A YEAR IN ADMINISTRATION

Introduction

1. In the past year there have been many cases dealing with insolvency administrations. The jurisprudence of old-style administrations still develops while new-style administrations raise interesting issues. During the course of the last 12 months the House of Lords has given its opinion regarding administration expenses in old-style administrations in connection with claims relating to asbestos liability. At first instance the courts have adjudicated upon new-style administration expenses and in particular whether non-domestic rates for retail premises occupied by a company in administration rank as expenses.

2. New-style administrators have a specific power to make distributions and in the last 12 months the High Court has ruled that the court has power under section 18(3) of the Insolvency Act 1986, and under its inherent jurisdiction on an application for discharge of an administrator, to authorise a distribution to those creditors of the company who would be preferential in the event of a winding up. On the other hand, the Court of Appeal has held that old-style administrators have no power to make free-standing distributions as such a distribution does not fall within the administrator's functions.

3. A duo of new-style administrations have looked at trust issues arising in the course of administrations leading in one case to the rejection of claims from pre-payment creditors of Christmas hampers. These are just some of the issues that have arisen this year and leaves out of account altogether the thorny issue of office holder fees.

4. This paper will focus on some of the above issues starting with administration expenses.

Administration expenses

5. The authors of this paper spoke about expenses at the first Guildhall insolvency event at the Watershed (2005). At that time a comparison was made between section 19(4) and (5) of the Insolvency Act 1986 ("the IA 1986") and the new provisions under paragraph 99 of Schedule B1 to the IA 1986. The authors spoke about the impact of *Khan v Commissioners of Inland Revenue*, *Re Toshoku Finance UK plc* [2002] 1 WLR 671 and the possible impact the case may have on administrations. References were made to *Atlantic Computer Systems Plc (No. 1)* [1992] Ch 505; *Re Salmet International Ltd* [2001] BCC 796; *Re Lundy Granite Co; Ex p Heavan* (1871) LR6 Ch App 462; *Re Oaks Pits Colliery Co* (1882) 21 Ch D 322 and the then recent decision of *Re Allders Department Stores Ltd* EWHC 172(Ch).

6. At the time the interplay between paragraph 99(3) of Schedule B1 to the IA 1986 and the new insolvency rule 2.67 was a matter for speculation. This was particularly so after High Court decision in *Allders*. It was said in the accompanying paper:

> "Arguably, after the long-awaited decision of the House of Lords in *Re Spectrum Plus Limited*, the decision next most likely to have a significant impact within the corporate recovery and insolvency arena will be the case, whichever it may be, where the court provides definitive guidance on the extent to which the principles set out in *Re Toshoku* should (or should not) apply to questions concerning administration expenses"

7. In the intervening period between since May 2005 the Court of Appeal gave a decision strongly in favour of the policies behind new-style administrations. In *Huddersfield Fine Worsteds Ltd (in administration) and another* [2006] 2 BCLC 160 Lord Justice Neuberger noted that the policy of rescue evident in the IA 1986 was readily evident after 15 September 2003.

8. In *Allders* the Attorney General submitted that redundancy and unfair dismissal payments would not be provable debts. The submission was not challenged but almost certainly sought to

employ the proposition that if the unfair dismissal payments could not be proved, then they must fall to be expenses within the administration. The submission closely followed *Toshoku* where Lord Hoffmann said:

> "debts arising out of pre-liquidation contracts such as leases, whether they accrue before or after the liquidation, can and prima facie should be proved in the liquidation. In this respect they are crucially different from normal liquidation expenses which are incurred after the liquidation date and cannot be proved for."

9. If this proposition is taken to its extreme, all post liquidation expenses would be expenses of the liquidation. The question that was waiting to be answered was whether the courts would adopt the rational in *Toshoku* in new-style administrations.

10. It may be useful at this point to look at the actual provisions of sections 19(4) and (5) IA 1986, paragraph 99 of Schedule B1 to the IA 1986, Rule 4.218 and 2.67.

11. It is to be borne in mind that the remuneration of an administrator and his expenses are charged on and payable out of property of which he had custody or control immediately before cessation and payable in priority to the holder of a floating charge.

The legislation

12. Section 8 of the IA 1986 provides that Schedule B1 to the IA 1986 shall have effect in relation to the administration of companies. Paragraph 65(1) of Schedule B1 to the IA 1986 provides that the administrator may make a distribution to a creditor, subject to compliance with the rules as to preferential debts (see para 65(2)). But permission of the court is required to make a distribution to a creditor who is neither secured nor preferential.

13. Paragraph 69 of Schedule B1 states that when exercising his functions the administrator of a company acts as its agent[1].

