moorfields

A guide to the Administration Process

Appointment by the directors of a company or the company itself

What is administration?

Administration is a court process whereby one or more qualified insolvency practitioners are appointed to manage the affairs of a company [or partnership]. The advantage of this process is that it provides protection from the company's creditors whilst a restructuring plan or controlled disposal strategy is implemented.

The Administration process has been utilised by distressed companies since its introduction in 1986 and this legislation underwent an overhaul in 2003. The purpose of the 2003 legislation was to encourage the use of business rescue mechanisms in order to preserve viable businesses.

As a result of the 2003 legislation the Administration procedure was made more accessible and streamlined, allowing a floating charge holder, the Company or its directors, to appoint Administrators, in certain circumstances, without a court hearing.

The Administration process is governed by a number of Statutory Instruments. These are:

- The Insolvency Act 1986 ["IA86"]
- Insolvency Rules 2016
- The Enterprise Act 2002
- EC Regulation on Insolvency Proceedings 2000
- Small Business, Enterprise and Employment Act 2015

What is the purpose of administration?

The Administrators appointed have a duty to act in the best interests of the creditors of the company. Legislation sets out the purpose of the Administration and since the introduction of the Enterprise Act 2002 [effective 15 September 2003] this has been split into 3 objectives. These are as follows:

Rescuing the Company as a going concern

The Administrators must perform their role to achieve this objective unless they consider that it is not practicable to rescue the company as a going concern or that the second objective (see below objective) would achieve a better result for creditors.

This objective would typically be achievable in situations where there are third party funds available to return the company to solvency, usually from an investor in the company or through the proposal and acceptance of a Company Voluntary Arrangement ["CVA"].

Achieving a better result for creditors as a whole than would be likely if the company were wound up

If the first objective is not achievable then the second objective is to achieve a better outcome than a winding up of the company. This is often facilitated by the protection of the moratorium provided by an Administration Order allowing a sale of the business and assets as a going concern or through an orderly wind-down.

Realising property in order to make a distribution to one or more secured or preferential creditors

Should the previous 2 objectives not be achievable then the Administrators' objectives would be to realise the assets of the business and distribute them, in accordance with the priorities defined by the IA86.

If none of the 3 above objectives are achievable then Administration would not be the appropriate process. If Administrators are already appointed and it was established that one of the objectives could not be achieved, the Administrators would seek an end of the Administration.

Who can appoint administrators?

A number of parties are capable of appointing Administrators. These are:

- Qualifying Floating chargeholders
- The Company
- The Directors
- Justices chief executive for a Magistrates court
- One or more creditors of the company
- The supervisor of a CVA
- A liquidator
- A qualifying floating charge holder where the company is in compulsory winding up

When can administrators be appointed?

The court may make an Administration Order in relation to a company provided it is satisfied that:

1. The company is, or is likely to become, unable to pays its debts as defined by Section 123 of the IA86 (see below)); and
2. The Administration Order is reasonably likely to achieve the purpose of Administration.

This is applicable for both in and out of court procedures (See type of appointment).

A company is deemed unable to pay its debts if;

1. A creditor who is owed an amount over £750 has served a statutory demand on the company that the company has not paid (or agreed with the creditor a proposal for repayment) the amount within 3 weeks; or
2. In England and Wales, execution or other process issued on a judgement or order of the court in favour of a creditor is returned unsatisfied; or
3. In Scotland, the indicia of a charge for payment on an extract decree, extract registered bond, or extract registered protest, have expired without payment being made; or
4. In Northern Ireland a certificate of unenforceability has been granted in respect of a judgement against the company; or
5. It is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due; or
6. It is proved to the satisfaction of the court that the value of the company's assets is less than its liabilities (including contingent and prospective liabilities).

As soon as management or the board of a company become aware of its insolvency, professional advice should be sought. Failure to take steps to minimise the losses to creditors could render the directors personally liable for the debts of the company.

Who can be appointed administrators?

