ADMINISTRATIONS
DEVELOPMENTS IN LAW & PRACTICE

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Cases in the last year included *SofS v Cockayne & Dixon*; *SofS v Swan*; *Dyment v Boyden*; professional disciplinary tribunal proceedings concerning an MPR and threat to objectivity; successful challenge to IVA voting entitlement and revocation thereof; court approval of liquidator's assignment of causes of action against a director to that director; advising the liquidators of a book distributor on proprietary claims and contested *Berkeley Applegate* application; successful defence for national housing developer of alleged sham transaction.

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A. INTRODUCTION

1. The administration regime introduced by the Enterprise Act 2002 in September 2003 has been with us for long enough to justify no longer calling it "new". During last year's Seminar we highlighted several problems with the provisions of the Insolvency Act 1986 and the Insolvency Rules 1986 which govern the regime. Many of them have now been addressed by revision of the Rules or by clarifying judgments of the court. This year we shall cover some of the more recent of those developments but also concentrate on some of the key issues yet to be resolved: the uncertainties surrounding administration expenses, the risks of acting between filing and registration of a notice under paragraph 83 of Schedule B1 to move from administration to creditors voluntary winding up and the problems associated with an administrator being properly remunerated for the work he has performed. We shall also touch upon as yet unchartered territory questioning whether the use of administration, post Leyland Daf, where the purpose of administration can be achieved but where a liquidation might just as readily fit the bill, is an abuse of process or a perfectly legitimate use of a new, cost effective and flexible regime. Finally we take a brief look at the appallingly drafted, new TUPE Regulations to consider whether they apply to administration and if so, the relief which will inure to employees of companies in administration.

B. ADMINISTRATION EXPENSES – WHERE ARE WE NOW?

Employees – redundancy and unfair dismissal claims

2. The High Court has confirmed in ***Allders Department Stores Ltd (In administration)***[1] that where an administrator terminates a contract of employment, sums due to employees in respect of redundancy and unfair dismissal are not administration expenses.

Background - Rule 2.67 Insolvency Rules 1986

2.1 Since the introduction on 15 September 2003 of Rule 2.67 "Administration Expenses", there has been some doubt regarding the extent to which liabilities arising in the course of administration may or may not fall to be considered as expenses.

2.2 When an administrator sells a company's business and assets as a going concern, employees' rights will be protected by the Transfer of Undertaking (Protection of Employment) Regulations. However, where such a transfer cannot be effected, it is often necessary for an administrator to terminate contracts of employment. Such termination can give rise to substantial liabilities, including redundancy payments, sums due for unfair dismissal and protective awards as a result of the employer's failure to consult.

Background - Re Toshoku Finance (UK) plc

2.3 In *Re Toshoku Finance (UK) plc*[2] (which considered Rule 4.218 "liquidation expenses"), the House of Lords concluded that where a company in liquidation incurred a statutory liability to pay corporation tax, which was not a provable debt under Rule 13.12, the liability was a *"necessary disbursement"* within Rule 4.218(1)(m) and therefore payable as an expense of the liquidation. When analogies were drawn between the new Rule 2.67 and Rule 4.218 in the light of the House of Lords' decision, a suggestion arose that statutory liabilities connected with redundancy and unfair dismissal should similarly be regarded as "*necessary*

[1] [2005] EWHC 172 (Ch); [2005] BCC 289
[2] *Kahn v Commissioners of Inland Revenue, Re Toshoku Finance (UK) plc* [2002] UKHL 6; [2002] 1 WLR 671; [2002] BCC 110

disbursements", payable under Rule 2.67(1)(f) as administration expenses. If this view were to be correct, such sums would take priority over the administrator's remuneration and sums due to preferential and secured creditors.

The administration of Allders

2.4 Andrew Pepper, Alastair Beveridge and Fraser Gray of Kroll were appointed administrators of the 3 principal companies in the Allders department stores group. In the course of the administration, the Insolvency Service informed the administrators that it had been advised that the employment liabilities for redundancy and unfair dismissal (and from its perspective, particularly the element which would be met by the State) were administration expenses.

2.5 DLA Piper acted for the administrators and made an emergency application on 10 February 2005 for a declaration of the court, which was determined the following day. Mr Justice Lawrence Collins heard representations from leading counsel on behalf of the administrators and Her Majesty's Attorney General.

The arguments

2.6 In 1994, section 19 of the Insolvency Act 1986 was amended to incorporate specific protection to ensure that sums due to employees are paid. The amendments now appear in paragraphs 99(4), (5) and (6) of Schedule B1 to the Insolvency Act 1986. They afford so-called super-priority for "*wages and salary*" due to individuals employed by the administrator or existing employees of the business whose contracts of employment have been adopted by the administrator. "*Wages and salary*" are stated to include sums due in respect of holiday, illness and contributions to an occupational pension scheme. Counsel for the administrators pointed out that whilst it would have been open to the legislature to do so, it did not include redundancy and unfair dismissal payments in the paragraph 99 list.

2.7 The administrators explained that where they had adopted contracts of employment, but felt that it was in the best interests of the company's creditors as a whole for some such contracts now to be terminated, they intended to treat the relevant liabilities as preferential in part (within the provisions of Schedule 6 to the Insolvency Act 1986) and give sums due in respect of "*wages or salary*" under paragraph 99 the super-priority to which they were entitled under the paragraph. However, they considered that the remaining liabilities due to such employees in respect of redundancy or unfair dismissal would be unsecured claims in the administration and any liquidation which might follow the administration.

The judgment

2.8 Mr Justice Lawrence Collins concluded:

- The employee liabilities which are payable in priority to the administrator’s expenses under paragraph 99(5) of Schedule B1 are those which have been adopted by the administrators and are "*wages or salary*". Redundancy or unfair dismissal payments are not "*wages or salary*" and therefore do not have priority under paragraph 99.

- The position set out in paragraph 99 is not altered by the administration expenses provision in the Insolvency Rules 1986 under Rule 2.67.

- Redundancy payments and unfair dismissal claims cannot be considered to be "*necessary disbursements*" for the purposes of Rule 2.67(1)(f). If it were otherwise, such payments would take priority over employee claims which are expressly given preferential status under paragraph 99. That would be inconsistent with the scheme and purpose of the legislation.

- The House of Lords' decision in Re Toshoku Finance (UK) plc did not establish a principle that **any** liability imposed on a company which is not a provable debt is thereby automatically rendered a "*necessary disbursement*". When Lord Hoffmann noted that certain debts could not be proved, he was justifying his conclusion that they should be treated as expenses. He was not offering a definition of which liabilities are disbursements.

- Construing Rule 2.67(1)(f) to include liabilities in respect of redundancy and unfair dismissal as "*necessary disbursements*" would have such adverse policy consequences on the administration regime that it is impossible to see that such a result could have been intended.

The importance of the decision

2.9 The Insolvency Service had formed a contrary view to the judge's conclusions principally based upon an attempt to apply by way of analogy *Re Toshoku Finance (UK) plc* to the administration regime and an expansive interpretation of that case as regards "necessary disbursements". However the Service recognised the administrators' concerns, and in order not to prejudice various imminent, anticipated sales, it moved swiftly to accommodate a directions hearing the following day. Notwithstanding the considerable financial significance to the Service when applied to other cases, no attempt was made to appeal the decision. Mr Justice Lawrence Collins responded positively to the administrators' submissions that the interpretation contended for by HM Attorney General could seriously damage the use of administration as a rescue procedure and the availability of finance to such businesses in the future.

Employees – payments in lieu of notice and protective awards

3. The scope of paragraph 99 and other liabilities to employees also arose in ***Re Huddersfield Fine Worsteds Ltd and Re Ferrotech Ltd & Granville Technology Limited*** [3], where the Court of Appeal was asked to determine whether liabilities for protective awards and payments in lieu of notice, to employees whose contracts had been adopted by administrators, were included within the words "wages or salary" for the purpose of paragraph 99(4) – (6) of Schedule B1. The court held that they were not and did not have super-priority, save for "garden leave" payments in lieu of notice.

The conflicting first instance decisions

3.1 The Court of Appeal was asked to hear, at extremely short notice, a conjoined appeal in respect of 2 separate cases. In the first case, Huddersfield Fine Worsteds Limited (**"Huddersfield"**), Peter Smith J had given judgment on 27 July 2005 in favour of the employees. In the second case where the application was brought in respect of 2 different companies Ferrotech Limited (**"Ferrotech"**) and Granville Technology Limited (**"Granville"**) Etherton J gave judgment on the morning of 9 August 2005 in favour of the administrators.

3.2 There was considerable urgency in the hearing of the appeal because the administrators of Granville had to decide by the morning of 10 August 2005 (the 14 day deadline following commencement of the administration for the "adoption" of employee contracts) whether to dismiss over 150 employees of the company. That decision depended upon the outcome of the appeal, the administrators of Granville contending that if the Court of Appeal agreed with the decision of Peter Smith J, then they could not afford to continue to trade the company and would close the business immediately.

[3] [2005] EWCA Civ 1072

3.3 The Court of Appeal, in an impressive response to the urgency and commercial need for certainty, expedited the appeal, heard argument on the afternoon of 9 August 2005, gave judgment in principle the same day and provided their reasoned judgment on 10 August 2005, in favour of the administrators, save for one category of payment in lieu of notice.