14. Similarly section 19(3) IA 1986, paragraph 99(1) applies paragraph 99(2)-99(6) in circumstances where a person ceases to be an administrator of a company.

15. Upon cessation as an administrator, the former administrator's 'remuneration and expenses' shall be charged and payable out of the property of which he had custody and control prior cessation.

16. Section 411 of the IA 1986, confers power to make rules for the purpose of giving effect to Pts I–VII of the IA 1986 (which include administration and winding up) and provision as to the fees, costs, charges and other expenses that may be treated as properly incurred by the administrator of a company (see section 411(2)(a) and paragraph 18 of Schedule 8).

17. By r 13.12(1) 'debt' for the purposes of winding up (and the definition is extended to administration by r 13.12(5)) means:

> '(a) any debt or liability to which the company is subject at the date on which it goes into liquidation;
>
> (b) any debt or liability to which the company may become subject after that date by reason of any obligation incurred before that date …'

18. For convenience we set out paragraph 99 here:

[1] As regards Administrative Receivers they act as agent of the company unless and until the company goes into liquidation: section 44(1) IA 1986

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 subparagraph (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).

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 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.”

19. Rule 2.67 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 costs 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 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 chargable 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.[2]

20. In *Allders* the High Court had observed that "Rule 2.67 largely mirrors r 4.218", which applies in the context of liquidation. By section 115 of the IA 1986: 'All expenses properly incurred in the winding up, including the remuneration of the liquidator, are payable out of the company's assets in priority to all other claims.'"[3].

21. Although Rule 2.67 largely mirrors Rule 4.218 there are some minor differences which may have been thought to have been deliberate. The expenses in liquidation are payable out of the assets first in respect of expenses or costs which:

[2] This new, sub-paragraph (4) was inserted by the Insolvency (Amendment) Rules 2005 (SI 527 of 2005) with effect from April fools day 2005

[3] *Allders Department Stores Ltd and other Companies* [2005] 2 All ER 122, 126

"(a)(i) 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* or otherwise relating to the conduct of the legal proceedings which he has power to bring or defend whether in his own name or the name of the company" (emphasis supplied)

22. By contrast Rule 2.67(1)(a) provides that the expenses of the administration are payable in the following order of priority:

"(a) expenses *properly incurred* by the administrator in performing his functions as administrator of the company" (emphasis added)

23. The language used in Rule 2.67(1)(a) closely follows section 19(4) IA 1986 "His remuneration and *any expenses properly incurred by him*….".

24. As a general observation the matters contained in Rule 2.67(1)(a)-(e) comprise matters that involve expenditure or other form of outgoings incurred by the administrator or appointed agent in connection with the purpose of the administration or (in the case or Rule 2.67(1)(c)) prior to the appointment of the administrator but for the purpose of placing the company into administration and appointing an administrator. After these priorities, lie expenses necessary to the administration and after that (now a long way down the list) the remuneration of the administrator.

Administration Expenses and policy

25. The legislative history of administrations goes back to 1986. Prior to that the Companies Act 1985 consolidated the 1948 to 1981 Companies Acts, the Insolvency Act 1976, and the Companies (Floating Charges and Receivers) (Scotland) Act 1972. Sections 501 to 674 of the 1985 Act dealt with liquidation, and sections 196, 405 and 488 to 500 with receivership in England and Wales. The Insolvency Act 1985 amended the provisions of the Companies Act 1985 relating to liquidation and receivership and introduced for the first time administration orders and voluntary arrangements. However before the Insolvency Act 1985 was fully implemented the Insolvency Act 1986 was enacted consolidating all the provisions of the Companies Act 1985 relating to liquidation and receivership and incorporating the Insolvency Act 1985. The IA 1986 came into force on 29 December 1986.

26. The pre-Enterprise Act 2002 administration procedure was implemented as a result of the recommendation given by a Review Committee chaired by Sir Kenneth Cork. The review titled "Insolvency Law and Practice" (Cmnd 8558) was presented to Parliament in June 1982. Following the presentation to Parliament a white paper was produced entitled "A Revised Framework for Insolvency Law" (Cmnd 9175) in February 1984.

27. Professor Goode in Principles of Corporate Insolvency Law (second edition) explained (page 268):

"Prior to the Insolvency Act 1985 English Insolvency Law viewed liquidation as the centre piece of corporate insolvency law and concerned itself primarily with the disposal of the business where it could be sold as a going concern or with individual assets on a break-up basis. The only form of external management available was receivership which ….is first and foremost an enforcement weapon for the unpaid debenture holder and is not a proceeding for the benefit of unsecured creditors….

The grant of an administration order would, so long as the administration continued have the effect of freezing the enforcement of rights against a company, whether by secured creditors or otherwise, thus facilitating the simpler regime of voluntary arrangements proposed in the Report.

