

Insolvency Briefing – May 2009 Pre-Pack - are they a good thing?

What is a Pre-Pack?

It is a deal for the sale of the business or assets of an insolvent company that is put together before the company enters into a formal insolvency process, normally administration but sometimes liquidation. The deal is agreed before the formal appointment of the Insolvency Practitioner and completed immediately after the appointment takes place.

Pre-packs are not new having been used for many years but they have increased in number since the Enterprise Act 2002, mainly because of the introduction of the new administration process.

The aim of a pre-pack is to preserve the value of the business and in particular goodwill. They are especially appropriate in situations where customers and employees might desert if they became aware of the potential insolvency of the company or where continuity of trading is essential to the retention of contracts. Hence the business is often sold with little or no open marketing and no prior consultation with unsecured creditors. Secured creditors will normally be aware of the transaction as they will need to release their security. The buyer of the business will often be the management of the failed company who then begin trading again using a very similar name!

Understandably therefore pre –packs have been the subject of considerable criticism and adverse media publicity.

However it is worth mentioning that the directors of a company that is sold via a 'pre-pack' will still have their conduct investigated by the Liquidator or Administrator.

An example of a Pre-Pack

A couple of years ago Critchleys were advising a struggling company whose liabilities significantly exceeded its assets. The management were able to raise a significant sum, but were unsure about investing this into the business because there would still be a large deficit.

After some deliberation they decided to put together a 'pre-pack' and offer to buy the business from an Administrator who would shortly be appointed. Before the offer was accepted by the Administrator we ensured that marketing of the business was carried out albeit over a period of only a little over a week. Only one interested party made further enquiries, but their indicative figure for the business was several hundred thousand pounds less than management were prepared to pay.

The deal went through, and as a result several hundred employees kept their jobs. This saved the tax payer a large sum in redundancy and other wages payments that are underwritten by the government in all insolvencies. In addition the sale ensured that all the book debts were collected, and a sum significantly in excess of the auction value was received for the company's equipment. A large sum was also paid for goodwill.

The best part of the deal for the trade creditors in this case was that most of them were paid off over the next twelve months by the new company as management needed to trade with them in order to ensure continuity of supplies and services!

What are the benefits of a Pre-Pack?

Pre-packs preserve a greater number of jobs when compared to other business sales in insolvency situations. The value of the business is also preserved as once a company's insolvency is made public it is much harder to retain the staff, suppliers and customers who are essential to the company's viability and the value of its goodwill. If customers take their business elsewhere an Insolvency Practitioner can be left with no business to sell. As a result there is likely to be a better return to creditors as a whole (including preferential & secured creditors). Although regrettably in many cases where there are secured creditors such as a bank, there is still little or no return to unsecured creditors, but they frequently can still have the opportunity of not losing turnover by continuing to trade with the new entity.

In the current down turn with few buyers about a pre-pack is often a good option for a distressed business. However it is important to ensure that previous management weaknesses are identified and addressed as a part of the re-structuring process.

From 1 January 2009 in an Administration Insolvency Practitioners are required to provide creditors as quickly as possible with detailed information concerning the decision to proceed with a pre-pack sale, including the anticipated benefits and the purchasers' connection, if any, to the insolvent company.

In addition, Insolvency Practitioners are now required to send a copy of this information to the Insolvency Service for monitoring purposes.

It is to be hoped that this will improve the reputation of such pre-pack sales which are a valuable tool in preserving jobs and maximising the value of insolvent companies.

In conclusion, pre-packs can be the best solution in certain situations, but they are not always the answer! Employees may be better protected, trade creditors have the opportunity to continue trading with the business and make future profit, even if they have suffered a bad debt and better realisations may be made for the creditors as a whole. The directors' conduct will still be investigated because of their involvement with a failed business.

If you have any points that you wish to raise, or queries with regard to pre-packs; please contact Anthony Harris or Sue Roscoe of Critchleys on 01865 261 100.

For more information about our Insolvency Services please visit www.critchleys.co.uk/bri/bri