

Pre-Packaged Administrations and Company Voluntary Arrangements:

The case for a holistic approach to reform¹

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Abstract

The Company Voluntary Arrangement (“CVA”) and pre-packaged administration (“pre-pack”) both facilitate corporate rescue and enable the continuation of a business by its existing management, though in very different ways. Through analysis of longitudinal studies of CVAs and connected party pre-packs commenced in 2013, this paper provides a comparative analysis of the outcomes of the processes and their impact on stakeholders. In so doing the paper identifies issues arising from the operation of these procedures and makes suggestions for reform, both to the processes and the need for wider systemic reform.

1. Introduction

A financially distressed company with a viable underlying business and a management group determined to continue that business will commonly look to utilise one of two of the formal insolvency processes designed to facilitate corporate rescue: a company voluntary arrangement (“CVA”) or a pre-packaged administration (“pre-pack”). Whilst there are a number of key distinctions between the two processes, there is one common factor between a CVA and a pre-pack to a connected person,² namely the maintenance of control of the business by the existing management.

CVAs have risen to prominence since 2018 following a spate of high profile retail cases, leading to calls for reform,³ whilst the pre-pack has long been subject to scrutiny having emerged as a by-product of the Enterprise Act 2002 insolvency reforms, leading to the 2014 *Graham Review into Pre-Pack Administration* (“Graham Review”) and subsequent industry-led reforms.⁴ Whilst both processes achieve a similar outcome in terms of business continuity, they do so in very different ways, which are likely to create different outcomes for stakeholders.

¹ This paper is based on a conference paper entitled “Pre-Packaged Administrations and Company Voluntary Arrangements: A comparative evaluation of outcomes” delivered at the Cross-Border Corporate Insolvency and Commercial Law Conference at City University, London on 26 April 2019 and a presentation delivered to the Insolvency Service on 11 June 2019. The author would like to thank participants at both events for their comments which have aided the development of this paper.

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² As defined in Insolvency Act 1986, ss.249 and 435

³ See for example British Property Federation, ‘British Property Federation calls government for urgent review of CVAs’ (7 June 2018) available at <<https://www.bpf.org.uk/media-listing/press-releases/british-property-federation-calls-government-urgent-review-cvas>> [Last accessed 10 July 2019]

⁴ T Graham, ‘Graham Review into Pre-pack Administration: Report to the Rt Hon Vince Cable MP’ (The Insolvency Service June 2014) available at <www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Last accessed 10 July 2019]

In light of the commonality and yet contrasts of these processes, calls to reform CVAs, the Government's review of the pre-pack process following the Graham Review reforms,⁵ and a general reform agenda emanating from the Government,⁶ this paper will consider the outcomes of CVAs and connected party pre-packs to determine the impact on a variety of stakeholders. This will be achieved by a longitudinal study of the outcomes of CVAs and pre-packs commenced in 2013. This common census period will ensure that companies carrying on business following one of these processes will have been subject to comparable economic environments, whilst also allowing sufficient time to have passed to monitor the outcomes for a variety of stakeholders. In comparing these outcomes, the paper will both identify potential reforms to the processes to facilitate achievement of the aims of the insolvency framework, whilst also making the case for a consolidated approach to reform rather than the recent piecemeal reactive approach of Government.

2. The Pre-Pack Administration

Statement of Insolvency Practice 16 ("SIP 16") defines a pre-packaged sale in administration as "an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator and the administrator effects the sale immediately on, or shortly after, appointment."⁷ In essence, the process facilitates business rescue, with the new company carrying on the business free of the unsecured and preferential debts, and in most cases the secured debt, of the insolvent trading company.⁸

The pre-pack has grown in prominence since the introduction of the Enterprise Act 2002 reforms to the administration process. Most notably, this is due to the creation of the out-of-court routes to appointment of administrators introduced by the 2002 Act,⁹ despite the absence of any specific statutory provision enabling it. The concept of the pre-pack has been endorsed by the courts,¹⁰ extending the principle that an administrator can effect a sale of a company's business and assets prior to presentation of their proposals to the company's creditors for approval, and without the need for court approval.¹¹ Pre-packs accounted for over 30% of all administrations in 2018, with more than half involving sales to connected parties.¹²

⁵ Insolvency Service, 'Review of the pre-pack industry measures' (12 December 2017) available at <https://www.gov.uk/government/news/review-of-the-pre-pack-industry-measures> [Last accessed 10 July 2019]

⁶ See for example Department for Business, Energy and Industrial Strategy, 'Insolvency and Corporate Governance: Government Response' (BEIS, 26 August 2018) available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version_with_Minister_s_photo_and_signature_AC.pdf [Last accessed 10 July 2019]

⁷ Statement of Insolvency Practice 16 v.3, para.1 available at https://www.r3.org.uk/media/documents/technical_library/SIPS/SIP%2016%20Version%203%20Nov%202015.pdf [Last accessed 10 July 2019]

⁸ In some cases, some of the secured debt will be rolled over into the purchasing company if it is being funded by the same lender.

⁹ Insolvency Act 1986, Sch.B1 paras 14 and 22, introduced by Enterprise Act 2002, s.248 and Sch.16

¹⁰ *DKLL Solicitors v Revenue and Customs Commissioners* [2007] EWHC 2067 (Ch); *Re Kayley Vending Ltd* [2009] EWHC 904

¹¹ See *Re T&D Industries Plc* [2000] 1 W.L.R. 646, as confirmed by *Re Transbus International Ltd (In Liquidation)* [2004] EWHC 932 (Ch).

¹² Pre-Pack Pool, 'Annual Review 2018' (Pre-Pack Pool Ltd, 2019) 1 available at:

<https://www.prepackpool.co.uk/uploads/files/files/Pre%20pack%20pool%20202018%20Annual%20report>

Pre-packs have not been without objection nor controversy due to the lack of transparency, especially when the purchaser is connected with the insolvent company.¹³ This has led to safeguarding measures, such as the introduction in January 2009 of SIP 16, requiring insolvency practitioners to provide key information about the transaction to creditors within seven days of the sale, and Government consultation on the need for reform in 2010, though no reform was forthcoming.¹⁴ A comprehensive independent review of the pre-pack process was undertaken by Teresa Graham CBE in 2013, leading to the publication of the Graham Review in June 2014. The Graham Review concluded that pre-packs are an important feature of the UK's insolvency landscape, but that major improvements were needed to how they are administered.¹⁵ This led to the introduction of a number of industry-led reforms, including the voluntary review of connected party sales and the viability of the purchaser by a newly established Pre-Pack Pool and a revised SIP 16 addressing concerns around the marketing and valuation of the transactions.

The Graham Review reforms are under review by the Government at the time of writing, with the possibility of further controls being imposed on connected party sales pursuant to the powers available to the Secretary of State under paragraph 60A of Schedule B1 to the Insolvency Act 1986. The Government has until 25 May 2020 to introduce further reforms under this delegated power.¹⁶

3. The Company Voluntary Arrangement

A CVA allows the directors of a company to make a proposal to the company and its creditors "for a composition in satisfaction of its debts or a scheme of arrangement of its affairs."¹⁷ The process can also be initiated by an administrator or liquidator if the company is in either related process.¹⁸ If approved, the process will allow the company to continue trading under its existing management subject to compliance with the terms of the CVA, which takes the form of a contract between company and creditors.

The process was introduced by the Insolvency Act 1986 following the recommendations in the Cork Report for a simple procedure where the will of the majority of creditors in agreeing to a debt arrangement could be made binding on an unwilling minority.¹⁹ The process is overseen by an insolvency practitioner, first in the capacity as nominee who will opine on whether the proposal has "a reasonable prospect of being approved and implemented" prior to it being filed at court,²⁰ and

[%20v3%20NC%20edits.pdf](#) [Last accessed 10 July 2019]. In 2018 there were 1,464 administrations, of which 450 were pre-packs, and of those 241 were connected party pre-packs.

¹³ See e.g. P. Walton, 'Pre-Packaged Administrations – Trick or Treat?' (2006) 19 *Insolv. Int.* 113.

¹⁴ Insolvency Service, 'Consultation/Call for evidence Improving the transparency of, and confidence in, pre-packaged sales in administrations' (Insolvency Service, March 2010)

<http://webarchive.nationalarchives.gov.uk/20140311023846/http://bis.gov.uk/insolvency/Consultations/PrePack?cat=closedwithresponse> [Last accessed 10 July 2019]

¹⁵ Graham n4

¹⁶ Insolvency Act 1986, Sch.B1 para.60A, introduced by Small Business, Enterprise and Employment Act 2015, s.129. For discussion of possible actions that the Government could take, see e.g. J. Wood, 'The sun is setting: is it time to legislate pre-packs?' (2016) 67 *NILQ* 173; C. Umfreville, 'Review of the pre-pack industry measures: reconsidering the connected party sale before the sun sets' (2018) 31(2) *Insolv. Int.* 58; E. Vaccari, 'Pre-Pack Pool: Is It Worth It?' (2018) 29(2) *ICCLR* 697; B. Adeobola, 'The Case for Mandatory Referrals to the Pre-pack Pool' (2019) 32(2) *Insolv. Int.* 71

¹⁷ Insolvency Act 1986, s.1(1)

¹⁸ *Ibid* s.1(3)

¹⁹ *Insolvency Law and Practice: Report of the Review Committee* (Cmd 8558, 1982) ("Cork Report") ch 7

²⁰ Insolvency (England and Wales) Rules 2016, SI 2016/1024 ("Insolvency Rules 2016"), r.2.9(2)

subsequently as a supervisor if the creditors approve the proposals.²¹ For the CVA to be approved, it must be agreed to by at least 75% by value of the unsecured creditors voting, at which point it will become binding on all the unsecured creditors.²² Importantly, the CVA can only bind secured and preferential creditors with their consent.²³ As such, the company will need to be able to meet these liabilities in full or reach separate agreement with such creditors to vary their rights to repayment.

