Administration ins and outs

Defective, invalid or inchoate?

Jeremy Bamford, Guildhall Chambers

Introduction

1. The new administration regime introduced by the Enterprise Act 2002 was much lauded for the new out of court appointment process, which encouraged the use of administration by reducing costs and delay in appointments. In addition, the exit routes for the administrator were clarified, substantially expanded and costs were reduced by removing the necessity to apply to the court to end the administration. However, the severance of the administration process from the old regime's reliance on court control over appointment / termination has brought with it new issues over the validity of appointment of administrators, the extension of the administration and whether the favoured exit route has been achieved. These issues did not arise where the validity of appointment / extension / exit route were controlled by the court and founded upon court order.

   The issues are compounded by:

   1.1. the technicalities of the out of court appointment procedure and exit routes;
   1.2. the absence of a court power to dispense with either technical or substantive breaches or to directly address and cure defects in or invalid appointments.

   This paper seeks to highlight some of the issues that have arisen both in the reported cases and in unreported cases that the Guildhall Insolvency Team have been involved in and to suggest some practical solutions that have been adopted. It should be stressed that the arguments in this area have not, in general, been tested by adversarial argument or appeal.

A. Appointments
Extant winding up petition

2. The company and its directors[1] cannot use the out of court appointment procedure for an administrator under para. 22 Sch. B1 if:

   2.1. a petition for the winding up of the company has been presented and is not yet disposed of,
   2.2. an administration application has been made and is not yet disposed of, or
   2.3. an administrative receiver of the company is in office[2].

   Para. 25 Sch. B1 provides that in the above 3 cases an administrator "may not be appointed under paragraph 22". The words are prohibitory and go to the power of the company or directors to appoint. In the event that the company or directors purport to appoint an administrator under para. 22 but one of the circumstances set out in para. 25 applies, then the appointment is invalid[3].

3. The company, its directors and the proposed administrators will usually be aware that there is an administrative receiver in office and administration applications by persons other than the company or its directors are rare. Therefore in practice the problem tends to arise with regard to unknown (not issued, not served or served but not come to attention of company[4]) or overlooked (failure of directors to appreciate significance of petition, unaware of para. 25 prohibition and failure to notify IP and solicitors assisting the company of the petition) winding up petitions.

[1] There is no equivalent restriction on (i) a qualifying floating charge-holder appointing out of court under para.14 Sch. B1 or (ii) if an administration application is made by the company or directors to for a court appointment under para. 12 Sch B1.
[2] Para. 25 Sch. B1
[3] Re Blights Builders [2008] 1 BCLC 245, para.7.
[4] E.g. because there had been a failure to register a change of registered office when the company's accountants move

4. Winding up petitions presented to the Companies Court in London, a Chancery District Registry or a County Court are entered in a computerised register known as the Central Registry of Winding-Up Petitions, which is searchable by phone[5] or in person at the Companies Court General Office. Prior to the company or its directors appointing an administrator out of court under para. 22 Sch. B1 it is prudent and best practice for the lawyers advising to:

   4.1. seek confirmation from the directors that no winding up petition has been presented, served or come to their attention;
   4.2. check with the company's accountant that no winding up petition has been served at the company's registered office, if that is at the accountants' address;
   4.3. carry out a search of the Central Registry of Winding-Up Petitions.

5. However even if the above steps are taken it is possible that a winding up petition has been presented to a court but not yet entered by the court staff on the Central Registry of Winding-Up Petitions or come to the attention of the company. That occurred in *Re Blights Builders*[6] where, unknown to the company, a creditor presented a winding up petition to the court on 5 July 2006[7] but the court did not get round to sealing the petition and returning it to the petitioner for service until 25 July 2006[8]. In the meantime the executors of the deceased sole director and shareholder of the company, gave notice of intention to appoint an administrator under para. 22 Sch. B1 on 21 July, obtained the consent of the QFCH on 24 July and filed the notice of appointment at court on 24 July. HHJ Norris QC held that "presentation" of the petition under para. 25 Sch. B1 meant when the petition was delivered to the court for sealing and issue, rather than the issue date appended to the petition or when it was sealed as having been issued: see paras. [4] – [6]. As a result, the appointment of the administrators on 24 July was invalid as the company had no power to appoint by reason of the existence of the presented and undisposed of winding up petition: para. [7].

