IPA'S RESPONSE
TO THE INSOLVENCY SERVICE'S CONSULTATION/CALL FOR EVIDENCE: IMPROVING THE TRANSPARENCY OF, AND CONFIDENCE IN, PRE-PACKAGED SALES IN ADMINISTRATION

1. The Insolvency Service summarises what it sees as the "problem" as follows:

> "Despite the potential benefits of pre-packs there has been considerable concern amongst creditors, business and the public about their use. Much of the concern is voiced by unsecured creditors who perceive the procedure as not transparent, given that negotiations for the sale take place before the company goes into administration and usually without overt marketing of the assets. Unsecured creditors also have concerns about their inability to have any influence on the process before the sale takes place, and that sales, particularly to the same management team, may be at an under-value.
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> "Concerns have also been voiced by business, particularly competitors of prepacked businesses, that the purchaser obtains a competitive advantage, having 'dumped debts' and consequently reducing their costs. There are also concerns that the economic benefits of pre-packs may be short lived, and that jobs saved in the failed company may be at the cost of jobs lost elsewhere in the economy through the effect on formerly solvent companies who consequently suffer bad debts" (page 4 of consultation document).

2. The solutions proposed by The Service might be summarised as (1) do nothing; (2) and (3) require something more to be done after the event; (4) require something to be done at the event; and (5) require something to be done before the event – with the final solution of banning pre-packs altogether or at any rate to connected parties.

3. Before deciding on which of the Service's options (or another) to follow, we feel it is important to explore further the extent of these concerns, as each option seeks to address different concerns and to different degrees; and whether what the profession and its regulators are being asked to address are:

- widespread problems amongst insolvency practitioners ("IPs") generally; or
- limited problems involving a small number of IPs; and/or
- perceptions of problems; and/or
- creditors just do not like pre-packs – but is that only to the directors and/or connected parties or all pre-packs? – or
- creditors do not like any sales at any time of all or any part of a failed company's business to the directors and/or connected parties.

4. You will be aware that the IPA recently held a forum attended by representatives of a variety of parties interested in the pre-pack process in order to gather a greater understanding of different stakeholders' perspectives. With the benefit of this IPA Forum and the JIC's SIP16 consultation responses, including those from non-IP parties, we should like to add our observations on what we understand concerns some creditors.

5. Pre-packs or Connected Party Sales?

5.1. Almost without exception, the concerns raised by creditors relate to business sales to connected parties, in particular to the directors. Whilst some of the measures might be valuable in relation to pre-packs in general, it would seem that, in order to improve confidence in pre-packs, efforts should be focussed on connected party pre-packs. Some concerns would also appear to arise in relation to post-appointment business sales to connected parties, so we would encourage the Service to consider whether some measures might also be appropriate to those circumstances.

6. Post-Sale Transparency

6.1. SIP16 was introduced on 1 January 2009, but pre-packs have been carried out for many years (not only accompanied by Administrations and even pre-Enterprise Act, albeit to a lesser degree). The SIP16 consultation responses and IPA Forum demonstrate that creditors have observed a marked and welcome change since the SIP was issued, but some of their comments suggest that their view of pre-packs is coloured by a pre-SIP16 history of lack of transparency.

6.2. Although the Insolvency Service's reports suggest that SIP16 compliance remained fairly static over 2009, the IPA's perception as a consequence of monitoring licence-holders is that many IPs' internal systems for generating and reviewing SIP16 disclosures have been strengthened over recent months and we are confident that the overall quality of SIP16 disclosures will improve so that creditors are provided with better explanations and justifications of why a pre-pack was undertaken. Our monitoring also suggests that a consequence of SIP16 has been to encourage many IPs to consider more carefully the rationale behind the pre-pack, and indeed the Administration, route. Consequently, we believe that further time should be allowed for SIP16 to generate the desired improvement to transparency before any far-reaching change to the pre-pack process is decided upon, although we would support the JIC's plan to consider SIP16 in light of its recent consultation.

6.3. Clearly the Service's statistics on the number of disclosures that do not meet all the SIP16 requirements are of concern and demonstrate that IPs can improve on transparency even in relation to the current standards. As a regulator, the IPA welcomes opportunities to work with the Service in order to improve on the compliance figures. In particular, comments made at the IPA Forum suggest that

creditors' perception of pre-packs would be significantly improved if SIP16 disclosures were issued far closer to the sale completion. In this regard, we do not believe that the stipulation of a 14-day deadline (or any other specific timescale) encourages IPs to issue SIP16 disclosures as quickly as possible. It is possible that the new ability to seek approval for the IP's costs incurred pre-appointment, which were introduced to the Insolvency Rules 1986 on 6 April 2010, might facilitate prompt issuing of SIP16 disclosures, as IPs should be more comfortable in carrying out much of the preparation work prior to appointment.

