Companies in administration: an overview

SLAUGHTER AND MAY

DECEMBER 2011
Contents

1. Appointment 01
2. Effect of appointment on management and directors’ powers 02
3. Role of administrator 03
4. Effect of administration on contracts 04
5. Impact on company pension schemes 05
6. Bringing the administration to an end 05
Introduction

This note provides an overview of what happens to a company when it goes into administration. It briefly summarises the mechanics of the appointment of an administrator before considering such matters as the impact on management and the directors’ powers, the administrator’s role and the effect of administration on the company’s contracts.

1. APPOINTMENT

1.1 Procedure

An administrator may be appointed either by applying to the court for an administration order or by filing papers with the court documenting an out of court appointment. A modified form of the procedure is used for failing banks and building societies and specific entities such as the utilities companies. For practical purposes it is common for more than one administrator to be appointed to the company, in which case they will normally agree to act jointly and separately.

A court-based appointment will usually be made by the company’s directors or creditors. An out of court appointment may be made by the company or its directors or by a secured creditor who is the holder of a “qualifying floating charge” ("QFC"). For a charge to be a qualifying floating charge it must either alone or with other charges held by the same person constitute a charge over the whole, or substantially the whole, of the company’s property.

For applications other than by a QFC holder, it will be necessary to show that the company is or is likely to become unable to pay its debts.

A QFC holder, in contrast, is able to appoint an administrator at any time when an event has occurred that would allow him to enforce his charge (usually where there has been a default under a loan agreement). Note that in a court-based application, even if the relevant criteria are satisfied, the court still has discretion as to whether or not to make the administration order.

In all cases, the proposed administrator must provide an opinion that the statutory purpose of administration (set out as a cascade of objectives in the Insolvency Act 1986) is reasonably likely to be achieved. The primary objective is the rescue of the company as a going concern. Only if this is not reasonably practicable, or there would be a better result for the creditors as a whole, does the second objective apply. The second objective is to achieve a better result for the creditors as a whole than would be likely if the company were wound up without first being in administration; for example, by continuing to trade and then selling the business or parts of it as a going concern. Only if the second objective is not reasonably practicable does the third objective, of realising the company’s property for the benefit of one or more secured or preferential creditors, apply.
1.2 Moratorium

Once an application has been filed at court, or a notice of intention to make an appointment out of court has been given to any secured creditor who is entitled to appoint an administrator or administrative receiver or any other person entitled to notice, an interim moratorium will automatically arise. The purpose of the interim moratorium is to protect the company and its assets from creditor action in the short period until an administrator is appointed. During this period, unless leave of the court is obtained, the company may not be wound up except where the Secretary of State or the Financial Services Authority presents a petition on public interest grounds. There will also be a stay on enforcement of security and on all legal processes and proceedings against the company. Goods held under leasing, hire purchase, conditional sale or retention of title agreements may not be repossessed and a landlord may not exercise their right to forfeit any leases of the company’s proceedings. However, a QFC holder may appoint an out of court administrator or an administrative receiver and a petition to wind up the company may still be presented.

Where a QFC holder or the company (or its directors) is able to appoint an administrator immediately, because there is no one to whom notice must be given, there will be no interim moratorium as the full moratorium, which otherwise comes into effect when the administrator is appointed, will have immediate effect upon the filing of the notice to appoint an administrator. Once the full moratorium comes into effect an administrative receiver may no longer be appointed and (depending on the appointment procedure used) winding-up petitions are either dismissed or suspended.

2. EFFECT OF APPOINTMENT ON MANAGEMENT AND DIRECTORS’ POWERS

Upon appointment the administrator takes over the management of the affairs, business and property of the company as its agent and has a wide range of powers at his disposal. As he will be under a duty to act for the benefit of all creditors he is likely to impose additional controls over the company’s operations. The directors continue to hold office but cannot exercise any management powers without his consent which means that in some cases their powers and duties, like those of the company secretary, are likely to be significantly diminished.