6. Rule 7.55 of the IR 1986 entitled "Formal defects" provides:

> "No insolvency proceedings shall be invalidated by any formal defect or by any irregularity, unless the court before which objection is made considers that substantial injustice has been caused by the defect or irregularity, and that the injustice cannot be remedied by any order of the court."

   HHJ Norris QC in *Blights Builders* held that that rule did not enable the court to remedy the invalidity given:

   6.1. the appointment of an administrator out of court under para. 22 Sch. B1 was not an "insolvency proceeding", which was confined to legal proceedings rather than to para. 22, which constituted a statutorily prescribed procedure for the appointment of an administrator and the obtaining of the relief provided under Sch. B1[9];

   6.2. the failure to satisfy the statutory criteria for the exercise of the power to appoint was a fundamental flaw which could not be remedied under the rule[10];

   6.3. it was difficult to see how an invalid appointment could be said to occasion an "injustice" and, if it did, how that could be "remedied" by an order retrospectively validating the appointment.

Other grounds of invalidity

7. If the appointor of an administrator fails to comply with one of the requirements of para. B1, what is the effect of that failure and is the appointment valid, valid but defective, invalid or something else? That depends upon the precise failure that has occurred. However, a major difficulty is that many of the requirements for appointments in Sch. B1 are framed in mandatory terms ("shall", "must") and the documents to be filed in court must be in prescribed form, e.g.

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[5] 020 7947 7328
[6] supra
[7] As proved by the indorsement on the petition of a date stamp showing the date of presentation
[8] Although not addressed in the report of the case, a search had in fact been conducted of the Central Register of Winding-Up Petitions but the presented petition was not registered as it had not been entered by the court on the computer system.
[9] Cf. *Re a Debtor (No 88 of 1991)* [1993] Ch 286 as regards statutory demands.
[10] Cf. *Re Awan* [2000] BPIR 241

7.1. a QFCH "may not" appoint an administrator if there is a prior floating charge "unless" he has given 2 business days' written notice to that holder or obtained his consent in writing: para. 15(1);

7.2. a QFCH "shall" file with the court a notice of appointment and other prescribed documents: para. 18(1), the notice "must" include a statutory declaration containing the matters prescribed in para. 18(2) which "must" be made during the prescribed period: para. 18(6), "must" identify the administrator and be accompanied by a statement from the administrator containing the matters prescribed in para. 18(3) and the notice and accompanying documents "must" be in prescribed form: para 18(5);

7.3. the company or directors if seeking to appoint an administrator under para. 22:

7.3.1. "shall" give at least 5 business days notice in prescribed form to a person entitled to appoint an administrative receiver or administrator: para. 26(1);

7.3.2. "shall" give notice in prescribed form to such other persons as shall be prescribed, e.g. sheriff, person having distrained, supervisor: para. 26(2); r. 2.20(2) IR 1986;

7.3.3. "shall" file notice of intention to appoint and accompanying documents in court: para. 27(1), including a statutory declaration in prescribed form containing the matters referred to in para. 27(2);

7.3.4. the appointment "may not be made" unless the requirements of paras 26 and 27 have been complied with and the period of notice under para. 26(1) has expired or each person to whom notice is given has consented in writing: para. 28(1);

7.3.5. the appointment "may not be made" after the period of 10 business days beginning with the date on which the notice of intention to appoint is filed in court: para. 28(2).

8. Furthermore, the court has construed those requirements strictly, so even a technical failure as regards the form of notice used, is such as to render the purported appointment of the administrator invalid. In *Re G-Tech Construction Ltd* [2007] BPIR 1275 the company had sought to appoint an administrator. However it had filed the wrong prescribed notice of appointment in court – it filed a form 2.9B (to be used after giving of notice to appoint an administrator), when it ought to have filed a form 2.10B (to be used where there is no need to serve a notice of intention to appoint an administrator). The error was entirely accidental, technical and no one suffered any prejudice, given that there was no one on whom a notice of intention to appoint an administrator needed to be served. However Hart J held that the filing of the prescribed form 2.10B was a "critical step" which was "a necessary prerequisite of an appointment taking effect under para 31 of Sch B1". Notwithstanding the failure was entirely innocent, a technical breach and that the administration had been carried on for 12 months with success, the judge held that there had been no valid appointment of the administrator. The judge was asked to ratify or declare the appointment valid but concluded that he could not do so.

