

The rise of a new phoenix: The English light-touch administration

Eugenio Vaccari investigates if ‘Light Touch Administrations’ are a welcome addition to the rescue toolkit of English practitioners



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The economic impact of the COVID-19 outbreak has triggered calls for emergency fiscal and legislative measures to address liquidity and legal problems. Some of the measures directly aimed to companies in distress make it harder for creditors to wind-up companies.

However, in the wake of governmental intervention, the industry came up with ingenious solutions to avoid the demise of distressed yet viable businesses. One of these solutions is restructuring or “light touch” administration (‘LTA’). This article investigates if the rise of LTAs is a welcome addition to the rescue toolkit of English practitioners or a mischievous phoenix for the English insolvency framework. It will also speculate on the impact of the announced regulatory reforms for the future of LTAs.

LTAs are a current and quite popular feature of the English insolvency framework. They were recently reinstated in a briefing to the Government prepared by the Insolvency Lawyers Association (‘ILA’).¹ This idea originated as a mechanism to combine the principles of receiverships and the powers of the administrators.

Under English insolvency law, upon the appointment of an administrators, the directors remain in office and have a duty to co-operate with the appointed insolvency practitioner (‘IP’). However, usually, in a traditional administration, the management is replaced by IPs upon the opening of the procedure. While administration is widely seen as a management-displacing procedure, the law allows the

administrators to leave management powers to the existing directors of the company.²

In LTAs, the management is, therefore, not replaced by the appointed administrator. Within the process, the respective powers and duties of the administrators and directors are regulated by a ‘Consent Protocol’. A recent template of a protocol was prepared for the ILA and the City of London Law Society by Mark Phillips QC, William Willson and Stephen Robins of South Square and is subject to ongoing review.³

LTAs have happened in the past in high profile cases, such as *Railtrack*, *Metronet* and *Turner and Newall*. More recently, the retail company *Debenhams* announced its intention of using a LTA to turn around its business.⁴ There is evidence that several of UK retailers and restaurant chains such as *Oasis & Warehouse* intend to follow *Debenhams* down this road and are in talks to make use of LTAs during the COVID-19 pandemic.⁶

The management displacing aspect of administration arises out of a deeply rooted belief in English law that the party responsible for the company’s problems ought not to be left in control. However, the debtor’s crisis might be determined by external factors, such as the closure of a business due to Covid-19 emergency legislation and the ensuing downturn in the economy. In these circumstances, the argument that directors should be replaced because they are responsible for the company’s demise is less powerful. Hence, the need to explore solutions that retain the expertise of the existing management and workers, while

providing respite from financial problems.

LTAs seem to represent a valid mechanism to achieve this objective as they afford the company a breathing space in which the business can be stabilised and protected by individual actions from the creditors. In LTAs, the existing management team remains in place under the control and supervision of administrators. This debtor-in-possession approach emulates what happens during US Chapter 11 proceedings.

The idea behind the LTA is to protect the company when it cannot trade due to the lock-down measures or – more broadly – due to the consequences of the Covid-19 epidemic. Once these measures are lifted, the stores reopen and the economy bounces back, the staff who has been put on furlough will come back and there will be extra money injected by the current owners and lenders.

All these elements seem to suggest that LTAs represent a powerful tool to enhance the rescue options available to English companies and let breathe the otherwise under-used rescue procedure.

Davey v Money

The judiciary have also supported the use of LTAs. In *Davey v Money*,⁷ Snowden J gave three main guidelines on how to conduct these procedures:

1. Administrators have no obligation to consult on the shareholders and existing directors to decide the best course of action in insolvency;



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2. The persons who manage the company under the supervision of the administrator may be appointed or otherwise connected with the creditor who submitted the administration petition; and
3. There is no obligation to sell the debtor's assets in a competitive tendering process.

The decision in this case, however, may fail to properly put into practice the predicament that LTAs are not the modern version of old administrative receiverships.

The court held that the chosen objective should be open to challenge only if it was made in "bad faith or was clearly perverse". This threshold was not reached in the instant case despite the fact that the IP was constrained in the exercise of his functions as administrator by pre-appointment arrangements on fees with the secured creditor.

Furthermore, the court held that it is not necessary for the administrator to appoint property agents who are independent of the charge-holder. However, it is a well-established principle of common law that officers of the court like administrators should "maintain an even and impartial hand between all the individuals whose interests are involved" in the procedure. Referring the day-to-day management of the assets of a company to a non-independent party who has no duty or obligation towards the creditors as a whole is potentially a breach of the administrators' duties.

Finally, the court held that administrators will not necessarily breach their duties by selling real property following a 'soft marketing' campaign where only particular specialised and complex potential purchasers are targeted and contacted. It follows that, according to the Davey's guidelines:

- a) IPs have almost unfettered discretion to decide whether administration should take place as a pre-packaged, light touch or fully-fledged

- b) Courts exercise a light touch revision of the administrators' decisions, even if there is evidence of extensive negotiations between appointor and administrator before the commencement of the procedure, the persons in control of the company during administration are not independent of the charge-holder and the assets are not sold in a competitive tendering process.

