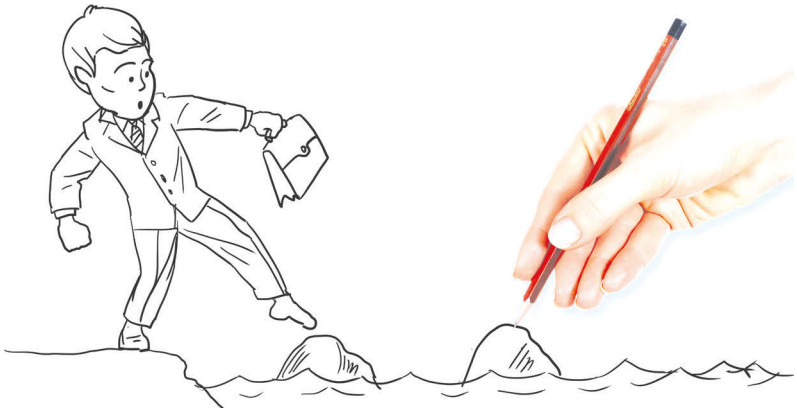
ITB4 Administration



administrations - the latest

introduction

A major change to insolvency legislation was introduced on 15 September 2003 in the form of the Enterprise Act 2002. The most significant of those changes relates to the wholesale amendment of the 'administration regime' brought in as part of the Insolvency Act 1986.

This ITB brings you up to date with both a revision of the procedures and some comments on the practical applications it has, together with general comments on its advantages and disadvantages.

For the purpose of this ITB, I refer to a company but the process applies equally to limited companies and partnerships (including LLPs). There is also an 'administration' procedure for individuals but this is fairly rare and is not dealt with here.

what is administration?

I am sure you will all have heard the term "administration" at some point, but it is often confused with "administrative receivership". The outcome of the two processes is usually similar but they are very different in how a company's affairs are dealt with.

There are only three statutory purposes for which an administration can now be entered into:

1. Rescuing the company as a going concern; or
2. Achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration); or
3. Realising property in order to make a distribution to one or more secured or preferential creditors.

These purposes are set out in order of importance and can be thought of as follows:

1. "rescuing the company…"

This is intended to lead to the company remaining a viable trading entity with an ongoing business and control of that business being eventually returned to the directors. The company would continue to exist. The most likely example of this would be a debt restructuring of some sort, or the agreement of a Company Voluntary Arrangement.

2. "achieving a better result…"

This would usually include achieving a higher value for a company's assets than in a straightforward liquidation and would also include situations where the company's core business is sold as a going concern. The corporate shell is unlikely to survive. This is the most common outcome for administrations.

3. "…to make a distribution to one or more secured or preferential creditors"

This would enable an administrator to achieve the best possible realisation of assets for the benefit of these classes of creditors only. Unsecured (e.g. trade) creditors would not receive any payment. An example here would be an administrator's ability to continue with limited trading to finish contracts or preserve debtors for the benefit of secured and/or preferential creditors. This option may not ultimately result in the survival of the company or its core business.

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who is the administrator?

An administrator must be a licensed Insolvency Practitioner and at all times acts as an Officer of the Court (whether or not he is appointed by the Court – see later).The administrator also acts as agent of the company and generally without personal liability. He also, most importantly, must act on behalf of all creditors generally and not just one class of creditor (e.g. a secured creditor).

why do an administration?

Where there is a possibility of the rescue and survival of the company and/or its core business, or simply a better realisation of assets, an administration should always be considered. This is because the statutory powers of an administrator are extensive and wide-ranging and the process itself provides almost complete protection for a company and its business from any creditor that may wish to take enforcement action against it. This gives a very valuable "breathing space" to enable a plan to be put in place by the administrator to achieve one of the three purposes.

who may put a company into administration?

The following may apply to put a company into administration:

1. the company (acting by its shareholders);
2. the directors of the company;
3. one or more creditors of the company;
4. where the company is in liquidation, its liquidator;
5. the holder of a Qualifying Floating Charge ("QFC"); and
6. a combination of the above.

(There are also a number of other parties who may make application, but these will only arise in exceptional circumstances.) The most important change here is number 5, the holder of a Qualifying Floating Charge ("QFC"). The Enterprise Act 2002 generally prevents the appointment of an administrative receiver by the holder of a floating charge (usually a bank) dated on or after 15 September 2003.

This effectively bars the appointment of administrative receivers under floating charges created after this date. To enable a floating charge holder to protect its security over a company's assets, it must now hold a QFC and if it does, it can appoint an administrator. This replaces the power to appoint an administrative receiver.