9. Whilst Fletcher, Higham & Trower in Corporate Administrations and Rescue Procedures, 2nd Ed. Para. 1.57 suggest that it might be possible to characterise minor non-compliance with the provisions of Sch. B1 as a formal defect and remedy the defect under r. 7.55 IR 1986, Hart J concluded that that rule could not be relied upon in the case before him because even if one accepted that the proposed administration was an "insolvency process"[11] because of the interim moratorium under para. 44(2), that process came to an end once the 5 days under para. 44(2)(b) elapsed, given that the appointment of the administrator did not take effect under para. 31 because the requirements of para. 29 were not satisfied. The judge regarded the provisions of para. 31 to 35 as being insuperable for the r. 7.55 argument.

10. Hart J also held in *G-Tech* that para. 104 Sch. B1 ("An act of the administrator of a company is valid in spite of a defect in his appointment or qualification") did not assist. It did not cure the

[11] Which HHJ Norris QC held in *Blights Builders* it was not as it was not an insolvency proceedings.

fact that the administrator had not been validly appointed and there had been no administration because the requirements of para. 29 had not been complied with: para. [16] *G-Tech*.

11. Given the entirely technical failure to use the correct prescribed form in *G-Tech*, it appears likely that failure to use the prescribed forms or comply with the other mandatory appointment requirements under Sch B1 will result in the appointment of administrators being held to be invalid. The difficulty in large part stems from the wording of the relevant paragraphs dealing with the commencement of the appointment of administrators, namely para. 19 for the QFCH "The appointment of an administrator under paragraph 14 takes effect when the requirements of paragraph 18 are satisfied" and para. 31 for the Company/directors "The appointment of an administrator takes effect when the requirements of paragraph 29 are satisfied" coupled with the mandatory wording and prescribed forms as regards the satisfaction of the requirements.

12. In *Fliptex Ltd v Hogg* [2004] BCC 870 the court rejected an argument that the appointment of an administrator is made or occurs as at the date of the notice of appointment by a QFCH and that there is a distinction between the date when the appointment is made and the date when the appointment takes effect. Peter Smith J rejected that contention in reliance on para. 19 (para. 32 judgment): "Where out of court appointments take place there will be no clear mechanism identifying the date and time when an appointment takes effect (contrast court appointments). It is therefore logical to dictate that the appointment is only effective when the conditions of paragraph 18 are satisfied. All documents executed before that date are executed subject to a condition that the appointment would become effective. … The appointment only becomes effective for all purposes when the conditions in paragraph 19 are satisfied and it is then unconditional. That gives a clear date when everybody knows all the conditions are satisfied and the appointment becomes effective. The idea that there is an appointment made, but not effective, but nevertheless is treated as having an effect is not a result that the draftsman of the schedule could have contemplated." The judge relied by way of analogy with the execution of a deed (para. [35] judgment) "A deed might be executed in advance, subject to a condition, which has to be fulfilled. In the case of deeds when the condition is fulfilled the deed operates retrospectively to the date it was executed. Paragraph 19 makes it clear that that is not intended to be the case in respect of the appointment of an administrator. It makes it clear that the effective appointment is only when the conditions are satisfied."

Inchoate appointments

13. The above analogy suggests that in certain cases one may have an inchoate appointment, i.e. the procedure for appointment has been commenced, e.g. by a QFCH filing a notice of appointment under para. 18 but if a particular mandatory document has not been filed (if there is a joint appointment, say a para. 100(2) statement annexed to the notice of appointment which "must" specify what functions are to be exercised jointly and what functions to be exercised by any or all of the appointees), the appointment is neither valid nor invalid but remains inchoate until the required document is filed at court. There may therefore be cases where the appointment can be validated and made effective by the subsequent filing of documents, albeit the administrator will not have had power to act in the interim.

Defect in appointment

14. It may be possible to argue that an omission or error in a prescribed form or other failure to comply with Sch.B1 provided it is not a mandatory requirement does not render the appointment invalid but merely defective. It would be necessary however to show that the requirements of para. 18 (for QFCH) or para. 29 (for Company/directors) were satisfied. The scope for a "defective" but valid out of court appointment appear to be limited.

