

## Pre-packaged applications in business reorganisations: International principles

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### ABSTRACT

This study aims to explore the operating environment of pre-packaged financing in various established reorganisation regimes, including the legal framework, practice, enablers, context and other governing structures. Pre-packaging in the United States, United Kingdom, Australia and Canada was examined with a view to establishing common elements. It is hoped that the resulting insights will assist in building up a framework for implementing pre-packaging in less developed regimes. Through examining secondary evidence using content and comparative analysis, the researchers developed a thematic outcome identifying common and divergent elements. The findings indicate that pre-packaging has different contextual applications in each regime; it developed largely through evolutionary practice, often forcing the hand of the legislators to adapt. Apart from general rescue legislation, no other legislation was found to have been passed specifically for introducing pre-packaging. Lastly, the presence of a distress-funding culture appears to play a significant role in the establishment of pre-packaged financing.

**Key words:** administration, bankruptcy, business rescue, business reorganisation, DIP financing, distress funding, insolvency, post-commencement funding, pre-packaged funding

### Introduction

Over the years, many regimes all over the world that operate insolvency or bankruptcy systems have adopted reorganisation plans to better aid financially distressed businesses, as opposed to allowing them to run the course of liquidation or

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bankruptcy. The prevailing view is that allowing companies to continue operations as going concerns provides better societal and economic value than breaking them up. In most cases this financial distress can be associated with severe cash-flow constraints in the business, resulting in an inability to service debt in the ordinary course of business. Consequently, some regimes have introduced various forms of funding mechanisms to allow the flow of funds into the distressed business. Pre-packaged funding is one such mechanism. It is defined by the United States (US)-based Association of Business Recovery Professionals 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. The administrator effects the transaction immediately on, or shortly after, his or her appointment.

Pre-packaged funding has been widely adopted in regimes across Europe, Asia and the Americas, and has found universal use in many advanced states such as the US, United Kingdom (UK), Canada and Australia (Burdette 2004). Pre-packaged funding is often used interchangeably with pre-packaging or pre-packs in different research papers, as well as across different regimes, many of which operate under different laws of insolvency and reorganisation, hence the application of pre-packaging is governed or overseen by different rules. Although the basic premise might be similar, the different legislations under which the practice is applied pose different challenges and produce different outcomes for each.

This article aims to review and gain a better understanding of the application of pre-packaging in select established regimes, namely the US, UK, Canada and Australia. The research aims firstly to define or identify the set standard or principle by which pre-packaging is applied in each regime, the context under which it applies, and the nature of the regulation overseeing the application. A thematic analysis is then done to identify common and divergent elements found in the application of pre-packs in these major regimes.

It is hoped that developing a pattern for pre-packaging will elicit insights that can be used to determine the applicability of pre-packaging to other, less developed regimes. This will enable them to determine the ability of existing regimes to accommodate new applications, and the relevant antecedents to the introduction.

## Literature review

The available literature provides an overview of pre-packaged funding across regimes globally. In line with this study of the four advanced regimes, it was necessary to identify key issues to be included in the analysis. A number of studies have previously been conducted with these four regimes, either singly or in comparisons, but mostly in the broader context of business rescue or reorganisation.

According to Windsor and Jarvis (2011), ‘pre-pack’ is used contextually in different regimes. For instance, in the UK it generally refers to a pre-agreed business sale which does not require prior or subsequent sanction of the court or creditors. With other regimes, as in the US, it is described as a fast-tracked restructuring plan that is agreed to by debtor and creditors prior to filing, and subsequently being sanctioned by the courts (Mallon & Waisman 2011).

All in all, pre-packaging is regulated under varying legislations which essentially govern restructuring under bankruptcy or insolvency, depending on the regime’s legislation. What follows is a sense-making of the concept, with descriptions of variants, legislations and contexts in the four regimes under study: the US, UK, Australia and Canada.

### Pre-packs in the US

The US is regarded as probably one of the oldest reorganisation administrations, yet it is not the least complex of the regimes under study. The US law for incorporation of companies or corporates (corporate law) is based on a regional system of incorporation applied variously to each of the federal states. However, insolvency and bankruptcy law is governed centrally under Article 1, Clause 8 of the constitution, which introduces uniformity in dealing with bankruptcies in the US. The main insolvency legislation is the Bankruptcy Reform Act of 1978, commonly known as the US Bankruptcy Code (USA 1978). The code incorporates insolvency as well as a reorganisation of companies facing bankruptcy (Bankruptcy Reform Act, 1978). Insolvencies are dealt with under Chapter 7 of the code.

Legislation that specifically addresses reorganisation is found in Chapter 11 of the code. Introduced in 1978 (and subsequently amended several times), the legislation is applicable to individuals as well as to all forms of business. The legislation’s premise is the rehabilitation of a corporate entity.

The triggering point generally used for insolvency and/or bankruptcy is failure to pay debts when they are due. Under Section 364 of Chapter 11, a debtor that has filed for bankruptcy is allowed to raise debt financing after filing and while management reassesses its business plan and negotiates the restructuring of its capital structure (Pretorius & Rosslyn-Smith 2014). This financing, called debtor-in-possession (DIP), is used primarily

- to pay for professional fees for the reorganisation process;
- as working capital to operate the business; and
- to finance capital expenditure or maintain existing assets.

As a top priority debt, DIP financing ranks higher than any existing debt and enables the debtor to remain liquid during the most challenging times after the filing. One of its major features is the control of the corporate by management throughout the DIP exclusivity period, which can range from the initial 120 days of automatic stay to allowable multiple extensions that may not, however, exceed 18 months (Altman 2009).

Despite the relative success of DIP financing, pre-packs have found their way into US bankruptcy legislation and practice. Normally arranged before filing by the debtor, pre-packs have emerged as a quick exit from bankruptcy. Pre-packs are often applied as part of Chapter 11 filings and have been coined ‘pre-packaged bankruptcy’. Such cases are typically implemented as a higher-level workout while complying with the Bankruptcy Code regarding debt restructuring (John, Mateti & Vasudevan 2013).

Pre-packaging is regulated by Section 1126 of the code, by providing for the solicitation of creditors before filing and court approval, provided that Chapter 11 is filed subsequently – as Mallon and Waisman (2011: 205) add, a pre-packaged bankruptcy occurs in a situation where a debtor approaches its creditors and proposes a plan of reorganisation in advance. The debtor thereafter files for bankruptcy protection, with the votes for the plan of reorganisation already having been agreed to by the requisite number of creditors. In this scenario the debtor files a Chapter 11 petition simultaneously with a creditor-supported plan of reorganisation and disclosure statement. The simultaneous filing allows the courts to immediately set a hearing date for the approval of the disclosure statement, as well as the reorganisation plan directly thereafter, thereby significantly reducing the bankruptcy period. Automatic stay is only applicable after filing.