In contrast to a pre-pack, once a CVA is agreed the business will be continued by the company subject to an insolvency process. The CVA will continue until such time as the creditors are paid in accordance with the terms of the CVA, in which case it will be implemented, or alternatively it may be terminated early if the terms of the CVA are not complied with, which will often lead to a further insolvency procedure such as administration or liquidation.

Given the involvement of the creditors in the process, a CVA has generally been less controversially received than the pre-pack. It has not, however, been without criticism, especially from landlords. The CVA process has come to the fore since 2018 following its use by a number of high profile high street retailers, including BHS, Debenhams, Homebase, Jamie's Italian and New Look. This period coincided with the publication by R3 of *Company Voluntary Arrangements: Evaluating Success and Failure* ("R3 Report"), a comprehensive report into the CVA process and its outcomes.²⁴ The R3 Report, *inter alia*, makes a number of recommendations for reform of the CVA process to improve its efficiency and outcomes for creditors.²⁵ The operation of SIP 3.2, which provides guidance to insolvency practitioners on the operation of CVAs, is currently under review by the Joint Insolvency Committee, and may address a number of these points. Additionally, although not specifically targeted at CVAs, the Government has proposed the introduction of a new pre-insolvency moratorium, which could act as a gateway to a CVA and would lead to the repeal of the current under-used moratorium process available to small companies under Schedule A1 of the Insolvency Act 1986.²⁶

4. Comparison of outcomes: Methodology

Both the CVA and pre-pack can achieve the same broad outcome, the continuation of a business by the existing management, albeit in very different ways. Notably, in a pre-pack the insolvent company's debt is left behind, whereas in a CVA this continues to burden the company, though on renegotiated terms. Both are currently subject to some level of review and potentially reform, although these processes are largely independent of each other. This is despite the clear links between the two. Whether to pursue a CVA or a pre-pack is one of the main considerations for a company in financial distress with a viable business. This choice is reflected in SIP 16, with insolvency practitioners required to keep a record of the reasoning for a pre-pack and alternatives considered, with many SIP 16 Reports consequently including an explanation of why a CVA was not appropriate.

²¹ Insolvency Act 1986, s.7(2)

²² Insolvency Rules 2016, r.15.34(3)

²³ Insolvency Act 1986, ss.4(2)-(3)

²⁴ P. Walton, C. Umfreville and L. Jacobs, 'Company Voluntary Arrangements: Evaluating Success and Failure' (R3, 2018) ("R3 Report") available at:

https://www.r3.org.uk/media/documents/policy/policy_papers/corporate_insolvency/R3_ICAEW_CVA_Report_May_2018.pdf [Last accessed 10 July 2019]

²⁵ *Ibid* 4.

²⁶ BEIS n6, paras 5.5-5.87, and in particular para.5.14

In light of the broad similarity here, and the apparent benefit of pursuing a pre-pack from the perspective of the management, there is a clear case to consider the outcomes of both CVAs and pre-packs and determine the impact on the debtors' stakeholders. The R3 Report included a longitudinal study on the outcomes of all 552 CVAs commenced in 2013, providing important data on the impact of CVAs on various stakeholders. In 2013 there were also around 430 connected party pre-pack administrations involving companies incorporated in England and Wales.²⁷ Comparing the outcomes of pre-packs from 2013 with the CVA data published in the R3 Report would allow a fair evaluation of the outcomes and impacts of each, as the businesses would be operating in the same prevailing economic conditions, before and after commencement of the process. In turn, this would allow assessment of the need for and direction of future reform.²⁸

The only published data on the outcome of pre-packaged administrations is the *Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration*, commissioned as part of the Graham Review, however this relates to pre-packs commenced in 2010.²⁹ The author has therefore carried out a longitudinal study on the outcomes of a stratified sample of 120 connected party pre-packs commenced in 2013. Initial data kindly provided by the Insolvency Service for all pre-packs from 2013 identified details of the company name, month of transaction and whether the sale was to a connected party. The author supplemented this information by collecting data from company records filed at Companies House to populate a database with information on pre-packs to allow comparison with the 2013 CVA outcomes. This database includes details of, *inter alia*:

- Characteristics of the insolvent company;
- Information about the Insolvency Practitioner (and firm) carrying out the procedure and their appointment;
- Details of the purchasing company, including any subsequent insolvency process;
- Details of the sale, including purchase price and use of deferred consideration; and
- Outcomes for stakeholders, including creditors and employees.

This will be compared with key aspects of the findings published in the R3 Report. As set out in the R3 Report, the database was based on initial information provided by the Insolvency Service which included *inter alia* the company name, company registration number and the CVA commencement date. This information was supplemented with information in company records filed at Companies House to populate a database with information on:

- The characteristics of companies entering into CVAs;
- Information about the Insolvency Practitioner (and firm) carrying out the procedure;
- Details of the outcome of the CVA;
- Details of any subsequent insolvency process;

²⁷ A small number of pre-packs apparently reported and recorded as involving a connected party did not appear to involve a connected party on the basis of the documents filed at Companies House. The number of connected party pre-packs is therefore lower than 430.

²⁸ As this census period pre-dates the implementation of the Graham Review reforms, there will be some variables compared to the current operation of pre-packs. This is a risk of any longitudinal study, when various factors which influence a process and its utilisation will vary over time. It is also apparent that the operation of CVAs has evolved in some aspects since 2013. This does not detract from the potentially significant insights that the data provides as to both processes.

²⁹ C. Umfreville, P. Walton and P. Wilson, 'Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration' (The Insolvency Service June 2014) available at www.gov.uk/government/publications/graham-review-into-pre-pack-administration [Last accessed 17 July 2019]

- In the event of termination of a CVA, information, where available, as to the reason for termination of the CVA.³⁰

This was then followed by a second phase of data collection, in respect of companies involved in terminated CVAs, to determine the outcomes of these CVAs in more detail. This secondary data collection included details of:

- Contributions made into the CVA;
- Amounts owing to different classes of creditors under the CVA; and
- Dividends paid to those creditors.³¹

The paper will now consider the key findings of the R3 Report in terms of the outcomes of the CVAs commenced in 2013, before identifying comparable themes from the sample of pre-packs which took place in 2013. This will be followed by a discussion on the outcomes of the processes in the context of the insolvency framework and its purported aims, and a consideration of the need for further reform to better facilitate these.

5. CVA Outcomes

The R3 Report identified a range of CVA characteristics in Phase I, broadly categorised into three areas: CVA outcome; company profile; and insolvency practitioner firm involvement. It then went on to consider in more detail the outcomes of terminated CVAs in Phase II. For the purposes of this paper, the key findings on CVA outcomes, company profile and payment of dividends will be considered. The data in the R3 Report reflects Companies House records filed and recorded as at 5 November 2017.

5.1 Headline outcomes

There were three possible outcomes for the CVAs under review at the end of the survey period. They had either been implemented (in accordance with the original or modified proposals), had been terminated early, or were still ongoing at the survey period cut off. This revealed some interesting data. Of the 552 CVAs commenced in 2013, 102 (18.5%) had been implemented, 90 (16.3%) were ongoing, and 360 (65.2%) had been terminated early. The termination figure stands out, with nearly two thirds of CVAs not achieving the aims agreed with creditors. This can be, and has been, viewed as a high rate of failure.³² Taking such a binary view of success and failure can, however, be misleading, as will be considered in section 5.3 below. From the alternative view, around a third of all CVAs were either implemented or ongoing by the end of the survey period. With over 16% of CVAs continuing for more than four years, there is a reasonable prospect of these progressing to implementation, especially in the context of a five year duration being common in CVA proposals and the profile of terminated CVAs considered below.³³

³⁰ Walton et al n24, 10

³¹ Ibid, 28-29

³² See e.g. Insolvency Service, 'A review of the corporate insolvency framework: Consultation Stage Impact Assessment' (Insolvency Service, 2016) para 1.58 available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525529/Consultation_stage_corporate_insolvency_consultation_Impact_Assessment_-_Mar_2016.pdf [Last accessed 17 July 2019]

³³ Walton et al n24, 11

It is instructive to consider the length of the CVA prior to its implementation or termination. As can be seen from Chart 1, the majority of all CVAs saw some form of outcome within three years of commencement.