The position of third parties

15. If there is little room for a defective but valid out of court appointment of an administrator, it does raise the issue as to the scope of the protection afforded by para. 104 Sch. B1 to third parties dealing with the purported administrator, which provides "An act of the administrator of a company is valid in spite of a defect in his appointment or qualification". If the administrator's appointment is not valid, then it is difficult to see how para. 104 can be engaged, as there

would be no act "of the administrator" as the act would be that of someone who was not an administrator.

Practical solutions

16. Depending upon when the problem is spotted, what actions have been taken by the purported administrator and whether there is co-operation between the company / QFCH it may be possible for a fresh appointment to be made out of court. If not, then the solution will usually be the appointment of an administrator by the court. In *Blights Builders* the petitioning creditor was persuaded to apply for the appointment of administrators instead of seeking a winding up order and to propose the original invalidly appointed administrators as administrators. On being satisfied as to (i) insolvency and (ii) likely achievement of purpose of administration (better realisation), the Court duly appointed the proposed administrators.

17. Where the petitioning creditor is less compliant, the more usual practice would be for the company or its directors to issue an administration application under para. 12 Sch. B1, including an application for a declaration as to the invalidity of the initial appointment of administrators, preferably returnable on a date before the hearing of the winding up petition and prior to its advertisement. Notice of the application has to be given to the petitioning creditor: para. 12(2)(d) Sch B1; r. 2.6(3)(b) IR 86. Ideally the applicant will seek to persuade the petitioning creditor to consent to the administration application or at least not oppose it. Provided that the petitioning creditor is satisfied as to (i) the independence of the proposed administrators, (ii) the purpose of the administration, (iii) that it is likely to result in a better return to creditors than a liquidation and (iv) that their costs as petitioning creditor are payable as an expense of the administration, in practice petitioning creditors will usually not object.

Ancillary orders

18. In *Blights Builders* HHJ Norris QC in addition to the appointment of administrators made further ancillary orders:

    18.1. providing the invalidly appointed administrators with an indemnity against the executors who purported to appoint them, pursuant to para. 34(2) Sch. B1 "against liability which arises solely by reason of the appointment's invalidity". Presumably, given the invalidity, the purported administrators' actions would have been as trespassers and their acts invalid and the indemnity was intended to protect them from claims by third parties, although this is not clear from the case.

    18.2. the judge considered that para. 34 did not enable him to grant an indemnity as against the executors to cover the purported administrators' remuneration whilst acting under the invalid appointment, as he did not consider that a claim for such remuneration was "a "liability" which arises solely by reason of their appointment": para. [13] judgment.

    18.3. as regards remuneration, the purported administrators could not recover their time costs for working as purported administrators, notwithstanding their subsequent appointment as administrators as such costs were incurred under an invalid appointment and prior to the date of their appointment as administrators by the court. However the judge considered that the purported administrators had a potential claim to recover remuneration and expenses incurred by them but by way of a quantum meruit insofar as such services in collecting in assets had benefited the estate. The judge considered that the purported administrators should seek to agree the same with the creditors and gave liberty to apply to the court if agreement could not be reached: para. [13] and [18] judgment.

    18.4. the judge also made a declaration (see para. 14 judgment) that pursuant to para 104 Sch B1, the purported administrators' acts "as joint administrators are to be treated as valid in spite of the defect in their appointment".

The alternative procedure – retrospective order

19. The procedure adopted in *Blights Builders* and in particular the ancillary orders referred to above were predicated on the appointment of the administrators taking effect from the date of