28. Lord Brown-Wilkinson has provided a clear exposition of the administration framework in *Powdrill v Watson* [1995] 2 A.C. 394, 441:

> "The Insolvency Acts 1985 and 1986 introduced for the first time the machinery of the court-appointed administrator. This was done on the recommendations contained in the Report of the Cork Committee on Insolvency Law and Practice (1982) (Cmnd. 8558). Chapter 9 of the report draws attention to an advantage which attaches to cases where an out-of-court receiver is appointed, viz., the ability of the receiver to carry on the profitable parts of the business of the company with a view either to procuring its recovery or to its disposal as a going concern. It said, at p. 117, para. 495, that such "preservation of the profitable parts of the enterprise has been of advantage to the employees, the commercial community, and the general public." The report states that where a receiver had not been appointed by a debenture holder, in a significant number of cases companies had been forced into liquidation and potentially viable businesses capable of being rescued had been closed down. To meet this need, the committee recommended the creation of a court-appointed administrator who should have similar powers to those customarily conferred on a receiver appointed out of court. Part II of the Act of 1986 implements that recommendation This "rescue culture" which seeks to preserve viable businesses was and is fundamental to much of the Act of 1986. Its significance in the present case is that, given the importance attached to receivers and administrators being able to continue to run a business, it is unlikely that Parliament would have intended to produce a regime as to employees' rights which renders any attempt at such rescue either extremely hazardous or impossible".

29. Under the IA 1986 the function of a duly appointed administrator was to manage the insolvent company for the benefit of its creditors in order to achieve one or more of the statutory purposes. The statutory purposes were contained in Part II, section 8 of the IA 1986:

> " (a) the survival of the company, and the whole of any part of its undertaking, as a going concern;
>
> (b) the approval of a voluntary arrangement under Part I;
>
> (c) the sanctioning under section 425 of the Companies Act 1985 of a compromise or arrangement between the company and any such persons as are mentioned in that section; and
>
> (d) a more advantageous realisation of the company's assets than would be effected on a winding up".

30. One of the special features of administration, which remains the case after the introduction of the Enterprise Act 2002, is the automatic moratorium imposed on the enforcement of remedies by the company's creditors. The moratorium applied to all secured creditors, suppliers of goods under leasing, conditional sale and hire purchase agreements, whose rights of enforcement of the security or recovery of their property would not be affected by winding-up: section 11 IA 1986 (for new administrations paragraph 43 of schedule B1 to the IA 1986). Section 11 IA 1986 provided that:

> "During the period for which an administration order is in force –
>
> (*a*) no resolution may be passed or order made for the winding up of the company;

(*b*) no administrative receiver of the company may be appointed;

(*c*) no other steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under any hire-purchase agreement, except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as the court may impose; and

(*d*) no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as aforesaid."

31. Nicholls L.J. explained the rational behind section 11(3) IA 1986:

> "Parliament considered that an administrator should be buttressed with a support which an administrative receiver does not have. That support encroaches upon the property rights of others…Thus the making of an administration order triggers the like prohibition on proceedings being brought or continued against the company as the prohibition which exists, and has long existed, when a winding up order is made. The owners of property, and of charges over property, are disabled from exercising their proprietary rights unless the administrator consents or the court gives leave" *Re Altlantic Computer Systems Limited* [1992] Ch 505, 527.

32. The same policy issues are maintainable after the introduction of the Enterprise Act 2002 as before. Professor Goode explains the important differences between post-Enterprise Act 2002 administrations and liquidation[4]:

(i) The administrator has full management powers; the liquidator may carry on business only for the beneficial winding up of the company and rarely does so;

(ii) The remedies of secured creditors and suppliers under reservation of title are frozen by an administration order, but are not affected by winding-up;

(iii) The assets of the company remain its property and do not become subject to a 'statutory trust' in favour of creditors as they do on liquidation;

(iv) The expenses of liquidation rank behind claims secured by a floating charge; the expenses of administration rank ahead of such claims[5];

(v) An administrator, unlike a liquidator, has no power to disclaim onerous property under section 178(3) of the IA 1986;

(vi) Only a liquidator can institute proceedings for misfeasance, fraudulent trading or wrongful trading except as regards proceedings against an administrator or former administrator which are initiated by a person listed in para 75(2)(a) of Sched B1;

(vii) In a liquidation, the convenor of the creditors' meeting may require the attendance of directors and employees; in an administration the duty is merely to provide the

[4] Professor Goode *Principles of Corporate Insolvency Law* Third Ed para 10-31. He further states that administrators now have the power to make distributions as do liquidators, albeit with the permission of the court.

