

Report to The Association of Business Recovery Professionals

A preliminary analysis of pre-packaged administrations

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Introduction

This report represents the preliminary findings of an investigation into the phenomenon of the 'pre-pack', a strategy that, from mid-2005, has come under considerable scrutiny and which is, and will probably remain, the subject of debate both within the insolvency profession and among other groups, including those directly affected by the actions of insolvency practitioners and those with a more academic interest in those actions.

Pre-packing, as an approach to an insolvent company, has arguably inspired more controversy than any other insolvency-related matter in recent years.¹ As the leading professional association for insolvency practitioners in the UK, The Association of Business Recovery Professionals, hereinafter R3, has a very clear interest in ensuring that the activities of its members engender confidence in those affected by corporate insolvency. Insolvency practitioners enjoy a legislatively conferred 'monopoly' as regards the power to accept insolvency appointments, and so to direct the course of a corporate insolvency procedure. Creditors of an insolvent company are therefore entitled to expect fairness, transparency and probity from the practitioner charged with administering the insolvent estate. To the extent that the pre-pack strategy is perceived (whether accurately or otherwise) as inequitable, opaque or suspicious, the integrity of the insolvency profession and, indeed, the entire system of corporate insolvency law in the United Kingdom is threatened. R3 has therefore commissioned this research in order to attempt an evaluation of the pre-pack and to discover, in particular, whether some or all of the charges against it are justified and, if so, what should be the response of the Association itself. Equally, if the justifications offered by its members for the pre-packing strategy are well-founded, the question arises as to whether, nevertheless, some form of action is required to dispel the very real misgivings of insolvency stakeholders as regards the pre-pack strategy.

This report presents the findings of a quantitative analysis of actual cases of pre-packs, and compares them to a similar analysis of a sample of cases where the sale of a business of an insolvent company has taken place without recourse to a pre-pack.² The term 'business sales' is used throughout this report to describe cases within this latter category.³ The cases themselves are drawn from a pre-existing database of administrations and administrative receiverships prepared and analysed for the Insolvency Service,⁴ and comprising roughly one third of all such procedures entered into between September 2001 and September 2004. As such, they provide a representative and significant sample from which a 'snapshot' of the pre-pack landscape can be derived. It is, of course, acknowledged that this picture is historical, and therefore does not capture developments in practice that may have taken place since September 2004.⁵ However, the later phases of the research programme will take in more recent cases in a roll-out of the databases, which may illustrate such developments.

This report also attempts to identify *questions*. An analysis of the databases used here is helpful in ascertaining certain quantifiable features of both pre-packs and business sales,

¹ With the possible exception of rapidly climbing levels of personal bankruptcy.

² The methodology of the research is described below, at p7.

³ The term non-pre-pack was considered, and rejected on the ground of a surfeit of hyphens.

⁴ The report produced from this investigation can be found on the Insolvency Service Website at: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/InsolvencyOutcomes.pdf>

⁵ The 'raw' data, from which the database is constructed, is necessarily historical in origin, being extracted from reports filed at Companies House by insolvency practitioners.

but it does not of itself *explain* those features. As will be seen in the following sections of this report, while it is possible to identify both similarities and diversities in the comparative performance of pre-packs and business sales, the underlying causative factors for these may not be immediately obvious. There may, for example, be a number of possible explanations for a particular finding and, although the author can claim some knowledge of the various legal regimes associated with insolvency, this is no substitute for the commercial expertise and experience possessed by those who deal with insolvency on a day-to-day basis. Therefore, this phase of the research is as much about pinpointing questions arising from the findings as it is about providing definitive answers to the specific issues posed by the pre-pack trend. It is also about identifying those best placed to answer questions raised, and while it is envisaged that insolvency practitioners will be invited to contribute to this aspect of the programme, the enquiry will necessarily range far more broadly.⁶

It is hoped, therefore, that this report will to some extent assist in informing the pre-pack debate, but also that it will lay the foundations for the next stages of the research process, both quantitative and qualitative. Its preparation has been an enlightening and fascinating process, and the author would like to thank Graham Rumney at R3 for his unfailing interest and support, Mike Norris at the Insolvency Service for agreeing to the use of the existing database, the many practitioners, academics and other stakeholders who have already expressed their interest in the project and, not least, Alan Katz and Michael Mumford, Research Fellows of the University of Lancaster, whose pioneering empirical work has always been a source of illumination and inspiration.

⁶ See the final sections of this report for more detail on the next phases of the research.

The pre-pack debate: issues and definitions

The impetus behind the research

The pre-pack debate is well-documented, and it is not proposed to rehearse it in more than general terms here.⁷ Exponents of the pre-pack strategy are to be found largely, but not exclusively, among practitioners, who point to commercial exigency as the driving force behind the procedure and maintain that, for some distressed businesses at least, a pre-pack is the *only* method capable of extracting value for creditors from the corporate estate. Those antagonistic to pre-packs offer a number of arguments in support of their position. These include questioning the legality *per se* of pre-packs in the light of the scheme of the Enterprise Act 2002, alleging a lack of transparency in the process, and highlighting the disenfranchisement of certain categories of stakeholders, most notably unsecured creditors, both financially and in terms of their ability to meaningfully direct the course of the insolvency. Perhaps even more a matter of concern is the charge that pre-packing either can be, or is being, used in an abusive and dishonest manner. John Moulton very pithily puts the matter in the following terms:

“A company is heading into trouble. Its directors and shareholders are introduced to an appealing fellow who drives a very nice BMW, who explains that if they work with him they will get rid of most of their creditors and buy the business back pretty well immediately at a very modest cost. Great sales pitch!”⁸

While this may veer towards caricature, there is no doubt that to those unfamiliar with the commercial exigencies of insolvency practice,⁹ the description might well ring true. It is also worth pointing out at this stage that practitioners themselves are all too aware that the appearance of the pre-pack may well be less than positive to those who do not benefit from it. Indeed, the author first became properly aware of the strategy during a series of interviews with practitioners and bankers conducted as part of the Insolvency Service research project in the summer and autumn of 2005. Even at this stage, while interviewees were generally supportive of pre-packing in appropriate cases, many expressed considerable concern at the manner in which it might be perceived and at the possibility that it might be the subject of disreputable practice. A few quotes from insolvency practitioners are worth including here, as they encapsulate the main concerns expressed by those who may actually have been instrumental in effecting pre-packs in the past:

“It’s practical, but it’s a difficult concept to explain to other creditors, and it’s one that I think the whole profession needs to work hard on, to explain why they do consider the pre-pack the best solution, to explain exactly why there hasn’t been a big advertising campaign, and so on.”

⁷ For a range of varied perspectives see: Finch, *Pre-packaged Administrations: Bargains in the Shadow of Insolvency or Shadowy Bargains?* [2006] JBL 568; Walton, *Pre-Packaged Administrations: Trick or Treat?* (2006) 19 *Insolv. Int.* 113; Moulton, *The uncomfortable edge of property – pre-packs or just stitch-ups?* *Recovery*, Autumn 2005, 2. See also, *Recovery*, Summer 2006, pp. 3, 15-25. A fuller survey of the existing literature on pre-packs will be included in later stages of the research, where it is more appropriately dealt with.

⁸ *The uncomfortable edge of property – pre-packs or just stitch-ups?* *Recovery*, Autumn 2005, 2.

⁹ Or, as the lawyer would put it, the man on the Clapham omnibus: see *Hall v. Brooklands Auto-Racing Club* (1933), *per Greer LJ*.

“We ensure that there’s a robust process before it, and that can be different depending upon the type of business... You make sure that you don’t have an unrealistically short period of marketing; you can have a short period of marketing, but not unrealistically short, so that you can justify the decision, you can show that you’ve marketed it for a proper time, you’ve contacted the right people, you’ve offered it on a share sale basis, and then you can say that, on the balance of probability, on any conventional assessment or wisdom, your decision to sell the business is the right one, that you can’t be criticised for selling it on a pre-pack basis to X, Y or Z company. You have to demonstrate that robust process and sometimes you don’t have the same opportunity.”

“I think it would be nice to see, perhaps through legislation or a guidance note from one of the regulators or the DTI, as a working document, on what represents in their eyes a good pre-pack, as opposed to a bad pre-pack; that would be quite useful guidance to have. A fear that’s common in the market place is with people who have done pre-packs and are just waiting for the regulator to come and hit them with a big stick and tell them that they’ve read the legislation wrong. And you get differing views from different lawyers who you might speak to: some will tell you you’re fine to do that deal whereas others would say that they’re a bit concerned. So what are the parameters, I suppose, where’s the sense-check? That might even be another Statement of Insolvency Practice: you know, this is what you need to have in place.”

“You’re right, there is potential for abuse where the cowboy liquidator comes along and says, ‘Look Harry, we’ll do a deal with you, we’ll come in on this basis, and we’ll stuff the creditors and leave them high and dry’, and that takes us back to the days of businesses disappearing overnight and turning up again to do the same trick all over again.”

Concern over pre-packing, or, more accurately, what are the appropriate and scrupulous methods of effecting pre-packs, are not confined to ‘outsiders’ therefore. There is a genuine apprehension that a tool considered to be potentially utilitarian may be misunderstood or even misused, and that this of itself will lead to unwelcome consequences, both for the stakeholders in insolvent companies and for the insolvency profession.

The aim of this preliminary report, therefore, is to attempt to evaluate the pre-pack by a process of comparison and to discover whether, in the first instance, some of the charges laid against it are grounded in measurable terms. The report does not address issues of the legality of pre-packs, or certain aspects of them, which will be considered in the next phase of the research. Nor does it attempt to probe allegations of impropriety. It is worth noting that, following an article in the *Mail on Sunday* which mentioned the research programme,¹⁰ the author was contacted by numerous parties expressing an interest in the research and, in some cases, wishing to draw attention to specific instances of pre-packing which they considered had been carried out less than directly. These communications were gratefully received, and will be investigated thoroughly during the course of the research programme, but for now the focus is on an objective evaluation of the pre-pack according to quantifiable criteria.

¹⁰ See *Probe into Bankruptcy ‘cosy deals’*, *Mail on Sunday*, 5/11/2006, p.5.

Methodology

A comparative approach

Pre-packaging is just one strategy for selling a business. In rather simplistic terms, upon appointment to an insolvency post, the office holder, whether administrator, administrative receiver or liquidator, is faced with a number of commercial decisions directed towards maximising the value of the estate for the benefit of one or more stakeholders. The identity of the beneficiary of the practitioner's efforts depends, as a matter of law if not practice, on the procedure in question: by and large, the orthodox understanding is that liquidators and administrators act in the interests of the general body of creditors, whereas receivers focus on the interests of their appointor. This understanding is open to debate,¹¹ but in any event it would probably be accepted that the main concern of the practitioner is to deploy the assets comprising the estate so as to achieve optimal value.

'Value' is, of course, a hopelessly imprecise term, and could encompass a range of outcomes, including the preservation of the corporate entity itself, the preservation of its business, of employment associated with it and of an outlet for supply (for its suppliers) or purchase (for its customers). However, as far as its creditors are concerned, 'value' can be measured in monetary terms. From their perspective, the practitioner's task is to extract as much money from the estate as possible and spend as little as possible in so doing. The estate is thus reduced to a collection of assets, tangible and intangible, to be mustered by the practitioner and realised for the maximum amount.

This can be achieved in a variety of ways. The perceived wisdom is that a sale of the *business* of an insolvent company will almost invariably raise more than a sale of its component assets on a piecemeal basis. Synergy is preserved, a premium may be negotiated for the goodwill of the business, key employees essential to its operation may be transferred to the purchaser and debts owed to the original entity may prove far easier to collect. While the proposition that business sales achieve higher realisations cannot be taken as a universal truth, it is reasonably widely accepted.

The debate around pre-packs essentially centres upon whether or not the pre-pack is *an appropriate and effective* method of selling a business. It may be considered inappropriate or ineffective for a number of reasons.¹² In summary, the main ones are as follows:

- A pre-packaged business has not, by definition, been exposed to the competitive forces of the market, which may lead to the business being disposed of for a consideration less than would have been obtained had it been marketed for an appropriate period.
- Where a pre-pack is effected through administration, the rights of stakeholders to participate in the decision-making process, as envisaged by the Insolvency Act 1986, are frustrated.
- The pre-pack process is insufficiently transparent: creditors, or at least certain classes of creditors, are not provided with information adequate to allow them to measure whether the practitioner has carried out his functions in a manner that has not improperly or unlawfully prejudiced their interests.

¹¹ Many commentators, including the author, would question whether there is any substantive distinction in approach engendered by an appointment as administrator or administrative receiver.

¹² The justifications for pre-packaging are examined later in the report.

- Linked to the previous point, a lack of transparency inevitably results in a want of accountability: creditors are entitled to challenge the practitioner's conduct¹³ but are disabled from doing so without the information necessary to mount a challenge;
- Pre-packs may be unacceptably biased towards the interests of secured creditors, most notably floating charge holders. There may be no incentive to negotiate a consideration for the business much over the amount necessary to discharge the secured indebtedness, especially where a valuation puts these two sums reasonably close.
- Pre-packs may also be geared rather more towards achieving enough to satisfy the claims of the floating charge holder and the practitioner's fees and expenses, with no effort at capturing any premium over and above these amounts.
- Where a pre-pack involves the sale of a business to a party previously connected with the company, usually as director, the process resembles the practice of 'phoenixing', which of itself gives rise to the imposition of qualification requirements on those who wished to act as office-holders in relation to insolvent companies, following the recommendations of the Cork Committee.¹⁴
- Linked to the above, the opportunities for and appearances of collusion with the purchaser of the business are heavily amplified where a sale of a business is effected through a pre-pack.

There are no doubt other objections to pre-packs that could be raised, but the above are sufficient for the present to serve as benchmarks against which to test them. Others will no doubt emerge through the process of consultation to follow this report, and will be examined at that stage. For now, the focus is on whether, on the basis of the data, one or more of these charges can be made out and, if so, if that is an adequate reason for some form of remedial action to be taken.

The alternative to a pre-pack, against which a comparison can be made, is a sale of the business which has not been negotiated prior to the appointment itself, and which is driven by considerations and assessments which may arise post-appointment. This does not necessarily encompass the case where the appointee has *no* involvement with the company prior to the actual appointment; indeed, the author's earlier research suggests that such cases are very rare indeed. There will usually be a period, which can range from days to weeks, or even months, during which the practitioner will have had the opportunity to assess the financial state of the company and its business and to formulate a strategy in relation to it, often at the behest of a secured creditor or, indeed, the company's management. For present purposes, the main distinction between the pre-pack and a business sale is that the sale itself, and to whom it is made, and what assets it will comprise, and at what price, has not been almost irrevocably pre-determined prior to the appointment.¹⁵ Quite simply, the practitioner remains open to offers following his appointment, and may take active steps to elicit them via a marketing campaign or some other method of ensuring that the market has been at least sensibly tested. It is this model against which the pre-pack is appraised in this report.

The databases

The comparative approach described above was carried out through the use of two databases, one comprising information on pre-packs, the other on business sales. As noted

¹³ See, for example, paragraphs 74 and 75 of Schedule B1, Insolvency Act 1986.

¹⁴ Insolvency Law & Practice: Report of the Review Committee (London: HMSO, 1982).

¹⁵ The definitional issue is addressed below in a little more detail.

earlier, both derive from an existing database of 2063 companies which entered into either administration or administrative receivership between September 2001 and September 2004. This database recorded information on each company, including the 'outcome' of the procedure itself, these outcomes being:

- A) rescue of the company¹⁶
- B) rescue of part of the company¹⁷
- C) going concern sale of the business of the company¹⁸
- D) going concern sale of part of the business of the company¹⁹
- E) asset sale²⁰
- F) procedure ongoing.

It should be noted that in a number of cases a combination of outcomes was recorded.²¹ The 'raw' data used to construct the database was extracted from documents filed at Companies House by the presiding practitioners. These consisted of notices of appointment, statements of affairs, statements of proposals (for administration), receivers' reports to creditors, progress reports (for administrators), abstracts of receipts and payments, notices of extensions (for administrators) and notices of vacation of office. These documents were the main sources of information recorded on the database. Where liquidation followed either receivership or administration these documents were also used to glean information regarding payments to unsecured creditors. The Insolvency Service has sponsored an update and a roll-out of this database, so that the information on it is up-to-date to around May 2007.

For the purposes of this research, the existing database was revisited to identify those cases where the outcome fell into categories C or D of the above list. The reports in relation to those cases were then consulted and used to construct both pre-pack and business sale databases. The information recorded on each database was as follows:²²

- company
- procedure (administration or receivership)
- practitioner(s) appointed
- practitioners' firm
- date procedure commenced
- date of exit from procedure
- purchaser of the business

¹⁶ Where the company emerges from the procedure under the same ownership and conducts substantially the same activities.

¹⁷ Where the company emerges from the procedure under the same ownership but conducts a reduced activity or set of activities. An example of this, drawn from the sample, was a company which produced conveyor belts and which also operated two other types of business. The two other operations were closed, but the company emerged with the conveyor belt arm intact.

¹⁸ Where *the business* of the company is sold as a going concern.

¹⁹ An example, drawn from the sample, was a company operating a chain of pubs. Several of the pubs were sold as going concerns and the remainder closed.

²⁰ Where the company's assets were sold on a break-up basis.

²¹ The most common of these being where the procedure was still ongoing but one of the other outcomes had occurred (e.g., A/F, C/F etc.). However, different combinations also occurred, including combinations of going concern sales and asset sales and partial rescue and asset sales.

²² As to the availability of this information, see below.

- whether the purchaser had a prior connection to the business: this essentially encompassed purchasers who were directors or shareholders of the original company
- date of sale
- whether a valuation was carried out
- whether the business was marketed prior to sale
- the number of employees transferred
- the percentage of employees transferred
- the amount of secured, preferential and unsecured debt at the commencement of the procedure
- returns to secured, preferential and unsecured creditors
- the overall percentage return to creditors
- whether 'Newco', the purchaser of the business, has since entered into an insolvency procedure²³
- and if so, the nature of the follow-on procedure, and whether the practitioners were the same as those conducting the original sale.

Once complete, these databases were used to compare outcomes in pre-packs and in business sales, as detailed in the main body of this report. It may be questioned why cases of receivership were included, given that many of the objections to pre-packs noted above are particularly relevant to administration. A number of explanations can be offered, including the fact that the author was interested in 'tracking' the incidence of pre-packs along a timeline, which would be less obvious if receivership cases were not included. Further, while the emphasis of each procedure may differ in terms of the practitioners' specific duties, the process of selling a business, whether through the medium of a pre-pack or otherwise, is virtually identical. Thirdly, given that administration appointments under paragraph 14 are at the behest of a qualifying floating charge holder, there is at least some sense that administration can be used as a substitute for receivership (most notably where the objective of the administration is to realise property to make a distribution to secured and preferential creditors under para.3(c) of Schedule B1 Insolvency Act). Fourthly, and most pragmatically, the use of cases of receivership going concern sales (whether pre-pack or otherwise) allowed for a much larger sample of cases, which in turn facilitated a more in-depth and significant analysis. The report, however, focuses on administration pre-packs and business sales where it is considered that this is most appropriate. Before moving to the findings of the research, two further points need to be addressed.

The definitional issue: identifying pre-packs

A question that is perhaps logically prior to the preceding discussion is how cases were categorised as either pre-packs or business sales from the reports used. It should be acknowledged from the outset that this was not always a straightforward matter, and for a number of reasons. It was suggested above that a pre-pack is essentially defined by the characteristic of pre-determination, although no doubt there is room for argument on this point, and, indeed, the following phases of the research will explore it further. However, this was the characteristic used as a yardstick for allocating cases to one or other of the databases. The question is then whether there is any room for error in applying that yardstick.

²³ To gauge survival rates, or, to use the author's preferred (and grander) term, the rate of recidivism. A little indulgence is begged at this point.

In the majority of cases the answer was 'no': reports from both administration and receivership were often patently clear as to whether the business had been pre-packaged or not. In some cases practitioners were absolutely explicit about the fact that the sale in question had been pre-negotiated and effected almost immediately upon appointment.²⁴ This is not to say that such cases always involved 'same-day' sales. In some reports practitioners explained that the deal in question had been negotiated prior to appointment, but not completed until a few days after appointment.²⁵ Many reports provided a great deal of information about the pre-procedure activities of the practitioner, including, in some cases, the fact that attempts had been made to sell the shares in the company, but that these had failed. It is also clear from some of the reports that a pre-pack had in fact been preceded by a period of marketing of the business itself, often presided over by practitioners through their own agents.²⁶ A common – but not universal – feature of such cases was that the eventual pre-pack was to a connected party.

As a corollary to this, the majority of cases categorised as business sales were also easily identifiable. Some reports²⁷ stated that efforts were being made to sell the business, the eventual sale being recorded in administrators' progress reports²⁸ or in abstracts of receipts and payments.²⁹ Others recorded the fact that the sale had occurred following an advertising campaign, and on the recommendation of valuers or other agents. The 'awkward' cases were small in number, but posed some problems of categorisation. A typical example would be the report that referred to a sale 'shortly after my appointment' but did not amplify upon whether or not the sale had been negotiated prior to the appointment. Initially, these cases were placed in a 'hybrid' category, but, in the interests of accuracy, it was decided in the end not to include them in the sample at all. Other cases involved a sale very shortly after appointment, often within two or three days, and, in a very few cases, on the day of appointment itself. A careful reading of the reports suggested that many of these were not, in fact, pre-packs. The practitioners in question often referred to the fact that an initial contact was made by an interested party post-appointment, that party often introduced by an agent charged with valuing the business pre-appointment. Such cases were often accompanied by a firm recommendation from the agent that the offer be accepted. The critical deciding feature here was that the approach was made very quickly after the appointment, but nevertheless did not appear to involve any element of pre-appointment discussion at all. In some cases, the post-appointment approach was made by a management buy-out team, or by an existing director of the company, but, again, there was no intimation in the reports that prior and decisive discussions had taken place.

It might certainly be argued, therefore, that at the margins there may be some room to doubt whether the categorisation adopted by the author is in fact the correct one. However, the number of awkward cases was extremely small and would not, therefore, be expected to have a distorting impact on the analysis that followed.

²⁴ Interestingly, the actual term 'pre-pack' did not appear in reports prior to March 2003, but the description of the process could leave no doubts as to the fact that what would now be described as a pre-pack had occurred.

²⁵ Gaps of up to seven days were recorded, in some cases to allow finance for the deal to be finalised.

²⁶ But often, it is conceded, discreetly, the justification for this being a concern not to alert suppliers, customers or employees to the fact that the company is in financial distress, and so to maintain confidence in the business.

²⁷ Specifically, administrators' statements of proposals of receivers' reports to creditors.

²⁸ For post-Enterprise Act cases.

²⁹ For pre-Enterprise Act administrations and all receiverships.

Gaps in the information

It should also be acknowledged that the reports used to compile the databases were not a failsafe source of complete information, nor, indeed, were they expected to be. Such reports are provided for the benefit of creditors,³⁰ and are drafted with a view to informing creditors of such matters that the practitioner considers will be of interest to them. That being the case, a number of the records on both databases do not record full information for each variable. The most common unknown was in relation to employees: while many reports mentioned that all employees had been transferred to the purchaser,³¹ specific numbers of transferred employees were rarely provided. Equally, some reports explained that redundancies had been made post-appointment, but did not specify how many, or what proportion, of employees had been made redundant. Others still referred to the fact that 'the majority' of employees had transferred to the purchaser of the business. This is not at all surprising, as practitioners are entitled to make the judgment that creditors will be less interested in the fate of their debtors' employees than in their own financial prospects.

