# Briefing

BURGES SALMON

## Corporate Turnaround and Insolvency

July 2014

# Pre-pack administration: recommendations for a better procedure

This update focusses on Teresa Graham's recent review on pre-pack administration published by the Government which sets out areas for improvement and provides detailed recommendations to help better the procedure.

## The background

Pre-pack administration has received plentiful criticism in recent years. Despite the number of pre-packs in a year being relatively small (700 of 20,000 insolvency procedures in the 2010 sample year), the lack of transparency, deals behind closed doors, and perceived failure to achieve the best value for businesses has given the procedure far more critique than might otherwise have been the case.

As part of the Government's wider 'Transparency and Trust' agenda, the Department for Business Innovation & Skills commissioned Teresa Graham CBE to publish a review of the pre-pack process, based on both qualitative information from interested stakeholders, and empirical evidence based on a study of reported pre-packs from 2010 conducted by Professor Peter Walton from the University of Wolverhampton. Her report concludes that the procedure is too beneficial (in business terms) to eliminate entirely, but that there are shortcomings in the process. Graham has therefore made makes six recommendations for reform.

## Pre-pack positives

Graham concluded that the positives of pre-packs include (i) preservation of jobs as the process allows companies to continue trading, (ii) the relatively cheaper costs compared with regular, up-stream insolvency procedures which involve greater court and creditor involvement (i.e. schemes of arrangement and CVAs), (iii) the likelihood of success of this procedure as deferred consideration is paid in full in nearly 90% of cases, and (iv) the overall benefit to the UK economy as overseas companies may well relocate activity to the UK for our flexible restructuring, insolvency and company law framework.

## What needs improving?

Graham's review highlights four areas for improvement: (i) the lack of transparency due to the notion that unsecured creditors have been kept in the dark, particularly when purchasers are connected to the company, (ii) insufficient marketing of pre-pack sales, as improved marketing strategies could alter creditors' perception of whether they are getting the best deal, (iii) valuations of assets, as the purchase price of a connected sale often matches the valuation figure (such valuations often being conducted on a desktop basis only) raising suspicion that the valuation is only indicating what the purchaser is prepared to pay, and (iv) the lack of consideration to future viability of the business as insolvency practitioners are seen to be responsible only to creditors of the old business and not so much the future success of the new business.

## Graham's Recommendations

Six recommendations have been provided to attempt to improve the process and address these concerns and, importantly, revamp the image of pre-packs - all of which are non-compulsory but are expected to be championed by practitioners with a view to making them common practice.

- **Pre-pack pools:** connected parties considering a pre-pack would, on a voluntary basis, approach a pool (being a panel of suitably qualified people with FD/CEO experience) before the sale and disclose details of the deal. A pool member will give an opinion on the deal. A negative statement by the pool member will not halt the deal but will feature in the SIP 16 statement.
- **Viability Reviews:** in a sale to a connected party, that party would complete a viability review on the new company, stating how it will survive for a minimum of 12 months and what it will do differently from the old company. If the connected party fails to execute a review, the administrator will state that it had asked but not received.
- **Valuations:** valuations should be carried out by a valuer holding professional indemnity insurance, as they are seen to be more reliable. Explanation must be given if such a valuer is not appointed.
- **Marketing:** all marketing of pre-pack should comply with the following principles of good marketing: (i) broadcast rather than narrowcast (i.e. marketed as widely as possible), (ii) justify the media strategy used, (iii) ensure independence, (iv) publicise rather than just publish, (v) include online communication by default, and (vi) explain the strategy to

all creditors, particularly in sales to connected parties where the level of interest is at its highest.

- **A new SIP16:** the Joint Insolvency Committee should adopt the redrafted SIP16 provided which incorporates the above recommendations.
- **Monitoring of SIP statements:** this should now be done by Recognised Professional Bodies, including, among others, the Institute of Chartered Accountants, the Insolvency Practitioners' Association and the Law Society, due to their better levels of practical experience.

## What does this mean for practitioners?

The review's recommendations are seen to be a positive as they work towards balancing transparency and the need to protect the value of a business in difficulty without introducing new and unwelcome regulation to the process.

Despite the recommendation of an added layer of requirements to the procedure, the review focusses on more than just the practitioner's role. It also turns the spotlight on directors' involvement and conduct in a connected party pre-pack.

It remains to be seen whether these recommendations will be immediately implemented and, equally, how the pool and marketing strategies will work in practice (as an increase in publicity may well be damaging for fragile businesses). It is to be expected, however, that practitioners will adhere to and embrace the recommended process both because (in most cases) they will already be undertaking many of these steps as a matter of in-house sanctioning of pre-packs, and in order to avoid the need for legislation on the matter.

## Contact

For more information on this subject please contact:

**Patrick Cook**
Partner

+44 (0)117 307 6807
patrick.cook@burges-salmon.com

**Richard Clark**
Senior Associate

+44 (0)117 902 6626
richard.clark@burges-salmon.com

Burges Salmon LLP, One Glass Wharf, Bristol BS2 0ZX   Tel: +44 (0) 117 939 2000   Fax: +44 (0) 117 902 4400
6 New Street Square, London EC4A 3BF   Tel: +44 (0) 20 7685 1200   Fax: +44 (0) 20 7980 4966
**www.burges-salmon.com**



BRM0793 07 14