The Liabilities – protective award

3.4 A protective award arises under section 189 of the Trade Union Labour Relations (Consolidation) Act 1992 ("the 1992 Act"). By virtue of s.188 of the 1992 Act, an employer is normally obliged to consult before dismissing more than 19 employees on the ground of redundancy. Although this duty can be avoided if there are special circumstances which render such consultation not reasonably practicable, insolvency per se, does not amount to a special circumstance[4]. If there is a breach of s.188 of the 1992 Act an employee may complain to the Employment Tribunal under s.189, which may make a protective award in favour of the employee by way of payment of remuneration for the protected period[5].

The Liabilities – payment in lieu of notice

3.5 These can be broken down into 4 principal categories[6]:

3.5.1 an employer gives proper notice of termination to the employee, tells him that he need not work until the termination date and gives him his wages attributable to the notice period as a lump sum ("garden leave");

3.5.2 the contract of employment provides expressly that the employment may be terminated either by notice or, on payment of a sum in lieu of notice, summarily. In such a case if the employer summarily dismisses the employee, he is not in breach provided he makes the payment in lieu of notice;

3.5.3 at the end of the employment, the employer and the employee agree that the employment is to terminate forthwith on payment of a sum in lieu of notice;

3.5.4 without the agreement of the employee, the employer summarily dismisses the employee and tenders a payment in lieu of proper notice. The employer is in breach of contract by dismissing the employee without proper notice, however the summary dismissal is effective to put an end to the employment relationship.

The arguments

The missing words from paragraph 99(6)(d)

3.6 The confusion arose in the interpretation of paragraph 99(6)(d). Paragraph 99(6) states:

"…"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,

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[4] See *Re Hartlebury Printers Ltd* [1993] BCLC 902 at 911-912.
[5] The protected period begins on the later of the date of dismissal or the date of the award and is to last for such period as the Tribunal considers appropriate, subject to a maximum of 90 days: s.189(4) of the 1992 Act.
[6] as per Lord Brown-Wilkinson in *Delany v Staples* [1992] 1 AC 687 at p.692D-H.

(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.

3.7 The Court of Appeal heard argument on four different interpretations of the meaning of sub-paragraph 99(6)(d):

3.7.1 Mr Reynold, appearing for Mr McMath, the representative of the employees of Huddersfield, claimed that it meant that any protective awards should be included in the definition of wages or salary, because there was an enactment about social security which classed protective awards as earnings.

3.7.2 Ms Toube, appearing for the administrators of Huddersfield, contended that it was referring to a specific piece of social security legislation, which provides that in certain circumstances, an employee who earns less than the norm for his particular job can be treated for social security purposes as earning the norm.

3.7.3 Appearing for the Attorney-General (who intervened in the Ferrotech and Granville cases to persuade Etherton J not to follow the judgment of Peter Smith J), Mr Caddick argued that the definition was intended to be limited to a period "of holiday", and compared the new paragraph to the old section 19(10) in his argument. Section 19(10) provided that

"…the reference to wages or salary payable in respect of a period of holiday includes any sums which, if they had been paid, would have been treated for the purposes of the enactments relating to social security as earnings in respect of that period."

3.7.4 Mr Caddick pointed out that sub-paragraph (d) of paragraph 99(6) omits the words "of holiday", which appeared after the words "in respect of a period" in section 19(10). This was an error of drafting. There had been no intention on the part of the legislature to change the meaning of the provisions when transposing them from section 19 to the new paragraph 99.

3.7.5 Finally, Mr Oliver, who appeared for the administrators of Ferrotech, contended that the reference to "a period" in the paragraph, was a reference to one or other of the periods referred to in paragraph 99(6)(a) or (b) (i.e. a period of holiday or a period of sickness).

3.8 The court commented that "on any view, paragraph 99(6)(d) is unsatisfactory". It rejected Mr Reynold's argument on the basis that to interpret it in such a wide manner would render the remaining sub-paragraphs surplus to requirements. It rejected Ms Toube's argument as "ingenious" but "fanciful".

3.9 When looking at Mr Caddick's argument, the court was reluctant to imply words into the statute because of an apparent mistake by the draftsman. Neuberger LJ, who gave the leading judgment, commented that to imply the words "of holiday" into the paragraph would require a thoroughly exceptional case. As the result produced by not so doing was neither impossible nor absurd, the court could only conclude that the omission of the words by the draftsman was intentional[7]. In addition, he indicated that even if he were to imply the words

[7] The fact that the Court of Appeal was not prepared to accept the Attorney General's submissions that the problem arose as a result of a drafting error is of some concern. The judgment highlights the very limited circumstances in which the court will be prepared to try to work out what the legislature intended. If another meaning, however unintentional, may be discerned, then that is likely to be adopted.

back into the paragraph, Mr Caddick had still not been able to offer an explanation as to what the sub-paragraph would then be referring to[8].

3.10 In turning to Mr Oliver's argument, the court considered that it, too, held difficulties, but favoured it as the "least unsatisfactory construction" of paragraph 99(6)(d). Protective awards would therefore not fall within the definition of wages or salary, as they did not refer to either a period of holiday or a period of sickness.

The double gateway of paragraph 99(5)

3.11 Looking at other arguments before him, Neuberger LJ commented that, even if they had considered that a protective award could come within the definition of "wages or salary" set out in paragraph 99(6), the court would strongly doubt whether it could get through the second part of what he called the "double gateway" of paragraph 99(5). Paragraph 99(5) applies the priority afforded to contracts entered into by the administrators by paragraph 99(4) to wages or salary "arising under a contract of employment" which was adopted by an administrator. Neuberger LJ observed that even if the court had held that a protective award did fall within the ambit of paragraph 99(6)(d), the court would doubt whether it could be said to pass the second part of the test as such payments arose by virtue of employment law and not "under" a contract of employment.

The public policy considerations

3.12 Quite apart from the interpretation of the language of paragraph 99, the court felt that it was appropriate to consider, by reference to the wider context, whether protective awards should be given the super-priority status afforded by paragraph 99(5). The court agreed with the judgment of Etherton J, who said:

"The clear evidence before me is that it would seriously undermine the "rescue culture" which underlies the administration regime introduced by the Insolvency Act 1986 if protective awards and payments in lieu are treated as having priority under paragraph 99(4)."

Protective awards under TULR(C)A 1992

3.13 The Court of Appeal reached the conclusion that, in the light of the natural meaning of paragraph 99(5) and (6), as reinforced by practical and policy considerations, a protective award should not fall within the ambit of those paragraphs and accordingly it should not enjoy super-priority.

Payments in lieu of notice

3.14 Having dispensed with the question of whether protective awards were wages or salary, the Court of Appeal found it straightforward to deal with the question of whether payments in lieu of notice should be considered as wages or salary. For guidance on what constitutes "pay in lieu of notice" the court turned to the decision of Lord Browne-Wilkinson in *Delaney v R J Staples (t/a De Montford Recruitment)* [1992]. He had set out four categories of payment in lieu of notice, three of which he called "compensatory" payments, and one (essentially a "garden leave" payment) as actual remuneration arising under a contract of employment.

3.15 The Court of Appeal held that the only one of the four categories which could come under the super-priority afforded by paragraph 99(5), applying the "double gateway" test, would be "garden leave". Where an employee is paid "garden leave", he continues to be employed for the agreed period. The payments made to him therefore continue to be "wages or

[8] Which was a more fundamental reason for rejecting the Attorney General's drafting error argument!

salary"[9]. Where, however, an employee is contractually entitled to a certain period of notice but instead of serving the notice period, his employment is immediately brought to an end and he receives[10] a payment(s) to recognise the notice period he would otherwise be entitled to receive, such a payment is more akin to damages than wages or salary.

Rates

4. The jury is still out on the issue of whether rates are an administration expense. Notwithstanding that *Re Trident Fashions Plc*[11] has been before a High Court Judge and up to the Court of Appeal, a substantive and determinative judgment has still not been given.

4.1 The proceedings relate to the ill-fated Ciro Citterio menswear retailers, Trident Fashions Plc ("Trident") having acquired the chain of stores from the administrators of Ciro Citterio Menswear Plc in June 2001.

4.2 Trident itself went into administration on 17 September 2003 and a CVA was approved in December 2003. However, notwithstanding the CVA, the administration continued and on 20 April 2004 the original administrators were replaced by 2 partners in Begbies Traynor ("the BT Administrators"). The administration was extended by order of the court for 6 months and that period expired on 17 March 2005 whereby the administration came to an end by effluxion of time and the BT administrators ceased to hold office.

4.3 The management of Trident therefore reverted to its directors, however it went into administration again on 7 April 2005 with different administrators and then finally was wound up by the Court on 27 April 2005.

4.4 On 15 March 2005, 2 days before the end of the first administration, Exeter CC issued an application in the Companies Court seeking a declaration that the non-domestic rates that had accrued due to them since 17 September 2003 in respect of one of Trident's shops in Exeter fell within Rule 2.67(1)(a) or alternatively (f). The sums alleged to be due were in excess of £75,000. The Respondents to the application were the BT Administrators and Trident.