6.4. No doubt, the JIC will take steps to consider whether SIP16 needs to be revised or enhanced now that the consultation has closed. We believe that slavish adherence to the SIP16 "checklist" of required disclosure points runs contrary to the spirit of the SIP and its key principle of providing an explanation and justification of why a pre-pack was undertaken. It seems that, in an attempt to satisfy every last detailed disclosure requirement of SIP16 and Dear IP 42, IPs have sometimes found it necessary to delay issuing the disclosure. The checklist approach also seems to run contrary to the Chancellor's view of regulation; we note that, at his recent Mansion House speech, he expressed a desire for regulation to be "less box-ticking and more exercise of judgement". We believe that a revised principles-based SIP16 would focus IPs' minds on the purpose of the disclosure and thus improve transparency and prompt communication.

6.5. In view of the understandings that some creditors tend not to distinguish between pre-packs and post-appointment sales to connected parties, that the distinction between a pre-pack and a post-appointment sale is not clearly defined, and that transparency of business sales in general surely is desirable, we would urge the JIC also to revise SIP13 (acquisition of assets of insolvent companies by directors) to ensure that it is consistent with the principles of SIP16. Comments made at the IPA Forum suggest that creditors' concerns centre almost entirely on business sales to connected parties. Therefore, we believe that measures to improve transparency and confidence via SIPs should focus on these transactions.

6.6. We believe that these actions, along with regulatory bodies' monitoring of their authorised practitioners' compliance with SIPs and appropriate disciplinary action upon identifying breaches, should go some way to meet creditors' general concerns regarding post-sale transparency. The IPA's regulatory Committees stand ready to use their judgement in regulating pre-packs.

6.7. One of the Service's options is to give statutory force to the disclosure requirements of SIP16 and provide penalties for non-compliance **(option 2)**. SIPs set out basic principles and essential procedures with which IPs are required to comply and departure from a standard set by the SIP may attract disciplinary or regulatory action by the IP's authorising body. We do not believe that the Service has any general doubts regarding the rigorousness with which the regulatory bodies monitor and enforce IPs' compliance with SIPs, therefore transferring the requirements into statute would appear to be unnecessary, unless creditors perceive SIP-compliance in

a different light to statutory compliance. We believe that the Service's annual reviews of IP regulation will do much to enhance creditors' confidence in the regulatory process.

6.8. We accept that transferring SIP16 requirements to statute might also be accompanied by penalties for non-compliance. The Insolvency Act 1986 provides for a number of breaches by the office-holder to attract fines, for example failing without reasonable excuse to attend a S98 meeting (S166) and failing to convene annual meetings in CVLs (S105 (albeit that this has been repealed by the 2010 LRO)). However:

- we are not aware that any such fines have been issued;
- creditors might expect fines to be routinely issued in the event of a statutory SIP16 breach, even if it were a minor breach; but
- we think that it would be difficult, time consuming and potentially costly to secure conviction for breaches where experience of monitoring SIP16 has shown that many cases are matters of judgment rather than of fact; and
- certainly we believe that the risk to IPs of action by their regulatory body is more influential in securing compliance than the risk of a statutory fine.

6.9. The addition of a penalty for non-compliance would also appear to put undue emphasis on the requirements to disclose details of the pre-pack undertaken, rather than seek to address any more fundamental concerns regarding the appropriateness of the pre-pack and the way it was carried out.

6.10. In addition, we suggest that formulating a statutory definition of a pre-pack will be a challenge. Both the IPA Forum and Dr Frisby's research ("A preliminary analysis of pre-packaged administrations", R3, August 2007) indicate that some cases fall in the fringes of what is generally accepted as a pre-pack; it would be disappointing if some IPs sought to avoid full transparency in some cases on a technicality. We believe that such an issue, as well as an appropriate emphasis on the purpose of the disclosure rather than its specific and extensive detail, would be better addressed by a principles-based SIP than carefully designed statute.

6.11. The Service also suggests that the new statute might include a provision that the information be filed at Companies House. We agree that this measure would be useful in improving transparency, but we suggest that it might easily be met by requiring – via a revised SIP16 – that, in addition to early disclosure, the details of the pre-pack be included as an appendix to the Administrator's proposals, which already are filed at Companies House.

7. <u>Pre-Sale Transparency</u>

7.1. The Service has indicated that unsecured creditors perceive the procedure lacks transparency because negotiations for sale take place before the administration

begins and usually without overt marketing, resulting in some doubts as to whether the sale was at an undervalue.

7.2. We believe that, in some circumstances, widespread publicity of a company's fragile position without the moratorium protection of Administration would be so damaging as to jeopardise ongoing trading and/or any pre-pack or at the very least cause a diminution of the business'/assets' value. Whilst some discreet exploration of potential business purchasers is possible in many cases, it is difficult to see how the pre-pack process may be modified in all cases to fully satisfy creditors' desires for pre-sale transparency. Thus, as things currently stand, the IP must be trusted to act with due regard for creditors' interests and perhaps it is this apparent lack of trust that needs to be address in order to build confidence in the process. However, we suggest there is another way, which is currently practised by some IPs, to satisfy creditors that the business was not sold at an undervalue.

7.3. The Administrator and purchaser might conclude a pre-pack sale agreement on the condition that no other party makes a better offer for the business. This condition would specify a time period during which the Administrator is entitled to market the business and consider other offers and during which the sale consideration is held in escrow. If a competitive offer is received, the original purchaser is allowed a further opportunity to improve its offer. The main advantage of such a conditional sale is that the business' trading is not significantly interrupted by the Administration process, thus giving other parties time to formulate offers and enabling the Administrator to satisfy him/herself that, having exposed the business more widely to the market, the sale eventually achieved was in the best interests of creditors.

