Pre-Packs – *Patronus* or *Dementor*?

As fans of Harry Potter will be aware, a *Dementor* is a dark creature which glories in decay, draining happiness and hope from people and creating an atmosphere of misery and disturbance. A *Patronus*, on the other hand, is a positive force of hope and happiness providing the desire to survive. The purpose of this note is to consider whether the magic of a pre-packaged administration is more *Patronus* than *Dementor*.

It is widely, but not universally, accepted that pre-packs often produce the best result for a company in financial distress. They often permit an ailing business to be sold, at a higher price than in liquidation, which safeguards the future of that business as a trading entity with minimal disruption and jobs saved.

Graham Review into Pre-pack Administration (2014)

The *Graham* recommendations, amongst other things, aim to make pre-packs more transparent and to ensure, as far as possible, that pre-packs are used, and seen to be used, to provide the best price achievable for the business. There is clearly a conflict of interest in existence where pre-pack administrators are instructed by a company's directors and then decide to sell the business to those directors. To manage this conflict, under the *Graham* recommendations, pre-pack administrators are to ensure that where a sale to connected parties is concerned, appropriate steps are taken to ensure that the business is properly exposed to the market so that the best consideration possible may be secured.

Re Ve Interactive Ltd [2018] EWHC 186 (Ch)

In this case, the court effectively delivered an *Expelliarmus* spell to remove and replace the administrators of a *Unicorn* company which had entered a pre-pack sale of its business to connected parties.

The court pointed out that as from the date of the decision to pre-pack, a conflict of interest arose, as it will always arise when a company's directors seek to purchase a company's business. On the facts of the case, there were serious issues to be investigated. First, whether the circumstances of the pre-pack were such that the directors had breached their duty by favouring their own interests at the expense of other options. Secondly, whether the administrators breached their duties of reasonable skill and care with the result that loss was caused to the company by a sale at an undervalue.

In removing and replacing the administrators the court pointed out a number of matters requiring investigation, including: whether the business was marketed with due diligence; whether the directors took advantage of information which they did not share; whether this lack of information effectively prevented a level playing field for possible rival bidders; and the role of the administrators' firm.

The case highlights the risks run by administrators who enter into a pre-pack sale to connected parties. Administrators need to be careful in such circumstances to provide the correct advice, ensure an appropriate marketing and sale process and intervene if necessary to

prevent directors taking unfair advantage of their privileged position. Administrators must assess any sale objectively. On the facts of the case there was no cause for creditor confidence in the administrators being able to investigate the issues raised. They had "lost perspective of their role".

Other options short of replacing the administrators were not considered: for example, the appointment of an additional administrator who would be specifically and only responsible for the investigations. Interestingly, this solution was recently adopted by the Australian Federal Court in a non-pre-pack voluntary administration (*Re Ten Network Holdings Ltd* [2017] BPIR 1707). An *obiter* statement in that case highlights a fundamental difference in approach to pre-packs to that of the UK courts. In considering a theoretical connected party pre-pack where the administrator is involved in the pre-pack planning stage, O'Callaghan J comments at [23] that in Australia: "… it is difficult to imagine a situation in which the taking of such an appointment … would ever be countenanced."

Prophecy

As the Government considers the future of connected party pre-packs, *Re Ve Interactive* comes at a difficult time for proponents of the *status quo*. If administrators are not seen to be following the terms of the *Graham* recommendations, designed to deal with apparent bias of a pre-pack administrator, it is difficult to see how the Government will continue to allow them to act both in the planning of a pre-pack and its subsequent execution. Although impossible to prophecy what the Government will pull out of its Sorting Hat, it seems possible that the *Graham* recommendations will become compulsory. Equally possible, the Government may decide to prevent the same insolvency practitioners acting both pre and post appointment. Although this latter option may increase costs, it might restore any wavering confidence in pre-packs producing the best overall result for creditors. Pre-packs may finally be seen as more *Patronus* than *Dementor*!