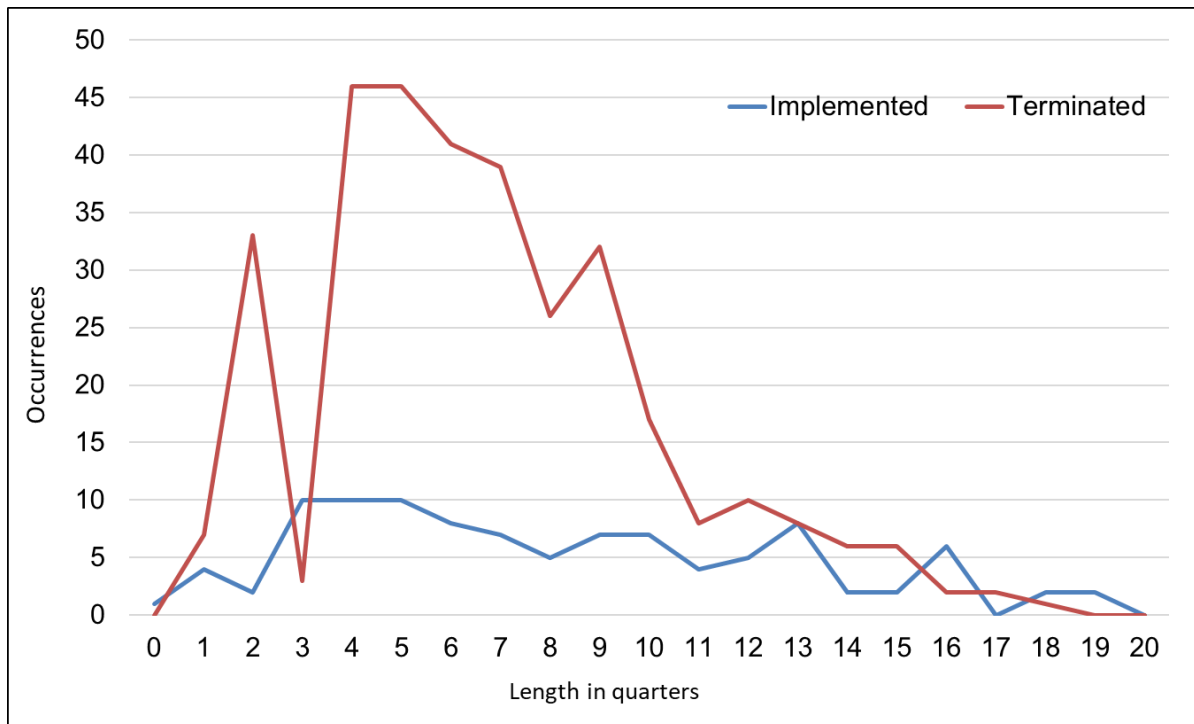


Chart 1: Length of CVA³⁴

CVA termination generally occurs reasonably early. Around a quarter of the 2013 CVAs (24%) were terminated within 12-18 months of commencement. There is also a noticeable spike of very early terminations, with 40 of the 2013 CVAs (7%) terminating within six months of commencement. In total, nearly a third of all CVAs were terminated within 18 months of proposals being approved by creditors.

Supervisors are required to terminate CVAs in a number of specified circumstances, which frequently include failure to make three consecutive (usually monthly) contributions. The R3 Report also observed that there was often a delay between such a trigger event and the CVA being terminated. On this basis, it is likely that these early terminated CVAs may have ceased being effective some time before termination, making little or no contribution to the CVA. This raises two key questions about these CVAs: first, whether the CVA was a suitable vehicle for these distressed companies; and secondly, whether the management teams were sufficiently adaptable to ensure the success of the CVA. Whilst it is conceivable that some companies will experience catastrophic events soon after approval of a CVA, it is highly unlikely that this fate befalls such large numbers of companies. This suggests that further thought needs to be given to the preparation and approval processes for CVAs to ensure they are appropriate and achievable.

5.2 CVA user profile

³⁴ Ibid 15

The R3 Report also revealed interesting data about the profile of companies using the CVA process in 2013. CVA usage was dominated by micro or small companies, representing 93.1% of all users.³⁵ CVAs were also most popular with companies which had been incorporated for between two to four years at the date of commencement, with nearly 20% of all users falling within this range. Indeed, as can be seen in Chart 2, around 24% of all users had been incorporated for less than four years before resorting to a CVA.

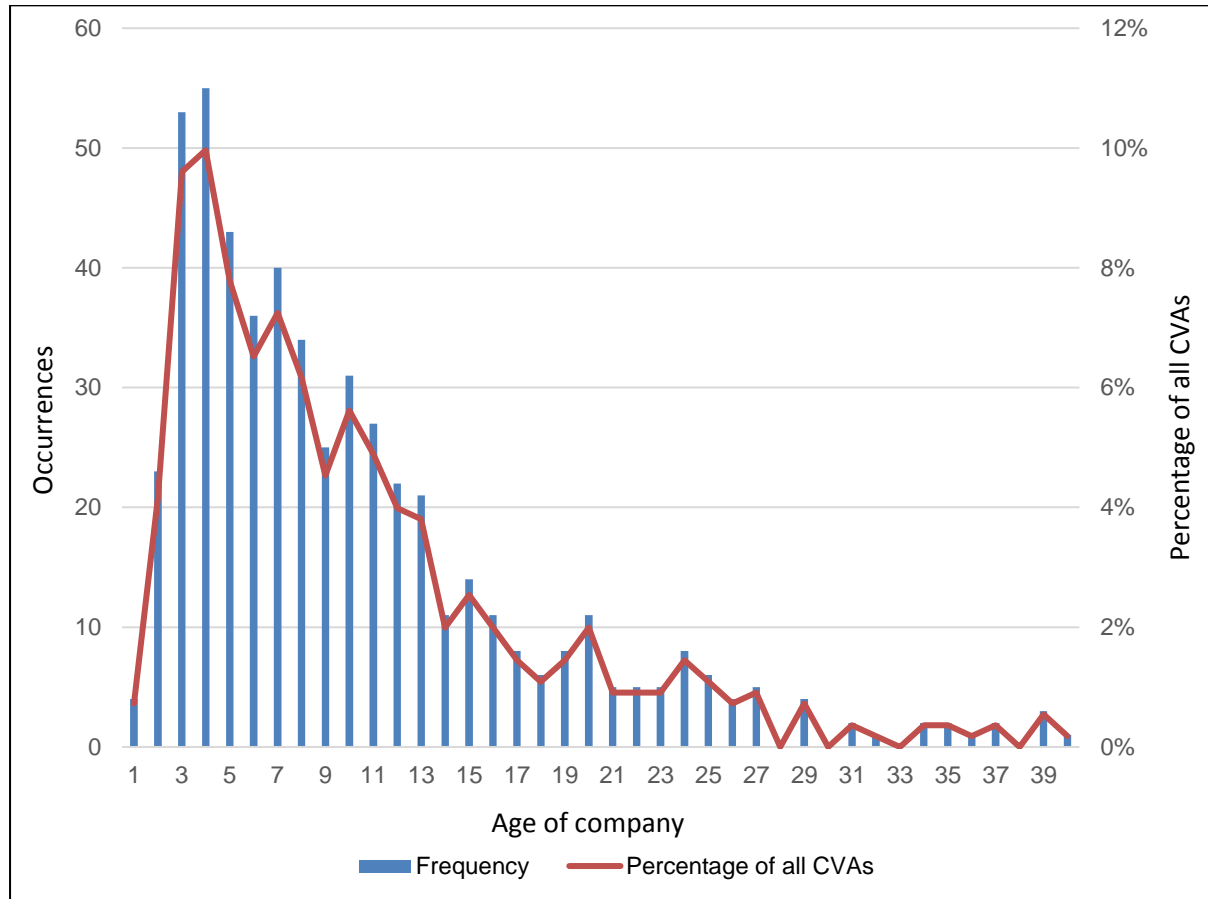


Chart 2: Age of company at commencement of CVA³⁶

What is most striking here is the relative youth of companies seeking to resolve their difficulties through a CVA, especially when we consider that it has become common for CVA proposals to set out a five year term for fulfilment of their objectives. It is also common for companies in a CVA to face restrictions to ensure that returns to creditors are prioritised, including prohibition on shareholder dividends and limits on director remuneration. For a company that has struggled to be financially viable in its first four years, or less, the ability to survive, let alone thrive, under such restrictions for a longer period is questionable. In the context of a small or micro company, there would no doubt be a temptation once the realities of the restrictions take hold for management to terminate the CVA and continue the business through the medium of a new company. It is perhaps not surprising, therefore, that the rate of termination for these younger companies is higher than the general population, and increases the younger the company.³⁷

³⁵ Ibid 15-16

³⁶ Ibid 20

³⁷ Ibid The rate of termination was 82.6% for companies aged 1-2 years, 77.4% for 2-3 years and 70.9% for 3-4 years, compared to the overall average of 65.2%.

One of the inherent weaknesses of the CVA process is the lack of a comprehensive moratorium to allow for proper preparation of the proposals. A moratorium can arise in two situations: first if the CVA is proposed by a company already in administration; and secondly in the case of small companies, if the process in Schedule A1 of the Insolvency Act 1986 is followed.³⁸ Although 93.1% of the companies (514) using a CVA in 2013 were eligible for the Schedule A1 moratorium, it was only used eight times (1.4% of cases). The administration moratorium proved more popular, being used on eleven occasions, seven of which involved small companies.³⁹ Although used infrequently, the outcomes of the CVAs which followed some form of moratorium varies noticeably from the general trend. Whereas only 18.5% of all 2013 CVAs were implemented, the implementation rate when a moratorium was used increased considerably to 42.8%. Conversely, only 21% of CVAs commenced following some form of moratorium were terminated, compared with the overall figure of 65.2%. Whilst the sample of companies using a moratorium is too small to draw any firm conclusions on the efficacy of a moratorium leading into a CVA, the divergence from the general trend is striking.

5.3 Stakeholder outcomes

In light of the length of CVAs prior to termination considered above, which reveals termination rates declining considerably after three years, it is not unreasonable to expect that the majority of those ongoing CVAs will be implemented. If the 16.3% of CVAs which were ongoing at the end of the census period are ultimately implemented, then around a third of all CVAs will have been implemented in accordance with the terms agreed with creditors. As a result, in around a third of all cases unsecured creditors will be paid what they agreed to accept, secured and preferential creditors will have their rights preserved (unless they agreed to accept less), the business will continue to the benefit of suppliers and customers,⁴⁰ and employees' jobs will be preserved subject to any reorganisation effected as part of the CVA.⁴¹ As such, these implemented CVAs will have produced positive outcomes acceptable to the creditors and broader stakeholders.

