Administration Expenses

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Introduction

1. Any insolvency lawyer worth his or her salt appreciates that this is a complicated topic. Prior to the coming into force of the EA 2002, the application and operation of the rules which govern whether any particular item may rank as an administration expense were uncertain. The new regime introduced by that Act and subsequent amendments to it have increased the uncertainty. It would be a rash practitioner who expressed a perfect understanding of it.

2. This has been underlined by the decision of HHJ Purle QC in *Goldacre (Offices) Limited v Nortel Networks UK Limited* [2009] EWHC 3389 (Ch) in which the court decided, probably for the first time after full argument, that rent falling due under a pre-administration lease should be treated as an expense of the administration under r.2.67(1)(f) IR 1986 (or, possibly, r.2.67(1)(a)) in any case where an administrator is using part of the demised premises beneficially for the purposes of the administration. The decision has already caused some flushing amongst insolvency professionals. Quite apart from the judge's evident dislike for parts of previous decisions of David Richards J[1] in Exeter and the CA[2] respectively, the judge has grafted the *Lundy Granite* principle onto r.2.67 in circumstances which it is considered could, without further refinement, constitute a considerable blow for rescue operations in the middle market.

3. First, it is necessary to remind ourselves of the rather strange statutory regime.

<u>Expenses of administration: Paragraph 99 of Sch B1 IA 1986 and Rule 2.67 IR 1986.</u>

4. The expenses of administration are set out in paragraph 99 schedule B1 to the Insolvency Act 1986 ("para 99") and Rule 2.67 Insolvency Rules 1986 ("rule 2.67").

5. Para 99 is entitled "Vacation of office: charges and liabilities" and provides:

> "99(1) This paragraph applies where a person ceases to be the administrator of a company (whether because he vacates office by reason of resignation, death or otherwise, because he is removed from office or because his appointment ceases to have effect).
>
> 99(2) In this paragraph—
>
> "the former administrator" means the person referred to in sub-paragraph (1), and
> "cessation" means the time when he ceases to be the company's administrator.
>
> 99(3) The former administrator's remuneration and expenses shall be—
> (a) charged on and payable out of property of which he had custody or control immediately before cessation, and
> (b) payable in priority to any security to which paragraph 70 applies.
>
> 99(4) A sum payable in respect of a debt or liability arising out of a contract entered into
> by the former administrator or a predecessor before cessation shall be—
> (a) charged on and payable out of property of which the former administrator had custody or control immediately before cessation, and
> (b) payable in priority to any charge arising under sub-paragraph (3).

[1] In *Exeter City Council v Bairstow* [2007] BCLC 236
[2] In *Sunberry Properties Ltd v Innovate Logistic Ltd* [2009] 1 BCLC 145

99(5) Sub-paragraph (4) shall apply to a liability arising under a contract of employment which was adopted by the former administrator or a predecessor before cessation; and for that purpose—

(a) action taken within the period of 14 days after an administrator's appointment shall not be taken to amount or contribute to the adoption of a contract,

(b) no account shall be taken of a liability which arises, or in so far as it arises, by reference to anything which is done or which occurs before the adoption of the contract of employment, and

(c) no account shall be taken of a liability to make a payment other than wages or salary.

99(6) In sub-paragraph (5)(c) "wages or salary" includes—

(a) a sum payable in respect of a period of holiday (for which purpose the sum shall be treated as relating to the period by reference to which the entitlement to holiday accrued),

(b) a sum payable in respect of a period of absence through illness or other good cause,

(c) a sum payable in lieu of holiday,

(d) in respect of a period, a sum which would be treated as earnings for that period for the purposes of an enactment about social security, and

(e) a contribution to an occupational pension scheme."

6. Rule 2.67(1) provides:

"(1) The expenses of the administration are payable in the following order of priority–

(a) expenses properly incurred by the administrator in performing his functions in the administration of the company;

(b) the cost of any security provided by the administrator in accordance with the Act or the Rules;

(c) where an administration order was made, the costs of the applicant and any person appearing on the hearing of the application and where the administrator was appointed otherwise than by order of the court, any costs and expenses of the appointor in connection with the making of the appointment and the costs and expenses incurred by any other person in giving notice of intention to appoint an administrator;

(d) any amount payable to a person employed or authorised, under Chapter 5 of this Part of the Rules, to assist in the preparation of a statement of affairs or statement of concurrence;

(e) any allowance made, by order of the court, towards costs on an application for release from the obligation to submit a statement of affairs or statement of concurrence;

(f) any necessary disbursements by the administrator in the course of the administration (including any expenses incurred by members of the creditors' committee or their representatives and allowed for by the administrator under Rule 2.63, but not including any payment of corporation tax in circumstances referred to in sub-paragraph (j) below);

(g) the remuneration or emoluments of any person who has been employed by the administrator to perform any services for the company, as required or authorised under the Act or the Rules;

(h) the remuneration of the administrator agreed under Chapter 11 of this Part of the Rules;

(i) the amount of any corporation tax on chargeable gains accruing on the realisation of any asset of the company (without regard to whether the realisation is effected by the administrator, a secured creditor, or a receiver or manager appointed to deal with a security).

