Crisis management & insolvency

Chloe Shuffrey discusses 'light touch' administration as a rescue tool during the pandemic

IN BRIEF

- The consent protocol: key powers.

On 28 March 2020, the Department for Business, Energy, and Industrial Strategy (BEIS) announced a series of insolvency legislation reforms including a new court-based restructuring tool modelled on the Scheme of Arrangement and a short business rescue moratorium to protect companies facing the prospect of insolvency while they establish a rescue plan. While it is hoped that these new tools will provide a lifeline to many companies being pushed to the brink of insolvency as a result of the COVID-19 crisis, the full detail of the proposals and the relevant legislation remain unclear.

In the meantime, the insolvency profession has been gearing up to adapt the insolvency tools we currently have to meet the crisis, and in particular advocating the 'light touch' administration (currently being trialled by Debenhams, among others), whereby the administrators leave certain management powers and, essentially, the day-to-day running of the business with directors whilst they focus on devising a strategy to preserve the long-term viability of the company.

Administration would indeed appear to be the most effective tool for many companies facing immediate difficulties, providing as it does the protection of a moratorium from adverse creditor action together with a flexible framework in which to implement a rescue strategy and compromise the debt that is being accumulated in lockdown. WhilE CVAs have also been part of the discussion, and may of course be more appropriate in some circumstances, the difficulty is that they are generally premised on realistic forecasts of a company's future profitability and accurate asset valuation. At present there are likely to be three unknowns which make such forecasting extremely difficult, if not meaningless, for many companies, namely:(i) how long the current restrictions will remain in place: (ii) the rate of recovery: and (iii) the likelihood of a return to the status quo ante.

While those unknowns are, of course, also relevant to administration and will impact key decision-making by administrators, not least their ability to identify whether the company can meet the primary statutory objective of the company's being rescued as a going concern, the administration procedure is a highly flexible one which allows for manoeuvre and revision, eg, administrators may make substantial revisions to their initial proposals (para 54 of Schedule B1 IA86) to take account of changing circumstances.

The consent protocol

With a view to repurposing administration for effective (and affordable) use by swathes of companies which will need the protection of a moratorium but fear the costs associated with administration, the Insolvency Lawyers Association (ILA) and City of London Law Society (CLLS) have circulated a draft 'Consent Protocol' (the protocol) drafted by members of South Square, which administrators may enter into with directors pursuant to para 64 of Schedule B1 IA86. The protocol comprises four parts and, importantly, is prefaced by a declaration by the administrators that they only provide their consent for directors to exercise the powers on the basis that they have certified that that the administration is reasonably likely to achieve the rescue of the company as a going concern and are reasonably satisfied that the company has sufficient funding to pay essential key post-administration costs such as rent, employee salaries, utilities and suppliers on an on-going basis.

Part 1 of the protocol sets out (as illustrative examples) key powers that may be retained by directors, including powers: to manage, instruct and direct the company's employees; to acquire and dispose of stock-in-trade; to enter into contracts for the provision and receipt of services; to pay employee salaries; power to make payments in respect of other services; to incur credit with suppliers; and to enter into or renew specified types of contracts.

Importantly, these powers are subject to monetary limits to be determined at an appropriate level by the administrators taking into account the company's circumstances.

Part 2 sets out the conditions on which the powers are exercisable by the directors including that the powers are to be 'exercised only for the purpose of achieving the rescue of the company as a going concern.' The conditions include, under the sub-heading 'Control and Monitoring', a number of reporting duties or obligations on the part of the directors, such as informing the administrators immediately of any fact or information which would suggest to a reasonable person that there is no longer any reasonable prospect of achieving the rescue of the company as a going concern, providing to the administrators regular management (and/or other) accounts and reports on the business and affairs of the company, and complying promptly with any request for information that the administrators require.

Part 3 sets out certain restrictions to the directors' powers, namely that they may not, without the administrators' consent, do certain acts such as enter into new employment contracts, negotiate or vary the terms of any business lease, negotiate or vary the terms of any contract for services defined in s 233 IA86, or borrow money. Part 4 enables the administrators to vary or terminate the consent at any time.

The protocol has thus been devised to minimise the costs of an administration and streamline the process. In leaving the day-to-day management of the business with directors, it enables administrators to focus on their key role of restructuring debt and/or otherwise implementing a strategy to preserve the long-term viability of the company. This also crucially addresses the huge time constraints administrators are likely to face given the sheer number of appointments they are likely to have. At the same time key controls are retained by the administrators, the most obvious being the monetary limits attaching to the directors' powers and the administrators' power to terminate their consent.

An issue over personal liability

Administrators are likely nevertheless to have concerns about relaxing the tight control they might ordinarily expect to exercise in an administration and whether they will be exposed to claims making them personally liable for actions and possible mismanagement by directors during the administration period.

Administrators only face personal liability for losses if they are referable to a breach of duty on their part. Turning back to basic principles, administrators must carry out their functions in the interests of the company's creditors as a whole (para 3(2), Schedule B1 IA86), but they are accorded considerable latitude in the way they go about the exercise of their powers so as to achieve the relevant statutory purpose.

