

Pre-packs

What is a pre-pack?

A pre-pack is the name given to an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser **before** the appointment of an administrator. The sale is completed by the administrator shortly after their appointment. This reverses the standard process, where the administrators start marketing the business after they have been appointed. The purchaser may be a competitor or, as is often the case, the existing management team.

What are the advantages of a pre-pack?

- The main advantage of the pre-pack process is the speed with which it can be concluded. For example:
 - the costs of the administration process can be reduced, which can result in a better return for creditors;
 - key staff can be retained because they do not have the time to seek alternative employment;
 - more jobs may be saved than in a normal administration process;
 - if stock has a limited shelf life, there is more scope for it to be sold at full value;
 - adverse publicity, media speculation or damage to the goodwill of the business may be reduced.
- Some unsecured creditors, such as suppliers, may be engaged by the new business.
- Often there is no other option. The alternative would be liquidation and the immediate cessation of the company's business.

What are the disadvantages of a pre-pack?

- **A lack of transparency.** Pre-pack arrangements are generally made quickly and in private, albeit with the co-operation of secured creditors. Unsecured creditors are often unaware that a pre-pack is going to happen, so they do not have the opportunity to protect their interests by considering and voting on the pre-pack proposal.
- **A lack of accountability.** Administrators involved in pre-packs do not have to obtain prior approval for their actions from the court or creditors in the same way as they do in a normal administration. There are no specific regulations which deal with pre-packs, which can lead to a lack of confidence in the openness of the procedure.
- **They do not maximise returns for unsecured creditors.** A pre-pack sale of a business is often conducted with limited marketing compared with a normal administration. It is therefore impossible for the proposed administrator to test the market fully because of the risk of the company's financial difficulties being leaked, which could destroy the value of the business. Consequently, the assets of the company may be sold at an undervalued price or the goodwill of the business may not be valued accurately because of the speed of the sale.
- **Writing-off liabilities using a pre-pack is a short-term fix.** A pre-pack doesn't subject the company to a restructuring, which is often necessary if the business is to survive in the long

term. It is debatable whether a business that has already failed will do any better under the control of the same management team.

- **Pre-packs are similar to the outlawed practice of creating “phoenix” companies.** Creditors tend to be suspicious of pre-packs when the business is sold back to the original owners. Under the pre-pack guidelines administrators have to disclose to creditors the name of the buyer and whether there is any connection between the buyer and the company. There are concerns that there is the potential for abuse of the process by directors seeking to purchase the business at an advantageous price and simply avoiding paying creditors.

Issues for directors of a pre-packed company

- The directors of a company who are involved in a pre-pack need to make sure that they do everything they can do to minimise loss to creditors. Directors should take independent legal advice, especially if they acquire an interest in the company’s business and assets through the pre-pack.
- The Insolvency Service has indicated that it will use its enforcement powers to penalise any directors who misuse the administration process to seek to gain a benefit themselves.