4.5 No evidence was filed in support of the application and it came before Rattee J for directions on 5 April 2005. Given that the BT Administrators had ceased to act and that a bare declaration was sought with no substantive relief against the BT Administrators, they successfully applied to be removed as parties and for the claim for relief against them to be struck out. Rattee J refused to allow Exeter CC further time to put forward an amended application seeking relief as against the BT Administrators.

4.6 Leave to appeal was granted by the Court of Appeal on the basis that Exeter CC, in its application for leave to appeal, for the first time referred to an argument that the rates ranked ahead of the BT Administrators' remuneration.

4.7 The Court of Appeal gave judgment on the appeal against the removal of the BT Administrators on 10 March 2006[12], allowed the appeal and remitted the matter to the High Court for determination. It did so, on the basis that at the time of the first hearing before Rattee J it appeared[13] that the BT Administrators had during the course of the first administration paid themselves remuneration in excess of £440,000. As such, Exeter CC had a right to claim in respect of their rates as an administration expense in priority to the

[9] Although it seems unlikely that administrators would request an employee to go on garden leave, the case emphasises the advantage to the administrator in summarily terminating the employment.
[10] or makes a claim to such a payment
[11] sub nom *Exeter City Council v Bairstow*
[12] [2006] EWCA Civ 203
[13] there was no formal evidence put before the Court of Appeal on the point.

sums claimed or already taken by the BT Administrators. This would have justified the BT Administrators remaining as a party.

Agreement to account for mistaken payments

5. In ***Re Plymbridge Distributors Limited***[14] the company carried on business as a book distributor for publishers of scientific publications, supplying books to retail outlets.

5.1 The company went into administration and the administrators sold the company's business and assets to another distributor, NBN, which then continued to supply retail outlets with books on behalf of the publishers. NBN also agreed to collect the book debts owed to the company on behalf of the administrators.

5.2 Following the sale of the business, retail outlets by mistake continued to make payments for books supplied into the company's bank account, even though such books were supplied by NBN and notwithstanding notices to the retail outlets by NBN to make future payments to NBN. Some £900,000 of mistaken payments were made.

5.3 The administration ended and the company was placed into creditors' voluntary liquidation. The liquidators having obtained an order for payment of the balance that had accrued on the company's bank account and the remaining monies held by the administrator, held some £3.75 million. They applied to court for directions as to whether any of the publishers had proprietary claims to the receipts by the company and also whether NBN had any claim to the mistaken payments (given that none of the retail outlets who had made the mistaken payments had sought a restitutionary remedy to recover the same).

5.4 HHJ Weeks QC accepted the evidence from NBN that there was an oral agreement between NBN and the administrators at the time of the business sale agreement, that the administrators would reimburse NBN for any mistaken payments that might be made into the company or the administrators' bank account. The mistaken payments were therefore payable to NBN as monies due in respect of a debt or liability arising out of a contract entered into by the administrators and were charged on the assets formerly in the custody or control of the administrators under paragraph 99(4) of Schedule B1. Further, the judge commented that even if he were not satisfied that there was an oral agreement, he would in any event have implied a term to repay any mistaken payments into the business sale agreement to give it business efficacy.

C. APPOINTMENT

Appointment – choice of administrator

6. In ***Re World Class Homes Ltd***[15] there was a dispute between a petitioning creditor of the company and the company itself (which applied for an administration order) over who should be appointed as administrator, both parties accepting that an administration order was appropriate. Mr. Justice Lindsay appointed the administrators nominated by the company on the grounds that:

6.1 The company's nominees already had some acquaintance with the affairs of the company and had already gauged interest from prospective buyers of the company's assets.

6.2 The company's nominees had a branch office in a territory where the company carried on some of its business.

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[14] Unreported, HHJ Weeks QC 24 November 2005
[15] [2005] 2 BCLC 1

6.3 The appointment of more than one nominee would confer a practical advantage to the administration.

6.4 The judge considered that it was not simply a matter of head-counting of the creditors who supported a particular nominee, particularly as such might be unreliable where one of the directors and shareholders of the company claimed to be a substantial creditor of it.

6.5 The cautious reaction of the company's nominees to requests for information from the creditor's nominee was not unreasonable, given that there was a need for caution before disclosing information without direct authority from the company and without the company's nominees having an opportunity to vet the information requested.

7. ***Re Berkeley Berry Birch Plc***[16] also involved a dispute over the choice of administrator.

7.1 An application for an administration order in respect of Berkeley Berry Birch Plc ("BBB") was made by the trustee of BBB's staff pension fund as a creditor. BBB's directors did not object to the making of an administration order but objected to the trustee's choice of administrators, who were from KPMG. The directors contended that partners in PwC, who were already familiar with BBB's business and difficulties ought to be appointed.

7.2 The trustee contended that it was in BBB's best interests for independent partners from KPMG to be appointed.

7.3 Notwithstanding Etherton J inviting the directors to adjourn the application to enable them to adduce further evidence in support of their opposition, the directors declined that invitation.

7.4 The judge held that the trustee's nominated administrators from KPMG should be appointed, on the basis that the trustee's choice was to be preferred given that it was a substantial creditor of BBB and as trustee it owed a particular duty to the company's staff and former employees. In the circumstances there should be seen to be a rigorous and independent analysis of the administration.

D. DISTRIBUTIONS, EXTENSIONS AND EXITS

Extension

8. Paragraph 76(2)(a) of Schedule B1 allows the court to make an order extending the term of office of an administrator for a fixed term and thereby extend the administration. Paragraph 77(1)(a) clarifies that the court can extend the term of office, even if such term has already been extended either by way of consent of the creditors or by court order. However, paragraph 77(1)(b) limits the power of the court to extend the term by providing that an order:

> "may not be made after the expiry of the administrator's term of office".

9. The only prudent course in seeking an extension has always therefore been to ensure that any application is issued and also heard by the court prior to the expiry of the term of office by effluxion of time[17]. However in ***Re TT Industries & Anor***[18] an application for an extension of time was made 3 days prior to the expiry of the administration but the court office did not issue the application until 20 days later and the application was not heard until 14 days after that.

9.1 The application came before HHJ Norris QC who observed that the Birmingham District Registry in general adopted a procedure for such extension applications whereby the

[16] [2006] All ER (D) 303 (Mar) Etherton J 21 March 2006
[17] By pro-active liaison by the solicitor and/or counsel's clerk with the Chancery Listing officer
[18] 26 April 2005 Ch. Div Birmingham DR, HHJ Norris QC

application was immediately on receipt referred to a judge, who makes an interim order, extending the period for a short time until the application is substantively heard. Unfortunately, that procedure had not been followed in this case.

9.2 The judge referred to a number of old cases outside the administration regime concerning applications which had to be made by a particular date and which were filed before the date but not heard due to court delays until after the deadline. In reliance on those cases and the principle that unavoidable delays in the administration of justice should not interfere with the rights of parties, the judge held that the court did have jurisdiction to extend time notwithstanding the expiry of the term of office provided that: (a) the application to extend time was made before the expiry of the deadline, and (b) there was a real possibility that the way the application was dealt with by the court contributed to the fact that no extension order had been made before the deadline.

9.3 The administrator and his legal advisers in that case can perhaps consider themselves fortunate in the judge being prepared to hold that he had jurisdiction to extend time and in obtaining an extension in the circumstances. Notwithstanding the judge's reasoning, it is doubtful whether there is jurisdiction to extend time after expiry of the term of office and there is no certainty that another judge would follow this decision. Even if it was held that there was jurisdiction, it would be in very limited circumstances that the court would have contributed to the failure to make an order in time, rather than the failure lying with the administrator or his legal advisers.

Dissolution after distribution

10. In two separate applications, the court has confirmed that an administrator who has distributed funds to creditors is able to move the company straight to dissolution under paragraph 84 of Schedule B1 to the Insolvency Act 1986.

10.1 Since the new administration regime was introduced, there has been some doubt whether it is possible for an administrator who has distributed funds to creditors, to use the procedure set out in paragraph 84 of Schedule B1 to the Insolvency Act 1986 and move the company straight to dissolution.

10.2 Paragraph 84(1) of Schedule B1 provides:

"*If the administrator of a company thinks that the company has no property which might permit a distribution to its creditors, he shall send a notice to that effect to the registrar of companies.*"

10.3 The paragraph continues by providing for the registrar, upon receipt, to register the prescribed form of notice, whereupon, the appointment of the administrator ceases to have effect and three months later, the company is deemed to be dissolved.

10.4 In *Re Ballast Plc* (2005) 1 All ER 630 Mr Justice Blackburne commented, obiter, that this means that if an administrator has or has had any property at any time in the administration to distribute, he cannot avail himself of the dissolution procedure. His approach accords with the brief commentary on the section in Professors Sealy and Milman's Annotated Guide to the Insolvency Legislation (Second Revised Seventh Edition). However, in a recent edition of Dear IP, the Insolvency Service explained that the intention behind the provision was to facilitate the dissolution of companies after assets had been distributed to creditors.

