A Short Guide to UK Insolvency Law: Administration

BY KEITH WILSON AND ALPER DENIZ

Are you unfamiliar with the Administration process in the United Kingdom? Do you have contractual relationships with a company that has entered Administration? This short overview serves as a practical guide for those who are unfamiliar with the Administration process in the United Kingdom. For example, the UK Lehman entities that have filed for insolvency protection in the United Kingdom (there are four such entities: LB UK RE Holdings Ltd., Lehman Brothers International (Europe), Lehman Brothers Holdings PLC and Lehman Brothers Ltd) have all entered Administration rather than any of the other UK insolvency regime processes.

If the company with which you are dealing applies for insolvency protection in the UK, you need to check which process applies – Administration is highly likely, in which case this overview is relevant. There are other processes: liquidation, administrative receivership, receivership and it is also possible the company might propose a Company Voluntary Arrangement or Scheme of Arrangement from within or outside a formal insolvency process. Please note that this overview does not address these alternative processes. However, if you require further advice on these, please contact Keith Wilson.

What is Administration?

In broad terms an Administrator – a qualified insolvency practitioner – replaces the board of directors as the manager of the company in administration. In the UK there is no equivalent “debtor-in-possession” process like Chapter 11 in the US. Administration is intended to achieve one or more of three objectives:

- rescuing the company as a going concern;
- 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
- realising property of the company in order to make a distribution to one or more secured or preferential creditors.

These objectives are sequential in that the Administrator can only move to the second objective if the Administrator considers it not reasonably practicable to pursue the first objective and so on. The intention is to create a rescue culture.

Administration is often used as a “tool” to effect a sale of a business or significant assets conducted by the company. Frequently, this is achieved by way of a “pre-packaged Administration” – which simply means that the person who will be appointed Administrator will have been consulted prior to his or her appointment with a proposal as to how the Administration would be conducted. If the proposed Administrator is satisfied that the proposal meets the objectives of an Administration, he or she may indicate that they will adopt the proposal once appointed. The
advantage of this approach can be to facilitate a sale of assets or a business quickly.

Can Any Company Simply Apply for Administration?

Generally a company must be technically insolvent before it can enter Administration. The test is whether the company is “unable to pay its debts”; this phrase has a specific statutory definition. Among a number of tests is a balance sheet test – does the company’s liabilities, including contingent liabilities, exceed its assets? – and a cash flow test – is the company able to pay its debts as they fall due? The exception is that a Qualifying Floating Charge-holder – see below – may apply to the court to appoint an Administrator if the charge permits such appointment, even if the company is not likely to be “unable to pay its debts” at the relevant time.

How to Enter Administration

The administration process has a degree of flexibility in that it is possible to enter administration by way of either a court process or through an out of court route. The company, its directors or a Qualifying Floating Charge-holder may use the out of court route and the company, directors or creditors may use the court process.

Although an Administrator may be appointed using the out of court route, the Administrator will be an officer of the court. Details of the appointment will be required to be filed with the court and generally there can be recourse to the court in relation to the conduct of the administration.

Qualifying Floating Charge-holder

We said that a “Qualifying Floating Charge-holder” can go the out of court route to appoint an Administrator. So, what is a “Qualifying Floating Charge-holder”? It is a creditor who holds a security interest in all or substantially all of the company’s assets including, as part of the security package, a floating charge. Generally in a trading company this will be the trading company’s primary bankers. A floating charge is a form of security under which all assets and undertaking of the company from time to time are secured to a particular creditor. The peculiarity is that the assets and undertaking of the company can change in the ordinary course of the company’s business and yet the security captures the new assets and undertaking. Certain events will crystallise the floating charge into becoming a fixed charge.

The advantage of being a Qualifying Floating Charge-holder goes beyond the ability to appoint an Administrator out of court. Such a charge-holder may also block the appointment of an Administrator by any other party by appointing its own Administrator.

Effects of Administration: The Moratorium

Administration brings with it a statutory moratorium on certain actions of creditors against the company.

Exception: Where the Financial Collateral Regulations apply, the holder of financial collateral is not bound by the moratorium and remains entitled to enforce its security. This may be applicable to derivative contracts and other financial instruments. For further information on this, please contact Alper Deniz.