8. <u>Creditors' Influence</u>

8.1. The Service states that unsecured creditors also have concerns about their inability to influence the process before the sale is completed. The Service's proposal that the pre-pack sale to connected parties should require the approval of the court and/or creditors **(option 5)** would seem to seek to address this concern.

8.2. Although this might jeopardise some pre-packs in view of the time taken to seek approval, if the Service felt that it was essential to introduce a safeguard prior to the sale, this would appear to be the only viable option – and it would be directed to effectively precluding an inappropriate sale, rather than trying to see what might be recovered after the event, using any residual funds in the estates or having to go to creditors for funding. Prior to the Enterprise Act, Administration business sales were possible only with leave of the court or after the creditors had approved the Administrator's proposals covering his/her sale strategy. It might be argued that the barriers to post-Administration trading are greater than previously – companies generally have fewer unencumbered assets, so securing any finance for post-Administration trading is extremely difficult; the risk that a business sale will not be successful is greater, as there are fewer parties interested in acquiring businesses of

insolvent companies; there are some uncertainties around the status of some employee liabilities; and the new Rules introduced on 6 April 2010 provide a new right of challenge of any Administration expenses – and thus it is often impractical to continue to trade the company in Administration for any considerable time whilst proposals are prepared. A cynical person might think that an IP, attracted to the prospect of significantly enhanced fees for undertaking post-Administration trading, might find a way to overcome such obstacles. However, the rareness of post-Administration trading indicates that this is not the case (although we would maintain that the vast majority of IPs have higher ethical standards than to choose strategies based on fee prospects). Whilst we would not want to see businesses close because of the delay in seeking consent, we appreciate that recent case precedents (e.g. DKLL) suggest that the courts may be prepared to consent to a business sale in more pressing circumstances, although we do wonder whether the courts are equipped and prepared to handle quickly an influx of applications seeking approval of commercial proposals. Court approval would also be preferable to unsecured creditor approval, as there would be a smaller risk of challenge to the decision. However, if a secured creditor has approved the sale and the unsecured creditors have no direct financial interest in the insolvency, we do not believe that incurring the costs and delay of seeking also the court's approval would be appropriate.

8.3. The Service suggests that the consent of the court or a proportion of unsecured creditors might be required before executing a pre-pack sale to a connected party. We agree that, in some circumstances, this approach would shift the balance inequitably towards unsecured creditors who may have no direct financial interest. In addition, as it would take some time for the Administrator to seek unsecured creditors' approval – perhaps around 14 to 28 days – we wonder whether Administrators might be more attracted to conducting quick post-Administration business sales that do not meet the statutory definition of a pre-pack (whatever that might be). Whilst this shift in practice might be attractive, would it perhaps simply shift creditors' concerns over pre-packs to post-Administration business sales in general? Indeed, this provision might make creditors more sceptical of an Administrator choosing to conduct a post-Administration business sale, as he/she would not need to seek the approval of the creditors or the court.

9. <u>Should Pre-packs be banned?</u>

9.1. Some creditors feel that pre-packs (presumably only to directors) are unjust. As the Service's consultation puts it, "the purchaser obtains a competitive advantage, having 'dumped debts'."

9.2. We note that the Service proposes to extend the effect of S216 also to companies that enter Administration and that do not continue as a going concern (S Leinster's letter of 18 March 2010). This would seem to address the current disparity between phoenixes in Liquidations and those in Administrations. If the Service were to consider that stronger measures were necessary to curb pre-packs in

Administrations, we suggest that it should also consider whether those measures equally apply to Liquidations, Administrative Receiverships, and to post-appointment business or asset sales to directors.

9.3. The Service also identifies the concern that "the economic benefits of pre-packs may be short lived". Is the Service alluding here to the suggestion by Dr Frisby ("A preliminary analysis of pre-packaged administrations", R3, August 2007), albeit inconclusive in view of her sample size, that pre-pack purchasing companies may suffer a greater frequency of failure than post-Administration business purchasers? If so, then it is difficult to see how Administrators may be required to take this potential consequence into consideration when deciding on a pre-pack. The Administrator's responsibilities are to regard the interests of the company's creditors alone. Of course, if a sale involved deferred consideration, then it would be in the creditors' interests to ensure that the purchasing company remains able to make payment (or to adequately secure the assets/consideration). However, if there were no direct impact on the insolvent estate, should the purchasing company's future be of concern to the Administrator? Surely he/she would be in breach of his/her responsibilities, if he/she were to refuse to sell to a purchaser, with the consequence of reduced realisations and thus lower dividend to creditors, because he/she was not confident that the purchasing company was capable of continuing to trade over a lengthy period. Although, clearly, far more extensive enquiries should be undertaken before taking such a drastic step as banning connected party pre-packs, it would seem that this would be the only way such concern might be eliminated (although research into outcomes would be useful).