11. ***Preston & Duckworth Ltd (In Administration)***

11.1 DLA Piper's Manchester office made an application to court on behalf of Jonathan Newell and Kerry Bailey, the joint administrators of Preston & Duckworth Limited. The application

was made under paragraph 65(3) of Schedule B1 seeking permission for the administrators to make a distribution to unsecured creditors. The application also sought directions to confirm whether, after making the distribution, it would be open to the administrators to use the dissolution procedure set out in paragraph 84.

11.2 The matter was heard by Mr Recorder David Hodge QC sitting as a Deputy Judge of the High Court. He gave a full and reasoned judgment, ultimately deciding that it should be possible to dissolve a company under paragraph 84 notwithstanding that a distribution has been made to creditors. He noted the Insolvency Service's views and also those of Stephen Davies QC, editor and co-author of "Insolvency and The Enterprise Act 2002" who also opined that it should be possible to dissolve after making distributions to creditors.

11.3 In relation to Blackburne J's comments in *Re Ballast,* Recorder Hodge stated:

"*What paragraph 84(1) provides is that "if the administrator of a company thinks that the company has no property which might permit a distribution to its creditors, he shall send a notice to that effect to the Registrar of Companies". Blackburne J's parenthetical obiter observation involves rewriting the paragraph so that it reads "if the administrator of a company thinks that the company has and has had no property which might permit a distribution to its creditors, he shall send a notice to that effect to the Registrar of Companies". In my judgment, such a rewriting of the sub-paragraph is not permissible. Moreover, such a rewriting not only achieves no sensible or discernible purpose but seems to me, and to other commentators, to run counter to the clear policy underlying the reforms introduced into the administration procedure by the Enterprise Act 2002 and in particular the new exit mechanism introduced by paragraph 84 itself.*"

12. ***Re GHE Realisations Ltd***

12.1 Before Recorder Hodge's decision could be reported, an identical application was heard in London by Rimer J in the matter of ***GHE Realisations Limited***[19], who also concluded that a distribution to creditors should not preclude an administrator from moving the company to dissolution under paragraph 84:

"*… in engaging in the thinking exercise that paragraph 84(1) imposes on him, I consider that he is only required to "think" whether at that time the company has property which might permit a distribution to be made to creditors. This is consistent with the tense of the statutory language being the present tense. Whether the company had assets which have previously been distributable and distributed is in my judgment immaterial. I agree with Mr Eaton-Turner [counsel for the administrators] that if the prior distribution of all available assets precludes the giving of a paragraph 84(1) notice, it also precludes the giving of a paragraph 83(3) notice [for the company to move to creditors' voluntary liquidation] and so limits the exit options open to the administrator. Such an interpretation of paragraph 84(1) would appear to me to deprive the paragraph of a significant element of practical utility and I a not satisfied that it is correct*".

Distributions

13. Rimer J's judgment ***Re GHE Realisations Ltd*** also provides helpful guidance on the factors which the court should take into account when considering an application under Paragraph 65 of Schedule B1 to the Insolvency Act 1986 for permission to make a distribution to unsecured creditors.

14. Issues which the judge felt would be likely to be material (though not comprising a test or set of preconditions which must be satisfied) were:

[19] [2005] EWHC 2400 (Ch); [2006] 1 WLR 287

14.1 The administrator must have sufficient funds for the purpose;

14.2 He should not have proposed exiting the administration into CVL;

14.3 His approved statement of proposals should have included a proposal to make such a distribution;

14.4 The payment of a dividend should be consistent with the functions and duties of the administrator and any proposals made by him or which he intends to make;

14.5 Rimer J noted that by paragraph 3(2) of Schedule B1, administrators are required to perform their functions in the interests of the company's creditors as a whole. Any order permitting a distribution under paragraph 65 should ultimately be governed by that consideration. There may be cases where permitting an administrator to make distributions to unsecured creditors could adversely affect particular categories of creditors. However, he was content that the administrators before him had concluded that this was not such a case. Furthermore, they could see no benefit accruing to any party if the company were forced, in the alternative, to enter liquidation.

Converting into creditors' voluntary winding up

15. Paragraph 83 of Schedule B1 provides a quick and easy method for the administrator to bring the administration to an end and place the company into creditors' voluntary liquidation, by sending a paragraph 83 notice to the Registrar of Companies. Upon receipt of the notice the Registrar is required to register it and under paragraph 83(6) on registration of the notice, (a) the appointment of the administrator ceases to have effect and (b) the company shall be wound up as if a resolution for the voluntary winding up of the company under section 84 of the Insolvency Act 1986 were passed on the day on which the notice is registered.

16. Paragraph 83(6) envisages that a company will pass from administration to winding up without any gap between the two processes. However ***in Re E Squared Ltd and Re Sussex Pharmaceuticals Ltd***[20] the court had to deal with 2 cases where the paragraph 83 notice was sent by administrators to the Registrar before the expiry of the administration by effluxion of time but there was a delay by the Registrar in registering the notice, such that the administrators had by then ceased to hold office by reason of effluxion of time. The issue arose as to whether the notices were effective to place the companies into creditors' voluntary liquidation.

16.1 Sussex Pharmaceuticals Limited ("**Sussex**") entered administration on 31 January 2005. Its administrators sent a notice under paragraph 83 to the Registrar of Companies ("**Registrar**") on 27 January 2006 to register the Sussex' exit from administration into creditors' voluntary liquidation. The notice was received at Companies House on 28 January 2006. It was not registered until 1 February 2006, the day after the administrators' appointment expired by effluxion of time under paragraph 76[21]. The facts relating to E Squared Limited were not materially different. The administrators in both cases applied to court for a declaration as to whether the process was still effective to put the companies into liquidation.

16.2 Mr Justice David Richards observed that paragraph 83 does not envisage a hiatus between the administration and the liquidation. It simply requires the administrators to

[20] [2006] EWHC 532 (Ch)
[21] It appears that the delay may have been due to the notice being sent to the Registrar's office in London, which then had to be sent to the main registry in Cardiff for registration.

send the notice to the Registrar. The paragraph does not require the notice to be given a minimum period before the end of the administration.

16.3 He held that the administrators need not be in office for the registration of the notice to have the effects envisaged by the paragraph. The critical point is for the administrators to have sent the notice before the appointment ceases to have effect. The notice does not even have to have been received by the Registrar before the appointment as administrator ceases to have effect. In such circumstances, the provisions of paragraph 83(6)(a) (administrator's appointment to cease on registration of the notice) will simply have no effect.

16.4 It was not necessary for him to make a decision as to whether the administrators' appointment was extended beyond the maximum one-year period prescribed by the Act by necessary implication by reason of the administrators having sent the notice under paragraph 83, because in the present cases there was no actual time between the expiry of the administrators' appointment (31 January) and the registration of the notice (1 February). Richards J stressed that he had not reached any view on the point. He pointed out however that the point might be significant, for example, as regards time limits for the purpose of proceedings under sections 238 and 239 IA 1986.

E. REMUNERATION ISSUES – PRE AND POST APPOINTMENT

17. As a topic close to the hearts of most IPs and solicitors the issues concerning remuneration are summarised below. There have been no substantial developments over the last year, save that pre-appointment remuneration in the context of pre-packs remains a substantial live issue for IPs.

Pre-appointment remuneration

18. Rule 2.106(1) provides that an administrator

"is entitled to receive remuneration **for his services as such**"

The highlighted wording confirms that the administrator is only entitled to remuneration for his services as administrator, i.e. for work done after his appointment to the office of administrator. Work done prior to appointment is not covered by Rule 2.106(1).

19. Rule 2.67(1)(c) provides that certain limited costs pre-appointment in connection with the appointment as administrator can be recovered as administration expenses:

> "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"

It will however be noted from the highlighted wording that r. 2.67(1)(c) only provides for indirect recovery of remuneration for the proposed administrator, i.e. it is the applicant or appointor who is entitled to recover any of his costs and expenses, which would be costs and expenses incurred in instructing the insolvency practitioner.

20. The concern over pre-appointment costs has led to the Insolvency Services' Dear IP September 2005, Issue No. 24, which provides guidance as follows:

"The Insolvency Service has been made aware that some insolvency practitioners have questioned why they are not allowed to claim pre-appointment time as expenses of the administration.

Costs incurred prior to the administration are essentially a matter between the relevant insolvency practitioner and the party instructing them. For example if a company has **concerns regarding its financial situation and approaches an insolvency practitioner for advice**, then payment of fees incurred would be a matter between the company and the insolvency practitioner. In such a case any fees outstanding, at the date the company entered administration, would, in our view, rank as an unsecured claim.

However, time spent by a proposed administrator, prior to any appointment, in **determining that it is reasonably likely that the purpose of the administration would be achieved and to enable them to complete Form 2.2B**, are arguably costs and expenses of the appointer/applicant for the purposes of Rule 2.67 (1)(c) of the Insolvency Rules 1986 …"

21. That guidance emphasises the importance of pre-appointment costs being addressed and provided for by the company/directors/shareholders/QFCH and the inability of the IP to take such costs generally by way of remuneration qua administrator. Anecdotal evidence suggests that this issue will be scrutinised on inspection visits to IPs. The scope to claim that the costs are covered by Rule 2.67(1)(c) appears to be limited. A restrictive interpretation has been applied to pre-appointment expenses of a voluntary liquidation under section 115 IA 1986[22].