[5] This is as a result of *Buchler v Talbot* [2004] 2 A.C. 298.The effect of this decision is due to be reversed by Parliament.

administrator with information and to attend on him, making directors less exposed to actions from administrators;

(viii) The appointment of a liquidator is primarily a matter for the creditors, whereas the appointment of an administrator is usually left to the directors, though their decision may be influenced by major creditors.

33. Of major relevance to the payment of rates and rent is the inability of an administrator to disclaim and thereby escape post-administration costs and liabilities.

34. The Enterprise Act 2002 promoted the "rescue culture" and sought to recommend to insolvency practitioners administration as the primary tool of rescue. The moratorium recommended in the Report of the Cork Committee which provides a breathing space in which a rescue policy can be planned in respect of viable businesses (and according to Lord-Browne-Wilkinson was "fundamental" to the IA 1986[6]) has been retained: Paragraph 43 of Schedule B1 to the IA 1986.

35. In *Huddersfield Fine Worsteds Ltd (in administration) and another* [2006] 2 BCLC 160 Lord Justice Neuberger referred to the explanation of the rescue culture given by Lord Browne-Wilkinson in *Powdrill –v- Watson* (*HL*) p 441-442. The significance of the policy behind the rescue culture is that Parliament is unlikely to have intended to make a provision that would have an adverse impact upon the aims of administration. Thus the statutory provisions and rules should be read and construed in the context of underlying policy[7].

36. In July 2001 the Secretary of State for Trade and Industry presented to Parliament a white paper setting out her proposals for the reform of insolvency law: "Productivity and Enterprise Insolvency- A Second Chance" CM 5234. In the foreword to the white paper the Secretary of State explained that:

> "Companies in financial difficulties must not be allowed to go to the wall unnecessarily. Administrative receivership which places effective control of the direction and outcome of the procedure in the hands of the secured creditor is now seen by many as outdated. There are many other important interests involved in the fate of such a company including unsecured creditors, shareholders and employees"

37. Under a heading "The Way Forward" the Secretary succinctly put forward proposals that were to be enacted in the 2002 Enterprise Act:

> "2.5 It follows that we believe that administrative receivership should cease to be a major insolvency procedure…..
>
> 2.6 In taking this step we recognise that in order to ensure the position of secured creditors within collective procedures there will need to be substantial reform to the process of administration so as to make it more effective and accessible. Whilst our aim is to guarantee unsecured creditors a greater say in the process and its outcome, secured creditors should not feel at any risk from our proposals. We see no reason why, given the changes we propose to make to the administration procedure……their interests should not be protected equally well by an administrator as an administrative receiver….
>
> 2.7 The recognition of administration as an important tool in providing a company in financial difficulties with a breathing space in which to put together a rescue plan or, alternatively, in providing a better return to

[6] *Powdrill v Watson* [1995] 2 A.C. 394, 441

[7] Etherton J. at first instance in *Ferrotech* [2006] 2 BCLC 172 also took into account the policy concerns

creditors than would be likely in liquidation, has increased steadily in recent years."

38. The Enterprise Bill was brought before the House of Commons on 19 June 2002. Accompanying the Bill were published "Explanatory Notes" which were produced by the Department of Trade and Industry. The Department of Trade and Industry (responsible for the Bill) put in context administration and administrative receiverships and expressed a desire to conflate the processes by promoting the appointment of an administrator where ordinarily an administrative receiver would have been appointed:

> "The existing provisions contained in Part II of the Insolvency Act 1986 allow the court to make an administration order in respect of a company that is in financial difficulties. Broadly speaking, the effect of such an order is to afford the company protection from its creditors whilst attempts are made to save the company or achieve a better result for creditors than would be achieved in a winding-up. However, in practice, in many cases where a company gets into financial difficulties, this will lead to the appointment of an administrative receiver by those providing financial support for the company (typically the company's bank), since they usually will have taken a floating charge over all the company's assets. The holder of a floating charge has an effective veto over the appointment of an administrator. Such a person must be given notice of any application for an administration order, and if he or she appoints an administrative receiver, the court must dismiss the application unless the appointor of the administrative receiver consents to the making of an administration order…"
>
> An administrative receiver primarily owes duties to his or her appointor rather than the company's creditors as a whole…..His or her primary function is to seek repayment of the debt owed to his or her appointor. An administrative receiver has no powers or duty to seek to put proposals to creditors for a Company Voluntary Arrangement…..
>
> The clauses will alter the above provisions in the following way. *First, the appointment of administrative receivers will be restricted to certain exceptions (existing arrangements and capital markets) and the Bill seeks to provide that administrators will in future be appointed in situations that would have been dealt with through administrative receivership*." (emphasis supplied)

39. Section 250 of the Enterprise Act 2002 inserted after Chapter III of Part III of the IA 1986, section 72A which prohibits the appointment of administrative receivers in respect of debentures created after 15 September 2003. The prohibition does not extend to capital markets and there are a few other exceptions.