Furthermore, Section 363 allows a debtor to sell its assets outside of a plan of reorganisation, free and clear of liens, claims and other encumbrances, provided that it can be shown that such a sale was necessary to preserve the value of the assets. While this sale process occurs after filing and notification of Chapter 11 bankruptcy, it is normally quite quick, due to the fact that the sale is not imbedded within a plan of reorganisation. Upon notice and hearing before the bankruptcy court, a Section 363 sale may proceed, with only consent required from creditors (Mallon & Waisman 2011). Section 363(c) further allows the trustee (already appointed by the debtor) to negotiate the sale of the assets prior to notification and filing, provided interested parties have consented and the sale is consummated only after the hearing. Used together, the two sections (363 and 1126) provide the background legislation for what is termed a ‘quick sale’ or pre-packaged bankruptcy.

Ben-Ishai and Lubben (2011) mention, however, that in cases where a debtor-in-possession elects to use Section 363 to effect a sale of assets, the process would

typically involve a ‘stalking horse’, whereby the initial bidder is used to attract competing bidders in an auction. This would be done with the proviso that the stalking horse be compensated for costs in the event of losing the bid. Once the sale is consummated, the debtor completes the Chapter 11 proceedings or converts to Chapter 7. Interestingly, there does not seem to be much reference to a stalking-horse concept, particularly in Section 363.

McCormack (2008: 103) describes pre-packaged bankruptcy as mixing the elements of a private restructuring, by conducting restructuring negotiations outside of Chapter 11 with a traditional Chapter 11 restructuring process. Pre-packs are not formally subject to any of the rules associated with the confirmation of a plan (Ben-Ishai & Lubben 2011).

According to Ben-Ishai and Lubben (2011), the preference for Section 363 sales is driven largely by two factors:

- The speed of the process; and
- The ability to sell assets free and clear of most claims, under Section 363.

Using either sections 363 sales or 1126, it appears that speed and flexibility are of the essence in administering the US Chapter 11 process. This is strengthened largely by the sophistication of the bankruptcy courts and the constituency of major creditors. John et al. (2013) view pre-packaged Chapter 11 filings as combining the advantages of the issuing of a super-priority debt (Chapter 11 filing) and a workout. In terms of this view, the reorganisation plans are negotiated in advance and filed along with the bankruptcy petition, and are almost immediately accepted by creditors. Management is allowed to run the business during the process of reorganisation. An important consideration about the whole US bankruptcy process (including pre-packaging) is that it is highly court driven. In fact, the country operates one of the most advanced bankruptcy legal systems in the world, with specialised courts.

Through the buying of debt utilising the DIP provisions, many hedge funds hitherto not involved in the business of the debtor have found a way of participating in Chapter 11 reorganisations (Baird & Rasmussen 2010). This has encouraged the use of pre-packaged financing, as most of these financing agreements could be made prior to filing. Section 363 allows the use of debt swaps either prior to or after notice and filing.

As is clear from the above, pre-packs in the US were essentially designed as pre-arranged plans of restructuring, as per Section 1126. In reality, however, many pre-packs involve the sale of assets allowable under Section 363, after which the proceeds are allocated (Ben-Ishai & Lubben 2011).

### Pre-packs in the UK

Corporate law in the UK is governed by the Companies Act of 2006, which governs the registration, de-registration and restructuring of companies registered in the UK. In the event that such companies fail the solvency test, the act refers their treatment to the Insolvency Act of 2000. First introduced in 1986, the act traditionally provided a remedy to creditors through the appointment of a receiver over the assets of the company. The receiver's main function is to realise the secured assets for the benefit of the secured creditor(s) who made the appointment (McCormack 2009).

To be responsive to the concerns of all stakeholders, the UK introduced the Enterprise Act in 2002, while also abolishing the administrative receiver (Brown 2009). This act was aimed at rescuing the businesses of the affected companies as going concerns. To trigger business rescue under the act, a company has to pass the test of illiquidity, meaning it is unable to meet due debts in the ordinary course of business. It is worth noting that the rescue of a business entails either saving a particular company as a going concern or conducting a piecemeal sale of its assets for the benefit of creditors. The latter is often characterised by the sale of assets of the company, usually to a new company (newco). This distinction inadvertently gave impetus to the growth of pre-pack sales as part of the administration or business rescue process.

As a concept, pre-pack sales (or pre-packs) do not feature in or result from legislation in the UK (Mallon & Waisman 2011). Because there is nothing akin to the US's DIP financing, pre-packs found their way into the UK on the back of the Enterprise Act. This has addressed the risks pertaining to a lack of working capital for trading purposes once a company has filed for administration. Windsor and Jarvis (2011) describe UK pre-packs (or pre-pack sales) as used for:

A sale of the business or assets of an insolvent company (which could include a sale of shares in its subsidiaries);

- by an insolvency office holder (typically an administrator)
- where the preparatory work (identifying the purchaser and negotiating the terms of the sale) takes place before the appointment of the administrator.

The sale is then concluded almost immediately after the appointment of the administrator, without the sanction of either the court or creditors, and often with limited formal marketing of the business or assets being sold.

In terms of the Enterprise Act (2002), the process of voluntary administration (which often leads to the arranging of a pre-packaged sale) is usually initiated by the distressed company's management. Insolvency practitioners who are appointed as administrators for 'insolvent' companies under the Enterprise Act usually work

with management to arrange the sale of the business under pre-pack arrangements. Creditors' rights are anchored in their right to veto the appointment of such an administrator. Once the administrator is appointed, he or she plays a leading role in executing the pre-arranged sale.

Thus, in the UK there is no formal legislation governing the application of pre-packaged sales. However, the government introduced guidelines such as the Statement of Insolvency Practice (SIP) 16 (ICAEW 2009), to regulate the conduct of administrators in the application of pre-pack sales. More importantly, these guidelines aim to ensure that the administrators implement a transparent process for creditors and that a fair value is obtained in the sale (Conway 2015). In terms of SIP 16 (2009), sanction for non-compliance with this guideline is possible disciplinary or regulatory action against administrators by their respective practitioners' regulatory authorities. The administrator works with management to finalise a business rescue plan, which is then presented to the creditors for approval.

It is important to note that the process is mostly market driven, and the role of the courts is very limited. While the UK process is deemed to be creditor friendly, it is worth noting that cramdown is the norm when a two-thirds majority vote by creditors has been obtained, and unsecured creditors invariably have to accept the decision.

One of the major criticisms of the UK pre-packs is the lack of transparency in the process (Conway 2015). SIP 16 relies heavily on the regulations of the practitioner industry to sanction the duty of care to shareholders and the obligation to creditors to monitor the independence of the administrators. According to Crouch and Amirbeaggi (2011), the same administrator, while not yet appointed, will work with management in the sale process to achieve the following:

- Valuations of the business(es);
- Negotiations with potential buyers;
- Obtain the support of secured creditors and suppliers; and
- Set the sale price and terms of contract for the sale.

Once appointed, the same administrator proceeds to finalise the sale. Furthermore, sales of businesses under pre-packs are not openly advertised, and it is common for them to be sold secretly. The justification for a non-publicised sale is that the business would like to continue trading in the period leading up to the sale, without any negative connotations related to an administration (Crouch & Amirbeaggi 2011).

It is worth noting that an empirical study by Frisby (2007) found that many insolvency practitioners in the UK stated in their reports to creditors that the

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uncertainty associated with selling a business after the process of insolvency had commenced (and had therefore been publicised) was potentially fatal to the business.