Only persons who are licensed Insolvency Practitioners can act as Administrators. The Administrators must be independent of the company and ensure that there are no actual or perceived conflicts of interest.

The process of obtaining an Administration order

Type of appointment

There are two main types of appointment:

1. An in court appointment involves a court hearing where a judge considers the information and decides whether to appoint an Administrator; and
2. An out of court appointment is a streamlined and cheaper option but is only available in certain circumstances. This process involves filing papers at court and does not involve a court hearing.

The result and effect of these processes is identical, but the type of appointment affects the process for obtaining and discharging the Administration Order.

Flow charts summarising the procedure are attached to this document as Exhibits A and B.

Common activities

Review of position

The Directors of a company have a duty to maintain proper records and monitor the position of the company to ensure that the position of its creditors is not compromised. Upon considering that the company may be insolvent a full and detailed review of the financial position of the company should be undertaken. This is often undertaken in conjunction with the company's financial advisors or an independent firm of accountants.

This review would then consider the most appropriate procedure to implement.

Board Meeting

Should Administration be considered to be the most appropriate procedure, the directors must hold a formal board meeting, or the shareholders a formal general meeting, to resolve to place the company into Administration. This decision is based upon the understanding of the financial position of the company as determined by 6.2.1 above.

Such meetings must be held in accordance with the memorandum or articles of association of the company concerned.

Choice of process – in or out of court

Once the directors have resolved that the company is insolvent and that Administrators be appointed the process can be commenced.

The out of court procedure is available to both the company and its directors and provides a cheaper and more expedient option than a full court application.

However, it remains necessary in certain circumstances to make an application to court for an Administration Order. These circumstances are where;

1. A petition for a winding up of the company has been presented and not yet disposed of; or
2. An Administration application has been made and not yet disposed of; or
3. An Administrative Receiver is in office; or
4. If the company in the last 12 months;
    - Been in Administration; or
    - Had a failed moratorium led CVA.

Should any of these be applicable then the 'in-court' procedure would need to be followed.

Out of court process

Notice of Intention to appoint

A Notice of Intention to appoint is completed where the company has Qualifying Floating Charge holders ["QFCH"]. This notice contains statutory information and a declaration that (amongst others) the company is or is likely to become unable to pay its debts. Where there are no QFCHs the appointment can be made immediately in accordance with the process outlined in the appointment of administrator section.

Five business days' notice of intention to appoint an Administrator must be given to any person who is or may be entitled to appoint an Administrative Receiver or Administrator out of court. The QFCH may remain silent, provide its consent to the Administration Order or appoint its own Administrative Receiver or Administrator under their security documentation.

A statement is also completed by the proposed Administrators confirming that they consider that, in their opinion, the purpose of Administration is reasonably likely to be achieved.

Interim moratorium

In the period between completion of the Notice of Intention to appoint an Administrator and the appointment, the company may obtain an Interim Moratorium through the filing of the Notice of Intention to Appoint in Court.

This moratorium becomes effective upon the filing of the Notice in court and protects the company against action from its creditors [but not the QFCHs] without them first seeking the permission of the courts. The Moratorium exists for a maximum of 10 days.

Appointment of administrator

Following receipt of the consent of the QFCH or in the absence of an objection from the QFCH [and at the expiry of the 5 clear days notice period], the Administration Order may be made.

The company or its directors make such an appointment through the filing of a Notice of Appointment of an Administrator. Where no QFCH's exist the notice of intention to appoint and interim moratorium can be dispensed with and a notice of appointment together with statements from the proposed Administrators filed in court.

In the event that the QFCHs object to the appointment, they may seek to appoint Administrators nominated by them or in certain circumstances an Administrative Receiver.

Upon filing the relevant form the Administration becomes effective.