22. The need for the IP to ensure separate payment for his services pre-appointment is stark in the case of pre-packs, where substantial work will inevitably have been incurred by the IP in considering the financial position of the company, providing advice on options and a pre-pack, organising the marketing and valuation of the business and assets and preparing the sale documentation. It is understood that such costs are sometimes sought to be recovered as part of the transaction costs on the pre-packaged sale of the business/assets (which is ultimately completed, post-appointment). Whether recovery by that means will stand up to a challenge, given that on the face of it such costs would be a pre-appointment unsecured claim as against the company (assuming it is the client), is a moot point. In other cases, the IP is paid for his services by the company on the basis that they will lead to a better return for creditors as a whole, or the costs of his services are invoiced to the secured creditor on the basis that they properly fall within the provisions of the security document as costs to the charge holder of realising his security.

Post-appointment remuneration

23. There have been no substantial changes over the last year concerning the administrator's post-appointment remuneration. It is however perhaps worth re-emphasising the following points on post-appointment remuneration.

Leyand Daf (again) – impact on administration

24. As noted elsewhere in this paper, administration is popular as an insolvency process and has the advantage over a CVL of certainty concerning recovery of remuneration from floating charge realisations, following the *Leyland Daf* decision as regards a liquidator's remuneration. There is a suggestion in Sealy & Milman, Annotated Guide to the Insolvency Legislation 2005/2006, 8th Ed., p.535 that *Leyland Daf* might have application to administrations and the ability of administrators to recover remuneration from floating charge realisations:

[22] See e.g. *Re A V Sorge & Co Ltd* (1986) 2 BCC 99,306; *Re Sandwell Copiers Ltd* (1988) 4 BCC 227; *Re W F Fearman Ltd (No.2)* (1988) 4 BCC 141; *Re Gosscott (Groundworks) Ltd (1988)* 4 BCC 372

> "However, if a receiver has been in office prior to the appointment of the administrator (and also, it would appear, if the appointment of the administrator or any other event has had the effect of crystallising the floating charge), the ruling of the House of Lords in *Re Leyland Daf Ltd* …. indicates that the property subject to the charge becomes beneficially the property of the charge holder and forms no part of the fund from which the preferential creditors in the administration and the administrator's remuneration and expenses can be paid (see note to s.175). However, the application of *Re Leyland Daf Ltd* to the case where the company is in administration rather than in liquidation remains open to debate, since there are differences in the applicable legislation and, in particular, there is nothing in the rules governing liquidation corresponding to para. 99 (3)(b)".

25. The authors view is that the concern expressed by Sealey & Milman is misplaced and that it is clear that an administrator can obtain his remuneration from realisations of floating charge property, irrespective of whether the floating charge has crystallised. However, for completeness the point and reasoning is addressed below.

26. It is submitted that in so far as the floating charge remains floating at the time of appointment of the administrator, the administrator is given power to deal with those assets under paragraph 70 of Schedule B1. Furthermore, paragraph 99(3) of Schedule B1 provides that the 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. There is no such equivalent provision relating to liquidation enabling a liquidator to have recourse to floating charge realisations for the purposes of his remuneration. The *Leyland Daf* problem does not directly arise as regards administrators and it seems unlikely that the banks will be able to challenge an administrator's recourse to floating charge realisations by seeking to apply *Leyland Daf* by way of analogy, given the express statutory provision authorising such remuneration to be taken.

27. However, that does not deal with the situation (raised by Sealey & Milman) where the floating charge has crystallised at the time of appointment of the administrator, either because of the prior appointment of a receiver (which acts as a crystallising event) or because the appointment of the administrator is a crystallising event specified in the debenture[23]. Where a floating charge crystallises it attaches to specific property, is effective to pass equitable title, the charge becomes immediately enforceable and takes on the form of a fixed charge[24]. Lord Hoffmann summarised the position in *Leyland Daf* at para. 29:

> "When a floating charge crystallises, it becomes a fixed charge attaching to all the assets of the company which fall within its terms. Thereafter the assets subject to the floating charge form a separate fund in which the debenture holder has a proprietary interest."

If the administrator deals with and realises assets, which are subject to a floating charge which has crystallised and thereby become a fixed charge, is he entitled to remuneration out of the proceeds of sale of the same?

27.1 The starting point is to consider what, if any, power the administrator has to deal with those assets subject to a crystallised floating charge. At first blush paragraph 70(1) of Schedule B1 does not appear to allow the administrator to deal with those assets because it provides:

[23] Absent an express provision in the debenture for crystallisation on an application being made for the appointment of an administrator or the appointment of an administrator, the mere appointment of an administrator probably does not in and of itself crystallise the floating charge: Lightman & Moss, The Law of Receivers and Administrators of Companies, 3rd Ed., para. 3-067.

[24] See Lightman & Moss, para. 3-009.

"The administrator of a company may dispose of or take action relating to property which is subject to a floating charge as if it were not subject to the charge".

It might be argued that this does not assist the administrator because after the crystallising event the assets have become subject to a fixed charge, rather than being subject to a floating charge. Support for that contention might also be sought from a comparison with the power of an administrator under the old regime s. 15(1) IA 1986, which allowed an administrator to deal with assets subject to a security as if it were not subject to that security, s.15(3) providing that subsection (1) applied to "any security which, **as created**, was a floating charge". The highlighted wording meant that it was not necessary under the old regime to consider whether the floating charge had crystallised and thereby become a fixed charge. However that highlighted wording has not been included within the new paragraph 70(1). It might therefore be argued that paragraph 70(1) does not enable the administrator to deal with assets which were originally subject to a floating charge but have subsequently by reason of crystallisation of the floating charge become subject to a fixed charge.

27.2 Furthermore, if that be right, then if the administrator did realise assets that were subject to the crystallised floating charge, it could be argued that he would not be entitled to remuneration from the same. Whilst paragraph 99(3)(a) of Schedule B1 provides that his remuneration is charged on and payable out of property "of which he had custody or control"[25], which would cover the assets subject to the crystallised floating charge, the paragraph must be read as a whole including paragraph 99(3)(b), which provides that the remuneration is payable "in priority to any security to which paragraph 70 applies". If paragraph 70 does not apply because the floating charge has crystallised, then by necessary implication, the claim to remuneration would not take priority over the bank's security which has become fixed by reason of the crystallisation of the floating charge.

27.3 However, the contrary and preferred interpretation is that the absence of the highlighted wording in s.15(1) IA 1986 being repeated in paragraph 70(1) is, it is submitted, explained by reference to s. 251 IA 1986, which provides definitions of expression used in the First Group of Parts to the IA 1986, which includes the new administration regime in Schedule B1 because such is applied by the new s. 8 IA 1986. Section 251 provides that "floating charge" means

"a charge which, as created, was a floating charge …"

Paragraph 70(1) should it is submitted therefore be read as including that definition and therefore provides:

"The administrator of a company may dispose of or take action relating to property which is subject to a [charge which, as created, was] a floating charge as if it were not subject to the charge".

The omission to repeat in paragraph 70(1) the wording that had been used in s. 15(3) IA 1986 under the old regime can therefore be seen as deliberate because such wording was superfluous, given the definition of floating charge in s. 251[26].

27.4 If the above interpretation is correct, then the administrator would have power under paragraph 70(1) of Schedule B1 to deal with the assets which are subject to a floating charge, irrespective of whether that floating charge has crystallised or not. If that is

[25] As distinct from "the company's assets"

[26] That having been said, given that s. 251 IA 1986 has not been amended, it might be asked why it was considered necessary to include the extra wording in s.15(3) IA 1986 or for that matter s. 40(1) IA 1986.

right, then the administrator is entitled under paragraph 99(3) of Schedule B1 to his remuneration and expenses out of "the property of which he had custody or control" and such remuneration is payable in priority to the security to which paragraph 70 applies, i.e. the floating charge, irrespective of whether that floating charge has crystallised or not. *Leyland Daf* would not assist the charge holder because of the express statutory allowance of remuneration under paragraph 99(3) of Schedule B1.

SIP 9

28. Claims for the approval of remuneration of the administrator by the creditors' committee (Rule 2.106(3)) or by a creditors' meeting (Rule 2.106(5)) must be put forward with the particulars and detail set out in SIP 9.

Rule 2.106 (5A)

29. The Insolvency (Amendment) Rules 2005, rule 15 inserted a new Rule 2.106(5A), which provided that

> "In a case where the administrator has made a statement under paragraph 52(1)(b), if there is no creditors' committee, or the committee does not make the requisite determination, the administrator's remuneration may be fixed (in accordance with paragraph (2)) by the approval of –
> (a) each secured creditor of the company; or
> (b) if the administrator has made or intends to make a distribution to preferential creditors –
> (i) each secured creditor of the company; and
> (ii) preferential creditors whose debts amount to more than 50% of the preferential debts of the company, disregarding debts of any creditor who does not respond to an invitation to give or withold approval;
> and paragraph (4) applies to them as it does to the creditors' committee.

