REFORMING THE GOVERNANCE OF CORPORATE RESCUE: THE ENTERPRISE ACT 2002

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Abstract
English corporate insolvency law has been reshaped by the Enterprise Act 2002. The Act was intended to 'to facilitate company rescue and to produce better returns for creditors as a whole'. Administrative receivership, which placed control of insolvency proceedings in the hands of banks, is for most purposes being abolished. It is being replaced by a 'streamlined' administration procedure. Whilst it will still be possible for banks to control the appointment process, the administrator once in office owes duties to all creditors and must act in accordance with a statutory hierarchy of objectives. In this article, we seek to describe, and to evaluate, this new world of corporate rescue.

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1. Introduction

English corporate insolvency law is being reshaped. The Enterprise Act 2002 ('the Act'), the relevant provisions of which came into force on 15 September 2003, brings the most significant changes to insolvency law for over fifteen years. The Act is designed to 'to facilitate company rescue and to produce better returns for creditors as a whole'.[1] It seeks to achieve this through three principal changes. First, administrative receivership is for most purposes being abolished. This procedure was widely regarded as giving an unhealthy amount of power to creditors holding floating charges, who because of their secured status lacked sufficient incentives to rescue failing companies.[2] The second major departure concerns the refashioning of the administration procedure. Central to the scheme of the new legislation is the desire to capture the benefits of speed and flexibility associated with the receivership mechanism yet at the same time to foster accountability. Thus, entry to administration has been facilitated by allowing out-of-court appointments, both by the holders of floating charges—a sort of *quid pro quo* for the abolition of receivership—and by the directors of the company. Once appointed, the administrator must act in accordance with a statutory hierarchy of objectives and is required to give reasons justifying his course of action. Thirdly, the Crown's preferential status in insolvency proceedings has been abolished, and in its place a proportion of floating charge recoveries will be 'ring fenced' for the general unsecured creditors. The abolition of administrative receivership is only prospective,[3] and so the changes will take many years to be fully effective. Thus their impact will be more in the nature of a gradual, rather than a seismic, shift. It seems clear that as this unfolds, the new administration procedure will become the primary route for corporate rescue. In this article, we seek to describe, and to evaluate, this new world of corporate rescue.

The principal advantages of administrative receivership were that the appointing bank would typically have, in the course of its relationship with the debtor company, have acquired good information about the quality of the troubled company's management, and moreover that the procedure gave the bank the power to act on this information without interference from other, less well-informed parties.[4] The drawback was, of course, that where the company's assets were worth more than the bank was owed, nothing obliged the bank to do anything to save the business. The new administration regime, by providing for out-of-court appointment by a floating charge holder, is designed to capture many of the benefits of the information acquired by banks about their customers. However, the revised procedure is also designed to ensure that the bank's appointee is genuinely accountable to all creditors. The replacement of receivership signals the end of a regime under which a single creditor's proprietary rights could govern the resolution of insolvency proceedings. In administration, all creditors are subject to a statutory moratorium, and the company is run by the administrator on behalf of all interested parties. The complex tensions between the different varieties of creditor lead us to emphasise the importance of the checks and balances in the new regime that will shape the *governance* of companies in administration. This involves a triumvirate, of creditor decision-making, delegation to the administrator subject to heavily-specified duties, and, overseeing the tensions between the parties, court oversight and enforcement. This shift will render corporate insolvency law closer to company law, and further removed from property law. We suggest that the success of the new regime will largely depend on the way in which the courts approach their new role at the apex of the governance of corporate rescue.

The rest of the article is structured as follows. Part 2 discusses the perceived failings of the old law that informed the process of reform. In Part 3, we examine the process of entry to the new administration procedure. Part 4, considers the governance of companies in administration, including creditor voting, the administrator's duties, standing to enforce these duties, and the court's approach to reviewing the administrator's decisions. In Part 5, the article turns to the changes made by the Act to distributional matters. Part 6 concludes with a tentative evaluation of the new insolvency regime.

2. Background to the Reforms

The Act was preceded by a Review of Company Rescue Mechanisms,[5] the principal recommendations of which were largely adopted by the government. The White Paper, *Productivity and Enterprise: Insolvency – A Second Chance*,[6] explains the weaknesses of the previous law that it was hoped the new Act would remedy. First, the government considered that the existing law did not do enough to promote a 'rescue culture'.[7] This term refers to a legal and institutional response to financial distress that is geared in the first instance to attempting to save a troubled business, rather than simply to close it down and distribute proceeds to creditors as quickly as possible.[8] There was a perception that the existing system was not doing enough to promote rescues. The Insolvency Act 1986 had introduced two procedures that were geared towards corporate rescue—administration and Company Voluntary Arrangements—the uptake of both of which had been 'disappointingly low'.[9] The White Paper concluded that this was because secured creditors with relevant floating charges were able to block a petition for administration or a proposed CVA by appointing an administrative receiver (AR). By removing the secured creditor's right to appoint an AR, it concluded, the new Act would thereby increase the number of administrations and CVAs, and consequently the number of corporate rescues.[10]

Secondly, there was concern that the AR procedure was inefficient, in the sense that it failed to maximise value for creditors.[11] The problem with AR, well known to practitioners and academics alike, is that there may be a divergence between the interests of the appointing bank, to whom the receiver owes his principal duties, and who will be secured, and the interests of the general unsecured creditors.[12] Specifically, overall value may be maximised in some cases by continuing to trade the business for a limited period whilst a buyer is found who will purchase the assets as a going concern. However, this will take time and valuations will be uncertain. On the other hand, if the assets can be sold on a break-up basis for more than the bank is owed, then the bank and its appointee, the receiver, will prefer this option, even if it produces less returns overall, as it is likely to be quicker and more certain. Similarly, there was a concern that the availability of AR meant that when a bank was considering whether to 'pull the plug' on a distressed firm, it would tend to be too precipitate in doing so, knowing that AR ensured that it would be able to recoup its investment through a sale of the firm's assets on a break-up basis.

The Government's third reason for proposing reform was that the AR procedure was lacking in transparency and accountability to a range of groups who were affected by the receiver's decision-making, particularly unsecured creditors.[13] The receiver, who was not an officer of the court, owed unsecured creditors few duties and their information rights amounted to little more than an entitlement to be told about what in most cases was a *fait accompli*. The replacement of AR with a modified form of administration, under which the administrator, who is an officer of and subject to the directions of the court, owes an explicit duty to all creditors, it is hoped, will remedy this accountability deficit.

Finally, there was a concern that AR had become 'outdated', particularly in the international context.[14] Other jurisdictions have difficulty recognising AR as a 'true' insolvency proceeding, because of its inherent bias towards the interests of one particular creditor. This is exemplified by the EC Regulation on Insolvency Proceedings, which confers automatic recognition throughout EU Member States on 'collective' insolvency procedures, but does not recognise AR as such a procedure.[15]

Under the new law, administrative receivership will no longer be an option for most troubled companies.[16] The primary insolvency procedure will instead be the new 'streamlined' administration regime. In common with the previous law, this will involve the imposition of a moratorium on the enforcement of claims and repossession of security, and the appointment of an administrator who will take over the running of the company. The chief innovations will be the way in which an appointment can be made, and the duties to which the administrator is subject. We consider these in turn.

3. Entry to the New Administration Procedure

Under the old law, an administrator could only be appointed by an order of the court, on a petition by the company, its directors or any creditor(s).[17] It was necessary to show that the company was, or was likely to become, unable to pay its debts, and that an administration order was likely to achieve one or more of the statutory purposes[18]—which purpose(s) in particular would depend on those that were specified in the petition.

This gateway is retained under the new law. In addition, it is now possible for a company to enter administration out-of-court on the application of either the company or its directors,[19] or of the holder of a 'qualifying' floating charge (hereafter the 'QFCH').[20] This is in essence a floating charge or package of charges including a floating charge that together cover the whole or substantially the whole of the company's property, and that is created by an instrument reserving to its holder power to appoint an administrator. For court applications, there will be a slight change in the threshold of proof for purpose will be lowered to the court being satisfied that it is *reasonably* likely that the purpose will be achieved.[21] Where the appointment is made out-of-court, it will suffice that the person appointed as administrator is willing to declare that he thinks there is a reasonable likelihood of achieving the new statutory purpose.[22]

The rationale for granting expedited appointment rights to the company's directors is straightforward. The company's directors are usually in the best position to sense impending crisis. There is great value in providing incentives – 'sticks and carrots' – for them to take action at that point. The 'stick' already exists in the form of the wrongful trading provisions.[23] One way of providing the 'carrots' would be to ensure that the directors – who, for companies most likely to become subject to administration, would also be significant shareholders – would have some hope of regaining control and residual claimant status if they act at the earliest appropriate moment. The para 22 appointment mechanism, initiated by the company or its directors, would place in their hands the selection of the administrator, and thereby give the board more influence over the direction of proceedings than if the process is initiated by a creditor. However, the board are often likely to be part of the problem for the company. If we partition the causes of corporate financial distress into two broad categories:[24] 'management-related' (to do with the incumbent managers' "irrationalities, lack of ability, failures of strategy and deficiencies of understanding", etc.),[25] and 'management-unrelated' (external shocks, macroeconomic comparative disadvantages, inflation, over-regulation, delayed payments, government policies like those on taxation, etc.),[26] it is worth noting that surveys of insolvency professionals routinely identify management-related causes as being of the greatest importance in corporate failures.[27] So for example, one in two companies undergoing formal insolvency proceedings had suffered distress in the past,[28] "yet the company's directors still did not prevent insolvency".[29] In such cases, an administrator brought in by the board would be placed in the invidious position of having to replace his appointers. Of course, if the board anticipates this, then the 'carrot' will seem rather less juicy. In short, whilst expedited appointment by the directors is a useful innovation, it cannot be expected to be the main gateway to administration.

Nor, it seems, does the legislature assume that it will be. As between the different modes of appointment, out-of-court appointment by the QFCH will enjoy priority. If the company or its directors wish to appoint an administrator out-of-court, they must first give five days' notice to any QFCH,[30] who may then appoint an administrator themselves under para 14 in the interim. If an administrator has been appointed under para 14, then the directors may not appoint under para 22.[31] Similarly, if an administration application has been made to the court under para 11, any QFCH must be notified of the application,[32] and will then have the right to petition the court to have a specific person appointed as administrator.[33] Whilst applications to court and notices of intention to appoint out-of-court by the directors must state that the company is, or is likely to become, unable to pay its debts,[34] this is not necessary where the appointment is made by a QFCH.[35]

The privileged treatment accorded to the QFCH can be understood as the *quid pro quo* for the loss of the entitlement to appoint an administrative receiver. However, it appears that it is also underpinned by sound policy. Consider that administration, as a rescue procedure, is intended to 'save' a company in trouble, or at least to preserve any going concern value that its business might have. For a distressed company, the alacrity with which it is made subject to this procedure might determine whether or not either of these objectives is met. Yet, at the same time, to "put a company into administration is a serious matter."[36] The process is expensive, the company undergoes a hazardous decapitation with its management replaced by an outsider, and the fact that it is in administration might send quite adverse signals about its bargaining power and ultimate viability to its counter-parties. Thus it is crucial that the decision to initiate administration be taken at the right time and for the right reasons. We suggest that the QFCH will usually be best placed to do this.