A further fairly common omission in reports was as to the identity of the purchaser of the business. A minority of such cases cited commercial confidentiality as precluding the revelation of the purchaser, but many more simply stated that a sale had occurred without going into further detail. Others identified the purchaser as an existing director, or a management team, but without specifying the purchasing vehicle.³² In cases where the initial report stated that a sale was currently being pursued, and where no progress report was forthcoming,³³ it was virtually impossible to identify the eventual purchaser from abstracts of receipts and payments.³⁴ It might be argued, therefore, that this information is something in which creditors have a genuine interest, and that it should be provided as a matter of good practice. Having said that, the author does not discount the possibility that it is provided elsewhere to creditors by the presiding practitioners, perhaps at creditors' meetings³⁵ or in other correspondence.

Equally, it was not always possible to determine the actual date on which the business was sold, although this was a more common omission in relation to business sales than to pre-packs. Further, the level of unsecured debt was not universally disclosed (although levels of secured and preferential debt were virtually always mentioned). This was particularly the case where the practitioners' reports did not include a statement of affairs and no estimated statement had been prepared. Such reports, however, often made it clear that the dividend prospects for unsecured creditors were small or non-existent. It is perhaps questionable whether this kind of information would be of interest to creditors or not, but if it is available there is at least an arguable case that it should be provided.³⁶

Finally, on the question of returns to the various classes of creditors, this information was simply not available because the procedure itself, or its follow-on procedure, was still

³⁰ And not primarily to be probed by academics with a whim for poking around in insolvency practice.

³¹ Usually to explain that the level of preferential claims was therefore reduced.

³² For example, the name of the company to which the sale was made, or, indeed, whether the connected party had purchased the business as an individual, or through the medium of a partnership.

³³ i.e., receiverships and pre-Enterprise Act administrations.

³⁴ Although abstracts were usually adequate to reveal that a business sale, rather than an asset sale, had taken place.

³⁵ If they are held.

³⁶ The issue of transparency is addressed in more specific detail at various stages of this report.

ongoing. This was a circumstance that largely led to a dearth of information on returns to *unsecured creditors*. It was not at all unusual, even where procedures were ongoing, to find that payments, in full or in part, had been made to secured and preferential creditors. In such cases, however, an entry was made *only* in cases of full payment, the reasons for which should become clear later in this report. In such cases, a note was made on the database that the procedure itself, or a follow-on liquidation, was ongoing, which allowed for them to be discounted when it came to analysis of the figures.

Overall, therefore, this report does not purport to provide a complete picture, although it should be emphasised that the data-gathering process is ongoing, and that as procedures are brought to a close any gaps in the information will be filled in for later analysis. A perhaps more pressing issue is whether the gaps in information encountered in the data-gathering process give weight to one or two of the objections levied against pre-packs and detailed above.³⁷ On the assumption that the reports used to compile the database are the *only* source of information provided to unsecured creditors in particular,³⁸ there is certainly an argument that such creditors are left in the dark as to the manner in which the procedure has progressed, or is progressing, and to the reasoning behind the presiding practitioners' commercial decisions. However, it should be emphasised that such gaps are not only found in reports relating to pre-packs, but are equally common in reports relating to business sales. In other words, if it is thought that a lack of transparency is a problem afflicting pre-packs then it should also be addressed in relation to business sales. Interestingly, the Insolvency Service is presently consulting on the matter of pre-administration expenses, and one recommendation for an amendment to the Insolvency Rules³⁹ will require practitioners wishing to claim pre-administration expenses as expenses of the administration to have these sanctioned by creditors, which, in itself, will require the provision of reasonably detailed information as to how and why such expenses were incurred. This is a positive step forward, but there would seem to be no reason why it could not be pre-emptively adopted as good practice.

³⁷ At p8.

³⁸ As noted above, this may not be the case.

³⁹ Rule 2.67.

Part I: Features of the pre-pack landscape

A. The rise of the pre-pack

1. Profile of cases on the database

As described above, the databases were constructed by extracting information on companies whose business had been sold as a going concern during the course of an administration or administrative receivership between September 2001 and September 2004. Altogether, the sample comprises 639 cases. Of these, 412 were categorised as business sales and 227 as pre-packs.

The first observation to be made is that this research therefore identifies the level of pre-packing over a three-year period as 35.5% of all the going concern sales in the sample. Interview data gathered for the Insolvency Service project seemed to suggest that the level of pre-packs was considerably higher than this (interviewees who commented specifically on this point estimated the level of pre-packs between 50% and 60%, and some went as high as 80%). This dichotomy is most likely explained by the timing of the interviews and that of the cases under consideration. The interviews in question were conducted between August and November 2005, almost a full year later than the most recent cases on the database, and anecdotal evidence clearly supports the view that the pre-pack trend is accelerating.

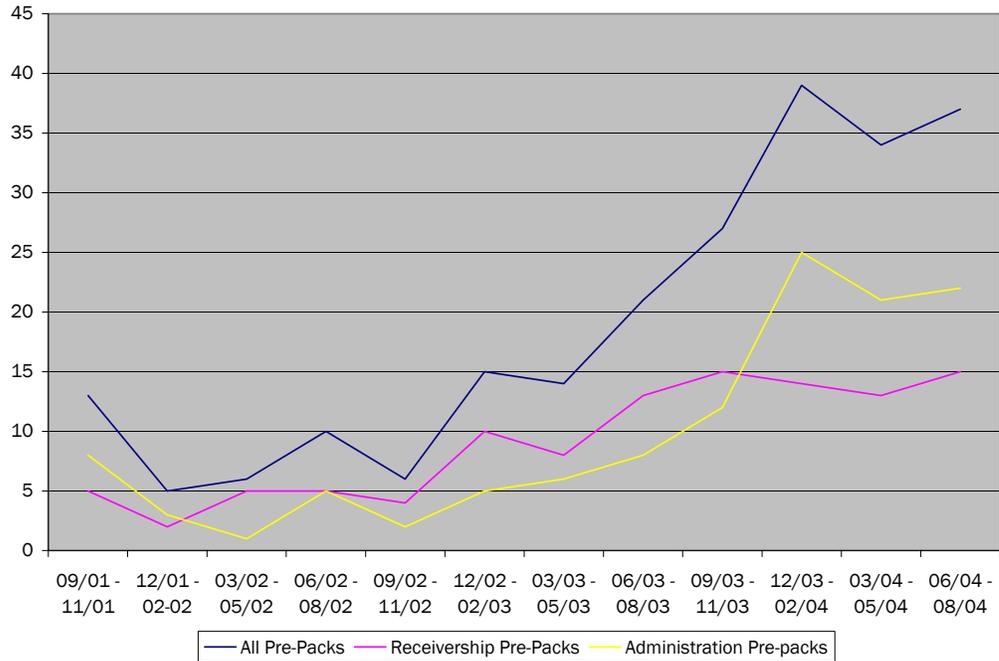
The business sale database consists of 222 administration cases (53.9%) and 190 receivership cases (46.1%). The pre-pack database comprises 118 administration cases (52%) and 109 receivership cases (48%). It was thought possibly instructive to examine the impact of the Enterprise Act 2002 on pre-packs and, indeed, on business sales, and so a further breakdown of the cases on each database revealed that, in relation to business sales, 208, or 50.5% occurred within the course of a procedure commencing prior to 15 September 2003 (i.e. pre-Enterprise Act cases) and 204 occurred post-Enterprise Act. In other words, the business sale database contains roughly equal proportions of pre- and post-Enterprise Act cases. This is in contrast to the pre-pack database. 92 of the cases contained therein, or 40.5%, pre-dated the Enterprise Act, with the remaining 135 (59.5%) post-dating it.

As between the two different procedures, an interesting dichotomy emerges when it comes to pre-packs, which is amplified upon shortly. Of the 118 administration pre-packs, 40 were pre-Enterprise Act cases (33.9%) and 78 post-Enterprise Act cases (66.1%). In contrast, the 109 receivership pre-packs were split much more evenly between pre- and post Enterprise Act cases, with 52, or 47.7%, falling into the former category and 57, or 52.3%, falling into the latter.

2. The increasing incidence of pre-packs

The breakdown of cases above is interesting in that it suggests that the incidence of pre-packs in administration is rising following the coming into force of the Enterprise Act 2003. The following tables attempt to demonstrate that trend graphically.

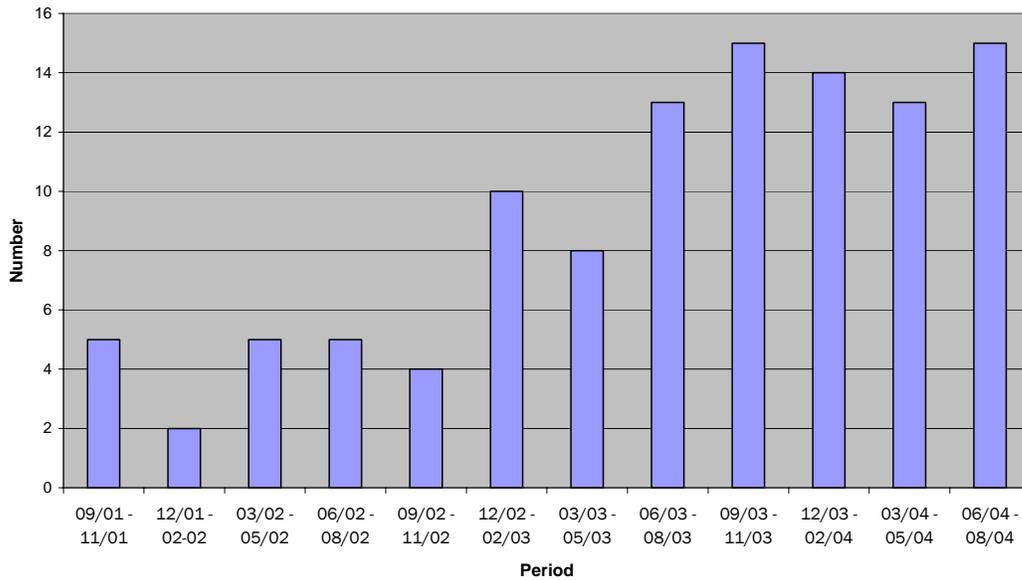
Table 1: Pre-Packs and Procedures



a) Observations

As far as pre-packs are generally concerned, the ‘boom’ in numbers occurs from around May 2003, from whence they have climbed sharply, and almost constantly. It is immediately obvious, however, that the upward trend occurs at a different point along the timeline depending on the procedure used to effect the pre-pack. This is demonstrated in the two tables below.

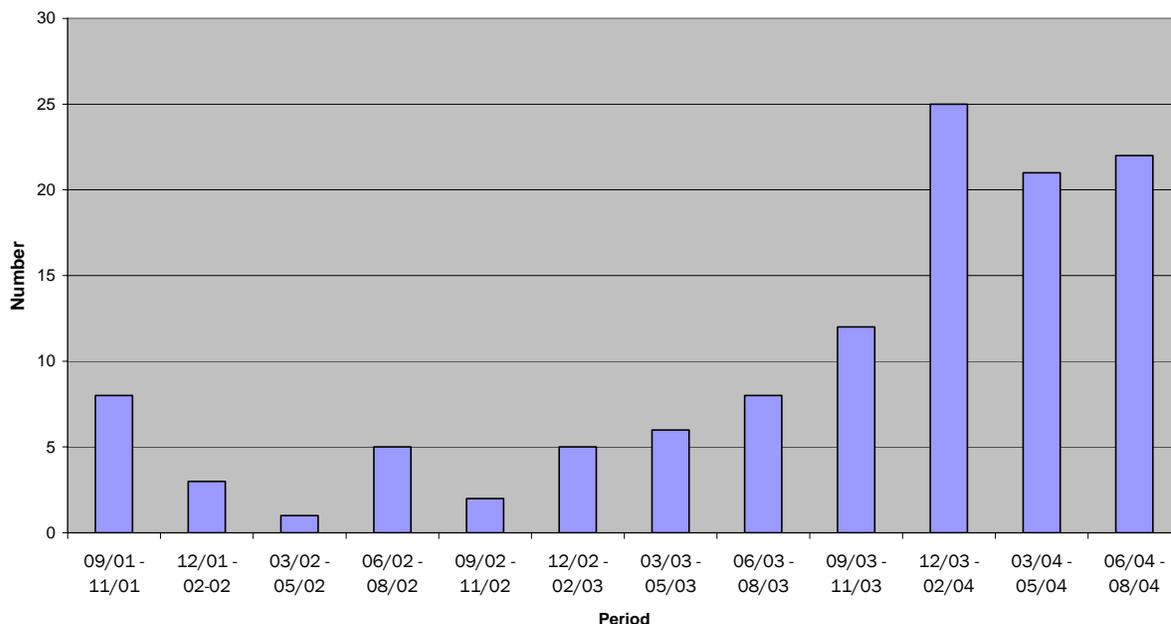
Table 2: Receivership Pre-Packs



b) Observations

This table illustrates a rise in the number of receivership pre-packs over time, but here the rate of acceleration becomes much sharper at an earlier date than seen in the entire sample. Numbers start to climb from around December 2002, and of the 109 cases in the sample 88 of them (80.7%) occur after this date. Further investigation may suggest an explanation for this, as nothing springs directly to mind. As far as the author is aware, no legal developments which might explain this rise occurred in the period immediately preceding it, so the answer may simply lie in developments in commercial practice. This is clearly an area on which the following phases of the research programme may throw some light.

Table 3: Administration Pre-Packs



c) Observations

This table illustrates a dramatic rise in the incidence of pre-packs from December 2003. Of the 118 cases in the administration sample, 68 (57.6%) occurred during the December 2003–September 2004 period, so that well over half of pre-packs take place in the final three quarters of the timeline. Over two thirds (67.8%) of all pre-packs in the sample are post-Enterprise Act cases, which suggests that, for administration at least, the Enterprise Act has some significance.

This is perhaps not surprising. The pre-Enterprise Act procedure for entry into administration required a court order, whereas post-Enterprise Act, appointments by qualifying floating charge holders under para.14 and the company or its directors under para.22 are far more common than court appointments under para.12.⁴⁰ It is pertinent to question, however, why this should make any difference:⁴¹ given that 38 (32.2%) administration pre-packs took place prior to the coming into force of the Enterprise Act, it can probably be assumed that the courts themselves were not averse to granting administration orders to effect pre-packs.⁴² One possible explanation is that practitioners themselves may have been cautious in taking pre-pack proposals to courts prior to the

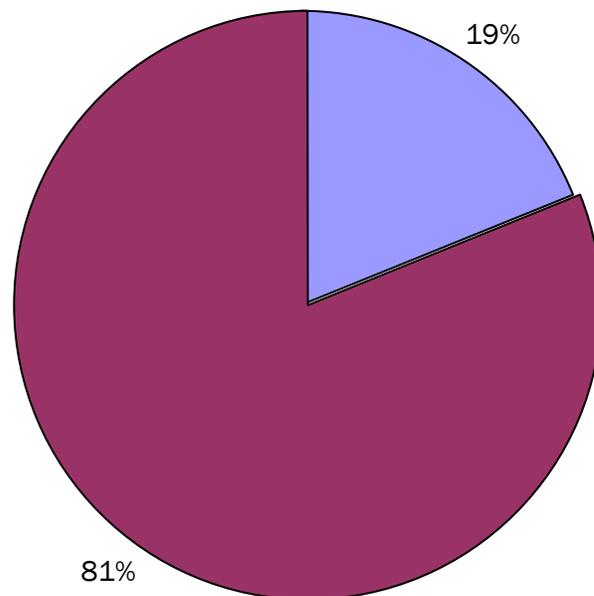
⁴⁰ This is demonstrated by the author's research for the Insolvency Service: see above, n.4. Katz and Mumford also make this point in their excellent study of administrations cases, also commissioned by the Insolvency Service and recently published on the Service's website - see: www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/studyofadmicases.pdf

⁴¹ The sample profile of itself would not appear to have any impact on this trend.

⁴² In eight of the cases in the pre-Enterprise Act sample the practitioners explicitly referred to the fact that the judge in question had been given full details of the proposed sale in the Rule 2:2 report accompanying the application.

Enterprise Act, and that, whenever the strategy commended itself, would advise that the transaction be effected through receivership instead. The out-of-court entry route to administration in paragraphs 14 and 22 of Schedule B1 Enterprise Act 1985 would enable a pre-pack through administration without court scrutiny and, if the above explanation is valid, at least partly explain what was behind the Enterprise Act impact. One way of testing this hypothesis is to examine the method of appointment in the administration pre-pack sample to see whether it was significantly biased towards out-of-court appointments when compared to administrations generally.

Table 4: Entry Routes- Administration Pre-Packs



d) Observations

A note of caution should perhaps be sounded here, as this table is based on a sub-set of 48 cases for which information on entry routes was actually available. It was not always possible to discern from practitioner reports whether an appointment had been made in or out of court, and where any doubt existed the case in question was excluded from the sample. A similar plotting exercise had been carried out for the Insolvency Service research on a sample of post-Enterprise Act administrations, and subject to the same qualification above, the results are shown on the table overleaf.

Table 5: Post-Enterprise Act administrations - entry routes



e) Observations

This table breaks out-of-court appointments down into charge holder and company appointments, but the important point to note is that it charts a rate of 30% for court appointments and 70% for out-of-court appointments. The pre-pack sample results, notwithstanding the much smaller sample size, seem to demonstrate a clear bias towards out-of-court entry routes. An interesting further enquiry is whether this is *necessarily* prompted by a desire to avoid court scrutiny or whether some other consideration is at work here. At the risk of speculation, it may be that the court appointment route is seen as inherently problematic in terms of cost and delay where a pre-pack is envisaged, and is therefore only used when its benefits clearly outweigh its drawbacks.⁴³ This is a question that can usefully be addressed more fully in the next phases of the research.

f) Conclusion

Very briefly, it is clear that the incidence of pre-packs has risen sharply over the three-year period under investigation. Whether this rise continues up to the present is to be examined as the database is rolled out.

⁴³ Fortuitously enough, a delegate at the R3 Lite Conference in Cambridge explained that, in relation to one case on which he was advising, the open court route was considered expedient where there was significant opposition to the contemplated pre-pack from one major creditor. In one sense, therefore, the court route may be being used as a quasi-cramdown device.

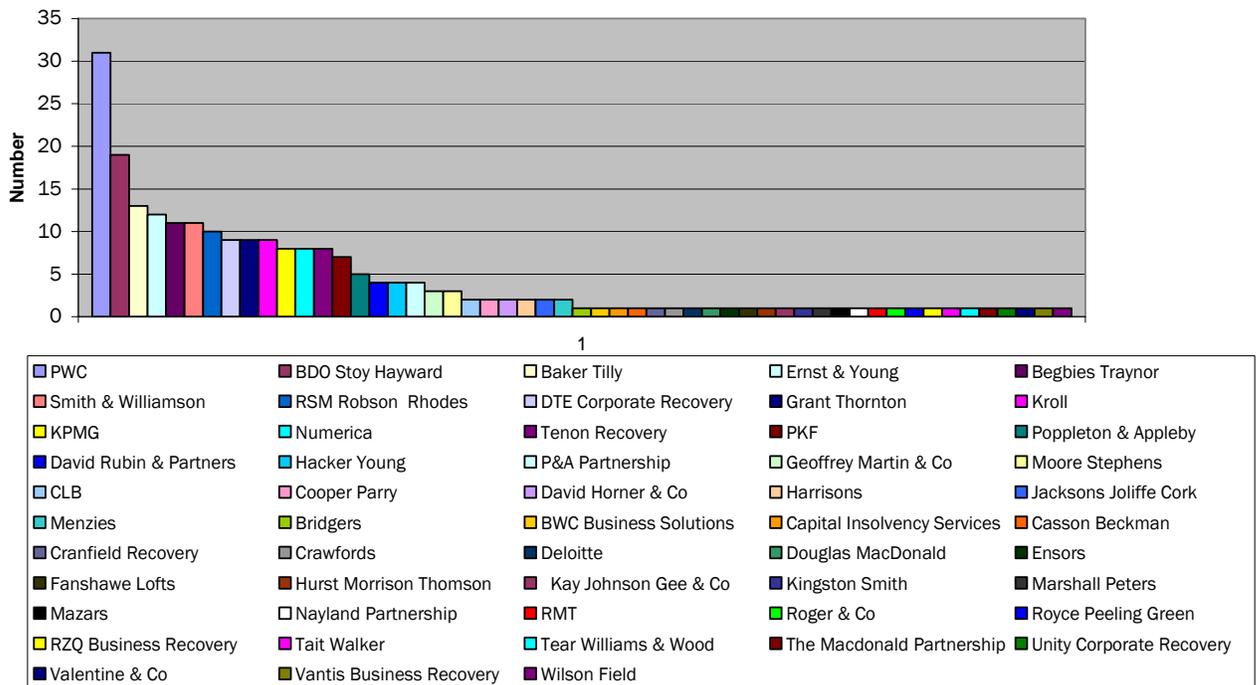
B. Firms and pre-packs

The table below looks at the firm appointed in the 227 cases of pre-packs.