(2) The priorities laid down by paragraph (1) of this Rule are subject to the power of the court to make orders under paragraph (3) of this Rule where the assets are insufficient to satisfy the liabilities.

(3) The court may, in the event of the assets being insufficient to satisfy the liabilities, make an order as to the payment out of the assets of the expenses incurred in the administration in such order of priority as the court thinks just.
(4) For the purposes of paragraph 99(3), the former administrator's remuneration and expenses shall comprise all those items set out in paragraph (1) of this Rule."

7. Combining both para 99 and rule 2.67 (and omitting the expenses not relevant for present purposes) gives the following order of priority:

a. A sum payable in respect of a debt or liability arising out of a contract entered into by the [former] administrator (para 99(4)).

b. The [former] administrator's remuneration and expenses payable in the order (para 99(3)):

i. expenses properly incurred by the administrator in performing his functions in the administration of the company (rule 2.67(1)(a)).

ii. any necessary disbursements by the administrator in the course of the administration (rule 2.67(1)(f)).

iii. the remuneration or emoluments of any person who has been employed by the administrator to perform any services for the company, as required or authorised under the Act or the Rules (rule 2.67(1)(g)).

iv. the remuneration of the administrator agreed under Chapter 11 of Part 2 of the Rules (rule 2.67(1)(h)).

v. the amount of any corporation tax on chargeable gains accruing on the realisation of any asset of the company (rule 2.67(1)(j)).

8. The order can, of course, be altered by the court if it there are insufficient assets to satisfy all the expenses and it considers it just to do so under rule 2.67(3). Note : there is no power in the court to re-order the expenses which fall within the super priority of para 99(4) of schedule B1.

9. Although at first sight the application of the order of priority may appear simple, there are a number of inherent difficulties:

a. para 99 applies retrospectively i.e. it applies on the vacation of office by the administrator. Therefore the question arises as to the order of expenses payable during the course of the administration. Are they to be applied in the same order? Or should they be paid out as and when they arise leaving the strict order of priority to be applied to only those expenses which remain unpaid when the administrator vacates office.

b. if they are to be applied in the same order during administration as they are when the administrator vacates office (and in our opinion they are), how is an administrator to deal with paying an expense in one of the lower categories if it is not certain whether there will be sufficient funds to pay an expense in one of the higher categories? Should an administrator wait until he vacates office to ascertain a final list of expense creditors or at least until there is certainty as to the extent of expenses and realisations? A deficiency as regards expenses will not usually arise because it will be apparent at the outset that there will be sufficient funds to pay all the expenses, in which case they can be paid as they arise. The issue arises on the rare (but increasingly occurring) occasion when there are insufficient funds to cover all the expenses in full.

10. In order to resolve these questions it is necessary to examine briefly the history of these provisions.

11. Para 99 effectively re-enacted s19 IA 1986 with minor changes in wording (which are thought to be a modernisation of the language and for present purposes are not considered to be significant). This was achieved with effect from 15th September 2003 by Part X of the Enterprise Act 2002 and at the same time as the introduction of schedule B1 into the Act. Para 99(3) corresponds to s19(4) and para 99(4) corresponds to s19(5). Prior to the introduction of para 99 there was no equivalent to rule 2.67. Rule 2.67 also came into force on 15th September 2003. Consequently, the expenses of administration pre-15th September 2003 were "debts and liabilities incurred ... under contracts entered into by [the administrator]" and "remuneration and any expenses properly incurred by [the administrator]" under what are now paras 99(4) and 99(3) respectively. There was no prescribed list of expenses and the generally held view was that the administrator had a discretion as to which expenses to pay and in which order. The decisions of the Court of Appeal in *Re Atlantic Computer Systems plc* [1990] BCC 859 and the House of Lords in *Centre Reinsurance International Co v Freakley* [2006] UKHL 45 support this view.