In Court process

Documents filed in court

Similar to other court processes, it is necessary to file relevant documents and evidence in support of the application in court prior to the hearing so that any interested parties can make appropriate representations. The following documents are filed and endorsed by the court with a date and location for the hearing:

1. Administration application in a statutory form
2. Statement of proposed Administrators in a statutory form; and
3. Witness statement/affidavit in support – this document contains a statement that it is the apManagement of the business o pay its debts. It must also contain information relating to the financial position of the company including:

- A statement of the company's assets and liabilities (including contingent and prospective);
- Details of security held by creditors of the company and whether these charge holders have the power to appoint Administrators or Administrative Receivers;
- Details of any insolvency proceedings in relation to the company including winding up petitions;
- If it is intended to appoint a number of Administrators details regarding the exercise of their powers; and
- Any other matters that the applicant considers may be relevant to the application.

Copies of the endorsed documents are then served on a number of parties including any QFCHs, any person petitioning for a winding up, the proposed Administrators, the company [if directors appointment], any person who has distrained or levied execution and any insolvency practitioner currently in office. An affidavit of service must be completed and filed in court to prove that these parties have received the documents.

Interim moratorium

Upon filing the above documents an interim moratorium takes effect, protecting the company from action from its creditors, without the express permission of court. This remains in place until the court hearing.

Court hearing

A number of parties may attend the hearing and it is usual for the applicant, in this case the directors or company, to be represented by a barrister experienced in dealing with such applications. It may be suggested that directors attend the hearing where there are complex matters and it is difficult to brief the barrister fully.

At this hearing the court may make an Administration Order, adjourn the hearing, dismiss the application or may make any such order as it considers appropriate.

Upon the granting of the Administration Order Administrators are appointed.

Matters following appointment

Moratorium

Upon the granting of an Administration Order no legal process or proceedings may continue against the company unless permission is obtained from court or the consent from the Administrators is obtained.

This moratorium protects the company against action from creditors who may wish to wind the company up or repossess goods (such as leased assets, stock subject to retention of title or landlords wishing to issue distress).

Directors' powers and duties

The Administrators and their staff will manage the company's business and affairs following their appointment. The powers of the directors will be effectively suspended, although the Administrators may delegate certain responsibilities to them.

Management of the business

Following the appointment the Administrators or their staff will normally attend the company's sites to take control of the business. The Administrators, by statute, act as at all times as agents of the company and contract without personal liability.

The employees would be addressed and the impact of the Administration explained. Typically the existing management lines would be retained but any commitments would need to be authorised by the Administrators' staff.

Reporting lines and processes for ordering goods, etc. would be set up should it be considered beneficial to continue the business during the Administration and funding is available.

Trading

The Administrators often utilise the first few days to establish whether it is feasible and beneficial to cause the company to continue to trade although in certain circumstances it may have been possible for the proposed Administrators to undertake this review and planning prior to the appointment.

The decision to continue to trade is dependent upon a number of factors;

- The benefit to creditors of doing so;
- The working capital requirements and the funding (if any) available;
- Health and safety, insurance, and environmental or industry specific legislation;
- Support from employees, customers and suppliers; and
- The detriment to creditors of not continuing to trade.

The decision as to whether to continue the business is a balancing act and if it the decision is taken to do so it may be for a limited period. It is also possible that a number of cost cutting measures may be necessary such as employee redundancies.

Employees

As indicated in the trading section it is often necessary to make the difficult decision to make a number of employees redundant in order to reduce costs. The cost reduction exercise is often necessary to ensure the business' survival through the Administration process.

Employees who are made redundant will normally qualify for a payment of redundancy, arrears of wages, holiday pay and pay in lieu of notice from the government's National Insurance Fund. The Administrators will issue the affected employees with the forms to make such a claim. These payments are subject to a weekly wage cap with any balance ranking alongside other creditors of the company.

Strategy

Company Voluntary Arrangement ["CVA"]

Should it be considered that creditors may accept a proposal for a voluntary arrangement and that the Administrators consider that it would be in the creditors' interest to do so then it is likely that in the early stages the Administrators will review the possibility in more detail. This would involve speaking to key creditors to determine whether they would support a proposal and drafting the detailed documentation.

Sale of the business

The Administrators may undertake a period of marketing of the business as a going concern. The business is typically continued during this period under the control of the administrators but this is subject to the constraints in trading the business.