### Pre-packs in Australia

The Corporations Act of 2001 governs all activities of corporations in Australia, including company insolvencies. The reorganisation of companies was only introduced in 1993 through voluntary administration, filed by entering a Deed of Company Arrangement (DOCA). According to O'Brien-Palmer (2012), voluntary administration is designed to maximise the chances of a company or its business remaining in existence, or alternatively providing better returns to creditors. This it does through

- an automatic stay on creditors; and
- providing the appointed administrator with time to investigate the affairs of the company and consider a possible proposal for the compromising of debt for the company.

The Corporations Act allows for the introduction of reorganisation through voluntary administration. The trigger to proceed with reorganisation/administration is the insolvency of the corporation. Voluntary Administration is based on the premise of rescuing either the company or the business. The latter has been the basis of sales of company assets to a newco, a process regarded by critics as a 'phoenix scheme' or the phoenix of an insolvent company. The staff, goodwill and goods or services of the old company are usually retained by the newco, in a practice which is the prevalent *modus operandi* of pre-packaged sales in Australia.

Pre-packs first became formal in Australia in 2009. According to Crouch and Amirbeaggi (2011), Australian pre-packs were formally introduced in a specific insolvency sale in 2009. The firm of accountants and lawyers involved in the transaction thoroughly examined the law and concluded that pre-packs could be made commercial and compelling, despite the apparently stringent and tight legal framework in Australia. This conclusion was, in effect, just a confirmation, because pre-packs had already been in practice for a while by then.

Pre-packaged sales are defined in Australian terms as a process whereby the sale of a business or assets of an insolvent company is agreed upon prior to the appointment of an insolvency practitioner, whose task is to review the sale terms and, if thought appropriate, ratify the sale (O'Brien-Palmer 2012). An Australian pre-pack model encompasses the following measures, among others:

- The directors of the distressed company are required to employ a reputable valuer, and the sale of this business will be based on that valuation;
- While the directors then arrange for the sale of such business based on this valuation, the completion of the sale will be subject to ratification by an administrator, and he or she will in turn ordinarily seek creditor input;
- The distressed company will then appoint the administrator, who will investigate the sale, test the market if appropriate, and report to the creditors;
- Only if the sale is ratified by creditors will the administrator complete the sale, otherwise the sale will be rescinded; and
- Most importantly, the administrator to be appointed should not advise the company on the process. (O'Brien-Palmer 2012)

In the unlikely event that such a sale should be completed prior to the appointment of the administrator, this would trigger the insolvency provisions and such a company would subsequently be liable to winding up through a creditors' voluntary liquidation. Under those circumstances the sale would be rendered voidable if found by the liquidator to be unreasonable (O'Brien-Palmer 2012).

Although there is no formal legislation in Australia governing pre-packs, the legal framework permits the use of pre-packaging. There is no prohibition of 'phoenix' sales in the Corporations Act or any other legislation. There are a few minor constraining factors, however, such as provisions governing the duties and responsibilities of directors and the prohibition of directors trading under insolvent conditions, both found within the Corporations Act (Crouch & Amirbeaggi 2011). Furthermore, the Insolvency Practitioners Association's (IPA) Code of Professional Practice sanctions members who contravene their professional ethic. As in the UK, the role of the courts is very limited regarding pre-packs, except in general jurisdiction.

A major comforting factor for creditors of a pre-packaged sale company is the knowledge that the sale is subject to the review and ratification of an independent administrator. The IPA adopted a code of ethics which essentially imposes independence requirements on practitioners, particularly with pre-packs. In combination with the act, this makes provision for the appointment of an independent administrator to oversee the valuation and sale of the company or assets (Crouch & Amirbeaggi 2011).

### Pre-packs in Canada

Corporate law in Canada is governed by the federal Canada Business Corporations Act (CBCA), or regionally by various provincial laws. These allow companies to register and be administered, either nationally or according to the provinces in

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which they are registered. The CBCA, however, plays an additional role which includes the regulation of debt compromises while also making reference to the insolvency laws.

The Bankruptcy and Insolvency Act (BIA) is one of the statutes that regulate the law on bankruptcy and insolvency in Canada. While Canadian commercial insolvency law is not codified in one exhaustive statute, the BIA is the main act as it applies to both natural and legal persons, and provides for both reorganisation and liquidation. It is the sole law governing company insolvencies in Canada, as financial institutions are governed by the Winding-Up and Restructuring Act.

The Companies' Creditors Arrangement Act (CCAA) was introduced in 1933 to deal with reorganisations. More remedial in nature than the BIA, it was intended to encourage reorganisation over liquidation. The act allows the 'insolvent' company to restructure its financial affairs using a plan of arrangement (Pretorius & Rosslyn-Smith 2014). The prerequisite for commencing with the CCAA arrangement is insolvency, and the plan's main premise is the rehabilitation of the corporate entity as a going concern. Prearranged restructuring (pre-pack) is based mostly on the CCAA. The literature reviewed is silent as to the timing of the initial use of pre-packs under the CCAA. The Canadian process appears less flexible than the US process, and therefore much slower (Ben-Ishai & Lubben 2011). Like the US administration, it is largely regarded as debtor friendly.

According to Ben Ishai and Lubben (2011), although the CCAA has been likened to the US Chapter 11 Bankruptcy Code, it lacks the detailed statutory framework for quick sales found in Chapter 11. Numerous statutory amendments have been made to the CCAA since its inception, including the new Section 36, which regulates the sale and disposal of assets. Intended to provide guidance in a manner similar to the US Section 363, the Section 36 amendment proposes the following process for quick sales under the CCAA:

- (i) Submission of letters of intent by potential buyers;
- (ii) Due diligence by the buyers;
- (iii) Binding offers and deposits by all interested buyers;
- (iv) Negotiations between debtor or monitor and shortlisted bidders, who are requested to submit "best and final offers";
- (v) Selection of preferred buyer;
- (vi) Application to court for approval of purchase agreement; and
- (vii) Court approval of final purchase agreement, which cannot be changed even when circumstances change.

In Canada, no special provisions exist regarding directors' liabilities in terms of trading under conditions of insolvency. The directors' duty of care extends only to the relationship with shareholders, and then only affects creditors if proven to be oppressive. However, merely operating in the knowledge of insolvency and creditors possibly not being paid when due is not deemed oppressive (Wood 2007).

Of importance under the CCAA is the introduction of a monitor, which is often an accounting firm (typically the firm auditing the company's books). The purpose of the monitor is to observe the proceedings and the behaviour of management and business operations while a plan is being drafted. The monitor is required to report to the bankruptcy judge and other parties regularly, throughout the restructuring process. In practice, however, such monitors are often conscripted as advisors to the debtor. To complicate matters, bankruptcy judges often have discretion on the precise roles of these court-appointed monitors (Ben-Ishai & Lubben 2011).

On the other hand, the CBCA, because it permits debt compromises and therefore is able to implement prearranged restructuring, has also been used in certain circumstances for implementing pre-packs, e.g., for financing in Essar Steel Algoma Inc.'s plan of arrangement. The CBCA is in fact recognised by US bankruptcy courts under Chapter 15 of the Bankruptcy Code, and seems to have a symbiotic relationship with US bankruptcy (Basta, Greco, Evans & Nguyen 2015). These authors argue that the CBCA plan of arrangement is less formal than the US Chapter 11 pre-packaged bankruptcy.