12. The question which expenses fell within s 19(4) and which fell within 19(5) arose often in practice but was seldom addressed in the reported case law. However, the issue arose directly for determination in *Re a Company (no 005174 of 1999)* [2000] 1 WLR 502, involving the payment of solicitors' fees for legal advice given to the administrator. Neuberger J took the view that:

> "As a matter of language it seems to me that a payment by the liquidator for legal advice falls equally naturally within the expressions "expenses properly incurred by him" and also "debts or liabilities incurred under contracts entered into by him." In my judgment, legal expenses properly incurred by an administrator in connection with his duty or role as an administrator fall within section 19(5), and not within section 19(4), as a matter of construction. ...
> "It seems to me that section 19(4) and (5) are best reconciled by limiting the expenses falling within subsection (4) to those which are not within subsection (5) . The administrator may for instance use petrol, stationery, stamps and other items which he or she cannot say were incurred pursuant to contracts which fell within section 19(5), as no contract was entered into by the administrator in respect of them save when the petrol, stationery or stamps were bought which may have been before the administration or for general purposes. However, the expenditure would, as I see it, be recoverable under section 19(4). This produces to my mind a more consistent correlation between subsections (4) and (5) . In my judgment, section 19(4) applies to cases where the administrator is entitled to recover sums other than under contracts he or she entered into on behalf of the company, i.e. his or her remuneration, and outgoings which cannot be said to fall within section 19(5)." (at page 514)

13. Neuberger J. therefore gave precedence to s19(5). Expenses incurred by the administrator would fall within s19(5) and if they could not be brought within the wording of this section they would fall within the residual category of s19(4). In this regard it is to be noted that the expenses in rule 2.67(1) are very narrow and cannot be described as liabilities arising out of a contract (with the possible exception of those within 2.67(1)(g)) such that, if an expense can be categorised as a liability arising out of a contract, it falls within para 99(4)). In particular, the expenses in 2.67(1)(a) were held by David Richards J in *Exeter City Council v Bairstow* [2007] EWHC 400 (Ch) to be restricted to "...typically small items such as travel expenditure ... ". These roughly correspond to those found by Neuberger J in *Re a Company (no 005174 of 1999)* to fall within s19(4) namely "...petrol, stationery, stamps and other items ...". However, HHJ Purle QC doubted this proposition in *Goldacre* (see paras 9 and 10). This may not be regarded a moot point and it is a very important one in any case where there is an insufficiency of assets from which to pay all expenses.

14. The other expenses listed in 2.67(1) are :

    a. the costs of security provided by the administrator (2.67(1)(b));

    b. the costs of any applicant for an administration order (2.67(1)(c));

c. the costs of the preparation of the statement of affairs (2.67(1)(d));

d. necessary disbursements which include statutory liabilities i.e. corporation tax (*Toshoku*) business rates (*Exeter City Council v Bairstow*) and, in our opinion, VAT (2.67(1)(f));

e. the remuneration and emoluments of employees (2.67(1)(g));

f. the remuneration of the administrator (2.67(1)(h)); and

g. corporation tax on chargeable gains (2.67(1)(j)).

15. In parallel to these decisions on administration expenses, the HL decided in *Kahn v IRC, Re Toshoku Finance (UK) Ltd* [2002] UKHL 6 that as far as liquidations were concerned rule 4.218 gave an exhaustive list of expenses, holding that there was no discretion as to how they were to be applied. The task of the liquidator was to ascertain into which category an expense fell and to apply the rules as to priority accordingly.

16. There are a number of theories as to why rule 2.67 was introduced. The predominant one is that when the administration regime was recast it allowed administrators to make distributions to be made to creditors thus obviating the need for a liquidation. Such distributions would be permanent, giving rise to the need to identify a similar regime for the priority of expenses as that obtaining in a liquidation. It is also understood that HMRC were concerned that this would allow the administrator to pay distributions following payment of expenses, which were considered to be at the discretion of the administrator, and would thus allow the administrator to make a distribution to creditors whilst at the same time excluding debts due to HMRC. Given that Parliament made it clear that it was intended that the administration procedure should become the "insolvency procedure of choice", it was considered necessary to make the administration expenses regime mirror that of liquidation so that the choice between the two should only be influenced by commercial factors and not other factors such as differences in the way the two regimes were taxed.

17. However, the introduction of rule 2.67 was not tied into para 99 and, to the extent that para 99 appeared to allow a discretion (following the decisions on s19) as compared to the strict order of priority provided for in rule 2.67, the two sets of provisions appeared to be contradictory. The apparent contradiction was resolved with effect from 1 April 2005 when rule 2.67(4) was added - providing that the administrator's remuneration and expenses mentioned in para 99(3) are those set out in rule 2.67 (Insolvency (Amendment) Rules 2005 (SI 2005/527), r.8).

18. The order of priority in rule 2.67 is obviously based on that set out in rule 4.218 for liquidations; however, liquidations have no equivalent to the priorities set out in para 99. This, in turn, gives rise to number of questions: first, is there any discretion left as to the payment of expenses in administration?; secondly, if rule 2.67 mirrors rule 4.218 and expenses previously in s19(5) (now para 99(4)) are now subsumed into the categories in rule 2.67, what expenses are now left in para 99(4) - other than employment contracts adopted by the administrator which are specifically provided for in 99(5)?

