

Rapid administration to protect a firm's goodwill can leave creditors in the lurch

Landlords left stranded by fast-track pre-pack rescue



Daniel Levy

After the collapse and rebirth of the Laurel Pub Company earlier this year left many landlords reeling, most will have reacted with dismay at suggestions that Britain's insolvency system should afford more protection to companies.

The thought of more tenants going into cheaper and quicker administrations will send shivers down the spines of real estate finance directors – the “rescue” of a company more often than not results in landlords being left with the fuzzy end of the lollipop.

There is perhaps no better example of this than the fashion for pre-packaged administrations, or pre-packs.

A pre-pack is a fast-track administration that avoids a failing business being hawked on the open market, with all the attendant disruption. Instead, an insolvency practitioner lines up in advance a purchaser to take over the business, or parts of it, with the company going into administration simultaneously.

This saves the haemorrhaging of goodwill and staff that can occur during traditional trading administrations. Creditors are presented with a *fait accompli* of an administration and immediate sale of (the profitable parts of) the business or assets. Any remaining unwanted parts typically drift into dissolution, leaving many landlords and other unsecured creditors with little. A pre-pack was used in the case of the Laurel Pub Company.

Advocates say it is the most effective way of preserving the goodwill of a business, replacing all that nasty publicity and uncertainty with a clean break and a new start. Detractors dismiss it as a smokescreen and a carve-up, not least where the buyers are, in effect, often the very same individuals wishing to abandon the onerous responsibilities of the failed company to hive off all the good bits, debt free, into a phoenix to rise from the ashes.

Even the luckier landlords owning properties wanted by the new business may face arrears, an assignee of dubious quality and the occasional sourness of a relationship with the management responsible for the failed former business.

To challenge a pre-pack, landlords will need to commit their own funds and overcome significant hurdles. When the stakes are high enough and the

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grievance deep enough, a class action by a landlord consortium cannot be ruled out. But it will need to be worthwhile.

What needs to be shown to prove foul play? First, for a lawful administration, the company must be insolvent, as per a number of statutory tests. These tests are usually met (many trading companies would fail the balance sheet test of liabilities greater than assets). If the suspicion is that a solvent firm has sought to avoid liabilities, like a long lease term, this is worth investigating.

Next, the administrator must get a fair price. In a conventional trading administration, like MK One, this is easier to demonstrate. With a pre-pack, much work is often done behind the scenes, and there is no public market testing. When the business is sold to its current owners, there may be a suspicion that some creditors have been treated more equally than others.

Challenging an administration

If there is evidence of irregularity, a landlord consortium can consider a court application. But the odds are stacked against you.

If there is serious and unfair prejudice (that is, not just bad news but unfairly bad news that singles landlords out), then a court may undo an administrator's action, including any asset sales. Ultimately, if there is evidence of a seriously undervalued sale, a landlord creditor can apply to discharge the whole administration. This would result in the company's liquidation and a subsequent claim against the administrator.

A recently developing route is to challenge the administration as falling foul of the strict purposes allowed by statute. Stitching up a landlord is not a purpose of administration. If – and it is a big evidential if – it can be shown that a company singled out its landlords for unfair treatment, an administration can be overturned.

The upshot of all this is threefold: there must be a clear irregularity; it must be economical to mount the challenge because more could be obtained for landlords on a liquidation fire sale than the pre-pack achieved; and there must be enough aggrieved landlords not only to spread the costs and risks but also to pursue a matter of principle.

With barriers to challenge and the low cost and high speed of a pre-pack, it seems a certainty that we will see more of them as the downturn continues. Perhaps it's landlords and not their tenants who need a little more protection.

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