There are no fixed rules which apply to managing a company while in administration. In a court-based appointment rules may be included in the accompanying court order, if there has been time to prepare for the administration. These will otherwise be determined by the administrator. There is often a period of dialogue between the administrator and the directors (which may last a few days or a few weeks depending on the administrator’s knowledge of the business) to determine whether the services of the relevant directors are likely to be required during the administration. This period of dialogue is likely to be particularly relevant to the executive directors who are involved in the day-to-day management of the company and who are arguably more likely to be required to provide ongoing assistance to the administrator.

In a trading administration, or where the administrator is satisfied with the company’s processes and controls, he may decide to leave some or all powers with the directors. Note that certain requirements of company law for directors, for instance to submit annual returns and accounts to the registrar of companies, will continue to apply but are unlikely to be enforced.
The administrator is also entitled to remove any of the directors from office and to appoint new directors although this is unlikely in practice. If a director or other officer is removed, the company may be liable in damages for breach of their employment contract. In some circumstances the company may also be liable in damages if any of the directors decide to resign from their positions, which they are entitled to do.

3. ROLE OF ADMINISTRATOR

3.1 Information gathering

Directors, former directors and other persons involved with the company are under a duty to co-operate with the administrator. Broadly, this duty imposes on them an obligation to give the administrator such information concerning the company and its promotion, formation, business, dealings, affairs or property as he may reasonably require, and to attend meetings with him as necessary.

As soon as reasonably practicable after his appointment, the administrator will require one or more of the current or former directors or other officers to provide him with a statement of the company’s affairs. This statement details the company’s assets and liabilities, including those assets that are subject to any fixed or floating charges, and enables the administrator to assess the company’s financial position and suggest proposals to be implemented during the administration. It is arguable that executive directors should be better placed to assist with the preparation of the statement than non-executive directors.

Unlike a liquidator, an administrator does not currently have the power to seek a court order against directors for a contribution to the company’s assets if his investigations reveal incidences of wrongful or fraudulent trading. He may, however, set aside transactions at an undervalue, preferences and transactions defrauding creditors in the same way as liquidators and is required, under the Company Directors Disqualification Act 1986, to submit a report to the Secretary of State for Trade and Industry on the conduct of the directors and former directors of the company within six months of the company entering administration.

3.2 Notices and creditors’ meetings

As soon as reasonably practicable after his appointment, the administrator is required to obtain details of the company’s creditors and to notify the company and all of its creditors of his appointment. The appointment must be advertised in the London Gazette and in a newspaper likely to bring it to the attention of the company’s creditors. The registrar of companies must also be notified. The administrator is also likely to immediately notify the company’s bankers of his appointment and may terminate existing bank mandates to take control of the company’s bank accounts.

Within eight weeks of his appointment the administrator must send a statement of his proposals to all creditors and members of the company, and file a copy of the proposals with the registrar of companies. In complicated cases, he may apply to court to have this period extended. An invitation to an initial creditors’ meeting, which must usually be held within ten weeks of his appointment, will be included with the copy of the administrator’s proposals sent to each creditor.

In certain circumstances the administrator will have the power to sell the company’s assets prior to the initial meeting and without the consent of the creditors. A person who deals
with an administrator in good faith and provides valuable consideration need not enquire whether he is acting within his powers. Thus a purchaser of assets from the insolvent company will not normally need to check the authority of the administrator.

The administrator is not required to hold an initial creditors’ meeting if he states either that the company has sufficient property to enable every creditor of the company to be paid in full or that the company has insufficient property to enable a distribution to be made to unsecured creditors other than from the statutory prescribed part for unsecured debts (the prescribed part represents a proportion of the proceeds of the sale of assets subject to any floating charge, up to a maximum of £600,000, which is set aside for the benefit of unsecured creditors). A meeting must however be summoned if 10% in value of the creditors demand it.