19. Some of these issues were addressed by David Richards J in *Exeter City Council v Bairstow* [2007] EWHC 400 (Ch), a case involving business rates. It had previously been held in *Freakley* that what was or was not an expense was a question for the administrator subject to the supervision of the court. Lord Hoffmann said:

> "The provisions of s.19(4) and (5) entrust to the administrator (subject to the supervision of the court) the power to decide what expenditure is necessary for the purposes of the administration and should therefore receive priority. But there is no reason to extend that priority to expenditure which neither the administrator nor the court has specifically approved."

20. On this basis, under the old regime, business rates were not an expense of administration. However, in the *Toshoku Case* it was held (again Lord Hoffmann) that the case of *Re*

Kentish Homes Ltd [1993] BCLC 1375, in which a post-liquidation liability to pay the community charge was held not to be an expense of liquidation, was wrongly decided. Consequently, a liability to pay post-liquidation rates was an expense and was a necessary disbursement. Following the introduction of rule 2.67(4), David Richards J held that the legislature must clearly have had in mind rule 4.218 when enacting it and so if something is an expense of liquidation it would be an expense of administration under the corresponding rule.

> "... the reasonable inference is, that by adopting for rule 2.67 the same terms as rule 4.218, the intention was that it should carry the same meaning."

21. He therefore held that the introduction of rule 2.67(4) importing rule 2.67(1) into para 99(3) had the effect of making rates an expense of administration.

22. It would appear that, based on the decisions of David Richards J in *Exeter City Council* and HHJ Purle QC in *Goldacre,* the application of 2.67 is to be informed by the application of rule 4.218. It is therefore necessary to determine whether a payment constitutes an expense and then to categorise the expense within those set out in rule 2.67. There is no (longer any) discretion in this matter. However, David Richards J was also of the opinion ([2007] EWHC 400 (Ch) at paragraph 63) that:

> "The costs of purchasing goods or services essential to the business would, if supplied under contracts made by the administrators, enjoy super-priority over expenses under paragraph 99(4)."

23. This continues to recognise the distinction drawn between s19(4) and s19(5) by Neuberger J and is consistent with the view expressed above that the expenses in rule 2.67 are not those incurred under contracts entered into by the administrator.

24. As already stated, in the vast majority of administrations the asset realisations will be sufficient to pay the expenses in full. It is usual therefore for an administrator to pay the expenses as and when they occur. This was recognised in the pre-Enterprise Act period by Dillon LJ in *Powdrill v Watson; Re Paramount Airways Ltd (No.3)* [1994] 2 All E R 513 at 522:

> "Although strictly sums payable are, under s.19(5), only payable when the administrator vacates office, it is well understood that administrators will, in the ordinary way, pay expenses of administration including the salaries and other payments to employees as they arise during the continuance of the administration. There is no need to wait until the end, and it would be impossible as a practical matter to do that. What is picked up at the end are those matters which fall within the phrase, but have not been paid".

25. As wages and salaries command a super priority over other expenses under para 99(5), these will be paid in priority to all other expenses and it is probable that an administrator is safe to pay them out as and when they arise. Only if there were other debts and liabilities incurred, which rank pari passu with the wages and salary, and insufficient funds to pay them all, would there be an issue. However, where there are different classes of expense, should the administrator pay out expenses in a lower category before those in a higher category and risk having insufficient funds when it comes to paying those in the higher category?

26. The issue in relation to liquidation expenses was addressed by Lord Hoffmann in Toshoku:

> "The fact that a debt counts as an expense of the liquidation does not necessarily mean that the creditor should be allowed immediately to bring proceedings or levy execution. The order of priorities under rule 4.218(1) may mean that if he is paid at once, the assets to satisfy prior expense claims may be insufficient. So the question of remedy is entirely a matter of discretion. But the discretion does not determine whether a claim is a liquidation expense or not. It is rather the other way round; the claim must be a liquidation expense before the court can have a discretion to grant a remedy which will enable the creditor to obtain payment in priority to other claims."

27. Following *Exeter City Council* and *Goldacre*, if the administrator has no discretion as to how the order of expenses is to be paid because rule 2.67 is to be construed as mirroring rule 4.218, it follows that the reasoning adopted by Lord Hoffmann in *Toshoku* (as to whether it is permissible to pay out expenses when it is uncertain whether expenses in a higher category will ultimately be satisfied) should also be followed. Consequently, if there is any doubt as to whether there are sufficient funds to satisfy the totality of the prospective expenses, the Administrators should refuse to pay those that are doubtful or seek the court's permission before paying them.

