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UK Individual Shareholders Society

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Edward Davey, M.P.
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01 April 2011

Pre-pack Administrations

Dear Mr Davey,

I understand that you are making an announcement concerning changes in the regulation of pre-pack administrations. Press coverage in the Financial Times suggests that the only change will be to require a period of 3 days notice to be given to creditors. This is hardly sufficient to allow time for creditors to put forward alternative proposals. In addition it totally ignores the rights of shareholders in such companies to be consulted on the matter.

There have been numerous cases where pre-packs have been arranged primarily to benefit former insiders in the business. Indeed the FT reports that research by the University of Nottingham showed that in 58% of cases of prepack administration, the sale was to a connected parties – typically to the former part owners or managers. In other words these are typical "phoenix" company situations where the company escapes its former creditors one day and starts up in business anew with the same assets, the same managers, and sometimes the same owners, the next day.

It is totally wrong for an Administrator to act in advance of his appointment as Administrator which is what happens in practice at present. Often arrangements are made with the connivance of the company's directors or bankers which are not in the interests of creditors or shareholders. These arrangements are often made in secret with no public knowledge and then put into place in a matter of a few hours after formal appointment of the administrator.

I had experience of this process not long ago in the case of Torex Retail Plc. This was a company that got into financial difficulty after an alleged fraud and claims of false accounting. The directors arranged to sell the business via a Pre-Pack Administration to some private equity investors – this mainly was to the advantage of the bankers who protected their loans to the company but also obtained a stake in the on-going business. This meant that shareholders were left with nothing, and creditors were presented with a fait-accompli. Torex was in essence a sound business that could have traded out of its problems given a short period of stability and some protection from short term creditors.

Before the Administrator was officially appointed, I tried to arrange an alternative refinancing which would have protected shareholders and other stakeholders' interests, but the directors ignored our approach. We then requisitioned an EGM to remove the directors and replace them, but the Administration was pushed through that pre-empted this move.

In essence there was no approach by the Administrators to the open market, no consideration by them of alternative offers, and the whole deal was stitched up behind closed doors before most people knew anything about it.

This was surely not how Administration was conceived as working when it was put in place by the original legislation. Regrettably legal precedent has been established that seems to condone this practice, and now companies left, right and centre are using it to evade their debts and create new “phoenix” businesses from the ashes of companies in financial difficulties. The directors or parent/related companies often being the beneficiaries of these arrangements.

Another example was covered by Alistair Blair in Investors Chronicle – namely of Axeon. This was an AIM company that was put into administration via a “pre-pack” arrangement at the behest of its main lender who was also a shareholder (Ironshield). The company was sold to AG Holding, a new company specially set up for the purpose by Ironshield about one hour after it entered administration. In effect, as with all pre-packs, the whole deal had been arranged some time before. In this case it seems even more outrageous than normal as the company’s press release said that “creditors would be unaffected”, so only the shareholders were deprived of their interest in the business.

There have no doubt been many other cases of small companies that are listed on AIM suffering the same fate (SCS Upholstery is another one that springs to mind). This system is pernicious and the only real beneficiaries are the insolvency practitioners. It needs full scale reform, not the putting of a sticking plaster on a failed system.

Yours sincerely

Roger W. Lawson
Chairman

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