

Changing the Narrative around Administration

The economic impact of COVID-19 has triggered calls for emergency fiscal and legislative measures to address liquidity and legal problems. In August 2018, the UK Government issued proposals for certain reforms to the corporate insolvency regime, and it is possible that new tools will be introduced into the English corporate insolvency law toolbox as part of the legislative reform process¹ But whether these reforms are implemented or not, practitioners should not discount the use of administration, either as a standalone process or in combination with other English law tools. For some of the problems which businesses are currently encountering, we already have a tried and tested workable rescue tool in the shape of administration..

It is vitally important, as businesses across the UK battle the enormous challenges posed by the COVID 19 crisis, that we remember that England has some of the most flexible and adaptable corporate restructuring processes anywhere in the world. In the decade since the financial crisis, lawyers and their clients have become used to resorting to the administration procedure only when other efforts to restructure have failed. There is a danger, therefore, that the narrative in the broadcast and press media, and among directors around the country, becomes that filing for administration inevitably means collapse and that, somehow, the US chapter 11 process is a better restructuring tool. Yet this fundamentally ignores the flexibility to mobilise administration to stabilise, protect, and, if necessary, restructure companies. The purpose of this brief note is to remind us all how administration can be used in this way.

Note that the thoughts set out in this paper are not intended as an alternative to other measures that are being considered (such as suspension of the wrongful trading provisions or the advancement of the corporate insolvency reforms referred to in the 2016 consultation paper). Those measures are still important and necessary. Rather, this paper is about reminding people that there is a restructuring tool already in existence that can be used in appropriate cases.

Administration as a stability and restructuring mechanism

The first purpose of any administration is to rescue the company.² Only if certain conditions are met, can the administrator move down a hierarchy of other purposes, but in the decade since the financial crisis administrators have commonly done so. Despite its primary rescue purpose, administration has to date primarily been used as a quasi-liquidation procedure or as a means of delivering the most attractive assets in a business to a new buyer or existing management team freed of some or all of its liabilities. But the starting point of the administration process is to rescue the company and in many COVID-19 related cases that will be the purpose of the filing. In this context, administration is a powerful tool to prevent the value-destructive race for assets by

¹ Department for Business, Energy and Industrial Strategy, *Insolvency and Corporate Governance: UK Government Response* 26 August 2018 available at: https://assets.publishing.service.gov.uk/uploads/system/uploads/attachment_data/file/736163/ICG - Government_response_doc_-_24_clean_version_with_Minister_s_photo_and_signature_AC.pdf

² Insolvency Act 1986 Schedule B1 paragraph 3(1)(a)

individual creditors, providing management with a breathing space in which to determine how best to preserve value for creditors as a whole.

Administration as a debtor-in-possession procedure

One reason why we associate administration with collapse is because it is widely seen as a management-displacing procedure. In fact, it is significantly more flexible than that. While the relevant statutory provisions do provide that an officer of a company in administration cannot exercise a management power without the consent of the administrator, the administrator can decide to leave management powers with those officers.³ Indeed, this has been done in the past in high profile cases such as Railtrack, Metronet and Turner and Newall. It seems likely that there are many cases arising out of the COVID-19 crisis where it would be appropriate to do so again, and there is no reason why it cannot be done in smaller cases where it could keep costs down.

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. That is clearly a much less significant concern where the challenges arise out of the wholly exceptional circumstances of the COVID-19 crisis. Many companies are likely to be facing severe liquidity crises, so that the ability to keep administration costs down by leaving the administrator only to fulfil their essential functions is likely to be a priority. And the purpose of many of these administration filings will be to stabilise and rescue the company. The directors know the business best, and with expert (more in the nature, perhaps, of a CRO) assistance provided by an administrator (or where necessary the court), in the circumstances which many businesses are facing, are most likely to be able to stabilise the situation and keep the company on an even keel. It is important to note that this does not involve the delegation of powers from the administrator to the directors. Rather, the administrator simply consents to management retaining the powers which they already have so that they can get on with running the business.

Administration and payment of creditors

Administration provides a highly flexible environment in which to make essential payments and to pause other payments, in order to stabilise and protect the business, and create much-needed liquidity, if necessary while a longer-term plan is worked out. While the starting point is that pre-filing liabilities are not paid, the administrator retains the flexibility to make any payment if he determines that that would assist the achievement of the purpose of administration.⁴ This will, of course, require careful working out. But administrators are very experienced at working out who has to be paid in the interests of the creditors as a whole. This enables the company (with the assistance of the administrator) to work with its creditors to determine which payments must be made, and which can sensibly be paused, in order to stabilise and protect the business in the interests of all stakeholders.