28. Alternatively it is for the expense creditor to apply to court to seek an earlier payment.

The categories of expense

29. Rule 4.218 provides for the expenses of liquidation. Set out below are the liquidation expenses with the administration rule equivalent given in brackets.

> "(3) ... the expenses are payable in the following order of priority—
> (a) expenses which—
>
> (i) ...
> (ii) are properly chargeable or incurred by the official receiver or the liquidator in preserving, realising or getting in any of the assets of the company ...
> (iii) ...
> (iv) ...
>
> (b) ...
> (c) ...
> (d) (i) ...
> (ii) .;
> (e) the cost of any security provided by a provisional liquidator, liquidator or special manager in accordance with the Act or the Rules; (***Administration rule 2.67(1)(b)***)
> (f) ...;
> (g) ...
> (h) the costs of the petitioner, and of any person appearing on the petition whose costs are allowed by the court; (***Administration rule 2.67(1)(c)***)
> (j);
> (k) any amount payable to a person employed or authorised, under Chapter 6 of this Part of the Rules, to assist in the preparation of a statement of affairs or of accounts; (***Administration rule 2.67(1)(d)***)
> (l) any allowance made, by order of the court, towards costs on an application for release from the obligation to submit a statement of affairs, or for an extension of time for submitting such a statement; (***Administration rule 2.67(1)(e)***)
> (la) ...
> (m) any necessary disbursements by the liquidator in the course of his administration (including any expenses incurred by members of the liquidation committee or their representatives and allowed by the liquidator under Rule 4.169, but not including any payment of corporation tax in circumstances referred to in sub-paragraph (p) below); (***Administration rule 2.67(1)(f)***)
> (n) the remuneration or emoluments of any person who has been employed by the liquidator to perform any services for the company, as required or authorised by or under the Act or the Rules; (***Administration rule 2.67(1)(g)***)
> (o) the remuneration of the liquidator, up to any amount not exceeding that which is payable under Schedule 6; (***Administration rule 2.67(1)(h)***)
> (p) the amount of any corporation tax on chargeable gains accruing on the realisation of any asset of the company (without regard to whether the realisation is effected by the liquidator, a secured creditor, or a receiver or manager appointed to deal with a security); (***Administration rule 2.67(1)(j)***)
> (q) ...

(r) any other expenses properly chargeable by the liquidator in carrying out his functions in the liquidation.

30. The two sets of provisions are effectively identical. There are 2 points to be made.

31. **First**, rule 2.67(1)(a) provides for expenses "properly incurred by the administrator in performing his functions in the administration of the company" there is no corresponding rule in 4.218. Instead, rule 4.218 provides for expenses which "are properly chargeable or incurred by ... the liquidator in preserving, realising or getting in any of the assets of the company". At first sight these might look similar. Any variations might be explained by the different functions of an administrator and a liquidator. In the case of the administrator the functions are potentially far wider in that an administrator must perform his functions with one of the objectives in paragraph 3 of schedule B1 in mind, namely: (a) rescuing the company as a going concern; or (b) 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 (c) realising property in order to make a distribution to one or more secured or preferential creditors. As is regularly pointed out, this is intended to be a rescue procedure; the primary intention is that the company and/or its business should survive. Whereas in the case of a liquidator the functions are effectively to realise the assets in what is a terminal procedure; ultimately the company will be dissolved but in the meantime the liquidator is to hold the assets until they are realised for the benefit of creditors.

a. However, in *Exeter City Council,* David Richards J adopted a very restrictive interpretation for the meaning of expenses "properly incurred by the administrator in performing his functions in the administration of the company" (for these purposes it will be assumed that his view will be preferred to that of HHJ Purle QC in *Goldacre*). He said ([2007] EWHC 400 (Ch) at paragraph 52):

> "... its terms ("expenses properly incurred by the administrators") are virtually identical to the words of section 19(4) which were construed in *Centre Reinsurance Co v Freakley* to mean expenses for which the administrator made himself personally liable. It was objected by Mr Trower that as the administrator acts as agent for the company (schedule B1 para 69) there is no little or no scope for personal liability. However, the administrator was also an agent under the old regime considered in *Centre Reinsurance Co v Freakley* (section 14(5)). Notwithstanding his agency status, there may be circumstances under both regimes when the administrator considers that he must assume personal liability. This is expressly contemplated by the 1986 Act in at least one instance, the supply of utilities (section 233). There are also likely to be circumstances where the administrator has properly incurred expenses which he has paid from his own resources and for which he can claim reimbursement, typically small items such as travel expenditure: see *In re A company (no 005174 of 1999)* [2000] 1 WLR 502 at 513-514. Secondly, if paragraph (a) is confined in this way, its priority over other expenses is more readily explicable. Thirdly, the City Council's construction would result in an overlap between paragraph (a) and other expenses. In particular this would apply to rates which, if the decision in *In re Toshoku Finance UK plc* is to be applied to administrations, would constitute necessary disbursements falling within paragraph (f). There is no sound reason for treating rates for the purposes of rule 2.67 as expenses incurred by the administrator as opposed to necessary disbursements."

