Consultation/Call for evidence on improving the transparency of, and confidence in, pre-packaged sales in administrations

MARCH 2010

RESPONSE SUBMITTED BY THE BRITISH PRINTING INDUSTRIES FEDERATION

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List of consultation questions

Question 1: Do you believe that the current framework governing the operation of pre-pack sales in administration provides a sufficient level of confidence that pre-packs are only being used in appropriate circumstances and with an appropriate degree of transparency?

No. These controversial business rescue arrangements enable the debts of previous owners to be written off, and have rightly attracted fierce and justifiable criticism from creditors and competitors alike. Creditors are aggrieved because they have lost money owed to them, and competitors because they are now faced with a rival who now has an unfair trading advantage. In an over-capacity industry such as printing, which is dominated by small companies, the incidence of pre-pack administrations is disproportionately high and the damage caused to both creditors and competitors alike has been very significant.

Question 2: If not, what are your main concerns with the way pre-packs are currently executed?

The current framework undermines the efforts made by legitimate business to meet their debt obligations. It is essential to give statutory effect to the requirements set out in Statement of Insolvency Practice 16 - with statutory penalties for non-compliance - in order to improve public confidence in the pre-pack administration process.

Question 3: Do you believe that pre-packs are presently subject to abuse? If so, how? Please indicate whether you believe it is the actions of directors, insolvency practitioners, secured lenders or any other parties that are contributing to any perceived or actual abuse and to what extent you believe this is a problem.

Yes. They are frequently used to avoid debt, particularly in 'same director' pre-packs, where the new owners are essentially the same as the previous ones. The directors of the company are often the prime movers in the decision to pre-pack a company, particularly if they have high levels of personal debt secured against the business. However their decision may be precipitated by pressure from an external secured lender, such as a bank for example. In some cases however insolvency practitioners have helped sell a business back to its original owners free of debt, without considering marketing the business, or have even proactively targeted failing businesses to offer the owners an easy way out of debt.

Question 4: Some of the following options would require a distinction to be drawn between pre-packs and 'conventional' administrations. What do you think should be included in a statutory definition as to what constitutes a pre-pack transaction?

We believe the following definition should be adopted:
"A new company formed as the direct consequence of a failed company having been placed into administration and then sold to new owners shortly after the appointment of the Administrator and without publicly marketing the business for sale. A common characteristic of a pre-pack is that the Administrator, the directors and the Bank agree a sale price and draft contracts to enable the business to be sold privately to new owners immediately after the appointment of the Administrator."

Question 5: Do you believe that the new pre-appointment cost recovery mechanism will have a significant effect on transparency and confidence?

Yes. It should mean that insolvency practitioners will have to justify their pre-appointment work and provide fuller details of the advice they have given prior to administration and the actions they have taken in arranging the pre-pack sale. It would also allow scope for a new provision should be introduced requiring that any person advising on a pre-pack should be precluded from becoming the administrator for the company concerned (see our response to Q11 below) since both insolvency practitioners would be able to recover their costs from the insolvency estate.

Question 6: Do you believe that by giving statutory force to the SIP 16 disclosure requirements creditors would be given better information about the reasons and justification for the pre-pack?

Yes. According to the Insolvency Service’s report on the second half of 2009, 38% of the 497 pre-pack sales in the period were not fully compliant with the disclosure rules set out in SIP 16. Of those identified, 7% were deemed to constitute a serious breach of the SIP 16 guidelines warranting referral to the relevant authorising body. The report stated that it was "of serious concern that overall compliance did not improve in the latter part of 2009", despite the Insolvency Service having issued further guidance clarifying what needed to be disclosed and when.

We consider that confidence in the pre-pack administration process would be boosted by making the SIP 16 guidelines legally binding. Since its inception, the impact of SIP 16 has been weakened by the fact that compliance is not a statutory demand, with those who don't comply going unpunished. In particular the appropriate information needed to make a justifiable case that the pre-pack will preserve value and jobs is not always being provided. According to the Insolvency Service, 29% of all administrations in 2009 resulted in pre-pack sales. However, it has admitted that it is concerned that it is not being sent SIP 16 data in all relevant cases, meaning the true figure could be considerably higher.