9.4. The Service continues: "and that jobs saved in the failed company may be at the cost of jobs lost elsewhere in the economy through the effect on formerly solvent companies who consequently suffer bad debts". Essentially this is an issue for economists to set their minds to: if the evidence supports the proposition, then it is a matter for the government to reach its conclusion on whether it should follow that *all* pre-packs should effectively be banned.

9.5. However, there may a positive result if pre-packs involving purchases by existing management teams were prohibited. Some may have a negative view of pre-packs because they feel that it provides directors with an easy escape route from existing debt that results in practically no change to the business' operations. If directors had no option to purchase the business via a pre-pack, the only way they might remain in control of an ailing business is to propose a CVA. Creditors would then have an opportunity to express their opinion on whether they wished to support the company through its difficulties. Such a measure might also incentivise directors to seek assistance at an earlier stage, when a CVA is more viable, rather than waiting until the situation is so hopeless that the company cannot possibly survive.

9.6. If the Service decides that pre-packs and similar practices should be allowed to continue (and on balance we believe they should), it must be accepted that some creditors will always object to them in principle.

9.7. Apparently without exception, the IPA Forum attendees saw the benefit of a pre-pack in the right circumstances and when conducted properly. What appears to be lacking is confidence that all IPs do pre-packs only when it is appropriate and using acceptable standards of professional behaviour. Whilst paragraph 2 of SIP16 requires IPs to take courses of action that are justifiable, we suggest that the regulators do more to provide guidance on acceptable standards of practice surrounding pre-packs, for example, what kinds of circumstances are appropriate to a pre-pack and what constitutes appropriate marketing. There is also the perception that some companies are placed into Administration when Liquidation would appear more appropriate. Unless there is post-Administration trading, it is unlikely that these two procedures would generate materially different dividends to creditors, however there is certainly a greater degree of creditor engagement in the Creditors' Voluntary Liquidation ("CVL") process. Consequently, guidance from the regulators may help redress the balance so that, where appropriate, the preferred option is CVL.

10. <u>Is the Pre-pack process being Abused?</u>

10.1. Of course, it is possible that some creditors' views that directors acquire businesses "on the cheap" have some foundation. It is perhaps inevitable that some will be suspicious of a pre-pack sale to directors, given that often an insolvency practitioner is first approached by the company directors, who may have the power to appoint an Administrator, and that, until recently, the IP was often dependent upon the company to pay his/her pre-Administration costs. We believe that the 2010 Rules providing for pre-Administration costs to be approved by creditors and discharged by the insolvent estate should go some way in dispelling creditors' fears that the IP is in "cahoots" with the directors.

10.2. Although, of course, it is very important to us that the reputation of IPs in general is enhanced, we do wonder how widespread this suspicion of abuse is and whether there have been any identified examples of pre pack abuse. We watch with interest the progress of the investigations of the Service's Corporate Complaints Team, which is described in its reports on the operation of SIP16. In addition, the IPA's monitoring team will continue to be on the look-out for evidence of abuse involving an IP.

10.3. Comments made at the IPA Forum suggest that there have been occasions when directors approach IPs, having already decided to proceed with a pre-pack, perhaps having taken advice on how to organise affairs so that it is probable that the directors' offer to purchase the business will be successful, and possibly knowingly continuing to trade to the detriment of suppliers. It is evident from the internet that there are unregulated advisers who market themselves as being able to help directors successfully retain a business via a pre-pack. We would urge the Insolvency Service to take action against such parties.

10.4. Although, regardless of the route of introduction, an IP might still draw his/her own conclusion that a pre-pack to the directors is in the creditors' interests, clearly the existence of such questionable practices does nothing to instil confidence in the process. It is therefore essential that regulatory bodies act decisively when they encounter evidence of IPs supporting directors in abusing the pre-pack process or failing to submit appropriate D-reports. Although we might come across such evidence in monitoring visits, it is important that creditors – and anyone else seeing abuse – lodge complaints to enable regulatory bodies to take action. It is recognised that disciplinary action will not remedy any damage caused, so it is desirable that victims pursue actions via the courts and/or contact the Insolvency Service's Hotline.

10.5. The Insolvency Service proposes two options to introduce an independent party to the process. The first option is that, following a pre-pack Administration, the exit should be restricted to compulsory liquidation so as to achieve automatic scrutiny of the directors' and Administrators' actions by the Official Receiver ("OR") **(option 3)**.

10.6. Given the very small number of actual cases where there might appear to be a question about the adequacy of the purchase price, this would appear to be a totally disproportionate, and costly, response:

- There would be for example where there were funds in the hands of the Administrator to hand over to the OR of say £100,000 Insolvency Service fees payable of some £22,000 – whether or not any sale at an undervalue or other impropriety was identified.
- Disqualification proceedings, funded out of general taxation, take on average 19.5 months to be launched; and from The Service's own reports on the operation of SIP 16 there can be few cases which would meet the public interest test. However, to provide the suggested scrutiny would involve significant additional resource within the Service to review all pre-packs in the first instance.
- Civil recovery proceedings would have to be funded out of any estate funds or otherwise by the creditors.

