Time to Pack Up the Phoenix Pre-Pack?

As our readers will know, a pre-pack is the process of selling the business and assets of a company immediately after it has entered into an Insolvency Act administration procedure. Pre-packs are a frequently used mechanism as they ensure that the value of a business does not ebb away through a protracted insolvency sale process. But the advantage of moving fast has to be counterbalanced with the perception the unsecured creditors will inevitably form: that they have been left with an unsecured claim against the rump insolvent entity, whilst the profitable business is hived off to a new company, without their prior knowledge or consent. Although the proceeds of the sale will be paid to the insolvent entity, it seems that there is rarely anything left over for the unsecured creditors after the administrator's fees have been satisfied and any secured lenders paid out.

This perception of sharp dealings is exacerbated where the buyer is, or is connected with, the previous management. The allegation is very often that the business was not properly marketed and its full value not achieved.

Against this background, Ed Davey, the Business Innovation and Skills minister, has announced measures aimed to improve the transparency of, and confidence in, pre-pack sales in administrations. Mr Davey's proposal involves giving a three-day notice period for connected parties to oppose a pre-pack deal before it is implemented.

Under SIP 16, administrators already need to provide an explanation as to why they concluded that a pre-pack sale was the best way of maximizing the return to creditors. Under the new proposals, administrators will also need to a file this explanation at Companies House, putting the information in the public domain. The administrators will also need to confirm in this filing that the sale price represents the best value for creditors.

To date, the industry response towards the proposals has been mixed. Unsecured creditors, such as landlords, have generally welcomed them whereas industry insiders have voiced their concerns. Steven Law, president of insolvency trade body R3, has commented that a by-product of such a law could be to increase numbers of liquidations. *"Three days is a long time in business, and if unable to trade in that period, [a business] is at risk of losing key staff and customers".* Meanwhile, Richard Fleming, UK Head of Restructuring at KPMG has struck a cautious tone, accepting that "phoenix" pre-packs are open to abuse, but noting that the solution is not to kill them off: *"It would be a step backwards for the insolvency regime if the pre-pack mechanism were lost through best-intentioned efforts to eradicate system abuse".*

The proposal could become law at the end of this year, and would be applicable to any sales back to connected parties in an administration process where the assets were not marketed.

But how far do these reforms really go, and are they likely to affect significantly the position of unsecured creditors in a pre-pack? Certainly, the new proposals would afford creditors an opportunity to express their concerns, which the administrator would need to consider or, where circumstances justify it, there would even be time to apply to court for an injunction preventing the sale from taking place. However, it is questionable whether 3 days will allow enough time for the unsecured creditors to obtain any meaningful valuation of the company which would arguably be necessary to defeat the pre-pack process. Indeed, whilst landlords have welcomed the government plans, the British Property Federation themselves have stated that 3 days would still not give landlords sufficient time to scrutinize pre-packs and have called on ministers to extend this notice period to one week. This call for an extended period is likely to go unheeded but only time will tell.