

Look before you leap

Anthony Judge offers some practical advice to negotiating the minefield of insolvency purchasing

IN BRIEF

- A key duty of an insolvency practitioner is to obtain the best price possible for the assets he is selling.
- Buyers paying a reduced rate in an insolvency sale must accept the correspondent risks.

In this economic climate, property speculators are shopping for cut-price properties being sold by distressed sellers, and we are starting to see insolvency-related sales.

When property is marketed by an agent on behalf of an insolvency practitioner (IP) the burden of verification is on the buyer, who must conduct due diligence investigations. Sales particulars from the IP tend to provide little information. A key duty of an IP is to obtain the best price reasonably obtainable for the assets he is selling. IPs frequently conduct parallel negotiations with a number of interested buyers and contract races are not unusual.

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THE PURCHASE CONTRACT

The IP's lawyers will prepare the first draft contract and transfer with no covenants, warranties or indemnities in favour of the buyer. The extent to which this is negotiable will depend on relative bargaining positions. Because title to the assets remains with the company, the company will be the contracting party (acting through the IP as agent). The IP is also usually a party in its own name so it can sue on the contract and enjoy the benefit of the protective clauses, but will rarely agree to personal liability.

As part of its due diligence the buyer will need to establish the validity of the IP's appointment. If the appointment is invalid the IP's acts can be challenged by creditors of the insolvent company, its directors and

shareholders. Because the IP will not have investigated title, IPs generally transfer only "such right, title and interest" in the property as the company has. In practice, the buyer may be able to satisfy itself as to the company's title through its normal investigations (particularly if the property is registered).

Although warranties or indemnities from the company are likely to be of negligible value, the IP will generally decline to give any. In practice, there are certain covenants that an IP may be persuaded to give, such as a covenant that he has not personally encumbered the property, and to insure between exchange and completion. Acting for the buyer, it is better to obtain a personal covenant from the IP rather than from the insolvent company—if you can persuade him to accept liability.

VALIDITY OF APPOINTMENT

Administrative receivers, administrators and receivers

The buyer can request a warranty from the receiver's lawyers that the receiver has been validly appointed, but this is unlikely to be forthcoming.

The buyer can rely on s 42(3) of the Insolvency Act 1986 (IA 1986) pursuant to which a person dealing with an administrative receiver in good faith, for value, need not enquire whether the receiver is acting within his powers. Paragraph 59(3) Sch B1 extends the same protection to administrators. Further, under IA 1986, s 232 the acts of an administrative receiver are valid notwithstanding any defect in his appointment. Paragraph 104, Sch B1 applies in the case of administrators. While helpful, doubts exist as to the meaning of "in good faith", and it is thought that s 232/para 104 are of no use where the debenture is invalid or where the appointment has been terminated or never existed. The buyer should obtain and check:

- The appointment and acceptance of appointment. If there are two receivers or administrators, check whether they can act jointly and severally.
- The debenture. Note that the ability

of the secured creditor to appoint joint receivers must be provided for here.

- Confirmation from the receiver's lawyers that a demand was properly made under the debenture or other circumstances entitling appointment properly arose.
- A company search to see if the debenture was duly registered under s 395 of the Companies Act 1985, whether there are any other charges over the assets (where consent may be required), and whether the appointment of the receiver or administrator has been notified to the Registrar of Companies. Where dealing with administrators, the court's consent may be required for disposal of assets free from charges or other encumbrances, in which case the buyer should seek a copy of the relevant court order.
- In relation to an administrator, where an initial creditors' meeting has taken place, a copy of any creditors' resolutions approving the administrator's proposal.

Liquidators

Section 232 of IA 1986 applies to liquidators as well as administrators and receivers. The buyer should obtain a copy of the liquidator's appointment (a copy of the chairman's certificate in a voluntary winding-up or a sealed copy of the court order for a winding up by the court) and, if in doubt, check his status as an IP. Again, the appointment should confirm whether joint liquidators can act severally. Undertake a company search to establish that no notice of resignation or removal has been filed.

ADDITIONAL CONSIDERATIONS

Pre-contract enquiries

An IP will usually refuse to answer pre-contract enquiries. He will claim not to know more about the property than the buyer could find out through investigation, although he may be prepared to provide information without legal recourse. In practice, if an IP has been in place for some time and has effectively been managing the property, one should expect replies to enquiries, albeit limited to the state of knowledge of the IP and to the duration of his role.

Leasehold property

Leasehold property (particularly a rack rent lease) may be subject to forfeiture by virtue of the insolvency, and assignment will probably be subject to landlord's consent. If the property is part of a business, eg a hotel, the delay in obtaining landlord's consent may be unduly prejudicial to the business.

The IP may be prepared to grant a licence to occupy until consent is obtained, provided that all risks (including forfeiture for parting with possession in breach of covenant) fall to the buyer who in turn indemnifies the IP. Where a significant value is attributed to the premises, the buyer may be able to negotiate a retention from the purchase price until the landlord's consent is forthcoming.

Location of documents

A perennial problem with buying assets from IPs is the lack of complete documentation relating to the property being sold. A buyer should not simply accept, however, a statement from an IP that information is

not available. It can often be found if there is pressure on the IP to check the company's and mortgagee's available records.

Tax considerations

Tax issues are beyond the scope of this article, but you should be aware that:

- the IP may not have access to all of the company's tax (including VAT) records;
- it may be unclear whether a VAT election has been made for a property or whether the IP should be using the company's VAT registration;
- the IP may not know the capital allowances history of a property.

Approval of mortgagee

Although principally the seller's concern, the buyer should ask for confirmation that the consent of any mortgagee to the sale has been obtained before contracts are exchanged. As the company is insolvent it may well be that a mortgagee will not be fully repaid. The buyer will have very limited recourse against the company or IP

if they are unable to complete the contract in accordance with its terms because a mortgagee will not release its security on completion.

"A perennial problem with buying assets from IPs is the lack of complete documentation relating to the property"

IPs often take an aggressive negotiating stance, so the most important message for a buyer is to carry out appropriate due diligence on the property and the appointment itself. If a buyer is in a strong position then an IP can sometimes be persuaded to give quite detailed information and may even be prepared to accept limited liability relating to matters within their control. That said, the commercial reality is that a buyer is paying a reduced price to reflect the fact that it is an insolvency sale and must accept the correspondent risks.

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