



Briefing Sheet

Pre-pack administration

Background

Following the adoption of the Enterprise Act 2002, Administration has become the gateway to corporate insolvency. When a business needs to be rescued there are often genuine worries about maintaining value – both for existing creditors and for prospective purchasers trying to restart the business. Continuity of supply is usually essential to keeping customers happy; key employees need to be retained; and current contracts need support to avoid potential claims for breach.

What is a pre-pack?

As a result of the need for business continuity, the practice of 'pre-packaging' the administration process has developed. In a Pre-pack, a company is placed into Administration and the business is sold shortly after the appointment of the administrator. Often, the insolvency practitioner (IP), the directors and the bank will have obtained valuations, agreed a sales price and drafted contracts to enable the business to be sold immediately after appointment.

So what is wrong with a quick sale?

Creditors are sometimes less understanding. Their perception is that assets may have been sold at an undervalued price or that goodwill has not been fully valued because of the speed of the sale. What critics often forget are the statutory and practical limitations under which the Administrator has to act.

Unlike Chapter 11 in the US, the Enterprise Act did not provide for super priority funding to enable the Administrator to raise funds for continuing trading while restructuring is planned and implemented. There is also an extensive list of other aspects to be considered: priority expenses during the administration, such as rent and rates; adoption of employee contracts; retention of title clauses on stock; the risk of trading losses; and the prospect of expensive marketing and lengthy – often contentious – sales processes. These factors have resulted in Pre-packs gaining increasing favour among turnaround specialists, directors and banks which, even with security and personal guarantees, still have capital at risk.

What do the courts and regulators think?

In September 2007 the High Court ruled in favour of using a Pre-pack to save a business and jobs, even though it meant going against the wishes of the major creditor. The judge rejected a claim by HMRC protesting against the sale of a firm of solicitors to allow an immediate sale of the business to another firm.

The judge stated he was particularly influenced by the fact that the proposed sale appeared to be the only way of saving the jobs of the 50-plus employees of the partnership. The proposed sale was also likely to result in minimum disruption of the affairs of the firm's clients.

Executive summary

From our own experience, Pre-packs have significant advantages, providing there is careful management of expectations among those affected. Marketing must be undertaken, even if a sale back to the current directors is envisaged and new regulations suggest that either creditor confirmation or an independent report from a third party evaluator will be needed to support a connected party sale. While advice from specialist agents can help maximise realisations, real world threats, certainty of outcome and reduced professional fees often mean that a Pre-pack solution can be recommended.

Have a question?

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In response to the growing use of pre-pack administrations, in January 2008 the insolvency profession issued a statement of insolvency practice on pre-packaged sales in administration. The main thrust of the guideline was on greater transparency and disclosure of why a prepack was thought necessary and what marketing was done to obtain the best price for the business. In addition, all insolvency practitioners were required to send a copy of their initial report to the Insolvency Service for review.

The Insolvency Service has been reviewing compliance with the guideline and has issued reports on their findings. In February 2021 the Government published draft regulations which will impose new restrictions on prepackaged sales in administration to connected parties. For 'substantial disposals' taking place within eight weeks of appointment, the administrator will either need creditors consent to the sale or a report in support from an independent 'evaluator'.

Case law continues to present difficulties for Administrators who wish to trade a business whilst trying to find a buyer. As a result it is likely that pre-packs to unconnected parties will continue to be a vital tool in rescuing a distressed business.



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