When a debtor appears to be on the verge of defaulting on its obligations, distinguishing between management-related and management-unrelated causes is crucial to achieving the correct balance between provoking useful assistance from the administration procedure and unwittingly decapitating companies that might resolve their difficulties themselves. Making this decision effectively requires information about the management team's ability, and the expertise to analyse it appropriately.[37] The QFCH is, in most cases, likely to be the creditor best placed, in terms of information and expertise, to make this decision. Creditors taking extensive security packages—typically banks—almost universally employ covenants requiring the provision of information by the debtor—management accounts and the like.[38] The banks monitor the performance of their debtors' accounts at individual branches, and if the account underperforms significantly, it is transferred to specialist 'central rescue units'.[39] There is also strong evidence that these units often prescribe appropriate remedies for troubled firms, frequently encouraging the replacement of members of debtors' management teams, and further, that debtor companies significantly improve their chances of being turned around if such changes are made.[40] Where these 'informal' rescue processes are unsuccessful, then the QFCH will be in a position to invoke administration proceedings.

Moreover, by giving the QFCH the right to commence administration unilaterally, it is able to draw on its information and experience quickly, and without the need to engage in costly and time-consuming negotiations with other creditors, or to verify information to the court. Finally, there appears to be little prospect of a QFCH using this power to put companies into administration unnecessarily so as to benefit itself, or simply through negligence, because once *in* administration, the QFCH's power to control the proceedings is substantially reduced.[41]

4. Governance

Considerable power is devolved to the administrator, so as to allow flexibility in achieving the procedure's purposes. At the same time, the statutory framework is designed to ensure that office-holder remains accountable to those with a tangible interest, and that decision-making is transparent. The two principal mechanisms by which such accountability is attained are the requirement that the administrator's proposals be voted upon by creditors, and secondly, the administrator's duties. In this section, we consider first the rationale for this governance structure, and then examine each of these in detail.

4.1 Governance in Solvent Companies

The concentration of managerial power in the hands of specialist agents—in healthy companies, the board of directors—is a fundamental feature of corporate law.[42] The rationale for this delegation is that it economises on the considerable costs involved in having decisions made by the persons in whose interests the decisions are made, owing both to lack of specialist expertise and to the costs of resolving disagreements.[43] As for healthy companies, so for sick: whilst the creditors have become the 'residual claimants' in respect of a company that is factually insolvent, they too are unlikely to be well-versed in the operation of its business, and so there is a continuing need for specialist management.[44]

Delegating managerial power gives rise to so-called 'agency costs'—costs caused by the fact that agents working on other people's property will tend not to exert themselves as hard as if the property were their own.[45] Much of substantive corporate law is concerned with the minimisation of the costs arising from these conflicts of interest. There are two principal varieties. The first is a 'shareholder-director' conflict, arising where the ownership of the company's shares is dispersed, and the board of directors are not themselves significant shareholders. In this situation, the concern is with self-dealing transactions and the like, and with giving the executives sufficient incentives to exert themselves on the company's behalf. The second is a 'majority-minority' conflict, and arises where share ownership is concentrated. If one group of shareholders has control, they may appoint themselves or their associates to the board, and arrange for the company to be run in their interests, to the detriment of the minority. Again, company law has a range of mechanisms for dealing with this type of conflict.[46]

4.2 Governance in Administration

Displacement of the board

Where the company becomes 'factually' insolvent,[47] creditors displace shareholders as 'residual claimants'—in other words, they capture the benefit or suffer the loss from any increase or decrease in the firm's total value. At this point, it no longer makes sense for the board of directors to manage the company on behalf of the shareholders. Hence directors' fiduciary duties are modified, so that the 'interests of the company' in which they are required to act become the interests of the *creditors*.[48] In itself, this is unlikely to be sufficient to placate creditors. On the one hand, the shareholders are still responsible for appointment and removal of directors,[49] but the latter are expected to mediate the conflicts that arise between creditors' and shareholders' interests. On the other hand, the board will often have been responsible for the company's financial difficulties, and their competence may be in doubt. The advantages of the administration regime, which gives creditors of companies that are, or are nearly, factually insolvent the opportunity to replace the board with a 'crisis' organ who is accountable to them rather than the shareholders, are therefore readily explicable.

Of course, the board are also likely to be those who have the greatest knowledge about the company's business and markets. Hence administration does not *ipso facto* terminate the board's appointment, but rather gives control over their appointment and removal,[50] and the scope of their management jurisdiction to the administrator.[51] If the administrator takes the view that they are competent but unfortunate, then he may allow them to remain in office and to exercise managerial powers. The management structure is a flexible one that will support a range of outcomes—including day-to-day management being effected by the administrator himself and the appointment of a new 'turnaround board'. In theory, it allows the administrator to decide whether or not the board are competent, and to deal with them accordingly.

A possible weakness with the system is that the administrator himself is likely to have been 'parachuted in' at short notice, and so lack sufficient information upon which to base a decision of this sort. However, as explained above, many administration appointments will, under the new law, be made by the company's bank, who will likely be the best-informed party as to the quality of the company's management. As is commonly the case in receiverships under the current law,[52] the bank will be able to impart to the administrator whether or not they have confidence in the management team. Moreover, if they do, then it is unlikely that an appointment will have been made, as in this situation the bank will usually have been willing to renegotiate beforehand.

The decisions about the composition and the power of the board are given to the administrator, rather than directly to the creditors, for similar reasons that power in a solvent company is vested in the board and not the shareholders directly—namely decision-making and expertise costs.[53] In particular, the different priority rankings and investment levels of different creditors meant that the *costs* of referring decisions to creditors are likely to be very high.[54] Thus the administrator is given plenary powers in relation to the company's assets and business. Para 59 provides that he has power to do 'everything necessary for the management of the company's business and affairs',[55] and Schedule 1 sets out (without prejudice to the generality of para 59) a specific list of powers exercisable by the administrator. In exercising these powers, he acts as agent of the company,[56] and any third party dealing with him in good faith need not be concerned to enquire as to whether he is in fact acting within the scope of his powers.[57] Additionally, the administrator has statutory *immunity* from an action in conversion by an owner if he seizes or disposes of chattels to which he reasonably believes the company is entitled.[58]

Secured creditors' rights of enforcement are also stayed by the moratorium, and the administrator is given power to decide what shall happen to the collateral, provided only that the secured creditors' *priority* position is maintained. Thus assets subject to fixed security or quasi-security may be sold, provided the administrator persuades the court that this is likely to promote the purpose of the administration, and the proceeds are held for the benefit of the secured creditor.[59] Assets subject to a floating charge may be dealt with by the administrator as if it were not to subject—that is, the charge is statutorily 'decrystallised' by the onset of administration.[60]

Administrator-creditor conflicts of interest

That said, the governance problems discussed in the context of solvent companies have their analogues in insolvency.[61] First, there will be a need to ensure the accountability of the administrator to those with claims against the company's assets. Most generally, the question here would be about the administrator's costs and his competence. Indeed, just as with solvent companies, it is justifiable to refer very fundamental decisions about the company's future to the general body of the creditors. Thus the first important mechanism of governance in administration is the creditors' meeting, to which the administrator must refer his proposals for a vote.[62] Correspondingly, the administrator's duties serve the purpose of keeping him accountable to the creditors. A close analogy may be drawn here with the way in which directors' duties and shareholder voting rights operate to keep the boards of solvent companies accountable.

Creditor-creditor conflicts of interest

However, the limitations of the analogy with solvent companies are reached when it is seen that the more salient conflict of interest in administrations will usually be that between secured (and preferential) creditors on the one hand and unsecured creditors on the other. For example, a bank with a debenture covering assets worth more than the outstanding indebtedness might simply wish to realise its security and would not have strong incentives to allow the business to continue to trade. In particular, it might be concerned that the collateral would lose value because of changes in trading conditions. On the other hand, unsecured creditors would wish the business to continue in the hope of maximising their returns. This type of conflict would manifest itself mainly as a question about what the administrator should seek to do, and how long he should spend trying to do it.

Before the Enterprise Act 2002, English law resolved this conflict clearly in favour of a secured creditor entitled to appoint an administrative receiver. Through the exercise of its veto rights, if such a creditor wished, its own appointee could always be controlling the insolvency proceedings, owing fiduciary duties exclusively to that creditor. As we have seen,[63] this led to perverse incentives where the creditor was 'oversecured', with a tendency to close businesses too quickly. The new administration regime is designed to ameliorate this problem by requiring all creditors to participate in the same procedure. This, of course, simply transfers the tensions to the mechanisms *within* the procedure for resolving the conflicts between creditors.

Thus, a second role for the governance mechanisms considered in this section is the mediation of conflicts between different creditors interests. Briefly, this works, in relation to the creditors' meeting, by limiting who can vote and what they can vote upon, and in relation to the administrators' duties, by defining a statutory hierarchy of objectives in accordance with which the administrator must act prior to the approval of proposals by the creditors' meeting. These mechanisms will now be considered in more detail.

4.3 Creditor Voting

Structure of Creditor Voting Procedures

The most basic mechanism for ensuring the accountability of the administrator is the creditors' meeting. As under the old law, the administrator is required to circulate to creditors his proposals for how the company is to exit the administration, and unless para 52(1) applies, must call a creditors' meeting to vote on the proposals. If the meeting accepts his proposals, these then become the purposes that he must seek to achieve,[64] and he may not subsequently change them without the revisions being accepted by another creditors' meeting.[65] If, however, the proposals are rejected, then the outcome is put in the hands of the court, which may terminate the administration, or make such order as it thinks appropriate.[66]

It is easy to see how a creditors' meeting fosters accountability to the creditors. More subtle, however, is the way in which the legislative framework is designed to respond to the problems of the differing interests of claimants of different priority rankings. By virtue of para 52(1), the obligation to put the proposals to the creditors' meeting does not apply if the administrator thinks either:

(a) that the company has sufficient property to enable each creditor of the company to be paid in full,
(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), or
(c) that neither of the objectives specified in paragraph 3(1)(a) and (b) can be achieved.