As can be seen, a wide range of firms have been using the pre-pack strategy over the period under investigation. Many of those firms account for only a single pre-pack in the sample, and there is one firm in particular which appears to use pre-packs considerably more than others. A total of 53 firms have used the pre-pack strategy, ranging from the 'big four',⁴⁴ who between them account for 52 cases, or 22.9%, of the sample, through the mid-tier to the small firms.⁴⁵

There is no really meaningful comparator for this table, although the author charted the level of administration appointments during the same period as part of the research programme for the Insolvency Service. The results were as follows:

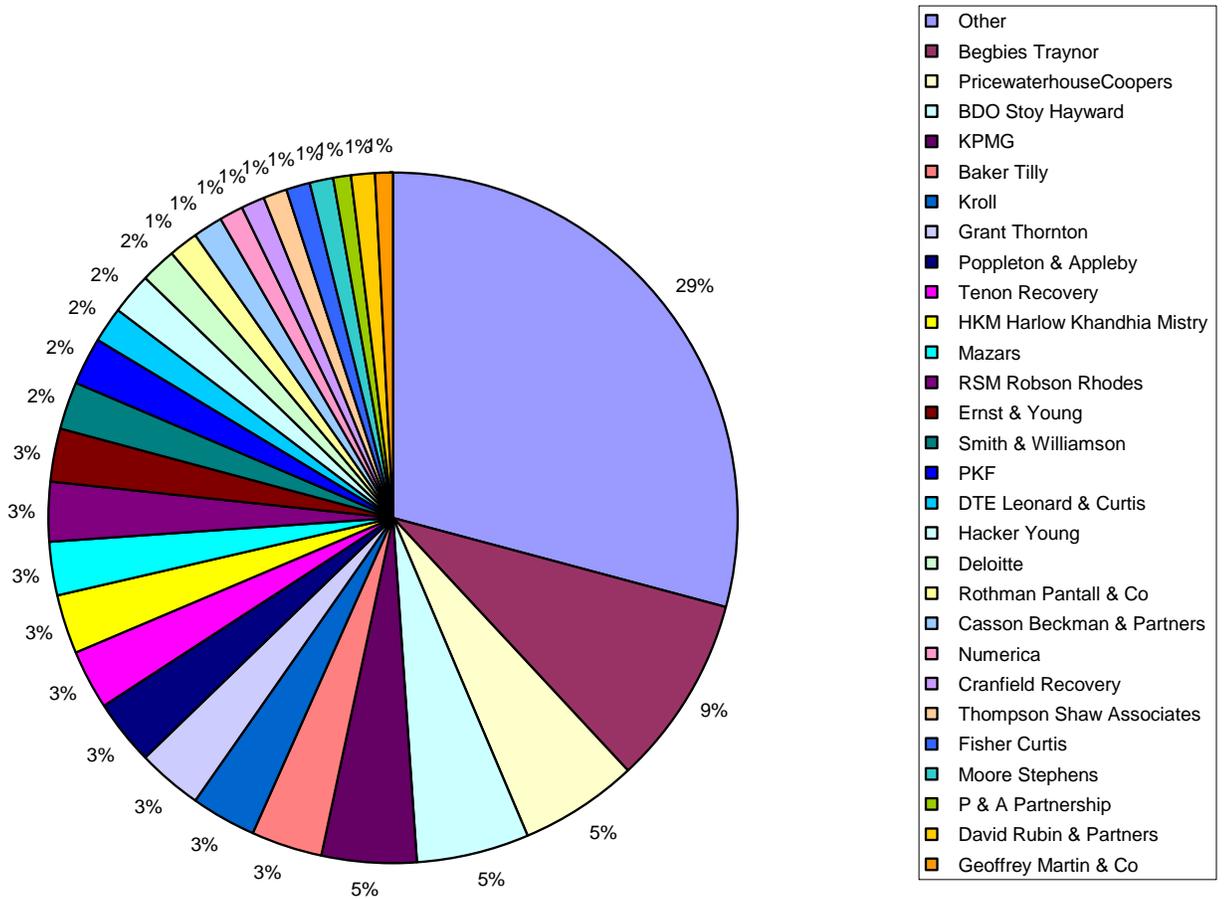
Table 6: Pre-Packs by Firm



⁴⁴ Deloittes, Ernst and Young, KPMG and PriceWaterhouseCoopers.

⁴⁵ Although the author can claim no expertise when it comes to categorising firms into size brackets and tends to use intuition in this respect, perhaps a hazardous tactic. Nor is the author definitively aware of changes in names of firms, so that there may be an element of 'under-counting' in the above table.

Table 7: Administration Appointments - Firms



Whether there is any value in attempting to compare these two tables is debatable, but a few observations may be made. The category of 'others' in Table 7, which accounts for 29% of the sample, comprised all those firms taking 10 or fewer appointments in the sample period. The vast majority of the firms in this category would, according to the author's (perhaps doubtful) scheme of classification,⁴⁶ have fallen into the 'small firms' category. In the pre-pack sample, however, 25 of the 53 firms carrying out pre-packs, or 47.6%, would have fallen into the 'others' category used for the Insolvency Service research. There may, therefore, be some room to contend that small firms carry out proportionately more pre-packs than large and mid-tier firms. However, it should also be noted that 22 of the 25 firms in the 'others' category only effected one pre-pack, whereas those firms that carried out five or more would all be described as either large or mid-tier. Perhaps the only certain observation to be derived from Table 6 is the very clear dominance of PricewaterhouseCoopers in the pre-pack arena, and perhaps nothing very much can or should be made of this.

⁴⁶ See n.45 above.

C. Size of cases

1. The definitional issue

It was decided to investigate the 'profile' of pre-pack cases by reference to 'size', which poses the immediate difficulty of how best to categorise the size of any particular case. Katz and Mumford, in their survey of administration cases,⁴⁷ note that while their sample comprises a 24% pre-pack presence, this 24% accounted for 13% of the overall asset values, which might suggest that pre-packs are being used in cases of relatively small value.

The investigation here focuses not on asset value, which was not recorded on either of the databases, but on levels of debt, specifically levels of secured and unsecured debt outstanding at the onset of the procedure, to see whether any material distinction could be discerned between pre-packs and business sales. Levels of preferential debt were not surveyed, given that the abolition of the Crown preference in the Enterprise Act 2002 means that a comparison might well be skewed by differentials in the proportion of pre- and post-Enterprise Act cases of pre-packs and business sales.

It may be objected that levels of debt are no real indicator of size of case, a point which, if made, the author would concede, having no real knowledge of how the profession would view this matter.⁴⁸ If necessary, and this matter is certainly open to further analysis, the databases can be rolled out horizontally to encompass asset values, or whatever other indicator of size is considered appropriate. A further point is that the author has no knowledge of what the profession, if judging size of case by reference to levels of debt, would consider to be a large case, a small case or a medium-sized case. Any comments on this aspect of the research are therefore most welcome.

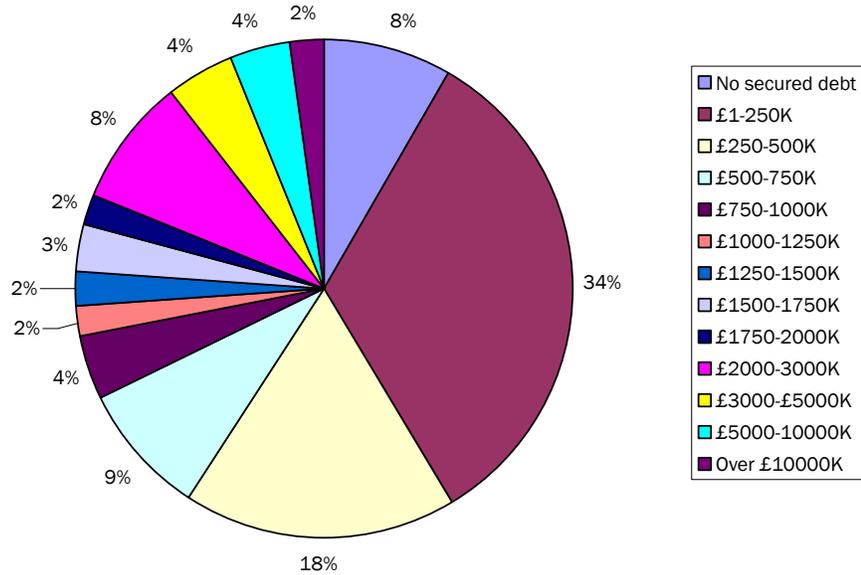
2. Levels of secured debt in pre-packs and business sales

The average amount of secured debt outstanding at the outset of the procedure was £1,680,052 for pre-packs and £2,359,419 for business sales. In both categories, however, there were individual cases with what appeared to be an unusually high level of secured debt (four cases of over £8 million in the pre-pack sample, and six cases of over £50 million in the business sale sample). Taking these cases out of the sample, the average amount of secured debt was £1,561,827 for pre-packs and £1,276,124 for business sales. The following two tables illustrate the outcome of a further breakdown of secured debt levels in both pre-packs and business sales:

⁴⁷ See n.40 above.

⁴⁸ Nor, it might be added, the good sense to ask delegates at the R3 Conference...

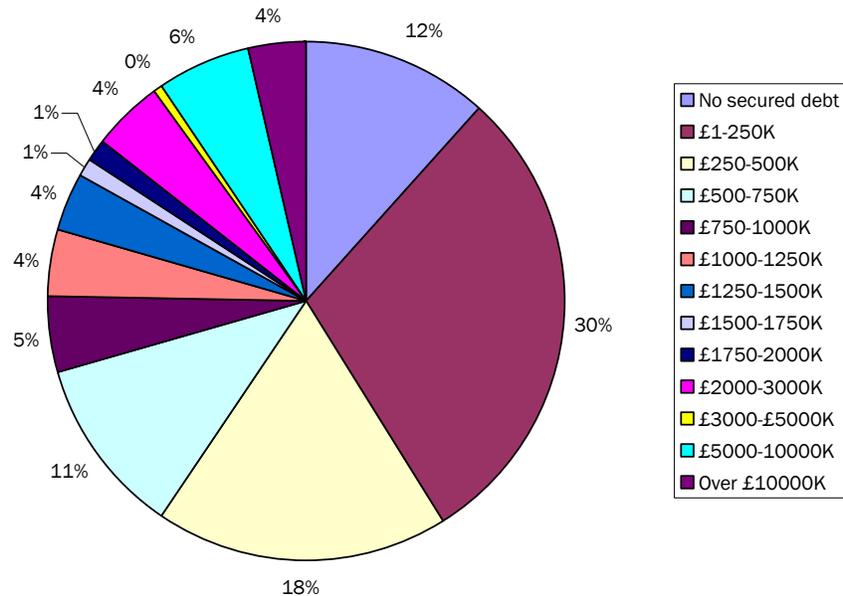
Table 8: Secured Debt Level - Frequencies in Pre-Packs



a) Observations

Of the 227 cases (the entire sample of pre-packs) well over half (60%) involve an outstanding secured debt of less than £500,000. Over two fifths of all cases involve a secured debt of between £1 and £250,000, and cases with a secured indebtedness of over £5 million account for 6% of the sample. To the extent that the profession would tend to agree that secured indebtedness of under £250,000 constitutes a 'small' case, therefore, then pre-packs can be said to be used frequently in small cases.

Table 9: Secured Debt Level - Frequencies in Business Sales



a) Observations

There appears to be little difference, and, indeed, considerable convergence, between pre-pack and business sales in terms of the number of ‘small’ cases dealt with. In both categories, 42% of the sample involves outstanding secured indebtedness of less than £250,000 and indebtedness of less than £500,000 in business sales is found in 60% of cases, precisely the same percentage as that in pre-packs.

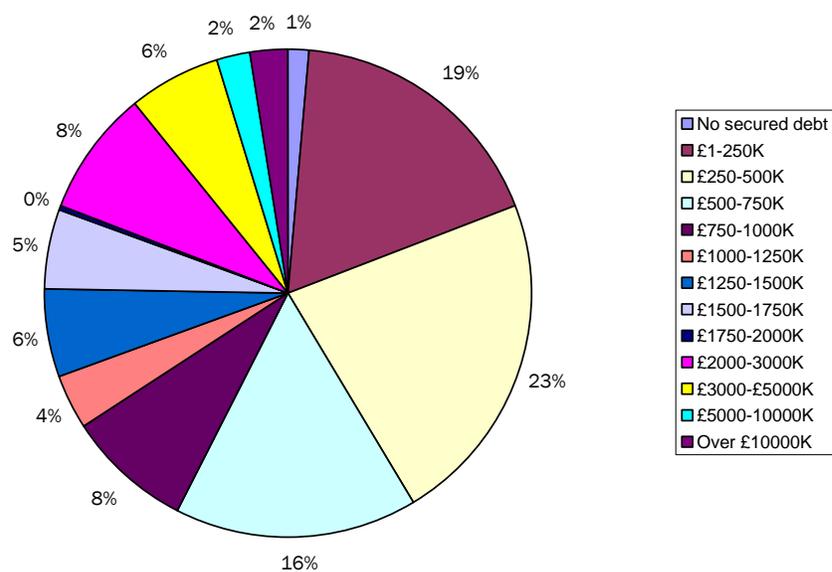
One point of divergence in pattern may be worth noting here, and that is at the very high end of the indebtedness scale. In 10% of business sale cases the secured indebtedness is over £5 million, as compared to 6% of pre-packs, but, overall, there is nothing to suggest that pre-packs are used any more than business sales in cases where the secured debt is reasonably small.

3. Levels of unsecured debt in pre-packs and business sales

As noted above, levels of indebtedness to unsecured creditors were not always available in the practitioner reports, and in the pre-pack sample were absent in 17 out the 227 cases. The average level of unsecured debt for the 210 cases was £2,098,090. The business sale database yielded information on unsecured debt in 382 out of the 412 cases, the average level being £4,108,248. Again, adjustment was made, this time to exclude two cases of extraordinarily high unsecured debt on each database. Once this was done, the average level of unsecured debt for pre-packs and business sales was £1,529,876 and £1,981,020 respectively.

The breakdown in unsecured debt levels for business sales and pre-packs is as follows:

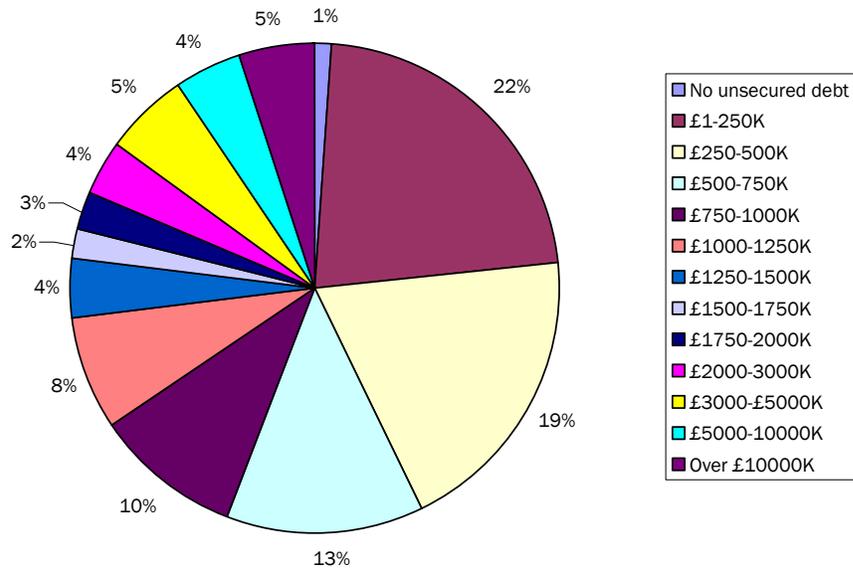
Table 10: Unsecured Debt Level - Frequencies in Pre-Packs



a) Observations

43% of all the cases in the sample involve a level of unsecured indebtedness of less than £500,000, with indebtedness of over £5 million present in only 4% of the sample. Again, therefore, if unsecured indebtedness of less than £500,000 is accepted as a 'small' case, a high proportion of pre-packs could be described in this way.

Table 11: Unsecured Debt - Frequencies in Business Sales



b) Observations

There are proportionately more high-value cases, in terms of unsecured debt levels, in business sales than in pre-packs, with 9% of cases in the former involving unsecured debt of over £5 million as compared to 4% of the latter. However, at the lower end of the scale results are very similar. 42% of business sales are cases where unsecured indebtedness is less than £500,000, the figure being 43% for pre-packs.

4. A tentative conclusion

If the taxonomy for testing size of case adopted above is considered valid, it would appear that there is no very significant difference between pre-packs and business sales when it comes to size. The one qualification to this proposition is at the very high-value end of the sample, where there is evidence that pre-packs are used less often than business sales.

D. Explaining pre-packs: information issues

1. *The democratic deficit*

The scheme of the Enterprise Act 2002 reveals a very clear objective of empowering *all* creditors. To amplify, the prospective abolition of the right to appoint an administrative receiver was intended to enhance the collective nature of insolvency proceedings and to ensure that rights to participate in determining the course of the procedure⁴⁹ were available to creditors other than the appointing charge holder.⁵⁰ Equally, the post-Enterprise Act administration procedure bolsters the right of creditors to receive follow-up information in the form of progress reports, and to vote on proposals made by the administrator. Rights of challenge to the conduct of the administration are found in paras.74 and 75 of Schedule B1 to the Insolvency Act, although whether these are any broader than the previous right to complain of 'unfairly prejudicial conduct'⁵¹ is a matter of debate.

In any event, it is understandable that critics of pre-packs point to the fact that creditors are entirely disenfranchised, in the sense that they are presented with a *fait accompli* when they receive the statement of proposals. That statement is, in effect, one of the actions taken to date, with the only true proposal being that the practitioner be paid for those actions. This issue will be examined in more detail a little further along in this section.

A further objection to pre-packs is that they are intrinsically undemocratic: creditors have rights to hold the presiding practitioner to account, but a meaningful exercise of such rights requires information about practitioners' actions and their reasons for taking those actions. If all that a creditor is told is that a pre-pack sale has taken place, on what basis can a challenge be mounted? It should be recognised here that unsecured creditors, as a constituency, are most likely to be affected by inadequate provision of information. They are many and dispersed. The reports used to compile the databases on which this research is based often included schedules of unsecured creditors, and it was not unusual to find their numbers running into hundreds, none having any connection to the others except the prospect of a meagre dividend at best.

Thus, unsecured creditors, as a constituency, are less able to mobilise than other creditors. Their secured counterparts are repeat players, with significant resources and the commercial muscle to ensure that they are kept fully informed by practitioners. Indeed, the author's earlier research for the Insolvency Service suggests that the vast majority of out-of-court appointments will be preceded by often lengthy and detailed consultation between charge holder, practitioner and management. This is likely to be the case even where the appointment is driven initially by management. Furthermore, the strategy to be adopted on appointment, whether pre-pack or business sale or straightforward asset sale, may well have been to some extent pre-determined during the course of such negotiations.⁵² This, of course, is the case *a priori* in receivership, where the appointor's interests are the focal point, and will no doubt dictate a free and consistent flow of information on the course of the procedure.

⁴⁹ Perhaps more accurately defined as 'inclusivity' than 'collectivity'.

⁵⁰ Although it could be argued that such rights are a double-edged sword, in that, if exercised too vigorously, control rights could lead to the loss of the appointee's agency status: see *American Express International Banking Corp v Hurley* [1985] 3 All ER 564.

⁵¹ See s.27 Insolvency Act 1986.

⁵² For a fuller account of this process, see *Report on Insolvency Outcomes*, above n.4, p.10 *et seq.*

It is important to be precise about the issues arising here. A number of charges can be levelled at pre-packs, but in order to evaluate them properly they need to be correctly characterised. The unarguable claim that pre-packs disenfranchise certain creditors, a point to be addressed shortly, goes to the question of *inclusivity*, whereas the charge that creditors are given insufficient information about the pre-pack itself goes more to the issue of *accountability*. A third charge could be that pre-packs are inherently *biased*, in the sense that secured creditors are favoured in pre-packs over other creditors in terms of their chance to sanction the transaction (or to veto it, as the case may be) *and* to have full information about the transaction in order to assess its merits. The second of these issues is addressed next.

2. Are creditors adequately informed about pre-packs?

This is not a question easily addressed in quantitative terms. What follows is an account based on the author's reading of practitioners' reports⁵³ to creditors on both business sales and pre-packs, and an evaluation of whether or not they provide adequate information to allow creditors to reach a determination of whether their interests have been adequately addressed or not. This information is not quantified, so that the account presents more of a general picture of the quality and substance of the reports in this respect. It has already been noted⁵⁴ that gaps in information were not uncommon in relation to a number of aspects of reporting to creditors, and this is considered further in this section.

a) Are reports the *only* source of information for creditors?

This is an important question that cannot be answered here.⁵⁵ One obvious further source of information is the creditors' meeting, required to be called under para.51 of Schedule B1 Insolvency Act.⁵⁶ However, para.52(1) dispenses with the requirement for a creditors' meeting where all creditors can be paid, where unsecured creditors' only prospect of a distribution is by virtue of s.176(A)(2) or where the objective of the administration is to realise property in order to make a distribution to secured or preferential creditors under para.3(c). This derogation is subject to para.52(2), which empowers creditors owed at least 10% of the company's total debts to require a creditors' meeting to be called. There may well be instances, therefore, where no creditors' meeting is called and, if earlier reports are deficient in terms of the provision of information concerning the transaction, creditors are left very much in the dark about the circumstances surrounding the pre-pack.⁵⁷

One further point to note here is that where a creditors' meeting is not called because the objective being pursued is that in para.3(c), para.49 requires practitioners, in their statements of proposals, to explain why it is thought that the objectives in para.3(a) and (b) cannot be achieved. Obviously, this is a provision that applies generally, and not only to administrations where pre-packs are effected. It was, however, not at all clear in all the reports examined whether the provision was being fully complied with, as some omitted to

⁵³ This includes statements of proposals and progress reports in administration, and receiver's reports to creditors under s.48 Insolvency Act 1986.

⁵⁴ See pp.12-13 above.

⁵⁵ One question arising is whether creditors are provided with information by practitioners in communications which are not filed at Companies House. Some reports referred to 'earlier letters', which may have given some details regarding the pre-pack transaction.

⁵⁶ This, of course, applies only in administration. The decision as to whether to call a creditors' meeting in a receivership rests with the practitioners.

⁵⁷ Of course, in such circumstances it is very likely to be the case that such creditors have no financial stake in the insolvency at all. This point is addressed in further detail below.

specify a para.3 objective. To be fair, this may be because it is unclear from the outset whether realisations will be sufficient to enable a dividend to be paid to unsecured creditors, in which case the weakness lies in the provision rather than the reports. Having said that, and in relation to pre-packs specifically, the consideration for the sale of the business is known at the outset, which may not be the case where it is proposed to market the business, and therefore the practitioners perhaps ought to have some idea whether unsecured creditors will receive a return or not.⁵⁸

It is also possible that creditors are able to seek information directly from the presiding practitioner, and that they do so. Again, this stage of the research cannot verify whether or not creditors do routinely seek further particulars in this way. The author's earlier research for the Insolvency Service reported practitioners' accounts of creditor apathy when it came to attending creditors' meetings,⁵⁹ which may be symptomatic of a generally jaded outlook on the part of unsecured creditors borne of earlier disappointments. In any event, it can be robustly argued that whether or not creditors can, or do, seek information from sources other than practitioners' reports is irrelevant. Good practice would be to provide that information in the statement of proposals or reports to creditors, and the onus should always be on practitioners to supply it rather than on creditors to seek it out.

b) How informative are reports?

The reports used to compile the database varied in terms of the amount and quality of information regarding the pre-pack transaction. A very few, it must be said, were woefully inadequate: the only fact conveyed was that a pre-arranged sale of the business had already taken place, with no further amplification on the identity of the purchaser, the reasons why a pre-pack was considered appropriate, the consideration for the business, and how it was arrived at and whether any attempt had been made to market the business prior to the pre-pack. At the other end of the scale, some reports were absolutely exemplary: a full history of the company was included, the pre-appointment period described, with an explanation as to how the decision to pre-pack the business was reached, the purchaser disclosed, including whether there was any connection to the existing company,⁶⁰ and the consideration, and how it was apportioned between various asset groups, revealed. As a guide for absolute best practice, these reports were clearly ideal models.

It was reasonably clear that different firms adopt different templates for practitioner reports. What is perhaps surprising is that, within this internal protocol, the quality of reports still varied. This was also the case, perhaps even more surprisingly, among specific practitioners. In other words, particular firms or practitioners might provide excellently informative reports in relation to one case and less pristine reports in relation to another case. One possible explanation for this is that the case in question might involve a hostile appointment, where the practitioners had had little time to investigate the full circumstances of the company, but this is probably weak, given that a pre-pack had taken place, the very fact of which indicates an element of pre-planning.

⁵⁸ It is conceded that doubts in this respect may arise where there may be unencumbered book debt realisations in prospect, but the magnitude and collectibility of such is subject to some uncertainty.

⁵⁹ See above n.4, p.54.

