STEVENS&BOLTON

ENTER STAGE LEFT: THE NEW 'LIGHT TOUCH' ADMINISTRATION

The extraordinary disruption to UK business caused by the COVID-19 lockdown has spawned much discussion about changes to existing insolvency laws to help businesses which are struggling to survive in this abnormal environment. One topic of discussion has been the so-called 'light touch' administration. Here we provide a quick overview of what this involves.

WHAT DO WE MEAN BY A 'LIGHT TOUCH' ADMINISTRATION?

In summary, it's where a business is placed into administration but the existing directors and management remain in day-to-day control of the business, albeit under the supervision and control of the administrators. This contrasts with a 'normal' administration, where the directors cease managing the business and the administrators take control of all day-to-day management activities.

It's important to note that this is not a new procedure. The provisions of the Insolvency Act dealing with administration have from the outset permitted administrations to be run on this basis. Unlike a liquidation – where the directors' powers of management are automatically suspended – the administration regime permits the directors to continue to exercise their powers, so long as – and to the extent that – the administrators permit this pursuant to paragraph 64 of Schedule B1 to the Insolvency Act 1986. However, in the vast majority of administrations to date, the administrators – once appointed – have tended to default to the familiar behaviour of excluding the directors from any meaningful role in the management of the company. In fairness to the insolvency practitioners, this is understandable, given that the administrators will normally be strangers to the business and will have the legal responsibility for what goes right – or wrong – in the business from the moment of their appointment. It would take a brave insolvency practitioner to entrust the fate of the business – and its likely impact upon their own professional reputation and PI policy – to the incumbent management upon whose watch the company had become insolvent in the first place.

WHY GO 'LIGHT TOUCH'?

The key consideration is what the ultimate aim of the administration is. If the principal purpose of the administration is to achieve a better result for the company's creditors as a whole than would be likely if the company were wound up, that points towards a sale of the business and a return to creditors arising from that sale. That is a task best performed by administrators rather than by existing management, and therefore lends itself to the more traditional model of administration we are more used to seeing. By contrast, if the objective of the administration is to rescue the company as a going concern, then the existing management may well be best placed to carry on in their existing management role, given their knowledge of the business and the likelihood that, post rescue, they will remain at the helm. The concept of the 'light touch' administration effectively allows them to do this, albeit with their wings slightly clipped (as we discuss further below).

ARE THERE ANY GOOD EXAMPLES OF 'LIGHT TOUCH' ADMINISTRATIONS?

Debenhams used to have a slogan which was to "do a bit of Debenhams". In keeping with that tradition, they have now elected to do a bit of an administration. The struggling retailer recently appointed FRP Advisory as its administrators but with the existing management team remaining in place. The light touch administration suits the business well, as it is targeted principally at keeping the business alive whilst staving off legal action from its creditors, which could otherwise push the business into liquidation. For want of a better phrase, the 'light touch' administration effectively enables the existing management team to keep calm and carry on.

This kind of administration is likely particularly attractive in the current climate, with many otherwise robust and successful businesses facing a precarious future in light of the COVID-19 outbreak and directors concerned about whether they can continue trading in circumstances where it is very difficult to project a company's future trading prospects.

Going back 20 years, the insolvency of the Federal Mogul group of companies is another example of a 'light touch' administration, albeit in a cross-border context. The Federal Mogul group comprised a large number of US and English companies in the heavy industrial sector. There were concurrent filings in the US under Chapter 11 of the Bankruptcy Code and in England under the administration regime. Given the large commonality of directors across the group, plus the fact that Chapter 11 is a debtor-in-possession proceeding where the management remain in control of the business during the insolvency procedure, the English administrators entered into a protocol with the US estate under which the administrators delegated day-to-day management functions to the incumbent directors (who were in any event subject to statutory oversight by the US Bankruptcy court and by the various stakeholder committees which are established under the Chapter 11 regime). The protocol permitted the administrators to intervene in directors' decision-making if they considered it appropriate, including by terminating the protocol altogether, if they saw fit.

BUT ARE THERE ANY LIMITATIONS ON WHAT EXISTING DIRECTORS CAN DO WHILST THE ADMINISTRATORS ARE PLACE?

