

# Insolvency: Use of Pre-Packs

Pre-packs are a buzz word at present. They have generated lots of heat and discussion in the insolvency world and in the media. However, if used properly, they can be an effective tool in ensuring that an insolvent business can continue to operate in a new form, ensuring continued use of productive assets, saving jobs and providing a better return to creditors.

## How does it work?

A pre-pack is an agreement for the sale of the business or assets of an insolvent company which is arranged prior to the company entering into administration or possibly liquidation. An agreement is reached for the purchase of the business or assets before the formal appointment of the administrator or liquidator and is completed immediately after the appointment of the administrator or liquidator takes place.

The aim of the pre-pack is to preserve the value of the business, particularly the goodwill. They are particularly appropriate where either the customers or employees of the business could leave the business if they became aware of the company's potential insolvency or where continued trading is dependent upon retaining the ongoing contracts with customers. Pre-packs are also used where there is a lack of available funds to keep the business trading whilst the administrator looks for potential buyers so that the administrator is unable to trade the business himself. Because of the need to deal with a sale of the business quickly, the business is often sold after limited marketing and no consultation with unsecured creditors.

Secured creditors need to be informed of the proposed sale of the business or assets as agreement will need to be obtained for them to release their security. The buyer is often a company which has been set up by or is associated with the directors of the insolvent company.

## Power to Sell

The Courts have ruled that an administrator has the power to sell the company's business or assets before the creditors' meeting without

the leave of the Court in appropriate circumstances. This is so, even where the majority creditor opposes the pre-pack.

Before he can market the business, the proposed administrator will need to obtain a valuation of the business on a going concern and forced sale basis in the usual way. The administrator will use specialist valuers where appropriate. Given that the main justification for a pre-pack is the likely dissipation of value in the event that an administrator trades the business, the valuation takes account of the goodwill on a going concern basis.

The Insolvency Practitioner (IP) will also establish the value of the ongoing contracts, the potential difficulties in trading the business and the factors which would lead to a diminution in goodwill before deciding whether it is appropriate to market the business.

## Marketing the Business

Most businesses have a limited market of potential purchasers. This applies whether the business is a multinational corporation or a small or medium enterprise operating in a local market. It is important to identify the market in which the business is operating and then assess whether there is a pool of competitors, suppliers or customers who would be interested in acquiring the business.

In some instances, the market can be very small indeed. The local nature of the business may mean that the pool of potential purchasers will be in low single figures. Alternatively, the business may operate in a geographic area in which a competitor from another part of the country is looking to expand. IPs take advice from agents as to the most appropriate media to be used to market the business.

As time constraints are usually tight, it may only be possible to advertise the business once e.g. in the Financial Times or in the appropriate trade press. The IP will also consider whether to approach competitors and suppliers direct to see whether they are interested in purchasing the business.

Often, the directors of the insolvent company are best placed to make an offer for the business as they have a detailed knowledge of the business and assets and their value. In many instances, they are the only party interested in buying the business and assets of the insolvent company. Ideally, the IP will ensure that he explores other possible sale opportunities before entering into negotiations with the directors regarding the proposed sale.

The main criticism of pre-packs is that they are not transparent. This is because unsecured creditors are not involved in the sale process due to the commercial pressures which require urgent action to be taken to sell the business. However, the administrator is required to give full details of the sale including an explanation and justification as to why the pre-pack was undertaken so that the creditors can be satisfied that the administrator has acted with due regard for their interests.

## Contact information

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