



Diving in at the deep end

Duncan Grubb offers an in depth look at the initial pre-packs.

Corporate insolvencies generate a range of emotions depending on whether one is directly affected or not; whether it be fear and uncertainty from the staff who are wondering if they will be retained or how they will cope if they are not (and I speak from experience here), or frustration from customers who want to know if their paid-for goods will materialise, to anger from creditors' credit controllers, who have to face telling their bosses that a bit more of the booked income will have to go into bad debts (I speak from experience here as well!). However, apart from the aforementioned and now bonus-free credit controllers, most of us will probably view any insolvency with a degree of sympathy for those affected, even if the company concerned has brought it all upon themselves.

Pre-pack administrations involving connected parties are a different animal however, and are often viewed as a cynical attempt to subvert the administration process, allowing bad businessmen to hold on to the fruits of their labours while, at the same time, forcing the creditors to pay for their mistakes. This may only be the case in a minority of situations, but the ability to manipulate the system in this way certainly exists. As a former head of credit for a retail landlord, I can think of more than one example where a national chain has placed a subsidiary into administration (having stripped out the assets by way of management charges) only for the holding

company to buy the profitable parts of that business back by way of a pre pack. This allowed the business to leave behind unwanted assets – including underperforming shop leases – for a liquidator to disclaim further down the road. Strategic insolvencies are therefore not an insignificant issue, particularly for landlords who often feature highly on creditor lists.

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The Graham Report

Increasing noise in the creditor community surrounding such connected party pre packs resulted in Vince Cable, the then Business Secretary, asking Theresa Graham CBE, a senior civil servant and director of the British Business Bank, to

- conduct an investigation into the effectiveness of connected party pre packs and their perception in the marketplace,

- produce a report for widespread circulation, and
- include recommendations for increasing creditor confidence in this type of corporate rescue.

In the run up to her report Teresa consulted with a number of institutions and creditor groups including the British Property Federation, which has its own insolvency committee made up of landlord representatives, lawyers and insolvency practitioners, and which I had the privilege of chairing at the time – hence my involvement in the outcome.

The report (published in June 2014) was balanced, and found that although pre packs were a valuable recovery tool – particularly in niche businesses where there are only a limited number of players – there was a clear disparity between the survival rate of a newco operated by a connected party following a pre-pack, and that of a newco with no connection to the failed company. The former often did not last a full year, whereas the latter generally fared much better. The report also considered that more needed to be done to bolster confidence in the pre-pack process as a whole, which had certainly got a bit of a bad name in the eyes of creditors.

The report also made two key recommendations; firstly that a viability study should be carried out on the business model being proposed by the owners of the newco where there is a connection to the oldco (and this can be either an individual or corporate connection), and secondly

that there should be a pool of unconnected, impartial and experienced business people to scrutinise and consider the appropriateness of the pre pack on the table – ideally giving a declaration that it contains nothing untoward or adversely prejudicial to creditors. In layman's terms I suppose this could be referred to as a 'this is not a stitch up' certificate! An application for scrutiny by the pool will be made voluntarily by the connected party proposing the pre pack (not the administrator, and I'll come back to that later), who will pay a fee for the service, and the pool member will then examine the proposal in some detail and within 24 hours give one of three prescribed opinions:

- Not unreasonable to proceed
- not unreasonable to proceed but with minor limitations in evidence (with a list of omissions list attached)
- case not made.

The pool member will be paid a fixed fee for his time funded by the application fee.

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The pool member's opinion will then be included in the recently redrafted SIP16 report, with the aim of giving creditors additional confidence that the proposals are a genuine attempt to rescue a distressed business, and not a strategic manipulation of the process.

The pre-pack pool was therefore born – or rather the idea was - putting it all together took a little bit longer.