30. The amended rule only applies to companies which have entered administration after 1 April 2005[27]. The general scheme of the rule is to make it easier for the administrator to obtain approval of his remuneration by the relevant interested parties where he has made a statement under paragraph 52(1)(b), i.e. (a) payment in full of all creditors, (b) no distribution to unsecured creditors beyond prescribed part, or (c) neither of the objectives in para. 3(1)(a) or (b) can be achieved. Usually such a statement will be made where the only objective that can be achieved is paragraph 3(1)(c), i.e. to make a distribution to one or more secured or preferential creditors. As such, the new rule is aimed at providing a means whereby in that situation the remuneration can be approved by the secured creditor or, if there is also to be a distribution to preferential creditors, with the approval of a majority of the preferential creditors.

31. Three points should however be noted:

31.1 **Default mechanism**. The rule only applies where there is no creditors' committee or that committee does not determine the remuneration. By implication, if there is a committee there appears to be an onus on the administrator to seek approval of his remuneration from that committee, even if the unsecured creditors have no interest in the amount of the remuneration claimed.

31.2 **Approval by all secured creditors**. The rule refers to approval by each of the secured creditors of the company, not just the secured creditor to whom a distribution is going to be made. Therefore if there are second or third chargees, as well as a bank holding a fixed and floating charge to whom the only realisations will be

[27] See Rule 3(1) and Rule 1(2) of the Insolvency (Amendment) Rules 2005.

distributed, the administrator must still seek the approval of his remuneration from the second and third chargees.

31.3 **The risk of paying off a secured creditor before agreeing final remuneration.** An as yet unanswered problem arises where an administrator has included in his proposals a statement under paragraph 52(1)(b) that the company has insufficient property to enable a distribution to be made to unsecured creditors other than by virtue of section 176A(2)(a) (the "prescribed part") but pays all sums due to the secured creditor before completing the administration. Having made such a statement, the provisions of Rule 2.106(5A) apply.

In some cases, whilst at the beginning of the administration, the administrator correctly thought that there would be no return to unsecured creditors, circumstances can change and a return subsequently becomes inevitable. There is no provision for such situations. Should the administrator consider this to be a substantial revision to his proposals and circulate creditors accordingly? If so, this could impose an unnecessary layer of costs. Or is he entitled only to consult the secured and preferential creditors regarding his remuneration? This would appear to be the case from a strict interpretation of the above Rule. What if the secured creditor is repaid in full during the early days of the administration? Who then should approve the administrator's remuneration. Having been repaid, does the secured creditor still have authority to make decisions under Rule 2.106(5A)? There is currently no answer to these questions. To avoid the last issue arising, most practitioners ensure that the secured creditor is not repaid all sums due to it until the administration is ready to be brought to an end.

32. Finally, if the administration pre-dates 1 April 2005, rule 2.106 (5A) does not apply. In such cases, reference should be made to its predecessor, rule 2.106(9) which has now been deleted. That rule was intended to have the same effect as the new sub-rule 5A, but its wording was considered to be ambiguous and was consequently clarified in the last rules revision.

Practice Statement

33. In so far as the administrator has to resort to obtaining approval of his remuneration from the court, the evidence in support thereof must comply with the requirements of the Practice Statement – The fixing and approval of the remuneration of appointees (2004) [2004] BPIR 953, albeit the courts have in general shown a willingness to temper the detailed requirements of that practice statement, depending upon the amount claimed, the recoveries made, what return will be made to creditors and what approval for the remuneration has been sought/given by creditors.

F. TUPE – THIS YEAR'S HOT TOPIC

Background

34. The Transfer of Undertakings (Protection of Employment) Regulations 2006 ("**New Regulations**") came into force on 6 April 2006, replacing in their entirety the Transfer of Undertakings (Protection of Employment) Regulations 1981. However the 1981 Regulations will still govern transfers which took place prior to 6 April 2006.

35. The Regulations implement the provisions of the revised EU Acquired Rights Directive and take account of judgments in the UK appellate courts and the European Court of Justice. The New Regulations extend the protection which the 1981 Regulations gave to employees to situations where services are contracted out, brought back in-house or where the employer

changes from one service provider to another. They also contain specific provisions which are intended to alleviate the detrimental effects of TUPE on insolvency-related transfers.

36. Whilst the 1981 Regulations provided good protection for employees of solvent enterprises, when employers become insolvent, the same regulations often worked against employees' best interests. In order to protect the value of an insolvent employer's business, some or all of the business will often be sold very swiftly. Some of the employees will not be required by the purchaser and will be dismissed, some or all may be owed arrears of wages and if the sale has been completed swiftly, it is unlikely that any of the employees will have been properly consulted in relation to the proposed transfer, entitling them to apply to a tribunal for a protective award. A combination of case law and the 1981 Regulations provided that liabilities in respect of the dismissals which were connected with the transfer (if held not to be for an economic, technical or organisational reason), the arrears and the protective award would pass to the purchaser. The prospect of inheriting such potentially large claims can deter prospective purchasers of the business from proceeding or result in them demanding a significant reduction in the purchase price, which, in turn, will affect the return to the insolvent employer's creditors.

37. The New Regulations (which are intended to give effect to EC Directive 23 of 2001) seek to encourage the rescue of insolvent enterprises first by providing for some of the liabilities due to employees to be met by the National Insurance Fund ("NIF") and secondly by permitting employers and employee representatives to agree changes to terms and conditions of employment if such changes are to be effected with a view to ensuring the survival of the business and the preservation of jobs. Unfortunately, despite the laudable intention behind the New Regulations, they represent the worst piece of insolvency related legislative drafting to have emerged from this Government. The EC Directive is drafted in wide terms: its provisions must be adapted by each Member State to take into account the very different types of insolvency regimes which exist throughout Europe. However the UK Government has adopted almost all of the wording directly from the Directive, without making any attempt to apply its terms specifically to UK insolvency proceedings.

Applying the New Regulations to UK insolvency regimes

38. In the UK, with the possible exception of compulsory liquidation, it is possible for there to be a going concern transfer of employees in every type of insolvency regime. Some commentators even suggest that although a winding-up order automatically terminates contracts of employment, it is possible for employer and employees to agree to waive the termination and for the contracts to continue. Despite the possibility of employees of insolvent enterprises being transferred in all types of insolvency regime, the New Regulations seek to draw a distinction between:

- "bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor"; and
- "insolvency proceedings which have been opened … not with a view to the liquidation of the assets of the transferor".

39. For those proceedings which are deemed to fall into the first category, new Regulations 4 and 7 do not apply. These are the provisions which state that rights and obligations under employment contracts automatically pass to the transferee and that a dismissal made by reason of the transfer is automatically deemed to be unfair. This appears to give rise to considerable scope for abuse. If, for example an administration which the administrator proposes to conclude by moving to creditors voluntary liquidation were to be considered to fall within this provision, it would be possible for all of the employees of the insolvent business to be dismissed and for the purchaser to continue the business, deciding free of any legislative fetters, whether, and if so how many, of the company's former employees he is prepared to re-

employ and upon what terms. This is precisely the type of scenario that TUPE is intended to avoid.

40. It is only those insolvency procedures which fall within the second category which result in employees being entitled to the new protection whereby certain sums are to be paid by the NIF instead of passing to the purchaser of the business and where amendments may legitimately be made to contracts of employment (thus, hopefully, rendering the employees more likely to be taken on by the new employer).

When do each of the provisions apply?

41. There are many possible interpretations of which insolvency regimes should fall within each of the categories. The categories themselves do not appear to be mirror images of each other, one referring as it does to bankruptcy or any analogous insolvency proceedings, whilst the other only refers to insolvency proceedings. Administration appears to fit almost as comfortably within the first as the second - or perhaps between each of them - it just depends how one interprets the words used.

42. The reference to liquidation is to the "liquidation of the assets of the transferor" which appears likely to be something different from liquidation of the corporate entity via an insolvency regime. Assets are realised in all types of insolvency regime.

43. When it heralded the forthcoming regulations, the Government stated that the insolvency provisions would relate to collective procedures but not private remedies such as receivership. This intention does not appear to have been brought into effect.

44. Judgments of the European Court of Justice suggest that if called upon to do so, the court or tribunal will seek to apply the employee protection provisions of the Directive (which are now reflected in New Regulations 4 and 7) whenever the insolvency proceedings facilitate on-going trading which can lead to a transfer of part or all of the business as a going concern, but that they should not apply where the procedure is truly terminal. However, each decision of the ECJ is limited to the type of (in most cases, overseas) insolvency procedures in question in that case. Where, in the UK, even liquidation can lead to a sale of part or all of the insolvent company's undertaking as a going concern, it is difficult to apply the ECJ decisions to UK insolvency regimes. Moreover, the leading case in which the ECJ held that the Directive's employee protection provisions should not apply to an insolvency scenario was *Abels.* In that case, the only justification given by the court for holding that the protective provisions should not apply to insolvent transfers, was that the court could not be certain that holding otherwise would not expose the insolvent business and its creditors to the risk that prospective purchasers would be frightened away by the potential liabilities. The New Regulations are expressly intended to address that risk. It is difficult, therefore to understand why the Government has sought to draw a distinction in the UK between proceedings initiated "with a view to" and "not with a view to" the liquidation of the assets.

45. The only explanation provided by the Government was that it wished to "future proof" the New Regulations from any new insolvency regimes which may be introduced. However, having just completed its most extensive review of insolvency legislation for 20 years, further changes seem most unlikely in the foreseeable future.

