BUSINESS RESCUE IN THE UK

ADMINISTRATION OUTCOMES

2011 – 2016

REPORT BY:

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AND

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INTRODUCTION

The Administration procedure introduced by the Insolvency Act 1986 has been the cornerstone of UK business rescue regime for three decades. It was conceived as a ‘ring fencing’ moratorium measure, designed to give troubled businesses breathing space to seek a positive way out of their difficulties. Under its provisions, creditors are prevented from taking enforcement action, which might otherwise prevent the restoration of the business to financial viability or obstruct the maximisation of the financial return for the general body of creditors.

The major criticism of the procedure was the complexity, cost and delays involved in applying to court for an Administration order, which in practice denied it to smaller companies and made it ineffective for scenarios where urgency was required. These shortcomings were corrected by the Enterprise Act 2003, which provided for the simplest and quickest of entry mechanisms through the filing of documents with the court.

Subsequently, there has been much debate between the insolvency profession and various interest groups, notably those representing creditors, about the less desirable outcomes of this well-meaned simplification of the process. The first of these is the so-called ‘Administration Liquidation’, whereby the lack of pre-appointment scrutiny allows unscrupulous directors and their advisers to put a company into Administration and then relatively shortly thereafter into Liquidation without the inconvenient necessity of holding a Section 98 Creditors Meeting.

The second is the rise of the Pre-Pack Administration, where a business and its assets are sold by the Administrators simultaneously with their appointment, either to the existing owners or managers (a ‘Phoenix Pre-Pack’) or to a third party. Deep public concern at the lack of transparency inherent in this tactic has not been neutralised, despite the introduction of tighter reporting requirements for insolvency practitioners (IPs) and potential professional sanctions for failure to comply.

This report seeks to assess the effectiveness of the Administration procedure in rescuing businesses by analysing the outcomes for companies entering the process during the past five years.

SCOPE

This report is based on a detailed analysis of 4,581 companies in England and Wales, which filed notices of the appointment of Administrators in the five years up to the 17th August 2016, using the database maintained by Company Watch to track the subsequent filing history of these companies to discover what commercial fate has befallen them since.
EXECUTIVE SUMMARY

- 1,974 (43%) of the companies remain in Administration or an ongoing Company Voluntary Arrangement (CVA).
- 2,344 (90%) of completed Administrations were unsuccessful, ending in Liquidation or Dissolution.
- 263 (10%) of completed Administrations have been successful, with the companies remaining active after the ending of the process or through the satisfactory implementation of a CVA.
- Failures may include effective business rescues via the Pre-Pack or Trading Administration route, raising the real success rate to 30%.
- 757 (39%) of ongoing Administrations have been in progress for longer than the timespan of one year envisaged by the legislation.
- The average return to unsecured creditors from completed Administrations is likely to have been no more than 7p in £ and in well over half of all cases there will have been no distribution to them at all.

COMPLETED ADMINISTRATIONS

The dominant outcome for Administration is the Liquidation of the company. Out of the 2,607 completed Administrations, 2,061 (79%) were eventually put into Liquidation. In 91 instances, this followed a failed CVA.

283 (11%) of the companies were dissolved without going into Liquidation first, indicating that there was no return at all for unsecured creditors.

188 (7%) completed the Administration process without the need for any other insolvency procedure and remain active.

75 (3%) remain active following the completion of a CVA.
ONGOING ADMINISTRATIONS

The current legislation provides for an initial period of twelve months for an Administration, after which positive action must be taken by the Administrators to extend the process. We found that 1,203 (61%) companies had been in Administration for less than a year, while for those where the procedure had been extant for over one year the longevity analysis was as follows:

- 456 (23%) 1-2 years
- 139 (7%) 2-3 years
- 94 (5%) 3-4 years
- 68 (4%) 4-5 years
We found the extent of these delays beyond a second year surprising, especially the volume of cases extending beyond three years, although it is possible that in some isolated cases there may have been a failure to file the appropriate notices of the completion of the Administration at Companies House or an omission of such a notice from the company’s file.

THE COMPANY VOLUNTARY ARRANGEMENT (CVA) ROUTE

One rescue route provided for by the legislation is the initial use of the Administration process to protect a struggling company from creditor enforcement action, whilst a solution to its problems is identified. In the event that this solution will result in a shortfall to creditors, the company can be kept alive through the agreement of a CVA with the creditors.

Our analysis reveals that the majority of the 194 Administration CVAs in our sample were unsuccessful:

- 91 (47%) ended in Liquidation
- 14 (7%) ended in Dissolution
- 14 (7%) are still in progress
- 75 (39%) ended successfully
COMPANY VOLUNTARY ARRANGEMENT OUTCOMES

PRE-PACK & TRADING ADMINISTRATIONS

Whilst our analysis shows that 90% of completed Administrations end either in Liquidation or Dissolution, it may be that this masks effective business rescues via the Pre-Pack and Trading Administration routes.