It is worth considering the recent case of *Davey v Money* [2018] EWHC 766 (Ch) which contains a helpful review of administrators' powers and duties. In that case it was held *per* Snowden J that 'Parliament intended a degree of latitude to be given to an administrator in deciding upon the objective to be pursued, and that *he is not lightly to be second-guessed by the court with the benefit of hindsight*' [255], that 'the appropriate standard of review by the court should be one of *good faith and rationality*' [255]; and the administrator's decision was only open to challenge 'if it was made in bad faith or *was clearly perverse*' [255] (emphasis added).

Snowden J went on to say that 'the assessment of the practicality of following one or other objective (eg whether a company which is insolvent or on the brink of insolvency can be rescued) will most likely require the exercise of a substantial amount of commercial judgment, often under significant time pressures. I see no good reason to adopt any more interventionist standard of review of an administrator's opinion in this regard than is applied more generally by the courts to the question of whether to interfere with specific business decisions taken by administrators: see e re *Egdennote Ltd* [1996] 2 BCLC 389.'

While Snowden J was specifically considering the question of interference with an administrator's decision regarding which of the statutory purposes to pursue, the same deferential standard of review is applied generally to administrators' decisions: In *re Edennnote Ltd* confirmed that 'the court will only interfere with the act of a liquidator if he has done something so utterly unreasonable and absurd that no reasonable man would have done it' (the reasoning applies equally to administrators as it does to liquidators).

Many companies may well face trading losses in the course of a trading administration notwithstanding that the statutory purpose of rescuing the company is likely to be achieved. In my view the issue whether an administrator would be held liable for losses incurred by the directors' day-to-day running of the business under the protocol during the administration period is likely to turn on whether the administrator's decision to enter into the protocol—such as it is, having been appropriately drafted and modified with respect to the particular company—could properly be impugned. The person seeking to challenge that decision would have to demonstrate that it was made in bad faith or was so utterly unreasonable and absurd that no reasonable administrator would have done it. Seeking so to persuade a court with respect to administrators' actions is not easy in the best of times; it would be a difficult argument indeed in the context of an administrator's best endeavours to preserve an otherwise viable company subject to acute and unprecedented financial distress. The intense economic uncertainty as to the long term impact of the present crisis renders it all the more difficult for any would-be claimant to persuade a Court that an administrator has acted irrationally.

Additionally, as the Explanatory Note to the protocol suggests, administrators will need to ensure that they comply with their 'Control and Monitoring' role, as envisaged and particularised in Part 2 of the protocol. The Explanatory Note comments that '[i]t is envisaged that, where the Joint Administrators have complied with their Control and Monitoring Role, they will have fulfilled their broader duties to stakeholders, and their conduct will not be open to challenge under IA86.' Administrators will also need to ensure that they exercise their power to terminate the protocol rationally (eg, where they believe that it is no longer reasonably likely that the company can be rescued as a going concern or where the directors have not complied with the terms of the protocol).

The impact on 'unfair harm' claims

Similar considerations apply in respect of creditors' 'unfair harm' claims pursuant to para 74, Schedule B1 IA86 for example, in respect of a possible claim by creditors in general that administration expenses incurred during a light touch administration have caused loss to all of them. It was held in the recent case of *Re Meem SL* [2018] Bus. L.R. 393 that 'in a case where there is no differential treatment of creditors, the *court will not interfere with the administrator's decision […] unless* the decision *does not withstand logical analysis. This probably means the same thing as perversity*' (emphasis added). In my view it will be difficult for creditors to succeed in any such unfair harm claim arising from the administrators' decision to enter into the protocol because such is likely to be regarded by the court as being the result of a commercial, cogent, and reasoned decision, justified by reference to the interests of the creditors as a whole and/or to achieving the objective of the administration.

Some comfort for administrators

The key decision for administrators will be whether they certify that the administration is reasonably likely to achieve the rescue of the company as a going concern and they are reasonably satisfied that the company has sufficient funding to pay essential key post-administration costs as the conditions upon which they enter the protocol. That will inevitably involve a very difficult assessment based on many unknowns, but the authorities confirm that the Courts will not second guess an administrator's decision with the benefit of hindsight. Furthermore, the administrators are free to adapt the protocol to the requirements of the company in question. It is thus open to them to attach further conditions or provisos as the basis on which they enter the protocol, which may be subject to review as economic circumstances change, thus rendering their decision and exercise of powers even less assailable.

Once the administrators have decided that they are satisfied that the company may be rescued as a going concern (subject to any provisos considered appropriate), and enters into a 'light touch' trading administration, the protocol with its inbuilt controls (so long as these are reasonably and appropriately drafted with respect to the particular circumstances of the company), should serve to protect rather than expose the administrator.

There has already been an encouraging indication from the Courts that they recognise the importance of administration as a means of preserving companies through the current crisis. Snowden J's recent judgment in *Re Carluccio's (In Administration)* [2020] EWHC 886 (Ch) not only provides comfort to administrators fearful of accumulating administration expenses that employment contracts may be adopted in such a way that only requires payment of wages and salary at a level equal to the grant received under the scheme in respect of the employee, but also provides more generally reassuring comments that 'promotion of the rescue culture is an important consideration when interpreting the Insolvency Act' and that 'in the current situation […] such an approach may be needed more than ever before'.

Insolvency practitioners should, in appropriate cases, be emboldened to make use of 'light touch' administration and the protocol to preserve and steer viable companies through the current crisis. **NLJ**

Chloe Shuffrey, barrister, 3 Hare Court, Temple (*www.3harecourt.com*).