Purchasing businesses out of administration
Deal features - points to consider and key risks

What is administration?

Administration is a form of collective insolvency procedure pursuant to which one or more insolvency practitioners are appointed as the company's administrators, in order to manage its affairs, business and property with a view to achieving one of the three statutory objectives set out in the Insolvency Act 1986:

- rescuing the company as a going concern;
- if that is not possible, achieving a better result for the company's creditors as a whole than would be likely if the company were wound up; or
- realising property in order to make a distribution to one or more secured or preferential creditors.

In practice, however, administrators are rarely able to achieve the first of these objectives, so swiftly move on to the second or third objective. They usually achieve these objectives by selling the company's business and assets.

What is an administrator?

The administrators take over the control of the company's business and assets from the company's directors in order to achieve one of the statutory objectives discussed above. An administrator acts as the company's agent, and has wide powers to trade the company and deal with its assets.

Buyer beware

There are several factors that make transactions involving the purchase of an insolvent company's business and assets distinct from typical private M&A transactions, both in terms of the process and the deal terms.

Instead of being a share sale, the transaction will usually be structured as a business and asset sale, with the insolvent company as the seller. The company will be acting by its administrators, rather than its directors, and the administrators will be under a duty to take reasonable steps to obtain the best price reasonably obtainable in the circumstances. Time will also be of the essence – the longer the business remains in the hands of the administrators, the greater the risk that the value of its assets will deteriorate.

In general, buyers must accept that they will incur more risk and enjoy less protection (both practical and contractual) than they would in a typical private M&A transaction. The administrators are likely to have very little background knowledge of the business, and as a result the due diligence exercise may be extremely limited and the buyer's warranty protection under the Business Purchase Agreement (BPA) will be negligible. There will also be no recourse to the administrators, who instead will often expect indemnities from the buyer in respect of certain of the assets being sold. Against this, however, the risk that the buyer is taking is likely to be represented in the price it pays for the assets, which can often be significantly lower than if the seller were solvent.

This note covers the key risks that prospective buyers face when buying companies from administrators and how those risks can be mitigated. It does not cover features which are common to all asset deals, such as consent requirements from contract counterparties or data protection issues.

Deal feature	Points to consider	Key risks	How to mitigate
Title to assets and encumbrances	▪ Rather than being able to say definitely what assets it is selling, the seller (acting by the administrators) will only sell such right, title and interest as it may have – if any – in the assets being sold. ▪ Similarly, the BPA will say that the assets are acquired subject to any encumbrances (rather than free from an encumbrances, as in an ordinary transaction).	▪ The buyer will have no entitlement to a refund of the purchase price and no other recourse against the seller should it later transpire that the seller did not own assets which the buyer believes it is acquiring or if the asset is subject an encumbrance. For example, title to assets that the buyer believes the insolvent company owns may turn out to be held by a different company in the group which is not in administration. ▪ In addition, the buyer will be obliged to indemnify the administrators if, as a result of the buyer acting as if it were the owner of or entitled to use the relevant assets, the actual owner claims against the administrators.	▪ Some comfort may be gained by the administrators covenanting that the business and assets are being sold with whatever rights, title and assets the seller may have (i.e. it is selling everything that it has in relation to the business). Where encumbrances are the result of registered charges, these can also be identified from searches at Companies House and then released prior to completion. ▪ However, the fundamental risk that the seller does not own the relevant assets, or that the assets are subject to unknown encumbrances, may ultimately need to be reflected in a lower purchase price. ▪ Insurance may be available, however it is usually expensive and is rarely seen in practice.
Negligible warranty protection	▪ In addition to the seller only selling what title it may have (if any) to the assets, the administrators will have limited knowledge of the assets being sold and so will typically offer no warranties. ▪ Even a buyer in a very strong negotiating position will only be able extract limited warranties pertaining to matters which are within the administrators' own direct knowledge and control (i.e. warranties concerning steps taken by the administrators during the course of the administration).	▪ The buyer will have no recourse against the seller for those matters which would ordinarily be covered by warranties on a solvent sale.	▪ A buyer in a particularly strong negotiating position may be able to mitigate its risk by placing part of the purchase price in escrow for a short period of time. ▪ Administration is, however, a time-limited process and, where there are secured creditors, those creditors will expect the administrators to make a distribution of the sale proceeds to them sooner rather than later. As a result, the administrators will resist any escrow and, even if they concede the point, will only agree to an escrow lasting a few months at most. ▪ Ultimately, the lack of warranty protection may again need to be reflected in a lower purchase price.