b. If the words in rule 2.67(1)(a) "are virtually identical to the words of section 19(4)" (and therefore to be interpreted as having the same function) and section 19(4) was re-enacted in para 99(3) it follows that rule 2.67(1)(a) is the same as para 99(3). The linkage of rule 2.67(1) to para 99 by the introduction of rule 2.67(4) either extends para 99(3) by adding further classes of expense below those already included in para 99(3) or, as in our opinion is more probable, merely lists those expenses which do not arise out of contracts entered into by the administrator but which need to be paid in priority to anything else.

c. Notwithstanding : (i) David Richards J's finding that the expenses in rule 2.67 are to be interpreted in the light of rule 4.218; and (ii) the similarity between the rule 2.67(1)(a) and rule 4.218(3)(a)(ii) (see paragraph 41 above), it is inconceivable that

4.218(3)(a)(ii) should be restricted to expenditure for which the liquidator is personally liable. Rule 4.218(3)(a)(ii) goes to the heart of a liquidator's function namely, preserving, realising or getting in any of the assets of the company for the benefit of the creditors.

d. Consequently, unless HHJ Purle QC is correct in *Goldacre*, there appears to be no such provision for administrations i.e. there is no provision in rule 2.67 (1) which allows the administrator to pay expenses which go to the heart of his functions in para 3. It is strongly arguable that this is the purpose of para 99(4). This was obliquely recognised by David Richards J when he said ([2007] EWHC 400 (Ch) at paragraph 63):

> "The costs of purchasing goods or services essential to the business would, if supplied under contracts made by the administrators, enjoy super-priority over expenses under paragraph 99(4)."

e. If an administrator incurs a contractual debt or liability in performing his duties in paragraph 3 this will be an expense in para 99(4). Other non-contractual liabilities fall into one of the other categories of expense in rule 2.67(1).

f. Against this background, it is instructive to enquire which category of expense fall the fees of lawyers instructed by the administrator to advise him on legal issues arising in the course of his office – para 99(4), rule 2.67(1)(a) or (f) ? Where there is an insufficiency, this might well matter greatly.

32. **Secondly**, rule 2.67 has no equivalent to the catch-all rule 4.218(3)(r) (namely: "any other expenses properly chargeable by the liquidator in carrying out his functions in the liquidation"). This is a residual category. It is unclear why there is no such residual category for administrations. It may be to the extent that the expenses are properly chargeable they are already included in the wider priority regime created by para 99(4). It is difficult to envisage a situation where the administrator has not incurred a debt of liability and yet is under an obligation to pay. Statutory liabilities would be dealt with as necessary disbursements under 2.67(1)(f).

A word or two on *Goldacre*

33. *Goldacre* raises many questions. Suppose a case where the landlord obtains an order forfeiting the lease for non-payment of rent and the company obtains relief from forfeiture but then breaches the terms of the relief (such that the lease stands forfeit subject only to a continuing right to apply again for relief – forfeiture in this respect being treated by the court as merely a security mechanism).

34. *Goldacre* confirms that it is necessary for the landlord to establish that the liability in question must fall within r.2.67 if it is to receive payment of rent as an expense of the administration. It also demonstrates that the only means of doing so (unless one wishes to persuade a court that the reserved and considered judgment of David Richards J in the *Exeter* case was wrong in relation to the narrow interpretation of r.2.67(1)(a)) is to show that the *Lundy Granite* principle applies. But that principle applies only to contracts adopted by the insolvency office-holder. In the hypothetical case of the forfeited lease, the relevant contract is a lease that has at all material times been forfeit – it does not exist and is incapable of being adopted. There is no room for the application of the *Lundy Granite* principle in such circumstances.

