ARTICLE

# The Powers of Administrators under Schedule B1 Prior to the Creditors' Meeting – Transbus International Limited

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## Introduction

The recent decision of Mr Justice Lawrence Collins in *Transbus International Limited* [2004] EWHC 932 (Ch) provides clarification on an important question for administrators appointed under the provisions of Schedule B1 to the Insolvency Act 1986 (i.e., the new provisions introduced in September 2003 by the Enterprise Act 2002). The question was whether administrators were required, before selling the business of the company in advance of their proposals being approved by a creditors' meeting convened under paragraph 53, to obtain the directions of the court. In fact no particular sale was identified in *Transbus*, the application being made in order to obtain a determination of this question preliminary to a subsequent application if the answer was 'yes'.

To many this will be a familiar question, and one which it is perhaps surprising needed to be asked, given the relatively recent decision of Mr Justice Neuberger in *Re T&D Industries Plc* [2000] 1 WLR 646, in which he held that administrators did indeed have the power to sell the whole of the assets and business of the company in advance of convening a creditors' meeting without the need to go to the court for directions. That decision was, however, given in relation to administrators appointed by the court under part II of the Insolvency Act 1986. The relevant provisions of Schedule B1 (principally paragraph 68), whilst broadly re-enacting the earlier provisions (principally section 17 of the Insolvency Act), differ from those earlier provisions in two respects. First, the structure and precise wording of paragraph 68 of Schedule B1 is slightly different from the structure and wording of section 17. Secondly, under Schedule B1 administrators may be appointed out of court.

This latter difference means that an interpretation of paragraph 68 of Schedule B1 consistent with the decision in *Re T&D Industries* could lead to administrators being appointed to the company and entering into an immediate sale of the entirety of the business of the company without any involvement either of the court or of the creditors. Accordingly, notwithstanding the likelihood that in view of the broad similarity between the new and the old provisions, the draftsman of Schedule B1 had not intended to effect any substantive change in the law, the fact that the new provisions differed in these two ways gave rise to the possibility that a change in the law had indeed taken place.

The issue is one of considerable importance in practice. Administrators will often be placed in a situation where they have to decide very quickly (and certainly more quickly than the time it takes to convene a meeting of creditors) whether the business of the company over which they are appointed should be sold and, if so, to whom. The consequences of a sale made when the administrators lacked the *power* to do so could be very serious.

In the *Transbus* case Mr Justice Lawrence Collins concluded that neither the change in the structure and wording of the provisions nor the change in circumstances that administrators can now be appointed out of court was sufficient to warrant a different approach to that taken by Mr Justice Neuberger in *T&D Industries*. Accordingly it remains the case that administrators have the *power* to sell the assets and business of the company (including the whole of the assets and business) in advance of convening a creditors' meeting without obtaining the directions of the court. As before, however, it is important to appreciate the limits on this decision – in particular the confirmation that the administrators have the power to sell the assets says nothing about whether it is appropriate in any given case for the administrators to exercise that power. In relation to the exercise of the power, the administrators remain fully accountable to creditors.

Following a comparison of the old and the new provisions, this article seeks to explain the sense of the *Transbus* decision and the attendant importance of the administrators' accountability to creditors.

## Part II of the Insolvency Act 1986

Prior to the decision in *T&D Industries* there was considerable uncertainty, assisted by conflicting first instance authorities, on the extent to which administrators could act in the absence of court directions prior to the approval of their proposals. This

uncertainty sprang from the ambiguity within section 17(2) of the Act, which states as follows:

> the administrator shall manage the affairs, business and property of the company (a) at any time before proposals have been approved (with or without modifications) under section 24 below, in accordance with any directions given by the court, and (b) at any time after proposals have been so approved, in accordance with those proposals as from time to time revised, whether by him or a predecessor of his.

There is no doubt that once the administrator's proposals were approved by the creditors, he was required to act in accordance with those proposals. What was the position, however, if the administrators wished (as frequently happens) to dispose of some or all of the assets of the company in the meantime? The words in section 17(2)(a) – 'at any time before proposals have been approved .... in accordance with any directions given by the court' gave rise to two possible interpretations:

> The first interpretation involves reading these words as meaning 'in accordance with such directions, if any, as are given by the court,' i.e. until the administrator's proposals are approved at a section 24 meeting, the administrator can exercise powers conferred on him by section 14 and Schedule ('the section 14 powers') save to the extent that a direction from the court otherwise requires. The second interpretation involves reading the words in section 17(2)(a) as meaning 'only to the extent specifically permitted by any directions given by the court,' i.e until the administrator's proposals are approved, he can only exercise his section 14 powers if and so far as sanctioned by the court.

