SQUIRE PATTON BOGGS

Administration

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This quick guide sets out an overview of an administration, explaining the procedure, objectives, and effect on third parties.

It is designed to give an overview, and is not intended to – and does not – constitute legal advice. If you wish to discuss anything in this guide in more detail, please contact one of the key contacts at the end of this guide.

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Overview of Administration

The primary purpose of administration is to try and rescue a company that is insolvent or likely to become unable to pay its debts, on a going-concern basis, by selling the business and assets of the company to a third party (sometimes former management) for a price that provides the best return to creditors.

In most cases, the company's directors will take steps to place the company into administration with assistance from its professional advisers.

Once appointed, there are a number of things that an administrator may do. If a buyer has not already been identified (see below for an explanation of a pre-pack sale) the administrator will look for a purchaser to buy the business and assets of the company and may do that in conjunction with continuing to trade the company while a buyer is sought.

In some cases, the company will cease to trade for a short while before the business and assets are sold, and in other cases, if a buyer for the business cannot be found, the administrator will simply sell the assets and the company will stop trading.

There are three objectives to an administration to:

(a) Rescue the company as a going concern

(b) Achieve a better result for the company's creditors as a whole than would be likely if the company were wound up

(c) Sell the company's property in order to pay one or more secured or preferential creditors.

How Are Administrators Appointed?

It is usually the directors of the company, or the company (i.e. the shareholders) who will take the necessary steps to appoint administrators. Sometimes, it will be necessary to make an application to court (for example if there is an outstanding winding-up petition) but more often than not, the directors will make an "out of court" appointment.

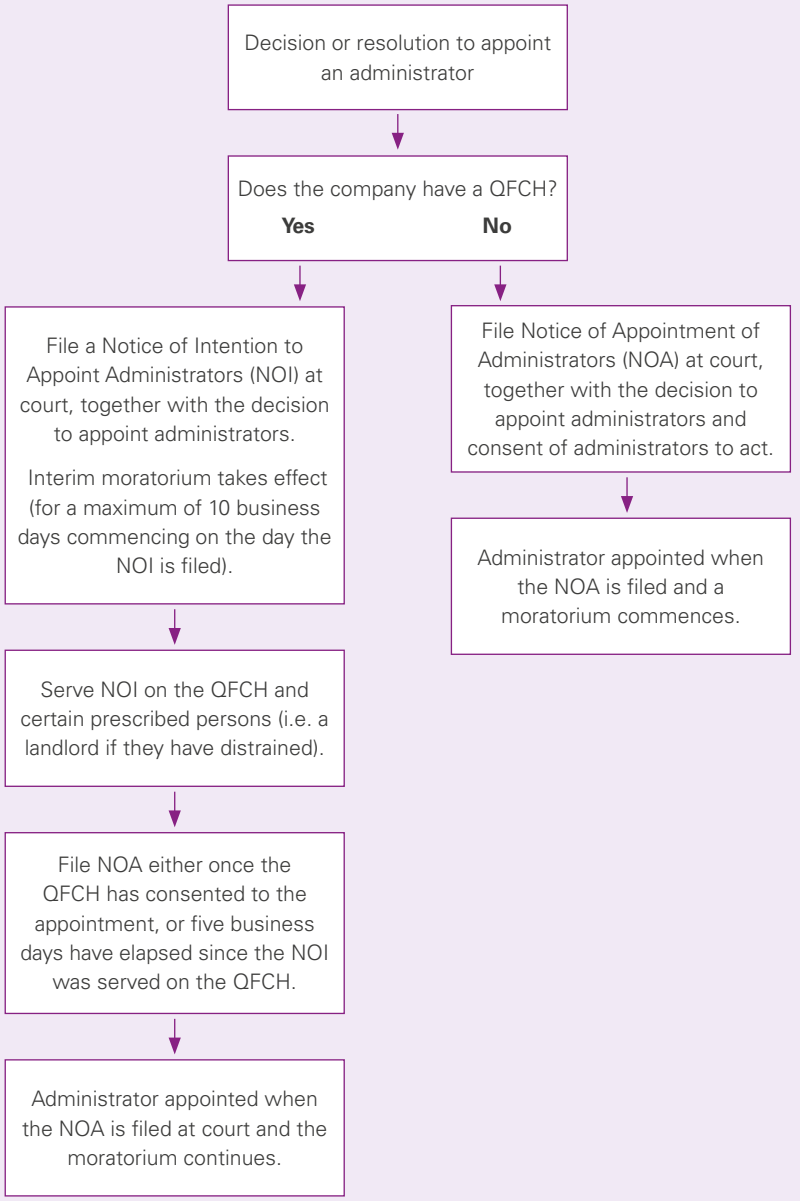
An out of court appointment is made by the directors filing certain documents at court (see below) and although the process is relatively straightforward, it is important that the process is followed carefully to ensure that the appointment is effective.