In short, yes. The Insolvency Lawyers Association and City of London Law Society have recently prepared a draft protocol (the "**Consent Protocol**") which is designed to support a 'light touch' administration process. This can be accessed by clicking here. In summary, the Consent Protocol operates to confer the consent of the administrators to the continuing exercise of management powers by the officers of the company pursuant to paragraph 64 of Schedule B1 to the Insolvency Act 1986. As drafted, this operates only for so long as the administrators are satisfied that the company can be rescued as a going concern, and to this end the administrators reserve the right to vary or terminate the consent at any time (as in the case of the Federal Mogul insolvency). Whilst the consent remains in place, the powers of the directors are strictly limited to matters such as the following:

- The power to acquire and dispose of stock-in-trade, and to enter into and perform obligations under contracts for the provision or receipt of services, in each case of the type ordinarily purchased, entered into or performed by the company in the ordinary course of the company's business, subject to agreed monetary limits
- The power to pay salaries or other payments for services due under any pre-administration contracts to any employees, contractors or agents, subject to agreed limits
- The power to make other payments in return for services, subject to agreed limits
- The power to incur credit with suppliers and other counterparties, subject to agreed limits
- Any other powers deemed necessary for the directors to rescue the company as a going concern

In addition, the powers conferred upon the directors pursuant to the Consent Protocol are subject to various conditions. By way of illustration, for so long as the consent remains in force, the directors of the company are required to:

- Safeguard and maintain the books and records of the company
- Provide the administrators with details of the company's bank accounts with authority to access those accounts
- Deposit any proceeds of sale form the company's stock-in-trade into a specified account to which the administrators are signatories
- Prepare management accounts at agreed intervals showing a true and fair view of the assets and liabilities and the profit or loss of the company
- Inform the administrators of any termination by contractual counterparties or any other information which could suggest to a reasonable person that there is no longer any reasonable prospect of achieving the rescue of the company as a going concern
- Obtain the administrators' prior written consent before paying any salaries or other sums to the directors or any other persons connected with the company

The Consent Protocol is designed as a starting point for negotiations and the powers and conditions can be amended on a case by case basis to suit the requirements of a particular estate.

HOW SHOULD DIRECTORS BEHAVE DURING A 'LIGHT TOUCH' ADMINISTRATION?

Even during a 'normal' administration, the duties of directors are said to continue, albeit their actions are more likely to come under the spotlight in the case of a 'light touch' administration where they are managing the business day-to-day. Directors might try to seek some protection from any personal liability in relation to a particular transaction by seeking the express approval of the administrators. That said, it is unlikely that such an 'approval' would be regarded by the courts as exonerating the directors from legal responsibility for any adverse consequences flowing from that transaction. In the context of directors' duties, English law does not embrace the concept of 'power without responsibility'. It is likely, furthermore, that an administrator would resist giving any such 'approval' without first thoroughly familiarising themselves with the relevant facts. An administrator's approval – if not fully informed – is unlikely to provide meaningful legal protection to the directors.

If any proposed administrators and the directors are contemplating embarking upon a 'light touch' administration, it is important that they check the terms of the directors' D&O insurance policy, since the language of that policy may well exclude cover in such circumstances. This will, therefore, require either an amendment to the existing policy or the taking out of new insurance cover. Both will inevitably involve the payment of an increased premium, as well as a not immaterial delay whilst the terms of cover are negotiated. It is important that this is factored into any administration planning timetable.

WHEN DOES THE 'LIGHT TOUCH' ADMINISTRATION END?

There is no fixed point in time when a 'light touch' administration ends. As it is anticipated that many businesses will opt to use this tool during the current lockdown, the Consent Protocol foresees that, once the COVID-19 lockdown is lifted and life returns to normal, the light-touch administration could be supplemented either by a company voluntary arrangement or scheme of arrangement to compromise or reduce the company's liabilities and secure its long-term future. Alternatively, if a company's fortunes have not been restored, it seems likely that the administrators would conclude that a formal administration sale or liquidation is the only other option, in which case we presume they would re-assume control of the business.

ISN'T THIS SIMILAR TO US CHAPTER 11?

Many have already pointed out that the concept of a 'light touch' administration rings bells to those familiar with the US Chapter 11 process which also allows current management to remain in place whilst protecting a business from hostile action by its creditors. Whilst the rationale for the introduction of a similar procedure in the UK, particularly given the current economic climate, is clear (and has indeed been the subject of much discussion and government consultation papers over the last eight years or so), the Chapter 11 process is not without its critics. Users of the UK's 'light touch' administration tool will need to be wary of potential flaws in the process. In particular, insolvency practitioners will be mindful of their duties and will need to be watchful of directors potentially overstepping the mark. Creditors will be concerned about value being eroded from a business and a bad situation potentially being made worse. And how and when a business emerges from a 'light touch' administration is not clear-cut.

In the longer term, it seems that a 'light touch' administration is not an adequate substitute for a fully-fledged debtor-in-possession procedure and the authors anticipate that such a procedure will be introduced into UK insolvency law in the near future. Given that the UK courts are unlikely ever to achieve the capacity and bandwidth which the US Bankruptcy courts have and which enable those courts to monitor and supervise individual Chapter 11 cases on a continuing basis, it seems likely that in the UK version of a debtor-in-possession procedure, insolvency practitioners will, in some form or other, be allocated that supervisory role. If that happens, the experience which they are now acquiring in 'light-touch' administrations will certainly come in useful.

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