A QFC is defined in the Enterprise Act and the effect of this is that "old" (pre-15 September 2003) floating charges allow the holder to choose between the appointment of an administrator or an administrative receiver and "new" (post-15 September 2003) floating charges only allow the appointment of an administrator. (Again there are a few exceptions in respect of the appointment of administrative receivers, but these are not detailed here.)

how does a company get placed into administration?

Previously, administration could only be entered into by a complicated, lengthy and expensive petition to Court. The Enterprise Act introduced an additional 'out of Court' route into administration and has simplified both the non-Court and Court-based routes. A flowchart of the processes is attached and certain conditions apply which dictate the appropriate route.

In summary, a company can be placed into administration either by simply appointing an administrator (with no involvement by the Court) or by making an application to the Court for the appointment of an administrator. It is also possible to obtain an administration "out of hours", e.g. on an evening or weekend, in matters of urgency. This was not possible prior to the Enterprise Act.

advantages & disadvantages

advantages

- The simplification of both routes has resulted in a substantial cost saving compared to the previous regime. In some cases, this had led to pre-administration costs being reduced by up to 80%! Because of this, administration is now available to smaller companies where costs were a major issue.

- Whilst the three purposes are quite specific in what needs to be achieved, how the purposes are achieved is entirely at the discretion of the administrator. There are very few restrictions on what can be implemented. Creditors do have the comfort of their own statutory option of bringing an administrator to task before the Court if he has done something they consider to be prejudicial to their interests.

- The moratorium (i.e. protection for the company) comes into force as soon as the papers are filed in Court (see flowchart). The process can therefore be started with almost no delay.

- The moratorium provides almost blanket protection from enforcement action. Such action is still possible but requires the permission of either the administrator or the Court.

- The timescale of the administration process has been reduced to 12 months (unless extended by creditors or the Court for a further 6 months) rather than being open-ended. This means that the administrator must deal with matters quickly and allows both the company and its creditors the satisfaction of a speedy conclusion. This can often result in reduced costs. ("Old" administrations often dragged on for a number of years!)

- The administrator can also now make distributions to creditors. Again, this reduces the timescale and costs of getting money back to creditors.

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disadvantages

- Where the application is not made by a QFC holder, that holder must still give permission for the appointment of an administrator. The QFC holder has up to five days to give its permission, hence there could be a potential delay in the administration starting. From the QFC holder's view point, this "permission" is obviously an advantage, as they will always be notified of an administration application and have an opportunity to exercise their other rights over their charged assets.
- The administrator has a duty to act in the best interests of all creditors and not just secured creditors. Secured creditors therefore lose a measure of control when compared to other methods of enforcing their charges.
- The most problematic area relates to the tax treatment of the company in administration. The date of administration starts a new accounting period for tax purposes and therefore affects how losses can be utilised. It is important to consider this area prior to administration, particularly where there are large losses or substantial assets for capital gains purposes.
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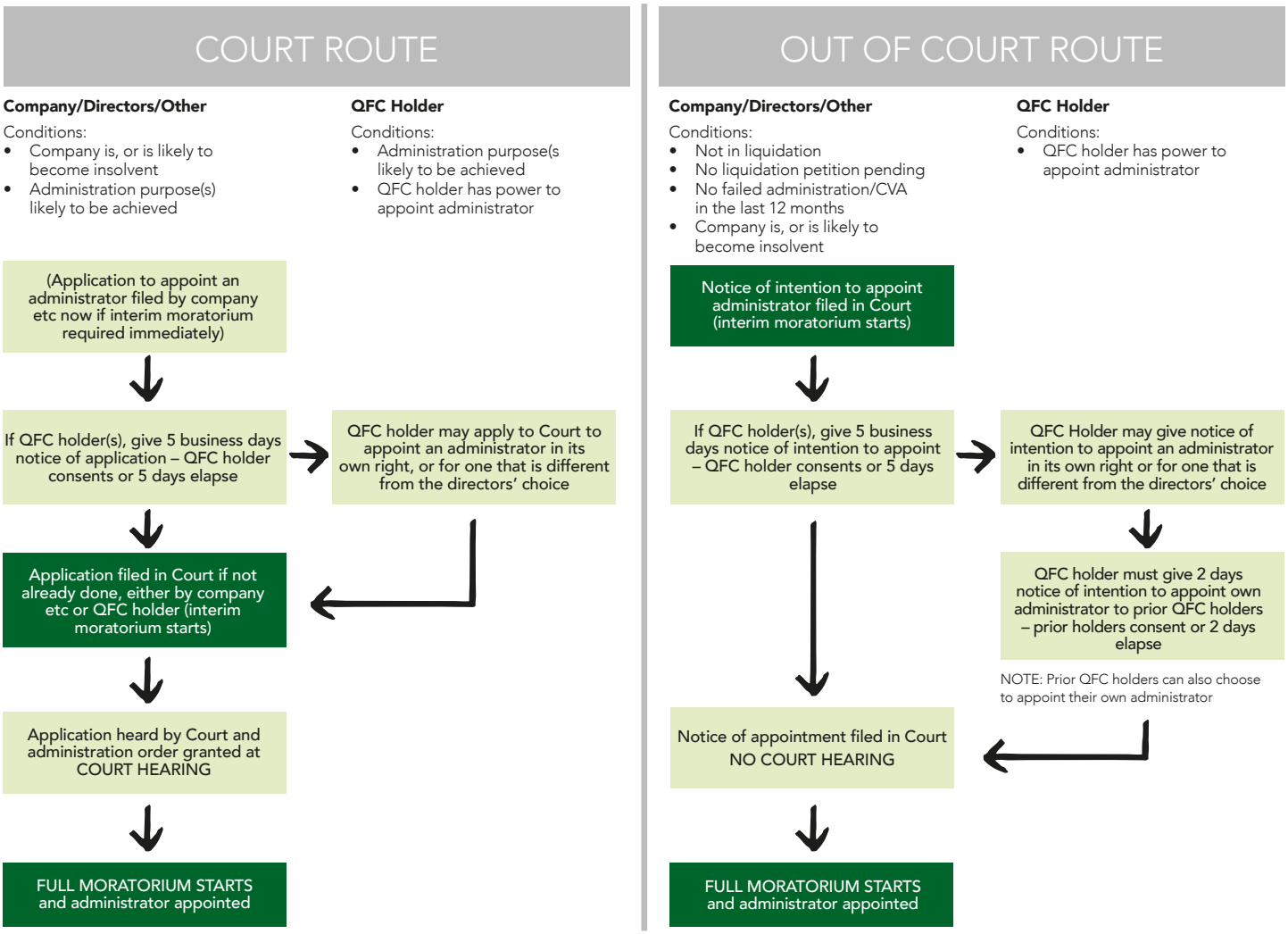
So how does a company get into administration? These flowcharts give an overview of the process. It is obviously more complex than this and we can provide you with more detail if required.