⁶⁰ As required by Statement of Insolvency Practice 13: it appears that this statement is not always complied with.

The most common omission in relation to provision of information thought to be particularly useful to creditors⁶¹ was the identity of the purchaser. In a few cases this was explained on the grounds of commercial confidentiality: how convincing this explanation is requires some further investigation. Certainly commercial confidentiality might be a persuasive justification for non-disclosure at a point where negotiations are still in progress, but this is, by definition, not the case in a pre-pack. It is submitted that this is a matter in which creditors have a genuine interest, and an entitlement to be fully informed unless there is some compelling reason for that information to be withheld. In particular, where the pre-pack is to a connected party, it is perhaps even more crucial for the practitioner to be completely transparent. As noted in an earlier footnote, SIP 13 considers disclosure of transactions with connected parties to be a matter of best practice. To the extent that this is not complied with, and to the extent that creditors discover the fact after the event, it is little wonder that those creditors would be highly suspicious of the probity of the pre-pack in the first place.

Most, but not all, reports gave details of the consideration provided. The amount of detail varied from a bare statement of the price paid for the business to a complete breakdown of how it was apportioned between asset groups. Of note is the fact that 190 of the 227 pre-packs (83.7%) explicitly referred to the fact that a transaction at that price had been recommended by valuers, and that a valuation had in fact taken place prior to the contract being concluded.⁶² Several reports also gave details of the valuer in question. This is not to say that the business had *not* been valued in the other 37 cases, but rather that this information was not included in the reports. In fact there was some evidence of valuation in a further 24 cases in the form of a payment to valuers being recorded in abstracts of receipts and payments. It might be thought expedient to include such information in the main body of reports, in order to reassure creditors that the price paid for the pre-pack has been the subject of independent scrutiny.

Overall, therefore, the informative value of reports to creditors is somewhat haphazard. This is certainly a matter of concern: a valid apprehension about pre-packs is the extent to which they provoke suspicion and mistrust among creditors, and unsecured creditors in particular. The fact that in a number of cases examined there were significant gaps in the information provided to creditors is worrisome: not because it inevitably points to subterfuge or impropriety but because it must surely engender at least some mistrust on the part of creditors of the pre-pack strategy and because it may disable them from reaching an informed conclusion as to whether their interests have been properly considered. Of course, and as noted earlier, this research is historical, and it may be that the more recent criticisms directed at pre-packs in this regard have prompted practitioners to be routinely more forthcoming in their reports to creditors: a roll-out of the database into 2005, and possibly 2006, will determine whether or not this is the case. In the final analysis, it is suggested that some of the criticisms concerning the transparency of pre-packs are well-founded in some cases. However, this is not an insurmountable problem, and simply requires the profession to devise some method of ensuring that minimum standards of disclosure are formulated, promulgated, maintained and monitored for the future.

⁶¹ It was noted above that information on the fate of corporate employees was often missing, and also noted that, in terms of enabling creditors to assess whether their interests had been properly contemplated, arguably irrelevant. The fact that employees had transferred to the purchaser under the TUPE Regulations was often accompanied by an explanation that this would reduce preferential claims on the estate.

⁶² The question of valuation, considered by the author to be extremely important, is addressed in further detail later in this report.

c) Are disclosure deficits exclusive to pre-packs?

This is actually an interesting point. There is a certain inference⁶³ that failures to provide information relevant to pre-packs are probative of some of the shadier aspects of the strategy overall. In fact, an examination of the reports on business sale cases reveals the same level of inconsistency in the provision of information as that noted in relation to pre-packs. In other words, there is no correlation between failures of disclosure and the nature of the transaction. Precisely the same observations made above in relation to reports on pre-packs can be made in relation to reports on business sales. In fact, reports on business sales were significantly less informative when it came to identifying the purchaser of the business, with that information being unavailable in 76 cases (18.4%) as compared to 16 cases (7%) of pre-packs. Certainly some of those 76 cases relate to pre-Enterprise Act administrations, for which no progress reports are available and so no medium through which disclosure could have been formally made, but, as will be seen, the business sale cases in which a sale had not been concluded by the time proposals were put to creditors are in a significant minority.

If, therefore, the submission made above in relation to pre-packs that provision of information should be as full and frank as possible is accepted, it should also apply to cases where a sale of the business is made after the commencement of the procedure. This may seem a minor point, but it does go some way towards rebutting the inference that disclosure deficits are an exclusively pre-pack-related phenomenon, and therefore worth making.

d) Practitioners' reasoning in pre-pack cases

This section briefly describes the reasons offered by practitioners for their adoption of a pre-pack strategy. It does not attempt to appraise the strengths or weaknesses of those reasons, an exercise best undertaken after the wider consultation of stakeholders to be carried out in the next phase of the research, but it was thought useful to give an account at this stage of the most common justifications for pre-packs.

Just over one third of the reports surveyed presented a reasonably full account of the practitioners' motives for preferring a pre-pack. By far the most common was that there was no funding available to meet the costs of trading during the procedure itself, even for a very short time, and that therefore the only means of preserving the business was through a pre-pack sale. It was also very frequently noted that there were grounds to believe that any goodwill associated with the business in question would be almost immediately obliterated on the commencement of insolvency. This was most often cited in relation to businesses with a large customer base, and where those customers could reasonably easily find an alternative source of supply. The uncertainty associated with insolvency was seen as potentially fatal to the possibility of selling the business *after* the procedure had commenced, as continuity of supply would become speculative as far as customers were concerned.

The necessity of retaining key employees also figured quite strongly in the justification stakes. Pre-packs were used where it was thought possible that employees critical to the business would be disposed to jump ship if there were doubts as to whether a sale of that business could be concluded in the short to medium term. In many of these cases, the pre-pack sale was to existing management, who, it was reported, were crucial to the business itself or could command the loyalty of its employees if the sale to them was achieved with the minimum of delay. Pre-packs in order to protect book debt collections also featured in the

⁶³ Some might call it a conspiracy theory.

sample. It was noted that some supply contracts, if not fulfilled, could give rise to set-off claims under either the common law or equitable rules, which might, if successful, reduce the value of the debtor ledger quite disastrously. Whether or not such claims had any prospect of success is arguably irrelevant here, as the financial and time costs of defending them would in any event have some depreciatory effect on the value of the estate.

Some cases involved reasons specific to the business in question: in one case a pre-pack was necessary to ensure insurance cover, in another to secure the continuation of a potentially profitable contract: in this case the counterparty was consulted and insisted that the matter be resolved if he was not to exercise his right to terminate the agreement on the appointment of the administrator. One point that should be made about all of these cases is that the practitioners in question had very obviously given considerable thought to the question of explaining their actions to creditors, whether or not those creditors would benefit financially from the pre-pack. Further, and interestingly, these very clear reports were not confined to administrations, with practitioners appointed as administrative receivers explaining their actions in some detail in a number of cases.

Other reports were less expansive. Statements such as 'this method of sale was adopted in order to preserve goodwill', or 'it was felt that the only way to preserve the business was to arrange for its sale prior to the commencement of the procedure' may be technically correct, but creditors must be entitled to ask themselves why a fuller account was not provided. It is worth here citing the remarks of Katz and Mumford:

"One specific finding and recommendation arising from our study is that it should always be made clear in the documentation provided to creditors whether a business sale was to complete a transaction that had been negotiated prior to the administrator's appointment. If it was, then we consider that the documentation should also provide basic background information to help creditors (and regulators and other interested parties) to understand the background to and rationale for the administrator's actions."⁶⁴

The same sentiment is expressed by the Insolvency Practices Council in its 2006 Annual Report as follows:

"We think it is essential that the Administrator should be required to include in his/her report to creditors a specific explanation of why the business was not offered on the open market, even for a short period of time, and why doing so would have been detrimental to the value of the business. A mere assertion that the pre-pack offer produces a higher price than a valuer has estimated for a hypothetical sale should not be regarded as a sufficient justification for setting aside the presumption that putting the business up for sale on the open market would normally be the surest way of maximizing the return to creditors."⁶⁵

These observations, coming as they do from experienced and respected sources, will no doubt be taken very seriously indeed by the profession. The author cannot help but agree that merely nodding in the direction of disclosure in the form of a rather bland statement of justification is hardly adequate, and it goes without saying that giving no account at all of the reasons for the pre-pack is simply unacceptable. As noted earlier, proposed amendments to rule 2.67 of the Insolvency Rules 1986 may compel a much more rigorous disclosure regime

⁶⁴ See *Survey of Administration Cases*, n.40 above, p.51.

⁶⁵ The report is available on the IPC's website at: <http://www.insolvencypractices.org.uk/index.htm>

for the future, but it might be thought apposite that the profession adopts such a regime freely and voluntarily, rather than to appear to do so only under 'duress' as it were.

3. Excluding stakeholders from the decision-making process

It is incontrovertible that pre-packs exclude certain categories of creditors, most perceptibly unsecured creditors, from any input into the decision-making process post-procedure. This is arguably more objectionable in administration cases, where the scheme of the Enterprise Act seems to envisage that all such creditors⁶⁶ should potentially be able to vote on proposals put by the administrators as to the direction of the procedure. This section deals with a number of related questions: firstly, whether this disenfranchisement is necessarily confined to pre-packs, secondly, whether there are circumstances where it is justified, and, thirdly, whether it leads to an unacceptable bias in favour of secured creditors at the expense of unsecured creditors.

a) An exclusively pre-pack phenomenon?

It might be all too easy to fall into the trap of condemning *only* pre-packs as undemocratic in the sense described above. As it turns out, the same charge can be levelled at a significant number of administrations and receiverships in which a sale of the business is effected without the use of a pre-pack. This is purely a function of commercial exigency: in a perfect world, or more accurately in a solvent world, business sales can take place at as leisurely a pace as the parties think fit, with stakeholders⁶⁷ being granted extensive rights of consultation and participation. This is most patently not the case where the business is housed in an insolvent corporate.

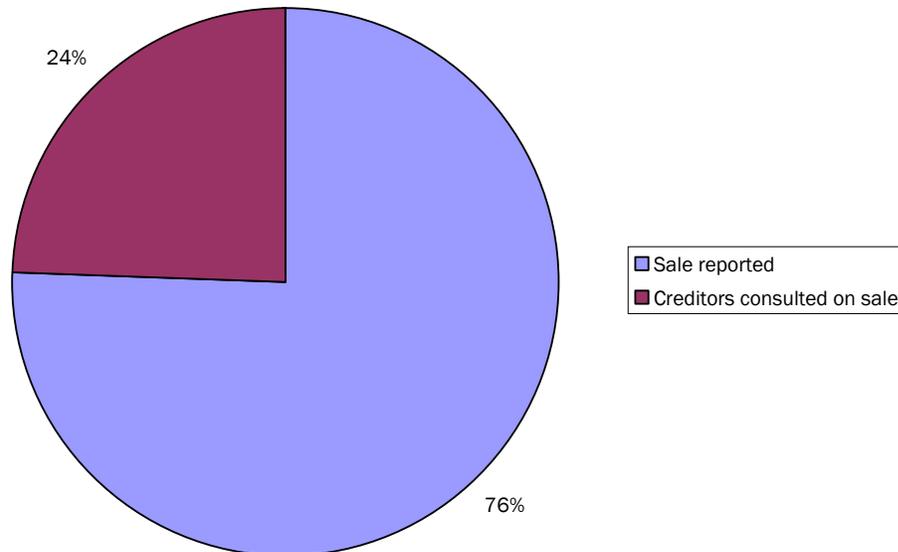
To discover whether or not pre-packs were the *only* instances of going concern sales on which creditors were not given an opportunity to vote, the business sale database was surveyed, most particularly to consider the number of cases where the sale of the business took place before the statement of proposals was sent to creditors. In terms of the whole database of 412 cases, in 97 of those cases the sale date was unknown. In the remaining 315 cases, the sale of the business had taken place prior to proposals being sent in 273 cases (86.7%). Creditors were invited to approve a sale of the business in 42 cases (13.3%).

Of course, this sample would include a significant number of receiverships, where creditors have no voting rights whatsoever, so the same exercise was performed in relation to a subset of cases where the business had been sold in administration. This yielded a total of 164 cases where information as to the timing of the sale was available, and those 164 divided into cases where the sale of the business was reported to creditors in the statement of proposals, as opposed to those where creditors were asked to vote on a proposal to sell the business as a going concern. The results are as follows:

⁶⁶ Secured creditors' voting rights are restricted to circumstances where a proportion of the debt owed to them will be effectively unsecured: see Insolvency Rules 1986, r. 2.40.

⁶⁷ In this context, members and, perhaps, employees.

Table 12: Consultation in Administration Business Sales



a) Observations

It can be seen from the above that while creditors are consulted in proportionately more administration business sales there is nevertheless a very significant majority of cases where the fact of the sale is reported to creditors in statements of proposals. While this will inevitably be the case in 100% of pre-packs, over three quarters of business sales involve no formal voting mechanism on the matter of the sale itself. Therefore, it is patently clear that the disenfranchisement issue is certainly not confined to pre-packs.

This is simply a result of the particular commercial forces at work when it comes to selling the business of an insolvent company. In short, and as the majority of reports pointed out, speed is of the essence. While there may be money available to trade for a short period, long-term trading within insolvency is uncommon. The risk that a trading loss will occur is a real one, and that loss may exceed any gains made from marketing and selling the business. Any premium on goodwill obtainable tends to depreciate the longer the business remains subject to an insolvency procedure, key employees may choose to resign, or may be poached by competitors in the same industry and locality, suppliers may refuse to supply and customers may take their business elsewhere, all factors which combine to reduce the overall value of the estate. These factors, as noted above, were often cited as justifications for adopting a pre-pack strategy. Their relevance is equally pronounced in business sale cases, with the result that creditors are much more often than not excluded altogether from the exercise of voting rights in this context.

b) Is exclusion from participation ever justified?

This amounts to something resembling a ‘West Lothian question’. Put simply, where certain stakeholders cannot expect to receive any financial return from an insolvency procedure,⁶⁸ does this justify their exclusion from the decision-making process? Or, to put it another way, should those creditors be able to influence the strategy adopted by the practitioner in a way that might possibly prejudice *other* stakeholders, most obviously secured creditors and employees?

On one level the answer is perfectly straightforward: the Enterprise Act envisages rights of participation for *all* creditors, whether or not they have any meaningful financial stake in the procedure. However, the legal response is not as clear-cut as this. While, as yet, no case has considered the propriety of a pre-pack sale, there are authorities from both the pre- and post-Enterprise Act era which effectively sanction a strategy involving a business sale without consultation of either creditors or the court. In *In re T&D Industries plc*⁶⁹, a pre-Enterprise Act case, Neuberger J put the matter thus:

“There will be many cases where an administrator will be called upon to make urgent and important decisions and where the urgency means that there is no possibility of a section 24 creditors’ meeting being called to consider the decision prior to it having to be made. However, the importance of the decision and the time involved may well be such that the administrator should have what consultation he can with the creditors. An obvious case might be where there were three days to make a decision and there were only four creditors of the company, or there were four creditors who make up 80% in value of the total creditors of the company. In those circumstances, it seems to me that the administrator should at least consider consulting those four creditors. Whether he should effect any consultation, with whom he should effect it, how he should effect it and what decision he should make following any consultation must be matters for him to decide by reference to the facts of the individual case.”⁷⁰

It is worth noting here that the learned judge made explicit reference to the fact that commercial decisions were the responsibility of the practitioner and that the court was not a ‘bomb shelter’ in this regard.

In *In re Transbus International Ltd*⁷¹, a post-Enterprise Act case, Lawrence Collins J was perhaps even more forthright in his views:

“There will be many cases where the administrators are justified in not laying any proposals before a meeting of creditors. This is so where they conclude that the unsecured creditors are either likely to be paid in full, or to receive no payment, or where neither of the first two objectives for the administration can be achieved: see paragraph 52 of the Schedule. If, in such administrations, administrators were prevented from acting without the direction of the court it would mean that they would have to seek the directions of the court before carrying out any function throughout the whole of the administration. The Enterprise Act 2002 reflects a conscious policy to reduce the involvement of the court in administrations, where possible.”⁷²

⁶⁸ As will be seen below, a not uncommon scenario.

⁶⁹ [2000] 1 WLR 646.

⁷⁰ *Ibid.*, pp.657-658.

⁷¹ [2004] 1 WLR 2654.

⁷² *Ibid.*, para.14.

The explicit reference to cases where administrators have concluded that creditors will receive no payment as among those where a failure to lay proposals before a creditors' meeting is justified is interesting, and goes further than the remarks of Neuberger J in *T & D Industries*. Of course, neither case is specifically concerned with the question of whether it is legitimate to act without putting *proposals* to creditors, looking instead to the creditors' meeting as the decision-making organ, but in substance this must amount to the same enquiry.⁷³

If these two decisions are correct, it appears that the Enterprise Act itself admits of circumstances where a failure to consult is justified in administration. That does not, however, deal with what is best described as the policy decision of whether it is acceptable to routinely exclude stakeholders on the basis of the absence of any financial stake. This is a question directed not so much at the pre-pack strategy, where blanket exclusion will be inevitable, but rather at business sales in general, and so will not be examined further here. It may, however, be thought relevant to the overall debate on the propriety of pre-packs.

4) Bias towards secured creditors: provision of information and control rights

It was noted above⁷⁴ that it is highly likely that secured creditors will be kept well informed as regards pre-packs and, further, that they may be able to exercise a degree of control over the strategy. The bias in question here relates to the question of accountability: it is almost unquestionable that secured creditors will be better informed and more in control of pre-packs than their unsecured counterparts, although, as seen above, the same can probably be said of the majority of business sale cases. What is at issue, therefore, is whether this fact in itself places unsecured creditors at an unacceptable disadvantage when it comes to holding presiding practitioners to account for their actions. This issue will be brought most sharply into focus where there is an element of conflict between the interests of the secured creditor and those of unsecured creditors.

It is worth noting that the Insolvency Act appears to sanction the prioritisation of the interests of secured and preferential creditors, but subject to a qualification. Paragraph 3(2) and (4) of Schedule B1 provides:

(2) Subject to sub-paragraph (4), the administrator of a company must perform his functions in the interests of the company's creditors as a whole.

(4) The administrator may perform his functions with the objective specified in sub-paragraph (1)(c) only if –

- (a) he thinks that it is not reasonably practicable to achieve either of the objectives specified in sub-paragraph (1)(a) and (b), and
- (b) he does not unnecessarily harm the interests of the creditors of the company as a whole.⁷⁵

The critical issue is therefore whether a pre-pack strategy which realises only sufficient to discharge all or most of the secured debt *unnecessarily* harms the interests of the

⁷³ Particularly as the Enterprise Act explicitly contemplates circumstance in which no creditors' meeting will be called: Schedule B1, para.52, noted above.

⁷⁴ See pp.27-28.

⁷⁵ It is possible that objective (b) of paragraph 3 could also be adopted in a pre-pack.

company's creditors as a whole or, more accurately, whether information deficits and a lack of control leaves unsecured creditors unable to hold the practitioner to account where they suspect this is the case.

Unsecured creditors may be considered vulnerable to this form of bias because, as noted above, they lack the commercial power of creditors of the secured variety, they are dispersed and therefore less able to mobilise, and they may lack the financial, as well as the informational, resources to mount a challenge. This is more emphatically the case where an administration moves to CVL under the same practitioners, so that no independent liquidator can scrutinise predecessors' actions.

However, it is also important to acknowledge that to bundle unsecured creditors into a homogenous group as though they are all possessed of the same characteristics may be misleading and distortive of the particular problems posed by pre-packs. Unsecured creditors, for example, now include among their ranks Her Majesty's Revenue and Customs, following the abolition of the Crown preference under s.251 Insolvency Act 1986. Revenue and Customs can hardly be described as vulnerable, except perhaps in the sense that funds allocated to it by the taxing legislation are subject to account in arrears, and therefore may be used by an ailing company in a desperate attempt to keep trading.⁷⁶ In some respects the Crown departments share characteristics of secured creditors: they are repeat players and they have resources to fund litigation. Equally, the emergence of a healthy credit insurance market may be of relevance here, as individual and dispersed creditors' claims are subrogated to a player of more commercial strength and experience. As yet, there have been no formal indications that these 'super' unsecured creditors are inclined to dedicate resources to challenging pre-packs. There are, however, numerous anecdotal claims that they are rapidly mobilising, and that the dam may be about the break. It remains to be seen whether this turns out to be the case or not.

To return to the query posed above, it is only possible to answer it intuitively here, and it will be further examined in the next phases of the research. It is arguably more pressing in relation to pre-packs, however, precisely because there may be an inadequate exposure of the business to market forces, so that the price paid is carefully calculated so as to cushion the secured creditor, without any real effort to extract a premium for others. If this is the case,⁷⁷ the complete lack of control rights and an inadequate provision of information on the part of the practitioner to unsecured creditors effectively disables them from calling upon the practitioner to demonstrate that he has paid due regard to the statutory scheme for protecting their interests. One solution to this dilemma is reasonably straightforward, and has already been suggested by many commentators, and that is that practitioners should routinely provide creditors with information sufficient to enable them to assess whether their interests have been *unnecessarily* prejudiced. An alternative would be to ensure that wherever a pre-pack occurs then any follow-on liquidation is conducted by a different practitioner.⁷⁸ Finally, this may be an area in which the regulators might devise appropriate stratagems in terms of monitoring.

⁷⁶ It is notable that sums owed to Crown creditors, where these are available in the reports, are often disproportionately higher than those owed to both secured and unsecured trade creditors.

⁷⁷ Another question to be investigated, in outline in this report and in depth in the later stages of the research.

⁷⁸ The author cannot take credit for this idea, which was proposed by a practitioner with experience of pre-packs.

5. Conclusions

The whole of section D is concerned with the imbalances in the provision of information, and with the quality of information that is provided. Overall, if there are difficulties in this respect they cannot be wholly associated with pre-packs, but that does not mean that they need not be addressed. It might be thought that many of the criticisms of a lack of transparency in pre-packs are worthy of consideration: the plain truth of the matter is that if creditors consider that they have not been properly informed about a pre-pack, they are likely to suspect that this is deliberate subterfuge to mask something dubious at best and downright crooked at worst. Full disclosure of all material facts, on the other hand, will at least allow creditors to make a properly informed judgment. They may not be particularly happy about the outcome, but at least they will be more inclined to consider that outcome a consequence of the financial position of the company rather than a 'cosy deal' struck between practitioners and other parties.