the court order. The ancillary orders were therefore required to cater for the invalidity of the purported administrators' actions under the invalid appointment. Subsequent to the hearing of *Blights Builders* (2 October 2006), the case of *G-Tech Construction Ltd* [2007] BPIR 1275 was reported, a decision of the late Hart J. given prior to *Blights Builders* on 29 September 2005[12]. In *G-Tech*, having held that the purported appointment of the administrators in the case before him was invalid[13], the judge was asked to and granted an order appointing administrators with retrospective effect. The invalid appointment had occurred on 14 September 2004 and the judge made the appointment with effect from 30 September 2004, that date being selected so as to avoid such appointment having automatically expired by effluxion of time as soon as the order was made. Whilst expressing some initial reservations as to whether he could make a retrospective order, Hart J was persuaded (paras. [20-21] judgment) that there was no prohibition in the IA 1986 preventing such an order and the wording of para. 13.1 of Sch. B1 was sufficiently wide to give the court power to make a retrospective order, albeit "it is a jurisdiction to be exercised in relation to administration orders with extreme caution". The reference in the judgment to para. 13.1 may in fact be a reference to para. 13.2 Sch. B1 which provides that "An appointment of an administrator by administration order takes effect – (a) at a time appointed by the order, or (b) where no time is appointed by the order, when the order is made."

20. It should be stressed that the decision in *G-Tech* was made without adversarial argument, in respect of a case where the invalidity arose from a very technical defect in the appointment process, the administration had been successful and was about to be concluded when the defect was spotted by someone with an eagle-eye in the administrator's staff and the administrator had very properly brought the defect to the court's attention. However the case has been followed and retrospective orders for the appointment of administrators have been granted in practice in a number of unreported cases.

21. Retrospective appointment of administrators is the preferred relief following an invalid appointment if the court can be persuaded to grant it[14] because the effect of a retrospective order is, as described by Hart J (para. [22] *G-Tech*) "designed to ratify the acts of Mr. Clarke in the period prior to the date hereof, and to render the fees and expenses incurred by him prior to today for acting as [purported administrator] to be treated as remuneration [and] his expenses under para. 99.3 of Sch B1; and, so far as possible to produce a situation in which, albeit … with effect from 20 September and not 14 September, as if he had all along been validly appointed as administrator and his term of office extended to a time sufficient for him to be able to complete the administration in the manner in which it is currently proposed to do". It thereby avoids the difficulties over remuneration, potential invalidity of dispositions by the purported administrator and whether the court can validate acts as HHJ Norris QC did in *Blights Builders*.

B. Exits

Effluxion of time

22. The most common exit problem is the inadvertent cessation of the administrator's appointment by effluxion of time under para. 76 Sch. B1 and/or coupled with a failure to obtain an extension order under para. 76(2)(b) by consent of the creditors[15] or an extension order from the court under para. 76(2)(a) prior to the expiry of the period. As regards extension by the court, it is of course imperative that the application comes before the court and order is made prior to the expiry of the administrator's term, as para. 77(1) provides that the court may not extend the term after expiry of the term. Whilst in *TT Industries Ltd* [2006] BCC 372 it was held that the court could extend the term if (i) the application for extension was made before the expiry of the term of office and (ii) there was a real possibility that the way the application was handled by the court contributed to the fact that no order was made prior to expiry of the term, HHJ Norris

[12] Because of the untimely death of Hart J the judgment was not corrected and approved by the judge prior to his death and the report of the case contains a number of gaps in the transcript of the judgment.
[13] See above.
[14] Alternative relief in the form granted in *Blights Builders* can be sought as a fall back.
[15] Particular beartraps are (i) only obtaining the consent of the main secured creditor and failing to obtain the consent of "each" secured creditor under para. 78(1)(a) or 78(2)(a), (ii) applying the less stringent consent provisions in para. 78(2) when in fact no para. 52(1)(b) statement is contained in the statement of proposals, and (iii) where a distribution may be made to preferential creditors, failing to obtain consent from 50% of the preferential creditors under para. 78(2)(b)(ii).

QC gave a clear warning that a similar order was unlikely to be made in future and gave "a clear warning that (in future) applications lodged within the last few days of a current administration (where no satisfactory reason is given for the lateness) and with which the Court cannot deal during the currency of the administration are likely to be treated as cases where the order has not been obtained simply because of the default of the administrator."

23. The unfortunate former administrator who does inadvertently have his term expire is left with the options of (i) seeking a fresh administration appointment (in respect of which it is highly unlikely that the court would be prepared to appoint the administrator with retrospective effect, given the almost inevitable fault on the part of the former administrator in allowing the term to expire), (ii) applying to wind up the company and seeking appointment as liquidator (and if necessary provisional liquidator pending hearing of the petition): *Lafayette Electronics Europe Ltd* [2007] BCC 890.