Thus, under the CBCA a debtor can only apply for court approval for a plan of arrangement that affects security holders (generally denoting shareholders). The court has jurisdiction to apply a stay of proceedings, though with limited authority over creditors. The court also does not appoint a monitor over the proceedings, as in the case of the CCAA. DIP financing is also not normally available under the CBCA. The process of the CBCA typically involves two court hearings and a meeting of security holders. The first court hearing obtains an interim order approving procedures and a notice of a meeting with security holders, very similar to the disclosure statement hearing of US Chapter 11. A final order is obtained in the second hearing approving the plan, again similar to the US Chapter 11 process. In the Essar Steel case, though, the CBCA process seems to have been followed mainly to obtain recognition and alignment with the US Chapter 15 proceedings (Basta et al. 2015). The effectiveness of this case was that the debtor had negotiated a restructuring support agreement with the majority of its creditors and the main shareholder (a fund) beforehand, and required a court process to bind other shareholders to the process. The main benefit was that the pre-pack financing arrangement became implemented faster and more effectively.

### Pre-packs in South Africa (SA)

The local business rescue regime was introduced into practice in Chapter 6 of the new Companies Act, 71 of 2008, as recently as May 2011. The sale of a distressed business or its assets under business rescue has not been specifically included in the act's governance structure. Furthermore, pre-packaging by definition refers to a sale that is negotiated before filing for business rescue, but after the directors have identified financial distress in the company. Within the local context, such action by the company directors would seem to automatically trigger an act of insolvency according to the Insolvency Act, 24 of 1936, because they have a fiduciary duty to report any indication of insolvency to the authorities. Additionally, the distress funding market is in its infancy, and has not yet developed enough to significantly influence the introduction of pre-packs in business rescue. An investigation of this distress funding culture and its effects will be the subject of a later study.

### Research aims and questions

The study aims to describe the similarities and differences in the application of pre-packaged funding in four established regimes, i.e., to understand the operating environment of pre-packs where these are deemed to have been well established. It therefore poses the following questions:

- Do the four regimes being studied espouse the same objectives, principles and methodologies in applying pre-packaged funding?
- What are the conditions under which pre-packaging is allowed to operate effectively?

The operating environment includes elements such as

- the legal framework;
- generally accepted practice;
- the enabling environment;
- the context under which pre-packaging occurs; and
- the existence (or not) of governance structures.

**Table 1:** Research design applied to this study

Component	Description
Research problem	What are the similarities in the guiding principles and practices of pre-packaged financing observed among global restructuring regimes?
Context	Business restructuring/rescue and administration
Propositions	1. Pre-packs are universally defined, and consistently and analogously applied, throughout the four major regimes 2. Standard legislation is required in order to introduce and apply pre-packs 3. The introduction and sustainability of pre-packs is underpinned by a defined rescue culture
Phenomenon investigated	The operating environment of pre-packaged financing
Unit of analysis	Internationally available literature International restructuring/rescue regime practices Relevant acts in international restructuring/rescue
Logic linking data to propositions	Regime contexts, legislation proven as functional, accepted practices and principles that exist
Criteria for interpreting findings	Principles Themes

## Research design and approach

### Research approach

This study, which is exploratory and qualitative, is aimed at analysing and identifying the principles and praxis of pre-packaged funding, so as to develop a theme which can be used as a scoreboard for the future implementation of pre-packaging in other regimes.

Given that the conceptual base for pre-packaged funding has emerged mainly from established regimes that have practised business rescues or reorganisations for a considerable time, it is to be expected that their existing practices could be used to establish frameworks in developing regimes. Therefore, a largely qualitative study was deemed appropriate for the initial building of a theoretical framework on pre-packaging. The questions raised under the research objectives and questions section were used to guide the research. Content analysis and comparative analysis methods were applied to develop schematic themes for discussion under the conclusions. In developing this narrative, care was taken to apply regime-specific terminology for each regime studied, although this was against a similar context throughout.

### Ontological positions

Ontological positions are the researchers' views on the nature and essence of things in the social world, which serve to articulate the essence of their enquiry (Mason 2002). The first author believes that while given facts often determine people's positions and their reaction to the same set of facts, most situations can be explained through closer observation or interaction. Nuances such as people's backgrounds, early influencers and experiences, cultural practices and other social dynamics tend to shape their actions, outlooks, paradigms and temperaments. It is therefore important to fully appreciate the background information prior to taking a position on any matter or subject. The first author's interest is mainly in funding for business rescue and turnaround purposes. As a positivist who is forced by the context of the research field to do qualitative research, the second author, when finding repeated appearances of issues and principles over regimes, 'generalises' from them. His interest is mainly in identifying directives to apply to local legislation (or the absence thereof) to guide business rescue processes.

### Epistemological positions

This represents the theory of knowledge of the researcher, and indicates how the underlying principles of social phenomena can be uncovered through a fully informed research process that demonstrates knowledge. The first author had personally experienced a pre-packaged funding failure as an investor, and this ignited his interest in the subject. Therefore, as a postgraduate scholar, he was looking for better ways of participating in funding for business rescue, and in the process of helping to ignite interest among potential distress funders. The second author was influenced by his role as a strategy consultant when facilitating strategic critiques and analyses to guide company boards and management – that of 'devil's advocate' – which depends heavily on challenging existing (conventional) thinking, assumptions, reasoning, accepted principles and rules. Sense making in these contexts could lead to application in other regimes.

### Research method

The data collection was guided by the research questions being answered. It followed a typical format of literature review in research (Babbie 2007; Creswell 2009). Wherever possible, recent literature was used. However, in cases where authoritative sources needed to be used (particularly much-cited text), older literature was used.

First, the legislative literature on business reorganisations or turnarounds in the four regimes of the US, UK, Australia and Canada was studied, to understand the full context of the establishment of the regimes, and the place of pre-packaging in those regimes. This literature was accessible via standard search engines. Second, scientific literature on reorganisations and turnarounds (and especially pre-packaging) was searched to provide background and analysis on the given subject. The search engines used included Harzing's *Publish or Perish* and Google Scholar, and especially for titles and authors, Sabinet, ProQuest and EbscoHost.

### **Research setting**

Four key established regimes were identified and studied with regard to their pre-packaged practices over the years. The regimes were selected because of their long-standing practices, the modification of their practices over the years and the transparency of their processes and proven case law, as well as the ease of availability of literature on such regimes. As themes emerged from the shared as well as divergent praxis of these regimes, guidance on the development of a framework on the resulting principles, praxis and antecedent factors also emerged (see Tables 2 and 3).

### **Data analysis**

Data were categorised into coherent themes for a proper mind-mapping. A combination of content and comparison analysis was used to formulate the insights for final discussion and conclusion.