This still leaves nearly two thirds of CVAs being terminated prematurely. At face value, a terminated CVA will not have achieved its aims, and therefore will not have been successful. This is a rather arbitrary distinction that potentially overlooks positive outcomes in CVAs which are ultimately terminated. The 360 terminated CVAs were brought to a close from anything between one and eighteen quarters after commencement. This provides considerable scope for what could have happened in this timeframe. In Phase II, the R3 Report looked at the outcomes of terminated CVAs to consider the extent to which dividends were paid to unsecured creditors. The sample of 64 CVAs terminated after more than 15 months revealed that the longer a CVA went on, the greater the chance of a dividend being paid, though there were examples of long-running CVAs with no dividend paid.⁴² Whilst a dividend was being paid, it was often not substantial, with an average dividend

³⁸ Introduced by the Insolvency Act 2000, with effect from 1 January 2003

³⁹ Walton et al n24, 15-17

⁴⁰ To the extent that this was the aim of the CVA. The R3 Report revealed that in some cases the CVA was used to facilitate an organised winding down of the company's affairs and/or cost effective distribution of its assets. See Walton et al n24, 12

⁴¹ See e.g. New Look, 'New Look creditors approve Company Voluntary Arrangement proposal' (New Look, 21 March 2018) available at <<https://www.newlookgroup.com/pressreleases/new-look-creditors-approve-company-voluntary-arrangement-proposal>> [Last accessed 17 July 2019]. The CVA entered into by high street fashion retailer New Look requires redundancies to be made from stores proposed to be closed under the CVA.

⁴² Walton et al n24, 31

between 10-20 pence in the pound.⁴³ This could be viewed favourably, however, when considered against what unsecured creditors might have received had the company gone into administration or liquidation. The reports filed at Companies House did not reveal the prospective outcome in liquidation, though it is unlikely to have bettered these figures. Furthermore, the unsecured dividend rates discussed in section 6.3 below with regard to pre-packs in 2013 suggest these CVA outcomes represent good returns. Creditors and stakeholders will have received further benefits from the company continuing to trade during the CVA, including time to adjust their businesses to cope with the potential loss of trade together with continued trading during the CVA. This 'soft landing' could have potentially insulated these creditors from the shock of the company going into administration or liquidation, as witnessed following the collapse of MG Rover in 2005.⁴⁴

The R3 Report also revealed some evidence to suggest that the longer a CVA runs for relative to the length agreed in the CVA proposal, the higher the rate of dividend paid when compared to the dividend proposed. Whilst in many cases there was a significant shortfall against what was offered to and accepted by creditors when proposing the CVA, this does support the contention that the longer a CVA continues, the better the dividend prospects for unsecured creditors.

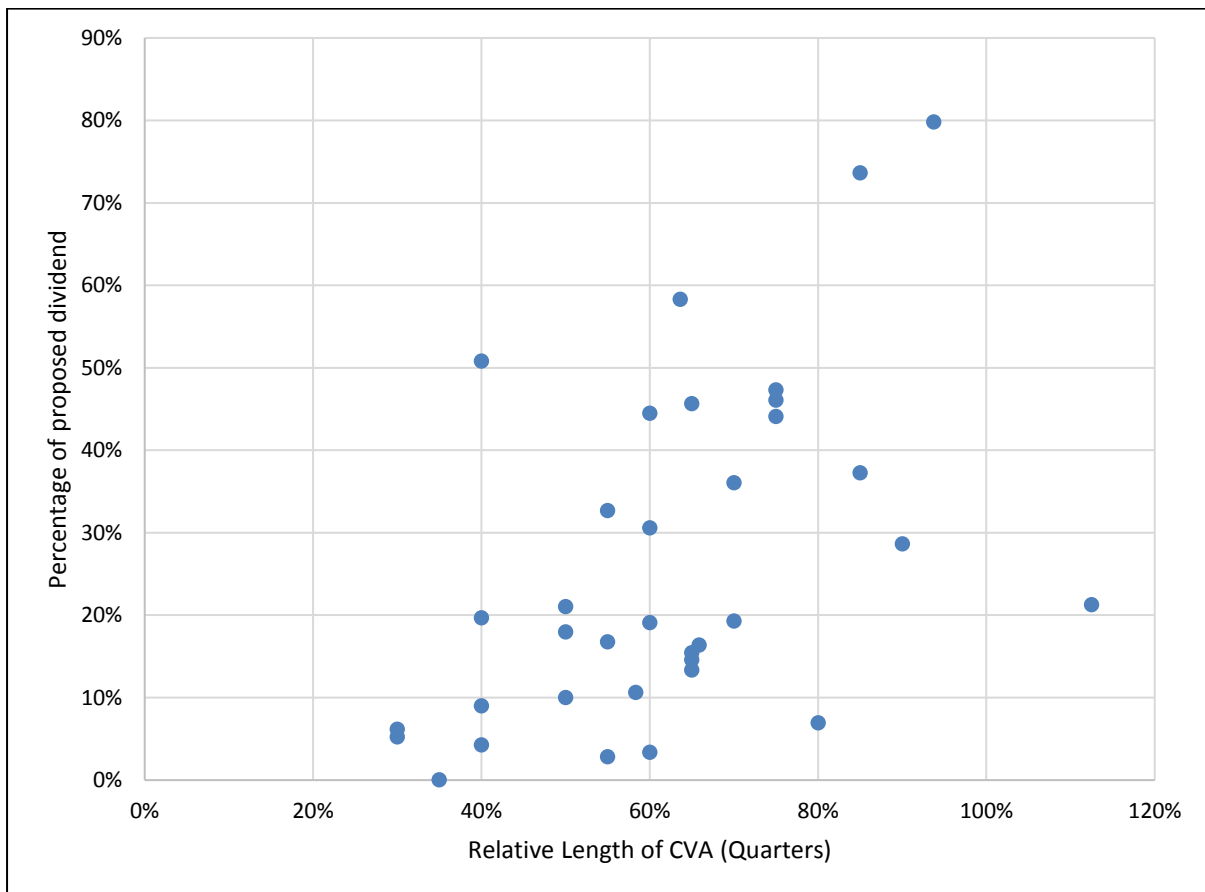


Chart 3: Dividend rates in terminated CVAs⁴⁵

⁴³ Ibid 32-34

⁴⁴ National Audit Office, *The closure of MG Rover: Report by the Comptroller and Auditor General (2005-2006, HC 961)* See for example pp.51-53 which details the level of government support provided to ease the impact of the collapse of the MG Rover group of companies on the local and national economy.

⁴⁵ Walton et al n24, 43

The shortfall itself brings in to question whether the proposed dividends were realistic, and whether CVA proposals should be more conservative in this respect. A common factor in terminated CVAs was an inability to make contributions to the CVA whilst continuing to trade. Whilst there may be many causes of this, including the failure of management to make necessary changes to the business, lower contribution levels stemming from reduced dividend proposals may enable companies to trade through the CVA, and in turn CVAs to be implemented more frequently.

Finally, it must be acknowledged that the termination of the CVA does not necessarily lead to the cessation of the company's business. Sixty of the terminated CVAs led into subsequent administrations. Whilst the R3 Report does not reveal the outcome of these, it is possible that the businesses, and in turn employment, were preserved in a number of these cases.

6. Pre-pack Outcomes

The outcomes in a pre-pack, whilst not mapping exactly on to those in a CVA, bear comparison in terms of business survival and impact on stakeholders, particularly creditors. The data collected in respect of the stratified sample of pre-packs commenced in 2013 will therefore be analysed in a manner to allow comparison with the CVA outcomes identified in the R3 Report and discussed above.

6.1 Headline outcomes

In the context of a pre-pack, the metric comparable to the outcome of a CVA is survival of the purchaser. In order to ensure consistency, this was measured as at 5 November 2017 to match the census period of the data presented in the R3 Report. Of the 120 pre-packs reviewed, the purchaser had survived in 59.6% of cases, whilst in 35.4% of cases the purchaser had gone into a subsequent insolvency process or been struck off the register of companies (hereafter referred to as failure).⁴⁶ Additionally, nearly a third of these purchasers entered into a voluntary arrangement or administration, which may have facilitated further business rescue. These survival figures represent a reversal of fortunes compared to the CVA outcomes, discussed above, with 65.2% of CVAs being terminated, with the remainder completed (18.5%) or ongoing (16.3%). This is not surprising given the purchaser will be operating free from many of the constraints facing those companies trading under a CVA.

In further contrast to the CVA outcomes, there is not such a distinct pattern in the period of time before the purchaser fails. As can be seen in Chart 4 below, the majority of purchaser failures occur in the fourth quarter after the transaction is completed, whilst nearly half of all failures occur between four and seven quarters. Whilst there are instances of early failure, there is no spike as there was with the 2013 CVAs, perhaps because the CVA will fail almost immediately if the opening instalments cannot be met, whereas the lack of immediate debt repayment in a pre-pack provides a buffer against the impact of financial difficulties becoming apparent. This is, notably, a much smaller sample than observed for the 2013 CVAs, given the lower failure rate.

⁴⁶ In the remaining 5% of cases, the outcome was either not known, due to the purchaser being an individual or foreign registered company, or, in one case where the pre-pack did not involve a transfer of a going concern, not applicable.

It should be noted that in a small number of cases there were two purchasers, with one surviving and the other failing. In such a case these are counted as 0.5 success and 0.5 failure, linking purchaser survival to the original company.