Mr Justice Neuberger, having noted that the previous authorities, the statutory language and the policy of the administration scheme in the 1986 Act all had features which could be said to support each of the two interpretations, concluded that the first interpretation was the preferred one.

## Schedule B1 to the Insolvency Act 1986

The equivalent provision to section 17(2) of the Act is now to be found in paragraph 68(1)&(2) of Schedule B1, as follows:

> 68(1) Subject to sub-paragraph (2), the administrator of a company shall manage its affairs, business and property in accordance with –
> (a) any proposals approved under paragraph 53,
> (b) any revision of those proposals which is made by him and which he does not consider substantial, and
> (c) and revision of those proposals approved under paragraph 54.
> 68(2) If the court gives directions to the administrator of a company in connection with any aspect of his management of the company's affairs, business or property, the administrator shall comply with the directions.

It is a reasonably safe assumption that the draftsman of paragraph 68 had the decision in *Re T&D Industries* well in mind when drafting these provisions. Indeed, it is relatively clear that paragraph 68(2) reflects a deliberate choice in favour of the first of the two interpretations identified in that case, i.e. the one preferred by Mr Justice Neuberger. That interpretation involved reading the reference to 'any directions of the court' in section 17(2) as meaning the directions *if* any. Paragraph 68(2) makes explicit what had to be read into section 17(2) – making it clear that the administrator is required to comply with the directions of the court '*if* the court gives any'.

Unfortunately, however, in seeking to resolve the ambiguity that was inherent in section 17(2) of the Act a different (but mirror-image) ambiguity has been created in paragraph 68(1)(a). The words 'the administrator of a company shall manage its affairs, business and property in accordance with ... any proposals approved under paragraph 53' are potentially open to two interpretations: (1) 'the proposals, if any, approved under paragraph 53'; or (2) 'only to the extent permitted by any proposals approved under paragraph 53'. In other words, the ambiguity in section 17(2) as regards the requirement to act in accordance with the directions of the court has been repeated as regards the requirement to act in accordance with the proposals approved by creditors. This leads to the potential argument that under paragraph 68(1) the administrator can act only when and if proposals are approved under paragraph 53. Further, the words 'subject to sub-paragraph (2)' do not assist since sub-paragraph (2) only applies '*if* the court gives directions' (and, incidentally, might be thought to state nothing more than the obvious – namely that an administrator should follow directions given to him by the court).

Furthermore, it could be suggested that the change in circumstances in which administrators are appointed justifies the conclusion that paragraph 68 has effected a change in the law. As noted above, administrators may now be appointed without any court involvement at all. The possibility arises, therefore, of an appointment being made by the company's directors followed by an immediate sale of the entirety of the company's assets and business where neither the court nor any of the company's creditors have any prior notice, let alone any right of veto. It might be thought that this change in circumstances warranted a more interventionist approach from the court in the

period before an administrator's proposals were approved by creditors.

Mr Justice Lawrence Collins, however, in his short judgment in *Transbus*, rejected the notion that the law had been changed as a result of the Enterprise Act. Instead, he favoured the view that parliament intended, in paragraph 68 of Schedule B1, to adopt the effect of Mr Justice Neuberger's decision in *T&D Industries*. Although not spelt out in the judgment, this involves paragraph 68(1)(a) being read as requiring the administrator to manage the affairs, business and property of the company in accordance with the proposals *if any* approved under paragraph 53. This is probably limited to the period prior to the proposals being put to a meeting of creditors (if required, as to which see below), since paragraphs 54(6) and 55 provide separately what is to happen in the event that proposals are put to creditors and rejected.

The policy indications that Mr Justice Neuberger identified in *T&D Industries* are not only replicated in the new legislation, but are supplemented by others that point even more strongly towards the conclusion he reached.

## The policy of the legislation

First, the policy of the legislation is to minimize, not maximize, the circumstances in which administrators need to run off to the court. This was a point made forcefully by Mr Justice Neuberger in *T&D Industries* in relation to part II of the Act. He noted that as a matter of statutory construction section 17(2) applied not only where the administrator was proposing to sell the entirety of the business of the company, but also to all of the powers of the administrator conferred by section 14 and Schedule 1. A construction of section 17(2) that required the court's direction before the administrator was able to exercise his powers would accordingly result in the administrator having to seek directions before, for example, appointing a solicitor, carrying on any part of the company's business or making a claim in any bankruptcy proceedings. Having regard to the fact that 'administration is meant to be a more flexible, cheaper and comparatively informal alternative, with a potentially less destructive result, to liquidation', Mr Justice Neuberger considered 'it seems to me that there is a powerful argument for saying that the fewer applications which need to be made to the court by administrators the better.'