In some cases, a qualifying floating charge holder (QFCH) – usually the company's primary debenture holder – will appoint administrators. This is usually only done where there is a reason why the directors cannot appoint, e.g. if there is an outstanding winding up petition issued against the company or if the directors are not cooperating with the QFCH.

It is also possible for other creditors of the company to apply to court to appoint administrators, although this is rare.

Steps Required To Appoint Administrators

The below sets out a high level overview of the administration appointment process by the directors or shareholders



What Is the Role of an Administrator?

An administrator is a licenced insolvency practitioner who has wide reaching powers to do anything necessary or expedient for the management of the affairs, business, and property of the company.

An administrator essentially steps into the shoes of the directors but acts as an agent of the company, not an officer. In most cases, two administrators are appointed who will act jointly and severally during the course of the administration.

When in office, administrators will do such things as:

- Take possession and control of the company's assets
- Sell the company's business and assets – this will include negotiating and agreeing any sale contracts
- Propose a company voluntary arrangement, restructuring plan or other rescue mechanism
- Deal with employees and their claims. This may include making redundancies
- Deal with creditors and their claims
- Bring or defend legal proceedings on behalf of the company
- Make payments, e.g. to suppliers if the company is continuing to trade
- Investigate the conduct of directors
- Assess whether there are claims against the directors/others and pursue those where appropriate (e.g. if there has been a previous sale at an undervalue of the company's assets)

Effect of Administration on Third Parties

Directors

Once administrators are appointed, directors are not excused from their directors' duties; however, they can only act if the administrators have agreed they can. It is unusual for directors to be involved in any decision making, but they are under a statutory duty to cooperate with the administrators, and it is likely that they will be asked to do so. For example, they are likely to be asked to provide information and documents regarding the company or explanations for past transactions.

Unsecured Creditors

When a company enters administration (or files an NOI – see above flowchart), a moratorium takes effect. This means that creditors cannot commence or continue with any legal proceedings against the company or its assets without the permission of the court or the administrators (where an NOA has been filed).

Creditors will receive a copy of the administrators' proposals – which will explain what it is that the administrators hope to achieve – and be asked to approve those.

During the course of the administration, creditors will (unless they "opt out") receive updates from the administrators explaining what they have done and what they still have to do in the administration. In some cases, creditors may be able to join a creditors committee in order to help fulfil the administrator's functions.

Creditors will also be asked to provide a proof of debt, usually with supporting evidence, to show what they were owed by the company at the point it entered administration. Unless a creditor holds security for its debt, or fall within a classes of preferential creditor, they will be an unsecured creditor.

The administrators are required to ringfence a maximum of £800,000 from any floating charge realisations, which will be used to pay a dividend to unsecured creditors, although, in reality, unsecured creditors are unlikely to receive a significant payment.

Employees

The position of employees once a company has or is about to enter administration can be quite complicated and, therefore, they should seek specific advice, but there are a few key points to note.

- When a company goes into administration it doesn't mean that employees are automatically dismissed.
- If the administrator decides to trade the company, then employees who are asked to work during that period will be paid, and, if that period of trading lasts longer than 14 days, the administrator will likely adopt the contracts of those employees who continue to work in the business (essentially meaning that they must honour them).
- Often, the administrators will try to sell the business, and, if they do, in most cases TUPE (Transfer of Undertakings (Protection of Employment) Regulations 2006) will apply, and the employees and their contracts will automatically transfer to the buyer.
- In cases where the company ceases trading, and/or the business is not sold, employees will likely be made redundant.
- If the administrators make redundancies, there is unlikely to be a long period of consultation, which employees might otherwise expect if the company were solvent.
- If employees have unpaid wages at the date the company went into administration, there are certain claims and amounts that they will be able to recover from the Redundancy Payments office – usually, the administrators will help with this.

Suppliers

If a company continues to trade while in administration, then it is likely that the administrators will want to continue to place orders with the company's existing suppliers. If the supplier agrees to this, then the supplier will be paid for any supplies made during the administration period.

In some cases, suppliers have no legal choice and must continue to supply. There is a prohibition on a supplier terminating certain supply contracts just because a company has gone into administration. Unless the administrators agree or the supplier gets a court order, the supplier must continue to meet orders under a supply contract, although it will be paid for any such supplies. There are certain exemptions, and a supplier that is concerned about the effect of these provisions should take advice.

In some cases, suppliers will have a retention of title (ROT) clause in their supply contracts that allows them to recover goods that have not been paid for. They may wish to enforce this if a company enters administration. In some cases, the administrator will wish to use or sell stock that is subject to a supplier's ROT claim. It is usual for the administrator to agree to pay for those goods or require the buyer to pay or return ROT stock if it is sold. The amount a supplier will be paid is often the subject of negotiation.