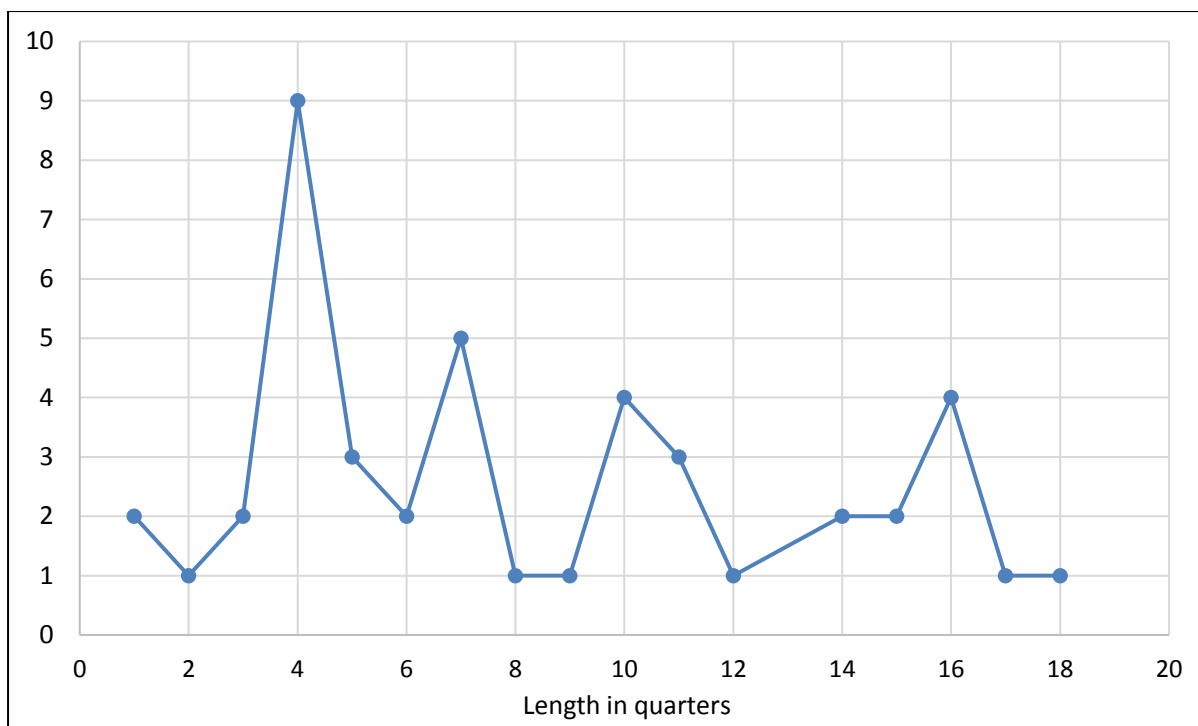


Chart 4: Period before purchaser failure following pre-pack

6.2 Pre-pack user profile

Pre-pack usage was also dominated by small companies in 2013, though not to the same extent as with CVAs. Eighty per cent of the pre-packs in the sample involved small companies.⁴⁷ It is perhaps surprising that a greater proportion of CVAs involved small companies. One reason for favouring a CVA over a pre-pack is maintaining control of the business. If a pre-pack is pursued, there is a risk that marketing of the business could lead to a third party's interest being stoked, and the original management losing control of the business in the pre-pack sale. With a smaller business, a great deal of goodwill and professional knowledge will be associated with the incumbent management, thus the business would not be appealing to a third party. That said, for many small companies, the management may not be able to fund the acquisition of the business via a pre-pack, making a CVA more appealing.

As with the 2013 CVAs, pre-packs completed in 2013 were dominated by younger companies, as seen in Chart 5. In the context of the average age of 8.6 years for live companies in 2013-14⁴⁸ and the majority of new businesses failing to last beyond five years,⁴⁹ this is not surprising.

⁴⁷ As with the R3 Report, this classification is based on Companies House records.

⁴⁸ Companies House, 'Statistical release: Companies Register Activities 2013-2014' (Companies House, 2014), 9

⁴⁹ RSA 'Growing Pains: How the UK became a nation of micropreneurs' (RSA, 2014) available at www.rsabroker.com/growing-pains-white-paper [Last accessed 11 July 2019]

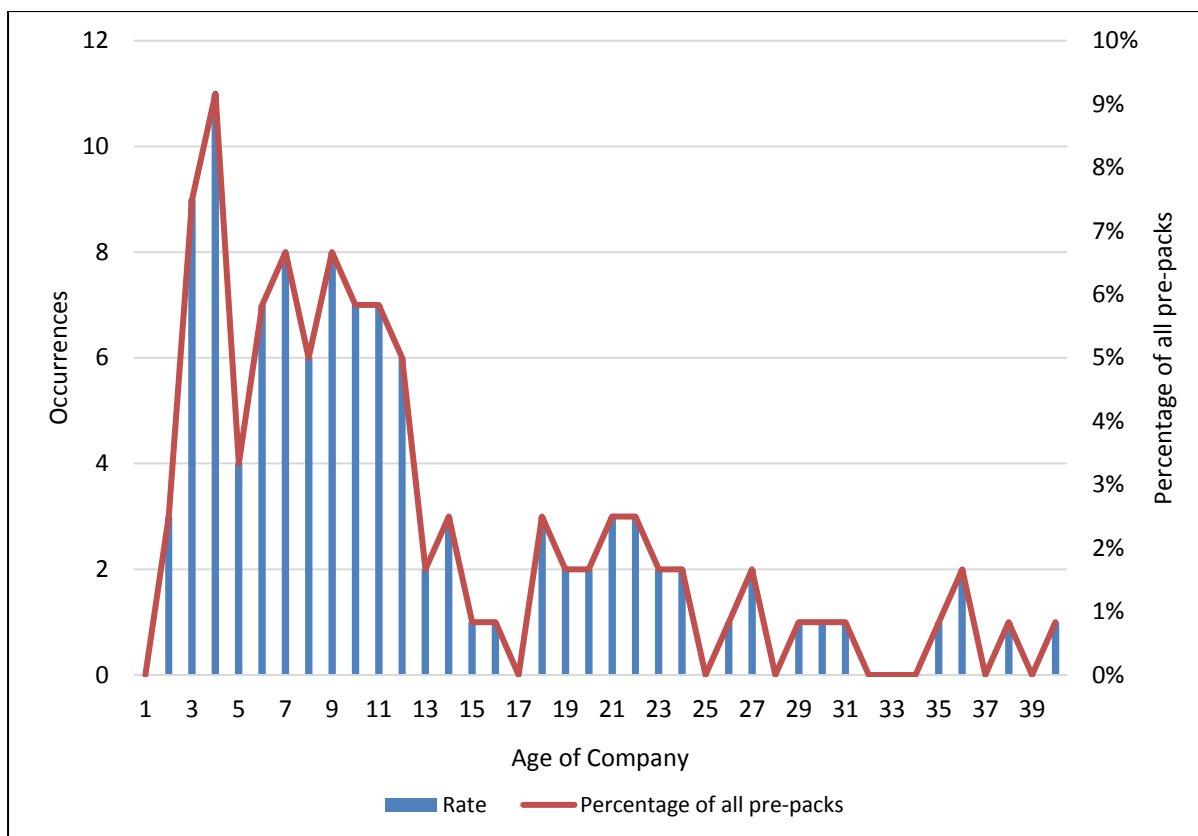


Chart 5: Age of insolvent company at time of pre-pack

One notable aspect of a pre-pack is that the insolvent company does not take advantage of the moratorium available in administration pursuant to paragraphs 43-44 of Schedule B1 Insolvency Act 1986, due to the timing of the transaction. There is, however, the interim moratorium available pursuant to paragraph 44 of Schedule B1 where an appointment is to be made by the company or its directors under paragraph 22, but notice has to be given to anyone entitled to appoint an administrative receiver or administrator out-of-court pursuant to paragraph 14. In 99 of the 120 pre-packs, the appointment was made pursuant to paragraph 22, and in 71 of these cases there was a secured creditor present (though it is not clear whether all had the requisite power of appointment to trigger the interim moratorium). Many of the pre-packs completed in 2013 would therefore have benefited from an interim moratorium of up to ten business days prior to the transaction being completed. A longer moratorium could have been effected by the filing of multiple Notices of Intention to Appoint Administrators (“NoI”), a common practice before the judgment of David Richards LJ in *JCAM Commercial Real Estate Property XV Ltd v Davis Haulage Ltd* made it clear that this would not be possible.⁵⁰ It is not possible to determine how many pre-packs in 2013 utilised such a moratorium, or the extent to which they did so, however that such an avenue is no longer available may impact of the survival of purchasers in future connected party transactions, given the added time pressures this would create.

⁵⁰ [2018] 1 WLR 24. The judgment stated that there must be a clear intention to appoint administrators by the company or its directors when filing a notice of intention to appoint administrators, as such it would not be possible to file such notice to provide an opportunity to review various options available to the company. For discussion of this case and its impact see C. Umfréville, ‘Curtailling the use of multiple notices of intention to appoint administrators: The case for a moratorium?’ (2017) C.L.N. 395 1.

6.3 Stakeholder outcomes

Unlike where a CVA is implemented, it cannot be said that the survival of the purchaser in a pre-pack will automatically constitute a positive outcome for (or at least one that is agreeable to, or agreed by) the insolvent company's creditors, as these debts remain with the insolvent company. The survival of the purchaser can be said to provide benefits of continuity for suppliers and customers, although this is purely anecdotal and these stakeholders may have suffered losses as creditors from debts owed by the insolvent company. Additionally, pre-packs are often lauded for saving jobs, as employees will transfer to the purchaser under the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE").⁵¹ This benefit is often highlighted by administrators in their statements and progress reports, in part due to the reduction of possible preferential creditor claims (though in itself the preservation of employment is not a statutory aim of administration). Of the 120 pre-packs reviewed from 2013, 95 appear to have resulted in full employment preservation.⁵² On its face, this appears very positive, however this is tempered by the fact that over a third of these purchasers subsequently failed, with over 70% of these failures represented by terminal processes. As such, a number of these jobs were only preserved for a limited time.

The purpose of administration is set out as a waterfall of objectives in paragraph 3 of Schedule B1 Insolvency Act 1986. The first objective, rescuing the company as a going concern, cannot be achieved in a pre-pack. It is possible for a pre-pack to achieve the second or third objectives, namely:

(b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration); or

(c) realising property in order to make a return to one or more secured or preferential creditors.⁵³

Whilst the second objective is regularly cited by administrators when a pre-pack is concluded, to what extent do creditors benefit from a pre-pack?