That is, if he thinks the company is solvent, or so hopelessly insolvent that there will be no realisations for the unsecured creditors other than the 'ring-fenced' funds, or that it will not be possible to achieve a rescue or a better result for the creditors than would have been obtained in liquidation.[67] If para 52(1) applies, a meeting must nevertheless be called if requested by creditors holding at least 10% of the value of the company's total debts.[68]

Para 52(1) should be understood in conjunction with the allocation of entitlements to vote. A resolution in the creditors' meeting is carried by a majority in value of those voting, either in person or by proxy.[69] In a mandatory creditors' meeting—that is, where the para 52(1) conditions are not satisfied—only unsecured creditors are entitled to vote.[70] However, if in circumstances where para 52(1) does apply and a meeting is requested under para 52(2), secured creditors *are* entitled to vote the full value of their claims.[71]

Read together, the provisions concerning the calling of, and voting at, meetings are designed to ensure that the voting is taken by the class who stand to gain or lose most from the implementation of the proposals. When the company is solvent, then it is not creditors, but members, who will be in this position. Hence there is no mandatory meeting. Where the administrator is proposing an outcome which is intended to generate a return for the unsecured creditors, then it is they who will be principally affected, hence the logic of requiring a meeting where only unsecured creditors vote. Moreover, the administrator is not required to put his proposals to a creditor meeting if he thinks that there will be no surplus for the unsecured creditors, beyond the 'ring-fenced' fund, after secured and preferential creditors have been paid, or if he thinks that neither objective (a) nor (b) under para 3(1) could be achieved.[72] The 'bottom line' is therefore that where the unsecured creditors have no tangible interest in the company's assets, or where it is not possible to achieve more for them than would be obtained in liquidation, then they drop out of the picture.[73]

Termination

Creditors' interests—and decision-making rights—also factor into the decision when to terminate an appointment. An appointment of an administrator will automatically come to an end after a period of one year.[74] This may be extended for a further six months with the approval of its creditors (unanimous approval of secured creditors, plus 50% by value of the unsecured claims, if they have a tangible interest)[75] or for longer with the approval of the court. An administration may also be ended on the application of the administrator or of a creditor.[76]

Balancing the Interests of Secured Creditors

Three 'balancing' features of the administration regime, and the structure of the creditors' meeting provisions in particular, are however designed to ensure that secured (and preferential) creditors are not prejudiced by this disenfranchisement. First, para 73 provides that no proposal of the administrator's may be accepted that would interfere with a secured creditor's ability to enforce their security, result in any preferential creditor being paid otherwise than in priority to unsecured creditors, or result in one preferential creditor being paid a smaller proportion than any other, unless the creditor in question consents.[77]

The meaning of 'interference' with a secured creditor's right of enforcement was recently considered, in the context of the identically-worded section 4(3) of the Insolvency Act 1986, by Hart J in *Swindon Town Properties Ltd v Swindon Town Football Co Ltd*.[78] The case concerned a CVA proposed by a company in administration. The claimant creditor, who had the benefit of a standard debenture package, objected to the proposed arrangement on the basis that it would result in funds being diverted to unsecured creditors that would otherwise have been available for itself. His Lordship held that for the purposes of the section, the secured creditor's 'right to enforce' had to be considered at the point at which the administration moratorium came to an end. The secured creditor would still retain the same formal legal entitlements as were the arrangement not in existence. Thus they would be able, by enforcing, to crystallise their floating charge and therefore to prevent the payments being made to the unsecured creditors. There was no contravention of the section notwithstanding that the arrangement may have made it more likely that the creditor would have needed to rely upon its enforcement rights, and that the functional context was that this was unpalatable because it would result in the destruction of the company's business.

However, in the context of the new administration regime, it is unclear what rights a qualifying floating charge holder will retain to 'enforce his security', following the abolition of administrative receivership. Whilst he will still be able to crystallise the charge for non-payment by the debtor, if the latter re-enters administration then this will in effect forcibly *de*-crystallise the charge again.[79]

Secondly, the position of secured creditors is protected by the less-than-absolute nature of the moratorium. The stay is intended solely to be procedural—that is, affecting the rights of enforcement, but not the substantive rights to priority against the collateral. Yet the ability to enforce—in particular, to dictate the manner and timing of enforcement—may significantly affect the value realised on sale. Thus the statute provides for the overreaching of secured creditors' rights, with their automatic attachment to the proceeds of sale.[80] Moreover, creditors with fixed or quasi-security have the additional protection that their collateral may not be sold without the consent of the court, and that the administrator must ensure their rights of priority carry over at least to the 'deemed market value' of what has been sold.[81] Additionally, secured creditors are free to apply to the court to have the moratorium lifted, or indeed to ask the administrator—for whom wrongful refusal will amount to an abuse of power.[82] In all cases, the harm done to secured creditors through the suppression of their proprietary rights must be weighed against the harm done to the company's creditors as a whole by allowing enforcement.[83] The scales are tipped firmly in favour of secured creditors, such that it is only justifiable to harm their interests in order to avoid a 'disproportionate' harm to the interests of the general creditors. Thus, where no better result than liquidation can be achieved, or the general creditors have no tangible interest in the company's assets, then secured creditors will surely be able to have the moratorium lifted as of right.

Relationship Between Creditor Voting and Administrator's Duties

The creditors' meeting functions to enable unsecured creditors to decide for themselves what should be done with the company. In situations where a creditors' meeting has taken place, the administrator's duties will focus primarily on *implementing* the proposals agreed by the meeting. If the proposals have been confirmed by the creditors, then it would seem that, akin to ratification by a general meeting of directors' actions, no challenge may be brought on the basis of breach of duty by the administrator as regards the selection of the objective to pursue. However, there are two sets of circumstances under which the administrator will act *without* having had his proposals approved by the meeting. Under such circumstances, the legislation indicates a clear preference for ensuring that the administrator is rendered accountable by the imposition of duties to the company, enforceable *ex post*, rather than requiring court authorisation to act *ex ante*. In such cases, the question of his compliance or otherwise with his duties will assume paramount importance. It is worth considering each case in a little detail.

The first will pertain where para 52(1) applies, and the administrator does not call a creditors' meeting because he considers that the unsecured creditors have no tangible interest or that neither objective (a) nor (b) may be achieved. In this case, there will be no confirmation of his decision by the creditors' meeting. Nor, however, is there a requirement of court approval. It would appear that the administrator's decision to dispense with a creditors' meeting may be open to challenge by disgruntled creditors if any defects in his decision-making process should come to light. It is likely that this situation will be a fairly common occurrence under the new legislation.

Secondly, there will be situations where although the administrator is undoubtedly required to call a creditors' meeting, important decisions need to be taken before the matter can come before the meeting. Companies in administration may be losing considerable value from day to day, as the very announcement of insolvency proceedings will provoke a precipitous decline in the value of goodwill.[84] As a consequence, the period for which potential buyers are willing to make offers for the business as a going concern may be very short. If administrator is permitted to sell the assets without first holding a creditors' meeting, then at first blush this seems to undermine the meeting's role, for there is nothing left for it to do. Yet not to permit such 'emergency action' might frustrate the objective of administration and lead to businesses being closed unnecessarily.

This 'Catch-22' problem was litigated under the old administration regime, where the principal question turned on whether the court had power to give directions to the administrator authorising a sale before the creditors' meeting took place. The courts' response was initially cautious, refusing to allow administrators to take steps of such significance that they would render the creditors' meeting nugatory.[85] However, this might not be in the creditors' interests if a sale was thereby stymied, and so practice evolved with a series of decisions authorising sales under section 17(2)(a), in advance of creditors' meetings.[86] The court thereby adopted the role of guardian *pro tem* of the creditors' interests.

However, in *Re T&D Industries*,[87] Neuberger J pointed out the difficulties with this approach. The court was not in a position to make a fully informed assessment of the position, being called upon to decide largely on the basis of information presented to it by the administrator. Rather than be forced back to the position that the administrator's hands should be tied, His Lordship adopted a broader construction of (then) section 17(2)(a) of the Insolvency Act 1986, finding that the 'court directions' to which it referred were not *permissive*, but rather *restrictive*. Moreover, the administrator's general powers were broad enough to encompass a sale, and the only question that arose was whether doing this in advance of creditor approval would amount to an *abuse* of power on the administrator's part. The court would not sit in judgment on this issue *ex parte*. Rather, a creditor would be free to challenge the administrator's decision *ex post*, but of course would give credit to his good faith assessment of the need for an immediate sale. An administrator wishing to protect himself from challenge would moreover be well advised to seek the consent of as many creditors as he could reasonably contact, however informally, under the circumstances in question. The equivalent provision under the new legislation, paragraph 68 of Schedule B1, amends the old wording slightly to make clear that Neuberger J's analysis in *T&D* was favoured by Parliament. Under paragraph 68(2), the administrator is required to comply with directions given by the court *if* the court chooses to do so, clearly implying that such directions are merely *restrictive* of the otherwise general nature of the administrator's powers under paragraph 59.[88]

To recapitulate: in cases where the administrator is not directly accountable to the creditors' meeting, the new legislation reflects a conscious policy to opt, as did the better interpretation of the old legislation, for accountability to be rendered *ex post* through enforcement of the administrator's duties, as opposed to *ex ante* through court directions. This has the clear advantage, recognised in Neuberger J's valuable analysis in *T&D*, of ensuring that decisions may be taken quickly and by the party with the best information—that is, the administrator. If a challenge is brought, this may be done in due course after the event, without delaying any possible rescue in 'real time'. Where the new legislation does, however, make a significant departure from its predecessor, is by the advent of a more comprehensive code of duties of the administrator. Any actions taken before the creditors' meeting will fall to be judged accordingly. We therefore turn now to the structure of these duties.

4.4 The Administrator's Duties

A useful prism through which to understand the administrator's duties is to see the office-holder as the 'crisis organ' of the company, taking over when the board of directors can no longer successfully deal with the company's difficulties. Like directors, administrators formally owe their duties to the company for which they act, a point recently reaffirmed forcefully by the Court of Appeal in *Kyrris v Oldham*.[89] The content of the administrator's duties are in part prescribed by statute, supplemented by the standard fiduciary proscription of conflicts of interest and a common law duty of care. Unlike directors, the statute prescribes the purposes for which the administrator must act.

Duties of Skill and Care; Efficiency and Speed

The Enterprise Act imposes on the administrator a specific duty to be *efficient*—that is, the administrator is required to 'perform his functions as quickly and efficiently as is reasonably practicable'.[90] However, it is hard to see that this adds much, if anything, to the duty of care that the administrator undoubtedly owes to the company at common law.[91] In the traditional sense of the word, an 'efficient' person is one who is 'adequately skilled',[92] which if this is the sense in which the new paragraph 4 duty is to be understood, makes it indistinguishable from the common law duty of care owed by a professional. Even if 'efficiency' is to be understood as meaning 'cost-effectiveness' it is hard to see how this would not have been covered by the common law duty—for surely to incur expenditure that it is reasonably practicable to avoid is unlikely to be consistent with a duty to take care in the performance of the administrator's functions. The better view is that the new duty, as with its common law analogue, is also owed to the company. Thus creditors' and members' individual rights to enforce the new duty are granted merely in a representative capacity.[93]

Loyalty and Proper Purposes

As we have seen, the administrator's powers are extremely broad. Being a fiduciary, these powers must of course be exercised subject to a duty of loyalty.[94] Moreover, just as a trustee must keep within the terms of his trust, and a director must abide by the company's constitution, the administrator's powers must be exercised in accordance with decisions taken under the 'crisis constitution' of the company prescribed by the administration regime, and not for an improper purpose. Namely, the administrator must act in accordance with any decisions of the creditors' meeting as to his proposals, and in the period before a creditors' meeting has met, in accordance with any direction given by the court.[95] In these respects, there is little change from the old law.