## **Observations and findings**

### **Key observations**

As regards the global view of insolvencies and reorganisations, it is important to recognise that different jurisdictions have a need to address their own issues of fairness and social justice, as understood by their societies. Consequently, the insolvency laws of any country are closely linked to its other laws and will inevitably reflect its fundamental values (Westbrook, Booth, Paulos & Rajak 2010).

Tables 2 and 3 provide a schematic outline of the environments in which pre-packs apply, starting initially with the legislative environment and then the specific pre-pack framework. It should be noted that while different terminology in various regimes

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often relates to the same things, there are exceptions where different meanings need to be ascribed. For example, the various practitioners used in the different regimes may occupy completely different roles in practice. Different professionals are used to fulfil the role of administrator, with the US employing a trustee, while the UK and Australia use an insolvency practitioner and Canada uses a monitor.

**Table 2:** Legislative environment and key issue comparison

Main corporate legislative regime				
Legislative Regime	United States	United Kingdom	Australia	Canada
<b>Main corporate legislation</b>	Regional – mostly Model Business Corporations Act & Delaware General Corporations Law	Companies Act 2006	Corporations Act 2001	Canada Business Corporations Act (federal); various (provincial)
<b>Main insolvency legislation</b>	Bankruptcy Reform Act 1978 (U.S. Bankruptcy Code) Chapter 7	Insolvency Act 1986; 2000	Corporations Act	Bankruptcy and Insolvency Act
<b>Reorganisation legislation</b>	Chapter 11	Enterprise Act 2002	Voluntary administration	Companies' Creditors Arrangement Act ("CCAA") 1933
<b>Commencement date (reorg.)</b>	1978	2002	1993	1933
<b>Reorganisation triggers</b>	Failure to generally pay debts when due	Illiquidity – inability to meet due debts in ordinary course of business	Insolvency	Insolvency
<b>Reorganisation premise</b>	Rehabilitation of corporate entity	Rescuing/saving the business – going concern or piecemeal sale (for creditors' benefit)	Rescuing company or business	Rehabilitation of corporate entity – as going concern
<b>Reorganisation terminology</b>	Reorganisation	Administration	Administration	Administration
<b>Regime orientation</b>	Debtor friendly; migration to creditors	Creditor friendly	Creditor friendly	Debtor friendly

Source: Author's compilation

In the first instance, the US and Canada have, as federal states, tended to legislate on the behaviour of corporates in a manner that speaks to the independence of the various states. Basic legislation governing the registration of companies is left to the different states. While Canada has subsequently sought to have an overall national standard in parallel, the US has left legislation as is, with many corporates migrating to the state of Delaware as a corporate haven.

In both cases, however, legislation governing insolvencies, bankruptcies and restructurings has been placed at the epicentre as standards for national application. In Canada, the BIA is enacted to deal with all matters of insolvency and bankruptcy, while the CCAA deals with corporate restructuring. Although this is limited to corporates that produce turnovers from C\$5 million upwards, it is a standard for such. The US, on the other hand, established through the constitution the US Bankruptcy Reform Act, which governs all matters pertaining to restructurings – from basic balance-sheet reorganisations to complex sales of distressed assets of businesses, and ultimately insolvencies. It is applicable to individuals as well as corporates (Spiro, Westerman & Dela Cruz n.d.). The reorganisation of Chapter 11 that deals with distressed businesses is also found in this act.

In contrast with the US and Canada, the UK and Australia operate single registries for companies or corporates. In the case of Australia, this legislation, the Corporations Act, also deals with all matters of insolvency and bankruptcy, including voluntary administration, which was established to deal with business rescues for companies that are under financial distress and therefore facing insolvency. Voluntary Administration is a process to be followed in dealing with companies that wish to voluntarily file for rescue administration under DOCA, to avoid possible liquidation.

In a manner not too dissimilar from the Canadian practice, the UK applies the Insolvency Act to deal with all insolvency-related issues, for individuals as well as companies. A separate Enterprise Act was legislated to deal with distressed companies, with the distinction being illiquidity as opposed to insolvency.

The reorganisation culture seems to follow similar dichotomous patterns among the four regimes, with the US and Canada being more focused on rescuing existing corporates as going concerns, while the UK and Australia seek to rehabilitate the business, as opposed to the corporate. This culture of business rescue in the UK and Australia has led to the practice of the stripping of assets of distressed businesses into newcos. The practice is implemented using new funds injected into newcos, irrespective of the stage of restructuring of said business. It has nevertheless led to criticism about ‘phoenix’ practices, which in effect mimic this practice, though in that case with the purpose of evading creditors. Pre-packaged financing has thus not escaped criticism, as its nature makes it easily amenable to this practice.

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**Table 3:** Pre-pack framework showing key elements

	Reorganisation funding and principles			
Funding	United States	United Kingdom	Australia	Canada
<b>Forms of funding</b>	Debtor in possession (DIP) financing; pre-packaged finance	Pre-packaged financing	Pre-packaged financing	DIP Financing; pre-packaged finance
<b>Post-commencement funding</b>	DIP financing	None specific	None specific	DIP financing
<b>Pre-pack first year of use</b>	1978	Unclear, but predates 2009	2009	Unknown
<b>Pre-packs theme/premise</b>	Fast-tracked process; sale of assets; funding of corporate?	Sale of assets, often to newco	Sale of assets to newco	Sale of company or assets
<b>Pre-pack driver</b>	Process based	Sale based	Sale based	Sale based
<b>Pre-pack governing legislation/guidelines</b>	Chapter 11:- Section 363 sales, Section 1126	None. Guideline SIP 16	None. IPA's Code of Professional Practice (code)	CCCA: S36 sale process & S11.7 appointment of monitor by courts
<b>Other related legislation</b>	None	None	Corporations Act: directors' liabilities & insolvency trading provisions	CBCA: insolvency provisions
<b>Legislation introduction</b>	1978; several amendments	2009; revised in 2011	N/A	1933; amended in 2009
<b>Legislation / guidelines' main purpose</b>	Allow quick sale; stalking horse bidding process (in practice)	Transparent process for creditors; fair value obtained	Ensuring fair price and administrator independence; creditor loss protection	Normal once-off bid process; monitor (CA) appointed as watchdog
<b>Non-compliance sanction</b>	Not applicable	Fines to administrators	Civil & criminal penalties for directors (s181) & advisors (s79) as per Corporations Act	Possible sanction by professional bodies
<b>Directors' insolvency provisions</b>	Not applicable	Trading allowed to a point	Not allowed to trade beyond insolvency point	None specific

	<b>Reorganisation funding and principles</b>			
<b>Funding</b>	<b>United States</b>	<b>United Kingdom</b>	<b>Australia</b>	<b>Canada</b>
<b>Role of creditors</b>	Involved in negotiations with debtor; often part of buyers	Not involved in pre-pack negotiation; have veto rights on appointment of administrator; unsecured creditors 'forced'	Ratifying the sale	To receive notice of sale; onus to prove unreasonableness of sale in appeal
<b>Role of courts</b>	Specialised; sanctioning agreement & process	None	None – limited to directors' liabilities	Approval & sanction
<b>Management/directors' role</b>	Runs the business during process; appoints trustee	Management works with administrator to arrange sale	Directors arrange the sale; administrator completes sale	Arrange the sale; monitor evaluates sales and reports to court – CCAA; but court has right to remove directors
<b>Role of administrators</b>	Trustee negotiates and consummates sale	Lead role in executing sale process, end to end	Ratifies sale with creditors; completes sale	None (monitor acts as watchdog over management)
<b>Administrator independence</b>	Appointed by debtor	No role distinction for IP	Administrator not same IP as advisor	Monitor independent
<b>Asset valuation</b>	Management's valuation	Directors' valuation; proposal of independent valuer tabled	Independent valuer	Management, but assessed by monitor
<b>Fundamental goal</b>	Speed	Funding	Funding	Speed

