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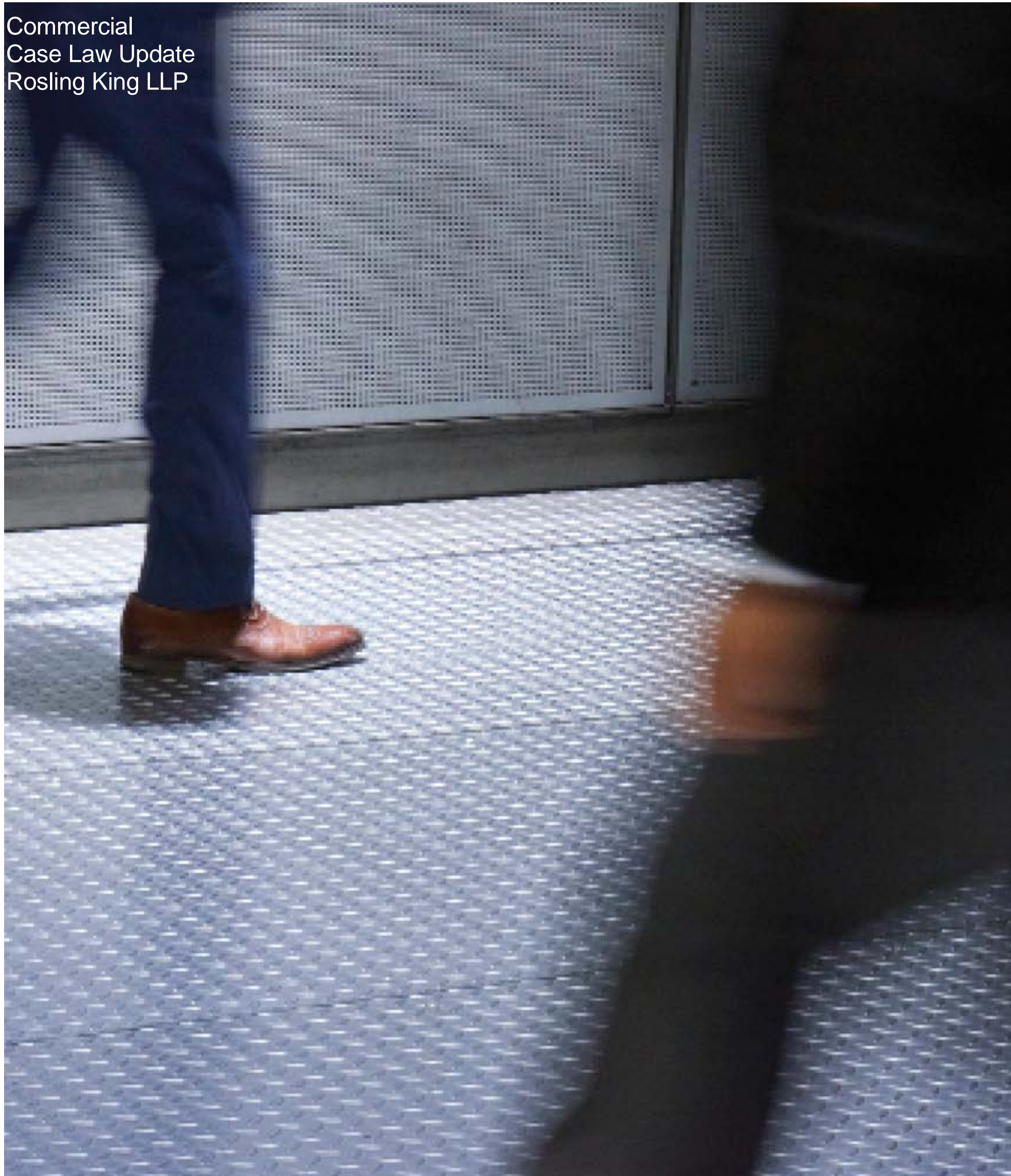

Commercial Case Law Update

Rosling King LLP

Background to the Case

In this case, the High Court scrutinised the conduct of the administrators appointed by a secured lender, Dunbar Assets plc, over a company, Angel House Developments Limited, whose sole asset was an office block in the London Docklands. The sole shareholder of the company had accused the administrators of breaching a number of duties. In particular, it was claimed that they had conducted a "light touch" administration in which they failed to exercise independence and instead paid excessive regard to the appointing lender's interest resulting in the sale of the property at an undervalue. The administrators appointed agents to sell the property, who had been recommended by the lender and had been incentivized by agreement to sell the property.

In reaching its judgement in favour of the administrators, the Court reiterated a number of key principles which administrators as well as appointing lenders will find helpful.