There have, however, been significant changes to the *purposes* for which an administrator may act in *advance* of the creditors' meeting. By virtue of para 3 of Sch B1, the administrator must, in short, exercise his powers in the interests of the company's creditors as a whole and for a proper purpose. Under the new law, the 'purpose of administration' is defined as one of three objectives set out in para 3.[96] This is a difficult provision, almost Delphic in its complexity. At the same time, it is probably the lynchpin of the new regime.[97]

Para 3(1) stipulates that the administrator of a company must perform his functions with the objective of—

(a) rescuing the company as a going concern, or
(b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
(c) realising property in order to make a distribution to one or more secured creditors or preferential creditors.

This section will proceed first to consider the scope and meaning of each of the three objectives, and secondly, the way in which the administrator must select between them.

How may each of the objectives be attained?

Objective (a), 'rescuing the company as a going concern', is somewhat curiously worded, as it is the company's *business*, rather than the corporate entity, which is or is not a 'going concern'. This form of words was introduced following an amendment tabled at the Lords Committee stage, designed to clarify that the first objective would not be satisfied merely through the 'rescue' of an empty shell company.[98] An administrator might achieve objective (a) either by 'turning around' the company's fortunes and restoring it to profitable trading, or, more realistically, facilitating a reorganisation of its capital structure through a CVA or a scheme of arrangement.[99] The better view is that (a) encompasses proposals that preserve a *substantial part* of the company's business.[100]

Turning to objective (b), this is attained by 'achieving a better result for the company's creditors as a whole than would be likely if the company were wound up'. The natural construction of the term 'better result' is that it refers to a better *financial* result.[101] This implies a comparison of returns to creditors in administration with their likely dividend in liquidation.[102] Moreover, it would seem preferable that the company's 'creditors as a whole' be understood to include both secured and unsecured creditors.[103]

Objective (b) is not mutually exclusive with objective (a), for both objectives will be achieved if a rescue of the company yields more for creditors than they might expect in liquidation. In contrast, objective (b) may be achieved independently of objective (a) if the company's assets are sold so as to realise more than they would raise in liquidation. This could occur if the administrator, making use of the statutory moratorium, is able either to sell the business as a going concern,[104] or to continue to 'trade out' existing contracts where the business has no long-term viability.[105] Moreover, it is plausible that a strategy that does not involve any 'trading on' might nevertheless be capable of achieving objective (b). For example, if the costs of conducting a liquidation are anticipated to be greater than those of an administration, then it would be possible for the administrator to propose to cease trading and liquidate the assets yet still to achieve objective (b).

Finally, the meaning of objective (c), 'realising property in order to make a distribution to one or more secured creditors or preferential creditors', is largely self-explanatory. In contrast to objectives (a) and (b), it is possible to achieve objective (c) even if the company does not survive, and if the administration does not achieve a better result for the company's creditors as a whole than liquidation.

How is the administrator to select which objective to pursue?

The appropriate selection as between the statutory objectives is closely prescribed by para 3. Under para 3(3),

> The administrator must perform his functions with the objective specified in sub-paragraph (1)(a) unless he thinks either-
>
> (a) that it is not reasonably practicable to achieve that objective, or
> (b) that the objective specified in sub-paragraph (1)(b) would achieve a better result for the company's creditors as a whole.

Consequently, if neither head of para 3(3) is satisfied, the administrator is under a *duty* to pursue objective (a), that is the rescue of the company as a going concern. Failure to do so would, it appears, result in his acting for an improper purpose. Conversely, where either head of para 3(3) is satisfied, a *power* is conferred on the administrator to choose between the objectives set out in paras 3(1)(a) and 3(1)(b).

The scope of the power of selection conferred by para 3(3) must be read as subject to the duty set out in para 3(2):[106]

> Subject to sub-paragraph (4), the administrator of a company must perform his functions in the interests of the company's creditors as a whole.

The natural reading of 'the interests of the company's creditors as a whole' in para 3(2) would again seem to be their *financial* interests.[107] As a consequence, the para 3(2) duty would compel the administrator, when exercising a power of selection under para 3(3), to pursue objective (b) where this would realise more for the creditors than a reorganisation achieving objective (a).[108] This reading is buttressed by the fact that the somewhat inelegant drafting of para 3 is the result of the insertion of para 3(3)(b) as a late amendment, motivated by the Government's desire to clarify that company rescue was not to be pursued at the expense of the company's creditors.[109]

Paras 3(3) is framed in subjective terms, referring to what the administrator 'thinks'. The early drafts of the Enterprise Bill did not contain this subjective wording. Rather, the administrator was to be permitted to pursue objective (b) where objective (a) was 'not reasonably practicable'.[110] The Government's expressed intention was that the question of 'reasonable practicability' should be one for the administrator's business judgment, and reviewable only on the grounds that he had acted irrationally.[111] However, there were doubts as to whether the original wording would have had its intended effect, and the Bill was amended to introduce the expressly subjective 'thinks' to para 3(3). However, whether deliberately or by oversight, no similar change was made to para 3(2), rendering its objective wording more stark by contrast. The resulting combination of subjective and objective language means that establishing precisely what must be shown before an administrator's choice of objective could be challenged is a matter of some nicety.[112] The options open to a court in construing the interrelationship of these provisions will be considered in the next section. First, however, attention must be paid to para 3(4), which governs the administrator's choice as between objectives (b) and (c).

Para 3(4) confers a *power* on the administrator to pursue objective (c) under the following circumstances:

> The administrator may perform his functions with the objective specified in sub-paragraph (1)(c) only if-
>
> (a) he thinks that it is not reasonably practicable to achieve either of the objectives specified in sub-paragraph (1)(a) and (b), and
> (b) he does not unnecessarily harm the interests of the creditors of the company as a whole.

Under para 3(4)(a), what matters is the administrator's opinion as to whether a company rescue or a better result for the creditors as a whole are reasonably practicable. Moreover, by virtue of the saving provision in para 3(2), if the administrator is permitted by para 3(4) to pursue objective (c), then he is no longer subject to a general duty to perform his functions in the interests of the creditors of the company as a whole.[113] That said, he must avoid causing 'unnecessary harm' to the interests of the creditors as a whole, a form of words that makes no concession to the administrator's subjective opinions. Hence para 3(4) too involves a combination of subjective and objective wording.[114]

When will an administrator pursuing objective (c) be liable to challenge on the basis that he lacked the power to do so under para 3(4)? A basic question will be whether if the company's assets, realised in the most advantageous fashion, will yield enough to pay the QFCH in full, after taking into account preferential creditors and the 'ring-fenced' funds. If not—in which case the QFCH may be said to be 'undersecured'—then it is difficult to see how a decision to realise the assets for the benefit of the QFCH could be subject to challenge. The unsecured creditors will receive nothing beyond the prescribed part however the company's assets are dealt with, and so have nothing to lose from choosing a mode of realisation that is in accordance with the interests of the QFCH. The QFCH's realisations will, on the other hand, depend on the way in which the assets are realised, and so it is submitted that under such circumstances the 'interests of the creditors as a whole' are in fact equated to those of the QFCH. This reasoning is buttressed by the fact that the size of the recoveries for preferential creditors, and in the ring-fenced fund, may also be affected by choices that will affect the recoveries to the QFCH.

The more interesting case will be where the assets are, at least on one possible mode of realisation, worth sufficient to yield a return to the unsecured creditors after the QFCH has been paid in full. In such a case the QFCH may be said to be 'oversecured'. Clearly, there will be many such cases in which realising property in order to make a distribution to the QFCH will be entirely *compatible* with the interests of the creditors as a whole, and indeed may be said to achieve objective (b).[115] However, there will doubtless also be cases where a conflict arises. For example, if an oversecured QFCH wants a quick sale, the administrator might be said to have harmed the interests of the unsecured creditors 'unnecessarily' if he accedes to the QFCH's wishes, if this results in a lower overall return than would have been achieved had the sale been delayed and marketed more carefully.

Rationality and Reasons: Reconciling Subjective and Objective Language

The crucial question, given the administrator's freedom to act, is the extent to which the court may review his selection of an objective under paragraph 3 in response to a challenge by a disaffected creditor or member of the company. The legislative history makes clear that it was Parliament's intention to make the administrator's decisions reviewable only on the basis of 'irrationality'.[116] Yet this intention has been implemented through a provision which, as we have seen, contains *objective* as well as subjective language. Moreover, we consider it to be significant that the administrator is also required to give *reasons* for his decision if he does not decide to pursue objective (a).[117] How might a court proceed when, as will inevitably happen, a challenge is brought? And how should an office-holder proceed so as to protect himself against the possibility of such challenge?

In order to make the clearest sense of paragraph 3, it is helpful to situate the role of the administrator within a milieu of other fiduciaries and decision-makers whose actions are subject to review by the courts. The degree to which courts are willing to interfere with the decision-making of a fiduciary depends upon the nature of his role—thus, it is a truism that a trustee's actions will be more closely scrutinised than those of a company director. We suggest that, on the spectrum of fiduciary discretions, those exercised by the administrator fit somewhere between those exercised by a director and those by a trustee.[118] Understanding his role in this way, a sensible reconciliation of the provisions of paragraph 3 would direct the administrator to take into account in his decision, and explain in his reasons, matters that he would reasonably have thought relevant and information that was reasonably available to him at the time. Failure to do so might lead to his decision being susceptible to challenge. These points will be developed *seriatem.*

Consider first a claim that the administrator failed to act in the interests of the creditors as a whole, or harmed their interests unnecessarily. As an evidential matter, the claimant would need to establish that some alternative course of action was open to the administrator that would have produced a greater return for the creditors as a whole tan the course actually pursued. However, it surely cannot have been the intention of Parliament to subject office-holders to strict liability if their chosen course of action turns out not to have been the best available for the creditors. The better view is rather than the notions of 'acting in the interests' and 'necessity' imply the selection of courses of action based on *the information reasonably available to the administrator at the time*.[119] Indeed, his duty to act efficiently (which here means cost-effectively)[120] will curtail the extent to which he is able to expend resources on gathering information. Provided that the administrator has not been negligent in gathering information—taking into account the circumstances surrounding his appointment—and his actions on the basis of this information are in accordance with the objective components of para 3, then he will not be acting for an improper purpose.

Now consider a claim that the administrator acted for an improper purpose in selling the assets, where the office-holder asserts that he thought it was not reasonably practicable to effect a rescue of the company. The grant of even a subjective power to a fiduciary is always subject to certain restrictions. The power must be exercised in good faith, and not for a collateral purpose.[121] Moreover, it is assumed that the fiduciary will appraise himself of the relevant question and direct his mind to answering it in a rational fashion. If it is shown that the fiduciary fettered his discretion, did not actually exercise it, or acted irrationally—that is, took a view that no reasonable decision-maker would have done—then the decision may be open to challenge. The legislative history suggests that it was the Government's intention leaves us in no doubt but that the administrator's most decision has been designed to be subject to a test of rationality.

Note also that the administrator is required, if he does not propose to pursue objective (a), to explain in his proposals why not.[122] If the administrator fails to give reasons, his decision may be open to challenge on the basis that has not demonstrated that he in fact exercised his judgment. Where reasons have been given, it might be possible in extreme circumstances to infer bad faith from the administrator's actions, or to suggest that the administrator must have acted irrationally, on the basis that no reasonable administrator could have thought that a company rescue was not reasonably practicable.

