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Quickguides

An Overview of Administration



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Quickguide overview

This Quickguide provides an overview of the insolvency administration process, including:

- How an administrator is appointed;
- What the effects of an administration are;
- What duties and powers an administrator has; and
- What a so-called "pre-pack administration" is.

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An Overview of Administration

1. What is administration?

Administration is an insolvency procedure that permits an insolvent company to continue to trade while protected from creditor claims by a statutory moratorium. This allows the company breathing space in which to re-organise, refinance or effect a sale of its business.

An administrator, who must be a licensed insolvency practitioner, is appointed. Directors are not automatically dismissed but the administrator takes over the control of the company's affairs.

The box below sets out the objectives that any administration must comply with:

OBJECTIVES OF AN ADMINISTRATION

Any administration must comply with one of three statutory objectives:

1. to rescue the company as a going concern;
2. to achieve a better result for the company's creditors as a whole than would be likely if the company were placed into liquidation; or
3. to realise the company's property in order to make a distribution to the company's secured or preferential creditors.

It is only permitted to consider the second objective if the first objective cannot be achieved and it is only permitted to consider the third objective if the first and second objectives cannot be achieved.

2. Entering administration

There are two ways in which a company can enter administration:

- By order of the court. A court may make an order for the administration of a company on the application of, among others, one or more creditors, directors or shareholders of the company.
- Alternatively, the directors, the shareholders or a holder of a "qualifying floating charge" can file certain forms with the court upon which the administration commences. No court hearing is necessary.

A party who has a floating charge over substantially all of the assets of the company (and meets certain other criteria) is a holder of a "qualifying floating charge". Any holder of such charge must be notified of the intention to appoint an administrator and can choose to appoint an administrator of its own choice instead of the person nominated.

3. Who pays the administrator?

The administrator's remuneration is paid from the realisation of the company's assets in priority to floating charge security holders and unsecured creditors. One or more creditors may provide the administrator with funding prior to the realisation of the assets to ensure that an administrator will take the appointment.

4. Effects of the administration

DIRECTORS

- Directors' powers are severely curtailed. A director may not exercise any management powers without the consent of the administrator.
- Directors may be asked to provide the administrator with a statement of the company's affairs – which includes details as to the company's assets and liabilities.
- In the unlikely situation that the company exits administration as a trading company, the management powers will be handed back to the directors.
- Administrators must provide the Secretary of State for Business, Energy and Industrial Strategy with a report of the conduct of each director of the company within three months of entering administration.

CREDITORS

- On the filing of an intention to place the company into administration, an interim moratorium takes effect. This becomes final once the company enters into administration. The moratorium means that:
 - no step can be taken to enforce security over the company's property or to repossess goods in the company's possession under a hire-purchase agreement;
 - no legal process may be instituted or continued against the company or property; and
 - a landlord may not exercise a right of forfeiture by peaceable re-entry(unless these steps are taken with the consent of the administrator or the permission of the court). The court will balance the interests of the creditor with the need of the administrator to continue to run the company to achieve the statutory objective when deciding whether to grant permission.
- Any pending winding-up petition will be dismissed or suspended and a receiver which a creditor may have appointed previously must vacate office if the administrator requests him to do so.
- Contracts with the company in administration are not automatically terminated. The terms of each contract will prevail (which may or may not include a right of the counterparty to terminate the contract, subject to general ipso facto provisions).
- An administrator does not have a right to disclaim onerous contracts (unlike a liquidator). However, an administrator will balance the benefit to the administration estate in complying with the contract against the costs to the estate in breaching the contract. Any damages will be an unsecured claim.

EMPLOYEES

- Employment contracts do not terminate automatically.
- Administrators have 14 days from their appointment to "adopt" an employment contract or to dismiss the employee.
- If the employee is dismissed, any redundancy costs are an unsecured claim. If the employee is kept on, his salary (but not any subsequent redundancy costs) will be an expense of the administration and be paid in priority to the administrator's own remuneration.

5. Duties of the administrator

On appointment, the administrator will take custody or control of all the property to which he thinks the company is entitled. The administrator must then prepare a statement of proposals for creditors to approve. The administration will then be conducted in accordance with the approved proposals.

An administrator performs his functions as quickly and efficiently as is reasonably practicable. The administrator acts in the best interests of the creditors as a whole and must act in an independent and impartial manner. A creditor may challenge the administrator's conduct by applying to the court. There is a high threshold for such claim to succeed and the burden of proof is on the applicant.