E. Profiles of purchasers

1. Sales to connected and unconnected purchasers

This section examines the question of whether pre-packs are inherently biased towards a sale of the business to a party connected to the vendor company.⁷⁹ It is therefore concerned primarily with the contention that pre-packs are ‘usually’, or ‘invariably’ made to parties who themselves hold equity in Oldco, or were concerned in its management, or both. It should be noted that there is nothing *intrinsically* objectionable about selling the business of an insolvent company to its existing stakeholders, and, indeed, there may be perfectly valid commercial reasons for doing so.⁸⁰ Further, there is some evidence that government policy in this regard is to encourage a ‘second chance’ culture in the arena of corporate insolvency.⁸¹

Having said that, the level of creditor suspicion and mistrust associated with pre-packs must surely be exacerbated when Newco is owned and controlled by the same people as Oldco. As noted at the beginning of this report, this smacks of the discredited practice of ‘phoenixing’, whereby the assets of an insolvent company were parcelled up and sold to its owner/managers by a tame liquidator for a consideration well below their worth and with no regard for the plight of its creditors. The substantive question of whether such sales are ever justified is not addressed here: rather, this section examines whether connected sales are a more pronounced characteristic of pre-packs than business sales. Once again, pre-packs in administrations are probably more likely to attract misgivings in this respect, and particularly post-Enterprise Act administrations where the appointment may have been made by the company or its directors. Therefore this section surveys all pre-packs, as well as those conducted in administration, both pre- and post Enterprise Act to see whether any notable trends emerge.

a) The sample

The databases record, where such information is available, the identity of Newco and whether there is a connection between Oldco and Newco. For business sales, this information was available in 336 of the 412 cases (81.6%) and for all pre-packs in 211 of the 227 cases (93%). For business sales taking place in administration, information on the destination of the business was available in 184 of all cases (82.9%) and for pre-packs in administration (118 cases in all) that information was available in 109 cases (92.4%). As for the breakdown between pre- and post Enterprise Act administration pre-packs, 40 cases were pre-Enterprise Act, for which information as to the purchaser was available in 34 cases (85%). 78 cases took place post-Enterprise Act, with information available for 73 (93.6%).⁸²

⁷⁹ For the sake of convenience, Newco and Oldco respectively.

⁸⁰ The most frequently cited of which was that the connected party was the *only* potential purchaser of the business.

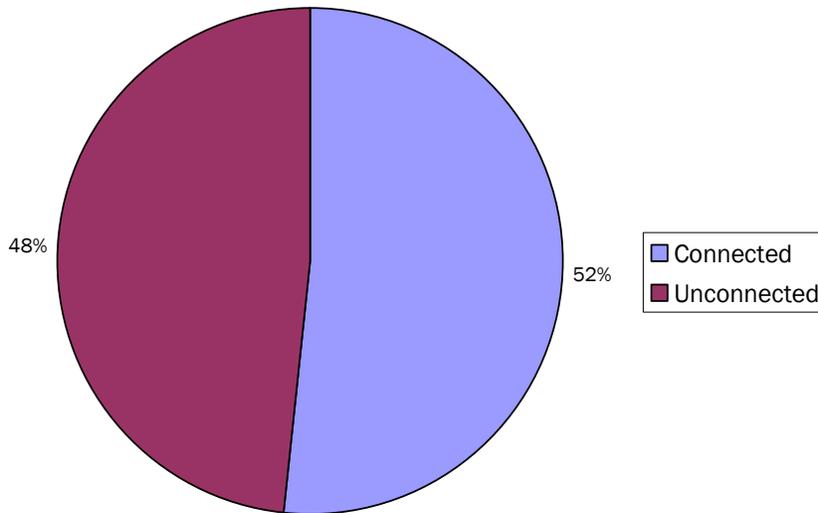
⁸¹ For which one need look no further that the title page of the White Paper preceding the Enterprise Act: see *Productivity and Enterprise: Insolvency – A Second Chance*, The Insolvency Service, Cm 5234 (2001), although whether the second chance in question should be conferred on the company or its existing owners and directors is perhaps debatable.

⁸² This may support a view that more information on this specific aspect of pre-packs is being provided over time. If so, this is to be welcomed.

2. Pre-packs and business sales compared

The two tables below show the proportion of sales made to connected and unconnected parties in all business sales and all pre-packs respectively.

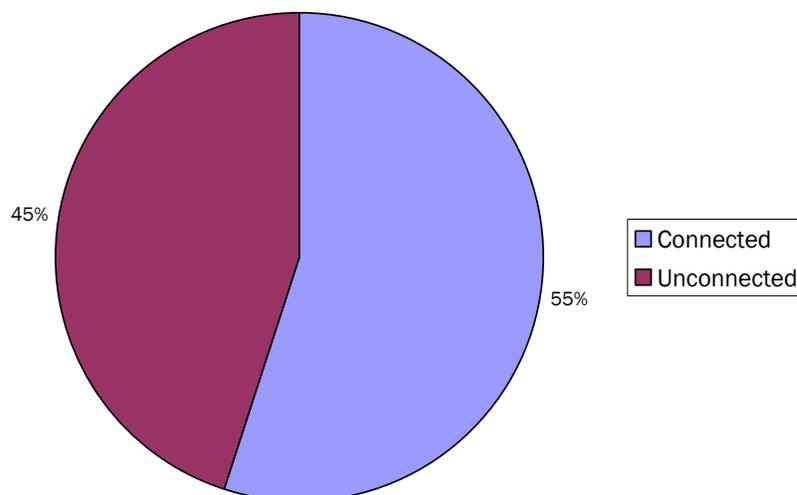
Table 13: Purchasers in all business sales



a) Observations

As noted above, this sample contained 336 cases, which represents 81.6% of all business sales. The table below represents 93% of the entire sample of pre-packs, so that the larger size of this sample should be borne in mind.

Table 14: Purchasers in all pre-packs

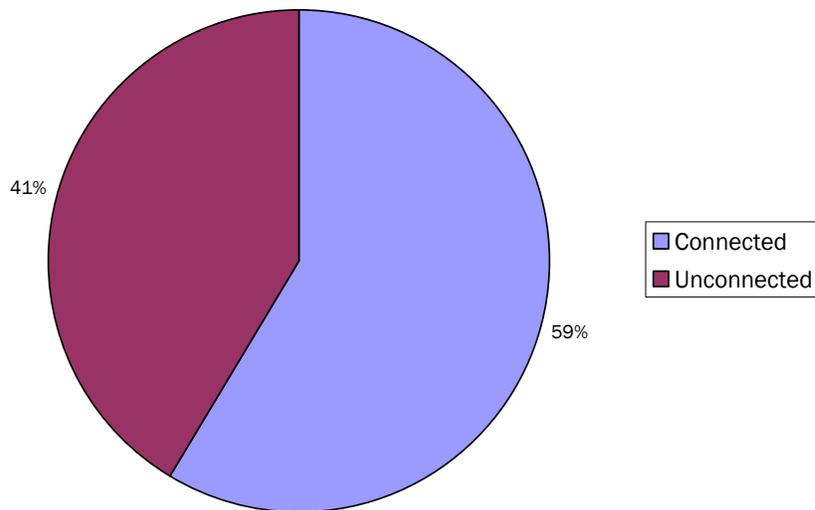


b) Observations

There is a slightly higher percentage of sales to connected parties in pre-packs than in business sales. However, because of the relative size of each sample it cannot be stated that a pre-pack sale is inherently *more likely* to result in a sale to a connected party than a business sale.

The next table extracts the figures for all administration pre-packs in the sample.

Table 15: Purchasers in administration pre-packs

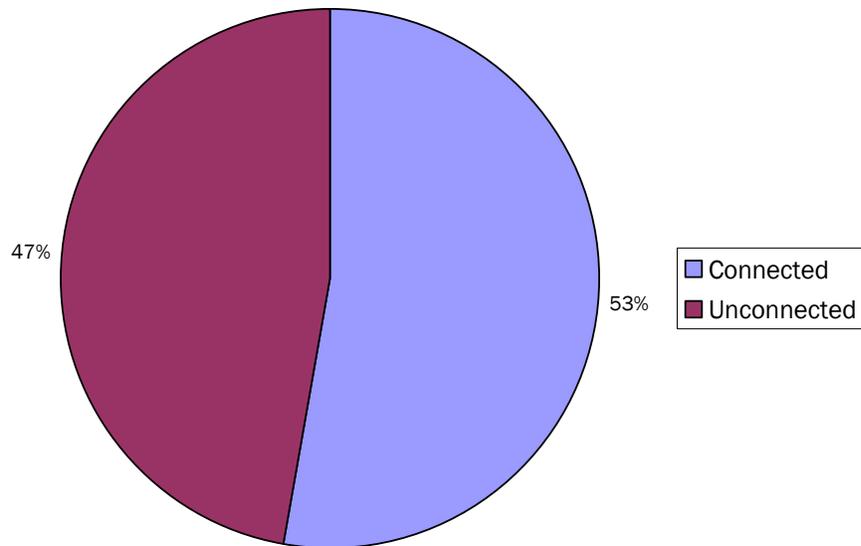


c) Observations

This table is interesting in that it seems to demonstrate that administration pre-packs result in a slightly larger proportion of sales to connected parties than the overall sample of pre-packs. This table draws on information from a sample of 118 cases for which information on 109 cases was available, the overall pre-pack sample comprising 227 cases. There is, therefore, no inherent bias in the sample which might skew this outcome.

Perhaps the most interesting comparison of all in this section is between pre- and post Enterprise Act administration pre-packs. As will be seen below, there appears to be a quantifiable trend towards sales to connected parties in the latter sample.

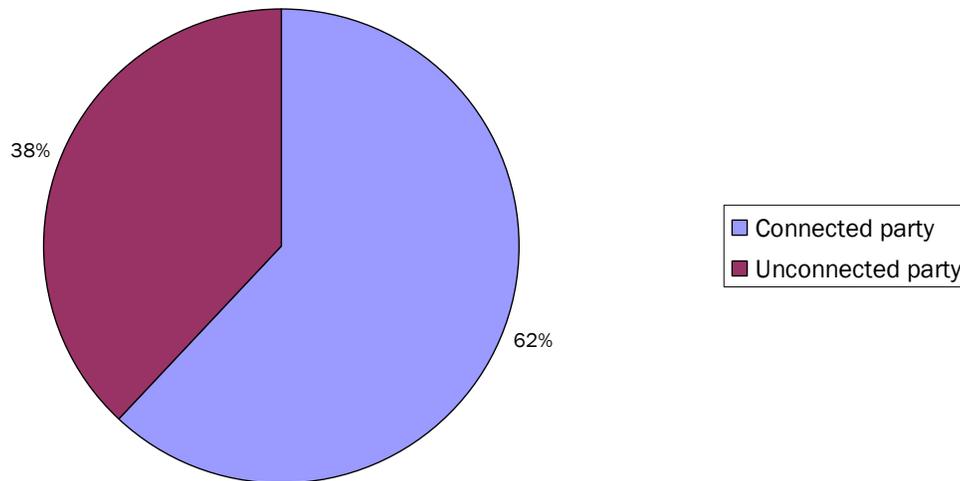
Table 16: Purchasers in pre-Enterprise Act administration pre-packs



d) Observations

This table is closer in profile to the entire sample of business sales, although a note of caution should be sounded in that it is made up of a much smaller number of cases (34) and comprises 85% of the total number of pre-Enterprise Act pre-packs. The table below, for post-Enterprise Act is made up from 73 cases, representing 93.6% of the entire post-Enterprise Act administration pre-pack sample.

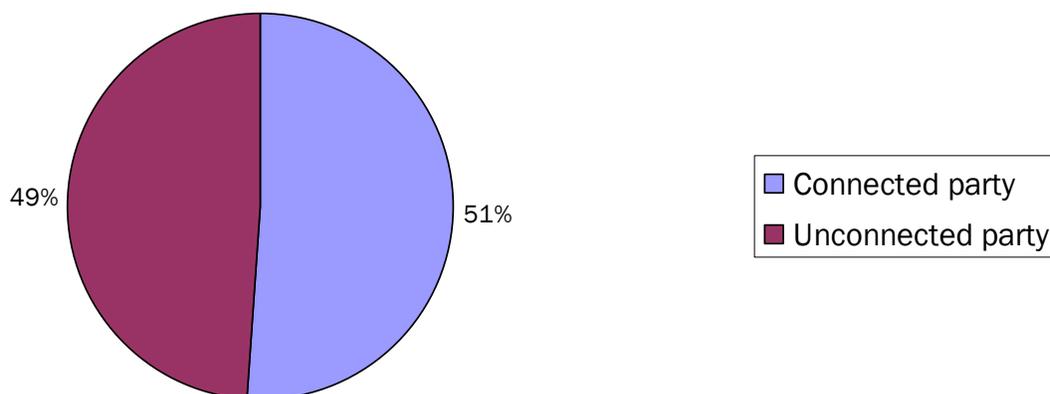
Table 17: Purchasers in post-Enterprise Act administration pre-packs



e) Observations

Notwithstanding the difference in sample size between pre- and post-Enterprise Act administration pre-packs, there is a discernible trend towards sales to connected parties. The final quantitative enquiry was therefore whether or not this trend was more or less pronounced in pre-packs than in business sales. To test this, the post-Enterprise Act sample of administration business sales was used, which comprised 103 cases for which information on purchasers was available, which represents 78.7% of the entire sample of 131 post-Enterprise Act administration business sale cases.

Table 18: Purchasers in post-Enterprise Act administration business sales



f) Observations

Once again, there is something of a mismatch in the size of each sample from which the above two tables were constructed. However, there is sufficient evidence to suggest that sales to connected parties have become more common in pre-packs taking place in post-Enterprise Act administrations.

g) Conclusions

The inference from the above is that the Enterprise Act, with its relaxation of the entry route into administration, has facilitated both pre-packs and sales to connected parties within pre-packs. Or, to put it another way, there is a demonstrable trend towards pre-packs to connected parties in post-Enterprise Act administrations. Further research is necessary to determine convincingly why this should be, and, indeed, whether it is a positive, negative or neutral trend. For the present the following tentative remarks can be made.

Firstly, the obvious point to make is that any acceleration in the rate of pre-packs to connected parties in the post-Enterprise Act period must surely be prompted by the changes made in that act to the methods of entry into administration. Unfortunately, it is difficult to discern whether this is a director-led trend, the most obvious conjecture being that it is. This is because it is not always clear whether the appointment in question was made by the court under paragraph 12 or by the company and/or its directors under paragraph 22. Even if this was a straightforward exercise, the influence of secured creditors on the appointment method has already been mentioned and should not be underestimated.

Secondly, although the trend seems to be accelerating in administration pre-packs, the actual figures for sales to connected parties are not startling enough to cause concern.

Indeed, in all cases where the business is sold, this is more often than not to a connected party. Interview data from the next stage of the research may confirm the author's instinctive response that the commercial backdrop to pre-packs makes it inherently more likely that Newco will be connected to Oldco. The very fact that a business is exposed to the market, even for a short time, may reduce the opportunities to a connected party to acquire the business.

Thirdly, and perhaps most importantly, whether or not this trend is positive needs to be investigated thoroughly.⁸³ In some senses it might be thought so, if it is symptomatic of the 'second chance' culture taking hold. The polar opposite view, of course, is that it is entirely negative, allowing those directors who may well have been responsible for the failure of Oldco in the first place an entirely fresh start in a new vehicle free of the very debts that they allowed Oldco to run up.

Fourthly, this question cannot be viewed in a vacuum. One might easily forget the very interesting question as to why directors of a failed company would actually wish to retain control of the business, and to pay for the privilege of so doing. A number of responses commend themselves, some of which are more principled than others. It may be, for example, that the insolvency of Oldco was caused by factors entirely external to the business and the way in which it was managed.⁸⁴ To deny directors in these circumstances their second chance might well be thought injudicious. Where their desire to purchase the business is driven more by the spectre of a personal guarantee executed in favour of the secured creditor⁸⁵ than any genuine belief that the new vehicle represents a potentially profitable and successful enterprise, one might take an altogether less sanguine view of the matter.⁸⁶

Overall, therefore, this would appear to be an area ripe for additional investigation. The focus of this will be on the explanations for the trend towards pre-packing to connected parties, and the desirability or otherwise of this trend. It is hoped that the final report will be able to comment more authoritatively on both of those points.

⁸³ There is a further examination of this aspect in Part II of this report – see below at p.78

⁸⁴ The 'disaster' scenario.

⁸⁵ And very likely secured by a charge over said directors' houses.

⁸⁶ Unfortunately, the existence of personal guarantees was not a matter routinely commented on in reports, although some mentioned the fact that the company's directors had agreed to act as surety in favour of its main creditor. An attempt to track personal guarantees was therefore regrettably abandoned, although the forthcoming interview phase of the research could be used to gather information in this respect.

Part II: Outcomes for stakeholders in pre-packs

A. Introduction

This part of the report considers the relative outcomes for stakeholders of the insolvent company in pre-packs and in business sales to determine whether there are any significant examples of benefit or prejudice as between the two methods of going concern sale. It focuses on two types of outcome: the financial, in terms of returns to various classes of creditors, and that of employment preservation, so that 'stakeholders', in this context, includes the company's employees.

To reiterate, there is a perception that pre-packs may not be best placed to maximise realisations because a failure to expose the business to the market may mean that the opportunity to capture the premium generated by competition is lost. This may have adverse consequences for all creditors, or for a particular class of creditors. This contention is tested by measuring returns to classes of creditors in all pre-packs and all business sales, and attention is also given to the performance of administration pre-packs in this regard.⁸⁷

The position of the company's employees is also considered to be a viable area for scrutiny. The insolvency legislation is studiously silent on the extent to which employment preservation is a legitimate concern for insolvency practitioners. While it confers preferential status on their claims, it does not explicitly require their interests to be prioritised, or even considered in the course of an insolvency procedure, the hub of which is invariably corporate creditors, and in a strict hierarchical structure. However, to the extent that a particular strategy is instrumental in preserving employment, it might be considered a success, and in some respects superior to alternative approaches which do not have this effect. Therefore an account of the fate of corporate employees is included in this part.

Some remarks on the methodology

Measuring value to creditors is a reasonably straightforward task, involving no more complicated an exercise than calculating the percentage of return they receive from the procedure in question. However, the enquiry becomes more complex when creditors are broken down into their various hierarchical classes, and their returns compared along those lines. The position is complicated further still by legislative initiatives which have a redistributive effect at a point roughly two thirds along the timeline on which this entire report is based. Finally, this is an area in which relevant information is most often unavailable, the reasons for which were mentioned earlier. The most notable omission is in the level of returns to unsecured creditors in a relatively large number of cases of both pre-packs and business sales, and this was most frequently because the underlying procedure itself, or a follow-on liquidation, was still ongoing in May 2007 (the cut-off point for data retrieval). This was the case in 169 of the 412 business sales in the sample (41.0%) and in 74 of the cases in the sample of 227 pre-packs (32.6%).⁸⁸ Thus, the information on which this comparison is based is by no means complete, and this necessarily weakens, sometimes quite intensely, the statistical significance of any findings. A note has been made in the main body of the report where this is thought to be most pronouncedly the case. However, in terms of providing an overview of how pre-packs affect creditors, it is suggested that some insights

⁸⁷ Because of the administrator's specific 'duty' not to unnecessarily harm the interests of creditors.

⁸⁸ It is too early to state whether these figures indicate that pre-pack cases are closed more quickly than business sale cases, and this question will be examined later in the research.

can be gained from what follows, and it should be emphasised that many of the gaps in the current information will be filled as the database is updated.

B. Pre-packs and creditors: a snapshot

1. Maximising realisations: marketing and valuations

Before considering in detail levels of return in pre-packs and business sales, it was considered useful to examine a fundamental concern about the former, namely that marketing will take place rarely if at all, and that this may have a depressive effect on realisations. A further criticism is that pre-packs may not involve a sufficiently robust valuation exercise. This second question is more difficult to address properly here, and requires the input of experts in the area of valuation of businesses. Their views are to be sought in due course, and here all that can be done is to document whether a valuation has taken place prior to sale. Even this was no easy matter, as some reports made no mention of whether the services of valuers had been engaged or not.⁸⁹

As far as the question of marketing is concerned, the databases both attempt to document whether any form of marketing has taken place or not, but again the best that could be done was to answer that question in the positive where reports indicated that this was the case. As far as pre-packs are concerned, it was considered reasonably safe to assume that no marketing of the business had occurred prior to the eventual sale unless the reports expressly indicated otherwise.⁹⁰ If this is the case, only 18 of the 227 businesses on the pre-pack database were marketed (7.9%). This should come as no surprise, unless that figure is higher than might have been expected. As to the method of marketing in pre-packs, this varied from case to case. Seven of the 18 cases referred to a reasonably widespread marketing campaign carried out by management and their agents in the months preceding the eventual pre-pack. In five of these cases a purchaser had been identified and eventually purchased the business through a pre-pack, but after a separate period of negotiation with the practitioners. A further four cases involved practitioner involvement in the marketing strategy, usually on a much smaller scale and over a shorter time period. Tactics adopted here included the use of specialist agents and in-firm databases of companies in a similar location and sphere of activity in order to identify prospective purchasers, who were then approached by the practitioners or their agents.⁹¹

For business sales the reports positively indicating that a marketing strategy had been undertaken were much higher in number. Out of the 412 cases on the database, 229 (55.6%) gave some account of a marketing campaign. Unlike the pre-pack reports, however, it is probably not a reasonable assumption that where no explicit reference to marketing is made this probably means that no marketing took place.⁹² The methods used here were slightly more varied than those reported in relation to pre-packs. Advertisements in the *Financial Times* were often used, as were advertisements in local newspapers. The use of agents was widespread, especially where the business in question was highly specialised in nature.⁹³ It is clear that a number of firms, and not just those at the larger end of the market,

⁸⁹ See p30 above.

⁹⁰ The author is perfectly open to arguments that this assumption is simply misplaced.

⁹¹ Possibly under cover of darkness and using *Da Vinci Code*-derived ciphers so as to ensure as far as possible that the company's distressed situation did not become public knowledge.

⁹² Obviously, this is a question to be put to practitioners.

⁹³ The author's particular favourite was a rope-making business, which the practitioner described as a victim of its own success, its products being so durable that demand for replacements was almost

maintain detailed records of corporate activity in their own specific locations or on a wider regional basis, and that these are consulted to pinpoint marketing strategy on a geographical or sectoral level. It is also clear that many practitioners working in smaller firms or one-man practices have developed very effective networks upon which to call when the sale of a business is contemplated, and although word of mouth may not be the most public method of marketing it may well be extremely efficient, and certainly cheap.

The business sale database did, however, contain 33 cases (8%) where it appeared reasonably clear that the business was not marketed before sale. A factor common to all of these cases was that the sale was made within one week of appointment, and to a connected party. Also, in 22 of the 33 cases, advice from agents suggested that the time and expense involved in marketing the business would be highly unlikely to deliver corresponding benefits, either because of the highly specialised nature of the business or, at the other end of the scale, a perception that the market was already saturated and the only likely interest would be in individual or groups of assets. The remaining 150 cases were simply silent on the question of marketing, most of them reporting that a sale had already taken place, or that attempts were being made to sell the business.

Pre-packed businesses were valued in 190 out of 227 cases (83.7%), although, as noted above, this may be undercounting as the remaining 22 cases did not positively state that no valuation had taken place, and abstracts of receipts and payments were somewhat ambiguous. For business sales, the figure is 364 out of 412 cases (88.3%), subject to the same disclaimer. The author's complete ignorance of valuation methods and procedures precludes much in the way of further discussion at this stage, but the issue of valuation is clearly critical to an evaluation of pre-packs, and will be fully researched in due course. Questions arising are as to what valuation mechanisms or techniques are used, whether valuers are given sufficient time and resources – particularly in larger cases – to conduct an accurate valuation, to what extent actual and potential employee liabilities are taken into account,⁹⁴ and how far the consideration in a pre-pack is calculated by reference to a pre-obtained valuation. Other pertinent enquiries will no doubt emerge as the research progresses.