It may, however, be possible to go further than this. If the administrator's statement of reasons suggests that important and relevant factors have not been considered, could his decision be open to challenge on this ground? Such a rule, stemming from the decision of the Court of Appeal in *In re Hastings-Bass*,[123] has recently seen rapid development in relation at least to trustees. The 'rule in *Hastings-Bass*'[124] has been interpreted as providing that,[125]

> '[W]here a trustee acts under a discretion given to him by the terms of the trust, the court will interfere with his actions if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought not to have taken into account…'

Warner J went on to explain that in the application of the rule, three questions arise:[126]

> '(1) What were the trustees under a duty to consider? (2) Did they fail to consider it? (3) If so, what would they have done if they had considered it?'

Note that the rule does not apply to *any* issue that may have affected a trustee's decisions, but simply issues which they were under a *duty* to consider and which they did not. Ordinarily, however, the exercise of a fiduciary power is understood as subjecting trustees to duties to inform themselves of matters relevant to their decision, and must take into account all relevant, and no irrelevant, factors.[127]

Were the *Hastings-Bass* principle to be applied to administrators, what would be the 'relevant factors'? Some insights may be drawn from the rule's application in *Stannard v Fisons Pensions Trust Ltd*.[128] The case involved the sale of a business as a going concern with consequent transfer of employees from the vendor's pension scheme to the purchaser's. The trustees of the vendor's scheme were required to hand over to the purchasers' pension trustees, in right of the transferring employees, assets of such an amount as they, 'after consulting the actuary, decided to be just and equitable'. In making their decision, the trustees relied on the most recent evaluation of the pension fund. They failed to take into account a significant rise in the stock market between the date at which the sale was agreed and that at which the assets were transferred. Consequently, the employees concerned received pension benefits at inferior levels than would have been the case if the assets transferred had been of the correct, higher, value. The Court of Appeal set aside the trustees' decision. Not only were the trustees required to 'give … consideration to the current value of the trust fund and its implications', they also needed 'to know the relevance of the value of the fund to the problem in hand'. The Court held, finally, that 'it might materially have affected the trustees' decision … if they had been properly informed as to the then current value of the fund and the implications of its value'.[129]

Were a similar analysis to be applied to the administrator's decision, then in seeking to decide on the practicability of different possible courses of action, he should ascertain and compare the expected values of the company's assets (i) if they were to be kept in the ownership of the company, or (ii) if (some of) the assets were to be sold off as a functioning unit, and (iii) if they were to be liquidated piecemeal for a distribution to (primarily) secured and preferential creditors. He should compile predictions of cash flows, identify creditors (if any) who might be persuaded to write down a part of their loans or to engage in a debt-for-equity swap, estimate the level of confidence (if any) that important creditors have in key members of the board of directors and ascertain the sources (and amount) of possible funding that may be available for the endeavour. Further, he would need to understand the significance of the appropriate combinations of these factors for his decision about which objective to pursue. In so doing, his duty would extend no further than to gather and analyse such information as is *reasonably* available to him.[130] Nevertheless, not to secure all the relevant information reasonably available, or once in possession of it, not to understand how this information affected his choice of objective, would, if the *Hastings-Bass* principle is applicable, cause the administrator to make a faulty decision in breach of his duty to act rationally.

Should the *Hastings-Bass* rule apply to the administrator's decision about which objective to pursue?[131] Against this, analogies might be drawn with the way in which courts have traditionally fought shy of becoming involved in reviewing the conduct of boards of solvent companies. First, at the level of the definition of duties, the orthodox view has been that save for cases where a director is negligent in respect of the *process* of decision-making,[132] or usurps the constitutional powers of the general meeting,[133] then the court will only intervene if a decision was taken by the directors without regard to the interests of the company and with a result that no reasonable director would have thought would be in the company's interests.[134] Secondly, at the level of enforcement, courts' activity has been restrained first by the rule in *Foss v Harbottle*,[135] and more recently the requirement that prejudice to shareholders resulting from breaches of directors' duties must be sufficiently severe as to be 'unfair'.[136] This approach has been rationalised as a means of keeping the courts' shadow out of the boardroom. As Lord Wilberforce famously put it, 'there is no appeal on the merits from a business decision'.[137] Courts lack expertise as to business decisions, and there are other, less costly ways to regulate directors' conduct than through litigation: shareholder activism and the use of section 303 of the Companies Act 1985, incentive pay, hostile takeovers (for public companies), the proliferation of non-statutory corporate governance codes (again, for public companies), and finally, public enforcement via the Company Directors' Disqualification Act 1986. Put together, this adds up to a relatively coherent case for the use of private litigation as a means only of catching particularly egregious cases of directorial misfeasance.

We consider that these analogies should be rejected for three reasons, which together are compelling. First, the premise that 'directors' decisions are not reviewable' is misguided.[138] It is clear that the courts are gradually developing a more intensive set of standards for scrutinising the adequacy of the systems used for information-gathering prior to directorial decision-making, and the scope of the consideration afforded to (ir)relevant factors.[139] Secondly, and of crucial importance, directors' decisions are not subject to the clear and objective statement of the purposes to be achieved set out in para 3 of Schedule B1.

Thirdly, whilst it is still true that trustees are subject to much more intensive court control than directors, this begs the question, in relation to administrators, as to where on the spectrum of fiduciaries they are best understood as being positioned. Simply to assert that administrators make business decisions, and that the courts are unwilling to scrutinise business decisions, is to over-simplify the picture. The judiciary are *of course* capable of scrutinising business decisions—the problem is not one of *capability*, but of the *cost* involved in adducing all the relevant evidence necessary for a decision to be made. Given this cost, it is worth asking whether fiduciaries (of any hue) can be made accountable to their principals by other, cheaper mechanisms. If so, then there is sense in restricting the availability of challenge before the courts so as to 'channel' grievances towards the lower-cost mechanisms. For company directors, a range of such mechanisms exist in the marketplace—the threat of removal by the shareholders,[140] monitoring activity by non-executive directors, performance-related pay packages and for listed companies, the ever-present background threat of a hostile takeover.

These market mechanisms do not, however, operate effectively in administration. Rather, the administrator may, generally speaking, not be removed without an order of the court.[141] Quite the contrast, it seems that there may be market mechanisms in play that would actively *hinder* the impartial performance of the administrator's duties. Given the structure of the rights to commence administration,[142] an overwhelming majority of administrators could be expected to be appointed by the distressed company's bank. Whilst, as has been discussed, there are good reasons both for the QFCH to be given the right to appoint an administrator, and for it to be able to do so out of court, it should be obvious the benefits from allowing this to happen come at a cost. In a substantial proportion of cases, there would be a divergence of interests between it and the other creditors. Problematically, insolvency practitioners would rightly expect most of their work to come from the banks. They would thus have strong incentives, in situations where the bank's interests diverge from those of other creditors of developing a reputation for favouring the former.[143]

Hence there may be a comparative advantage in having the administrator's decision-making subjected to review by the *courts.*

To recapitulate: the better view of paragraph 3 is that an administrator may be acting outwith his powers, or for an improper purpose, if in making his decision he has not taken into account all information reasonably available to him. As his statement of reasons will be likely to form the basis of the evidence as to the factors he has taken into account, there is a risk of such liability if the sum of reasonably relevant information is not included in his statement.

A crucial factor will be whether or not the company's existing bankers are willing to continue to support it during a period of 'trading on'.[144] If they are not, then it will in many cases be impossible for the administrator to continue. This will mean, subject to the point raised in the previous paragraph about costs, that it is not possible to achieve a better return for the creditors as a whole than in liquidation—simply because the only option practically open to the administrator will be a break-up sale, also open to a liquidator. The bank's ability to determine the outcome of proceedings in this way will, however, be limited by the existence of the administrator's power to use floating charge assets to fund the administration.[145] Coupled with the recent judicial retrenchment on the scope of fixed charges,[146] this means that in most cases there will be some floating charge assets that may be used to fund trading on, at least for a limited period.

4.5 Enforcement of the Administrator's Duties

In contrast to the plentiful attention received by the definition of the administrator's duties during the Enterprise Bill's passage through Parliament, the enforcement of these duties was little discussed. This is a pity, for the provisions concerning standing to enforce are not a model of clarity, and the remedial consequences are obscure in places.

Standing to enforce the administrator's duties is governed by three provisions of the new Sch B1. The first two of these are contained within para 74. First, under para 74(1), any creditor or member of the company is given standing to apply to the court claiming that the administrator has acted, is acting, or proposes to act in a way that has caused or would cause unfair harm to the interests of the applicant, whether alone or in common with some or all of the other creditors. Under the old law, section 27 provided that the court had power to grant a remedy to a creditor who demonstrated that the affairs of the company were being or had been managed by the administrator in a way that was 'unfairly prejudicial' to the interests of the creditors or members generally, or to some part of its creditors or members. As with section 459 of the Companies Act 1985, this provision was a vehicle that could be used for challenging breaches of duty by the administrator, subject to the proviso that they were sufficiently serious as to result in 'unfair' prejudice.

The new regime reformulates 'unfair prejudice' as 'unfair harm',[147] ostensibly to 'modernise' the language.[148] It is not thought that much will turn upon this change in practice. Perhaps more significant is the loss of the constraint, present under the old section 27 action, that the applicant need demonstrate that the unfair prejudice resulted from the way the administrator had *managed the company's affairs*.[149] The new wording, requiring simply that the (unfair) harm flow from an 'act' or 'proposed act' of the administrator would clearly be competent to include decisions as to which of the statutory objectives to pursue.

The second relevant provision is para 74(2), which gives standing to any creditor or member to apply to the court claiming that the administrator is not performing his functions as quickly or efficiently as is reasonably practicable. In response to a successful application of unfair harm, or tardiness or inefficiency, the court has a general power, under para 74(3), to grant relief. However, para 74(4) specifies particular instances of the relief that may be granted, all of which are directed to the ongoing regulation by the court of the administrator's performance of his functions.[150] This raises the question whether the court has jurisdiction under para 74 to render the administrator personally liable to the company.

The third remedial provision, para 75, does however make specific provision for personal liability. Under it, the official receiver, a liquidator, (subsequent) administrator, or any creditor or contributory of the company may apply to the court for an 'examination' of the conduct of an existing, former or purported administrator of the company in relation to alleged misfeasance. Para 75(3) provides that the application must allege that the administrator has either misapplied or retained, or otherwise become accountable for, corporate property, or that he has breached some *fiduciary or other duty* (emphasis added) in relation to the company, or that he has been guilty of some other misfeasance. It would appear that these words are broad enough to encompass breach of any of the duties described in section 4.4. The court then has remedial jurisdiction to order the administrator to repay, restore or account for property or money misapplied, or, more pertinently for present purposes, to order the administrator to contribute a sum to the company's property by way of compensation for misfeasance or breach of duty. This para would therefore appear to be the primary route by which disgruntled unsecured creditors might be able to bring actions against an administrator whom they consider has breached his duty to act for proper purposes. However, there is an important temporal constraint on action. If the administrator has completed his activities in relation to the company, and the administration has come to an end, then under para 98 he will receive a general discharge from liabilities accrued during the currency of his appointment. An exception is made for an examination under para 75, but post-discharge, this procedure may only be commenced with the permission of the court.[151]

An important remedial consideration is whether it may be possible to set aside a sale of assets on the basis that the administrator acted in excess or abuse of his powers, by reference to paragraph 3. Provided that the counterparty is in good faith and gives value, there is no risk of transaction avoidance. So far as excess of power is concerned, paragraph 59(3) provides that 'a person who deals with the administrator of a company in good faith and for value need not inquire whether the administrator is acting within his powers'. Should the administrator be taken to have abused his powers, then under general equitable principles, the counterparty to a transaction will likewise only be liable if he is not a good faith purchaser.[152]

5. Distribution

The changes to the governance processes are of course not the only changes brought about by the 2002 Act. It has also made significant changes to the way in which the distribution of the returns from the company's assets is ordered amongst claimants, to which we now turn.