10.7. In fact, the requirement that all pre-packs exit to compulsory liquidation to enable the OR to review the process might damage creditors' confidence because, as legislation currently stands, the creditors have the opportunity to seek the appointment of their own choice of IP as liquidator in the event that the Administration moves to CVL. However, it may be appropriate in circumstances where concern has been raised about a particular pre-pack for the Administration to exit via compulsory liquidation, rather than move to dissolution. Such a step can be taken by creditors proposing modifications to Administrators' Proposals.

10.8. We suggest that, in some circumstances, an alternative scrutinising party would be an IP acting as liquidator once the Administration has moved to CVL. This

approach would reduce costs to the estate that would be incurred if the exit route was only Compulsory Liquidation. As mentioned above, at present creditors can nominate their choice of liquidator when the Administrator makes his/her proposals, provided the Administrator intends to exit via a CVL, which would occur only where he/she anticipated a dividend to unsecured creditors. However, to ensure that creditors are not left with the burden of searching for an independent IP – although, of course, they would still have that power – it would appear a fairly straightforward measure to prohibit the Administrator from becoming the subsequent CVL liquidator in circumstances involving a pre-pack, as this prohibition might be introduced by amending the authorising bodies' Insolvency Ethics Code.

10.9. A disadvantage of both these approaches relates to the time that would elapse between the conclusion of the pre-pack sale and the commencement of the OR's or independent IP's involvement. It is presumed that a petition or move to CVL would need to follow the submission of the Administrator's proposals to creditors. Therefore, even in the most straightforward of cases, the liquidation would start a few months after the sale. We suggest that successfully proving, presumably against the Administrator, that his/her actions in completing a pre-pack sale had caused the estate to suffer loss and quantifying that loss likely would be extremely difficult even immediately after the sale, but it is difficult to envisage such an attempt being successful after a few months. Below, we highlight an existing route that might be modified to enable action to be commenced much closer to the pre-pack sale.

10.10. Another of the Service's options, which would seek to stop inappropriate pre-packs from occurring, is to require different IPs to undertake pre and post-Administration appointment work **(option 4)**. The consultation document indicates that some perceive that there is a conflict of interest in an IP advising on the use of a pre-pack Administration and subsequently being appointed Administrator. It is suggested by some that the IP has a vested interest in advising the company to enter into Administration as they stand to benefit in the fee income from the appointment. We suggest that this can be the perception in almost all cases where an advising IP is involved pre-appointment and, in some cases, the conflict will be real; it is one reason why authorising bodies take compliance with the principles of the Ethics Code most seriously.

10.11. We find it difficult to understand why the position is different where a pre-pack is involved; the consultation document suggests that there is "particular concern in pre-packs, where the majority of the work of the office-holder is concentrated in a relatively brief period of time prior to formal appointment in agreeing the sale". Would the perception of conflict of interest be any less in the event that the business sale process was carried out after appointment by the same IP as advised the company to enter into Administration? Given that an IP's pre-appointment and post-appointment fees are subject to much the same scrutiny and approval process

10.12. The consultation document states that "the initial IP would advise the company/QFCH and assist in the preparation of the pre-pack… The subsequent IP would then take the formal appointment as Administrator and complete the sale, if satisfied that it was in the best interests of creditors". The prospective Administrator would still need to be involved prior to appointment to enable him/her to be satisfied so that the sale could be completed immediately upon appointment. As mentioned in the consultation document, likely this would increase the costs of both the IPs pre-appointment (which likely would be borne by the estate), as efforts would be duplicated, and the process might be extended which might jeopardise the pre-pack and/or the company's ongoing trading. Also, if both IPs were communicating prior to appointment, we are very doubtful whether this arrangement would be sufficient to reduce the perception of conflict of interest of the prospective Administrator, particularly if the second IP had been introduced to the engagement via the first IP or the company/QFCH.

10.13. In summary of Options 3 and 4, we do not believe that an appropriate measure would be to enable the OR routinely to scrutinise pre-packs via subsequent compulsory liquidations, although perhaps more might be done to ensure that independent IPs are appointed as liquidator where Administrations involving pre-packs exit to CVL. In addition, whilst the introduction of a different IP to the Administration prior to appointment would enable scrutiny at a much earlier stage, we do not believe that the second IP would be seen as sufficiently at arms'-length to counteract the perception of abuse.

10.14. What of course is already in place is an independent consideration of cases – whether pre-packs or post-Administration sales – where there are real grounds for concern and complaint. In its 6-monthly reports on the operation of SIP16, the Insolvency Service has reported its work in considering D1 reports and the work of the Corporate Complaints Team in considering complaints lodged via the Insolvency Service Hotline. It is likely that over the past year, as a consequence, the public's appreciation of the work carried out by these departments has grown and we wonder whether this might provide the independent scrutiny that appears to be necessary to improve confidence in the pre-pack process. Would it be possible for the Insolvency Service to accelerate consideration of the D-reports in the event that there had been a pre-pack, and particularly if a complaint had been lodged?

10.15. Of course, if creditors suspect that the Administrator has colluded with the directors to complete a sale that is not in their interests, then simple reliance on the Administrator's D-return will not help bring it to the Service's attention. Creditors must be encouraged to bring their complaint to the IP's authorising body and/or to the Insolvency Service Hotline.