2. Average percentage returns to creditors: a basic approach

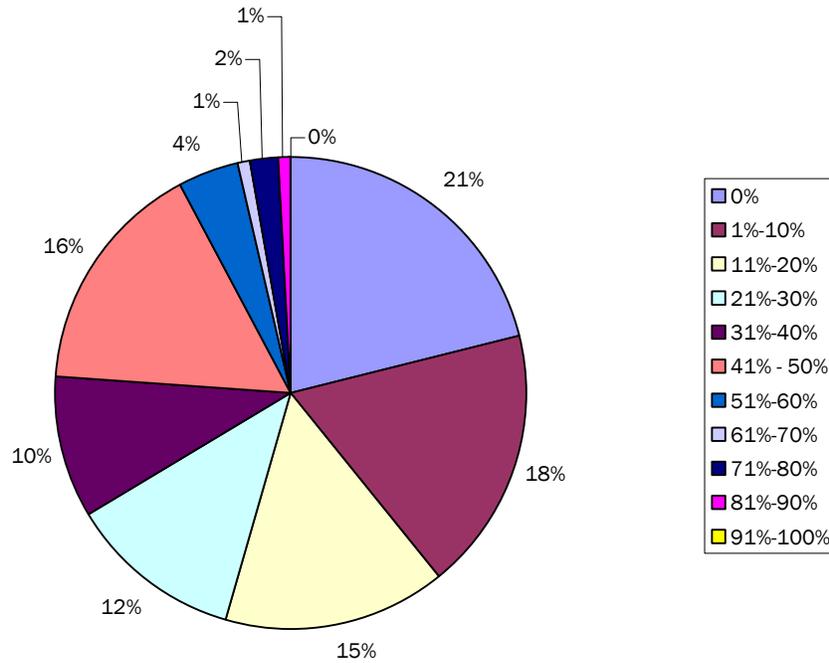
As a starting point, the overall average return for all creditors was calculated for pre-packs and for business sales. Any cases where a procedure was ongoing, or where the case had closed but where information on returns to a particular class of creditor was unavailable, were excluded. For pre-packs, this sample comprised 143 cases (63% of the entire sample) and the average return to all creditors was 22%. For business sales the sample comprised 239 cases (58% of the sample) and the average return to all creditors was 21.8%. This is an undeniably crude method of comparison, but it can act as a simplistic indicator of the fact that, in very general terms, pre-packs do not necessarily under-perform when compared to business sales, and, in fact do marginally better.

Clearly, however, a much more exhaustive analysis of the matter of returns is called for. A further illuminating exercise was to break down the level of returns to all creditors into categories and to chart the frequencies of returns in each category for both pre-packs and business sales. The results of this analysis are illustrated in the following two tables.

non-existent. This report demonstrated, if nothing else, that corporate insolvency can be as much a tragedy for the company as for its creditors.

⁹⁴ The significance of this point will become clearer later.

Table 19: Average Overall Returns - Pre-Packs

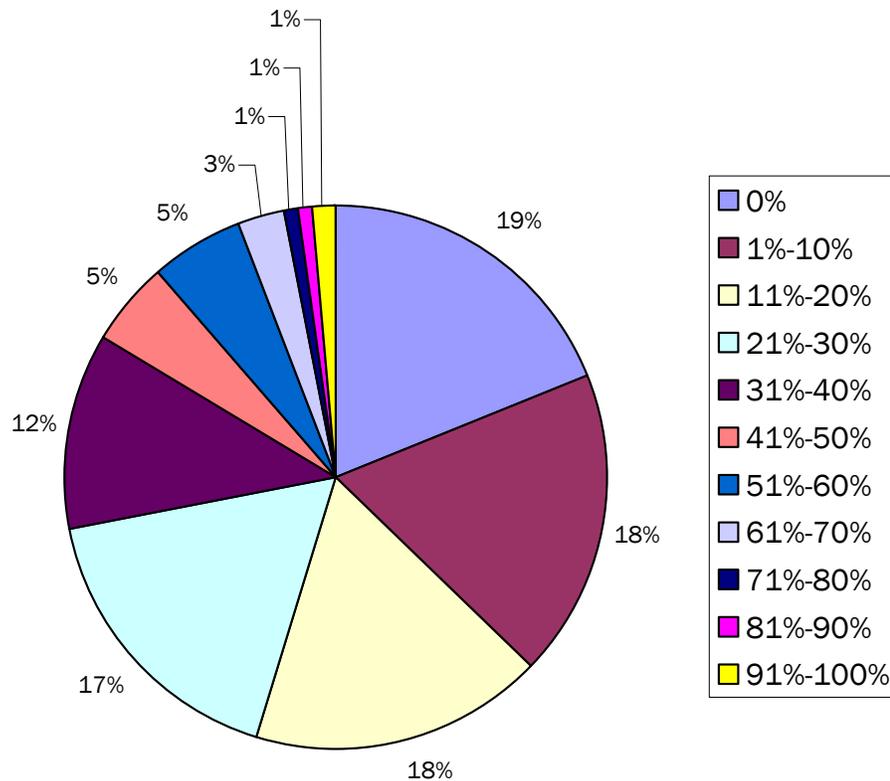


a) Observations

For pre-packs, 21% of cases returned nothing to any class of creditor,⁹⁵ and a further 45% of cases returning on average less than 30%. The figures for business sales are shown on the next page.

⁹⁵ The phenomenon of the 'insolvent insolvency' where any realisations are eaten up by the costs and expenses of the procedure.

Table 20: Overall Average Returns - Business Sales



b) Observations

Here there are slightly fewer cases of zero returns, but 7% more cases where the average return was under 30%. A comparison of the two tables seems to demonstrate that the pre-packs deliver notably higher levels of mid-range recoveries (i.e., 40%-60%, accounting for 20% of all pre-packs as compared to 10% of all business sales), whereas business sales perform marginally better in delivering at the very top end of the scale.

The next stage was to consider average returns to classes of creditor, namely secured, preferential and unsecured creditors in both pre-packs and business sales. It should be acknowledged that this necessarily involves sub-samples that vary in size and proportion to the entire sample in each category of sale. Secured creditors, having priority conferred upon them purely by virtue of the contractual arrangements granting the security interest, are almost invariably paid as soon as funds become available to them⁹⁶, so that more cases for analysis were available. Even where the procedure was ongoing, it was often the case that reports, or abstracts of receipts and payments, indicated that the secured creditor's debt had been fully discharged. Figures for unsecured creditors, by contrast, were only available where the procedure itself was closed.⁹⁷ Preferential returns fall somewhere between these two extremes, and the abolition of the Crown preference resulted in no preferential debt being owed in a number of post-Enterprise Act cases. Whether or not variances in sample sizes may lead to ambiguity in the analysis will be addressed at various stages on this part.

⁹⁶ From fixed charge assets, or, where preferential creditors have been or will be satisfied, from remaining floating charge assets.

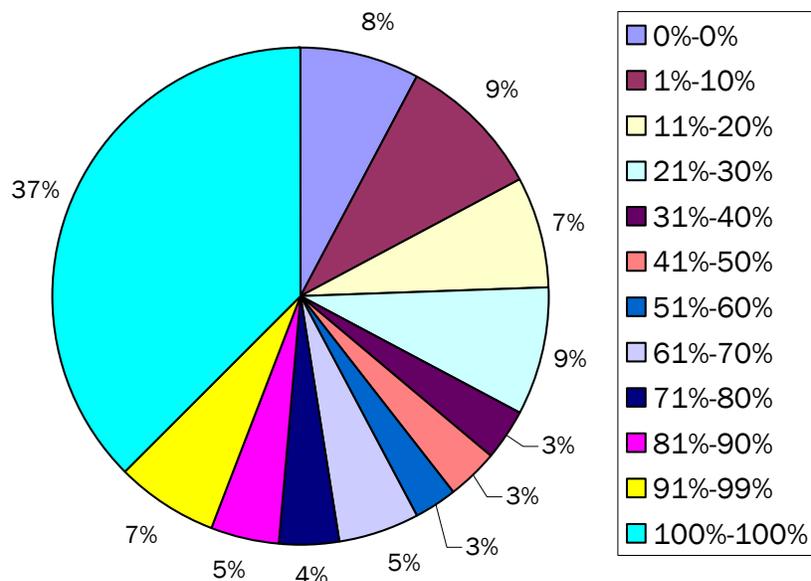
⁹⁷ And the company had been dissolved.

3. Secured creditors: all pre-packs and business sales

Records were available in 152 of the 227 pre-pack cases (67%) and in 251 of the 412 business sale cases (60.1%). The average return to secured creditors in pre-packs was 42%, and in business sales the average return was 28%. This is a significant difference, notwithstanding the variance in sample size, and points to the conclusion that secured creditors can expect a higher average return from a pre-pack than from a business sale.⁹⁸ It should be added that both samples were checked for secured indebtedness of unusual magnitude which might have distorted the results, but none was present in either. It is also worth recalling here that, after excluding potentially distorting levels of secured debt, the average secured debt was £1,561,827 for pre-packs and £1,276,124 for business sales.⁹⁹

The frequencies of categories of return to secured creditors in pre-packs and business sales make interesting viewing.

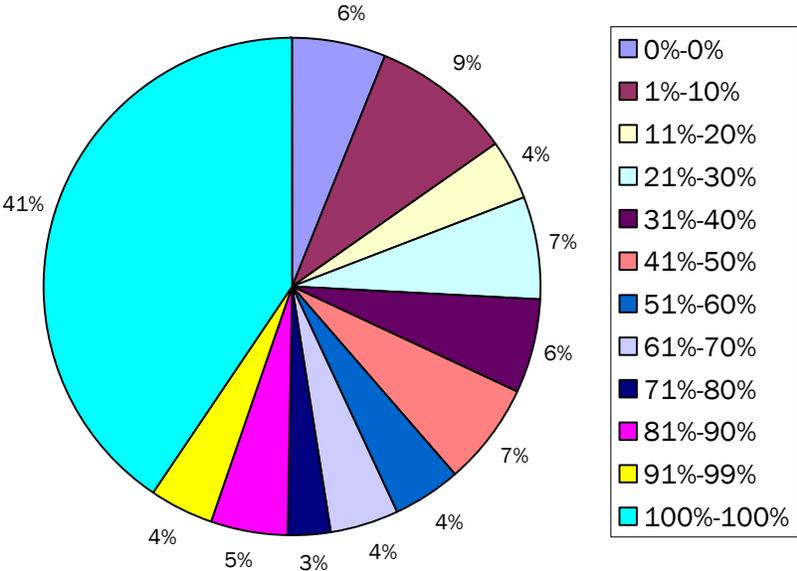
Table 21: Secured Returns - Frequencies - Pre-Packs



⁹⁸ The possible explanations for this are explored in outline later in this report, and will be investigated in detail during the interview phase of the research.

⁹⁹ See above, p.22.

Table 22: Secured Returns - Frequency - Business Sales



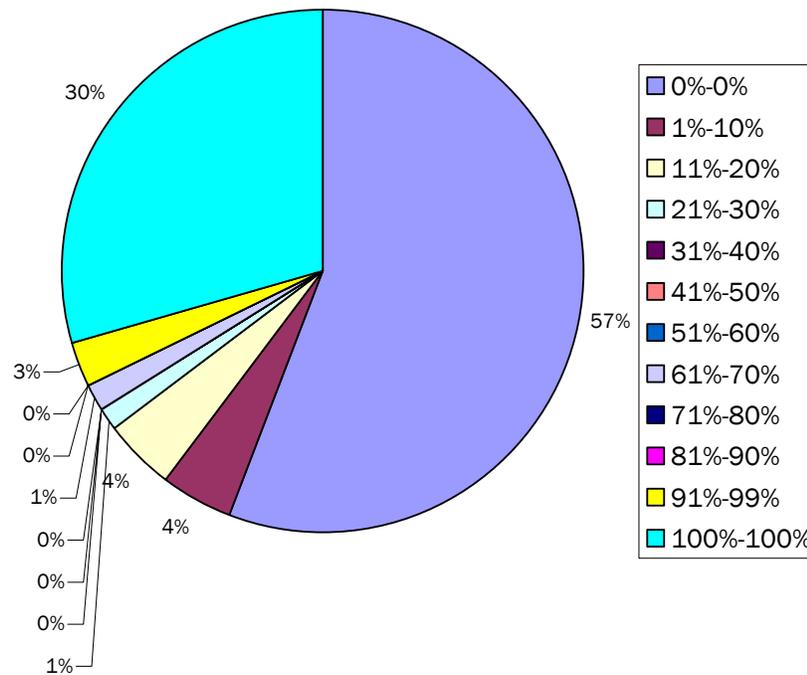
a) Observations

Here, as in relation to overall returns, business sales deliver proportionately more cases of higher returns, with 41% of cases delivering a 100% return as compared to 37% of cases in pre-packs. Business sales also result in zero returns in fewer cases than pre-packs. This finding might seem to be at variance with the assertion above that pre-packs seem to deliver a much better average return for secured creditors than do business sales, but an explanation for this is offered a little further on in this section.

4. Preferential creditors: all pre-packs and business sales

The average return to preferential creditors in all pre-packs was 13%, this being derived from a sample of 68 cases for which information was available (30% of the entire pre-pack sample). For business sales the average return was 38%, derived from a sample of 188 cases (45.6% of the entire sample). Clearly, the sample sizes vary more sharply here, and this is explained by the fact that, as will be seen shortly, the number of cases where no preferential debt is owed is significantly higher in pre-packs than in business sale cases. The initial impression that business sales deliver higher returns to preferential creditors than pre-packs is therefore subject to some qualification. The breakdown into frequencies of return for pre-packs and for business sales is as follows:

Table 23: Preferential Returns - Frequencies - Pre-Packs

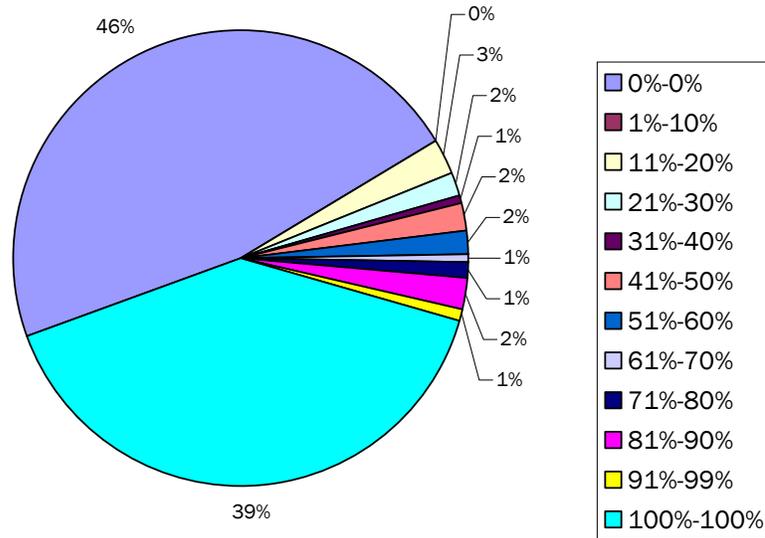


a) Observations

The most notable feature of this table is the predominately ‘all-or-nothing’ performance of pre-packs when it comes to returns to preferential creditors. They receive zero return in 57% of cases and 100% return in 30% of cases. Only 13% of cases fall between these two extremes. The impact of the Enterprise Act, and specifically the abolition of the Crown preference, will be examined shortly, as will one further, and perhaps important explanation for this outcome.

The corresponding table for business sales below demonstrates a similar pattern, but with a notably higher level of 100% returns and, as a corollary, a conspicuously lower level of zero returns. Again, the variance in sample size somewhat weakens the absolute authority of any finding that business sales perform better than pre-packs in terms of returns to preferential creditors, but there is nevertheless some evidence here to suggest that this is the case. Again, possible explanations for this are reserved for later in this section.

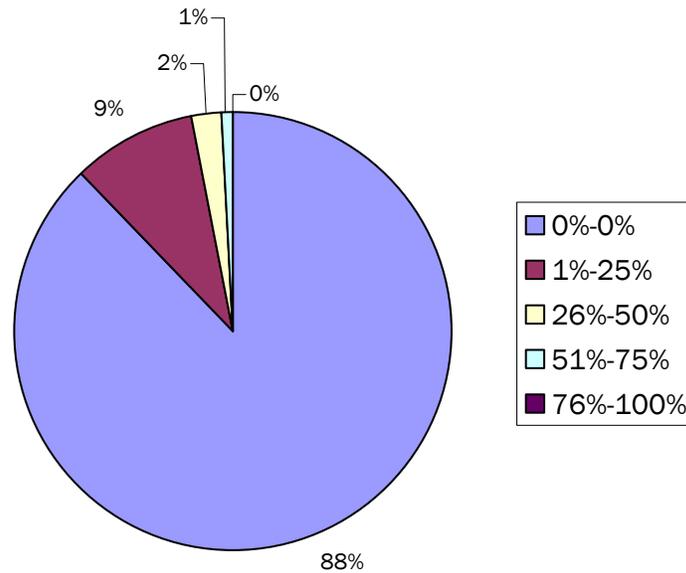
Table 24: Preferential Returns - Frequencies - Business Sales



5. Unsecured creditors: all pre-packs and business sales

130 records were available for pre-packs (57.2% of the sample), showing an average return of 1%, and 221 records were available for business sales (53.6% of the entire sample), showing an average return of 3%. The samples were much closer in terms of proportion in this quantification, and therefore the initial enquiry suggests that although both pre-packs and business sales offer very little prospect of a return to unsecured creditors, business sales are the better option for them. This is ostensibly confirmed by the breakdown of frequencies of return as between pre-packs and business sales.

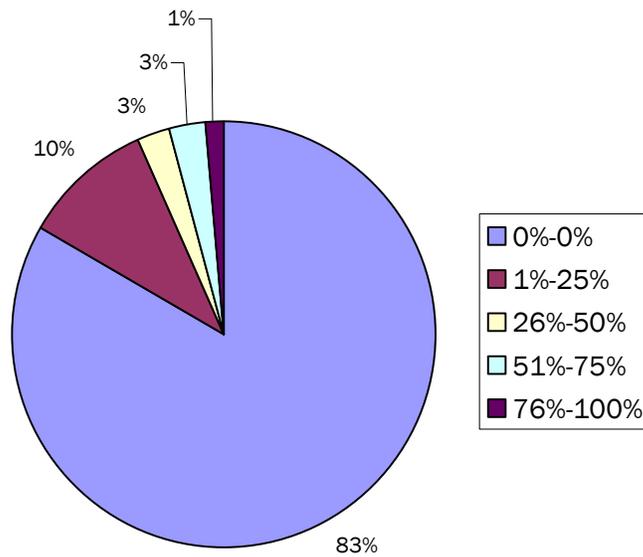
Table 25: Unsecured Returns - Frequencies - Pre-Packs



a) Observations

As can be seen by comparing the two tables, the likelihood of a zero return seems 5% higher in pre-packs than in business sales as far as unsecured creditors are concerned, and while returns of 51% or above were seen in 4% of business sale cases they occurred in only 1% of pre-packs. Further, no pre-pack cases returned over 75% to unsecured creditors, as opposed to 1% of business sales. At first sight, therefore, and taking into account the preceding analyses, the picture that emerges is that pre-packs operate to deliver overall better average returns to secured creditors, at the expense of the prospects of preferential and unsecured creditors, thus supporting the criticisms of bias aimed at pre-packs.

Table 26 - Unsecured Returns - Frequencies - Business Sales



However, this is to ignore two potentially important factors. The first is the comparative profiles of the two samples, and the second is the possible impact of the provisions of the Enterprise Act 2002. There is one further factor that should be considered, but this is left to the next section of this report. As to the comparative profiles of the pre-pack and business sale samples, it will be recalled that both contain receivership cases. Receiverships account for 48% of the pre-pack sample and 46.1% of the business sale sample. It was therefore necessary to examine whether the slightly higher proportion of receiverships in the pre-pack sample might in part account for the apparent bias towards secured creditors.

As for the impact of the Enterprise Act, one potentially distorting factor would be the abolition of the Crown preference, which had the short-to-medium-term effect¹⁰⁰ of allocating a much higher proportion of floating charge assets to secured creditors, while at the same time swelling the ranks of unsecured creditors considerably. As far as the two databases are concerned, the impact of the Enterprise Act would be most significant in relation to pre-packs. 59.5% of the sample of pre-packs came from the post-Enterprise Act period, as opposed to 49.5% of the business sale sample. Moreover, when considering only administration cases, the same bias towards post-Enterprise Act cases can be seen in relation to pre-packs. 66.1% of the sample of 118 cases occurred in the post-Enterprise Act period, the figure for business sales being 59%. It is therefore necessary to attempt to quantify the question of bias by reference to these factors, and the following section therefore focuses on a comparison of administration pre-packs and business sales, and on

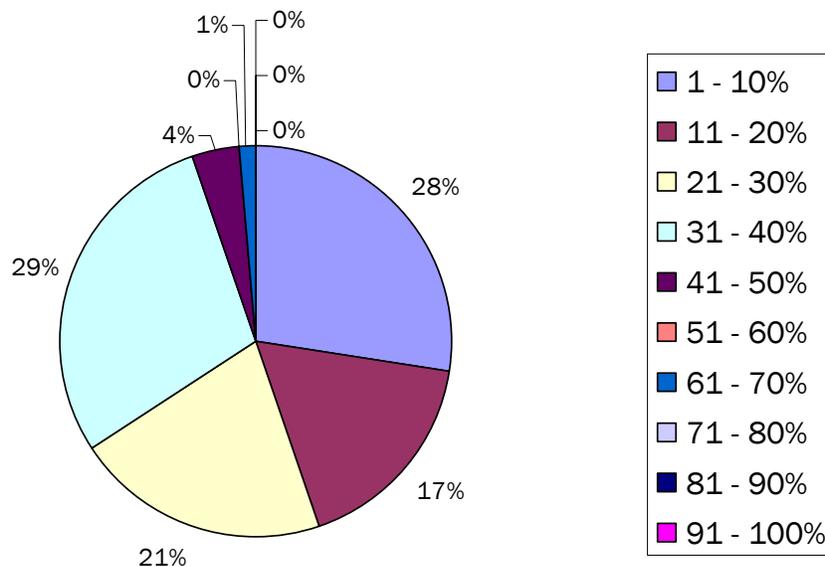
¹⁰⁰ i.e., Over time, the number of floating charges pre-dating the Enterprise Act will shrink, and those post-dating the Act will be vulnerable to the prescribed part in s.176A Insolvency Act 1986, so that this redistributive effect may be neutralised.

the relative performance of pre- and post-Enterprise Act administration pre-packs and business sales.