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Cherry-picking assets	▪ The buyer can negotiate to acquire only those assets of the seller which it wishes to acquire. ▪ Other than certain employment, environmental and pensions liabilities, the buyer is also not obliged to take on any existing liabilities of the seller, except to the extent that it is willing to agree to do so. ▪ The default position is that, unless an asset is listed as being sold in the BPA, it will be excluded from the sale.	▪ While this ability to cherry-pick is generally a positive feature of acquisitions from administrators (and of business and asset acquisitions generally), the requirement to specify the assets being acquired can mean that assets that are needed for the continued operation of the business are not acquired. ▪ This risk is exacerbated by the combination of a lack of warranties (especially regarding sufficiency of assets), limited due diligence (which might otherwise enable the buyer to identify the assets needed) and the lack of a full title covenant in respect of the assets being sold. ▪ This will be a particular risk where the insolvent business is being carved-out from a group (whether insolvent or not) or from a company that operates multiple businesses (e.g. if it trades under distinct brands).	▪ The buyer should take extra care to ensure it has identified all of the assets it needs to acquire to run the business and that such assets are all referred to in the BPA (ideally specifically, but also generically). ▪ In the event that neither the buyer nor the administrators were aware at the date of the sale that a particular asset existed, it may also be possible to acquire such asset separately after completion. The administrators could in theory charge the buyer a ransom price for that asset, but rarely do so in our experience.
Administrator indemnities	▪ The BPA will ordinarily contain a variety of indemnities in favour of the administrators and the seller. ▪ These are intended to cover situations where, as a result of the buyer's post-sale actions, either the administrators might suffer personal liability or new liabilities may arise which would rank ahead of the seller's existing creditors. ▪ Such indemnities are typically found in clauses relating to ongoing company contracts, intellectual property, retention of title and other third party assets, employee claims, and data protection.	▪ The buyer might incur liability to the administrators or the seller as a result of its actions following the sale.	▪ The buyer can make it clear that its indemnities will not extend to any liability which would only rank as an ordinary unsecured liability of the seller and does not impose personal liability on the administrators. ▪ Despite the number of indemnities commonly found in such agreements, our experience is that these are largely precautionary – we have rarely seen an administrator actually call on such an indemnity.

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VAT	▪ If the business is continuing to trade, the acquisition is likely to be a transfer of a going concern (a TOGC). If it is a TOGC, there is no VAT on the purchase price. ▪ Even if VAT would ultimately be recoverable, TOGC treatment offers a cashflow benefit (and a SDLT saving if transferring properties, as SDLT is paid on VAT-inclusive consideration for properties).	▪ If the business has been significantly wound down or the buyer is taking little more than a collection of assets, the acquisition may not qualify as a TOGC. ▪ If any land or properties are being acquired, there may be further conditions to meet to ensure the acquisition is a TOGC. It can be difficult to establish whether these conditions are required, given the limited information typically provided by administrators. ▪ Administrators are likely to want the buyer to indemnify them against interest and penalties if the acquisition is not a TOGC.	▪ The buyer should establish whether the administrators are expecting to treat the sale as a TOGC (as it is the administrators that are primarily liable to account for any VAT to HMRC). ▪ If any properties are being transferred, and insufficient information is available to determine whether there are additional conditions to meet for TOGC treatment, the buyer may take steps to meet certain additional requirements regardless of whether relevant conditions are met (e.g. provide for elections to “opt to tax” the properties and an “article 5(2B) notice” in the BPA). ▪ The buyer should try to limit any indemnity relating to interest and penalties from the acquisition not being a TOGC, such that the indemnity only covers circumstances where this is a result of a failure by the buyer.
Capital allowances	▪ Any capital allowances (i.e. tax deductions for depreciation in value) in connection with fixtures at any property being transferred will only pass to the buyer if the parties make a “section 198 election” to fix the disposal value of the fixtures for tax purposes.	▪ Administrators may not have the information available to them before signing the BPA to confirm the available capital allowances.	▪ Parties have two years from completion to make a section s.198 election. As a result, the parties can agree in the BPA to make the elections within, say, 30 days of completion. ▪ While this is a practical solution not to delay completion, the risk is that the s.198 election is never signed because the administrators are under less pressure once completion has occurred.
Unpaid suppliers	▪ The seller’s creditors are likely to include many of its suppliers.	▪ The buyer may in practice need to agree to pay at least some of the seller’s debts to these suppliers in order to persuade them to supply the business in the future.	▪ To clarify the position, the buyer may expressly agree to take over the responsibility for paying particular debts in full and negotiate a lower price to reflect such liabilities.