40. So it appears that not only is the policy of rescue maintainable, but Parliament sought to promote and encourage the rescue culture through the Enterprise Act 2002. Rationally, the primary and secondary legislation should support the policy. One way of promoting the rescue culture is to ensure that the professionals who carry out the day to day work (the insolvency practitioners) are paid in priority to other claims on the estate. It is worth mentioning here (although obvious), before we move onto a recent case dealing with all the above issues, that expenses incurred by an office-holder in the course of dealing with an insolvent estate, are payable out of the assets of the debtor company in priority to the debts, obligations and liabilities of the company incurred prior to the commencement of the insolvency process.

Toshoku tested

41. The case that tested whether or not the principles of Toshoku are applicable to administrations concerned non-domestic rates: *Exeter City Council v Bairstow and others* [2007] All ER (D) 45.

42. Just prior to the hearing of Exeter City Council the House of Lords gave its opinion in *Centre Reinsurance International Co and others v Freakley* [2006] 1 WLR 2863. The question that was asked of the House of Lords in *Freakley* was whether or not insurers who were obliged to indemnify a debtor company, in administration, in respect of liabilities arising from the use of asbestos in its products, could claim the cost of handling claims (which the insurer had a right to do under the insurance contract) as an expense of the administration.

43. Lord Hoffmann (who gave the only speech) expressly stated that the matter concerned the pre-Enterprise Act 2002 administration scheme (paragraph 6):

> "Before looking at the specific statutory provisions under which priority is claimed, I should say something about the general scheme and purpose of administration as it existed under the Insolvency Act 1986. Changes have since been made by the Enterprise Act 2002 but I say nothing about these because they were not in force at the relevant time."

44. There are 10 features of Lord Hoffmann's reasoning which were relevant to the Exeter City Council case notwithstanding that it concerned an old-style administration. These are as follows:

    a. The purpose of administration was taken into account. Reference was made to *Powdrill v Watson* [1995] 2 AC 394, 441-442;

    b. The effect of an administration order was to bring a procedural bar on the enforcement of security over the debtor company's property or any other legal proceedings;

    c. An administration order did not alter substantive rights or the ability of the debtor company to continue to trade and incur debts;

    d. It was necessary for an administrator to be able to pay for *necessary* goods and services in order to preserve the business as a going concern;

    e. "any expenses properly incurred"[8] deals with claims against the debtor company by the administrator himself. These would include claims for goods and services supplied to the company for which the administrator has paid or chosen to make himself liable but for which he has not yet reimbursed himself out of the company's assets;

    f. Liabilities incurred or contracts incurred by the debtor company are not necessarily liabilities for which an administrator is liable. Just because a company in administration could act only by its administrator, it did not mean that any liabilities incurred on behalf of the debtor company must have been incurred on behalf of the administrator;

    g. Allied to the above is the proposition that a debtor company may, before the appointment of an administrator, have conferred on someone an authority to contract on its behalf which, in law or in practice, the administrator cannot revoke. Such contracts are made on behalf of the company but not on behalf of the administrator;

[8] The same wording is used in Rule 2.67(1)(a) of the Rules

h. There is no reason why such obligations (which may or may not be in the interests of administration) should be given priority over the company's other debts;

i. The flexible approach to administration expenses expounded by Nicholls L.J. in *Re Atlantic Computer Systems plc* [1992] Ch 505 was approved; and

j. An investigation may be necessary on the facts of each case in order to determine whether certain expenses are 'necessary to the carrying out of the purposes for which the administration order was made'.

45. On the facts of *Freakley* Lord Hoffmann was prepared to accept that the Court of Appeal was correct to conclude that the claim handling was a *necessary* expense. As a result those expenses were not an expense within section 19(4) IA 1986 and not an expense of the administration. The reason for this was that old-style administrations did not incorporate any express expenses provision which allowed *necessary* expenses.

46. The facts of *Exeter City Council* (an unlikely test case) can be stated in quick form. Trident Fashions Plc ("Trident") was incorporated on 29 March 2001. It purchased the assets of a company known as Ciro Citterio Menswear Plc from administrators and commenced trading on 12 June 2001. Trident traded from 98 retail units throughout the United Kingdom and Ireland. One of the retail units it occupied as lessee was at 240 High Street Exeter ("the Exeter Property"). Exeter City Council ("ECC") is responsible for levying and collecting non-domestic rates in respect of the Exeter Property.