The same points can be made in relation to Schedule B1 but, for two reasons, with even more force. The first of these reasons is that the intention of the legislature in passing the Enterprise Act was, in part at least, to simplify further the administration procedure. This is readily apparent from the mere fact that the need for a court application has, in many cases, been done away with. It is echoed by the comments of the Insolvency Service on their website, under the heading 'Aims of the insolvency legislation':

> ... facilitating the rescue of viable companies, and if that is not practicable, or it would not produce the best outcome for creditors, achieving a better result for the company's creditors as a whole. The Act will achieve this by restricting the use of administrative receivership – (where a single secured creditor has effective control) – and shifting the balance in favour of administration – (which takes account of the interests of all creditors). The Act also streamlines administration – making it more efficient and effective – by providing 'without court order' routes into administration for floating charge holders and companies; removing bureaucracy and reducing the time limits.

The second reason the policy arguments advanced by Neuberger J have even more force under the Enterprise Act focuses on the fact that in at least three circumstances an administrator need not call a creditors' meeting to consider his proposals. These are where the administrator thinks that (a) the company has sufficient property to enable each creditor to be paid in full, (b) the company has insufficient property to enable a distribution to be made to unsecured creditors at all (save out of the 'prescribed part' under section 176A) and (c) the only objective under paragraph 3(1) that can be achieved is the realization of the company's property in order to make a distribution to one or more of the secured or preferential creditors. In each of these cases, therefore, if paragraph 68(2) were construed as requiring an administrator to seek directions before exercising any of his powers, in advance of his proposals being approved by creditors, the administrator would effectively be paralysed from acting throughout the whole of the period of administration without directions from the court. It is highly unlikely that this was Parliament's intention.

## The court is not a bomb shelter

Perhaps the single most compelling reason why administrators ought not to be required to seek the court's directions before exercising their powers, including the power to sell the entirety of the company's business and assets, is the fact that such an application will usually serve no useful purpose, whether from the perspective of the administrators, the court or the creditors. In most cases, given the urgency normally associated with a sale of the company's business as a going concern, the application would be made without notice. On any such application, the court has only the information placed before it by the administrator. It has sometimes been suggested that if the administrator seeks the directions of the court then that provides him with some protection against a future attack upon the exercise of his power

by creditors or a future liquidator. This cannot be right, and probably stems from a misplaced analogy with the rights of trustees to apply to the court for guidance. Whilst there is a clear justification for permitting trustees (many of whom will have had the burden of trusteeship thrust upon them and will be required to carry out their tasks without reward) to seek the court's guidance on how to exercise a particular discretion *and* thereby to obtain protection against a subsequent complaint about that exercise of discretion, there is no similar justification in the case of administrators. An administrator is always a licensed professional and always remunerated, often very well. He is appointed in order to take difficult commercial decisions, sometimes on an urgent basis. He is far better placed to take such decisions than is the court, which is necessarily equipped with only as much information as the administrator has placed before it. As Neuberger J put it in *T&D Industries*: 'if the court is told that a particular offer is very attractive and has to be accepted in three days or it will be withdrawn, so that it cannot wait until the creditors' section 24 meeting, and that the administrator's advisers are strongly of the view that the offer should be accepted, is it really right, at least in the absence of special circumstances, for the court to stand in the way? Equally, can it be right in those circumstances to give the administrators the apparent benefit of a court order to invoke against creditors who subsequently complain about the course that has been taken?' The answer to both questions is clearly 'no'.

An application for directions, therefore, would in the normal run of cases be one where (a) the court is faced, not with an issue to be determined, but with a set of circumstances in which it has no real choice, (b) any choice it does have is a commercial one, which it is less well equipped than the administrators to make, (c) those who will ultimately be affected by the outcome, i.e. the creditors, are not parties and (d) whatever order the court makes provides no comfort or protection to the person (the administrator) who is asking for it. This does not sound like a good use of the court's time or the company's (or the creditors') money.

## Accountability

If on one side of the coin is written 'the court does not act as a bomb shelter', then on the other side is written 'the administrator is accountable for his actions'. This has always been so, but is ever more important where there is no judicial scrutiny of the administration appointment or the administrator himself at any time before he acts.