3.3 Publicity

While a company is in administration, every business document issued by or on behalf of the company or the administrator must state the name of the administrator and that the affairs, business and property of the company are being managed by him.

4. EFFECT OF ADMINISTRATION ON CONTRACTS

4.1 Contracts generally

The company’s contracts do not automatically terminate when it enters administration and the administrator (unlike a liquidator) is given no express power to disclaim a contract if “onerous”. He may nonetheless, after weighing up the interests of the company against those of the creditors, decide on a balance of fairness test not to perform the contract if non-performance would help to achieve the purpose of the administration. If he does disregard a contract in this way, then the counterparty to the contract may seek an order for specific performance. If the court declines to make such an order, the counterparty will have an unsecured claim against the company for any loss incurred.

Other than in respect of a landlord’s right to forfeit a company’s lease (which may not be exercised while the moratorium is in place), the moratorium does not prevent counterparties from terminating contracts with the company and it is a typical term of many contracts that they may be terminated upon the company entering into an insolvency procedure such as administration. The administrator may therefore need to negotiate the continuance of contracts with the company’s key suppliers and customers in order to enable the company to continue trading.

4.2 Employment contracts

While the appointment of an administrator will not operate to terminate the contracts of employment of the company’s employees, the administrator does have powers to terminate them and will do so if they are inconsistent with the running of the business. He has fourteen days in which to decide whether or not to “adopt” them. If he does so, wages and salary (including holiday pay), sick pay, payments in lieu of holiday and contributions to occupational pension schemes incurred after adoption will be paid in priority both to the administrator’s fees and expenses and to any monies payable to floating charge holders.

Employees who are made redundant may have a claim against the National Insurance Fund (“NIF”) for statutory redundancy payments up to a prescribed limit (and the NIF will then claim against the company for those amounts).
employees will prove in the administration for any other claims they have against the company, some of which, again up to a prescribed limit, may have preferential status.

If the business of the company is sold, the operation of the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE") may apply to protect the position of the employees. Note that the interpretation of TUPE is not straightforward and some difficult issues in relation to its precise scope remain to be resolved.

5. IMPACT ON COMPANY PENSION SCHEMES

The funds of any pension scheme sponsored by the company generally have immunity from the company’s insolvency. There are, however, a number of areas of concern which the administrator may need to address. These include whether surplus funds can be recovered from the pension fund for the benefit of creditors, whether contributions to the scheme should be continued, whether the pension scheme trustees have a claim against the company in respect of an underfunded scheme and whether pensions obligations affect the chances of selling the business.

If amendments to the pension scheme are required the administrator will be able to use his wide-ranging powers of management to agree to these.

Directors who are trustees of the pension scheme may have to resign from their positions as trustees in order to avoid a conflict of interests and in some circumstances the Pensions Regulator may decide to appoint an independent trustee.

6. BRINGING THE ADMINISTRATION TO AN END

The administration will end automatically after one year unless, as is often the position in large or complex cases, the administrator’s term of office is extended with the consent of the creditors or the court.

Where the administrator is appointed by the company or its directors, or by the holders of a floating charge, he may end the administration when the purpose of the administration has been sufficiently achieved. If the secured creditors are likely to be paid in full and funds remain for a distribution to made to any unsecured creditors he may decide that the administration should terminate in a creditors’ voluntary liquidation. Otherwise, he may conclude the administration by way of a company voluntary arrangement, a scheme of arrangement or a compulsory liquidation. If there is no property for distribution to creditors, the administrator may decide to dissolve the company.

In certain limited circumstances, an administrator appointed under a court order or by a creditor can apply to the court to end the administration.

This note provides an overview of companies in administration and is not intended to contain definitive legal advice, which should be sought, as appropriate, in relation to any particular transaction. If legal advice is required, please refer to George Seligman, Ian Hodgson, Sarah Paterson or Ian Johnson (or your usual contact) at Slaughter and May.