The way forward

The analysis of these guidelines shows a pro-LTA attitude of the English commercial courts. If unchecked, this may favour the interests of some parties (mainly, the appointor and leading creditors) at the expense of other key, interested players. It is surprising, but, to a certain extent, encouraging that the light-touch approach has not been followed by other companies such as Antler⁹ that found themselves in a position comparable to *Debenhams*. It is to be hoped that the new emphasis on LTAs will not bring about a rise of phoenix practices, as well as issues of transparency and fairness similar to those observed with reference to pre-packs before the Graham Review and the ensuing reforms.

Some of the concerns raised in this paper might have been indirectly addressed by the recently enacted *Corporate Governance and Insolvency Act 2020*,¹⁰ which received Royal Assent on 25 June 2020. This Act introduces two new corporate restructuring tools:

1. A new moratorium to give companies breathing space from their creditors while they seek a rescue;
2. A new restructuring plan for companies in financial distress. This includes new cross-class cram down procedures that allow a class of creditors to be bound by the restructuring plan even if they do not agree to the plan (provided that dissenting creditors are no worse off

than they otherwise would be in the next most likely outcome and that the plan is fair and equitable and in the interests of creditors as a whole).

The new restructuring plan is a debtor-in-possession procedure modelled after the UK schemes of arrangement and the US Chapter 11 procedure. This could be used by companies with a connection to the jurisdiction or English law governed credit agreements or contracts, even if the moratorium is unlikely to have effect outside the UK.

There is no space here for a detailed analysis of the proposed restructuring plan. However, several features suggest that this plan is likely to replace LTAs in the future. First, the debtor-in-possession aspect is a key characteristic of the plan. Then, there is the possibility to combine the plan with a moratorium, even if this moratorium is narrower in scope than the one provided in administration. In fact, under the new moratorium all amounts falling due under financial contracts, including loan agreements, must continue to be paid during the moratorium. Finally, the cross-class cram down could potentially limit the ability of "hold-out" or ransom creditors to block a viable restructuring proposal which has the overwhelming support of those creditors who retain an economic interest in the business.

Conclusion

The administration procedure is open to abusive or at least opportunistic practices when debtors are allowed to run their business in LTAs. The guidelines provided by English courts do not seem to be exhaustive and appropriate. LTAs raise issues of transparency and fairness. However, it is expected that these issues will be confined to a few – albeit high profile – cases due to the rise of a new restructuring toolkit: the restructuring plan and moratorium outlined in the recent *Corporate Insolvency and Governance Act 2020*. ■



It is to be hoped that the new emphasis on LTAs will not bring a rise of phoenix practice, as well as to issues of transparency and fairness



Footnotes:

- 1 Insolvency Lawyer Association, "Changing the Narrative around Administration" (26 March 2020), available at: www.citysolicitors.org.uk/storage/2020/03/UKP1-ChangingtheNarrative.pdf
- 2 Paragraph 64, Schedule B1, Insolvency Act 1986.
- 3 Available at: www.r3.org.uk/technical-library/england-wales/technical-guidance/covid-19-contingency-arrangements/more/29356/page/1/the-consent-protocol-administration/.
- 4 J. Booth, "Debenhams administration could provide blueprint for 'freezing' companies during coronavirus crisis" (*City A.M.*, 6 April 2020), available at: www.cityam.com/debenhams-administration-could-provide-blueprint-for-freezing-companies-during-coronavirus-crisis/.
- 5 E. Jahshan, "202 immediate job cuts as Oasis & Warehouse files for administration" (*Retail Gazette*, 15 April 2020), available at: www.retailgazette.co.uk/blog/2020/04/202-immediate-job-cuts-as-oasis-warehouse-files-for-administration/.
- 6 J. Eley and T. Kinder, "Companies explore 'light touch' administration in the wake of Debenhams" (*Financial Times*, 16 April 2020), available at: www.ft.com/content/76c7e985-f83c-4707-b4e4-28eb7a817b62.
- 7 *Davey v Money* [2018] EWHC 766 (Ch), [2018] Bus. L.R. 1903.
- 8 *Re Contract Corp* (1872) 7 Ch App 207, 211. The judgment was issued with reference to the duties of liquidators in a winding-up procedure but it applies to all officers of the court.
- 9 E. Thicknesse, "Luggage brand Antler collapses into administration" (*City A.M.*, 19 May 2020), available at: www.cityam.com/luggage-brand-antler-collapses-into-administration/.
- 10 For the text of the Corporate Insolvency and Governance Act 2020, see: www.legislation.gov.uk/ukpga/2020/12/contents/enacted.