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BUYING FROM AN ADMINISTRATOR

By David Morrison and Dominic Palmer

The increase in corporate insolvencies is an unfortunate side effect of the current economic climate but it has undoubtedly created tempting opportunities. If executed properly, acquisition from an administrator (or other insolvency officeholder), permits a purchaser to obtain assets free and clear of encumbrances, but these purchases differ from ordinary transactions.

Key differences

When contemplating this type of deal, purchasers must understand that administrators have limited knowledge of the sale assets. Therefore they will not give title guarantees and will exclude all personal liability. Administrators sell "such right, title and interest as the seller may have (if any)", and rarely give warranties or indemnities in relation to the assets. Certain concessions are possible (such as a warranty that the administrator has not encumbered assets during the course of the administration) but these are seldom given.

The absence of title guarantees, warranties and indemnities reinforces the need for a thorough due diligence exercise, but this is rarely possible. Due diligence can be just a site visit or a day or two in a hastily arranged data room. Ultimately, purchasers have to get comfortable with the risks inherent in this type of deal. Insolvency sales are rapid transactions where speed and ready cash are vital bargaining chips. The key is to ensure gaps in the purchaser's knowledge are reflected in the purchase price.

What are you buying?

Purchasers can encounter difficulties that would not be expected in an ordinary transaction. Obviously, these will vary dependent on the asset but below are some common issues and suggestions for tackling them.

Reservation of title ("ROT") and hire purchaser/leased assets – ROT clauses may apply to stock, and large ticket items can be subject to hire purchase agreements meaning good title cannot be purchased. Where possible, identify these assets and exclude them from the sale price. Where items are crucial, approach the finance providers to ensure they will remain in place. Always consider the costs of removal of items from premises and watch out for access issues where landlords are hostile.

Land/buildings – ideally leases will be assigned, but this can be time consuming, requiring landlord's consent (at your cost) and agreement over treatment of outstanding rent. If you need access in the interim, consider requesting a short term licence to occupy the premises from the administrator, but be aware these are typically terminable without notice and can breach the lease.

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Customer/Supplier contracts – potentially valuable agreements may have been terminated on administration and therefore excluded from the sale. Initiate contact with key customers and suppliers as early as possible and take steps to sustain and rebuild crucial relationships. Include a further assurance clause in the sale agreement requiring the administrator to take reasonable steps to assist in the contract transfer (normally at your cost).

Stock/work in progress – because post completion price adjustments are unusual and limited due diligence can make value difficult to ascertain pre-completion, estimate conservatively.

Book debts/receivables – often excluded from the sale. The administrator may require the purchaser's assistance in collecting pre-appointment book debts and there is often scope for commission. Consider such arrangements as they may be a useful way of managing relations with customers.

Employees – the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE") can be a crucial consideration. Under TUPE, employees of an insolvent company may automatically transfer to the purchaser. Dismissals of staff by the administrators or the company prior to the sale will not necessarily circumvent TUPE, and worse, may give rise to claims against the purchaser for unfair dismissal. TUPE applies by operation of law even if the sale agreement states it is for assets or specifically excludes employee liabilities. Purchasers should obtain as much information as possible regarding existing and recently dismissed employees. Seek advice as to whether any potential issues arise and, if they do, reflect them in the purchase price or seek an indemnity.

Payment – administrators may require the consideration to be paid into the administrator's solicitor's account (and held to the purchaser's order) prior to completion. It is possible to negotiate payment in instalments or retentions, but in competitive bidding situations an administrator may well deal with whoever offers the best cash deal up front, rather than the highest bid.

Is this for you?

We have only scratched the surface of the issues that can arise in these transactions and any purchaser, new to this sector, will require guidance if he is to navigate that minefield. However, so long as discount prices remain available, there will be candidates willing to brave the risks and, as so long as the risk/cost ratio is right for you, these deals can be a great way to secure a bargain.

Pre-packs and the future

Finally, we should mention "pre-packs". These are pre-arranged sales where the directors and secured lenders agree in advance with a proposed administrator to sell the business as a going concern (often, although not exclusively, to a company formed by existing management), immediately on the administrator's appointment. The opportunity to get involved in these deals is limited as normally they occur before third parties hear of the administration. Pre-packs can represent the best chance for a business rescue and preservation of goodwill and employment, but have attracted negative attention for being open to abuse. The SIP 16 guidelines were introduced to increase the transparency of pre-packs. In reality they enforce what was previously 'best practice'. It is too early to tell whether the guidelines will have real commercial impact but as increased transparency may benefit administrators by pre-empting complaints, it seems unlikely that the pre-pack will be disappearing.