

COVID-19: THE EMERGENCE OF LIGHT TOUCH ADMINISTRATION IN THE UNITED KINGDOM

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UK Restructuring and Insolvency Alert

By: Jonathan Lawrence, Barry B. Cosgrave, Erin E. Valentine

SUMMARY AND KEY TAKEAWAYS

- Light touch administration is intended to allow Administration to be used as a true rescue tool in a manner similar to Chapter 11 in the United States
- Administrators appoint the incumbent board to continue to manage the company subject to certain limitations imposed by a Consent Protocol
- Caution will need to be exercised as Administrators retain personal liability for acts of the company notwithstanding the fact that they are not in full control
- This follows the general direction of travel in the UK as evidenced by the suspension of the offence of wrongful trading which is seen as an effort to allow honest directors to save their companies in these unique times
- Creditor support for a light touch administration may prove to be a key gating item

BACKGROUND

The COVID-19 pandemic, and the lockdown that has been enforced as a result, has led to unprecedented financial distress and liquidity issues for UK businesses across all sectors. Naturally, all stakeholders are considering what options are available to them in the case of the corporate insolvencies that will inevitably result from the stay at home protocol. Amongst the various options available under the UK Insolvency Act, administration is one of the most likely to be pursued. Originally conceived as a rescue mechanism (the first duty of an administrator is to try to rescue the company as a going concern) in the recent past in the UK the entry by a company into administration has painted a potentially bleak picture for its future.

However, the difficulties that the global economy faces as a result of the Covid-19 crisis are unlike any seen before. Whereas the 2008 global financial crisis originated in the financial sector and spread to multiple others, the shock to the system this time has been absolute with all sectors and businesses affected. This raises the question as to whether traditional restructuring tools are fit for purpose to address the unique nature of the upcoming recession (or depression). There are clearly multiple businesses that have been well run and were profitable but which have suffered a terrible case of bad fortune. Should such businesses suffer the fate of the majority that go into administration and be sold off in parts to market competitors? And, more pointedly, are there

any willing and, more importantly, able buyers in the market that will allow administrators to follow their typical protocol and allow the business to trade on?

To address this, a recent approach that has come to prominence is that of “light touch” administration. Light touch administration allows company directors to retain control of the company, rather than ceding power to insolvency practitioners during the period of administration. The Insolvency Lawyers Association and City of London Law Society have published a template for administrators to run such an insolvency event - the Consent Protocol. In many ways, a light touch administration may be likened to the Chapter 11 process in the United States which is more focussed on the rescue of a business with its directors left in place. It may also better fit the first aim of administration: rescuing a company as a going concern.

LIGHT TOUCH ADMINISTRATION

Light touch administration allows company directors to file for administration but retain day-to-day control of the company as they seek to find a way out of financial distress. The process is based on a provision in English insolvency law which states officers of the company may not exercise management activities “without the consent of the administrator”. Whilst this consent would not normally be given, where a company's difficulties stem from the Covid-19 pandemic and the UK lockdown, consent may be appropriate.

Light touch administration provides the usual protections afforded by administration, such as a moratorium on claims for unpaid debts. It also enables directors to continue to run the business within the parameters of management powers set by the administrators. These parameters are outlined in the Consent Protocol and include limits on (a) borrowing and (b) the ability to enter into contracts above a certain value. The principle is that companies that would not be in administration but for the Covid-19 pandemic now have the ability to weather the storm and allow the directors to rescue the business, which should ultimately be the desired outcome for all interested parties.

It is worth noting that many insolvency practitioners have emphasised that light touch administration will not always be a suitable mechanism. For example, it is unlikely to be appropriate for companies that were facing the possibility of administration prior to the crisis caused by Covid-19. Other factors such as the quality of existing management and long-term viability of the company will also factor into an administrator's decision. The other glaring issue for administrators to consider is that they remain personally liable for the actions of the company in light touch administration notwithstanding the fact that they have ceded control of the company to incumbent management. Whether the UK Parliament considers relaxing that aspect of the Insolvency Act in a manner similar to that adopted for the suspension of the offence of wrongful trading remains to be seen. The spectre of moral hazard looms.

CHANGES TO UK INSOLVENCY LAW

The rise of light-touch administration follows the direction of travel set by the UK Government when it announced on Saturday 28 March 2020 that it is amending the UK Insolvency law to retrospectively suspend the offence of wrongful trading by directors of UK companies (such suspension having deemed to commence on 1 March 2020) [see prior article here]. Current rules stipulate that directors of limited liability companies can become personally liable for debts if they continue to trade when they are uncertain as to whether the company can continue to meet its debts. The relaxing of these wrongful trading rules will reassure directors that the decisions being made about

the future viability of the company during the pandemic will not result in personal liability. However, the suspension does not extend to the offence of fraudulent trading which remains an offence of which directors need to be aware.

It appears that the UK Government is taking the approach that the best way forward to address the turmoil is to allow honest directors to try to manage their company back onto a sound financial footing.

CONSENT PROTOCOL

The Consent Protocol was drafted to provide the framework to enable directors to play a central role in stabilising and rescuing the company, whilst protecting the interests of shareholders and creditors.

The key features of a light touch administration under the Consent Protocol are as follows:

- Light touch administration should only be used under circumstances where the administrators are satisfied that the company can be rescued as a going concern. In particular, the company must have sufficient working capital to pay key post-administration costs such as rent, employee salaries, utilities and suppliers on an ongoing basis.
- It provides companies with the protection of a moratorium so creditors and suppliers cannot sue or threaten to wind up the company during the administration period.
- The administrator will identify broad management powers that can continue to be executed by the directors, in order to facilitate the day-to-day running of the business.
- Transaction limits will be put in place that are sufficiently high to enable the company to engage in ordinary business, and will exclude unusually large transactions, which will still require the approval of the administrator.
- Specific conditions will be identified with which the directors must comply in order to exercise their powers. For example, directors under a light touch administration will not be able to do the following without consulting administrators: enter into, renew, adopt or vary employment contracts; negotiate or vary the terms of any business lease with the company's landlord; negotiate or otherwise vary the terms of any contract for the supply of essential goods and services or borrow money.
- Administrators will be responsible for supervising the actions taken by the directors during the light touch administration process to ensure that they are complying with their obligations.

It is clear that the Consent Protocol is not a “one size fits all” template. It will have to be a fluid process, where the scope of the powers and restrictions placed on directors will be determined dependent on the situation of each individual company. The role of the administrator will involve balancing the protection of creditors' and shareholders' interests, affording directors of viable companies the best possibility of being rescued and ensuring that in cases where the business is no longer viable, normal administration practices will be followed.

DEBENHAMS: A CASE STUDY

Debenhams became the first high street business in the UK to enter a light touch administration process in April 2020, after sales plummeted under the nationwide lockdown. The department store chain has stated the goal of

the administration was to protect it from legal action from its creditors and to avoid being pushed into liquidation. It believes the protection afforded by the administration will mean it will be possible to reopen after the virus-related restrictions are eased.

It is perhaps important to note that Debenhams' lenders and owners are "highly supportive" of the light touch administration process and will fund the administration fees. The ability to enter into a light touch administration may not be as easy where a major creditor, or a group of creditors, is not supportive of the application.

KEY CONTACTS



JONATHAN LAWRENCE

PARTNER

LONDON

+44.(0)20.7360.8242

JONATHAN.LAWRENCE@KLGATES.COM

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