47. Trident traded and made profits until 1 February 2002. In the year to February 2003 the operating profits turned negative. In January 2003 Trident sought to reduce the number of retail outlets by 30 and to sell the unoccupied leasehold interests. On 17 September 2003 an administration order was made and Mr Gray, Mr Pepper and Mr Johal of Kroll Buchler Phillips were appointed as joint administrators ("the Kroll Administrators"). This administration was one of the first 'new-style' administrations (the Enterprise Act 2002 came into force on 15 September 2003).

48. On 12 November 2003 the joint administrators called a creditors meeting pursuant to section 3 of the Insolvency Act 1986 ("the IA 1986"). The meeting was convened on 1 December 2003 and the creditors voted in favour of a Creditors' Voluntary Arrangement ("CVA"). According to a letter from the Kroll Administrators to creditors dated 12 November 2003, the CVA was intended to provide "a more advantageous outcome for creditors" and act as an "exit route" from the administration. At the meeting on 1 December 2003 the Kroll Administrator were appointed joint supervisors. There appears to have been a challenge to the CVA, but the challenge was defeated in the High Court in January 2004.

49. The Kroll Administrators resigned on 20 April 2004. On the same day Vivian Bairstow and James Martin of Begbies Traynor ("The Begbies Administrators") were appointed joint administrators.

50. During the period of the administration the Begbies Administrators continued Trident's occupation of the Exeter Property, and continued to trade the business as agents of Trident.

51. On 13 September 2004 the Begbies Administrators obtained a court order made pursuant to paragraph 76 of schedule B1 to the IA 1986 extending the term of the administration until 17 March 2005.

52. On 17 March 2005 the administration expired in accordance with paragraph 76 of schedule B1 to the IA 1986 and the subsequent court order obtained on 13 September 2004.

53. On 22 March 2005 Trident filed a notice of intention to appoint administrators.

54. On 7 April 2005 Trident's only qualifying floating charge holder appointed Dermot Justin Power and Charles Macmillan of BDO Stoy Hayward as joint administrators ("The BDO Administrators"). The administration in which the BDO Administrators were agents of Trident did not last long. A petition was presented for the winding up of Trident by Connection Europe Limited on 21 March 2005 and a winding-up order was made by the court on 27 April 2005.

55. ECC received no payments for non-domestic rates in respect of the ECC Property during the period when Trident was in administration.

56. The headlines are that non-domestic rates are an expense of administration within Rule 2.67(1)(f) Insolvency Rules 1986. They are not an expense falling within Rule 2.67(1)(a) Insolvency Rules 1986. If a company is trading from premises non-domestic rates will have to be paid as an expense ahead of an administrator's remuneration. This (to some) is not a surprising result. The court was also able to state that non-domestic rates were not an expense of old-style administrations. There are no reported cases concerning non-domestic rates and old style administrations.

57. The court found that so far as the nature of a company's liability for corporation tax or rates is concerned, there is no distinction between a company in liquidation and a company in administration. In both cases they are payable by the company. It went on to find that *Toshoku* applied to administrations as it applied to liquidations due to the similarity of rules. Accordingly

> "The observations on rates, as being necessary disbursements within rule 4.218(1)(m), in *In re Toshoku Finance UK plc* may, strictly speaking, be obiter but all members of the House of Lords concurred in Lord Hoffmann's speech ……. Just as rates are payable in a liquidation as a necessary disbursement, so in my judgment they are payable in an administration."

58. However as a consequence of aligning liquidations and administrations through the application of *Toshoku* an administrator will be liable to pay non-domestic rates even if the company is not trading from premises. The court said:

> "The status of unoccupied property rates is not raised for decision in this case, as Mr Trower was careful to point out. However, Mr Briggs submitted, on the basis of Mr McLoughlin's evidence, that the position regarding unoccupied property rates is a matter of widespread practical importance in administrations and he invited me to express my view. Mr Briggs submitted that if I were to decide, as I have, that the construction of rule 4.218(1)(m) adopted in *In re Toshoku Finance UK plc* applied also to rule 2.67(1)(f), there was no relevant distinction between business rates on occupied and unoccupied property and both would be payable as expenses in an administration. Mr Trower advanced no arguments against this submission and, in reply, accepted it as correct. I have not therefore heard any submissions to distinguish the two categories of rates in these circumstances and no basis of distinction occurs to me. As presently advised, therefore, my view is that unoccupied property rates are payable under rule 2.67(1)(f) as an expense in an administration to which schedule B1 applies."

59. The consequence of the application of *Toshoku* to new-style administrations is that other expenses will now rank above remuneration of the administrator. Non-domestic rates are just one example of the type of expense that will be classified as *necessary*. If the facts of *Freakley* were to arise in a new-style administration the claim handling will also be payable as an expense ranking above remuneration.