Of the sample of 120 pre-packs from 2013, secured creditors were present in 91 cases. These secured creditors represented a broad range of debt, from just £35 to in excess of £90 million. Although secured creditor approval would be needed to sell assets subject to a fixed charge,⁵⁴ in only 39 cases were all of the insolvent company's secured creditors paid in full.⁵⁵ Perhaps this is not surprising when the median purchase price observed was £46,000, with half of all transactions falling in the range of £23,000-£163,000.⁵⁶ Of these 91 cases, 63 included debt factors who were fully repaid in 46 cases.⁵⁷ The position appears to be no better when preferential claims are made.

⁵¹ SI 2006/246

⁵² In 9 out of the 120 cases the level of employment preservation could not be ascertained on the records available.

⁵³ Insolvency Act 1986, Sch. B1 paras 3(1)(b)-(c)

⁵⁴ In exceptional circumstances, the administrator can make an application to the court for consent to dispose of charged assets, in accordance with Insolvency Act 1986, Sch. B1 para 71.

⁵⁵ There were two cases where it is not known from the records filed at Companies House whether the secured creditor was paid in full.

⁵⁶ In a number of cases the realisation of other assets, such as real estate and in particular book debts, provided further sums for distribution.

⁵⁷ The term debt factor is used in its general sense, and includes invoice discounters and similar funders. Again, there were two cases where it is not known from the records filed at Companies House whether the debt factor was paid in full. It was common practice for debt factors to charge termination and other fees, which increased the debt owed. In some instances the underlying debt was repaid, but these additional fees were not paid.

There were only preferential debts in 30 out of 120 cases, in large part due to the preservation of employment under TUPE. These claims were only paid in full in 15 cases, however, with no preferential dividend at all paid in 11 of the 30 cases where claims were made. The position of preferential creditors differs significantly from that in a CVA, where their rights can only be varied with consent.⁵⁸

Turning to the unsecured creditors, the position declines further. Despite the high rate of purchaser survival in the 2013 pre-packs, especially when compared to the percentage of implemented and ongoing CVAs, there is a low rate of unsecured dividend payments in the sample. Of the 120 pre-packs, unsecured dividends were paid in only 38 cases, and of these 12 were paid purely out of the prescribed part. The rate of unsecured dividend payments declined further when the purchaser failed, with payments to unsecured creditors in only 7 of the 44 cases, a decline from 31.7% in the general population to just 15.9%.⁵⁹ This compares poorly with CVAs, where unsecured creditors will receive what they agreed to if the CVA is implemented (potentially a third of all cases in 2013), whilst it was shown in the R3 Report that where the CVA continued for at least six quarters unsecured creditors received some form of dividend in over half of the sample reviewed, as discussed in section 5 above.

On closer inspection of the level of dividends being paid in a pre-pack, the situation does not improve. In 24 of the 38 cases where an unsecured dividend was paid, it was no more than five pence in the pound, and two pence or less in 14 of those cases. This position declines where the purchaser fails, with 5 of the 7 unsecured dividends being no more than four pence in the pound, and 3 being a penny in the pound or less. There were some exceptions, with full repayment made to unsecured creditors in two cases and expected in a further two where the purchaser guaranteed to pay all unsecured creditors (though the level of these was very low). On the whole, the picture is relatively bleak for unsecured creditors.

There are a number of factors which undermine the payment of dividends to unsecured creditors. The deferral of payment of the pre-pack consideration is arguably one of these. Deferred consideration was present in 86 of the 120 pre-packs in the sample, and in 50 of those cases it represented at least three quarters of the purchase price, excluding contingent sums, as seen in Chart 6.

⁵⁸ Insolvency Act 1986, s.4(4)

⁵⁹ This includes two cases where there were two purchasers and one failed in each case.

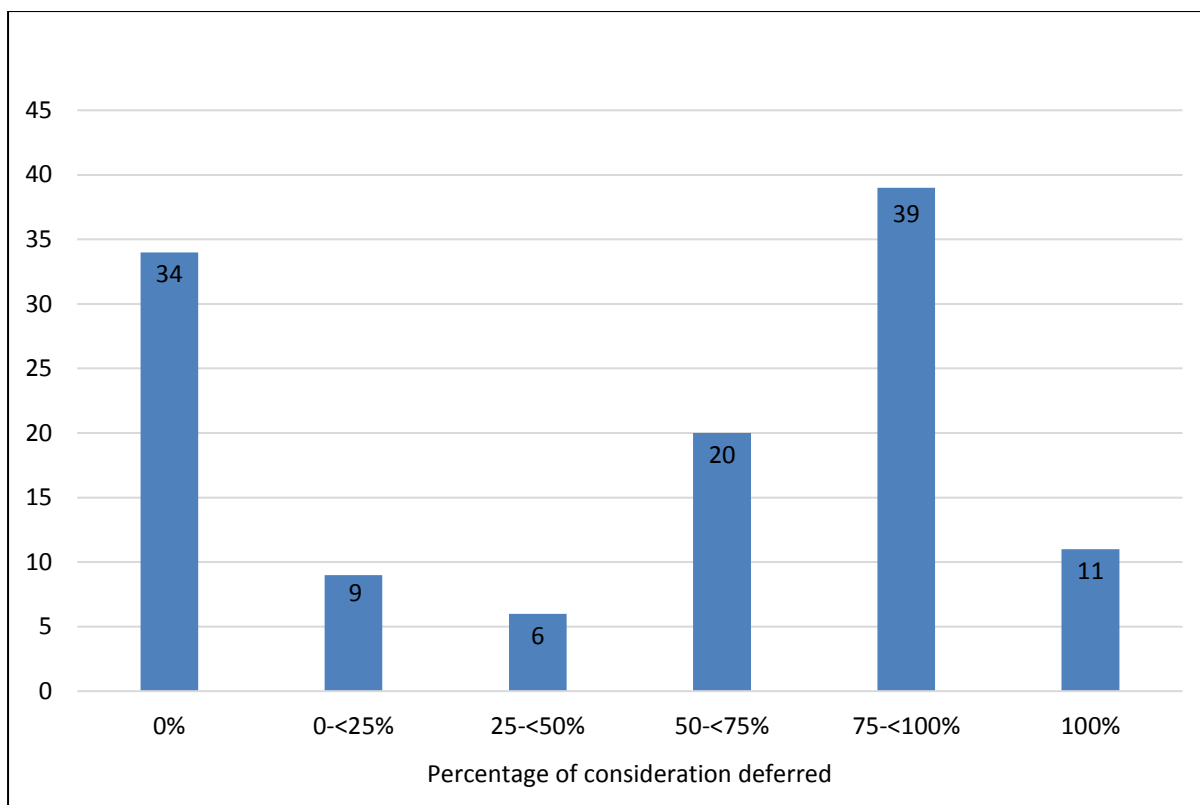


Chart 6: Level of deferred consideration in connected party pre-packs

Whilst deferred consideration was paid in full in 67 of the 86 cases where it was present, the progress reports reveal that delays and chasing of payment were not uncommon, with security having to be relied upon in some cases. Security was only taken in 49 cases, and sometimes this was relatively weak, including unsecured personal guarantees and retention of title clauses. The presence of deferred consideration also appears to impact on other stakeholders, with an increased rate of purchaser failure, up from 35.4% to 41.86%. Of those failed purchasers, there was a shortfall in deferred consideration in 30% of cases. This may be a cause of the reduced dividends where the purchaser fails, referred to above. The presence of deferred consideration arguably puts a burden on the purchaser akin to having to make contributions into a CVA, and appears to impact on survival. It is notable that SIP 16 statements frequently stated that a CVA would not be viable and a pre-pack was necessary as the business could not generate sufficient funds to make payments into the CVA. Yet the same business was often then expected to generate sufficient income to pay deferred consideration, often of a significant level, whilst also covering its costs of trading. Although deferred consideration was not considered to be a problem by the Graham Review,⁶⁰ in light of these findings combined with the potential for improved outcomes in a CVA, there is an arguable case to restrict the use of deferred consideration in connected party sales. A useful starting point could be a figure based on a percentage of the purchase price.

The failure in a number of cases to collect all of the deferred consideration reflects a wider detriment to creditors and stakeholders that was observed during the data collection. In a number of cases, actions against former management for collection of deferred consideration, repayment of director's loan accounts and similar were either not pursued or settled for lower amounts by the administrators because it was not economically viable to chase, usually in light of the quantum and

⁶⁰ Graham n4, 7

the directors' personal financial situations. As such, the former management of an insolvent company were able to escape liability for actions during office. If administrators were not able to pursue such easily provable claims, it brings into question whether potential preferences and transactions at undervalue, which will involve higher evidential burdens and require fuller investigation,⁶¹ may also not be fully investigated and pursued due to lack of resources. Furthermore, whilst the administrators and subsequent liquidators will have prepared reports on the directors for the Secretary of State, this does not necessarily lead to sanction under the Company Directors Disqualification Act 1986. This lack of action will impact on stakeholders in two ways: first the reduction in returns to allow for creditor dividends, and secondly the potential for directors to repeat such behaviours in future enterprises, to the detriment of a broad range of stakeholders including future customers, employees and suppliers. One perceived benefit of the CVA over a pre-pack for management is that they will be free of investigation during the process. In practice it appears that this benefit is not so apparent.