Once the company is in administration…

- The administrator must hold a meeting of creditors within 10 weeks of his appointment for creditors to approve his proposals for achieving the purpose(s) of the administration.
- However, a creditors meeting need not be held if there will be either a full payment to unsecured creditors, or no payment to unsecured creditors at all.
- The administrator implements the agreed proposals.
- The administration must be concluded within 12 months (unless extended up to a further 6 months by the creditors or the Court) and a suitable exit utilised as detailed below.

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concluding the administration

The administration can be concluded by achieving its purpose(s). If the company has survived, control is handed back to the directors and the administrator is released.

However, if the company does not survive, there are further exits, in addition to the compulsory liquidation of the company:

1. a Creditors Voluntary Liquidation can be put in place to enable the affairs of the company to be dealt with after the 12-month administration period; and
2. the company can proceed straight to dissolution if all matters have been dealt with within the administration period

the future for administrations

Given the flexibility of the process and the fact that smaller companies can take advantage of it due to reduced costs, the number of administrations being undertaken has increased dramatically since 2003.

This can only be good news as the administration regime enables more companies to be rescued or a better return to creditors than a liquidation. Directors and their advisers must become more astute in recognising financial problems and tackling them earlier, thereby giving them more options than simply ending the life of the company.

One concern following the introduction of the new process was that administrations would frequently be used when a company should properly have gone into liquidation, particularly as in some circumstances in an administration, there is no need for a creditors' meeting. Analysis of historical data by the Insolvency Service suggests that this is not generally the case (as always there are exceptions) and the integrity of the administration process as a means of achieving a rescue or greater return to creditors has been preserved.

In addition Statement of Insolvency Practice 16 ("SIP16") has been introduced to deal with the so-called "pre-pack" administrations to ensure the administration process is not further abused. SIP16 is covered in a separate ITB.

there is no substitute for expert advice

I have been advising individuals and businesses suffering financial distress since 1986, a substantial part of that time having been spent within the Insolvency and Business Recovery practices at two of the "Big Four" UK accountancy firms.

In that time I have come across many instances where administration has proven to be a blessing in disguise for directors who may have no idea of what they can do.

As a Fellow of the Association of Business Recovery Professionals (also known as "R3" - Rescue, Recovery and Renewal) you can be assured that I am an expert in my field and will be able to help with an individual's needs.

Get in touch

Please call me for further information or to arrange a free initial meeting.

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