Trusts in administration

60. This year has seen the issue of trusts arise in the context of new-style administrations. The *Matter of Sendo International Limited* [2007] BCLC 141 concerned an application by the joint administrators of a group of companies that manufactured and distributed mobile phones. The administrators applied for directions regarding the distribution of funds held on the terms of two separate trusts. The first ("the first trust deed"), established by a declaration of trust dated 27 May 2005 and made by SIL, comprised a sum of £3,961,659.97 held in an account with HSBC. The second ("the second trust deed"), established by a declaration of trust dated 24 June 2005 and made by SIL, comprised a sum of £276,289.33 held in a separate account with HSBC. Each fund had earned interest. The group relied very much on the financial support of its major supplier called Celestica.

61. The Celestica group was a secured creditor of SIL, the effect of which was that by the time the administration orders were made, the debt owed to Celestica and covered by its security, amounted to US$220 million. That indebtedness greatly exceeded the value of the security available to meet it.

62. The first trust deed had effect with respect to liabilities incurred between 13 May 2005 and the presentation of the application for administration. The second trust deed covered liabilities incurred between 21 June and (in the event) 5 pm on 28 June 2005 (the administrators being appointed on 29 June 2005). Shortly following the appointment of the administrators, the Sendo business was sold to Motorola realising US$25.3 million gross. As a result of the sale and the shortfall in the monies held subject to the first trust deed to meet the liabilities intended to be secured by that deed, the administrators held a further sum of US$1 million pursuant to an agreement between Celestica and SIL dated 25 May 2005 which was to be dealt with in accordance with the terms of the first trust deed.

63. The administrators wanted to distribute the balances available on the two HSBC accounts, together, in the case of the first trust deed, with the additional US$1 million in accordance with a draft protocol. The protocol provided that, after allowing for reasonable costs, expenses and disbursements, the net funds held on the trusts of the first trust deed should be distributed pro rata to the persons listed on a schedule ("the Creditors Trust Account Schedule") in proportion to the amounts shown against the names of those persons in the final column of that schedule. The same was the position in the case of the funds held subject to the trusts of the second trust deed, namely that they should be distributed pro rata to the persons listed on a schedule relating to that second trust deed, in proportion to the amounts shown against the names of those persons in the final column of that schedule.

64. The court was asked as to the persons to whom, and the amounts in which, the two funds should be distributed and what if any further investigation should be undertaken.

65. Mr. Sims (acting on behalf of Celestica) submitted that the size of a beneficiary's share should be determined objectively by looking at the amount of the liabilities incurred during the period covered by the relevant trust deed. The opposing argument was that the size of the beneficiary share should be determined by reference to the relevant schedule on which the name of the creditor appears together, in the last column of the schedule with the amount of the creditor's claim.

66. The court concluded that the answer came from construing the trust deeds correctly with result that the creditors were paid *pari passu* in accordance with the draft protocol.

67. In *Re Farepak Foods & Gifts Limited* [2006] EWHC 3272 the administrators applied for directions as to whether and how they should distribute certain funds held by them. F operated a Christmas savings scheme under which customers could spread their Christmas savings over a year. The scheme operated through a system of agents. The agents collected money from the customers and forwarded it to F. On October 11, 2006 F's directors decided to cease trading

and F went into administration on October 13. The moneys paid to F by the customers had largely gone. However, in the three days leading up to the administration the directors sought to ring-fence moneys received by customers in that period so that it could be returned to them if necessary. A deed of trust was executed, though there was a mistake as to the bank account identified in it.

68. The administrators argued that the moneys received in the administration period and the period from October 11 to October 16 (when Farepak entered administration) were held on trust for the customers. The administrators argued that the trust arose from several possible sources: a Quist close resulting trust; a constructive trust arising out of the unconscionability of retaining customer moneys received after the decision to stop trading; the express declaration of trust, or an implied declaration arising out of the related facts.

69. The court held that there was no Quist close trust. The relationship between the customers and F was contractual. As regards the express trust there was a mistake in the declaration of trust which was rectifiable. However, where money had already been paid to F, via the agents, the relevant customers were already creditors of F. By declaring the trust those customers were apparently given a preference. That was an obstacle, at the practical level, to any sums being paid out on the footing of the rectified deed of trust.

70. As regards a constructive trust it could not be determined that all the moneys, in relation to which the court was asked to make a decision, fell within that line of argument. If the principles in *Neste Oy v Barclays Bank* [1983] 2 Lloyds Rep 658 were to be applied, then they should be applied by reference to the time at which the moneys should be taken to have been paid to and received by F. That was not necessarily the same date as the credit appeared in F's current account. Problems arose because some items credited had a three-day clearing cycle, and all the money credited was money that had already been paid, by some mechanism or other, to agents. Since the agents were agents of F, receipts by those agents fell to be treated as receipts by F.