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Third party assets	▪ As with any asset sale, title to any assets which are in the possession of the seller, but which are owned by third parties, will not pass to the buyer on completion. ▪ Unlike a normal asset sale however, the administrators may not be able to identify easily which assets belong to the seller outright and which do not, especially in the case of stock. ▪ Third party assets in this regard will include stock which is subject to a valid retention of title claim and assets which are leased to the company.	▪ The administrators' concern is that they may be sued personally for passing possession of such assets to the buyer without the consent of the supplier/owner. ▪ The administrators will want the BPA to require that the asset in question be returned to the third party if matters cannot otherwise be resolved with that third party, and to contain an indemnity from the buyer to the administrators and the seller against any related loss they may suffer.	▪ The commercial reality is that, provided the buyer wants the third party assets in question, matters are likely to be resolved between the buyer and the supplier/owner of those assets. The supplier/owner will prefer in most cases to reach a deal with the buyer, rather than recovering and re-selling or re-letting the assets (particularly if such assets are depreciating in value). ▪ However, if the buyer's diligence suggests that a substantial number of the assets it is expecting to acquire may be third party assets, consider negotiating the price downwards in recognition of this.
Employee considerations	▪ As these transactions are structured as asset sales rather than share shales, the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) will apply. ▪ TUPE operates to transfer in-scope employees automatically to the buyer. Employees move on their existing terms and with most of their existing liabilities (which is an exception to the general principle that the buyer can cherry pick liabilities). ▪ Changes to terms, redundancies and other dismissals are more difficult where TUPE applies.	▪ Because warranty and indemnity protection is typically unavailable when buying an insolvent business, the buyer's ability to manage risk is limited. ▪ The buyer may not want all in-scope employees. ▪ The administrators may have dismissed some employees before sale, e.g. to make the business more attractive. Such dismissals may be unfair and liability will pass to the buyer where the dismissals are deemed to be connected to the sale. ▪ TUPE mandates an information process with affected employees, with a sanction of 13 weeks' pay per employee for non-compliance. Given the pressure to effect the sale as soon as possible, it may not always be feasible to undertake the information process pre-completion as required.	▪ Some employee debts will be left behind, to be paid from the National Insurance Fund. ▪ Any changes to the workforce, either to employee numbers or to employment contracts, should take place post-completion. If a redundancy process is required, it will come at a cost. ▪ Transactions with a split signing and completion typically avoid the difficulties relating to the timing of the information process required by TUPE, as that process can be carried out in the period between signing and completion.

Deal feature	Points to consider	Key risks	How to mitigate
Book debts	▪ The seller's book debts (i.e. amounts owed to it by third parties) are generally excluded from a sale by an administrator.	▪ Where customers of the seller will continue to be customers of the buyer, the administrators will want to make it clear that any amounts collected by the buyer from such customers are applied first to book debts owed to the seller, prior to being applied to new debts owed to the buyer. ▪ If the administrators are permitted to continue to collect the seller's book debts, they may be more heavy-handed than the buyer would be, as they are likely to worry less about damaging an ongoing relationship.	▪ The buyer will ordinarily agree to collect the seller's book debts as agent for the seller. ▪ The buyer may be able to negotiate a fee for doing so, to be deducted from proceeds before paying the balance to the administrators, however this is rarely agreed in practice.
Premises	▪ Where the seller occupies its premises as the tenant under a lease, the administrators are unlikely to be able to transfer the lease to the buyer without the landlord's consent. There will rarely be time to arrange this before completion. ▪ The administrators will generally grant the buyer a licence to occupy the premises in consideration for the payment of a regular (usually monthly) licence fee equal to the amount of rent and other outgoings payable under the lease for the period of the licence to occupy. ▪ The licence to occupy will usually be granted for a period of up to six months, during which the buyer will seek to negotiate an assignment of the lease, or a new lease, with the landlord, or to move to a new property.	▪ The risk is that the landlord does not consent to the transfer of the lease to the buyer and so the buyer does not acquire the premises that it requires. ▪ For the duration of the administration there will be a moratorium which prevents landlords from enforcing the forfeiture provisions under the lease without an order of the Court or the consent of the administrator. The Court is usually reluctant to grant such an order if the amounts due under the lease continue to be paid. As a result, despite the grant of a licence to the buyer being a breach of the lease, the landlord will not be able to evict the buyer so long as the administrators continue to pay the amounts due under the lease (which will be funded out of the licence fee paid to the seller by the buyer). ▪ This is only a short-term solution, however, as the licence will usually only last for up to six months. If the licence expires and the buyer has not negotiated an assignment of the lease or a new lease, it will be required to vacate the premises. The uncertainty about the final outcome can also impact employment and capex decisions by the buyer in relation to the premises.	▪ In our experience, most buyers negotiate successfully with the landlord for the assignment of the lease, as they do not want the costs and loss of income that will result from having to re-let the premises. ▪ This is particularly true in the current pandemic, as the balance of negotiating power has shifted towards tenants and away from landlords. ▪ The buyer may seek to mitigate some of the potential financial loss by only agreeing to pay the seller for the premises once landlord consent is obtained (and only paying a licence fee in the meantime). However, the time-limited nature of administrations means that administrators will likely push back on this.

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