Customers, competitors, management and other interested parties would be approached and adverts may be placed in relevant publications. Some of these parties may attend the site in order to undertake due diligence work. The Administrators will normally set a deadline for offers. The timing of this is dependent upon the trading position in the Administration and the effect of a delay on the goodwill of the business.

Any such sale would typically involve a purchase of the goodwill, business and assets of the company and the purchaser would not acquire the majority of creditors [some employee liabilities and certain others may transfer].

Pre-packaged Sales or 'Pre-packs'

A pre-packaged sale is a sale which has been agreed prior to the company entering Administration. A sale contract will have been negotiated and agreed prior to the filing of the administration application. The consideration payable upon completion will be placed in escrow and released upon the appointment of the Administrator.

The reason why pre-packs are considered is that they avoid the professional costs associated with trading a business in administration, protect the business and speed up the process. The principal criticism against them is that they can prevent the business and assets being fully marketed. Recent changes made by the Insolvency industry have sought to improve marketing.

In some instances the business and assets will be marketed before the filing of the application if there is sufficient time. Very often there is no opportunity or a very limited opportunity to market the business and assets in this way as the Company will be under creditor pressure and the directors will wish to avoid the risk of being accused of Wrongful Trading under the provisions of S214 Insolvency Act 1986. Where it is possible to carry out a marketing process before entering into a pre-pack this has become known as accelerated or distressed M&A.

In smaller situations where the Company is under creditor pressure there will be limited opportunity to market the business and assets before the Company will have to make an application for administration or enter another insolvency procedure. If continuing the business will result in trading losses and incur significant costs a pre-pack sale could be desirable if it is believed that the realisations will be greater than would be achieved in a break-up sale in liquidation. Again with smaller businesses which may be dependent on a few key employees they can often be the only realistic purchasers and represent the only alternative to cessation and a break-up sale. Any sale which is agreed would have to be recommended by an expert valuer to ensure that the sale represents a better result than would be achieved on a break-up. It is also normal for such sales to include an anti-embarrassment clause so that the creditors can claw back any gain that arises on the assets being quickly sold-on.

When completing a pre-pack it is also necessary to comply with Statement of Insolvency Practice No. 16. This primarily sets out the

Practitioner is expected to provide creditors with the information stipulated in SIP 16 within seven days of the sale. I have attached a copy of SIP 16 for your information as you will see administrators are expected to provide details of the marketing undertaken and any valuation advice received.

Controlled wind down

This strategy may be implemented should a sale of the business as a going concern be unachievable or it may be the objective of the Administration in order to realise assets for the benefit of the secured or preferential creditors.

This would involve the Administrators instructing agents to dispose of the company's assets in the most appropriate manner and these would be sold off to one or more parties.

Statutory matters

There are a number of matters that, under Insolvency legislation, the Administrators must undertake following their appointment.

Notification to creditors

It is a legal requirement under the Insolvency Act that notice be given in the London Gazette. The costs of placing this advertisement are met as an expense of the Administration.

Notice needs to be dispatched to the members and creditors of the company within 28 days of the granting of the Administration Order.

Statement of affairs

The directors are required to provide the Administrators with a Statement of Affairs within 11 days of receipt of the notice requiring it. In practice, such notice is usually issued with one week of the Administration Order being granted.

The Statement of Affairs summarises the company's assets, their anticipated realisable value and the company's liabilities. It also contains a list of creditors and shareholders of the company.

Report on directors' conduct

The Administrators are required to submit a report on the conduct of the directors of the company to the Department for Business Innovation and Skills ("BIS"). This report covers both the period leading up to and following the insolvency and is based upon the Administrators findings during the course of the Administration process.

In order to assist the Administrators in this task a questionnaire is often issued to the directors in the early stage of the Administration process.

The report is confidential between the Administrators and BIS and is used by BIS to determine whether any action is required under the Company Directors Disqualification Act 1986 or if there are any civil or criminal matters to consider.