Pool structure

A steering committee was quickly assembled composed of senior figures from the institutions involved in the initial consultations, including the CICM, R3, ICAEW, IPA, ACCA, BPF, ICAS, CARB, BPIF, IOD and Teresa herself. The first issue was a legal basis for the pool, as there had to be an administrator and a beneficial owner of the pool bank account. This is where I volunteered to take on the role of administrator, as none of the above organisations felt they were in a position to provide sufficient full-time resources, and I was shortly to take early retirement from my existing day job and work as a consultant, so it all fell into place.

We decided to form a limited company (cleverly named Pre Pack Pool Ltd), with three directors: me, my colleague from

thee steering committee and CICM Vice President Stuart Hopewell, and Teresa Graham herself. Teresa was only to remain in position until the launch date in order to avoid any accusations of conflict of interest.

Pool members

The recruitment process for pool members commenced in spring 2015, and applicants were required to submit a full CV and a covering statement outlining the skills they felt they could bring to the pool. Following ads in various trade publications we were soon oversubscribed. A register of 20 members was regarded as an optimum number, and at present this looks to be about right. The applications were analysed by the steering group, not only for commitment and suitability, but also to provide as broad a background of experience as possible. Applications from retired IPs were accepted, but practicing ones were excluded to avoid possible accusations of conflict and tribalism.

Pool website

The next step was to provide an online portal through which all this could happen. Mole Productions were brought in to construct the website, having been recommended by a member of the steering group. This part of the process probably took the longest, as notwithstanding the computer geek side of the set up, we needed to agree on the specific information required by people applying to the pool for an opinion, turnaround time limits and practicalities (48 hours was agreed due to the time critical nature of pre packs, and this has worked well so far), an extensive Q&A section, and finally guidance notes not only for the applicants, but for the pool members as well. Test pre-pack scenarios were circulated to the pool members to help familiarise them with the application format and the information they were likely to receive, and also to highlight any inconsistencies in the opinions.

Pool launch

Given that this entire project is by its very nature reactive, in that it relies not only on the willingness of potential buyers of distressed businesses to engage with the pool, but also on the wider economic climate, it was anybody's guess how popular the pool would be, and how much media attention it would receive following the 2 November 2015 launch. Notwithstanding an endorsement by Minister for Small Business, Industry and Enterprise, Anna Soubry, it's fair to say that press coverage was unspectacular – with more than one publication mistakenly claiming that the pool is there to scrutinise the actions of the IP. Most however were generally supportive if a little sceptical about what is, after all, a voluntary procedure.

I'd like to respond formally on both these points: firstly to answer the question 'if all this is voluntary, why should anyone

bother?' Well, apart from providing comfort to oldco creditors (who might otherwise restrict supply to the newco), it should be remembered that the government has already reserved the right to ban connected party pre packs outright within the term of this parliament if the voluntary regime proves ineffectual. That would remove a valuable recovery tool from everyone – not just the rogues – so it's up to everybody to make this scheme work. Secondly, the pool does not exist to scrutinise or comment on the professional decisions made by IPs, whose role remains to get the best deal possible for the creditors of the oldco. The pool is there to examine the appropriateness of the proposal made by the prospective buyer of the business, and only after the opinion is given is the IP informed. At no point is his work scrutinised or commented on.

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Furthermore we are hearing that certain banks are building applications to the pre-pack pool into their procedure requirements for lending to connected party newcos, so the project is clearly gaining traction.

Outlook

It's still early days, but so far the pool has examined a number of proposed pre packs including one national chain, and the pool members have provided their opinions professionally and within the required deadlines. Clearly we don't ultimately want to see more companies fail, but where it is unavoidable and a pre pack to a connected party is one of the solutions, we would obviously like to see IPs encouraging prospective connected party purchasers to engage with the pool.

Finally, in a House of Lords debate immediately following the pool launch, one of the participants (a retail director) stated that pre packs were very valuable as they are the only way for companies to get rid of long leases they don't want anymore! Clearly then we still have much to do. □



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