With this exception, the moratorium prevents the following:

• no resolution or order can be passed to wind up the company, (in other words, no liquidation);

• no steps can be taken to enforce security over the company’s property except with the consent of the Administrator or permission of the court;

• no steps can be taken to repossess goods in the company’s possession under a hire purchase agreement, retention of title arrangement, lease or bailment without the consent of the Administrator or permission of the court;
• a real estate landlord may not exercise a right of forfeiture by peaceable re-entry in relation to premises let to the company except with the consent of the Administrator or permission of the court; and

• no legal process, including commencing legal proceedings and executing or enforcing judgments, may be instituted or continued against the company or property of the company except with the consent of the Administrator or permission of the court.

What the Moratorium Does Not Prevent You from Doing

A counterparty to a contract with a company remains entitled to terminate the contract if the contract contains a right of termination exercisable at that time. This is a material difference to Chapter 11 in the US.

How Will I Know if a Company is in Administration?

The Administrator must, as soon as reasonably practicable after appointment, obtain details of the company’s creditors and notify the company and all of the creditors of the appointment. The notice must be in writing and must be sent by post. It must also be advertised in the London Gazette and a relevant newspaper. Details of the appointment must also be filed at Companies House within 7 days of appointment. This will then show up on a company search.

Certain Powers of an Administrator

If the Administrator reaches the conclusion that it is not possible to sell the company as a going concern, it is possible to sell all or part of the company’s business to a subsidiary leaving behind certain of the liabilities. The subsidiary may then be sold.

In support of the Administrator’s ability to sell the company or all or part of its business, the Administrator has certain powers:

• power to dispose of property subject to a floating charge as if it were not subject to that charge. The holder of the floating charge will have the same priority in respect of the proceeds of sale as it had over the disposed of property;

• power to dispose of property that is subject to a security other than a floating charge or which is in the company’s possession as a result of a hire purchase arrangement, retention of title arrangement, lease of other bailment as if the company were the owner. Such a disposal requires a court order and the net proceeds or the market value (if greater) of the property disposed of must be paid to the security holder or owner.

Note: Neither of these powers apply to collateral subject to the Financial Collateral Regulations.

Conduct of Administration

Within 8 weeks of appointment, the Administrator must make a proposal to all creditors and members of the company and send this to each of them. Proposals will also include an invitation to an initial creditors meeting which must take place no more than 10 weeks after the company went into Administration. Note, however, that a meeting is not required if the company has sufficient property to pay all creditors in full or if there will be insufficient assets to enable a distribution to be made to unsecured creditors.

At the initial creditors’ meeting the Administrator will present his proposals and the creditors vote. The voting is by way of value of claims and a simple majority will approve the proposal. Generally secured creditors only vote any unsecured portion of their debt because they cannot be crammed down. There are also rules as to how claims of lessors are to be valued. If the proposal is rejected, the Administrator must report to court and seek directions.
An Administrator will send regular progress reports to the creditors, the court and the Registrar of Companies.

An Administrator’s appointment automatically ends after 12 months unless it has been extended by the court or with the approval of the creditors.

Cram Down of Debt

There is no automatic cram down of debt. However, the Administrator’s proposals may, in effect, lead to this for unsecured creditors – while secured creditors can only be made to accept a reduction in the amounts they are owed with their agreement or through a Scheme of Arrangement (a formal court sanctioned process that can lead to a cram down in certain circumstances with a less than unanimous vote of the class of creditors of which the secured creditors form part). The usual exits from Administration for a company with insufficient assets to meet its liabilities will be a Company Voluntary Arrangement, a Scheme of Arrangement (either of which can include a cram down (including secured debt in the latter case)) or liquidation of the company. Each of these may occur after implementation of sales of assets or of the company’s undertaking as part of the proposal.

Position of Employees

Administration itself does not terminate or amend the employment contracts of employees. In the Paramount Airways case, the court held that an Administrator will be taken to be continuing employment contracts if the Administrator continues to employ and pay staff on the same terms after 14 days from the date of appointment as Administrator. In such circumstances, employees’ wages, salary (including holiday pay), and contributions to occupational pension schemes will become a priority claim ranking above even the Administrator’s own fees and expenses. If the Administrator chooses to terminate contracts of employment, then the employee will be entitled to statutory compensation and any contractual compensation due but these will each rank only as unsecured claims.

If you have further questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:

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