What You're proposing: meeting a challenge to the remuneration of administrators

What happens when the creditors fail to approve office holders' remuneration or they reduce it to an unacceptable level? A number of our Insolvency Practitioner ("**IP**") clients have met this hurdle recently, leading to applications to the High Court to approve or increase the level of their remuneration.

Here we look at what is involved in an application, how the courts exercise their discretion in practice and the risks to office holders.

Guiding principles: detail is everything

When planning creditor resolutions to approve remuneration and canvassing for support, office holders should keep in mind that if these are not approved, any application to court to permit payment of the IP's fees will be inherently time-consuming, costly for creditors and may present risks to the IP's firm – including the risk that the Court will reject even a well-prepared application outright.

The Practice Direction for Insolvency Proceedings ("**PDIP**") requires very detailed evidence, organised under 9 separate headings (or "**Guiding Principles**") in support of any remuneration application. These are intended to ensure that the amount and basis of remuneration is *fair, reasonable and commensurate with the nature and extent of work properly undertaken or to be undertaken by the office-holder*.

The PDIP explicitly places the onus on the office holder to justify every element of their costs – if there is any doubt as to whether a cost item is appropriate, it is to be disallowed. In Re Friar (2011), for example, the Court reduced remuneration by 30% on the basis that there was no detailed narrative of the precise work undertaken,

and time had been recorded in 30 minute blocks, so the value of the work to the creditors was not clear. Thus, although the PDIP suggests that the evidence provided should be proportional to the asset values, amount of remuneration and complexity of work done, the risk of having costs disallowed means that most office holders will err on the side of providing as much detail as possible.

In theory, this is supposed to ensure that remuneration requests are *"fixed and approved by a consistent and predictable process"*. In practice, we have found that this is not the case. The presumption against IPs' costs and the sheer volume of evidence the unfortunate judge must review means that the level of fees approved seems to depend more on the attitude of the court to the applicant and their conduct of the case than the PDIP's drafters intended. And where multiple hearings on an application involve different judges, a consistent judicial approach cannot be relied upon.

The upshot for office holders is that office holders' staff will spend many hours reviewing time records and disbursements, and preparing detailed statements justifying every element of their fees. Weeks of staff time may be required, leaving office holders unable to deploy staff on other jobs and building up significant "WIP", some or all of which may ultimately be disallowed by the Court.

The 'Full Monty'

One of our recent cases illustrates the scale of the problem for office holders.

Following modifications to creditor resolutions which imposed arbitrary reductions to administrators' pre and post appointment fees, our clients were forced to apply to court.

Mindful of the PDIP and Re Friar, our client's application to the Court for an increase in their remuneration was accompanied by a 72 page witness statement and a 270 page exhibit, following the Guiding Principles to the letter. Despite the considerable costs incurred by the administrators and their legal team in preparing the evidence, the Judge acknowledged that the PDIP required that level of detail.

Multiple hearings before different judges required nearly a year of time before a final hearing (which eventually took place after the case had moved from administration to voluntary liquidation) and supplementary witness statements had to be prepared to keep the Court abreast of developments in the case. Due in large part to the costs of the application and multiple hearings required by the courts, the IPs' total remuneration was by then over £300,000. This was ordered to be paid in full save for £2000, plus all legal costs of the application. The number of hearings and weight of evidence had imposed substantial burdens on the office holders' firm, lengthened the insolvency proceeding and absorbed realisations which could have been used to pay creditors.

But does this painstaking exercise have to be undertaken each time remuneration is not approved in the amount an office holder seeks?

The minimalist approach

The PDIP does permit the judge hearing an application to "summarily determine" an application. In unusual circumstances, Courts may use this discretion to approve remuneration without the full evidence which the PDIP assumes will be provided.

In a recent matter we were involved in, an unsecured creditor holding almost all of the voting debt voted against the Administrators' proposals and post-appointment remuneration, not having had proper legal advice and despite standing to receive a very substantial dividend. Once the effect of his vote was explained to him, the creditor changed his mind, but in the circumstances the administrators had no option but to seek directions and Court approval of their remuneration.

As an application following the Guiding Principles to the letter would have incurred substantial costs, we made an application requesting approval of the administrators' costs on a summary basis, supported by a brief witness statement explaining the unusual facts and exhibiting the office holders' time-costs ledger.

Since the course the office holders had to pursue was a sale of the company's sole asset, which had been achieved by the final hearing, and all creditors were now supportive, and the costs of a full remuneration application would severely reduce dividends, the Court agreed it was appropriate to approve remuneration on a summary basis.

Room for flexibility?

The above case suggests that in the right situation a court may depart from the normal requirements of the PDIP and take a more flexible and practical approach. However, convincing argument from your barrister and a carefully worded witness statement explaining to the Court why a departure from the normal requirement for detailed evidence is justified will be needed.

A request to the Court to approve remuneration on a summary basis might work in circumstances where some or all of the following elements are present:

- there is no dispute as to the course the office holders must pursue;
- there is support from all major creditor constituencies;
- there is evidence that deciding votes were submitted in error;
- there is evidence that the cost of an application will substantially harm the creditors / reduce a dividend;
- the assets of the insolvent company are very small; and/or
- there has been no criticism of the office holders' conduct.

IPs should bear in mind that unusual circumstances which make a summary disposition necessary to protect the creditors – as opposed to the legitimate expectations of the office holders – are likely to be required.

The Court will have in mind the fact that an application to increase or fix remuneration will only come before it because creditor approval has not been obtained. Substantial creditor support for the IP or evidence that the creditors voted against their own interests is thus not likely to be sufficient for a Court to dispense with strict compliance with the Guiding Principles. The PDIP clearly intends judges to give remuneration applications close, independent scrutiny and a judge is only likely to feel confident in making a summary determination where unusual circumstances have led to remuneration being fixed incorrectly and where the request for summary determination is clearly in the interests of the creditors.

The lesson to IPs is to ensure office holders and staff consider the implications of a failure to obtain fee approval at a first meeting or decision procedure, that appropriate resources are put into obtaining the necessary votes, and ideally that a viable backup plan exists to manage the appointment should fee approval not be obtained.

If you are an IP concerned about obtaining approval to your remuneration, or a creditor questioning the level of remuneration, we would be happy to advise on the best way forward. Contact our insolvency team.

Ian Lindley

Partner