6. Powers of the administrator

An administrator has wide-reaching powers. The administrator can do anything necessary or expedient for the management of the affairs, business and property of the company. He acts as the agent of the company and can enter into contracts with counterparties on behalf of the company. Other powers include:

- disposing of unsecured property and property subject to a floating charge. Property which is subject to a fixed charge may only be disposed of with the consent of the chargeholder or with the permission of the court;
- bringing legal proceedings to challenge certain pre-administration transactions (e.g. transactions at an undervalue or preferences) and/or the conduct of the directors;
- bring proceedings against the directors for wrongful trading if at some point in time before the administration they knew (or ought to have known) that insolvency or liquidation was unavoidable and they failed to take every step to minimise the loss to creditors;
- the power to assign (for value) these transaction avoidance or wrongful trading claims to a third party; and
- agreeing creditors' proofs of claim (including negotiating and settling claims) and making distributions to secured and/or preferential creditors and if the court has granted permission, to unsecured creditors.

7. How does an administration end?

An administration automatically ends after one year, unless the term is extended either by the court or by the creditors. In practice, many companies remain in administration for a considerably longer period than one year.

8. What is a pre-pack?

A pre-pack is an administration where the administrators sell the business and/or assets of the company immediately upon their appointment. The proposed administrators will be involved in the negotiation of the sales contract and any marketing exercise to ascertain the price for the business and/or assets prior to their appointment.

What are the conditions for a pre-pack?

A pre-pack is in essence an administration and all criteria for an administration (the objectives of the administration) will need to be satisfied. A pre-pack is not a separate insolvency tool but a method of achieving the objective of an administration.

Are pre-packs regulated?

Yes. Where there is a sale of all or a substantial part of a company's business or assets to one or more connected persons within the first 8 weeks of an administration, the connected purchaser will have to

obtain an independent written opinion on the sale. Alternatively, the administrator can obtain creditor approval, but typically, the independent opinion option will be much quicker and therefore preferable.

The independent opinion will need to state either that the case is made for the sale (i.e. that the consideration payable for the relevant property and the grounds for the substantial disposal are reasonable in the circumstances) or that it is not, with reasons for the conclusion. A 'case made opinion' should be helpful in providing confidence in the reasonableness of the transaction. However, where the opinion provider finds that the case is not made for the sale, the administrator will still be able to proceed with the sale as long as they set out their reasons for doing so. The independent opinion (together with the administrators' reasons for proceeding with the sale notwithstanding a 'case not made' opinion) must be sent to all creditors of the company and Companies House.

Further, Statement of Insolvency Practice (SIP 16) specifies a list of information which the administrators must make available to creditors where there has been a pre-pack. While SIP 16 is not legally binding, failure to comply with it may lead to disciplinary action for the administrator. The information that the administrator must make available includes:

- the background to the administrator's involvement with the company;
- any valuations obtained;
- alternatives to a pre-pack and whether major creditors were consulted in advance;
- the price paid by the buyer, the buyer's identity and whether there is a connection between the buyer and the company; and
- where the buyer is a connected person, a copy of any independent opinions obtained by the buyer.

WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF A PRE-PACK?

Advantages	Disadvantages
<ul style="list-style-type: none">• Quick sale: A quick and smooth transfer of the business, with limited or no trade disruption.• Preservation of jobs: A pre-pack can save jobs if the goodwill of the company can be preserved and transferred without the need for (or fewer) redundancies.• Costs: A quick sale will result in lower professional fees and will therefore be cheaper.	<ul style="list-style-type: none">• Disgruntled creditors: The lack of opportunity to be involved in or challenge the sale prior to its implementation may leave creditors disgruntled.• Not the best price: The limited marketing may mean that the best price has not in fact been obtained and that a more thorough and open marketing could have resulted in a better price.• "Phoenix companies": The company buying the assets from the insolvent company is often a sub-set of the old company's management or owners. This is sometimes seen as asset-stripping and allowing the company to walk away from its debts.• PR spotlight: Pre-packs have received a large amount of press attention which may lead to a decline in counterparty confidence which an ordinary sale out of the administration might have avoided.

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Giles Boothman
Practice Group lead, EMEA/US, RSSG

T +44 20 7859 1707
giles.boothman@ashurst.com



Lynn Dunne
Partner

T +44 20 7859 3242
lynn.dunne@ashurst.com



Ru-Woei Foong
Partner

T +44 20 7859 3158
ru-woei.foong@ashurst.com



Olga Galazoula
Partner

T +44 20 7859 1607
olga.galazoula@ashurst.com



Drew Sainsbury
Partner

T +44 20 7859 1784
drew.sainsbury@ashurst.com



Inga West
Counsel

T +44 20 7859 1245
inga.west@ashurst.com



Rebecca James
Expertise Lawyer

T +44 20 7859 2185
rebecca.james@ashurst.com



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www.ashurst.com