Source: Author's compilation

Specifically with regard to pre-packs the US is very process driven, with every action along the way being detailed in the act, including the stages of involvement by the courts or judiciary. This means that the judiciary is very involved throughout implementation, with specialised bankruptcy courts in place. Because different sections of Chapter 11 of the act are used to detail each step in the process, it is possible to implement pre-packs without the funding- or capital-raising aspect. In this case, the main goal is the speed of the process. This seems to be a fundamental difference between US and European-based (particularly UK) pre-packs. However, despite the definition, funding often follows due to the unavoidable requirement for funding by most companies under Chapter 11.

As in the UK and Australia, Canada's major driver in pre-packs is the sale of assets or the company. However, unlike the former two regimes, Canada seems to

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mirror its practice and legislation on the US, with the involvement of the courts, although to a much lesser extent. Canada's legislation is also made user friendly for US processes (Basta et al. 2015). Another cultural similarity to that of the US is the regime orientation, which is regarded as debtor friendly, unlike those of the UK and Australia which are largely regarded as creditor friendly. The debtor-friendliness of Canada and the US is exemplified by the DIP reference in their regimes. DIP, in essence, puts the management or directors in the driving seat of a company under administration. In Canada this is further exacerbated by the fact that the creditor also has the onus to prove the unreasonableness of a sale of the company or assets by debtors, on appeal.

The creditor-friendliness of the UK and Australia can be seen as merely a compensatory safeguard to protect creditors, since the concept of business rescue itself is intended to protect debtors from possible rogue creditors whose only interest may be a quick exit and maximum recovery. In the UK specifically, the direct route to insolvency is followed by the creditor appointment of a receiver, whose sole aim is to maximise the recovery to the creditors. Nevertheless, a creditor in the UK is still not involved in a pre-pack negotiation (unlike in the US), and its powers are limited to vetoing the appointment of an administrator. Australia is slightly different, in that the creditor can still ratify the sale.

Of great interest is the fact that Australian pre-packs are governed neither by legislation nor by guidelines. The only check to pre-packaged sales in Australia is the voluntary administration process which requires the appointment of an independent administrator in valuing the assets of the business being sold, and that of creditors ratifying the sale. This process, based on DOCA, is included as part of restructuring in the Corporations Act. Outside of that, the only other check is the sanctioning of directors on their liabilities in cases where insolvency has been deemed to be triggered by trading under insolvency, also under the Corporations Act. This insolvency provision allows little time or incentive for directors to pre-pack, if it means that a liquidator may later allege that they held off past an insolvency point. In the case of the UK, directors are allowed to trade up to a point, even though the business may be under the cloud of insolvency, with a generous interpretation of when the directors ought to have stopped trading (Brown 2009).

An interesting aspect of the restructuring process in these four regimes, in particular with regard to pre-packaged financing applications, is that management or directors are allowed to run the companies or businesses even when under administration. It is not clear if there is a distinction between management and directors; this is a moot point. The role of the appointed administrator differs, but is essentially in relation to the conducting or overseeing of the sale. In the US and the UK the trustee and

administrator respectively play a lead role in negotiating and consummating the sale. In Australia, while the administrator ratifies a sale that has already been negotiated by the directors, he or she is then also charged with executing the sale agreement. Furthermore, distressed companies in Australia often appoint their own advisors (usually auditing firms) to work in parallel with the administrator. The advisors also provide an independent valuation of the sale price. This practice is deemed to create price fairness, although one can question the independence of these ‘independent’ advisors, since they are appointed by the directors themselves.

Independent valuations have not been deemed necessary in regimes other than those of Australia, and are normally done by managers or directors. Furthermore, in the UK the sale process is not even considered transparent, as it can be concluded almost entirely without any assessment of fair value in the process. This is done to avoid publicly advertised processes from having a negative impact on employees and customers (Crouch & Amirbeaggi 2011).

The Canadian monitors’ role is even more at arm’s length, as their sole duty as watchdog is to evaluate the merits of the sale and report back to the courts. The sale, however, is through a bidding process conducted in an iterative manner with a view to obtaining the highest bid price. This sale process therefore makes up for the lack of independent valuation.

Section 363 in Chapter 11 in the US regulates the sale of companies under distress. A peculiarity is that while the act makes no mention of the particular process to be followed in the sale, some authors mention a stalking-horse process that allows the price of the original bidder to be iterated through the process of determining the fairest price. A note has been made of this inconsistency in the relevant section.

### The evolution of pre-packs

The US and Canada are characterised by DIP, which is a form of post-commencement financing, although this is informally practised in Canada. What distinguishes this form of financing is that it is legislated to be implemented right after filing, but prior to the approval of business plans by the debtor. It furthermore leaves the possession of the business in the hands of management or the directors. The intention is to introduce cash flows into the already distressed company, to avoid further deterioration while the formalities of restructuring are followed. It also helps to dilute the effects of stigma normally associated with distressed companies. Practices related to DIP financing have encouraged distress funders to proactively engage in such funding practices in anticipation of distress. Distress funders, especially in the US, have created hedge funds, with mandates to acquire the existing debts of their

creditors (Moyer, Martin & Martin 2012). In fact, it is common practice for these hedge funds to enter into agreements with creditors from the onset of the debt, with a clause that replaces them as new creditors in the event of distress in a ‘loan-to-own’ strategy (Jiang, Li & Wang 2012).

It appears that this practice has subsequently evolved to the full funding of distressed companies, with the idea of influencing the business plans formulated thereafter by management. In some cases, funders would even be able to introduce their own management team (Jiang et al. 2012). Such a team would be able to sell assets of the business which it deemed surplus to its needs, to help increase the business’s cash flows. In the case of the US, such a sale would happen under Section 363 of the act. An agreement to complete the reorganisation of the distressed company within the shortest possible time is permitted under Section 1126 in Chapter 11 of the act – a process which has subsequently become known as pre-packaged restructuring. The normal definition of a pre-packed process in the US does not include the funding aspect, and strictly relates to a quick process that culminates in a business plan. A combination of sections 363 and 1126 would be used to fund the fast-tracked process of restructuring in what has generally been accepted as a pre-packaged sale.

Having closely followed developments in the US, UK practitioners and companies have over time adopted practices that mirror the US pre-pack sale. However, this has had to be adapted to local legislation. According to Conway (2015), pre-packs in the UK are not specifically provided for in legislation, but have arisen out of practice and judicial approval. Wellard and Walton (2012) argue that it is the ability – under Schedule B of the Enterprise Act (2002) – to appoint an administrator out of court with minimal formalities that has led to the widespread use of pre-packs in the UK. In adapting, rescue-based legislation had to make do with these changes in practice, and practice note SIP 16 was introduced to at least avoid potential fallouts with the creditor community, while allowing developments that brought about speed in resolution as well as the salvaging of jobs and businesses. It should be noted that SIP 16 introduces the only formal and ‘legal’ reference to pre-packs of the four regimes studied.