A bird in the hand - practical guidance

46. However one chooses to interpret the New Regulations is of little significance without a decision of the court or, on a more practical level, assurance that the Redundancy Payments Office ("RPO") which administers the NIF on behalf of the Secretary of State agrees with the interpretation. On 3 April the RPO wrote to all insolvency practitioners to clarify the manner in which it intends to interpret the regulations, with a totally new take on the Government's

interpretation of its own regulations, but a helpful one nevertheless. The RPO has stated that in its view, the only type of insolvency procedure definitively outside the scope of Regs 8 and 9 is compulsory winding up. In all other cases (except members voluntary liquidation which should not be regarded as an insolvency procedure at all) it will interpret the regulations purposively and the test of whether or not assistance will be given by the National Insurance Fund will depend upon whether a transfer of all or part of an undertaking has in fact taken place. This is a sensible approach and is to be welcomed, even though it does not appear to relate to the words used in the Government's own regulations!

Payments to be made by the NIF

47. Here too, there has been considerable uncertainty. The Government's guidance notes which accompanied the New Regulations and its response to the consultation exercise, clearly stated that employees who transferred to a new employer would be entitled to claim redundancy pay. That did not, in fact, appear to have been provided for in the New Regulations. The RPO's letter of 3 April confirms, that in its view, no redundancy payments should be made to employees whose contracts transfer to the purchaser, because there has been no redundancy - such employees enjoy continuity of employment. The RPO has said that the same would apply to employees who are dismissed for a non economic, technical or organisational reason connected with the transfer - which the New Regulations provide will be automatically considered to be an unfair dismissal. According to the RPO, such employees will only be entitled to arrears of wages and holiday pay, as they, too, have not been made redundant.

48. All liabilities not met by the NIF, including those in excess of the statutory payment limits (currently £290 per week for arrears of wages for a maximum of 8 weeks and £290 for holiday pay for a maximum of 6 weeks) still pass to the purchaser of the business.

49. If the RPO's interpretation of the amounts which it should pay under the New Regulations is correct (or, bearing in mind that the RPO is holding the purse strings - even if it is not) the regulations provide significantly less relief from the potentially onerous effects of TUPE than was promised and anticipated. At this point, the New Regulations start to take on the impression of a mirage.

How much relief will the New Regulations really provide?

50. Arrears of wages tend not to be the main concern of a prospective purchaser of an insolvent business. Often, in order to keep the employees, they will have been paid more or less up to date. Far more onerous are the potential liabilities for (i) employees who are dismissed for a non-ETO reason connected with the transfer and (ii) protective awards for a failure to consult regarding the proposed transfer.

51. In relation to the former, as stated above, the RPO is of the view that employees dismissed for a non-ETO reason should only be entitled to claim arrears of wages and holiday pay. All remaining sums due to the employee will pass to the purchaser.

52. In relation to the latter, as far as insolvency practitioners are concerned, matters have very recently taken a turn for the worse and the New Regulations may serve to compound the situation. In the matter of *Sweetin v Coral Racing* (UKEAT/0039/05) the Employment Appeal Tribunal recently held that a tribunal should regard the award which should be made in an employee's favour as a result of an employer's failure properly to consult regarding a proposed transfer, as penal in nature, rather than merely serving to compensate the employee for the loss which he suffered. As such, the tribunal should start from the maximum liability of 13 weeks' pay (with no cap on amount) reducing it only if the circumstances justify leniency.

53. New Regulation 15(9) provides that liability for a failure to consult regarding a proposed transfer shall now be joint and several between transferor (insolvent company) and transferee (purchaser). The regulations expressly provide that contracting out is not permissible. The clear risk to insolvency practitioners who fail properly to consult is (a) that the transferor could be held liable to pay substantial sums in respect of protective awards under the New Regulations; (b) at best such liabilities will reduce any anticipated dividend to unsecured creditors and (c) at worst, in light of the uncertain status of administration expenses, that such liabilities could be held to be administration expenses under Rule 2.67. In the light of the CA decision in *Re Huddersfield Fine Worsteds Ltd* and *Re Granville Technology Ltd* [2005] EWCA Civ 1072 this last point is hopefully most unlikely. However, practitioners should bear in mind that the CA merely held that protective awards (in that case under the Trade Union Labour Relations (Consolidation) Act, as opposed to TUPE) did not fall within the term "wages or salary" in paragraph 99(5) of Schedule B1 to the Insolvency Act 1986. No consideration was given to whether they could fall within any of the heads of expenses set out in Rule 2.67 nor was any express consideration given to protective awards under TUPE. It is to be hoped that the same public policy considerations which influenced the court in *Allders and Granville Technology* would apply equally to a consideration of protective awards under TUPE. However, that cannot be guaranteed.

New duties

54. Not only do the Regulations expressly provide for vendor and purchaser of an insolvent business to be jointly and severally liable for a failure to consult employees regarding the proposed transfer, they also impose a new, onerous obligation upon the insolvent vendor to provide employee information to the purchaser. New Regulation 11 requires the transferor to provide detailed information to the transferee about the employees who are to be transferred. There is no exception or relief for insolvency practitioners in relation to this obligation. The information must be provided to the prospective purchaser of the business not less than 14 days before the intended transfer. A purchaser is entitled to bring a complaint to an employment tribunal about a failure to provide such information and a fine of not less than £500 per employee can be imposed on the transferor (less if the Tribunal is satisfied that it is just and equitable in all the circumstances to order a lesser sum).

55. Insolvency practitioners often do not have enough information to comply with the requirements of Regulation 11 and usually do not have enough time to do it sufficiently in advance. In the case of some pre-packaged sales it will be impossible to comply. However, contracting out of Regulation 11 is not allowed. It remains to be seen whether devices such as indemnities or assignments of rights, frequently employed by lawyers to overcome such issues, will be deemed acceptable or held void as an attempt to contract out of the statutory provisions.

56. The New Regulations should incline insolvency practitioners very carefully to consider and seek advice regarding the possibility and requirements of consulting employees in relation to any proposed transfer.

Legislative amendment?

57. Despite an outstanding motion to revoke the New Regulations which has been tabled for debate on 3 May, and despite acknowledging that the regulations are ambiguous and will ultimately have to be interpreted by the courts, to date, the Government has provided no indication of a willingness to introduce amending legislation. The insolvency market must make of the New Regulations what it will. It seems likely that clarity will only arrive at the expense of employees and creditors when, one day, as is inevitably the case, the issues are referred to a court or tribunal for determination. The introduction of such poorly drafted insolvency provisions is not consistent with the stated aims of a Government apparently intent upon promoting a rescue culture. It should be ashamed of the New Regulations and take immediate action to correct them.

G. THE CVL / ADMINISTRATION CONUNDRUM: SENSIBLE USE OF A NEW, FLEXIBLE REGIME OR ABUSE OF PROCESS?

58. Many of today's administrations would once have been voluntary liquidations. Often there is no element of trading. The new, streamlined administration procedure simply facilitates a realisation of the company's assets: either a straightforward asset sale, or a pre-packaged sale of the company's business, more often than not, to its former management. Whilst the Insolvency Service's stated aim when introducing the new administration regime focused upon the rescue of viable companies, the types of asset realisations which now appear to be commonplace fall further down the hierarchy of objectives which comprise "the Purpose" of administration. With the benefit of a moratorium, there are few hurdles for an insolvency practitioner to jump before being able to "think" that in administration he could achieve a better result for the company's creditors as a whole than would be likely if the company were to be wound up without first being in administration. Even where that simple goal appears elusive, provided he can do so without unnecessarily harming the interests of the company's creditors as a whole, he can perform his functions for the sole objective of realising property in order to make a distribution to one or more secured or preferential creditors.

59. Statute has facilitated the appointment of an administrator in almost any case. And yet the word "abuse" is bandied about. Practitioners faced with financially distressed companies which could so effortlessly fall into the Purpose of administration are hesitant to pursue what appears to be such an easy and from their point of view, potentially more remunerative option. Under the old administration regime the symptoms and prognosis would have been straightforward. A prescription for creditors voluntary liquidation would have been written out and a dalliance into the more exotic of remedies, administration, never even contemplated. It was known and accepted that one had to have very good reasons and purposes to justify such strong medicine[28].

60. Now that administration has become an over-the-counter remedy it is time to consider the notion of abuse and ensure that it is confined to the very limited number of cases where the Purpose of administration really cannot be achieved. Practitioners should be freed from the shackles of the former administration regime and not left to worry that they may somehow be abusing the system by pursuing administration where, under the old regime, voluntary liquidation would have been the only viable option.

The origins of the notion of abuse

61. In March 2004, the Insolvency Service prefaced its 17th edition of Dear IP with a letter which included a paragraph addressing "Abuse of the Administration Procedure":

> "There have also been comments about the possible significant abuse of the new insolvency regime and that the "fast track" administration procedure might be used in a way which runs counter to the best interests of creditors. To date however, we have no evidence to suggest that the increase in administrations is due to the process being used in preference to a creditors voluntary liquidation as a method of avoiding the need to hold a meeting of creditors.

These are serious allegations and ones which, if evidenced, the Service will act upon[29].

