The advantages of a pre-pack administration

When faced with bankruptcy, company directors have several options. Liquidation and winding up loom as the most obvious. Business owners and stakeholders divest themselves of assets, pay off what they can, send the staff home, and close the doors.

Closing up, aside from the sting of failure, means the loss of employment for many who likely had nothing to do with the business failure. Customers likewise will be forced to go elsewhere for services or products, and vendors will be left to fight for the remains. Also, closing the doors does not automatically result in a clean slate for the winding up directors and managers. If any personal assets were put up as collateral, they would be forfeited to creditors, and directors' accounts must still be paid. The directors' action for the past three years will be investigated, and any wrongful or fraudulent trading will be sanctioned. A bankruptcy record will remain in the director's credit file for six years, which may hamper the ability to obtain credit wherewith to begin again.

Options other than closing down

Should the company directors find liquidation and winding up to be unacceptable, they may opt for administration. If the courts have not mandated administration upon filing for bankruptcy, the directors, shareholders, and others with controlling interest can appoint a licensed insolvency practitioner (IP) to take over. The IP will determine if the company should be liquidated and closed down, sold as a going concern, or whether a company voluntary arrangement (CVA) or a Chapter 11 reorganization might be advisable.

A CVA or Chapter 11 reorganization leaves the most control in the hands of the existing directors, as opposed to an administration. In these situations, a director-appointed bankruptcy professional will sit down with the vendors and creditors to negotiate new terms for repayment. The company goes on operating, but the debt-load is now much more manageable, often 20 to 40 percent of the original. A smaller dollar amount spread out over a longer length of time may reduce the hemorrhage of cash enough that a company can pull out of the red.

A company sale under standard bankruptcy administration tends to prove unsatisfactory. The administration process can drag out over a year or so, during which time "business as usual" can be problematic. Vendors may be loath to prolong current contracts when they are not sure of getting back what they have already extended to the original owners. Transfer of ownership does not guarantee that employment will transfer for all of the existing staff. Rumors and other factors can serve to erode public trust.

Pre-pack administration

A pre-pack administration is an approach to administration and sale of the company that can mitigate the downside of the sale as a going concern. In this case, a sale of all or part of the company's assets to a specified buyer is already negotiated before the IP is brought aboard. Sometimes the purchaser is a third party such as an industry buyer, or it can be the original owners starting trade under a new name. Once the IP is formally appointed, the new company purchases the pertinent assets and carries on with business. The original business typically liquidates any remaining assets and closes down.

The primary value seen in a pre-pack administration is the fact that trading can continue uninterrupted, losing less revenue to downtime, and losing fewer clients and customers to competitors. The company brand can maintain integrity. The speed with which the sale can be completed means that costs of operating while insolvent do not stack up for the directors or administrator, and more of the proceeds of the sale can be directed to creditors rather than operations. Job preservation is also usually a significant element in negotiating a pre-pack sale.

The principal objection to a pre-pack administration is that the creditors, particularly those who are unsecured, do not see any repayment because debts are written off. The fact is that at this point in bankruptcy, unsecured creditors are unlikely to realize any of their money regardless of what action the IP undertakes. Creditors want assurance that the administrator took every effort to obtain the highest valuation for assets being sold, and the pre-pack side-steps the exposure of the business to every potential buyer, and thus perhaps, top dollar.

On a practical level, there may be the same loss of goodwill from the public upon the report of a pre-pack sale, and the new company may find it difficult to obtain new credit or favorable contracts from the same vendors or others in the industry.

As in liquidation and winding up, the directors of the original company will undergo investigation by the IP, and any misconduct will be prosecuted. Misconduct may impact future ability of those individuals to conduct business; for example, a bond may be required before the newly-formed company can register for VAT and resume trading. The new business leadership also may not alter employment contracts, rights or status upon transfer, so this existing outlay for employees must be carefully considered.

Avoidance of the losses of bankruptcy and the costs of standard administration makes a well-negotiated pre-pack sale an extremely viable option. For the directors who can arrange a purchase on terms that creditors will not find culpable, there should be no need to wind up.