Canada, on the other hand, has a detailed definition of pre-packs that includes the sale and acquisition of the distressed business. Canadian law on corporate restructurings, while even older than the current US legislation, had to be adapted as the years progressed to accommodate its neighbour’s updated requirements. The CCAA was first introduced in 1933, but due to several amendments now looks a lot closer to the US regime. The Canadians have gone so far as to informally adopt terminology such as ‘DIP funding’ to recognise the debt-related financing of distressed companies. The benefit of adapting has been that they have managed to

make some improvements, such as the introduction of an independent monitor to oversee the sale process, in sections 11.7 and 36. A further improvement is that of being less reliant on the courts to sanction and oversee the entire pre-pack process, making it slightly less expensive. Arguably, pre-packs can also be done based purely on the CBCA, saving even more costs.

Australian legislation governing restructuring, while covered only in the Corporations Act, closely follows that of a fellow Commonwealth country, the UK. This development has gone further to encapsulate even the UK practices of pre-packaged financing, which are very similar. Due to the fact that as in the UK, the restructuring legislation is geared towards business rescue as opposed to corporate rescue, both countries' practice of pre-packaged financing mainly involves transferring the assets of the existing company into a newco, bringing along the same management. (A practice largely criticised for being virtually a phoenix scheme.)

Australia has decided not to legislate further to include governance on pre-packaged financing, and has mainly left the regulation in the hands of practitioner bodies. The effect is obviously a diluted sanctioning in the event of failure to comply – it is, in fact, professional misconduct rather than law-breaking. So, as it stands, Australia has no legislation on pre-packaged financing, yet the practice is prevalent in that country.

The existence of a healthy funding appetite for distressed businesses in these markets appears to fuel most of the activity in pre-packaged financing. Of the four regimes, the US appears to have the most robust distress funding market, dominated mostly by hedge funds and private equity funders. Some non-private equity funders also exist to fund this market. As part of Europe (until Brexit), the UK has experienced a steady flow of funders in this market that have aided the evolutionary growth of pre-packed funding.

Due to the advantages of speed and prospects of a successful corporate or business rescue, pre-packaged financing seems set to be a process that is simply driven by market forces, and legislators may need to be prepared for this eventuality.

## Findings

In explaining the findings, 'pre-packs', 'pre-packaged financing' and 'pre-packaging' will be used interchangeably, as all these terms are used by various authors in the literature.

The data gathered indicate that pre-packaging is generally accepted as a practice in all four regimes, as it has the potential to rescue corporates or businesses speedily enough to give them a better chance of maximising stakeholder returns. While it was

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perhaps not originally intended as currently practised, it is a concept that has evolved in many of these regimes, forcing the hand of legislators and/or the developers of practice guidelines.

In responding to the proposition, the following questions need to be contextualised:

- What is the context in which pre-packaging applies, and is it specific to each of the international regimes?
- What are the common or divergent elements found in pre-packaging in international business restructuring regimes?
- What is the standard required of each participant, in order to achieve set objectives for pre-packaged financing?
- Is there a typical restructuring/administration philosophy that serves as a basis for the successful implementation of pre-packaged financing?
- Are the regulatory conditions in each country made conducive for the implementation of pre-packaged financing?

The themed presentations that follow seek to answer these questions using propositions defined earlier. It is quite clear from the table that all four regimes display both similar and dissimilar rules and applications.

**Table 4:** Schematic comparison of pre-pack principles for US, UK, Australia and Canada

<b>Pre-pack rules and application</b>	<b>US</b>	<b>UK</b>	<b>Aus.</b>	<b>Can.</b>
1. Pre-pack defined by sales of business/corporates	N	Y	Y	Y
2. Judiciary-driven pre-pack practices	Y	N	N	Y
3. Use of new companies to absorb the assets of the former company	N	Y	Y	N
<b>Legislation required</b>				
4. Pre-packs governed by legislation	Y	N	N	Y
5. Pre-pack guidelines	N/A	Y	N	N/A
6. Legislated PCF	Y	N	N	Y
7. Insolvency legislation in tandem with pre-pack concept	Y	Y	N	Y
<b>Rescue culture</b>				
8. Business rescue vs. corporate rescue	N	Y	Y	N
9. Strong creditor protection in pre-pack practices	N	Y	Y	N
10. Existence of strong PCF practices	Y	N	N	Y
11. Established distress funding communities	Y	Y	Y	Y

Proposition 1: Pre-packs are universally defined, and consistently and analogously applied throughout the four regimes

A common motive for pre-packs is that they provide for speed in execution, even though the definition and the means to get there may be different. The US, as the pioneer of pre-packs, did not initially envisage sales of corporates or assets as the key driver of what became colloquially known as pre-packaged bankruptcy, but it soon embraced the inevitable sale aspect. Technically, therefore, pre-packaged bankruptcies in the US do not include sales, but in practice the funding is concomitant, and the entire process occurs as a combination of sections, especially 363 (sale) and 1126 (speedy agreement), within Chapter 11. In practice, their application ultimately produces similar outcomes to those of the other three regimes, which are technically premised on the sales of assets or corporates. The dissimilarities are, however, dichotomous in most respects. For instance, the UK and Australian environments differ from the US and Canadian situation in that their processes are not court driven. Furthermore, the application of pre-packs in both the US and Canada is fully covered in legislation, while in Australia prepacks are not covered at all, and the UK prepacs are covered only by government-sanctioned guidelines. Both the UK and Australia tend to prefer the sale of assets of distressed companies to newcos, based on their respective legislations' bias towards business rescue instead of corporate rescue. In the US and Canada, on the other hand, pre-pack restructurings usually retain the same company, with a few structural adjustments; rarely do new companies result from pre-packs. Therefore, while pre-packs generally embrace a similar definition in practice, their respective applications are different, and made to suit the circumstances and context of each regime.

Proposition 2: Standard legislation is required in order to introduce and apply pre-packs

Apart from the context of a rescue-based regime, no specific legislation is required to introduce and apply pre-packs. Only the US and Canada have legislation that ultimately governs pre-packs, whilst the UK has government-sanctioned guidelines that regularise pre-packs. The UK regulation aims to set standards under which company directors/management and administrators would operate, in order to give some credence and create confidence in the pre-packaged financing process. Without these standards, management and practitioners run the risk of delegitimising the process. For some reason, though, Australia manages to pull through without directly aimed pre-pack legislation. In the US and Canada, the court-sanctioned process ultimately sets and administers the standards of application of pre-packs.