[28] The administration process under the old regime was in all cases commenced by court order; the proposed administrator had to commit his assessment of the financial position of the company, the prospects of achieving the purpose of the administration and a consideration of the alternate insolvency processes to writing in the firm of a detailed r. 2.2 report. The administration process remained subject to the on-going supervision of the court, which in some cases limited the period of the administration and required update reports to justify continuance of the administration. The process of ending the administration and exit route was subject to court supervision and required a report to the court regarding the outcome of the administration.

[29] It is not clear how it is envisaged that the Insolvency Service will act. However, in light of the next but one paragraph of its letter, the most likely course of action, at least in the first instance, would appear to be for the Insolvency Service to lodge a complaint with the IP's professional body.

The administration procedure provides for a creditors meeting to be held within 10 weeks. Only in cases where there are no funds available for unsecured creditors, is the requirement for a creditors' meeting relaxed. In such cases creditors representing 10% in value can requisition the meeting within 12 days of the date that the statement of the administrator's proposals is sent out.

If there is evidence to show that an insolvency practitioner is wrongly encouraging administration instead of liquidation, the Service would regard it as a regulatory issue rather than a legislative one. Where insolvency practitioners are acting outside the standard of behaviour expected of them, it is a matter to be considered by their authorising body, and we would ask anyone who has evidence of abuse in this area, to report it to Insolvency Practitioner Policy Section and/or the practitioner's authorising body. It is not acceptable to say that the system is being abused but then fail to take action that can help to tackle the alleged abuse."

62. During the same month, the House of Lords delivered its judgment in the matter of *Buchler & Another v Talbot & Another and Stichting Ofasec & Others* [2004] UKHL 9, more commonly referred to as "*Leyland Daf*". In holding that a liquidator is not entitled to deduct the general costs and expenses of a liquidation from floating charge realisations, the House of Lords gave administration an overnight make-over. The administration regime, which expressly provides for the expenses of administration to rank ahead of the floating charge, suddenly became more attractive[30]. It gave a degree of assurance for the insolvency practitioner that he would be paid for the services which he provided to the company. Liquidation could no longer provide such certainty.

63. From the statistics which are currently available, it is impossible to ascertain the number of administrations which might once have been creditors voluntary liquidations. Whilst there has been a reduction in the number of CVLs since the *Leyland Daf* decision, it has not been as marked as many might have expected. During the last quarter of 2005, there were still 1914 CVLs compared with 580 administrations.

Abuse?

64. Whilst the Insolvency Service's warning (above) regarding perceived abuse initially focussed on the possibility of practitioners favouring administration over CVL in order to avoid holding a creditors' meeting, its concluding paragraph appeared more general:

> "If there is evidence to show that an insolvency practitioner is wrongly encouraging administration instead of liquidation, the Service would regard it as a regulatory issue rather than a legislative one."

65. In the author's experience there is little evidence of practitioners promoting administration in order to avoid a creditors' meeting which could change the appointee. The main concern of practitioners is whether they are acting properly in promoting an administration where they have little difficulty thinking that the purpose of administration is reasonably likely to be achieved (and can thus comfortably make the declaration required of them in Form 2.2B) but where they know that one of the key factors motivating them to consider administration is far closer to home: that they have greater certainty of being paid for the work they are about to undertake than might be the case in a liquidation.

[30] Legislation should seek to remove such incentives/disincentives between the different insolvency processes, so that the appropriate process is prescribed for the patient, cf. the costs incentive to place into CVL (or distribute realisations to unsecureds in administration) rather than compulsory to avoid depositing realisations in the Insolvency Service Account. The proposed new section 174A of the Insolvency Act 1986 which is intended to address some of the issues thrown up by Leyland Daf will be of relevance here.

If the Purpose of administration can be achieved, does the motive matter?

66. How much better must the result for creditors be? A moratorium can facilitate negotiations with creditors keen to repossess their vehicles, assets or premises which might not have been so easy in a liquidation. Is that enough to achieve the second objective of the Purpose of administration? The answer would appear to be that it is sufficient. Provided creditors are genuinely getting more than they would otherwise receive in a liquidation, why should there be any cause for concern.

67. Which creditors must benefit from the "better result"? In order for an administrator to perform his functions by reference to the second objective, the Act requires a better result to be achieved for the company's creditors "as a whole". If the administrator's work results in a larger pool of assets than would be available in a liquidation, but the pool is still only large enough to extend to payments to secured or preferential creditors and the IP's fees, does that amount to getting a better result for creditors as a whole? Where does it say that in order to fall within the second objective there must be a return to unsecured creditors? In any event, does it matter? In many cases, the administrator would still be able to perform his functions by reference to the third objective. So where is the abuse?

68. By performing his functions by reference to the third objective, an administrator may be paid more than might have been the case (as a result of *Leyland Daf*) were he to have realised the secured assets in a liquidation. Provided the insolvency practitioner is properly performing his functions (which may be more likely if he is assured of payment) does it matter that he is unable to attain the second objective and get a better result for the company's creditors as a whole? Is it enough that he does not prejudice the interests of the unsecured creditors? Probably not, but nowhere are such issues clearly written down.

69. We are still married to the old notions and standards of administration. Now that it is in part a replacement for administrative receivership, we need to take into account the different purpose of administration, whilst, at the same time, not regarding it as receivership by another name. It is all too easy to slip from the concerned practitioner cautiously concerned not to abuse the administration regime, to a quasi receivership, where the obligation not unnecessarily to harm the interests of creditors appears so lame as to make almost no difference at all.

Administration to facilitate pre-packs

70. Administration currently facilitates pre-packaged sales of a company's assets or business before and without the approval of a creditors' meeting in a manner that is not possible in liquidation. The issue of pre-packaged sales is an area ripe with controversy. Proponents rightly hail the advantages which can inure to creditors by a thorough but discreet pre-insolvency valuation, marketing and sales negotiation exercise. Critics, just as correctly, highlight the considerable scope for abuse, the possibility of little or no testing of the market and a regime which facilitates phoenixism at its worst.

71. If a pre-packaged sale is properly conducted, there is unlikely to be any suggestion that the practitioner was wrong to promote administration. Where, however a pre-packaged sale features elements of the worst that the practice can provide, then the insolvency practitioner's regulatory body should indeed question the manner in which the sale was achieved and whether the IP has breached his duties to creditors. Creditors also now have the right, individually, to complain that their interests have been unfairly harmed or that the administrator should be liable for misfeasance. It is perhaps in this arena that we are most likely to see a court consider a practitioner's motives for proposing administration[31]. An administration which

[31] What, if any, contemporaneous record is kept by IPs as to their decision and advice to recommend administration over the other insolvency processes? Absent such records the IP may be exposed to awkward cross-examination as to his motives.

includes distributions to creditors and moves swiftly to dissolution will not present creditors with the possibility of the protection of or an action under section 216, re-use of company name nor any of the scrutiny which should accompany a subsequent liquidation.

72. Choosing administration instead of a CVL to avoid such scrutiny would or should amount to abuse in anyone's eyes. However, it is the less obvious situations which cause concern and where there is doubt. If a pre-pack results in a return to one of more secured or preferential creditors, the Purpose of administration has been achieved. There is no express guidance or specific criteria by reference to which anyone can measure whether it has been achieved *enough*.

The future

73. Just as the new administration regime started to bed down, the *Leyland Daf* decision changed the landscape in which it was to operate. The *Transbus* decision[32] facilitated pre-packaged sales which have reached unprecedented heights and depending on the future of the new TUPE regulations there may be other potent factors to influence the choice of regime. However, some of the attractions of administration, for example, the benefit of a moratorium; no automatic set-off; and different administration expenses to liquidation expenses (which are justified by reference to the differing nature of administration and liquidation) appear inappropriate for cases where there is no attempt to save the company or trade or sell the business/assets as a going concern. The notion of "abuse" has been bandied around without specifics. It would be helpful for those regulating insolvency practitioners to provide guidance. Administration is now easy to get into, cost effective, limited in time and providing as it does, a moratorium, an attractive insolvency regime. That was what the Government intended it to be. If the objectives can be met and creditors are not prejudiced, does the motive matter? Practitioners deserve to know. If it is acceptable for administration to be seen as liquidation by another name, then several of the principles associated with the old regime should be revisited. The amount of attention recently devoted to phoenixism may well give rise to new guidance or regulation. It would be helpful for the issues raised in this paper also to be addressed. The overwhelming majority of practitioners want to do the right thing. But with relics of the past regime still impressed on their minds, with notions of abuse being raised but not properly articulated, it is almost impossible to determine what is right from wrong. Such uncertainty cannot be in anyone's best interests.

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[32] *Transbus* [2004] 2 BCLC 550 approved the previous decision of Neuberger J in *Re T&D Automotive Ltd* [2000] 1 BCLC 471 under the old administration regime and held that it applied equally to the new regime, thereby allowing the exercise of the power of sale by the administrator prior to the formal creditors' meeting. However, Neuberger J in *T&D* did not give the administrator carte blanche to ignore the creditors but gave guidance as to whether the administrator should seek to call a creditors' meeting on short notice or at least contact and seek the approval of the major creditors of the company prior to completing a sale.