An analysis of the financial outcomes of our sample of Administrations is beyond the scope of this study, but we are indebted to the research carried out by University of Wolverhampton. The outcome of this research was published in April 2014 as “Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration”, more generally known as the ‘Graham Review’. The head of the research team was Professor Theresa Graham CBE. This research examined the detailed outcomes of almost 500 Administrations, which had commenced during the calendar year 2010. The basis of this research was that approximately one in four of all Administrations involve the use of the Pre-Pack strategy. In addition, a further 4% (99 out of 2,682 in 2010) of Administrations involve a sale of the business as a going concern after a period of trading.

The final Graham Review report can be found at:

https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration

The headline findings of the study relevant to our analysis were:

➤ Pre-Pack Administrations
  o A quarter (25.5%) of Pre-Pack purchasers failed again within three years
  o The recovery for unsecured creditors where the Pre-Pack route was used was only just over 7p in £
In 58% of Pre-Pack Administrations there was no distribution to unsecured creditors.

Trading Administrations

- A fifth (19.6%) of Trading Administration business purchasers failed again within three years.
- The recovery for unsecured creditors where there was a Trading Administration business sale was 13p in £, although this outcome was skewed by two significantly larger distributions.
- In 50% of Trading Administrations there was no distribution to unsecured creditors.

Applying these findings to our research, the 2,344 apparently unsuccessful Administrations (those ending in Liquidation or Dissolution) may include 586 (25%) Pre-Packs, of which 437 (74.5%) would have produced a rescue of the business via a transfer to a new owner, which survived at least three years.

In addition, there may have been 94 Trading Administration business sales, of which 76 (80.4%) would have produced a rescue of the business via a transfer to a new owner, which survived at least three years.

This calculation increases the success tally for completed Administrations from 263 to 776 and the success rate from 10% to 30%.
RETURNS FOR UNSECURED CREDITORS

The scope of our research into Administration Outcomes did not extend to the amounts, which may or may not have been paid out to unsecured creditors.

However and as noted above, the Graham Review identified that the mean distribution to unsecured creditors via Pre-Pack Administrations for which such data was available was just 7.22p in £. In the case of Trading Administrations it was 13.06p in £, which may be overstated.

Despite extensive research on the internet and discussions with credit industry experts, we have been unable to find up-to-date statistics for the average distribution to unsecured creditors across all types of insolvency procedure in the UK. However, research by The Association of Business Recovery Professionals (R3) carried out in 2001 suggested that the average return then was 7p in £.

Post the worst recession in living memory and with a low growth economy continuing to depress asset values, there is nothing to suggest that returns to unsecured creditors will have improved since 2001, indeed they may even have deteriorated.

At best, it appears that unsecured creditors of a company undergoing a formal insolvency procedure in the UK can expect to recover 7p in the £, apart from a tiny minority in the case of a Trading Administration who might recover 13p in £. This outcome appears to be the same whether the company is passing through Administration or another process and whether it is through a Pre-Pack Administration.

In over half of successful business rescues via the Pre-Pack or Trading Administrations, unsecured creditors are likely to receive no distribution at all.

THE ASSOCIATION OF BUSINESS RECOVERY PROFESSIONALS (R3): VALUE OF THE INSOLVENCY PROFESSION REPORT 2015

In May 2015, R3 published the results of a membership survey carried out in conjunction with pollsters ComRes, and data from the Insolvency Service. Its key findings were in respect of business distress were that in 2013/14 the UK insolvency profession rescued 41% (6,700) of the insolvent businesses which it dealt with and saved 230,000 jobs.

The full report can be accessed via this link: https://www.r3.org.uk/what-we-do/about-us/the-insolvency-profession

The findings do not differentiate between business rescues undertaken via the various insolvency procedures, so it is not possible directly to correlate this research, which is
of course largely anecdotal rather than empirical, with our own findings in respect of Administration outcomes.

Nevertheless, we believe that it is broadly supportive of our findings. The vast majority of all business rescues are achieved either via Administration or by using a CVA. A CVA is likely to be a more productive route for business rescue, because it is essentially a consensual process involving the continuing support of key stakeholders, such as suppliers, service providers and lenders. As such CVAs may be the cause of at least some of the differential between the R3 membership survey suggestion of a 41% business rescue success rate and our findings that 30% are saved when Administration is the procedure used, taking into account the impact of Pre-Packs and Trading Administrations.

**CONCLUSIONS & REFLECTIONS**

Including hypothetical successes via the Pre-Pack or Trading Administration routes, fewer than a third of Administrations (30%) result in a rescue of the business as a going concern. Out of these, only 10% result in the continuation of the insolvent company itself.

The recovery for unsecured creditors remains small at approximately 7% and for over half there will be no recovery. There appears to be no difference in the outcomes for unsecured creditors as between their debtors going through the Administration procedure or any other form of insolvency process such as liquidation.

The unanswered question is not whether Administration is a successful business rescue tool; but whether the outcomes might be materially better if rescue attempts were started earlier in the distress cycle, when more beneficial options are still available, most notably when a consensual workout is still possible and the potential financial damage of an Administration can be avoided.

Maybe then the UK insolvency profession could save many more than the 230,000 jobs that R3 members say they preserved in 2013/14.