Administrators' proposals

Within eight weeks of their appointment, the Administrators must set out and circulate proposals for achieving the purpose of Administration, which must include an explanation, where applicable, of why objectives cannot be achieved and the proposed basis for their remuneration.

Committee

The creditors must be asked with any notifications whether they wish to appoint a Creditors' Committee.

The committee must have at least three and not more than five members. Any creditor of the Company is eligible to be a member of the committee, so long as his or her claim has not been rejected for the purposes of being entitled to vote. The function of the committee is to generally assist the Administrators in discharging his duties. The committee often acts as a sounding board for ideas, and in addition it will monitor the further progress towards a conclusion of the Administration.

Costs and remuneration

The creditors decide the basis for the remuneration of the Administrators and this can be either on a time cost basis, as a percentage of realisations, as a set amount or a combination of these bases.

The costs and remuneration incurred by the Administrators in the performance of their duties is payable out of the assets realised. Similarly the costs incurred in obtaining an Administration Order are payable out of the assets of the company.

Distributions to creditors

Administrators have the power to distribute funds to creditors. Typically, should there be funds to pay a distribution to unsecured creditors, the Administrators would seek to do this through placing the company into Liquidation (see CVL section below) since it avoids the costs of obtaining a court order. The Insolvency Act 1986 defines the priority of payments.

Ending administration

There are a number of routes to ending an Administration. If the appointment was 'in court' as outlined earlier it is usually necessary for there to be a final court hearing. The primary routes for both in and out of court appointments are:

Automatic end

The Administration automatically ceases after one year, or sooner if the purpose of Administration has been achieved, or cannot be achieved or a creditors meeting so requires. The creditors of the company or court may agree to an extension of this period (although the former of these parties can only extend the period for a maximum of twelve months).

Dissolution

The Administrators may file papers to say that the Administration has come to an end and that dissolution of the company is most appropriate. The company will be dissolved 3 months following the filing of the documents.

This exit route is used should there be no funds available for a distribution to unsecured creditors and there are no outstanding matters that a liquidator may need to consider.

Creditors Voluntary Liquidation ["CVL"]

Where the Administrators think that they have paid or set aside sufficient to pay all secured creditors in full and there will be a surplus distributable to unsecured creditors, they file a notice to that effect. On registration of this notice, the Administration will end and the company will automatically go into CVL (some of the normal statutory provisions being disapplied and thereby avoiding the need to pass shareholders resolutions at a general meeting of shareholders). Whilst the creditors may nominate a different liquidator, in practice the Administrators usually become the liquidators thereby ensuring continuity and reducing costs.

Compulsory Liquidation

In certain circumstances the Administrator may apply to court for the company to be placed into Compulsory Liquidation. The Administrators may seek appointment as Liquidators or the Official Receiver or other insolvency practitioner may undertake this task.

This is typically used as an exit route where there are no funds to distribute but there are matters for a liquidator to consider.

About Moorfields

At Moorfields, we understand that any business – no matter what its size – can experience a reversal in fortune. We also know that when things are taking a turn for the worse, innovative thinking is as important to your survival as capital. And that's exactly what we offer.

We're business owners ourselves, so we know all about the pressures of trying to keep your stakeholders happy. We've also got years of experience in the world of finance, so we know a thing or two about keeping companies afloat.

But our innovative thinking isn't just about expert business advice. It's about breaking the mould of insolvency and rescue practitioners: helping you through your problems, treating you like a human being, and actually understanding exactly what you're facing.

We'll never surprise you with last-minute charges, because our fees are totally transparent (and actually quite affordable). We'll also never try to force you into a one-size-fits-all solution. Because we get it: your business is unique.

Finally, we'll never back out when the going gets really tough. We do what we say we'll do. And whatever happens with your business, we'll be here to help you every step of the way.

If you would like to discuss how Moorfields can assist you with an Administration or any other issues please contact

Simon Thomas:
T: 020 7186 1144
E: sthomas@moorfieldscr.com