There are two principal ways in which administrators may be held accountable for their actions. First, a creditor or member may apply to the court claiming that the administrator is acting or has acted so as unfairly to harm the interests of the applicant (whether alone or in common with some or all other members or creditors): paragraph 74(1). Secondly the court may, on the application of (among others) a creditor or contributory, examine the conduct of a person who is or was (or purports to be or to have been) an administrator. On such an application, if it is established (among other things) that the administrator is guilty of a breach of fiduciary or other duty in relation to the company or otherwise guilty of misfeasance, then the court can order the administrator to pay compensation to the company: paragraph 75 of Schedule B1. This latter provision replaces section 212 in respect of administrators, the only material change being that it is no longer necessary, in order to invoke the provision, that the company is in liquidation. In addition, it is possible for creditors and others to apply to court *prospectively* in order to regulate the conduct of the administration, in circumstances where proposed action would unfairly harm the interests of the applicant, or where it is shown that the administrator is not performing his functions 'as quickly or as efficiently as is reasonably practicable': see paragraph 74(1)&(2) of Schedule B1. These are unlikely, however, to be relevant avenues where the administrators are carrying out an urgent sale of the company's assets, and certainly of no use if the problem faced by creditors is action being taken by the administrators without notice to them.

The extent to which creditors can be comforted that administrators, as independent professionals, will apply the highest standards in deciding on the most appropriate course of action for the company and its creditors is likely to depend, at least in part, on the extent to which the courts are prepared to take action under these provisions in cases where the business has been sold in advance of a creditors' meeting.

At the end of his judgment in *T&D Industries* Mr Justice Neuberger made a number of general observations on the appropriate conduct of administrators faced with an urgent need to sell the company's business. These observations remain equally apposite after the Enterprise Act. They, and the considerations referred to below, are likely to be relevant both to the court's investigation of an administrator's conduct, and as guidance to administrators as to how they should act.

Mr Justice Neuberger first emphasized the need for administrators to put their proposals to creditors, and call a creditors' meeting, as soon as possible. Secondly, he noted the importance of the administrator not limiting himself to the formal requirements of the legislation relating to creditors. The mere fact that there is not sufficient time to formulate proposals and convene a meeting of creditors does not mean that the administrator can ignore creditors. There will be many cases where an administrator could, and therefore should, consult at least one, a few, or more of the

major creditors in advance of acting – particularly where those few or more make up the majority of the creditors. Thirdly, he pointed out that the fact that administrators do not need to apply to the court before exercising their powers (and should not do so where the only decision is a commercial one for them) does not mean that they are in an appropriate case *unable* to ask the court for guidance. Paragraph 68(2) of Schedule B1 specifically contemplates the possibility that the court will give directions. Three circumstances in which it would be appropriate to apply for directions were identified in the *T&D Industries* case: (1) where there is dispute between one or more of the creditors as to proper course to take, (2) where there is a point of principle that needs determining, or (3) where the proposed action falls outside the purposes for which the administrator was appointed. The last of these, however, is unlikely to be of relevance in a Schedule B1 appointment, since there is only one purpose of administration.

The new statutory provisions reinforce the importance of the above points. In the first place, whilst under section 23 of the Act an administrator was required to convene a creditors' meeting to consider his proposals 'within 3 months (or such longer period as the court may allow)', Paragraph 51 of Schedule B1 requires the administrator to send his proposals to creditors '(a) as soon as is reasonably practicable after the company enters administration and (b) in any event, before the end of the period of eight weeks beginning with the day on which the company enters administration.' Moreover, the date set for the meeting of creditors (unless one is not required) must be 'as soon as reasonably practicable after the company enters administration ... and in any event within the period of ten weeks beginning with the date on which the company enters administration'. The greater urgency incorporated by the new provisions is likely to mean the court will need greater persuasion as to why, in any given case, there was insufficient time to convene a meeting of creditors.

Further, it is important to appreciate that under the Enterprise Act an immediate sale of the company's business is unlikely to be compatible with the first objective of administration – rescuing the company as a going concern under paragraph 3(1)(a) of Schedule B1. An administrator is positively required to perform his functions in accordance with the objective specified in paragraph 3(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.' Whilst this involves an element of subjectivity (i.e. having regard to what the administrator 'thinks') the courts will inevitably require the administrator (in any subsequent challenge to his actions) to establish that he had reasonable grounds for thinking as he did. The questions to which the administrator will need to have answers are likely to include what steps he took to consider the alternatives to a sale, what expert advice he took, whom he consulted and what reasoned conclusions he reached.

Moreover, the administrator is required (at the time that he makes his statement setting out his proposals for achieving the purpose of administration) not only to have, but also to articulate, his reasons for thinking that the objective of survival of the company could not be achieved: see paragraph 49(1)&(2)(b). A possible consequence of laying his thought processes bare is that any shortcomings in that process will equally be laid bare. On the other hand, the requirement to give an explanation for the decision is itself an incentive to take care in making that decision.

Finally, it is important to note that given the single purpose of administration and the hierarchy of objectives in paragraph 3 of Schedule B1, the scrutiny that an administrator can expect is likely to go beyond the question whether in all the circumstances the best price was obtained for the assets, but will include consideration of whether it was appropriate to be selling the business at all, or whether the administrator ought to have made attempts to rescue the company.