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The US, UK and Canada have insolvency legislation that does not typically contradict pre-packs, and is therefore essentially friendly to pre-packs. Australia's pre-packs, on the other hand, are susceptible to a flouting of insolvency provisions insofar as directors' liabilities are concerned. The UK does have a similar risk in legislation, though in practice it is rarely applied. This could be due, in part, to the fact that the onus lies heavily on the creditors to prove that directors knowingly triggered the insolvency provisions. The US and Canada have legislated for PCF in the form of DIP financing, which has, through an active distress-funding market, interestingly encouraged the expansion into pre-pack financing. The UK and Australia, on the other hand, have not adequately legislated for PCF, with the result that pre-packaged financing has been forced on their regimes, since there were not enough options for funding distressed businesses. The argument could be raised that the lack of adequate legislation has only served to fuel phoenix-type transactions. In most cases the US and Canada seem to apply similar standards to pre-packs, while the UK and Australia work on slightly different standards from the rest and from each other. A major factor is that Australia, even though it works on broadly the same legislation as the UK, does not have pre-pack-regulating legislation or guidelines.

### Proposition 3: The introduction and sustainability of pre-packs are underpinned by a defined rescue culture

Rescue culture does seem to define the method of execution of pre-packs. A case in point is that because of the UK and Australian rescue orientation towards business and not companies *per se*, pre-packs in those regimes are geared towards asset purchases by newcos created specifically for that purpose. A debtor-friendly culture has helped drive the growth in strength of US and Canadian pre-packs with lesser creditor protection, since it is adequately offered by the courts. More creditor caution has been necessary in the UK and Australia due to the strong creditor-protection culture prevalent in those countries. Of particular interest is that there appears to be virtually no PCF culture in either the UK or Australia, with funders and financiers seeming rather more comfortable with early funding engagements, that is pre-packaged financing. An alternative view is that the relative absence of PCF in legislation makes it easier to finance distressed businesses prior to any announcement of filing, as opposed to after the fact. On the other hand, the existence and robustness (especially in the US) of PCF (in the form of DIP) has inadvertently fuelled and pushed for the creation of early-stage funding of distressed corporates (pre-packaged finance) through innovative funding structures. In other words, pre-packaged finance seems to have strengthened the distress-funding process in the US, through a supplementary role to DIP financing. The same seems to have occurred

in Canada. The four regimes have a vibrant distress-funding market, with the US at the stronger end and Australia at weaker end of the spectrum. Nevertheless, these serve as a strong basis for the implementation of pre-packs, with the strongest market providing more pre-pack solutions than the weaker one. It seems clear that in all four regimes culture plays a major role in business rescue or administration, with the existence of a vibrant distress-funding market being very influential in fuelling and sustaining pre-packaged financing. Also worth noting is that the existence and non-existence of PCF in both cultures has, with opposite effects, ultimately helped fuel pre-packs.

### Gaps, inconsistencies and controversies

The following issues have been identified as being either inconsistent or controversial:

- Stalking horse in US sales (inconsistency) – at least one author mentions the sale process in a Chapter 11 reorganisation being a stalking-horse process, but there is no reflection of that in the legislation;
- Pre-packs under the CBCA in Canada: some researchers (Basta et al. 2015) completed a research study on the use of the CBCA (not the CCAA) in Canada for pre-packaged financing. In fairness, this process worked in tandem with a Chapter 11 reorganisation of the same company, having been commenced in the US;
- Phoenix-style criticism in Australia (controversial): several researchers raise this argument but defend it on the basis of the Australian process being very transparent and therefore preventing such practice;
- Wellard and Walton's (2012) argument that there is no real pre-pack in Australia, despite contradicting literature (controversial): further research needs to be done on the incidence of pre-packs in Australia, and whether they are reflective of the true practice; and
- Creditors' approval of a sale in the UK (inconsistency): due to the fact that legislation is silent on pre-packs, and only SIP 16 speaks to this process, little information is available outside of journal articles and the like.

### Discussions and implications for industry

The study is intended to provide key insights into pre-packaged financing, as practised by more established international regimes. These insights could be used to assess the appropriateness of environments or regimens involved in business rescue to allow and regulate pre-packaging. The patterns identified in the four regimes give

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an indication of the circumstances surrounding the seemingly successful practice of pre-packaged financing.

First, many of the regimes had not legislated for pre-packaged financing from the onset, but were affected by pull factors towards such a practice. For new business-rescue regimes there should be an expectation of the creeping in of pre-packs in one form or another, and legislators may need to take note and accommodate more sustainable environments.

Second, despite general similarities in the business-rescue environment, every regime has its own nuances that make it more or less practical to implement pre-packaging. Of more importance is that pre-packs do not seem to require legislation in order to apply in environments with a rescue culture. In fact, they seem to be a reality created by the existence of vibrant investment communities. For a country like South Africa, in particular, business rescue is relatively new. However, the global influence of rescue culture from as near and far as Europe and the US could open doors for the evolution of pre-packs, whether legislated for or not, and legislators would do well to prepare for this eventuality.

## Limitations, future research and implications

### Implications for business

This study is intended to provide insight to stakeholders affected by business rescue or administration, particularly in the developing world where the legislation is fairly new. This is specifically as it relates to funding for financially distressed companies, and the relatively quick turnaround offered by a pre-packaged financing regime. Practitioners and legislators alike need to be equipped to deal with pre-packs, as they continue to spread throughout business-rescue regimes.

It is evident in many of the cases studied that pre-packs are a market-driven phenomenon, and tend to drive their own agenda if not properly anticipated and regulated. It is therefore clear that legislators need to plan ahead in regimes where business rescue or administration is practised.

Pre-packs seem to thrive under different legislative environments, and many regimes already provide the right elements for their introduction either by practitioners or legislators, and legislators may therefore need to ready themselves. A case in point is SA, which has a similar environment to Australia in that directors are called to account for any breach of insolvency provisions. This has not prevented pre-packs from being introduced by practitioners, however, and it can be expected that sooner or later pre-packs will also see the light of day in this country. In such cases, legislators

need to either adapt the legislation to accommodate pre-packs, or take active steps to regulate pre-packs in the event that they occur.

### Research limitations

As with most research, there are numerous limitations to this study. While pre-packaged financing is a growing phenomenon in Europe and Asia, this study focused only on the four aforesaid regimes. Consequently, new factors influencing or affecting the practice outside of these regimes may have been overlooked, as the established regimes studied may not yet account for any new dimensions affecting the phenomenon.

The most significant limitation is that as this was a qualitative study, it relied on available material and therefore author bias can possibly not be discounted. This was further illustrated by one or two authors who were found to disagree.

### Suggested future research

Empirical research needs to be conducted on the use of pre-packs in Australia, measured against the use of directors' liabilities provisions aimed at calling directors to account for trading beyond insolvency. Also, judging from Wellard and Walton's argument that there are no real pre-packs in Australia, an empirical test that follows the pre-pack processes against a set standard may need to be conducted.

For this country, the contextual limitations imposed by the impact of directors' liabilities on the Act of Insolvency need to be studied in depth, along with the lack of governance on sales of businesses and assets, with a view to formulating appropriate recommendations. Sales of distressed businesses and assets seem to transcend these limitations, though, even if it is not yet clear whether these occur as part of pre-packs. An empirical study needs to be conducted to understand the extent of these sales in the South African business rescue scenario, as well as their implications for pre-packs. A further article will seek to investigate this phenomenon.

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