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Pre-Pack Administrations

The "pre-pack" is becoming increasingly relevant in today's business environment. This article considers what a "pre-pack" is, their increasing use, and the additional implications for both directors and unsecured creditors of a company that is pre-packed.

Background

- A pre-pack involves a purchaser of some or all of the assets of an insolvent business being lined up in advance of the appointment of an administrator (or less commonly an administrative receiver), with the sale completing immediately after that appointment. Often the new purchaser will be the original owners or managers of the business.

Public Perception of pre-packs

- The recent increase in (often high-profile) administrations has led to a growing use of pre-packs. Recent examples include Whittard of Chelsea and Tom Aiken's London Restaurants.

- A public perception exists that pre-packs allow owners of a failed business to acquire valuable assets of that business and continue trading, whilst loss-making assets and debts are left behind. The creation of these "phoenix" companies, essentially carrying on the same business but freed of its debts, has led to suspicion amongst creditors regarding pre-packs.

Directors of an insolvent business

- However, directors of an insolvent business cannot arrange a pre-pack without careful consideration of the legal issues involved: For example:
    - directors must ensure that they provide detailed information to the administrator about the business, specifically to enable the administrator to make a proper assessment of its value (and so the sale price);
    - under s.214 of the Insolvency Act 1986 personal liability can be imposed on directors for "wrongful trading", where they cause a company to trade beyond the point at which there is no reasonable prospect of avoiding an insolvent liquidation. This potential liability cannot be extinguished by a pre-pack;
    - as ever, directors need to consider their statutory duties under the Companies Act 2006.

Rights of unsecured creditors

- Where a pre-pack is implemented by an administrator appointed out of Court, often a sale will be completed before the unsecured creditors are aware of the pre-pack and have an opportunity to object. If the administrator is court appointed, the proposed pre-pack will need to be considered by the Court and so creditors can make their objections to the Court.

- However, any challenge to a pre-pack is extremely difficult, with the Court generally placing reliance on the experience and judgment of the administrator if he favours a pre-pack.

- Creditors also have a right to bring an action against an administrator if the administrator's conduct has unfairly prejudiced the interests of the creditors, or where an administrator is not performing his functions quickly and efficiently. Again however, these are difficult tests to meet.

- A quicker and cheaper way of challenging a pre-pack is to contact the Insolvency Service's Pre-Pack Complaints Hotline.

Insolvency Service statement

- From 1 January 2009 the Insolvency Service introduced a new Statement of Insolvency Practice ("SIP16"), which identifies information that the administrator is required to disclose to creditors where there has been a pre-pack.

- SIP16 requires details of the pre-pack to be disclosed, including the name of the purchaser, the price paid and details of any connection the purchaser had with the former directors and shareholders. The aim of SIP16 is to provide transparency.

Do I need to be concerned?

- There is little doubt that pre-packs are here to stay and that their use will grow. Even if your own business is solvent, the chances of it being affected by a pre-pack of one of its debtors are increasing all the time. If you are an unsecured creditor of a business which enters into a pre-pack you will inevitably be put in a difficult position – it is important that you are aware of the basic issues outlined in this note so that you are able to move quickly as and when the need arises.

For further information please contact:

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