

Pre-pack administration vs company voluntary arrangement (CVA)

A Guest Article by Simon Parker
January 2010

Pre-pack administration vs CVA

A Guest Article by Simon Parker for TCii Strategic and Management Consultants

Insolvency procedures compared

This article compares the popular but controversial pre-pack administration with the less used company voluntary arrangement (CVA).

Pre-pack administrations

When a company goes into an insolvency procedure such as an administration, it is inevitable that there will be an immediate reduction in the value of the business, caused by loss of people, expertise, contracts and leases by forfeitures, etc. A pre-pack, which is an arranged sale of a business on the appointment of an administrator, is therefore a legitimate means of preserving value for creditors.

Concerns arise where a pre-pack is simply used as a vehicle to enable existing managers to purchase troubled businesses. It may also be considered that pre-pack enables them to replicate the same mistakes at the expense of creditors, while allowing the directors and shareholders to benefit.

There has been much criticism about the misuse of pre-pack administrations and how they might be used by owners to rid their businesses of debt and liability and start over again. Disquiet over secret deals being agreed and the lack of transparency for creditors resulted in the issue of SIP 16 (the Statement of Insolvency Practice) in January 2009. Insolvency practitioners are required to give better information to creditors about the buyer of and the price for the business.

Pre-packs empower administrators

The increased use of the pre-pack administration process can be attributed in part to the implementation of the Enterprise Act 2002. It provides an administrator with the power to sell in advance of the creditors' approval of his or her proposals, and subsequent judgments.

Legal cases in the last three years have shown that the courts are reluctant to interfere with the decision of an insolvency practitioner, but he or she must not be seen to be too closely involved with the sale negotiations leading up to his or her appointment.

The pre-pack is not a saviour of businesses and an easy route to getting a business back on the road to recovery. It has to be viewed in the context of the two primary objectives of administration: the rescue of the company as a going concern, or achieving a better result for the company's creditors as a whole than would be likely if the company were wound up.

Pre-pack administration vs CVA

A Guest Article by Simon Parker for TCii Strategic and Management Consultants

Company voluntary arrangements (CVAs)

A CVA is a procedure brought in by the Insolvency Act 1986. It allows a financially troubled company to reach an agreement with its creditors about payment of all, or part of, its debts over an agreed period of time. It can be proposed by the directors, the administrator or the liquidator of the company, but not by the creditors or shareholders.

The proposals could include anything – for instance, a sale of the company or an injection of additional funding. When a CVA has been proposed, a nominee, who must be an insolvency practitioner, reports to court on whether a meeting of creditors and shareholders should be held to consider the proposal.

The meeting decides whether to approve the CVA. If 75% of the creditors agree to the proposal, it is then binding on all creditors who had notice of the meeting and were entitled to vote. The nominee then becomes the supervisor of the arrangement.

Stand-alone CVAs leave companies vulnerable

Stand-alone CVAs, i.e. those not proposed by an administrator or liquidator, are relatively rare because the company remains vulnerable to attack by creditors while the proposals are being put together.

The Insolvency Act 2000 tried to address this problem by bringing in a 28-day moratorium period for small companies (turnover less than £5.7 million), during which creditors are unable to take action.

However, the moratorium is cumbersome to implement, requires an application to court, and puts considerable onus and risk on the nominee. As a result, they are very rarely used.

Advantages of stand-alone CVAs

Nevertheless, if creditors are carefully managed, stand-alone CVAs can succeed, and the advantages of this procedure over administration and/or liquidation are many. They including the following.

- Creditors will benefit from a better return – otherwise they would not approve the proposals.
- The arrangement allows the directors time to reorganise and restructure the company without the threat of creditor action.

Pre-pack administration vs CVA

A Guest Article by Simon Parker for TCii Strategic and Management Consultants

- Customers do not have to know of the CVA and therefore there is little negative publicity.
- The insolvency practitioner's costs are lower than for other formal insolvency procedures.
- There is no requirement for the insolvency practitioner to investigate the affairs of the company as there is in the case of liquidation.
- There is no requirement for the insolvency practitioner to report on the conduct of the directors.
- The company remains and therefore the tax losses are protected, and there are no similar-name issues as there are with "phoenix" companies.

With the cooperation of creditors there is no reason why CVAs, with their obvious advantages, cannot be used as an alternative to pre-pack administrations, especially at the small to medium-sized end of the market.

Simon Parker

Chartered Accountant and Licensed Insolvency Practitioner

Antony Batty & Company LLP

If you would like more information on any of the points covered in this Guest Article, please contact **TCii** on **020 7099 2621**.

Disclaimer:

The above information has been provided to TCii Ltd by third parties in good faith and is thought to be reliable. However, the reader should not assume that the information is accurate, up to date or complete. TCii Ltd does not assume responsibility for errors or omissions.