71. The overall position was of sufficient uncertainty that the court was unwilling to determine the issues on the basis of the material before it.

72. During the course of the determinations the court considered the imposition of an institutional constructive trust and a remedial constructive trust.

73. It has been said that constructive trust may be used as a remedy and may be “imposed by law whenever justice and good conscience require it”: *Hussey v Palmer* [1972] 1 WLR 1286, 1290 per Lord Denning MR. More recently the House of Lords have expressed the view the constructive trust has been regarded as a substantive institution rather than a remedy: *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 at 715-716 per Lord Browne-Wilkinson. To add to the descriptions Lord Millett has said that the constructive trust is “nothing more than a formula for equitable relief”: *Paragon Finance v Thakerar* [1999] 1 All ER 400, 409.

74. The commonly accepted distinction between remedial and institutional constructive trusts is that an institutional constructive trust arises independently of any court order, once the facts on which the creation of the trust depends, have occurred (that is upon an informal expression of intention or upon a wrongdoing). In such circumstances the function of the court is merely to declare its prior existence: *Westdeutsche Landesbank* page 714.

75. A remedial constructive trust would arise if the circumstances required an order of the court for its creation. Such a requirement would be dependent upon the court exercising a discretion with regard to both its existence and its extent.

76. Sir Peter Millett said (1998) 114 LQR 399-418 at 399

> "The remedial constructive trust has taken root in the United States and Canada: it is unlikely to do so in England and Australia. The distinction between personal and proprietary rights is fundamental to the law of insolvency."

.

77. However by 1998 Australia had unlocked the door and turned the handle. In a case involving recovery of money paid under a mistake of law (money had and received) the High Court added (*Australia and New Zealand Banking Group Limited v Westpac Banking Corporation* (1998) 164 CLR 662 at 673):

> "The common law right of action may arise in circumstances which also give rise to a resulting trust of specific property or *which would lead a modern court of equity to grant relief by way of constructive trust*" (emphasis supplied)

78. Remedial constructive trusts are now prevalent in Australia.

79. In *Neste Oy* a payment was made when the company had decided to cease to trade. The payment was made to discharge certain liabilities incurred as agent, but the company had not itself incurred the liabilities. Bingham J held that in those circumstances the company held the monies paid on constructive trust:

> "Given the situation of [the recipient company] when the last payment was received, any reasonable and honest directors of that company would, I feel sure, have arranged for the repayment of that sum to the plaintiffs without hesitation or delay. It would have seemed little short of sharp practice for [the company] to take any benefit from the payment, and it would have seemed contrary to any ordinary notion of fairness that the general body of creditors should profit from the accident of a payment made at a time when there was bound to be a total failure of consideration….It seems to me that at the time of its receipt [the company] could not in good conscience retain this payment and that accordingly a constructive trust is to be inferred."

80. In Farepak the company received payments at a time when it had decided to cease to trade. As such the directors of the company would have known that there would be a total failure of consideration as it would not have been able to provide the goods or services promised. Does such an action make receipt unconscionable resulting in the imposition of a constructive trust?

81. The rational of *Neste Oy* has been much criticised since, but in *Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105 Goulding J. decided that a payment made under a mistake of fact could give rise to a proprietary interest in the payer. This was supported in *Westdeutsche* where Lord Browne-Wilkinson thought that a proprietary interest may arise once the recipient of money or transfer had knowledge of the mistake (but not before). It is therefore the retention of the money that gives rise to a constructive trust.

82. Applying the mistaken payment route is a way to avoid praying in aid a remedial constructive trust. The payment made in *Neste Oy* could be described as a mistaken payment rather than a payment made in circumstances where there was a total failure of consideration. The total failure of consideration appears to fail to give rise to a constructive trust because it is not "just the pricking of the conscience that gives rise to the constructive trust; there [has to be] something more." The mistake vitiates consent. The receipt makes retention unconscionable. In *Farepak* there was uncertainty as to when the moneys were received and insufficient court time to investigate the receipts to make a distribution before Christmas.

83. However the rhetorical question that can be asked is whether the court's willingness to describe what are really remedial constructive trusts as institutional constructive trusts provides an indication that English law may succumb to this now established Commonwealth remedy. Since

1998 it has been thought that the real objection of remedial constructive trusts is that the imposition of such a remedy would inevitably affect the ranking of proprietary interests: *Polly Peck International Plc (in administration) (No 2)* [1998] 3 All ER 812.

84. This objection has been easily overcome in both Canada and Australia, where the award of a constructive trust is based upon what is just in all the circumstances and the interests of intervening creditors are considered and protected.

Nicholas Briggs, Guildhall Chambers
Catherine Burton, Begbies Traynor

13 April 2007