Choosing the Objective of the Administration

At the outset, administrators have to decide which of the three statutory objectives can be applied in the administration; namely, (1) rescuing the company as a going concern or (2) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up or (3) realising property to make a distribution to one or more secured or preferential creditors. As a general principle, administrators are required to have regard to the interests of all the company's creditors. Therefore, they should only embark upon realising assets to repay a specific creditor if they think that it is not reasonably practicable to achieve anything else (and does not unnecessarily harm the interests of the creditors as a whole). However, this decision by the administrators is afforded a degree of latitude and is not to be second-guessed lightly by the Court with the benefit of hindsight.

In fact, it should only be challenged where the decision not to rescue the company was made in bad faith or was clearly perverse in the sense that no reasonable administrator could have made the decision. This approach however does not extend to the methods adopted by administrators to achieve the objective, which are subject to a more objective standard of review.

There is no fundamental rule requiring administrators to go through a consultation process with the directors and shareholders (although it may be sensible in most cases) or, still less, that the administrators should seek their confirmation that rescue of the company as a going concern is not feasible. However, once administrators have decided to sell a property for a distribution to a secured creditor, their statement of proposal should explain explicitly why they thought that their proposed course of action would not be likely to result in the rescue of the company or a better realisation for creditors than a liquidation. If an explanation is not given, the statement will be defective. Nevertheless, this defect will be of no consequence if administrators attempt to achieve the proposed objective of the administration.

Appointing Agents

When appointing agents, there is no hard and fast rule stating that administrators should carry out a "beauty parade" (i.e. selecting from a range of agents after they have pitched their

services). Such a decision will be determined on the facts of each case and there might be practical reasons against it, such as agents' limited scope of duties and the pressure of time in an administration.

Similarly, there is no rule prohibiting the appointment by administrators of agents who have been recommended by the secured creditor. The essential question in all cases will be whether the agents to be appointed are competent and able to discharge their fiduciary duties to the company. This will depend upon the precise nature of the duties and all the circumstances of an individual case.

Agreeing Financial Incentives with Office Holders or Agents

The Court commented that agreeing and providing a financial incentive to office holders and/or agents to sell an asset at the level exceeding the debt secured by the property is not an issue. In fact, it might be in the interests of unsecured creditors. When assessing the appropriateness of the incentive, the levels at which the incentive is designed to operate compared to the likely range of sale prices and the amount (i.e. the percentage and absolute amount) of the incentive should be taken into consideration.

Relying on Agent's Advice

The Court also confirmed that, if administrators make decisions based on advice from agents who appeared to be competent, they cannot be held to have acted negligently.

Advertising Property

It was further stated that there is no rule requiring administrators to advertise the property on the open market. It is the nature of the asset and the relevant market that will dictate the steps required to discharge the administrators' duty to take reasonable care to obtain the best price. It was recognised that while broad marketing is in administrators' interest to discharge their duties, it could deter some bidders from participating.

Selling Property

When it comes to sale of the property, administrators' duties in acting as agents of the company are not analogous to those of trustees. Namely, administrators owe a duty to take reasonable care to obtain the best price in the circumstances and the standard of care is that of an ordinary, skilled insolvency practitioner.

Moreover, administrators are required to have regard to the interests of a wider group of stakeholders than just of the secured creditor. If that is not adhered to, this could amount to a breach of fiduciary duty. Administrators (unlike administrative receivers and fixed charge receivers) cannot, therefore, sell a company's assets at a specific time to solely suit the secured creditor's interests.

Conducting Administration

The general rule is that administrators must exercise independent judgment at all times. They must not allow another person to dictate how they should exercise their powers as administrators. However, administrators are entirely at liberty to consult with those creditor(s) whose interests are likely to be affected by their decisions to ascertain their views. In fact, in

many cases it will be sensible for them to do so. They are not, however, bound to follow the creditors' views.

The Court specifically stated that, in a situation where the secured creditor benefits from a fixed charge, an agency relationship will be created between the administrators and the secured creditor, resulting in the secured creditor being liable for any breach of duty to the company or any other party interested in the equity of redemption.

Secured Creditor's Liability

Where the secured creditor or another third party try to dictate the course of an administration, they are exposing themselves to the risk of being held liable in tort for procuring a breach of statutory duty by administrators. For such a claim to be successful it would have to be shown that the secured creditor knew or was reckless as to whether the administrators were in breach of a duty owed to the company.

Commentary

While the case turned largely on the facts, the judgment provides useful guidance on administrators' duties and the interaction with the secured creditors that often appoint them. Administrators must always have regard to their statutory duties and ensure they can justify their methods independently to avoid criticism. Secured lenders must ensure that, whist they can liaise with the administrators and express views, they avoid being seen to influence the administrators in a way that compromises the administrators' independence.

For further information, please contact Alexander Pelopidas or the Partner with whom you usually deal.