Question 7: Do you believe that such a requirement will increase costs and reduce the returns available to (a) secured creditors, and (b) unsecured creditors? If possible, please provide an estimate of the impact on each.
Question 8: Do you believe that it would be appropriate for details of the pre-pack to be filed at Companies House? If not, why not?

Yes. We believe that the remit of insolvency practitioners involved in pre-pack administrations to provide for this to be more akin to that of an auditor. Specifically, insolvency practitioners should be required to:
• consider wider issues of public concern, such as whether or not it is in the public interest for directors of a failed company to continue to serve as directors of a new company;
• adopt a “scorecard” approach to both directors and shareholders involved in pre-packs, under which they would give a risk rating to these parties;
• file their report on these matters with Companies House, together with any BIS report filed on the company concerned.

Question 9: Do you believe that it would be appropriate for a statutory offence to be created in circumstances where the pre-pack disclosure requirements are not adequately met?

Yes. We would wish to see provision for automatic scrutiny of the directors' and administrators' actions by an independent body, and the introduction of a mandatory requirement for court or creditor sanction for any deals involving connected parties.

Question 10: Do you believe that confidence in pre-packs would be improved by requiring companies whose business and assets had been sold through a pre-pack to exit administration via compulsory liquidation? What would be the possible costs and benefits?

Yes, particularly as the Official Receiver will have not have been involved in the pre-pack negotiations and can therefore take a more independent view of the directors' conduct.

Question 11: Do you believe that an insolvency practitioner providing advice to a company on the potential for a pre-pack has an inherent conflict of interest when accepting a formal appointment as administrator with a view to subsequently executing a pre-pack sale?

Yes. We consider that a new provision should be introduced requiring that any person advising on a pre-pack should be precluded from becoming the administrator for the company concerned.

Question 12: If so, do you believe that such a conflict extends to circumstances where the insolvency practitioner has had an ongoing prior relationship with the company in the context of undertaking review work for a secured lender?
Yes, given that the secured lender will have a commercial interest in the new company that will have been enhanced by the act of pre-packing the company and releasing it from previous debts

Question 13: Do you believe that a requirement for a different insolvency practitioner to accept appointment as administrator would improve confidence that pre-packs are only used in appropriate circumstances?

Yes. We believe that this would avoid conflicts of interest arising and to enhance the confidence of creditors in the insolvency practitioners handling the administration

Question 14: Do you believe the requirement to use two separate insolvency practitioners would increase costs and delay therefore reducing the returns available to (a) secured creditors, and (b) unsecured creditors? If so, please provide an estimate of the impact on each.

There is no reason why it should do, given that the overall amount of work to be performed is unchanged. The Insolvency Service would need to keep this matter under close review, and should be given powers to require insolvency practitioners to share information in any case where there is evidence that work would otherwise be duplicated, thus creating unnecessary additional costs.

Question 15: Do you believe the requirement to use two separate insolvency practitioners would reduce the number of business sales effected through a pre-pack sale? If so, please provide an estimation of the impact.

It would hopefully curb those instances where an insolvency practitioner attempts to secure new business by inviting distressed businesses to enter a pre-pack, since the insolvency practitioner advising on the pre-pack would then be precluded from subsequently accepting appointment as the Administrator.

Question 16: Is it desirable that unsecured creditors, who may not stand to receive any dividend from the proceedings, be given an opportunity to influence the proposed pre-pack sale where the business is being purchased by a connected party? If so, why?

Yes. Unsecured creditors have a legitimate interest in any case where those who are in debt to them are likely to benefit from a transaction that relieves them of those debts. For this reason they should be allowed to influence any proposed pre-pack sale to a connected party.

Question 17: Should approval for such a sale initially be sought from unsecured creditors with a recourse to the court, or from the court in the first instance? If you believe unsecured creditors should be given the
opportunity to approve in the first instance, what percentage in value of their claims should be required for approval to be obtained?