The prevalence of debt factoring also appears to have a detrimental impact on unsecured creditors. With the improved rate of returns for debt factors seen above, it is not surprising to see the increased use of this funding stream, although its use appears to remove potential returns for unsecured creditors, especially with the application of additional fees. In the absence of debt factoring, a company's book debts would otherwise most likely represent a floating charge asset,⁶² the proceeds of which would be available for the prescribed part for unsecured creditors⁶³ or the funding of the administration, and pursuit of actions in the gift of the administrators.⁶⁴ The prescribed part is, however little used in practice, only appearing in 15 of the 91 cases where there was secured debt, and never hitting the upper limit of £600,000.⁶⁵ This brings into question whether the Government's proposal to increase the upper limit of the prescribed part will have any impact.⁶⁶

7. The inter-relationship of CVAs and pre-packaged administrations

Both CVAs and pre-packs facilitate corporate rescue, whether it be the preservation of the trading company or continuation of the business through a new vehicle. The legislative frameworks that facilitate these outcomes are, however, inherently creditor-centric. A CVA expressly requires the consent of three quarters of unsecured creditors in order to proceed,⁶⁷ whilst an administrator can choose to eschew the primary aim of rescuing a company as a going concern in favour of the

⁶¹ See Insolvency Act 1986, ss.238-240

⁶² Re Spectrum Plus Ltd [2005] 2 AC 680. See also S. Worthington, 'An 'Unsatisfactory Area of the Law' - Fixed and Floating Charges Yet Again' (2011) International Corporate Rescue (spec.) 1 for commentary of how fixed charges may be created over book debts.

⁶³ Insolvency Act 1986, s.176A

⁶⁴ See e.g. P. Walton, 'Fixed and Floating Charges: the Great British fund-off?' (2015) 30(1) JIBFL 3; (2015) 8(1) CRI 18 and P. Walton, 'Assignments of Book Debts – outright transfers of rights or unregistered securities?' (2018) 1 Wolverhampton Law Journal 1

⁶⁵ Some of these secured creditors may not have held floating charges, which would not have triggered the prescribed part, or these may have been created prior to 15 September 2003, in which case the prescribed part would not have applied. For further discussion of the prescribed part see e.g. K. Akintola, 'The Prescribed Part for Unsecured Creditors: A Pithy Review' (2017) 30(4) Insolv. Int. 55 and K. Akintola, 'The Prescribed Part for Creditors: A Further Review' (2019) 32(2) Insolv. Int. 67.

⁶⁶ BEIS n6, 30

⁶⁷ Insolvency Act 1986, s.4 and Insolvency Rules 2016, r.15.34(3)

secondary objective if this would achieve a better result for the company's creditors as a whole.⁶⁸ Are the outcomes of these processes, though, beneficial to creditors?

It was observed that where CVAs are completed, or continue for a period for at least six quarters, there are positive outcomes for unsecured creditors, whilst the position of secured and preferential creditors will only have been varied with consent. Even in those terminated CVAs, unsecured creditors received more from the CVA contributions than they could have expected in a winding up or even a pre-pack, based on the outcomes considered above. There are certainly problems with the CVA process which need to be addressed, in particular the excessive length in proposals which appears overbearing for such young companies, and the ambitious targets for creditor returns which all too frequently appear unachievable, but the findings of the R3 Report suggest that the CVA provides a framework which can work towards both company rescue and protecting the position of creditors.

The same outcomes are not apparent for the pre-packs observed from 2013. Here, whilst the longer term business continuation appears enhanced based on purchaser survival, returns to creditors are less impressive. All creditor groups appear to suffer some form of shortfall, with the debt factors seeing the best outcomes, but still not always being paid in full despite being able to exercise controls on the companies' access to funding. Preferential creditors frequently experience a shortfall, with no returns at all in over a third of cases, despite the relatively modest claims permitted pursuant to Schedule 6 of the Insolvency Act 1986. Unsecured creditors in particular appear to receive little from a pre-pack, and the position deteriorates if the purchaser does not survive. This may be coincidence, but there may be a link to the impact of deferred consideration and the relatively modest consideration frequently paid. This casts some doubt as to whether pre-packs actually achieve a better return for creditors than a winding up, pursuant to the second objective, as often stated.

This position could decline further in light of recent developments. Prior to 2018, it appears to have been common practice for financially distressed companies to effect a rolling moratorium through the filing of repeated Nols, giving rise to the interim moratorium of ten business days each time.⁶⁹ This practice allowed these companies to explore options, including a CVA, pre-pack or even an informal restructuring outside of an insolvency process. Following the decision in *JCAM Commercial Real Estate Property XV Ltd v Davis Haulage Ltd*, it has been made clear that there must be a settled intention to appoint administrators when filing a Nol.⁷⁰ As a result, companies will no longer be able to 'buy time' in this way to consider the possible options. Rather, a moratorium can only be accessed if a company commits to either administration or, if a small company, a CVA.⁷¹ Both these moratoria are unpopular in terms of pursuing company rescue, as the R3 Report revealed.

The absence of a workable moratorium could impact on companies making the right choice as to which process to follow, or lead to the process being rushed and thus not achieving the best possible outcome. The Government has proposed the introduction of a new pre-insolvency moratorium that would provide a gateway to a variety of outcomes, and therefore potentially address this lacuna.⁷² This could prove a positive reform, though there remains much detail to address in the current proposals to produce a viable solution, such as the qualifying criteria, its length and anti-abuse

⁶⁸ Insolvency Act 1986, Sch. B1 para.3(3)(b)

⁶⁹ Insolvency Act 1986, Sch. B1 para.26

⁷⁰ *JCAM Commercial Real Estate Property XV Ltd v Davis Haulage Ltd* [2018] 1 WLR 24

⁷¹ Insolvency Act 1986, Sch.B1 paras 42-43 and Insolvency Act 1986, Sch.A1

⁷² BEIS n6, 41-58

measures.⁷³ Furthermore, the Brexit process and its potential aftermath will likely starve the reform of adequate parliamentary time for its introduction in the near future, when it is arguably most needed.

A second potential issue awaits from April 2020: the reintroduction of the Crown preference. Prior to the Enterprise Act 2002 insolvency reforms, certain Crown debts enjoyed preferential status in insolvency, with a right of repayment ahead of floating charge and unsecured creditors. This was abolished from 15 September 2003, with the prescribed part introduced to “ensure that the benefit of the abolition of preferential status goes to unsecured creditors.”⁷⁴ With little warning, and apparently little thought, the Chancellor of the Exchequer announced the reintroduction of the Crown preference in the Budget in October 2018.⁷⁵ Following a consultation as to its operation (rather than its reintroduction, which appears a *fait accompli*),⁷⁶ the terms were set out in the draft Finance Bill 2019-20.⁷⁷ The Crown will become a secondary preferential creditor for certain unpaid taxes, including PAYE and NICs collected from employees but not paid to the Exchequer. Significantly, this goes further than the previous regime, with no cap on the size of claim or age of debts. This could reverse the gains for unsecured creditors made possible by the introduction of the prescribed part, and significantly eat in to monies available to unsecured creditors generally.

This policy, described by R3 President Duncan Swift as “a case of the Government shooting first and asking questions later,”⁷⁸ raises a number of concerns with regard to the prospect of corporate rescue and protecting wider creditor interests. It is likely that CVAs will prove more difficult to launch if there are arrears of any substance to HMRC, given that these will have to be accounted for in full as a preferential creditor,⁷⁹ as opposed to their current treatment as an unsecured debt. This could lead to pre-packs being pursued instead of a CVA, with the consequent negative impact on creditors, and especially unsecured creditors, considered above. In light of the paucity of preferential creditor returns in pre-packs identified in section 6.3 above, HMRC may see little benefit in such situations.

The R3 Report found that HMRC was considered amongst stakeholders to be the most engaged creditor, whilst also the most likely to oppose a CVA proposal. It was also considered that with its support, CVAs could become a more effective rescue tool.⁸⁰ Additionally, the lengthening of CVAs to five years and proposals for full repayment have in part been influenced by the demands of HMRC.⁸¹ These excessive and unmanageable proposals are arguably a cause of CVA termination, as discussed above and in the R3 Report. Enhancing HMRC’s status could see it disengage from the CVA process,

⁷³ For discussion of the proposals see e.g. C. Umfrville, ‘A revised moratorium to help business rescue: A review of the latest reform proposals’ (2018) C.L.N. 411 1

⁷⁴ Department of Trade and Industry, *Productivity and Enterprise: Insolvency – A Second Chance* (Cm 5234, 2001), para.2.19. The prescribed part was introduced as Insolvency Act 1986, s.176A by Enterprise Act 2002, s.252.

⁷⁵ HM Treasury, *Budget 2018* (HC 1629), 52

⁷⁶ HM Revenue & Customs, ‘Protecting your taxes in insolvency’ (HMRC, 26 February 2019) available at < https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/781323/Protecting_your_taxes_in_insolvency.pdf > [Last accessed 17 July 2019]

⁷⁷ HM Treasury, ‘Finance Bill 2019-20: government publishes draft legislation’ (HM Treasury, 11 July 2019) available at < <https://www.gov.uk/government/news/finance-bill-2019-20-government-publishes-draft-legislation> > [Last accessed 17 July 2019]

⁷⁸ ‘HMRC insolvency cash grab a ‘bad deal’ for UK’ (R3, 11 July 2019) available at: <https://www.r3.org.uk/index.cfm?page=1114&element=33673&refpage=1008> [Last accessed 16 July 2019]

⁷⁹ Insolvency Act 1986, s.4(4)

⁸⁰ Walton et al n24, 53-54

⁸¹ Ibid 63

with no incentive not to pursue a winding up to recover the arrears, thus undermining the efficacy of the CVA. Such an outcome appears to have been apparent prior to the abolition of the Crown preference in 2003. A survey of insolvency practitioners in 1999 revealed that 78% considered the possibility of rescue was undermined by the Crown preference, whilst according to over half of the insolvency practitioners surveyed in the majority of cases the company's assets were absorbed by preferential creditors.⁸² A further unintended consequence of the new Crown preference is its potential impact on the availability of finance, both to distressed companies seeking to use a CVA, and the purchaser in a pre-pack. It is also unlikely to enhance the perception of the UK in international standings.

Finally, the reintroduction of the Crown preference appears to undermine wider reform proposals. The Government had previously announced plans to extend the upper limit of the prescribed part from £600,000 to £800,000.⁸³ It appears that the current upper limit is rarely reached in practice,⁸⁴ and the introduction of a priority creditor without limit is only likely to further undermine this, and in turn bring into question the logic of raising the upper limit. At an economically challenging time, this level of confusion and lack of coordination is unhelpful and unlikely to promote rescue or the protection of stakeholders.