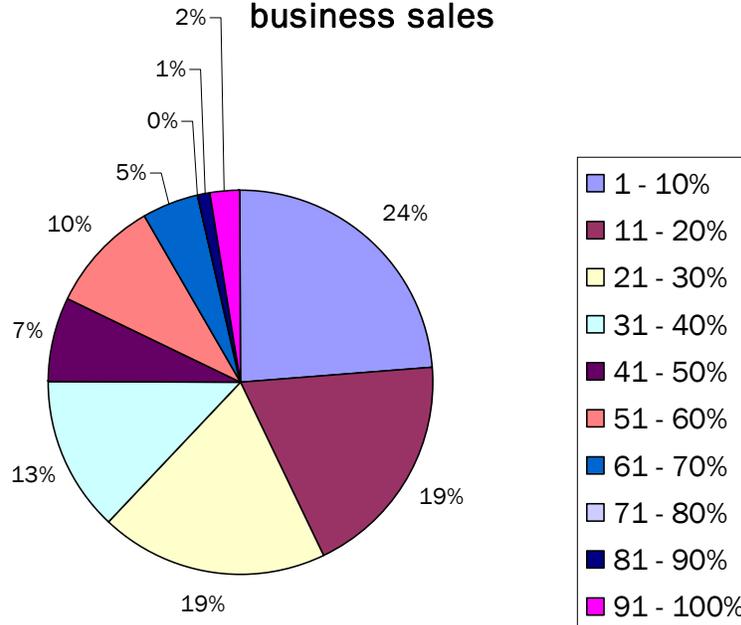
6. Pre-packs and business sales in administrations

The same exercise of analysis was carried out for administration business sales and pre-packs. Tables 27 and 28 below begin by comparing the frequencies of levels of returns to all creditors, but it can be noted here that, for administration cases, the average overall return to creditors was 22.7% for the pre-pack sample of 74 cases (32.5% of the entire sample) and 22.8% for the business sale sample of 132 cases (32% of the entire sample).

Table 24: Overall returns - frequencies - administration pre-packs



**Table 28: Overall returns - frequencies - administration
business sales**



a) Observations

The main point to note here is that administration pre-packs, as with pre-packs overall, tend to deliver a substantially higher proportion of mid-range returns than do business sales. Zero returns in administration pre-packs are also 2% lower than in administration business sales, a reversal of the position seen in relation to the entire sample for both pre-packs and business sales. However, and as noted in relation to the entire sample, business sales produce a higher number of top-range returns, 7% of the business sale sample returning 60% or more to creditors generally, as compared to only 1% of the pre-pack sample.

Given the very close similarity in size (as a proportion of the entire sample) of both samples in this analysis, a reasonably robust inference is that, overall, there is little to distinguish the performance of administration pre-packs and business sales in terms of overall returns to creditors.

7. Secured creditors: administration pre-packs and business sales

The following two tables consider returns to secured creditors in administration pre-packs and business sales. They are based on samples of 74 pre-packs cases and 124 business sale cases, accounting for 32.6% and 30% of the entire samples respectively. The average return to secured creditors in administration pre-packs was 59.1%, as compared to an average return in administration business sales of 27.5%, an even more emphatic difference than that seen in relation to all pre-packs and business sales.¹⁰¹ This would appear to be explicable once again by reference to the superior performance of pre-packs in returns in the mid range, and, in slight contrast to earlier tables, the fact that administration pre-packs deliver a proportionately lower level of returns at the lower end of the scale.

¹⁰¹ See p. 52 above.

Thus, while administration pre-packs and business sales perform identically in delivering 100% returns, present in 48% of the cases in both samples, returns of over 50% are recorded in 74% of the pre-pack sample as compared to 66% of the business sale sample. It is worth noting also, however, that the average secured debt in the administration pre-pack sample was £1,469,155, as compared to an average of £1,570,005 in the business sale sample. While the above distinctions remain valid, therefore, they are not quite as pronounced as might at first seem to be the case.

Table 29: Secured returns - frequencies - administration pre-packs

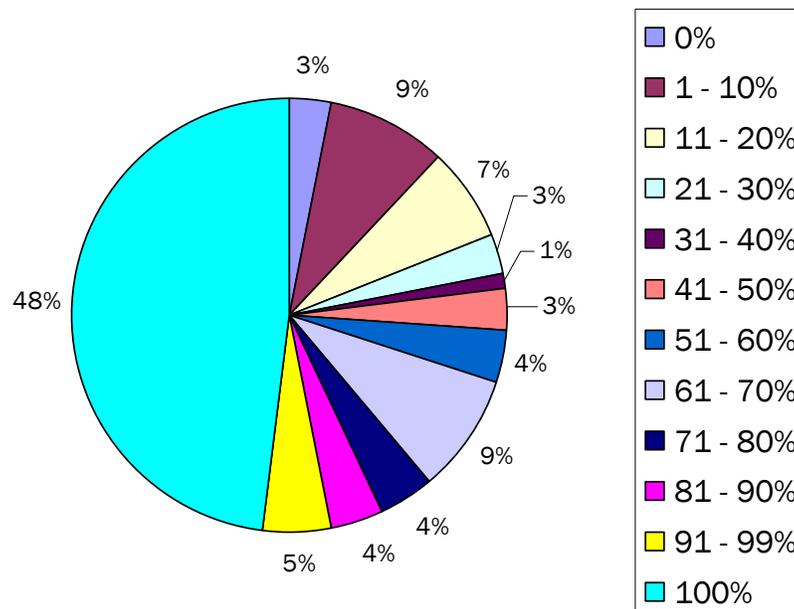
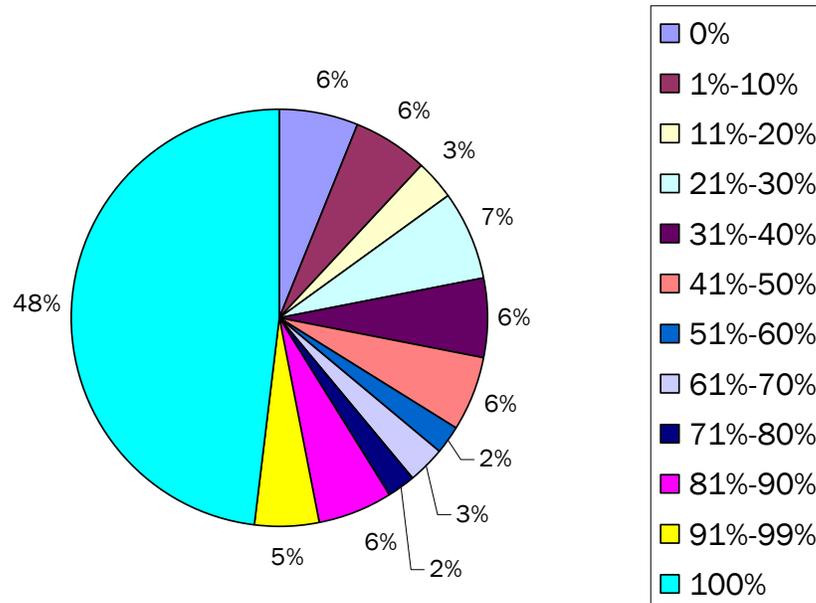


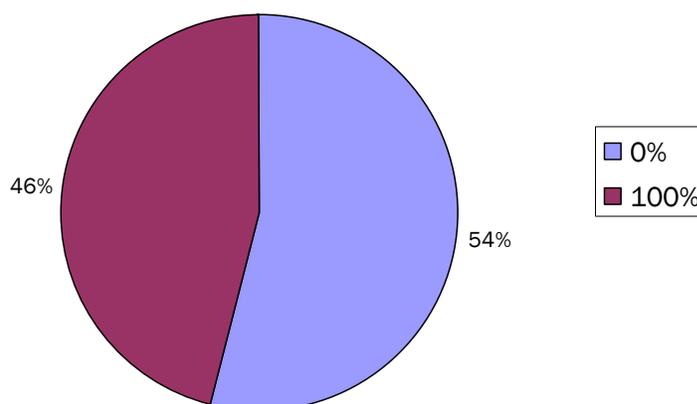
Table 30: Secured returns - frequencies - administration business sales



8. Preferential creditors: administration pre-packs and business sales

The following tables are based on a sample of 26 administration pre-pack cases (11.5% of the entire sample) and 92 administration business sale cases (22.3% of the entire sample). Given the significant variation in sample size, therefore, any findings are necessarily open to doubt in terms of their representative validity. Nevertheless, it was thought worthwhile to examine this category of claim if only to identify questions to be considered in the next phases of the research. The average overall preferential debt in the 118 administration pre-packs was £128,977, and that for the 222 administration business sales was £107,057.

Table 31: Preferential returns - frequencies - administration pre-packs

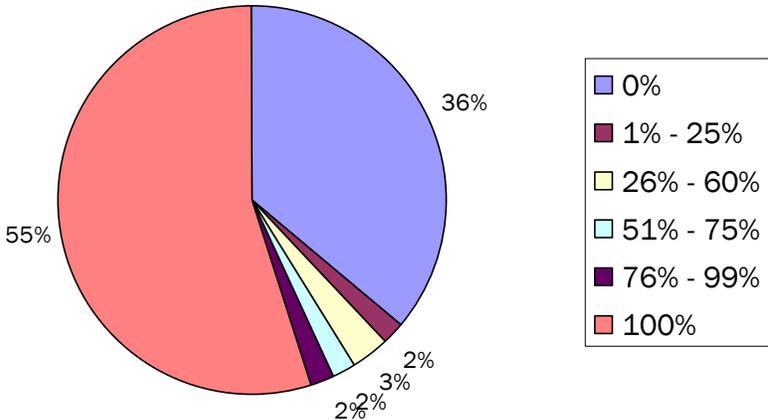


a) Observations

The 'all-or-nothing' performance of pre-packs in terms of returns to preferential creditors was noted earlier, and it is even more pronounced when the pre-pack takes place in administration. However, and as noted above, given the very small sample size, such a result could almost be predicted. Excluded from the sample are the 88.5% cases where the procedure, or its follow-on, is ongoing and the preferential claims have not already been met in full, which inevitably means that this table cannot possibly be taken as representative.

Table 32 is compiled of 22.3% of administration business sale cases, a sample roughly twice the size in proportionate terms of the pre-pack sample, and this is probably reflected in the more varied range of returns to preferential creditors. While a higher level of 100% returns is present in business sales, and a concomitantly lower level of zero returns, it would be hazardous to read too much into this point at this stage of the enquiry. The impact of the Enterprise Act will also be felt in this sample, and the next section considers it in greater detail.

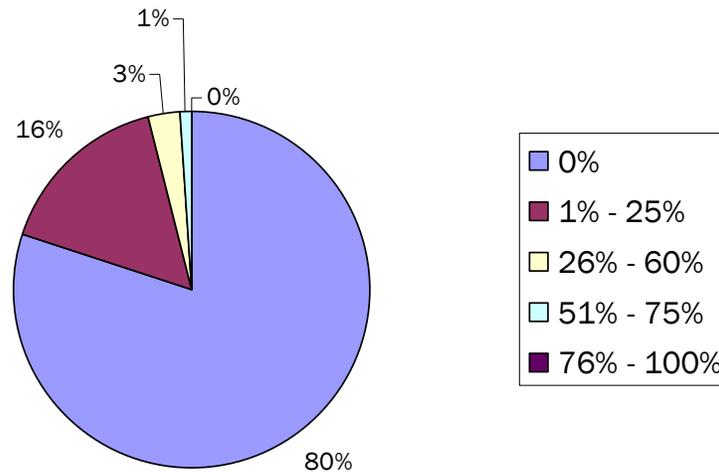
Table 32: Preferential returns - frequencies - administration business sales



9. Unsecured creditors: administration pre-packs and business sales

This sample comprises 70 administration pre-pack cases (30.1% of the entire sample) and 127 administration business sales (30.8% of the entire sample) and is of a more equal size. The average unsecured indebtedness in administration pre-packs was £2,973,938 and in business sales £5,369,662. The average pre-pack return was 2%, and that for business sales 4%. This breaks down as follows:

Table 33: Unsecured returns - frequencies - administration pre-packs

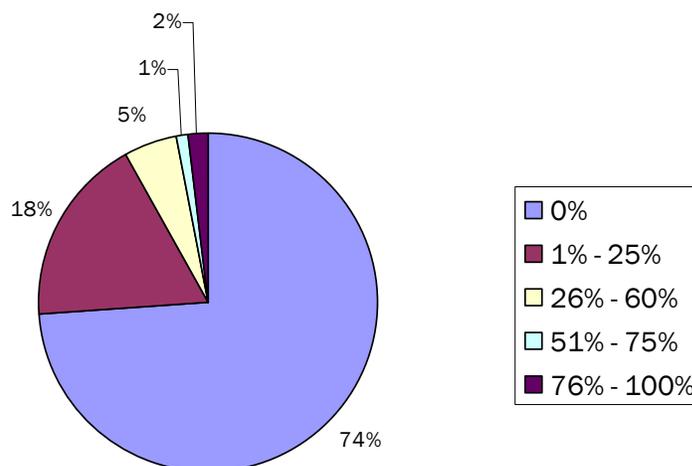


a) Observations

The distinction between these two tables is immediately obvious, with pre-packs returning nothing to unsecured creditors in 6% more cases than business sales, and, as a corollary, with business sales returning over 25% to unsecured creditors in twice as many cases as pre-packs. This seems to confirm the earlier tentative analysis that pre-packs, in terms of levels of return, favour secured creditors at the expense of unsecured creditors. Given that this result seems to apply equally in administration cases as in all cases, and so would not appear to be a function of the very slightly higher level of receivership cases in the pre-pack sample,¹⁰² some explanation should be sought. The impact of the Enterprise Act was also considered as a possible explanatory factor, and this is now examined.

¹⁰² An idea the author considered, but did not find particularly convincing.

Table 34: Unsecured returns - frequency - administration business sales



10. The possible impact of the Enterprise Act

It was considered possible that the bias in the pre-pack sample towards post-Enterprise Act administrations might partially explain the apparent bias towards secured creditors noted above. The following brief section investigates this point, although it should be pointed out that it can only do so cursorily because of the small samples available for analysis. This is most emphatically the case in relation to preferential and unsecured creditor returns, for which very little information was available, given the large proportion of ongoing cases in both administration pre-packs and business sales.

In summary, therefore, a sample of 63 post-Enterprise Act administration pre-packs (27.7% of the entire sample) recorded an average return to secured creditors of 55%, as compared to an average return of 62% from the sample of 84 post-Enterprise Act administration business sales (20.3% of the entire sample). For preferential creditors, the average return was 72.3% in pre-packs (based on a sample of 11 records, or 4.8% of the entire sample), as opposed to 53.8% for business sales (based on a sample of 44 records, or 10.6% of the entire sample). For unsecured creditors, the average return was 0.4% for pre-packs (based on a sample of 52 records, or 22.9% of the entire sample) and 4.4% for business sales (based on a sample of 79 records, or 19.2% of the entire sample).

This is curious in the extreme. It seems to demonstrate, for post-Enterprise Act cases, a better performance by business sales in relation to secured creditor returns, whereas pre-packs perform better in relation to returns to preferential creditors. This is a complete reversal of the trend mapped in the previous sections. It should, of course, be treated with extreme caution: the two samples will only comprise cases, in relation to secured creditors, where *either* the procedure and its follow on has closed *or*, if this is not the case, 100% of the secured debt has been discharged. Intermediate cases, where the procedure is ongoing but *part* of the secured debt has been discharged, are not included. Much the same can be said for the sample of cases dealing with preferential returns. As far as returns to unsecured

creditors are concerned, there remains a suggestion that business sales deliver a higher level of returns than pre-packs, but with less than a quarter of cases closed in both samples it is arguably far too early to predict whether this state of affairs will persist once all the gaps in the information are filled.

However, it is possible to discern from this very basic survey that the Enterprise Act appears to have some impact on creditor returns in pre-packs and business sales. In relation to unsecured creditors, this might be expected, as the abolition of the Crown preference shifts substantial sums from the secured to the unsecured category, and, as a corollary, swells the assets available to satisfy the debts of secured creditors, at least in the short term.¹⁰³ However, this effect will be felt in relation to *both* pre-packs and business sales, and, as noted above, the average level of unsecured debt in post-Enterprise Act cases was much higher in relation to the latter category, notwithstanding that a higher proportion of the cases in the pre-pack sample occurred post-Enterprise Act.

What, then, can be made of this? At present, and subject to the raft of disclaimers above, it would appear that while the data as they presently stand are inconclusive as to the question of whether pre-packs are biased towards higher returns to secured creditors as against preferential creditors, it remains the case that there is some evidence to suggest that they favour secured creditors over *unsecured creditors*. One possible explanation for this has already been mooted: it may be that pre-pack sales have a tendency to take place at a consideration which will deliver value to secured and preferential creditors and cover the costs of the procedure, but will fail to capture any premium which would then drip down to unsecured creditors. This is clearly a matter for further investigation. The fact that unsecured creditors bear the costs of the procedure may also be relevant: Armour, Hsu and Walters have cogently demonstrated that while administration delivers higher realisations than receivership, it also incurs proportionately higher costs.¹⁰⁴ As the pre-pack sample is biased – particularly in the post-Enterprise Act period – towards administrations, this may too assist in explaining why unsecured creditors appear to receive lower average returns from pre-packs. However, there is one further possible factor in play here, and it is examined in the next section of the report.

¹⁰³ The impact of the prescribed part in s.176A Insolvency Act is not considered here, not least because none of the cases in the sample involved the setting aside of a prescribed part.

¹⁰⁴ See *The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings*:
www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/ImpactofEARreport.pdf.

C. Pre-packs and employees

1. *The status of employees in the insolvency scheme*

It was observed earlier that employees are, apart from the preferential status of their claims, something of an afterthought in the general scheme of insolvency law. It is left to employment legislation to protect them,¹⁰⁵ and the most momentous piece of employment legislation to consider here is the Transfer of Undertakings (Protection of Employment) Regulations.¹⁰⁶ It should be noted that the 2006 version of the Regulations, with its derogations applicable to transfers taking place in the course of insolvency proceedings, was not in force at the time the cases on the databases were taking place. This may be extremely relevant for future transfers, but for the purposes of this analysis it is simply necessary to note that on the sale of a business, whether through a pre-pack or otherwise, employees' contracts of employment, and any liabilities existing in relation to them, will transfer to the purchaser of the business and cease to be a liability on the vendor.¹⁰⁷

As far as practitioners are concerned, however, there is no legal duty to take account of the interests of employees in insolvency: practitioners' attention is directed by statute¹⁰⁸ to the interests of the creditors of the company, or, at common law, to the interests of the secured creditor who appointed him.¹⁰⁹ If a business sale takes place, and employees are transferred to the purchaser, this might best be described as a happy accident occurring entirely outside the scheme of the insolvency legislation.

So much for the insolvency law position. In more general terms, the plight of employees is taken rather more seriously, as they are seen as peculiarly vulnerable on the insolvency of their employer. Not only may they be owed considerable arrears of wages and other benefits,¹¹⁰ but their livelihood is threatened and the vagaries of the welfare state loom large on their horizons. There are frequent calls from the media and the public to 'do more for employees' when insolvency strikes,¹¹¹ and it might therefore be posited that any strategy for dealing with an insolvent company that has the knock-on effect of preserving employment would generally be deemed a worthy one. This section of the report considers whether pre-packs or business sales are more 'worthy' in this context.¹¹²

¹⁰⁵ And to pensions legislation to protect their pension rights.

¹⁰⁶ SI 2006/246

¹⁰⁷ This is an outrageous simplification of the position, but it suffices for the purposes of the analysis to follow. No attempt is made here to deal with the legal regime under TUPE, and the reader is directed to David Pollard's outstanding work on the subject: see *Corporate Insolvency: Employment and Pension Rights* (3rd Ed., 2007: Tottel Publishing)

¹⁰⁸ In the case of administration.

¹⁰⁹ In the case of receivership.

¹¹⁰ Media coverage of the Kwik Save administration has been devoted almost exclusively to this issue, and perhaps not surprisingly, given that the employees in question had volunteered their services for nothing in the hope that a rescue plan could be devised and activated.

¹¹¹ The MG Rover administration is a very good example of this tendency. Much of the attention it generated centred on the very difficult position of Rover employees, and all manner of task forces, governmental and otherwise, have allocated resources to finding alternative employment for the workforce, many of whom had spent their entire working lives with the company.

¹¹² The whole question of whether jobs saved equates to value delivered is, of course, open to debate, which will hopefully be stimulated by what follows.

2. Employment preservation in pre-packs and business sales

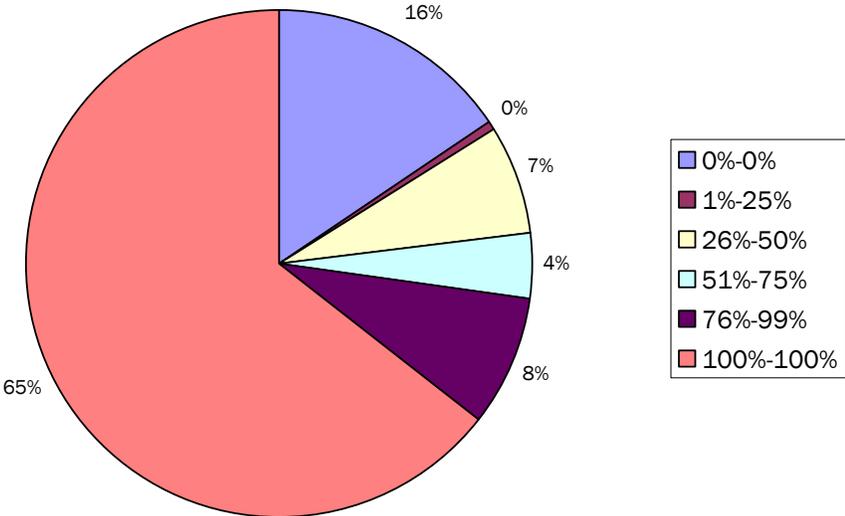
As noted earlier, it was not always possible to extract this information from the reports on which the two databases are based. Most particularly, actual *numbers*, as opposed to percentages, of employees transferred to the purchaser were rarely mentioned. For what it is worth, 37 pre-pack cases (16.3% of the entire sample) recorded this information, compared to 63 business sale cases (15.3% of the entire sample). Pre-packs account for 3,181 cases of employees being transferred, compared to 5,369 cases in business sales, although one particularly large business sale case resulted in 1,040 employees being transferred to the purchaser. Absolutely nothing can be made of this, given the very small sample sizes for each method of sale.

A more productive manner of testing pre-packs against business sales was to consider the percentage of employees transferred in each type of sale, and this information was more often available in the reports; in fact, in many of them, the presiding practitioners expressed their satisfaction at this outcome, not only because it was beneficial for the employees concerned but also because it reduced the level of preferential claims on the estate. On the business sale database, 231 cases recorded information on the percentage of employees transferred to the purchaser, a total of 56.1% of the sample. For pre-packs, 186 cases conveyed this information, a total of 81.9% of the sample. A point that should be noted here is that it is highly likely, but not conclusively so, that those business sale cases that did not record a percentage figure for employees transferred were cases where at least some, and perhaps all, of the employees were made redundant. The reasoning behind this claim is that for those cases reasonably high level of employee preferential debts were recorded in statements of affairs and practitioner reports. This could, of course, be accounted for by resignations among the workforce, rather than redundancies, and therefore it was thought safer not to count such cases as incurring redundancies.

Equally, in cases where preferential claims of zero were recorded on the database, but no mention made of the percentage of employees transferred, there is perhaps an inference that all employees have transferred, along with what would have been preferential claims.¹¹³ However, this is once again not a certainty, as it is possible that the company, before the insolvency, had prioritised its employees in terms of wages and other benefits so that no potentially preferential claims were incurred. Moreover, some reports made mention of the fact that arrears of wages were met as expenses of the procedure so as to ensure the continued co-operation of the workforce. This being so, again it was thought that for the sake of certainty no assumptions should be made about these cases, and they were duly excluded from the sample. How, then, do business sales and pre-packs perform in this area?