10.16. It might be made mandatory (perhaps via a revised SIP16) for Administrators to ensure that, when they provide to creditors details of the pre-pack, they also make creditors aware of the complaints hotline and invite creditors to make complaints direct to the Insolvency Service. We would also welcome information on such complaints, so that we may target our monitoring efforts accordingly. Whilst it is accepted that the Insolvency Service would still be faced with the difficulties of taking appropriate action on deciding that the conduct of directors or IPs had been found wanting, we suggest that such action would be more likely to succeed if it were commenced as close to the pre-pack as possible.

11. Summary

11.1. Our preferred option is option 1, by which we mean that we do not support the proposals to make significant statutory changes and certainly not before there have been more consideration and research into the extent and source of the concerns – see paragraph 3. However, as mentioned above, we do believe that some minor adjustments to the current processes would improve transparency and confidence in pre-packs. In particular, we suggest a change to the Insolvency Ethics Code to prohibit an Administrator who was involved in a pre-pack from accepting the appointment as a subsequent Liquidator on the company's move from Administration to CVL (paragraph 10.8).

11.2. Above and summarised below, we have suggested a number of alternative measures that we feel ought to be considered, as we believe they have significant potential to improve transparency and confidence. The vast majority also have the advantage of being relatively simple and inexpensive to introduce and implement. We believe such measures should be explored first, before more substantial and costly measures, many of which attract the risk of unintended consequences, are progressed.

- A revision of SIP16 to ensure that it emphasises a prompt and reasoned explanation and justification of the pre-pack and other business sales, particularly those to connected parties (paragraphs 6.4, 6.5 and 6.10)
- The use of a conditional sale agreement to allow the Administrator an opportunity, post-sale, to explore other interest (paragraph 7.3)
- The extension of S216 of the Insolvency Act 1986 to Administrations that do not result in a survival of the company as a going concern (paragraph 9.2)
- Enhancing the attraction of CVAs to directors who wish to continue to remain in control of the business (paragraph 9.5)
- The provision of more guidance from the regulators in relation to the pre-pack process (paragraph 9.7)
- Decisive action against parties – IPs and unregulated advisers – who carry out abusive practices (paragraphs 10.3 and 10.4)
- Increased awareness of creditors' rights to complain and/or challenge (paragraphs 10.4, 10.15 and 10.16)
- A change to the Insolvency Ethics Code to prohibit an Administrator who was involved in a pre-pack from accepting the appointment as a subsequent

Liquidator on the company's move from Administration to CVL (paragraph 10.8)

- An accelerated process of review of D-reports in pre-pack cases (paragraph 10.14)
- A greater exchange of information between the regulatory bodies (paragraph 10.16)

The IPA's Response to the Consultation Questions

Question 1: **Do you believe that the current framework governing the operation of pre-pack sales in administration provides a sufficient level of confidence that pre-packs are only being used in appropriate circumstances and with an appropriate degree of transparency?**

We believe that the current framework is adequate for generating a sufficient level of confidence in pre-packs. We accept that, as the situation currently stands, confidence is at a disappointing level, but we are confident that, given time, this will improve. We do not believe that the framework needs changing, but we do believe that some minor adjustments would assist. These are discussed in paragraphs 6.2-6.6, 9.2, 9.7, 10.4, 10.8, and 10.14-10.16.

Question 2: **If not, what are your main concerns with the way pre-packs are currently executed?**

N/A

Question 3: **Do you believe that pre-packs are presently subject to abuse? If so, how? Please indicate whether you believe it is the actions of directors, insolvency practitioners, secured lenders or any other parties that are contributing to any perceived or actual abuse and to what extent you believe this is a problem.**

Our views on the potential for abuse and our concerns regarding current abusive practices and those that contribute to perceived abuse are described in paragraphs 10.1-10.4.

Question 4: **Some of the following options would require a distinction to be drawn between pre-packs and 'conventional' administrations. What do you think should be included in a statutory definition as to what constitutes a pre-pack transaction?**

The current SIP16 makes a valiant attempt to define a pre-pack. However, we believe that a solution to improving confidence does not necessarily lie in attempting to address only the pre-pack process; we believe that connected-party sales in general result in some creditor dissatisfaction and it might be argued that transparency of all business sales should be improved. Therefore, we favour principles-based solutions, rather than those that treat pre-packs differently from other business sales. Our further comments on the challenges of creating a distinction are described in paragraphs 5.1, 6.5, and 6.10.

Question 5: Do you believe that the new pre-appointment cost recovery mechanism will have a significant effect on transparency and confidence?

No – it is clear to us that transparency and confidence are only improved by early communication. The new provision for pre-appointment cost recovery requires disclosure of matters handled pre-appointment in the Administrator's Proposals. Therefore, this disclosure occurs too late in the process to meet creditors' expectations. The effect of the disclosure requirements of SIP16 is that creditors will have already received the relevant information and in *all* pre-pack cases, not only those for which the IP is seeking payment. As described in paragraphs 6.3 and 10.1, however, the new Rules may have a minor effect.

Question 6: Do you believe that by giving statutory force to the SIP 16 disclosure requirements creditors would be given better information about the reasons and justification for the pre-pack?