5.1 Expenses of the Administration

The new law provides, as did the old, that certain liabilities and expenses incurred by the administrator shall, upon his cessation of office, form charges on the property in his custody immediately before his appointment ceased, and payable in priority to any floating charge(s) in existence in respect of the property.[153] The charged sums will comprise, in order of priority, first, liabilities under administration contracts and liabilities for wages and salary for work done during the administration period, and secondly, the administrator's remuneration and any expenses properly incurred in the performance of his functions.[154]

An innovation of the EA is the introduction of a formal 'expenses of the administration' regime.[155] Under the old law, no formal provision was made in the legislation for expenses of administration. Whilst contracts entered into by the administrator were given priority on the cessation of his appointment,[156] this did not on its terms extend to contracts adopted by the administrator save for employment contracts. In *Re Atlantic Computers*,[157] the Court of Appeal considered the position as respects periodic payments under pre-administration finance leases. Nicholls LJ considered that the court had a broad discretion to treat payments made pursuant to such financing arrangements as 'expenses' for the purposes of s 19(4) where the administrator made use of assets to which the counterparty had some proprietary entitlements—e.g. ownership or security interest of some variety.[158] The discretionary nature of the old administration expenses regime should be contrasted with the position in respect of liquidation expenses, the scope of which, as explained by the House of Lords in *Re Toshoku Finance plc*,[159] is determined simply by the statutory list in rule 4.218 coupled with the 'benefit principle', which is no longer of a discretionary character. The introduction in the new regime of a statutory list of expenses of administration suggests that the *Toshoku* reasoning will now be applicable in place of the discretionary approach to administration expenses used in *Atlantic Computers* and based upon the open-ended framework under the old law.

5.2 Abolition of Crown Preference and 'Ring Fencing'

Whilst much of the treatment of expenses and administration contracts may 'pass through' from the old law to the new, considerable changes have been effected in respect of preferential creditors. First, the groups to whom preferential status is accorded have been changed quite radically. Formerly, Crown claims for VAT (via Customs and Excise) and PAYE and Social Security deductions (via the Inland Revenue), were treated as preferential. Section 251 of the 2002 Act has abolished the preferential status of these claims. At the same time, section 252 of the Act has inserted a new section 176A to the Insolvency Act 1986, creating a 'carve out' from floating charge recoveries for unsecured creditors. Very loosely speaking, this provision—the genesis of which is probably traceable to the '10% fund' suggested in the Cork Report—can be seen as a *quid pro quo* for the abolition of the Crown's preferential status. It places an obligation on an insolvency office-holder to pay a proportion of the company's 'net property'—defined as assets that would otherwise be available to satisfy the claims of floating charge holders—and to pay these over to unsecured creditors.[160] The current the minimum net property for the purposes of s 176A is set at £10,000, and that the proportions that should be set aside should be 50% of net property up to £10,000, and 20% of any amounts exceeding this up to a global maximum to be set aside of £600,000.[161]

5.3 Making Distributions in Administration

The Act modifies also the administration regime in other important, but less clearly signalled, ways. Most notably, it provides machinery for the administrator to make distributions to creditors.[162] Where the administrator makes, or proposes to make, a distribution to any class of creditors, the new Insolvency Rules set out a detailed framework for such distributions.[163] This provides for the proof and quantification of claims,[164] rules on set-off,[165] and perhaps most notably, the importation of the *pari passu* principle,[166] which was never a feature of the old administration regime. Although para 65(3) provides that the administrator must seek the permission of the court if he wishes to make a distribution to any group other than secured and preferential creditors, it seems likely, given the provision made in the Rules for distributions to unsecured creditors, that this permission would be granted as a matter of course where it forms part of a proposal that has been agreed by the creditors' meeting. Moreover, para 66 provides that the administrator may make distributions otherwise than in accordance with para 65 if he considers that this is likely to assist in the achievement of the purpose of administration. If it is the case that an administration will achieve greater returns for the unsecured creditors than a liquidation, then it would appear that para 66 could be invoked if necessary.

The incorporation of the *pari passu* principle will mean that the common law rule that 'there cannot be a valid contract that a man's property shall remain his until his bankruptcy, and on the happening of that event shall go over to someone else, and be taken away from his creditors',[167] will apply in administration. However, it is likely that it will need to do so in a slightly modified form. There is, after all, a certain tension between a statutory moratorium from which the exercise of self-help contractual remedies are excluded,[168] and a principle that strikes down terms in contractual agreements that purport to limit the ambit of the company's interest in choses in action such that they determine in insolvency.[169]

6. Conclusion: Transforming Insolvency Law?

The new administration procedure will be exceedingly flexible, capable of being employed in similar fashion to the existing procedure, or to an administrative receivership, or even, given the administrator's powers to make distributions,[170] a liquidation. It seems likely, therefore, that the take-up rate of the new procedure will be considerably higher than under the old law—as desired by the Review Committee.[171] What is not yet clear is how far the development will go. Is it possible that administration might become the primary insolvency procedure?

Clearly, the streamlined administration regime will be the sole insolvency procedure used for reorganisations[172] and going concern sales. However, it could also be used for cases where the firm is to be closed and the assets sold off piecemeal. The extent to which administration will be used for 'closure' cases will depend on the on the relative net recoveries that will be achieved in administration and liquidation, and the position of the company's secured creditors. The interesting case will be where closure is immediate, and the assets are to be sold piecemeal, yet some recoveries will endure for the unsecured creditors. Here, it may be that the administrator will be able to achieve objective (b) even though the company has been closed, if the total expenses of administration can be expected to be less than those in liquidation. The House of Lords' recent decision in *Buchler v Talbot*,[173] establishing that liquidation expenses do not rank ahead of floating charge recoveries, may make administration more attractive to unsecured creditors and create a further impetus towards using administration for what are in effect liquidations.

In conclusion, then, will the new regime be successful in achieving its twin objectives of enhancing accountability *and* efficiency? In principle, it appears that the administrator's statutory statement of purposes provides a framework within which he will be directed to work to maximise returns to the creditors as a whole. This, therefore, looks like a clear solution to the problem of the 'lop-sided' incentives of the administrative receiver. However, the operationalisation of the administrator's duties will come at a price, the extent of which will largely depend on the way in which the courts approach their new role in the governance of rescue. It is to be hoped that practice will rapidly evolve towards the administrator informally checking important preliminary decisions with major creditors, and thereby ensuring as much *direct* accountability to creditors as possible, whilst simultaneously shielding him from the possibility of litigation.

Notes

[1] Hansard, *HC Deb* 10 April 2002, 53 (Ms Patricia Hewitt MP, Secretary of State for Trade and Industry).

[2] See, e.g., *Insolvency Law and Practice: Report of the Review Committee* (Chair: Sir Kenneth Cork) (‘*The Cork Report*’) Cmnd 8558 (1982), para 233; *HC Debs* vol. 78, cols. 153-154 (30 April 1985) (Mr Brian Gould); *HL Debs* vol. 459, col. 851 (7 Feb 1985) (Lord Bruce of Donnington); *HC Debs* vol. 298, col. 299 (15 Jul 1997) (Austin Mitchell MP); *HL Debs* vol. 596, cols. 942-951 (26 Jan 1999); M. Grylls, ‘Insolvency Reform: Does the UK Need to Retain the Floating Charge?’ [1994] 9 *JIBL* 391; J.S. Ziegel, ‘The Privately Appointed Receiver and the Enforcement of Security Interests: Anomaly or Superior Solution?’, in J.S. Ziegel (ed.), *Developments in International and Comparative Corporate Insolvency Law* (1994), 451; D. Milman and D.E.M. Mond, *Security and Corporate Rescue* (1999); V. Finch, *Corporate Insolvency Law: Principles and Policies* (CUP, 2002), 234-72; R.J. Mokal, ‘Administration and Administrative Receivership: An Analysis’, forthcoming (2004) 57 *Current Legal Problems*; *Cf* J. Armour and S. Frisby, ‘Rethinking Receivership’ (2001) 21 *Oxford Journal of Legal Studies* 73.

[3] For charges created after 15 September 2003 (Enterprise Act 2002 (Commencement No. 4 and Transitional Provisions and Savings) Order 2003, SI 2003/2093).

[4] This case is put in J Armour and S Frisby, ‘Rethinking Receivership’ (2001) 21 *Oxford Journal of Legal Studies* 73.

[5] The Insolvency Service, *A Review of Company Rescue and Business Reconstruction Mechanisms* (London: TSO, 1999).

[6] Cm 5234 (London: TSO, 2001) (henceforth ‘*Insolvency—A Second Chance’*).

[7] See, e.g., Hansard, *HL Deb* 2 July 2002, Col 188 (Lord MacIntosh of Haringey):

‘We want to put company rescue at the heart of insolvency procedures because we want to save companies which have a decent chance of survival so that they are not driven to the wall unnecessarily.’

[8] Refs.

[9] *Insolvency—A Second Chance*, 9.

[10] *Ibid.*

[11] *Ibid.* See also Hansard, *HC Deb*, 10 April 2002, Col 53 (Ms Patricia Hewitt MP, Secretary of State for Trade and Industry).

[12] Refs.

[13] *Insolvency—A Second Chance*, 9.

[14] *Ibid.*

[15] Regulation 1346/2000 EC [2000] OJ L160/1, Annex A.

[16] Exceptions.

[17] Insolvency Act 1986 (prior to 15 Sept 2003, henceforth 'old IA 1986'), s 9(1).

[18] *Ibid.* s 8(1).

[19] Insolvency Act 1986, as amended by Enterprise Act 2002 (henceforth 'IA 1986'), Sch B1, para 22.

[20] *Ibid.* para 14.

[21] *Ibid.* para 11.

[22] *Ibid.* paras 18, 29. Giving such a declaration without reasonable grounds for believing it to be true will constitute an offence.

[23] *Ibid.* s 214. For an analysis, see R. Mokal, "An Agency Cost Analysis of the Wrongful Trading Provisions" [2000] CLJ 335.

[24] See generally V Finch, *Corporate Insolvency Law* (CUP, 2002), 126-40.

[25] *Ibid.* at 259.

[26] *Ex hypothesi*, this latter category excludes 'external' factors which a reasonably competent management would have anticipated and taken steps effectively to deal with.

