is the minimum proposal which is consistent with the principles in section 15. Therefore the Applicant's proposal is not consistent with the principles in section 15.

62. I must also consider what is the maximum amount payable consistently with the principles in section 15, in order to consider whether the Respondent's proposal is consistent with the principles. In my view, the maximum amount payable consistently with the principles is based on the February 2022 EBITDA (save to substitute the actual figures for Q1 2022). I do not consider that it is justified to increase the EBIDTA estimates from those figures,

notwithstanding the fact that the actual figures were better than the February 2022 forecast for this quarter, because the evidence is that historically management's estimates were overestimates.

63. The Respondent has used the February 2022 EBITDA figures in the April 2022 Forecast, rather than using the February 2022 Forecast, to calculate its figures. This is relevant because there are also differences between the Forecasts as regards entries for movement in member debts, VAT Routine and so forth. I consider that this approach is consistent with the principles, and if (as in fact is the case) this approach results in the KX Group being able to make a payment out earlier than it would if the February 2022 Forecast were adopted in its entirety (when a payment out could not be made until October 2022 bearing in mind the need to maintain the £20k float), this is the approach which should be adopted when considering the maximum figure which could be justified as being consistent with the principles. On this basis, the Respondent's proposal is consistent with the principles in section 15 for the period down to the end of 2023, as the table below shows:

	Arbitrator's maximum	Respondent's proposal
August 2022	45,000	22,388
October 2022	100,000	62,473
January 2023	40,000	7,798
April 2023	120,000	139,955
July 2023	25,000	
October 2023	130,000	136,481
Total	460,000	369,385

64. As noted above, the February 2022 Forecast does not provide figures for 2024. It is therefore necessary for me to consider what is the maximum assumption it would be reasonable to make about growth. Management have assumed growth of 23% over their 2023 figures in the April 2022 Forecast, but I am not attracted to the idea of simply assuming that the same growth rate would arise if there had been more growth during 2022 than that forecast was based on. Pre-pandemic the EBIDTA never exceeded 1,223,000, so I think that 1,200,000 is the figure I should adopt as the EBITDA for 2024 on the least conservative reasonable basis. I must then consider how to split this £13,000 increase from the 2023 estimated EBITDA across the year. Applying the increase proportionately to the monthly 2023 figures seems like a reasonable approach to me. This gives the following figures for EBIDTA for 2024:

January 2024	51,500

February 2024	103,000
March 2024	135,000
April 2024	107,000
May 2024	138,000
June 2024	118,000
July 2024	69,000
August 2024	1,000
September 2024	125,000

Given the sums involved, this is very little different from applying the increase evenly across the year.

65. Using these figures, the amounts which it is possible to draw during the year 2024 is £580,000, in the instalments set out below. The table also shows these instalments against the Respondent's proposals:

	Arbitrator's maximum drawings	Respondent's proposal
January 2024	£95,000[4]	201,332
April 2024	£343,000	345,185
May 2024	£25,000	
July 2024	£117,000	107,382
	£580,000	£653,899

66. The grand totals allowed under the arbitrator's maximum (£1,040,000) is very slightly larger than the Respondent's proposal (£1,023,284). However, the Respondent's proposal does require the Applicant to pay about £15,000 more in January 2024 and about £2,000 more in April 2024 than my analysis of the cash-flow on a best case scenario supports.

[4] If one adds back the "delta" between what I consider to be the maximum drawable prior to 31 December 2023 to the Respondent's proposal (£90,615), £185,615 is the most that could be drawn in January 2024.

67. Since the figures are so close given the sums at issue in this arbitration, and given that the cash flow analysis is not the only factor to be considered – indeed it is not even a mandated factor under the Act – I consider that the Respondent's proposals are consistent with the principles in section 15. The Respondent's proposal is in line with the maximum amount which I consider consistent with those principles, based largely on the Applicant's own pre-arbitration forecasting and bearing in mind the points set out in paragraph 61 above.

68. I must therefore make an award in the terms of the Respondent's revised formal proposal, in so far as it deals with substantive matters.

69. The Respondent's formal and revised proposals are silent as to VAT, as is its expert evidence. I assume that it was intended to be a VAT inclusive proposal because the debt was stated as a VAT inclusive figures in the Reference, and the parties have not addressed VAT at all. Further, the proposal is based on what the Applicant can afford to pay, and the evidence does not demonstrate that requiring the Applicant to pay VAT on top of the amounts in the Respondent's proposal would be consistent with the principles:

    i. Although the Applicant / the KX Group could reclaim the VAT as input tax if they were registered for VAT and they charged more VAT on sales than the VAT they had to pay, the Respondent did not explain in its evidence that they were registered for VAT or make any assessment of the VAT charged on sales; and

    ii. In any event, the need to pay VAT in addition to the amounts in the formal proposal has not been factored in to any of the cash flow forecasts, so, even if it could be reclaimed in principle, there might well be a cash flow consequence of the need to pay VAT which would mean that a requirement to pay VAT on top of the amounts stipulated would mean that the business would not be viable.

Costs

70. Although the Respondent has purported to deal with costs in its formal proposal, I do not consider that costs are to be dealt with in the formal proposals. Section 19(7) provides that, save in relation to the arbitrator's fees, the parties must meet their own legal costs. There is no need for a formal proposal to state this (and there would be nothing to be gained by attempting to include some other provision as to costs in a formal proposal).

71. As regards the arbitrator's costs, the effect of section 19(5) and (6) is that the arbitrator must make an award requiring the Respondent to reimburse the Applicant half of the arbitration fee unless the circumstances of the case make another award more appropriate.

72. The Applicant says that the Respondent's pre-action conduct, its changes of position in the various iterations of its expert evidence, and the way in which it has approached this arbitration have increased costs, and I have no doubt that this is true. Were it not for the fact that the Respondent's revised proposal was consistent with the principles in section 15 and the Applicant's proposal was not, I might well have been minded to require the Respondent to bear the whole of the arbitration fee. However, given that the Respondent has won (on its secondary case), and the arbitration fee itself was fixed (so has not increased despite the considerable additional work that the Respondent's conduct has generated for the arbitrator), I consider that the right order is that each party should bear half of the arbitration fee, in accordance with the default position under the Act.

Now I, Stephanie Tozer QC, having carefully considered the submissions of the parties, hereby award and direct as follows:

1. The Applicant shall pay to the Respondent £1,023,284 (inclusive of VAT) in respect of the arrears due under the First Lease (re Unit K) in the following instalments:

August 2022	£22,388
October 2022	£62,763
January 2023	£7,798
April 2023	£139,955
October 2023	£136,481
January 2024	£201,332
April 2024	£345,185
July 2024	£107,382

2. The Applicant is to be relieved from paying any other sums under the terms of the leases in respect of the period from 18 March 2020to 18 July 2021.

3. The Respondent shall reimburse the Applicant for half the arbitration fees, by deduction from the amount which the Applicant is to pay to the Respondent in August 2022.

MADE AND PUBLISHED by me, Stephanie Tozer QC at Falcon Chambers Arbitration, London, which is the seat of the arbitration, on 11 August 2022.

Stephanie Tozer QC
11 August 2022