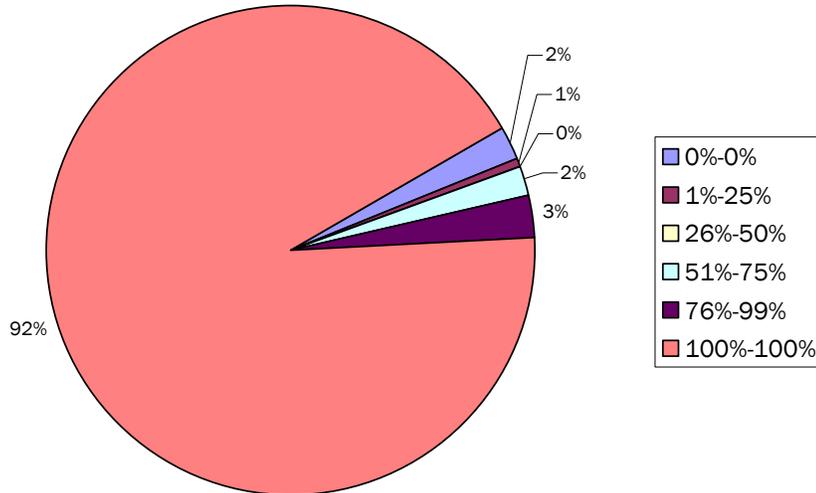
¹¹³ This would apply most strongly in post-Enterprise Act cases.

Table 35: Employees Transferred - Business Sales



This table charts the percentage of employees transferred in the 231 cases in the business sale sample. It demonstrates that business sales can clearly claim to have a preservative effect on employment, with 65% of all cases resulting in a transfer of the entire workforce. In 16% of cases, on the other hand, the entire workforce was made redundant prior to the transfer. A total of 73% of cases resulted in job savings of over 75%, which can be said to be respectable, at the very least. The table for pre-packs, however, is almost startling in comparison.

Table 36: Employees Transferred - Pre-Packs



The superior performance of pre-packs in relation to employment preservation seems reasonably clear from this table. 92% of the cases recorded resulted in a 100% transfer rate, and only 2% resulted in a 100% redundancy rate. Overall, 95% of cases involved an employment preservation rate of 76% or over.

Of course, it might be objected that the smaller sample size, in proportionate terms, on which the business sale table is based might in part account for this very clear dichotomy. This is a possibility that should not be dismissed, but, nevertheless, it is thought unlikely. As noted above, many of the cases in which no information on employees was recorded in the business sale sample nevertheless did record levels of employee preferential debt, which might suggest that at least some redundancies were made prior to transfer. Secondly, and as also noted above, practitioner reports tend to advertise the fact that job savings have been made; indeed, in some cases this is used as a partial justification for the particular strategy adopted. It is perhaps reasonable to assume, therefore, that where no mention is made of job savings, this is because none, or only a very small number have been made. Overall, therefore, it can be stated with some confidence that pre-packs have a clear advantage over business sales when it comes to preserving employment rates.¹¹⁴

¹¹⁴ Whether this is the case *long-term* is addressed below.

3. Accounting for the pre-pack superiority

This is clearly a matter that should be investigated further, but a few preliminary observations as to why pre-packs preserve more jobs can be made here. The first is that this should not really come as any great surprise. One factor common to most administrations and receiverships, and one which is often documented by practitioners as driving the pre-pack, is the scarcity of resources with which to trade for any protracted period after appointment. It is usually the case that the business will have to keep trading if there is to be any prospect of a going concern sale, but lack of funding will in many cases be a barrier to a long-term trading strategy. Where savings have to be made, therefore, one of the first casualties is likely to be that section of the workforce that is not thought to be critical to the business' continued operation. A number of the business sales reports document this process explicitly; on appointment, the practitioner takes steps both to sell the business but also to minimise the costs of keeping it running in the interim, and many reports referred to the need to make 'some', or 'a few', or 'a majority' of the workforce redundant.

The pre-pack sale, on the other hand, is often preferred precisely because it avoids any need to find a means of funding trading. By definition, there is no gradual necessity to make employees redundant. What is more, there is far less scope to effect 'opportunistic' redundancies in advance of a pre-pack in order to make the business more saleable. 'Economic, technical or organisational reasons entailing changes in the workforce of the transferor or transferee'¹¹⁵ are far less likely to be available in a pre-pack scenario than they are in a business sale scenario, and it is thought unlikely that either practitioners or purchasers of businesses in a pre-pack form would wish to chance their hands in an attempt to rely on such, particularly given the consequence that, if unsuccessful, the employees in question will have been unfairly dismissed and a further liability will arise.

Finally, and unashamedly speculatively, it was noted above that a higher proportion of pre-pack sales are made to 'connected' purchasers, most notably existing owner/managers. It may be the case that such parties have a far more entrenched 'attachment' to the existing workforce and might therefore be anxious that the interests of employees are protected on the transfer. Such purchasers might also be more optimistic about the future prospects of the business, and so consider that it can sustain its current workforce in its new corporate shell.

All of the above notions may help to explain why pre-packs appear to save more jobs than business sales, but there is clearly scope for further research here. In particular, it will be worth tracking carefully the effects the 'new' TUPE Regulations in this respect.

4) Employment preservation and its influence on creditors

Again, this is more of a question than an answer. However, it is worth noting that the higher rates of employment preservation in pre-packs may have a knock-on effect on returns to unsecured creditors, and might, therefore, partially explain the findings of the previous section, which seem to point to pre-packs returning proportionately less to them than business sales.

The basic point is this: where the transfer of a business is contemplated, a well-informed and advised prospective purchaser may well make some estimation of the level of actual and contingent employee liabilities, which he may then use to calculate what he is prepared to

¹¹⁵ See SI 2006/246, reg.7.

offer for the business. It is not just actual liabilities that are important here: these may well be quite small, but the uncertainty associated with insolvency sales, and the prospect of having to make post-transfer redundancies of possibly long-serving employees, may lead to a much higher estimation of *contingent* liabilities. In short, the extent to which purchasers accept a high proportion of employees from the vendor, may dispose them to discount their offer for the business to take account of this.¹¹⁶ The effect of this is to lower, to a greater or lesser degree, the price of the business, and this depreciation is inevitably borne by creditors at the tail end of the queue for payment. It may be, therefore, that unsecured creditors are subsidising employment preservation, and this may shed some light on what appear to be lower returns to them in pre-packs.

If this is correct, it raises some interesting questions that cannot really be answered here. As a matter of policy, it might be thought that in this scenario employees should be prioritised. The personal cost to them, and to the state which may have to support them in the short-to-medium term, might be thought to outstrip by some distance the cost to unsecured creditors in terms of their return. This is especially the case when one considers that while levels of unsecured debt may appear high, the total sum is made up of the claims of often high numbers and, of course, HM Customs and Revenue.¹¹⁷ Moreover, the monetary difference to unsecured creditors between a 1% dividend and a 4% dividend is, in many but not all cases, likely to be negligible. Of course, some unsecured creditors are 'more equal' than others, and if called upon to referee the relevant merits of the interests of the Kwik Save employees and the Farepak families, public opinion might find itself on the horns of a dilemma. A fuller debate on this issue is, however, better left aside for now. Overall, the finding that pre-packs perform significantly better than business sales in terms of job savings is an interesting one: the next section of the report examines one further issue that may qualify it slightly.

¹¹⁶ This may be ascertainable in interviews with valuers. Practitioners have mentioned that this is a not uncommon state of affairs.

¹¹⁷ For whom the public is not disposed to feel much sympathy.

D. Rates of recidivism in pre-packs and business sales

1. *The issue*

The sale of a business in insolvency, by whatever means, is generally viewed as a more positive result than its liquidation. The perceived wisdom that realisations are maximised in business sales has already been mentioned, and, further, an economic entity continues to exist and is able to service its pre-existing customers. It might also be in a position to generate business in the form of orders for its pre-existing suppliers, which might just sugar the pill of unsecured creditor status in the preceding insolvency. Further, business sales are a function of the 'second chance' ideology driving the Enterprise Act, and so may be seen as in furtherance of an underlying policy.

However, what is at issue here is the question of the fate of the business post-transfer. To the extent that it fails again, are unsecured creditors in particular faced with an unjustifiable 'double whammy'¹¹⁸? Are the benefits of employment preservation in the previous sale neutralised? Is this potentially a return to the past 'phoenix' age? And should there be steps to prevent a 'third chance' being offered to connected parties, in particular in the form of another going concern sale? This section attempts to gauge the frequency of post-transfer failure of pre-packs and business sales.

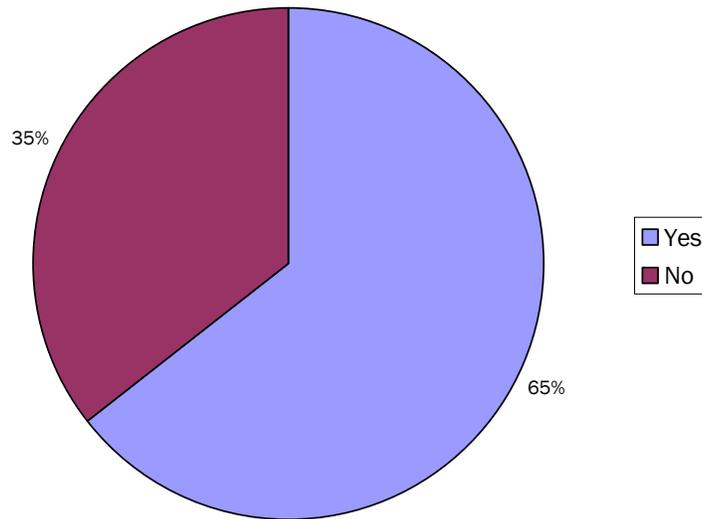
One point should be made at the outset, and that is that it is almost certainly no concern of presiding practitioners whether or not the new business is or is not likely to fail. If they are satisfied that the offer before them is a good one, and probably the best obtainable in the circumstances, then their duty is to accept it in the interests of their creditor constituency. It is virtually impossible to read into any of the provisions of the Insolvency Act or the common law any obligation to assess the prospects of the purchasing vehicle. One slight qualification to this is where the consideration for the business is deferred over a period of time, or payable in tranches, and the chances of it actually being paid are intrinsically dependent upon the survival of Newco.¹¹⁹ Nevertheless, it is necessary to consider this issue if a reasonably full picture of the relevant performance of pre-packs and business sales is to be presented. The following tables illustrate survival rates in all business sales and pre-packs, and in all administration business sales and pre-packs. They are based on a sample of 313 business sales (76% of the entire sample) and 204 pre-packs (89.9% of the entire sample). The administration-only tables are based on a sample of 173 business sales (77.9% of the entire sample) and 105 pre-packs (89% of the entire sample). There is, therefore, a significantly higher proportion of pre-pack cases in both samples, and this should be borne in mind in the comparison.

¹¹⁸ To the extent that they lost money in the original insolvency.

¹¹⁹ Deferred consideration was found to be a reasonably common feature of both business sales and pre-packs. However, most practitioners reported that a charge had been taken over the assets of Newco to guard against the prospect of non-payment.

2. Survival rates compared

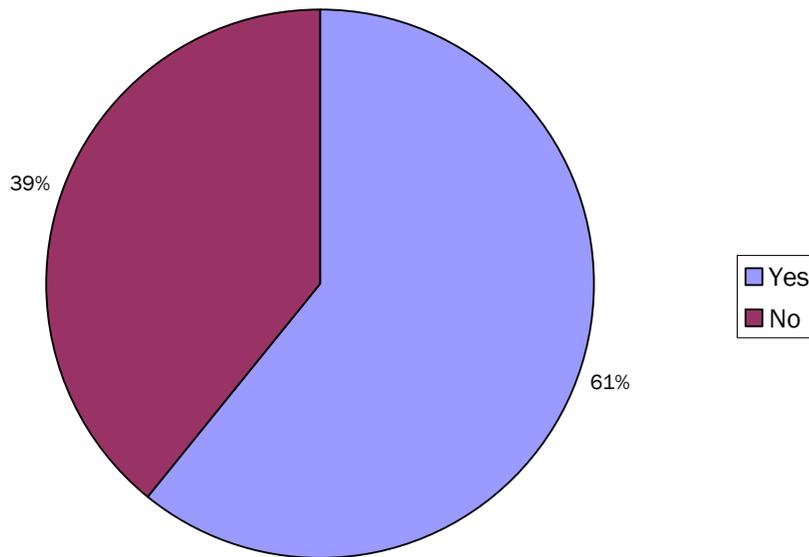
Table 37: Survival Rates - Business Sales



a) All business sales and pre-packs

65% of purchasing vehicles continue to trade in the business sale sample. Of course, it should be noted that this estimation could only be made where the purchaser was either a limited liability company or a limited liability partnership for which records were available at Companies House. This was not the case in 24% of the business sale sample. A slightly higher proportion of pre-pack transferees failed following the transfer, the survival rate being 61%. It is submitted that this cannot be treated as a significant variation, given the variance in sample size.

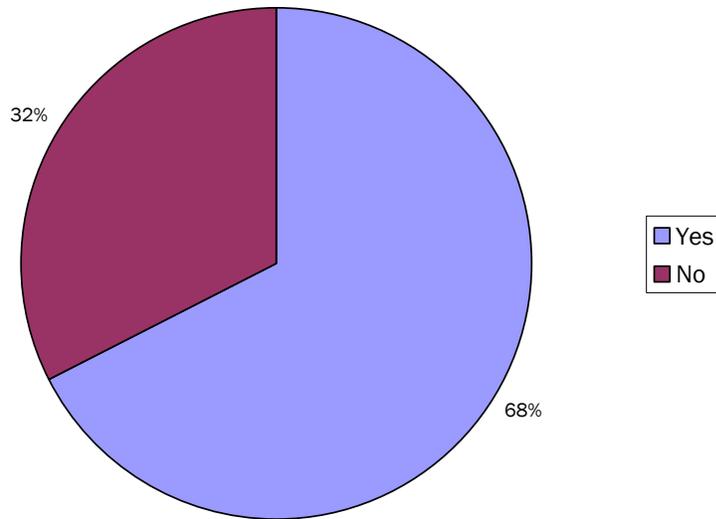
Table 38: Survival Rates - Pre-Packs



b) Administration business sales and pre-packs

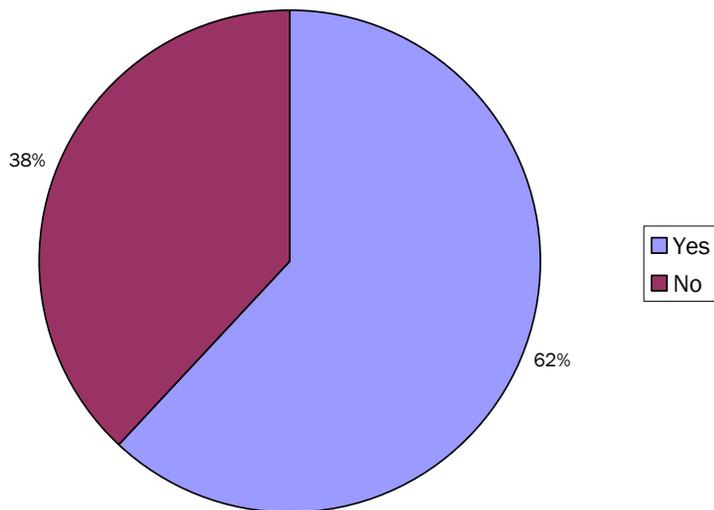
A similar pattern can be seen in administration business sales and pre-packs. Again there is a variance in sample size which makes it difficult to state with certainty that administration pre-packs are slightly more likely to fail than administration business sales.

Table 39: Survival Rate - Administration Business Sales



It is perhaps worth mentioning here that survival rates in administration business sales are 3% higher than in all business sales, and that failure rates are consequently 3% lower. For administration pre-packs, this distinction is less pronounced.

Table 40: Survival Rates - Administration Pre-Packs



Again, slightly more administration pre-packs fail post-transfer than administration business sales. And again, the variance in the sample sizes renders this finding inconclusive as to the probability of a higher failure rate in pre-packs.

Overall, therefore, the two methods of sale seem to perform quite similarly in this respect. The truly fascinating question, of course, is as to the fate of the failed transferee, and it is not possible at this stage to comment. One point that perhaps should be made is that it was relatively rare to find the practitioner who had presided over the original insolvency then acting in relation to the second insolvency. In the entire business sale sample, this occurred in 10% of cases, and in the pre-pack sample in 6.7% of cases. Further research is to be carried out into this area to try to account for the reasons for the subsequent failure, and how it was dealt with in the follow-on insolvency. A number of these cases involved a second administration, and it will be fascinating to plot whether any involved a second sale, whether pre-pack or not, as soon as the necessary information is available at Companies House.

3. Some final observations on connected parties and survival rates

The final step in the analysis was to consider whether there was any correlation between sales to connected parties and subsequent failures. This turned out to be the case in relation to both business sales and pre-packs. In the business sale sample, where the sale was made to an unconnected party, survival rates post-transfer rose from 66% to 71.9%, whereas for sales to connected parties it dropped to 58%. For pre-packs, sales to unconnected parties resulted in a survival rate of 71.5% (rising from 61% overall); sales to connected parties saw a much lower survival rate of 51.4% (falling from 61% overall).

This is clearly yet one further area ripe for more research. In this regard, the author is most grateful to Michael Green¹²⁰, whose expert and insightful advice to ‘follow the money’ will be taken in this regard!

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Concluding remarks

A. A summary of the findings of this research

The main findings of the research are as follows:

- Pre-packs are increasing quite sharply in number over time, most notably in administrations.
- A wide range of firms carry out pre-packs, ranging from the 'big four' to the small and sole practices.
- It may be that pre-packs are being used in predominantly 'small' cases.
- There are grounds for calling for a more rigorous disclosure regime, particularly in relation to practitioners' statements of proposals and other reports to creditors. However, overall, pre-pack reports tend to be more informative than reports on business sales.
- While pre-packs give creditors no chance to vote on the sale of the business, this is also true of the majority of cases where the business is sold other than through a pre-pack.
- Proportionately more pre-pack sales are to connected parties than are business sales, and this trend is accelerating in post-Enterprise Act pre-packs in administration cases.
- There is some evidence to suggest that pre-packs result in lower overall returns for unsecured creditors.
- There is clear evidence that pre-packs perform better than business sales in preserving employment.
- Pre-packs may fail slightly more often than business sales, but this is inconclusively demonstrated. There is, however, clearer evidence that where a business is sold to a connected party it is more likely to fail thereafter.

B. The next steps

In order to present a more complete and accurate picture of trends relating to pre-packs, it will be necessary to consider cases more recent than those on the existing database. The Insolvency Service has agreed to fund data collection for companies entering administration or administrative receivership between September 2004 and September 2005 and also to fund the collection of data for a sample of companies entering company voluntary liquidation (without having first been in administration or administrative receivership) during that period. The Service is happy for this data to be used for the pre-pack research project, and therefore will be available for the databases described above. The collection of data on CVLs will allow for a comparison between business sales and asset sales, again according to criteria used during this phase of the research.

Questions raised during this phase will be addressed, and hopefully through interviews in as many cases as possible. Two immediately obvious stakeholder groups are insolvency practitioners and bankers (responsible for dealing with those of their clients in financial

difficulties, and largely housed in the 'intensive care' units of banks). A further interest group is independent receivables financiers who, on present findings, receive very good levels of return in insolvency. As far as insolvency practitioners are concerned, their views are critical, as they are one of the prime movers when it comes to pre-packs.

Equally, practitioners' subjective views are valuable, particularly those relating to whether they feel guidance on pre-packs from the regulator, R3, the courts, their firms or any other source, is either necessary or desirable. Experience also demonstrates that the interview process itself may suggest questions to be posed so that the above list is not exhaustive. Finally, the definitional problem of pre-packs will be addressed at this stage in order to attempt to construct a working definition of a pre-pack that can inform the rest of the research programme.

Financiers can also assist, in that they are very likely to be consulted *ex ante* on any pre-pack scheme, and, indeed, their sanction of and support for the scheme may well be critical to its success. Financiers here include bank lenders, receivables financiers and other asset-based financiers, such as leasing and hire purchase companies. Attitudes to the general practice of pre-packing may vary between different financiers, and there may exist particular corporate policies which will inevitably impact upon any specific pre-pack scheme.

Thus far in the author's experience, practitioners in particular have been extremely helpful in their willingness to be interviewed and to speak freely on the subject of pre-packs. It is hoped to seek information from a wide range of practitioners, encompassing those working in large, mid-tier and small firms, and the database will be used to identify those practitioners who have wide experience of pre-packs. It might also be possible to seek information of a straightforward nature by the use of online questionnaires housed on a customised project website.

Regulatory Bodies

Given the current debate about the probity or otherwise of pre-packs, the views of the regulatory bodies are extremely important. In particular, it will be useful to know whether the issue is itself one that has been detected on the regulatory radar and, if so, what steps are being taken or have been taken to address it. Again, regulatory bodies and their representatives are readily identifiable, and R3's sponsorship of the research will be of considerable assistance in gaining access to appropriate sources of information.

Other stakeholders

Other stakeholders directly and indirectly affected by pre-packs are reasonably easy to identify. Groups include preferential creditors, unsecured creditors, shareholders, directors, managers and other employees. Given the current finding that independent valuation is often seen as a critical stage in the pre-pack process, those firms specialising in the going concern valuation of insolvent companies should also prove to be a valuable source of information. The main task of this phase will be to consider how best to make contact with and seek information from these various groups. Preferential creditors will, for the most part, comprise those employees whose employment was not preserved by a pre-pack. Unsecured creditors are a diverse group, which may include the Crown, trade creditors who have supplied goods or services to 'Oldco', customers who have pre-paid for goods or services from Oldco, utility companies, local authorities and so forth. The group might also

include credit insurers. Of these, the Crown authorities should be reasonably easy to contact.

It is important that empirical evidence gathered from all groups, including insolvency practitioners and financiers, should be as free from the possibility of 'bias' as possible. It might be contended, for example, that practitioners' views should be treated with caution because of their own involvement in pre-packs. This contention can be countered by seeking the views and experiences of stakeholders such as those above, but again it is important to consult widely so as to avoid seeking information from a 'self-selecting' group (i.e. a group which agrees to provide information precisely because it has a particular agenda, whether positive or negative). Attempts will therefore be made during this phase to ensure that any interviewee sample is sufficiently varied so as to provide as reliable a picture of the impact of pre-packs upon it as possible.

In conclusion, it is hoped that this report is of some informative value not only to R3 but to anyone who has more than a passing interest in insolvency-related matters.¹²¹ It is sincerely hoped that the next phases of the research will allow for a far broader enquiry into *all* aspects of pre-packs, including their legal and ethical implications. Questions that this report has raised but cannot provide answers to will be thoroughly investigated. In this regard, the author welcomes the input of anyone who has anything to contribute to whatever area of enquiry they feel appropriate. The assistance provided thus far has been invaluable, and it is hoped that it will enhance this project well into the future.

¹²¹ A collective noun should be devised as a matter of urgency.

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