[27] Finch at 126 n. 34, provides a useful summary. Perhaps this is to be expected: insolvency practitioners clearly have an incentive to reinforce the suggestion of their relative superiority over humdrum non-'professional' managers. This might encourage their services to be resorted to more frequently and at an earlier stage of the corporate distress cycle (and so perhaps for longer). Even if that is the case (on which no position is taken here), it is probably true that, for the reasons to be explained in the text below, management failings are the primary cause of a significant proportion (perhaps the majority) of corporate insolvencies.

[28] *9th Survey* at 2. Franks and Sussman report this figure to be just over one in three; *Cycle* at 7 Table 2.

[29] This comes (inevitably, since that is the main available source of information) from the 2; note, however, that this seems to assume that managerial action *could* have prevented insolvency.

[30] IA 1986, Sch B1, para 26.

[31] *Ibid.* para 25.

[32] *Ibid.* para 12.

[33] *Ibid.* para 36.

[34] *Ibid.* paras 11(a), 27(2)(a).

[35] *Ibid.* paras 16, 35(2).

[36] *In the matter of Colt Telecom Group Plc* [2002] EWHC 2815, [25], *per* Jacob J.

[37] See J Armour and S Frisby, 'Rethinking Receivership' (2001) 21 *Oxford Journal of Legal Studies* 73.

[38] D Citron, 'The Incidence of Accounting-Based Covenants in UK Public Debt Contracts: An Empirical Analysis', (1995) 25 Accounting and Business Research 139, especially at 144-5; see also J Day and P Taylor [JIBL papers].

[39] Firms sent to these units remain there for seven and a half months on average, and up to seventy-five percent of these are turned around.

[40] This summarises some of the evidence in *Cycle*.

[41] See *infra*, section 4.

[42] PL Davies, *An Introduction to Company Law* (Oxford: Clarendon Press, 2002), 9.

[43] FH Easterbook and DR Fischel, *The Economic Structure of Corporate Law* (Cambridge, MA: Harvard University Press, 1991), Chs.1-2. [Explain 'costs of resolving disagreements'—hold outs and free riders.]

[44] A company's bank is likely to be the only of its creditors that is capable of fulfilling these desiderata. The fact that the bank was given decision-making rights in receivership was therefore one of the srongest arguments in favour of the old law: Armour and Firsby, *supra* n ??.

[45] MC Jensen and WH Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305.

[46] The most important being the right to petition the court for relief from 'unfair prejudice' under Companies Act 1985 s 459.

[47] In other words, it becomes 'unable to pay its debts' within the meaning of section 123 of the Insolvency Act 1986.

[48] *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722 at 730; *West Mercia Safetywear Ltd v Dodd* (1989) 4 BCC 30 at 33; *Official Receiver v Stern (No 2)* [2001] EWCA Civ 1787 at [32], [2002] 1 BCLC 119 at 129-30.

[49] See in particular Companies Act 1985 s 303. Whilst it is arguable that this power would, in factually insolvent companies at least, theoretically only be exercisable in the interests of the company (*pace* creditors) as a whole (see J Armour, 'Avoidance of Transactions as a "Fraud on Creditors" at Common Law' in J Armour and HN Bennett, *Vulnerable Transactions in Corporate Insolvency* (Hart, 2003)), it is difficult to imagine a court being able review such a decision effectively.

[50] IA 1986, Sch B1, para 61.

[51] *Ibid*. para 64 (directors and officers unable to exercise any management powers without consent of administrator).

[52] See Armour and Frisby, *supra* n ??.

[53] See *supra*, text to nn ??-??.

[54] The administrator does, of course, have the power to call a creditors' meeting, or to refer a matter to the court for directions, where he considers it appropriate to do so: para 62.

[55] The administrator's powers *include* anything which directors would have had power to do (*Polly Peck International plc v Henry* [1999] 1 BCLC 407—e.g. appointing a trustee to employee pension scheme), but are not so limited—'management of the company's business and affairs' in para 59) is broader than 'management of the company's business' in art 70 of Table A.

[56] Para 69.

[57] Para 59(4).

[58] IA 1986 s 234.

[59] Or at least so much of them as represent the secured debt. If there is a shortfall on sale, the administrator must make up from the fee assets the difference, if any, between the actual sale price and the sale price which would have been obtained from a sale at fair market value.

[60] Para 70. Court consent is not required to deal with floating charge assets in this way.

[61] *Supra*, section ??.

[62] IA 1986, Sch B1, para 51.

[63] *Supra*, section 2.

[64] If the meeting rejects the proposals, then under para 55, the court may either terminate the administration, put the company into winding up, or ‘make such other order as it thinks fit’. The better view is that this does not give the court jurisdiction to impose proposals on the creditors.

[65] Para 54.

[66] Para 55(2).

[67] IA 1986, Sch B1, para 49(2)(b). The circulated proposals must, if applicable, give reasons why the administrator is choosing not to pursue either of the first two statutory objectives prescribed by para 3. On para 3, see *infra*, section ??.

[68] Para 52(2).

[69] Insolvency Rules 1986 (as amended), r. 2.43.

[70] Votes are calculated according to the amount of the creditor’s claim as at the date at which the company *entered* administration (Insolvency Rules 1986, as amended, r. 2.38). Secured creditors are not entitled to vote, except insofar as their claim exceeds the value of their security (r. 2.40). Similar provisions limit the rights of holders of negotiable instruments, and hire-purchase creditors (rr. 2.41-2).

[71] *Ibid*. r. 2.40(2).

[72] *Ibid.* para 52. This paragraph also contains a ‘balancing mechanism’ designed to protect shareholders: the administrator is not required to put proposals to the creditors’ meeting if he thinks that the company will have sufficient assets to pay all its creditors in full: para 52(1)(a).

[73] This is subject to a countervailing safeguard: the meeting must nevertheless be summoned if requested by creditors holding more than 10% in value of the company’s total debts: para 52(2).

[74] Para 76.

[75] That is, if no statement has been made under para 52(1)(b).

[76] Paras 79, 81.

[77] There is a second exception, for cases where such proposals are put as part of a scheme of arrangement or CVA. In each case, however, the affected creditor would have similar protection: the right to vote as a class under a scheme, and under Insolvency Act 1986 s 4 for CVAs.

[78] [2003] BPIR 253.

[79] IA 1986, Sch B1, para 70. See *supra*, text to nn ??-??.

[80] Paras 70-72.

[81] Paras 71-72.

[82] Para 43(2); See also old IA 1986 s 11(3); *Barclays Mercantile Business Finance Ltd v Sibec Developments Ltd* [1993] BCLC 1077.

[83] *Re Atlantic Computer Systems plc* [1990] BCC 859, 880-882.

[84] G Meeks [paper about destruction of goodwill when insolvency proceedings are announced]

[85] *Re Consumer and Industrial Press* [1988] BCLC 177.

[86] See, e.g., *Re Montin Ltd* [1999] 1 BCLC 663; *Re Dana (UK) Ltd* [1999] 2 BCLC 239.

[87] [2000] 1 BCLC 471.

[88] *Re Transbus International Ltd* [2004] EWHC 932 at[13].

[89] [2003] EWCA Civ 1506.

[90] IA 1986, Sch B1, para 4.

[91] *Re Charnley Davies (No.2)* [1990] BCLC 760.

[92] *Oxford English Dictionary*, 2nd ed. (1989), online version www.dictionary.oed.com

[93] IA 1986, Sch B1, para 74(2).

[94] As Millett LJ explained in *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18: ‘The distinguishing obligation of a fiduciary is the obligation of loyalty.’

[95] Para 68.

[96] IA 1986, Sch B1, para 111(1). This is referred to in the Explanatory Notes to the Enterprise Act 2002 as a ‘single overarching purpose’: Explanatory Notes, para 647.

[97] Lord Hoffmann described this paragraph as the 'centrepiece' of this part of the Enterprise Bill. Hansard, HL Deb, 21 Oct 2002, Col 1103.

[98] See Hansard, HL Committees, 29 July 2002, Cols 764-67 ; HL Deb 21 Oct 2002, Cols 1100-02. See also Explanatory Notes to the Enterprise Act 2002, para 649.

[99] Pursuant to Part I of the Insolvency Act 1986, or section 425 of the Companies Act 1985, respectively.

[100] However, the overlap with objective (b), discussed below, means that this point is largely academic.

[101] See Explanatory Notes to the Enterprise Act 2002, para 650. See also Hansard, HL Deb, 21 October 2002, cols 1101-02.

[102] The schedule is ambiguous as to whether the hypothetical winding up used as a comparator is to be a compulsory or creditors' voluntary liquidation. It is submitted that to be safe, the administrator should use as a comparator whichever form of liquidation he considers would be likely to yield the greatest return to creditors.

[103] If the phrase were construed as referring to the unsecured creditors alone, then it might argued that para 3 legitmates the use of the moratorium in a purely strategic fashion so as to extract compromises from secured creditors. It was established in *Barclays Mercantile Business Finance Ltd v Sibec Developments Ltd* ([1992] 1 WLR 1253) that for an administrator to refuse a secured creditor's request for delivery up of assets subject to his security, where those assets were not necessary to the achievement of the purpose of administration, was an abuse of power by the administrator. Under the old law, the most likely question would be whether the retention of the property was necessary to 'obtain a more advantageous realisation of the company's assets'. The difference between 'more advantageous realisation' under the old law and 'better result for the creditors' under the new is that the former looks to the price fetched for sale of the assets, whereas the latter looks to what the creditors ultimately end up with. 'Ransom demands' made to secured creditors will not increase the price at which assets may be sold, making them an abuse of power under the old law. Yet if 'creditors' in para 3(1)(b) were to mean simply *unsecured* creditors, then such demands might conceivably be compatible with *achieving* the purpose under the new law. Such a radical change in the law—that would amount in effect to an expropriation of secured creditors in favour of unsecureds—cannot have been the intention of Parliament in passing the Enterprise Act 2002. *Cf.* the position in winding-up: Insolvency Rules 1986, rr. 12.3, 13.12, as interpreted in *Tottenham Hostpur plc v Edennote plc* [1995] 1 BCLC 65, 68-69.

[104] "Rescuing businesses is exactly the kind of outcome that the second objective is… intended to recover [sic]. If it is not reasonably practicable to rescue the company, selling the constituent businesses as going concerns will almost always be the next best thing… the effect of the provision as drafted will to cover and give priority to business rescues", *per* Lord McIntosh of Haringey, the Minister responsible for steering the Enterprise Bill through the House of Lords; Hansard, Committee, 29 July 2002: Column 768.

[105] The lack of moratorium on secured claims would preclude these outcomes in liquidation.

[106] It might in theory be possible to argue that the para 3(3) power operates independently of the para 3(2) duty, by distinguishing between a power to *select the objective* towards which the administrator's functions are to be performed, and the *manner of performance* of those functions. However, such a distinction would render irrelevant para 3(2)'s express saving for the operation of para 3(4), which under specified circumstances confers on the administrator a power to choose objective (c).

[107] See *supra*, text to nn ??-??.

[108] An alternative construction might distinguish between the *objective*

[109] See Hansard, HL Deb, 21 October 2002, cols 1101-02.