Administration and new money

Administration also offers a more flexible mechanism for getting new money into the company: likely to be a pressing need for many companies as the COVID-19 crisis unfolds. An administrator has the power to raise or borrow new money, and any debt or liability arising out of a contract which the administrator enters into achieves a priority ranking over most of the company's existing

³ Insolvency Act 1986 Schedule B1 paragraph 64

⁴ Insolvency Act 1986 Sch B1 paragraph 66 and Schedule 1 paragraph 13

liabilities.⁵ To the extent that difficult questions arise about restrictions in existing contracts, the administrator has the power to apply to court for directions and there are mechanisms which can be engaged in order to navigate those challenges.

Administration and restructuring

For some companies, it may simply be enough to use administration to afford the company a breathing space in which the business can be stabilised and protected during the extraordinary circumstances which we face. Others, however, will inevitably need to restructure some of their liabilities before they can emerge from the period of stabilisation and protection. English law already has two flexible and adaptable corporate restructuring mechanisms, the company voluntary arrangement and the scheme of arrangement, which can be used in conjunction with the administration for this purpose, and if the UK Government reform proposals are progressed (when Parliament reconvenes), there may be a third tool in the shape of the new restructuring plan procedure. In addition, there are other mechanisms, which can be engaged in the administration process to achieve a restructuring transaction.

Administration, Government stabilisation measures and the expenses regime in a restructuring case

An administrator may be able to take advantage of some of the financial measures announced by the Government. For example, the ability to “furlough” employees for a period of time helps preserve the value in the business which may not be able to trade due to current restrictions. In addition, the Government has announced a number of grants for UK businesses. Coupled with the breathing space afforded to a company in administration, these measures provide additional support and could help stabilise the business. There may be further work to do to understand how the Government measures interact with the administration regime. New questions may arise about the application of the administration expenses regime to the Government measures,⁶ and clarity will be needed about any specific demands which will be made of an administrator. Furthermore, new questions may arise about the interaction between actions which the administrator takes where he is proposing to restructure the company (such as retaining property while he works out the scope of the restructuring plan) and the administration expenses regime. The ability to apply to court for directions is likely to be important here, at least in early cases, while the relatively high-level nature of the statutory scheme provides scope for the courts to consider how the principles ought to apply to entirely new and unprecedented factual matrices.

Administration and termination of contracts

Current, first instance authority suggests that the moratorium which arises on an administration does not prevent termination of contracts or the exercise of set-off rights.⁷ However, this will not be a concern for all companies, and in many cases it seems likely it will be possible to navigate the challenge given the consequences of terminating contracts or exercising set off rights in the current circumstances. Moreover, it may be possible to use other mechanisms to address these issues.

⁵ Insolvency Act 1986 Sch B1 paragraph 99(4)

⁶ Insolvency Act Schedule B1 paragraph 99

⁷ *Re Olympia & York Canary Wharf Ltd* [1993] BCC 154

The Administrator

A significant benefit of the English law administration process is the role of the administrator. Administrators are qualified, licensed and regulated practitioners with the skills and experience to protect and stabilise businesses, which face financial challenges. This means that it is possible to keep applications to court to a minimum (indeed the appointment process itself can be conducted without a formal hearing at all), reducing the costs of the process and the speed at which decisions can be taken, when compared with other jurisdictions where the relevant regimes implicate significant amounts of court time.

The Legal Community

England also benefits from a highly expert legal community, which has the initiative and the experience to adapt England's deliberately flexible regime to meet the demands of the day. Our last challenge was to adapt this regime to meet the demands of financial restructuring, and English lawyers rose to that challenge by turning to a procedure (the scheme of arrangement) which had been rarely used since the Second World War and adapting it to meet modern demands. The new challenges are different: problems are unlikely to be contained in the capital structure; in many cases stress will have spread to the operations of the business; and the liquidity needs are likely to be immediate and urgent as the UK government has recognised by implementing economic measures to support business. We need to adapt our regime in new ways to meet this challenge demonstrating, once again, the world-leading flexibility which English corporate restructuring law offers. This may require us to get to grips with new tools, or it may require us to adapt our existing regime, but, in both cases, we should not forget that administration may have a role to play as a mechanism to stabilise, protect, and where necessary restructure businesses.

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