8. Moving towards a solution

The Cork Report identified twelve "aims of a good modern insolvency law," but acknowledged that "the ideal solution must yield to the limitations of the possible."⁸⁵ Whilst it paved the way for the introduction of the rescue culture in the UK, the proposals were inherently creditor focused, proposing that "insolvents should be encouraged of their own accord to face their creditors at the earliest moment," and if they are unwilling to do so, "then there should be as few obstacles as possible in the way of creditors who seek a collective administration for the benefit of all."⁸⁶ The importance of investigative processes, to ensure that the "demands of commercial morality can be met," were also highlighted.⁸⁷ Whilst the Insolvency Act 1986 diverged from the recommendations in the Cork Report in a number of instances,⁸⁸ the processes introduced by Parliament and amended over time reflect this creditor-centric approach to facilitating rescue and investigating the conduct of an insolvent company's management where appropriate.

This paper has considered the outcome of corporate rescue procedures which result in the existing management retaining control of the business of the insolvent company, whether by restructuring the debts of the insolvent company or continuing the business through another corporate vehicle under their control. It has been shown that in around two thirds of cases, CVAs do not ultimately result in company rescue, although the process does often result in beneficial outcomes for creditors and other stakeholders. In contrast, pre-packaged administrations have been seen to be more

⁸² A. Keay and P. Walton, 'Preferential Debts: an empirical study' (1999) *Insolvency Lawyer* 112.

⁸³ BEIS n6, 30

⁸⁴ As seen in section 6.3 above. See also K. Akintola, 'The Prescribed Part for Unsecured Creditors: A Pithy Review' (2017) 30(4) *Insolv. Int.* 55 and K. Akintola, 'The Prescribed Part for Creditors: A Further Review' (2019) 32(2) *Insolv. Int.* 67.

⁸⁵ Cork Report, paras 196 and 198

⁸⁶ *Ibid* para.219

⁸⁷ *Ibid* para.235

⁸⁸ For discussion of the passage of the Insolvency Act 1986 see e.g. J. Tribe, "'Policy subversion" in corporate insolvency: political science, Marxism and the role of power interests during the passage of insolvency legislation' (2019) 32(2) *Insolv. Int.* 59.

efficient when it comes to preserving the business of the insolvent company, with consequential benefits for stakeholders from this continued trade, though this appears to come at the expense of outcomes for creditors. It also appeared that management were escaping liability for debts owed to the insolvent company due to the financial constraints of the administration, which may be indicative of management avoiding potential liability for antecedent transactions, given the costs and uncertainty involved in pursuing such claims.⁸⁹ As such, one of the benefits of a CVA in contrast to administration or liquidation, that directors' behaviour prior to the process will not be investigated, may be being eroded.

The outcomes of the pre-packaged administrations from 2013 appear not always to meet the statutory objectives. Whilst the survey period pre-dates the introduction of the Graham Review industry-led reforms, including voluntary referral to the Pre-Pack Pool and completion of a viability review which have the potential to address some of these issues, it must be noted that take up has been very low. Referrals to the Pre-Pack Pool dropped to just 24 out of 241 connected party sales in 2018, whilst use of the viability review was not even mentioned in the past two annual reports.⁹⁰ It is therefore questionable whether these will have significantly affected the outcomes.

There have been a number of consultations and proposals for reform over the past three years, which continue to adhere to the core principles evident in the Cork Report. Whilst the *Review of the Corporate Insolvency Framework* in 2016 sets out proposals to further facilitate corporate rescue, including the introduction of a new pre-insolvency moratorium, this is framed by the need to protect employees and creditors.⁹¹ Subsequent proposals within the 2018 consultations *Insolvency and Corporate Governance*⁹² and *Tax Abuse and Insolvency*⁹³ follow this theme of creditor protection and management discipline, with reforms targeting behaviours which prove detrimental to creditors, from controls on sales of businesses in distress, reversing value extraction schemes and transferring tax liabilities of an insolvent company to its management. It is not the purpose of this paper to review these reform proposals, but rather to identify the connection between them and the necessary reforms.

It is encouraging to see attempts to address issues affecting the insolvency sector. These are however being approached in a piecemeal and disparate fashion: the three consultations between 2016 and 2018 referred to above were led by the Insolvency Service, Department for Business, Energy and Industrial Strategy and HM Revenue & Customs respectively, and sit amongst the ongoing review of connected party sales in administration by the Insolvency Service and the

⁸⁹ See e.g. *Re Ralls Builders Limited, Grant v Ralls* [2016] EWHC 243 (Ch); and *Re Ralls Builders Limited (No.2), Grant v Ralls* [2016] EWHC 1812 (Ch). For a succinct review of these cases and their impact, see G. Moss QC, 'No compensation for wrongful trading - where did it all go wrong?' (2017) 30(4) *Insolv. Int.*, 49.

⁹⁰ Pre-Pack Pool, 'Annual Review 2018' (Pre-Pack Pool Ltd, 2019) 1 available at: <<https://www.prepackpool.co.uk/uploads/files/files/Pre%20pack%20pool%20%202018%20Annual%20report%20v3%20NC%20edits.pdf>> [Last accessed 10 July 2019] and Pre-Pack Pool, 'Annual Review 2017' (Pre-Pack Pool Ltd, 2017) 1 available at: <<https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack-Pool-Annual-Review-2017.pdf>> [Last accessed 10 July 2019]

⁹¹ Insolvency Service, 'A Review of the Corporate Insolvency Framework: A consultation on options for reform' (Insolvency Service, 2016), 5 available at <<https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework>> [Last accessed 17 July 2019]

⁹² Department for Business, Energy and Industrial Strategy, 'Insolvency and Corporate Governance' (BEIS, 2018) available at <<https://www.gov.uk/government/consultations/insolvency-and-corporate-governance>> [Last accessed 17 July 2019]

⁹³ HM Revenue & Customs, 'Tax Abuse and Insolvency: A discussion document' (HMRC, 2018) available at <<https://www.gov.uk/government/consultations/tax-abuse-and-insolvency>> [Last accessed 17 July 2019]

reintroduction of the Crown preference by HM Revenue and Customs. Given the wider connected issues identified in this paper, there is a strong case for adopting a more aligned approach.

9. Conclusion

Describing the state of insolvency law encountered by the Cork Committee, Finch observed: “A pragmatic tradition manifested itself in piecemeal development of the law; reactive solutions were adopted rather than coherent frameworks of principles; and legal provisions were scattered throughout a plurality of statutes, statutory instruments and judicial decisions.”⁹⁴ Finch could have been describing the current insolvency framework. Sitting within the Insolvency Act 1986 but with regular amendments introduced by primary and secondary legislation, such as the Insolvency Act 2000 amendments to CVAs and the Enterprise Act 2002 reforms to the administration process, and key aspects of practice, including the pre-pack, based on judicial interpretation of those provisions. This approach is continuing, with the publication of a call for evidence on *Regulation of insolvency practitioners: Review of current regulatory landscape* on 12 July 2019, which could lead to further legislative reform.⁹⁵

In addition to the recent consultations and ongoing reviews, further need for reform has been identified. The R3 Report made a number of recommendations for the improvement of the perception and performance of CVAs. These include limiting the duration to no more than 3 years without good reason, a revised SIP to articulate better the roles and duties of nominees and supervisors, and considering the adoption of insolvency practitioner fee systems used in other processes.⁹⁶ There have also been calls for reform in light of the recent use of CVAs in the retail sector.⁹⁷ This paper has also identified issues with the practice of pre-packs which would benefit from being addressed, but may fall outside of the scope of the ongoing reviews. In particular the role of deferred consideration in connected party sales and the viability of purchasers, given that over a third of all failures occurred within 12 months of the transaction, would warrant attention.

Instead of the reactive, piecemeal and disjointed approach from a number of departments currently in operation, it is argued that there is a strong case for a proactive, strategic and aligned review and reform process to address these issues holistically and put the insolvency framework on a firm footing for the 21st Century. Much has changed since the Insolvency Act 1986 was introduced. For example, as the *Review of the Corporate Insolvency Framework* acknowledged in 2016, the development of the capital markets has provided diverse funding options for businesses, but these can lead to complex debt structures which may hinder or undermine turnaround, especially in the context of basic insolvency procedures largely unchanged since 2004.⁹⁸ The CVA and pre-pack procedures have a lot to offer, though would benefit from reform. There is even a case to be made for reconsidering the ‘one size fits all’ approach to insolvency.⁹⁹ With, for example, the same pre-pack process being used to rescue both large multinationals and what are essentially incorporated

⁹⁴ V. Finch ‘The Measures of Insolvency Law’ (1997) 17(2) OJLS 227, 228

⁹⁵ Insolvency Service, ‘Call for evidence: Regulation of insolvency practitioners. Review of current regulatory landscape’ (Insolvency Service, 2019) available at <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816560/Call_for_Evidence_Final_Proofed_Versionrev.pdf> [Last accessed 16 July 2019]

⁹⁶ Walton et al n24, 4

⁹⁷ BPF n3

⁹⁸ Insolvency Service n88, 6

⁹⁹ See e.g. S. Paterson, ‘Rethinking Corporate Bankruptcy Theory in the Twenty-First Century’ (2016) 36(4) OJLS 697

sole traders, it is questionable whether the Pre-pack Pool is equipped to opine on such differing transactions in the necessary timeframes. It would be logical to take a joined up approach to this reform. With a reform appetite apparent in Government, it would be an opportune time to instigate a Cork Report for the 21st Century, bringing in wide-ranging industry and academic expertise with the benefit of experience of the pre- and post-Insolvency Act 1986 frameworks to maximise its effectiveness.