35. In *Goldacre*, the administrators had already paid rent under an existing lease for the beneficial use of the premises and the question arose whether they were liable for the future rent as an expense of the administration. In many cases and in the hypothetical case, the position will be substantially different. The newly-appointed administrators will be considering whether to apply for relief from forfeiture in respect of a contract which had ceased to exist under which there was no longer any ongoing liability at all to pay rent. They will be in the first stage of the administration, considering the nature and extent of proposals

to make to creditors. *Goldacre* did not address the issue whether administrators are permitted a 'breathing space' to decide whether or not to use premises for the benefit of creditors before any liability to pay rent as an expense arises. For example, if a monthly rental payment fell due two days after the company has entered administration are the administrators obligated to pay that rent in full as an administration expense even if by the end of that week they have decided to return the premises to the landlord? In this respect, the reasoning and decision in *In re A.B.C Coupler & Engineering Co. Ltd (No.3)* [1970] 1 WLR 702 is of relevance. Even if the lease had remained in existence, as *Coupler* demonstrates, there may well be no beneficial use of the premises during the early period when a decision is still to be made whether to adopt the lease.

36. There was no question raised in the judgment in *Goldacre* as to whether there was a market for the premises in the hands of the landlord. By contrast, in many cases in the current climate there is no such market – see e.g. the facts of *Sunberry*. It is unclear whether "rent" or an occupation fee should be payable when the landlord cannot re-let?

37. More generally, in the hypothetical case, the pre-administration decision to allow a company tenant to continue in occupation after forfeiture of the lease would appear to be fatal to a subsequent claim by a landlord in respect of continued occupation by the administrators (ignoring for present purposes the possibility of a wholly different claim based on alleged trespass). Whilst one would understand entirely the commercial reasons for doing so – if there was no market for the premises at that time – the corresponding risk was that the company should become formally insolvent at a time when the lease had ceased to exist. It would appear to be inevitable that any responsible office-holders appointed as administrators in such circumstances would require a short time to consider whether to apply to revive the lease (which in turn would depend on finding a purchaser for some or all of the business). That period of reflection by the administrators will often be less than the statutory period allowed for placing proposals before creditors.

38. It is predicted that the real problem posed by *Goldacre* derives from the understandable reliance placed by the judge on para 39 of Lord Hoffmann's judgment in *Toshuko* (see para 26 of *Goldacre*). This point will be amplified at the seminar. In the meantime, it might be worth bringing out a few more wrinkles in the statutory expense regime for administrators by a brief consideration of the position when they *receive* rent.

Administrators receiving rent – treatment of VAT as an expense?

39. Suppose that the company has granted a valid fixed charge over rental income (i.e. a typical and effective opco / propco situation) but not the other tenant contributions (including VAT), what is the status of the VAT in the administrators' hands? The case law demonstrates that the issue of accounting for taxes in an insolvency is coloured as much by public policy as it is governed by the application of legal principle. This is nowhere better expressed than in the case of *Re John Willment (Ashford) Ltd* [1979] STC 286 in which Brightman J considered the argument that a receiver had a discretion which operated to allow the receiver a choice between paying the chargee or Customs. At page 287(f-g) he expressed his view:

> "This is a summons by a receiver and manager appointed by a debenture holder to decide what he should do with value added tax charged and received by him in the course of trading on behalf of the company. The obvious answer is that he should account to the Commissioners of Customs and Excise. But an answer is not quite so simply given and it has been necessary to consider the absurd alternative that he is entitled to collect the tax and apply the money in discharge of the principal, interest and other moneys due under the debenture."

40. Similarly, in *In re Wedgecroft Ltd* (unreported) 7 March 1986 Harman J. referred to Crown debts [tax] as "quasi-trust" moneys and the failure to pay them more morally culpable than failure to pay ordinary commercial debts. In *Sargent v CCE* [1995] STC 398 Nourse LJ (giving the only judgement of the Court of Appeal) referred specifically to the public policy aspect at page 404d:

> "In my judgement the argument based on public policy remains a sound one"

41. The facts in both *Sargent* and *John Willment* were very similar. In both cases a receiver was appointed under a fixed charge and received rents and VAT in respect of the properties over which they were appointed. It was argued in *John Willment* that a receiver had a discretion whether or not to pay over the VAT element to Customs. It was held that although there was a discretion, it was illusory; to exercise the discretion in favour of paying the chargee instead of Customs would result in the company committing a criminal offence and therefore there was really no discretion. The VAT had to be accounted for to Customs. By the time that *Sargent* came to be decided the criminal sanction had been repealed; however, it was held that public policy dictated that the VAT element still had to be accounted for to Customs. It was also held that the receiver was not personally liable for the VAT as a taxable person in his own right.

42. In both *Sargent* and *John Willment* it was accepted that the fixed charge covered both the rental income and the associated VAT. But suppose that, as is more usual, it is only the rental element that is covered by the fixed charge (i.e. that the charge always accepted that the VAT element was paid over to the company and the VAT subsequently accounted for on behalf of the Propcos. If administrators were appointed, the obligation to account for VAT would fall on them; they are the ones in receipt of the VAT element under the residual floating charge.