No – we believe that this action would, at best, have no discernible effect and, at worst, would detract from the need to provide adequate reasons and justification for the pre-pack. Our reasons are described in paragraphs 6.4, 6.7, and 6.10.

Question 7: **Do you believe that such a requirement will increase costs and reduce the returns available to (a) secured creditors, and (b) unsecured creditors? If possible, please provide an estimate of the impact on each.**

The cost increase would be insignificant, as it would only involve an additional filing with the Registrar of Companies.

Question 8: **Do you believe that it would be appropriate for details of the pre-pack to be filed at Companies House? If not, why not?**

Yes – however, this could be achieved by a small change to SIP16 to ensure that the Administrator's Proposals also include the information – see paragraph 6.11.

Question 9: **Do you believe that it would be appropriate for a statutory offence to be created in circumstances where the pre-pack disclosure requirements are not adequately met?**

No – as we do not believe that such a measure would improve transparency and confidence – see paragraphs 6.8 and 6.9.

Question 10: **Do you believe that confidence in pre-packs would be improved by requiring companies whose business and assets had been sold through a pre-pack to exit administration via compulsory liquidation? What would be the possible costs and benefits?**

No – our reasons are described in paragraphs 10.6, 10.7, and 10.9.

Question 11: **Do you believe that an insolvency practitioner providing advice to a company on the potential for a pre-pack has an inherent conflict**

of interest when accepting a formal appointment as administrator with a view to subsequently executing a pre-pack sale?

No – there is no inherent conflict, although there is a risk that the pre-appointment work on a particular company might lead to a conflict that would make accepting the appointment inappropriate. We believe that this issue is already adequately covered in the Insolvency Ethics Code. As we explain in paragraphs 10.10 and 10.11, we do not see this issue as unique to pre-packs.

Question 12: If so, do you believe that such a conflict extends to circumstances where the insolvency practitioner has had an ongoing prior relationship with the company in the context of undertaking review work for a secured lender?

N/A – however, we would like to point out that we believe the Insolvency Ethics Code also appropriately addresses this scenario.

Question 13: **Do you believe that a requirement for a different insolvency practitioner to accept appointment as administrator would improve confidence that pre-packs are only used in appropriate circumstances?**

No – our reasons are described in paragraphs 10.12 and 10.13.

Question 14: **Do you believe the requirement to use two separate insolvency practitioners would increase costs and delay therefore reducing the returns available to (a) secured creditors, and (b) unsecured creditors? If so, please provide an estimate of the impact on each.**

Yes – but it is difficult to estimate the impact on the returns available to each class of creditor.

Question 15: Do you believe the requirement to use two separate insolvency practitioners would reduce the number of business sales effected through a pre-pack sale? If so, please provide an estimation of the impact.

It is difficult to estimate the impact. However, it is clear that the more barriers that an IP encounters in seeking to rescue a business by the pre-pack mechanism, the less likely he/she will be to use it.

Question 16: Is it desirable that unsecured creditors, who may not stand to receive any dividend from the proceedings, be given an opportunity to influence the proposed pre-pack sale where the business is being purchased by a connected party? If so, why?

No – our reasons are described in paragraph 8.3.

Question 17: Should approval for such a sale initially be sought from unsecured creditors with a recourse to the court, or from the court in the first instance? If you believe unsecured creditors should be given the opportunity to approve in the first instance, what percentage in value of their claims should be required for approval to be obtained?

We do not see either approach as attractive, but we would prefer court approval to unsecured creditor approval. Our reasons are described in paragraphs 8.2 and 8.3.

Question 18: Would the prior approval of the court or creditors for the proposed sale improve confidence that pre-packs are only used in appropriate circumstances?

Yes – however, we do not believe that these would be proportionate measures. There are other ways of improving confidence that will not adversely affect the costs, delays, and effectiveness of the pre-pack process.

Question 19: Do you believe the requirement to obtain court or creditor approval would increase costs and delay therefore reducing the returns available to (a) secured creditors, and (b) unsecured creditors? If so, please provide an estimate of the impact on each.

Yes – but it is difficult to estimate the impact on the returns available to each class of creditor.

Question 20: Do you believe the requirement to obtain court or creditor approval would reduce the number of business sales effected through a pre-pack sale? If so, please provide an estimation of the impact.

It is difficult to estimate the impact. However, it is clear that the more barriers that an IP encounters in seeking to rescue a business by the pre-pack mechanism, the less likely he/she will be to use it.

Question 21: Do you believe that any provision requiring the prior approval of the court or creditors for business sales to connected parties should be extended to apply to such sales out of all formal insolvency procedures (i.e. not restricted solely to administration)? If so, why?

As described above, we feel that a requirement to obtain prior approval of the court or creditors would be a disproportionate measure to take in order to tackle the issue of transparency and confidence.

Question 22: Do you believe that a requirement to obtain court or creditor approval for a pre-pack business sale to a connected party should be combined with the attachment of personal liability to directors and connected parties who purchase a business without obtaining the requisite approval?