It should be possible for approval to be sought from unsecured creditors, with a recourse to the court, with 10% in value of their claims being required for approval to be obtained.

Question 18: Would the prior approval of the court or creditors for the proposed sale improve confidence that pre-packs are only used in appropriate circumstances?

Yes, since those contemplating a pre-pack sale would know in advance that the proposed sale would be subject to an approval process.

Question 19: Do you believe the requirement to obtain court or creditor approval would increase costs and delay therefore reducing the returns available to (a) secured creditors, and (b) unsecured creditors? If so, please provide an estimate of the impact on each.

The requirement to obtain court approval would significantly increase costs and delay, thereby reducing the returns available to creditors. Hence our preference would be for the option of creditor approval, with recourse to the court in reserve if needed.

Question 20: Do you believe the requirement to obtain court or creditor approval would reduce the number of business sales effected through a pre-pack sale? If so, please provide an estimation of the impact.

Yes, as it is likely that the desire to avoid such delay and costs could incentivise efforts to market the business and generate interest from unconnected parties. The resulting competition may well result in the business being sold at a higher price, increasing returns for creditors and limiting the scope for pre-packs to be used to enable connected parties to purchase businesses below market value.

Question 21: Do you believe that any provision requiring the prior approval of the court or creditors for business sales to connected parties should be extended to apply to such sales out of all formal insolvency procedures (i.e. not restricted solely to administration)? If so, why?

Yes, in order that all sales out of insolvency procedures are subject to the same requirements, accountability and scrutiny.

Question 22: Do you believe that a requirement to obtain court or creditor approval for a pre-pack business sale to a connected party should be combined with the attachment of personal liability to directors and connected parties who purchase a business without obtaining the requisite approval?
Yes. There would have to be sanctions for not obtaining the requisite approval.

Question 23: Do you believe that it would be appropriate for pre-pack business sales to connected parties executed without the requisite approval to be rendered void?

Yes.

Question 24: To what extent do you believe that pre-packs provide a positive contribution to the wider economy by allowing economically viable parts of insolvent companies to continue trading? How would you quantify such a contribution? Please provide any evidence you may have to support your comments.

We recognise that pre-packs may sometimes be the only way that an unprofitable business can be sold intact, particularly where competitors are hungry for new contracts and customers may be concerned about continuity of supply. However while the interests of employees, shareholders and customers alike may, in some cases, be best served by handling the sale discretely until the deal is concluded, greater protection needs to be given to the interests of creditors and competitors, who have suffered greatly to date as a consequence of the current lack of regulation in this area.

Question 25: To what extent do you believe that pre-packs create market distortions by allowing companies to ‘dump debts’ and continue trading to the detriment of competitors? How would you quantify this? Please provide any evidence you may have to support your comments.

In an over-capacity sector such as printing, the fact that unviable businesses can be resurrected from failure through pre-packing, thereby dumping debts and gaining unfair competitive advantage over their rivals, does create market distortion. Pre-packs militate against necessary industry consolidation that would otherwise improve the trading position and future prospects of other companies, who have managed to remain in business by operating efficiently and providing a quality service while continuing to maintain their payment obligations to their suppliers. Any jobs preserved as a result of allowing a failed business to be preserved through pre-packing are often more than outweighed by those lost in competitor companies whose trading position is undermined by the unfair competitive advantage achieved by the pre-pack company. This is of course accentuated in those instances, by no means unknown in the printing industry, where the pre-packed company has gone on to fail again after a relatively short period of time.

Question 26: To what extent do you believe that pre-packs create job losses ‘upstream’ by allowing companies to ‘dump debts’ and continue trading to the detriment of suppliers who then experience knock-on
financial difficulties? How would you quantify this? Please provide any evidence you may have to support your comments.

Suppliers have suffered significantly from bad debts left by pre-packs, causing many of them to review their policies on trading with such companies. However the effects of this are then felt by all companies, as suppliers tighten credit terms to protect themselves from similar losses in future

Question 27: To what extent do you believe that any economic value preserved by a pre-pack sale (e.g. employees, customers, suppliers) would otherwise transfer to alternative ventures (e.g. competitors) if a pre-pack sale was not undertaken? Please provide any evidence you may have to support your comments.