[110] See Enterprise Bill, as Amended in Standing Committee B on 16 May 2002, Sch B1 para 3(1)(b).

[111] This was emphasised several times in the legislative process; see e.g. Hansard, Columns 569-70, 768, and 1105 ("If necessary, we would expect the courts to assess whether the office holder, in this case the administrator, has been rational in his decision [about which objective to pursue]. We are not seeking to apply any other test.").

[112] The existence of the power to select depends, by virtue of para 3(3), upon what the administrator *thinks*, whereas its exercise, under para 3(2), does not. Read literally, the statutory wording therefore gives rise to an apparent asymmetry, whereby it may be more difficult to challenge an administrator's decision to pursue objective (a) over (b) than *vice versa*. Proving that an administrator should have pursued (b) where he in fact pursued (a) would require a challenge to the administrator's statement as to what he thought. Yet an administrator pursuing (b) will naturally declare that he thinks one of the conditions in para 3(3) is satisfied. So a claimant challenging a decision to pursue objective (b) over objective (a) need not contradict the administrator's

statement as to his own beliefs, but simply focus on whether or not objective (b) was in fact in the interests of the creditors as a whole.

[113] IA 1986, Sch B1, para 3(2).

[114] Analogously with the choice between objectives (a) and (b), it will be more difficult to allege that an administrator *should* have dropped down to objective (c) than that he *should not*. The former will necessitate proof that he thought that objectives (a) and (b) were not reasonably practicable, whereas the latter may be made out by demonstrating that in so doing he unnecessarily harmed the interests of the creditors as a whole. One possible reconciliation might be to suggest that whilst para 3(4)(a) governs the selection of the *objective* towards which the administrator must perform his functions, para 3(4)(b) relates to the *performance* of those functions. However, this does violence to the opening words of para 3(4), which provide that the administrator may *only* pursue objective (c) if the conditions set out in sub-paras 3(4)(a) and (b) are *both* satisfied.

[115] For example, where, as happens in many receiverships, the assets of the business are sold as a going concern, it can be argued that this will generate a better result for the creditors as a whole than a piecemeal sale in liquidation. Even if it is necessary to sell the company's assets on a 'break-up' basis, it may still be possible to achieve objective (b) if the costs of administration are lower than those of liquidation. Where the company has granted charges to one or more secured creditors, then a liquidation might involve the appointment of a receiver in addition to a liquidator, with the total fees consequently being likely to be more than by an administrator. Hence the net recoveries to creditors as a whole will be likely to be more in administration.

[116] See e.g. Hansard,10 April 2002 : Columns 569-70 ("The word 'thinks' in those paragraphs means that the administrator will have to reach a considered view [about which objective to pursue]. In such situations, the administrator's decision would be subject to a rationality test by which it would be challenged if it could be shown that no reasonable administrator would have acted in such a way in those circumstances"); 29 July 2002 : Column 768 ("The present wording would mean that if the administrator's view were then to be tested, it would be subject to a 'rationality' test — that is, his decisions would be subject to successful challenge if it could be shown that no reasonable administrator would have acted in such a way in the particular circumstances of a case."), and 21 October 2002 : Column 1105 ("If necessary, we would expect the courts to assess whether the office holder, in this case the administrator, has been rational in his decision. We are not seeking to apply any other test.").

[117] IA 1986, Sch B1, para 49(2).

[118] This 'spectrum' can be understood as intersecting with another axis along which discretions may be classified for the purposes of determining the extent to which they are judicially reviewable—that is, the spectrum of 'public' to 'private' decisions. Whilst trustees and directors are classified as private decision-makers, the administrator's status as an officer of the court (Sch B1, para 5) may imbue his decisions with a more public character. However, this point merely reinforces the one made in the text—namely, that the administrator's decisions should be subject to a more intensive standard of review than those of company directors.

[119] See *Re Charnley Davies (No.2)* [1990] BCC 605, ___.

[120] Mokal, CLP.

[121] *Vatcher v Paull* [1915] AC 372.

[122] IA 1986, Sch B1, para 49(2).

[123] 1975] Ch 75, 41 (Buckley LJ).

[124] See, however, the comments by Jonathan Parker J in *Green v Cobham* (unreported, 19 January 2000), who preferred not to refer to the principle derived from *In re Hastings-Bass* as a rule.

[125] *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587, 1621. See also e.g. *Abacus Trust Co (Isle of Man) and Another v. Barr*, [2].

[126] *Mettoy* [1990] 1 WLR 1587, 1625.

[127] *Scott v National Trust* [1998] 2 All ER 705, 717; *Edge v Pensions Ombudsman* [2000] Ch 602, 627-28.

[128] [1992] IRLR 27.

[129] *Per* Dillon LJ; note that both parts of this statement were crucial to the Court's actual decision.

[130] In the present context, the administrator's duties, as he goes about deciding upon the correct objective, (i) not unnecessarily to harm creditors as a whole, and (ii) to act in their interests as a whole, places upon him the obligation to obtain all of the information reasonably available to him which bears upon the question of how best to serve those interests and to protect them from unnecessary harm. So for example, not to take into account reasonably discoverable factors relevant to determining whether the continuation of the company as a going concern (by preserving for its benefit the specific skills and knowledge of the local market of its pre-distress shareholder-managers, say)

would result in better expected returns for its creditors than if the company's business were to be sold off to another company (with little knowledge of and enjoying no goodwill in the market), would be to ignore considerations relevant to serving the creditors' interests, and would thus constitute a breach of duty.

[131] Jonathan Hilliard, while observing that "we must take care here to heed Fletcher Moulton LJ's famous warning in *Re Coomber* [1911] 1 Ch 723, 728 that '[f]iduciary relations are of many different types'", argues that the rule should apply to all fiduciaries since, *inter alia*, it is a solution to the general problem of dealing with flawed decision making; see "*Re Hastings-Bass*: Too Good to be True?" (16.12.02), available at <www.TrustsTaxEstates.com>. In the context of the pre-Enterprise Act law, see also the interesting discussion of the implications of the rule for administrators in I. Dawson, 'Administrator's Reprieve' (2002) 5 *Insolvency Lawyer* 180.

[132] *Re Barings plc (No.5)* [1999] 1 BCLC 433, 486-489. On the procedural nature of the 'duty of care' , see R Nolan, 'The Legal Control of Directors' Conflicts of Interest in the UK: Non-Executive Directors Following the Higgs Report' working paper, University of Cambridge.

[133] *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Hogg v Cramphorn Ltd* [1967] Ch 254; *Howard Smith v Ampol Petroleum Ltd* [1974] AC 821; *Lee Panavision Ltd v Lee Lighting Ltd* [1992] BCLC 22; See L Sealy, '"*Bona Fides*" and "Proper Purposes" in Corporate Decisions' (1989) 15 *Monash University Law Review* 265.

[134] *Charterbridge Corp v Lloyds Bank Ltd* [1970] Ch 62; *Colin Gwyer & Associates Ltd v London Wharf Ltd* [2003] 2 BCLC 153 at [70]-[95].

[135] (1843) 2 Hare 461.

[136] See *Rock Nominees Ltd v RCO (Holdings) Plc* [2003] EWHC 936.

[137] *Howard Smith v Ampol Petroleum Ltd* [1974] AC 821, ___.

[138] It has been argued cogently that the development of the courts' jurisdiction to review directors' decisions on the basis that they have acted for improper purposes is both a genuine, and a desirable, innovation: see RC Nolan, in BAK Rider (ed.), *The Realm of Company Law* (Kluwer, 1998).

[139] CLR

[140] Companies Act 1985 s 303.

[141] IA 1986, Sch B1, para 88. See also *ibid* paras 90-97.

[142] *Supra* section 3.

[143] In the context of receivership, this problem is discussed by D. Milman and D.E.M. Mond, *Security and Corporate Rescue* (1999).

[144] [Refs to Committee Stage discussion about this point.]

[145] IA 1986, Sch B1, para 70.

[146] *Agnew v CIR* [2001] 2 AC 710.

[147] *Ibid.* para 74.

[148] See Hansard, HL Debs, 2 Jul 2002, Col 84 (Lord McIntosh of Haringey).

[149] Simply showing that such prejudice was caused by some act or omission of his which did not amount to such management would not suffice: *Re Charnley Davies Ltd (No 2)* [1990] BCLC 760, ___.

[150] Namely, the order may (a) regulate the exercise of the administrator's functions; (b) require the administrator to do or not to do a specific thing; (c) require a creditors' meeting to be held for a specified purpose; (d) provide for the appointment of the administrator to cease to have effect; or (e) make consequential provision.

[151] Paras 75(6), 98(4)(b).

[152]

[153] IA 1986, Sch B1, para 99. By a process of implication, the statutory charges will therefore rank behind any fixed security or title retention claims in respect of the property.

[154] [Check: does pursuing insolvency litigation count as an expense of *administration*?]

[155] Insolvency Rules (as amended), r. 2.67.

[156] Old IA 1986 s 19(5).

[157] [1992] Ch 505.

[158] *Ibid.* at 525-31.

[159] [2002] 1 WLR 671.

[160] The provision will be inapplicable either if, where the company's net property is below a minimum, the office-holder considers that it would be disproportionately costly to set the funds aside, or, where the minimum value of net property is exceeded, the court considers the exercise disproportionately expensive (IA 1986 ss 176A(3), (5)). It may also be waived by a majority of creditors voting in favour of a CVA or scheme of arrangement (s 176A(4)).

[161] Insolvency Act 1986 (Prescribed Part) Order 2003, para 3.

[162] IA 1986, Sch B1, para 65.

[163] Insolvency Rules 1986 (as amended), Part 2, Chapter 10. See in particular r. 2.76.

[164] Insolvency Rules 1986 (as amended) rr. 2.72-2.80 (proof of claims), 2.81-2.94 (quantification).

[165] *Ibid.* r. 2.85. The new set-off rule for administration differs in several respects from rule 4.90, applicable in liquidation.

[166] *Ibid.* r. 2.69.

[167] *Ex p Jay, In re Harrison* (1880) 14 ChD 19, 26, *per* Cotton LJ.

[168] *Re Olympia & York Canary Wharf Ltd* [1993] BCC 453, __ . An exception to this is the landlord's right of peaceable re-entry. However, this was specifically included by the Insolvency Act 2000.

[169] *British Eagle International Airlines* v. *Compagnie Nationale Air France* [1975] 1 WLR 758; *Money Markets International Stockbrokers Ltd v London Stock Exchange Ltd* [2002] 1 WLR 1150.

[170] See *supra*, section 5.3.

[171] See DTI, *Productivity and Enterprise: Insolvency—A Second Chance*, Cm 5234 (TSO, 2001), paras 2.1, 2.7.

[172] Of course, many reorganisations are achieved outside of insolvency procedures at all: see P. Kent, 'Corporate Workouts—A UK Perspective' (1997) 6 *International Insolvency Review* 165; J. Armour and S. Deakin, 'Norms in Private Insolvency: The "London Approach" to the Resolution of Financial Distress' (2001) 1 *Journal of Corporate Law Studies* 21.

[173] [2004] UKHL 9, [2004] 2 WLR 582.

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