

Business Phoenixing – Is a Pre Pack a practical way to avoid company failure?

As the recession continues to bite, more and more businesses are finding it difficult to continue trading. However, very often these difficulties are not because customers have stopped buying completely. Rather, they are buying in reduced volumes and asking for lower prices.

Facing these circumstances, many businesses could continue to trade if they did not have the burden of servicing legacy debts. Since the Enterprise Act of 1984, it has been possible to request relief from corporate creditors using a Company Voluntary Arrangement or CVA. With the agreement of creditors, a CVA allows a portion of corporate debt to be repaid at a manageable rate over a set period of time, the remaining debt being written off. However, this procedure has long been criticised by both creditors and insolvency professionals alike due to the high percentage of early failures. The main argument against the CVA is that the fundamental structure of the business and its management team do not change. As such, even if the burden of legacy debt is lifted, the reasons for past failures are not likely to be resolved in the future.

Given the criticism levied against CVAs, the process of Phoenixing (also known as Pre Pack sale in liquidation or administration) has become more widely considered as a practical way of saving a business. Simply put, the act of Phoenixing is where a new company is formed which then buys the assets, contracts and goodwill of the failing business for a reasonable market rate. The legacy debt is left within the old business which is then liquidated thus allowing the new Phoenix business to trade on, debt free.

Since the beginning of 2009, much comment has been made about the Phoenix process in the media. Very often this has taken a negative stance because of the fact that creditors are left with unpaid debts which may in turn lead them to suffer their own financial difficulties. However, what has been largely overlooked in these published arguments is the reason for the failing company is not the Phoenix process. The reason for the failure was the company's inability to continue to trade. In these circumstances, liquidation was extremely likely if not inevitable whether or not a Phoenix process took place. As such creditors would always have been out of pocket.

A further criticism of Phoenixing is that creditors are not afforded the right to reject the new company's proposal to purchase the business assets from the failing company. However, it is widely recognised that to go through an open process of sale due to failure (often using administration) often destroys many of a company's valuable assets such as good will and contractual obligations. In addition, discussing matters with creditors before a potential sale of assets opens the possibility of the creditor taking unilateral recovery action which may well be detrimental. As such, a Pre Packaged sale will actually deliver the best possible return to creditors. Creditors are afforded increasing protection in terms of getting the best deal when the old business assets are sold. In November 2008, the Insolvency Service published strict guidelines for this area in the form of SIP (Statement of Insolvency Practice) 16 which requires insolvency practitioners to ensure that proper market value is paid for the assets and a full report of why this was beneficial to creditors must be submitted to them.

The arguments for the Phoenix process are compelling. There is the obvious advantage that the new business is not saddled with the old company's debts. In addition, unlike a CVA, there is no obligation for debt repayment. Fundamentally and unlike the CVA, a Phoenix allows a new business to begin with the introduction of new procedures and ways of working. All or part of the management team may remain the same. However, inappropriate property location or lease agreements are not taken on by the new company giving it every chance of success. In addition, the new Phoenix company will offer a far better chance that employees' jobs are protected than if the business were simply liquidated. TUPE (Transfer of Undertakings and Protection of Employment) rules apply meaning that the maximum number of jobs are saved.

Given these advantages it seems certain that Phoenixing will be seriously considered by many business owners trying to manage the issues of a failing company. This is not to say that the process will be right in every situation. However, with increasing numbers of businesses under financial pressure and at risk of failure, Phoenixing must certainly be given serious consideration.

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Cooper Matthews specialise in Business Recovery Services Advice offering provide straight forward insolvency advice for businesses with financial problems. They have significant experience in working with small to medium sized businesses.

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