Conversion to voluntary liquidation

24. The new para. 83 Sch. B1 notice procedure to enable the company to move from administration to voluntary liquidation is a popular exit route, particularly with the former administrator being appointed a liquidator but has thrown up a number of issues concerning the validity of the appointment of the former administrator as liquidator.

No prospect of distribution to unsecureds

25. Para. 83(1) provides that

"This paragraph applies in England and Wales where the administrator of a company thinks-

(a) that the total amount which each secured creditor of the company is likely to receive has been paid to him or set aside for him, and

(b) that a distribution will be made to unsecured creditors of the company (if there are any)."

26. If the notice procedure is used to convert to CVL in circumstances were there is no prospect of a distribution being made to unsecured creditors, then the condition within para. 83(1)(b) would not be satisfied, the administrator could not "think" that there was such a prospect and therefore the paragraph would not apply and could not be used by the administrator to convert the administration into a liquidation. His appointment as liquidator would therefore be invalid. If , but for the para. 83(1) notice, the administrator's term would still be running and had not expired by effuxion of time, then the administrator would still be in office as administrator. If not, then the control of the company would have reverted to the directors. The former administrator might seek a fresh appointment as administrator, if one of the purposes of administration could be achieved[16], alternatively, he could seek to wind up the company if he were still owed unpaid remuneration as administrator: see *Lafayette* (above). It appears reasonable clear that the court could not make a winding up order or appoint a liquidator with retrospective effect. Whilst s. 125(1) IA 1986 allows the court to make "any other order it thinks fit", s. 129 IA 1986 provides that "the winding up of a company by the court is deemed to commence at the time of the presentation of the petition for winding up". Furthermore, any attempt to backdate the commencement of the winding up could have adverse effect upon third parties: see e.g. s. 214, 216 IA 1986.

Failure to comply with r.2.33(2)(m)

27. Rule 2.33 (2) IR 1986 prescribes the information to be included in the administrator's statement of proposals and as regards exit via voluntary liquidation, r. 2.33(2)(m) provides that the proposal should state:

"how it is envisaged the purpose of the administration will be achieved and how it is proposed that the administration shall end. **If a creditors' voluntary liquidation is proposed, details of the proposed liquidator must be provided, and a statement that, in accordance with paragraph 83(7) and Rule**

[16] And arguably seek a retrospective order.

2.117(3), creditors may nominate a different person as the proposed liquidator, provided that the nomination is made after the receipt of the proposals and before proposals are approved."

28. If the administrator converts the administration into a voluntary liquidation and is himself appointed as liquidation in circumstances where his proposals to creditors did not (i) include creditors' voluntary liquidation as a proposed exit route or (ii) provide a statement in accordance with para. 83(7) and r. 2.117(3) that the creditors may nominate a different person as liquidator, is the liquidator's appointment valid? It is suggested that:

    28.1. notwithstanding the failure to comply with r. 2.33(2)(m) the appointment of the liquidator would be valid;

    28.2. para. 83 Sch. B1 deals with conversion to CVL. Provided para. 83(1) is satisfied (discussed above), it would appear that the notice served under para. 83(3) would be effective to result in the cessation of the administrator's appointment under para. 83(6)(a) and his appointment as liquidator under para. 83(6)(b).

    28.3. para. 83(7) provides that the administrator shall be (a) a person nominated by the creditors of the company in the prescribed manner and within the prescribed period, or (b) if no person is nominated under paragraph (a), the administrator.

    28.4. there has been no other person nominated as liquidator (albeit the creditors were not in fact given opportunity to do so), so the administrator is, by default, the liquidator.

    28.5. there would however have been a failure to comply with r. 2.33(2)(m), which the liquidator may have personally benefited from by obtaining the appointment without the creditors being informed of their right to nominate a different liquidator. It has certainly denied them any choice, even if they would in practice simply have approved the proposals and the administrator's proposal that he be appointed as liquidator. The liquidator should, it is suggested, notify the creditors of the failure to comply with r. 2.33(2)(m), that they have a right to seek to replace the liquidator with an alternative liquidator and, if appropriate, seek directions from the court.

Jeremy Bamford
Guildhall Chambers, Bristol
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