In some respects, our comment here is the corollary of that given in response to Q25. Because pre-packs often militate against necessary industry consolidation that would otherwise have improved the trading position and future prospects of other companies, it follows that other companies would benefit from being able to absorb their trade should the pre-pack sale not be undertaken. Since these businesses are not distressed, the economic value preserved in the trade as a result would be better preserved, offering greater protection for employees, customers and suppliers. While we acknowledge that in tough trading conditions some of the pre-pack’s competitors may also be struggling, one thing that could bring them down as well is the resurrection of a failed business that is now able to compete against them more advantageously as the result of freeing itself of its previous debts.

Question 28: Do you believe that any of the options identified would have a significant impact on the behaviour of secured lenders? If so, what do you think this is likely to be? If possible, please provide an estimation of the impact.

We would not wish to speculate on this. This question might best be put to typical secured creditors, particularly the banks

Question 29: Which of the five proposed options would be your preferred solution(s), and why?

We believe that Option 5 would be particularly beneficial as it addresses our principal concern, which is that a business may be sold below market value for the personal benefit of the directors whilst allowing them to continue trading through a new company which is free of debt. It would also prevent the sale of substantially the whole of a business to connected parties or to a company controlled or owned by connected parties without the prior approval of creditors or the court.

Question 30: Are there any alternative measures that you believe ought to be considered?
Options 2, 3 and 4 are all sensible measures and we believe that all three should also be introduced.

Question 31: Please provide an indication (if not obvious) as to the nature of your involvement in, or exposure to, pre-pack transactions and the approximate incidence of that involvement or exposure if relevant.

The BPIF is the principal trade association representing printing companies in England, Wales and Northern Ireland. Printing is an overcapacity industry, dominated by small companies, and 60% of our members employ less than 25 people. The cost of acquiring a smaller business in the sector is relatively low compared to most other manufacturing industries, particularly if the company being purchased has lost value through weak trading and lack of goodwill. Not surprisingly, as the appendix to this response serves to illustrate, the incidence of pre-packing in the sector is relatively high.
EXAMPLES OF PRE-PACK ADMINISTRATIONS IN THE PRINTING INDUSTRY SINCE JANUARY 2009

In January 2009, five sites previously run by finishing specialist Celloglas were sold to new company Newcelloco. The new company was formed on 29 December 2008. That same month Euro Media Solutions bought Bridge Communications out of administration in a pre-pack deal. The Essex-based company was facing declining sales and appointed Tenon as administrator on 29 December. It was bought by Euro Media Solutions on the same day.

In April 2009 B&P Lightbrigade’s consumables division was sold out of administration to a new company set up by two previous B&P directors. B&P Graphic Supplies, incorporated on 27 February bought the engineering maintenance arm of the company after Vantis Business Recovery Services (BRS) failed to find a buyer for the company in its entirety. The sale took place on 23 March after BRS received interest from a number of buyers but ran out of time because of timescales imposed due to the company’s financial position. Also in that month, print management firm Affinity Connected was bought out of administration by a company owned by the director's father, Lord Evans of Watford. Affinity Connected went into administration with Vantis Business Recovery Services on 26 March 2009. The company was sold in a pre-pack deal to TU Ink, for which Lord Evans was a director.

In June 2009 digital financial printer 4Cilities went into administration and re-emerged as litho and digital company Inc Solutions - a company set up by former directors of 4Cilities and local company Print Logic Litho. MCR Corporate Restructuring were appointed joint administrators on 19 May 2009. The company was sold the same day. The same month, finishing company Clayton Park Print Finishing Services (CPPFS) went into liquidation with the company’s assets being sold to a new company set up by the previous directors. The sale of the assets to new company Steelmark, which was formed on 18 May, was finalised at a meeting of creditors on 5 June 2009.