As described above, we do not favour the introduction of court or creditor approval. However, we agree with the Insolvency Service's earlier proposal to extend the provisions of S216 (and consequently S217) of the Insolvency Act 1986, as described in paragraph 9.2.

Question 23: Do you believe that it would be appropriate for pre-pack business sales to connected parties executed without the requisite approval to be rendered void?

No – this would seem unnecessary in the event that a contravention of S216 – as extended to Administrations – attracted personal liability under S217

Question 24: To what extent do you believe that pre-packs provide a positive contribution to the wider economy by allowing economically viable parts of insolvent companies to continue trading? How would you quantify such a contribution? Please provide any evidence you may have to support your comments.

We would refer the Insolvency Service to the research of Dr Sandra Frisby, "A preliminary analysis of pre-packaged administrations" (R3, 2007).

Question 25: To what extent do you believe that pre-packs create market distortions by allowing companies to 'dump debts' and continue trading to the detriment of competitors? How would you quantify this? Please provide any evidence you may have to support your comments.

We have no evidence that would enable us to provide a reasoned answer.

Question 26: **To what extent do you believe that pre-packs create job losses 'upstream' by allowing companies to 'dump debts' and continue trading to the detriment of suppliers who then experience knock-on financial difficulties? How would you quantify this? Please provide any evidence you may have to support your comments.**

The company's insolvency inevitably impacts suppliers, who may then experience knock-on financial difficulties, and we would suggest that it is this impact that generates the greatest creditor unhappiness. We cannot see how a business rescue would result in creditor suppliers being in a worse position than they would have been had the business not been rescued.

Question 27: To what extent do you believe that any economic value preserved by a pre-pack sale (e.g. employees, customers, suppliers) would otherwise transfer to alternative ventures (e.g. competitors) if a pre-pack sale was not undertaken? Please provide any evidence you may have to support your comments.

We have no evidence to enable us to comment materially. However, we suggest that any transfer would by no means be complete, so pre-packs must represent a better outcome overall. We also suggest that such considerations might also be relevant to other business sales (i.e. not involving a pre-pack), so if there were considered any merit in the transfer of economic value to alternative ventures, it would raise fundamental questions about the concept of corporate rescue in general.

Question 28: **Do you believe that any of the options identified would have a significant impact on the behaviour of secured lenders? If so, what do you think this is likely to be? If possible, please provide an estimation of the impact.**

We believe that, if secured lenders are unable to maximise their recoveries from the pre-pack process because of the introduction of additional barriers, they may be encouraged to explore other mechanisms, which might not be as rigorously regulated.

Question 29: **Which of the five proposed options would be your preferred solution(s), and why?**

Our preferred option is option 1, by which we mean that we do not support the proposals to make significant statutory changes and certainly not before there have been more consideration and research into the extent and source of the concerns – see paragraph 3. However, as mentioned in our answer to question 1, we do believe that some minor adjustments to the current processes would improve transparency and confidence in pre-packs. In particular, we suggest a change to the Insolvency Ethics Code to prohibit an Administrator who was involved in a pre-pack from accepting the appointment as a subsequent Liquidator on the company's move from Administration to CVL (paragraph 10.8).

Question 30: Are there any alternative measures that you believe ought to be considered?

In our full response, we have suggested a number of alternative measures that we feel ought to be considered:

- A revision of SIP16 to ensure that it emphasises a prompt and reasoned explanation and justification of the pre-pack and other business sales, particularly those to connected parties (paragraphs 6.4, 6.5 and 6.10)

- The use of a conditional sale agreement to allow the Administrator an opportunity, post-sale, to explore other interest (paragraph 7.3)
- The extension of S216 of the Insolvency Act 1986 to Administrations that do not result in a survival of the company as a going concern (paragraph 9.2)
- Enhancing the attraction of CVAs to directors who wish to continue to remain in control of the business (paragraph 9.5)
- The provision of more guidance from the regulators in relation to the pre-pack process (paragraph 9.7)
- Decisive action against parties – IPs and unregulated advisers – who carry out abusive practices (paragraphs 10.3 and 10.4)
- Increased awareness of creditors' rights to complain and/or challenge (paragraphs 10.4, 10.15 and 10.16)
- A change to the Insolvency Ethics Code to prohibit an Administrator who was involved in a pre-pack from accepting the appointment as a subsequent Liquidator on the company's move from Administration to CVL (paragraph 10.8)
- An accelerated process of review of D-reports in pre-pack cases (paragraph 10.14)
- A greater exchange of information between the regulatory bodies (paragraph 10.16)

The vast majority of these measures also have the advantage of being relatively simple and inexpensive to introduce and implement. We believe such measures should be explored first, before more substantial and costly measures, many of which attract the risk of unintended consequences, are progressed.

Question 31: Please provide an indication (if not obvious) as to the nature of your involvement in, or exposure to, pre-pack transactions and the approximate incidence of that involvement or exposure if relevant.

In addition to the IPA's exposure to pre-packs via its monitoring and disciplinary functions and the fact that a number of its Committee members, who were involved in considering this consultation, act as Administrators and sometimes engage in pre-pack sales, we found it particularly helpful to explore different stakeholders' perspectives via the IPA Forum held on 16 June 2010.

IPA Secretariat
24 June 2010