If a supplier does not have a ROT claim but it has unpaid invoices at the date the company goes into administration, then it will be treated as an unsecured creditor (see above), although a supplier might be able to negotiate a payment with the administrators if the administrators intend to trade the business and need the supplier to continue to supply.

Supply contracts may be transferred to a buyer as part of a sale of the business and assets of the company, although it is often up to the supplier to decide whether they wish to continue the supplier relationship with the new owner.

Landlords

If the administrators intend to use the company's leasehold property for the purposes of the administration, a landlord is entitled to its rent as an expense of the administration. It may not be possible for a landlord to take possession of its property if this is the case, although a landlord can apply to court if it wants the property back. The court will then have to weigh up the landlord's position against what it is that the administrator is trying to achieve (usually a sale of the business) when determining whether the landlord is entitled to possession.

If the administrators do not use the company's leasehold property, a landlord will not be paid its rent as an expense of the administration. In addition, all rent outstanding at the date of the administration will generally be an unsecured claim in the administration regardless of whether the administrators use the property or not.

Administrators do not have the power to disclaim a lease, but will likely agree (and try to agree) a surrender of the lease if they do not wish to use the property. Landlords may decide against this if they do not have a tenant lined up because liability for business rates remains with the company in administration.

If the administrators sell the business, it is common for the administrators to grant a licence to the purchaser (often in breach of the terms of the lease) for a short period of time. This allows the new owners time to negotiate an assignment of the lease (or a new lease) with the landlord, or time to relocate the company's assets. During the period of the licence, the landlord will be paid monies owed to it under the terms of the lease. A landlord is not obliged to agree to an assignment and may choose not to, if, for example, it has found an alternative tenant, but if it is willing to agree to an assignment, it may be able to negotiate a payment in respect of any rent that was outstanding at the date of administration.

Hire/Lease Companies

Although the entry into administration usually terminates a hire/lease agreement entitling the hire company to take back its equipment, it will only be able to do this with the consent of the administrators or permission of the court. The administrators may wish to use hired/leased assets, particularly if they are integral to the business and they intend to trade it. If they do this, the hire/lease company will be paid as an expense of the administration for the period that the administrators use them. Any outstanding hire costs at the date of administration will be an unsecured claim in the administration.

If the administrators sell the business and assets of the company, they will often "sell" the hired/leased assets to the purchaser with the intention that the hire/lease agreements will be assigned/novated to the new owners who will take over payment. The hire/lease company is not obliged to agree to an assignment/novation and can then recover its assets, but it is often more cost effective to agree an assignment/novation than incur the costs of uplifting the assets. It may also be possible to negotiate payment of outstanding hire charges (or part of them) as part of agreeing to assign/novate the agreement.

If the administrators consider that there is no value in using or "selling" the hired/leased assets, the hire/lease company will usually be given access to the company's premises to collect them.

Sales and Pre-Packs

Depending on the purpose of the administration, administrators will often look to sell the business and/or assets of the company once appointed. They will conduct a sales process and look for a sale that will bring the best return to creditors. It is not unusual for proposed administrators to start looking for a potential buyer once the NOI has been filed.

In some cases, the best "persons" to buy the business are the former directors, who are often willing to pay more than a third party who has no knowledge of the company. If this is the case, the sale might be completed as a pre-pack sale. A pre-pack is when a company is put into administration and either its business or assets (or both) are immediately sold by the administrators via a sale that was agreed before the administrators were appointed.

Duration and End of Administration

An administration automatically ends after 12 months unless it is extended. It can be extended once by 12 months if the creditors or court agree. After that, the court will have to agree to any further extensions.

Typically, an administration will run for between one and three years, but complex administrations can last several years.

Although administration is badged as a temporary process with a view to returning the company to its directors, this rarely happens.

Usually, once the purpose of the administration has been achieved, the company will either be dissolved or placed into liquidation. It is however possible for the company to exit administration via a company voluntary arrangement.

Benefits of an Administration

The alternative to administration is often liquidation (see our quick guide on liquidations). Liquidation essentially means that the life of the business has come to an end. Administration therefore offers a number of benefits over liquidation.

Moratorium	One of the key advantages of administration is the fact that it provides a statutory moratorium for the company. This prevents creditors taking action against the company, helping preserve the value of the business.
Continuity	An administration often provides the best chance of a business surviving because, in a lot of cases, the business is sold as a going concern.
Higher Returns	Compared to a liquidation, an administration is likely to result in better returns to the company's creditors.
Preserves Jobs	If it is possible to sell the business as a going concern, then, as noted above, often most if not all employees' will transfer to the buyer, and their employment will continue.
Better Outcome for Suppliers	Although a supplier may suffer a loss as a consequence of unpaid debts owed at the date of the administration, if the business is sold as a going concern, the buyer will usually try to engage the same suppliers moving forward.

If you have any questions about the content of this guide, then please get in touch with one of our experts below.

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