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ABUSE - PRE-PACK ADMINISTRATION

The concept of a pre-pack administration is not new but its use is growing. It is a procedure in which the sale of a struggling business is agreed before the company is put into Administration.

Procedure

The basic procedure is as follows:

- The old company is insolvent
- A "sale" is agreed with the party wanting to take the business forward
- A new company is formed
- The administrator is appointed
- The "sale" is completed with the new company immediately on, or shortly after, appointment
- The debts of the old company are left with it
- This gives the business a fresh start financially in the new company (the business survives but the old company does not).

Abuse

As a procedure it is open for abuse. The public view pre-packs as a way for owners and directors to buy back a business for very little consideration and the overall perception is negative.

The Insolvency Service introduced Statement of Insolvency Practice 16 which are guidelines for Insolvency Practitioners to avoid abusive pre-packs occurring. The effect has been more efficient and greater transparency than was previously the case however the key elements justifying pre-packs have to be:

- Valuations being obtained for the business and /or underlying assets, and
- The marketing steps and processes.

These are the fundamental building blocks to the proposed administrator. They demonstrate how he fulfils his duty to the creditors as a whole and if he has genuinely achieved the highest possible realisations in the timescales involved.

The statistics show that despite the dodgy deal perception pre-pack administrations improve the financial returns to both secured creditors and unsecured creditors alike.

But what of the business bought out of administration?

A pre-pack is only viable in a turnaround situation if the three key ingredients of turnaround are addressed during the process:

- restructuring (the Administration process itself)
- refinance (new and/or replacement money), and
- management (both people to take the business forward and a properly structured game plan)

Conclusion

Used correctly, the pre-pack administration can benefit all parties. The secured and unsecured creditors of the old company benefit through the sale process. The business going forward has the best possible kick start free from historic debt. The onus however, is on directors and Insolvency Practitioners alike, to avoid inappropriate behaviour and ensure the best possible deal really does taken place.

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