43. A lease is treated as giving rise to a continuous supply of services. Regulation 90(1) VATR 1995 provides:

> "where services ... are supplied for a period for a consideration the whole or part of which is determined or payable periodically or from time to time, they shall be treated as separately and successively supplied at the earlier of the following times-
>
> (a) each time that a payment in respect of the supply is received by the supplier, or
>
> (b) each time that the supplier issues a VAT invoice relating to the supplies."

44. Consider the position in receivership. The supplies of services for VAT purposes are made by the Propcos and this will be so regardless of whether a receiver is appointed. A receiver acts as agent of the chargor, the Propcos. Regulation 13(1) VATR 1995 provides that when a taxable supply is made, the person making the supply must provide a VAT invoice. Regulation 13(5) VATR 1995 provides that a VAT invoice must be provided within 30 days of the time when the supply is treated as taking place. Reg 90(1)(a) is in point for determining who is responsible for issuing the VAT invoice.

45. Regulation 90(1)(a) applies when payment is "received" by the Propcos. On a simplistic view, if no payment is received because payment is made to a receiver it could be argued that no supply has been made for the purposes of Regulation 90. However, payment to the receiver is as agent for, and for the benefit of, the company in that it goes to pay outstanding interest, principal and other amounts owed by the company to the charge. Payment is received by the company at the earliest, when the rental income is paid to the receiver and at the latest when the receiver pays it to the bank. In practice this is likely to be the same time as the amounts will be paid into the receiver's account with the bank. This also accords with the VAT treatment of the other side of the transaction. The Opcos will pay the rental income and other contributions to the receiver and will thereby be able to deduct input tax i.e. the VAT paid. It would be absurd to suggest that the Opcos could not recover this input tax because it is held "in limbo" because there is no payment to the company. As payment is made to the company the receivers would have an obligation to issue the relevant VAT invoices under Regulation 13 (5) VATR 1995 within 30 days of the payments. A tax liability will be an expense of the administration if it falls within one of the categories of expense set out in Rule 2.67 IR 1986. Under the law in force before the 15th September 2003 there was some debate as to whether tax was an expense of administration. However the matter was put beyond doubt for the purposes of the new administration regime in schedule B1 IA 1986 by the introduction of Rule 2.67 in terms similar to those for liquidations in rule 4.218.

46. Under Rule 4.218 all tax liabilities arising during the course of liquidation are expenses of the liquidation. Tax liabilities are within category (m) as necessary disbursements (unless it is corporation tax on chargeable gains in which case it falls in category (p)). There have

been attempts in the past to argue that in order for tax to be an expense it has to arise out of something done by the liquidator for the benefit of the company or its estate. In *Toshoku* the HL rejected this argument and held that rule 4.218 defined expenses of winding up and determined their priority. In that case the expenses included corporation tax on accruing interest that would never be received. It was held that the tax was within the definition of expenses and was therefore payable as an expense.

47. In our opinion, Rule 2.67 provides a similar regime to that in liquidations and VAT arising during the course of administration will be an expense within 2.67. It will fall within category 2.67(1)(f) namely: "any necessary disbursements by the administrator in the course of administration". It should be noted that (f) excludes any corporation tax payable under (j). This implies that such corporation tax would be payable under (j) as a necessary disbursement were it not excluded.

48. In *R*e *Grey Marlin Ltd* [1999] 4 All E R 429, it was held that VAT in a provisional liquidation effectively fell within category (a) (in fact it was held that it had super priority over the other expenses because of the nature of provisional liquidation). *Grey Marlin Ltd* is occasionally cited as authority for the fact that VAT enjoys the status of an expense properly incurred by the administrator in performing his functions in the administration of the company within Rule 2.67(1)(a) by analogy to the situation in that case. In *Grey Marlin* the judge held that as the VAT was charged for sales made whilst carrying on the business it was in effect paid as an expense of preserving an asset of the company, namely the goodwill. This wording in Rule 4.218(a)(i) for liquidations does not appear in Rule 2.67.

49. Since *Grey Marlin* and as already mentioned above, there has been a detailed analysis of the nature of the categories of expense within Rule 2.67 by David Richards J in *Exeter City*. He held that in order for an expense to be within 2.67(1)(a) it had to be an expense for which the administrator is personally liable. He recognised that there might be few such expenses, noting those under s233, IA 1986 and possibly expenses paid from an administrator's own resources for which he could claim reimbursement such as travel expenses. There is no suggestion that an administrator is personally liable for VAT payable by the company over which he is appointed. In our opinion VAT is an expense under Rule 2.67(1)(f). again, as already mentioned, HHJ Purle QC in *Goldacre* was not disposed to agree with avid Richards J in this respect. The debate lives on.

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