In July 2009, bookbinder and finisher WH Ware & Sons went into administration and was sold to a new company set up by some of the previous directors. New managing director Terry Kelly announced at the time that he would be honouring all trade debts owed by Clevedon, WH Ware & Sons and offering staff continued employment. Also that month, senior management at Wellprint bought the stricken promotional packaging firm out of administration. Administrators at insolvency firm SFP were called in on 3 July. The purchasing vehicle used to buy the business was a new company Wellprint UK, set up on 19 June 2009.

In November 2009, digital and litho printer Maincolour Print was bought out of administration in a pre-pack deal. The company went into administration with MCR on 9 November. It was later sold to Arrival Data. Arrival Data was formed on 18 October.
In December 2009 the key elements of mailing house **Formpro Mail Marketing** were sold in a pre-pack deal to Formpro shareholder Michael Hughes.

In January 2010 **Midway Colour Print** was bought in a pre-pack deal by a company called Trowbridge one day after the Wiltshire company went into administration (28 January). Harrisons advertised the sale of Midway on its website, encouraging prospective suitors to contact the firm by 22 January. A statement on the site read: “The company will be placed into administration and this opportunity is to acquire the business in a pre-packed sale, which would be an attractive option in its own right, as well as a bolt-on to an existing business.”

In February 2010 **Church Street Litho**, which traded under the name of its predecessor Belgravia Colour Printers (BCP), went into administration. The failure came just 18 months after the business and assets were bought out of administration by BCP director Martin Draycott. That same month, direct mail house **Blackburns DMS** went into administration just over a year after the previous incarnation of the business had gone into administration. Created on 13 February 2009, Blackburns DMS had employed around 150 staff when it took on the business and assets of failed business John Blackburns. At that time it had employed 315 staff and had a turnover of £32m. The direct mail arm was sold in a pre-pack deal to a management team a day later, with 151 staff moving across. Around a month later, the print arm was closed after a buyer could not be found. In total, 147 employees were made redundant as a result of the administration.

In March 2010 **C&R Print**, the company that had previously bought the assets of failed Belfast printer Graham & Heslip, closed just five months later amid accusations of “blackballing” by rival firms. The insolvency practitioner Napier & Sons said that since C&R Print bought the assets of Graham & Heslip in December last year, suppliers and rival printers had not supported the company, leading to its demise. C&R Print closed its doors on 26 March. Graham & Heslip’s administration had been controversial at the time, with trade union Unite alleging that proper actions were not taken before redundancies took place, and a later revelation that Graham & Heslip had left £3.1m worth of bad debt behind.

In April 2010 the administrator for **Lick UK** confirmed that it has sold the assets of the business to Lick Group in a pre-pack deal. Direct mail company Lick UK, which traded as Lick Group, went into administration with insolvency practitioner BWC Business Solutions on 7 April. That same month, the customer communications business **Mailcom** closed its direct mail and placed the entire company into administration before it was bought back in a pre-pack sale for £1m. Bond Partners was appointed administrator of Mailcom PLC on 30 March and the pre-pack sale of the company to Mailcom (UK) took place two days later on 1 April. According to a creditor report, three other offers, two of which were greater than the Mailcom UK bid, were made for the business, all of which were rejected. Mailcom PLC left £1m worth of debt behind, taking the total amount of debt dumped in the preceding 10 months to £4.5m. On 19
June 2009 Mailcom (North) went into administration leaving £3.5m owed to unsecured creditors. It was sold to Mailcom PLC for £85,000. Also in April 2010, coatings specialist Best Cover UV was sold out of administration to its previous owners. Leonard Curtis were appointed as administrators of Best Cover UV, the Leeds facility, and Bestcover (Bristol) on 26 March 2010. The assets and goodwill of both companies were sold to Best Cover UK, which listed Darren Crake, April Crake, Philip Lister and Noeleen Smith as directors. Darren Crake was a director at Best Cover (Bristol) and Best Cover UV, while April Crake was a director at Best Cover UV.

In May 2010 label printer The Plain Label Company (PLC) went into administration and was bought back again by its previous directors. The company entered administration with SFP on 14 May.

BPIF
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