IMPROVING THE TRANSPARENCY OF, AND CONFIDENCE IN, PRE-PACKAGED SALES IN ADMINISTRATIONS

Comments by the Association of Business Recovery Professionals ('R3') in response to the consultation document issued by the Insolvency Service in March 2010

Introduction and Option 1

1. The consultation document invites views on ways in which the transparency of pre-packs, and confidence in pre-packaged sales, can be improved. The document notes two factors that already encourage transparency. These are Statement of Insolvency Practice 16, and the new rules requiring disclosure of pre-appointment work in the administrator's statement of proposals. Taken together, these support of the first suggested option, which is to make no change to current arrangements. Whether this will be perceived by the wider business community as a satisfactory response is a matter for government to decide.

Option 2 – Giving statutory force to the SIP 16 disclosure requirements

2. The important point to note about SIP 16 is that it does not just set out a list of items to be disclosed for its own sake, but is intended to influence the conduct of practitioners involved in setting up a pre-packaged sale at the time the transaction is entered into. Its purpose is to try to ensure that pre-packs are only undertaken where they can be fully justified and are in the best interests of creditors. The effectiveness (or otherwise) of SIP 16 should therefore be judged by whether there is a decline in the number of pre-packs which are perceived as being unjustified. We are not aware that data is currently available to make this assessment.

3. As far as we are aware, the vast majority of insolvency practitioners are complying with the SIP 16 requirements, and it is therefore reasonable to suppose that it is having the desired effect on pre-appointment conduct when considering whether pre-pack arrangements are appropriate. If this is so, it is unlikely that giving statutory force to the disclosure requirements will lead to any substantial change in the number of perceived unjustified pre-packs.

4. Giving statutory force to the SIP 16 requirements implies that the regulatory bodies are not currently taking effective action in cases of non-compliance. We are not aware of any evidence that this is the case. Moreover, the regulatory bodies are able to impose a range of sanctions, including fines in excess of the statutory penalties laid down for breaches under the Insolvency Act.

5. Statutory provisions would also suffer from inflexibility. It would be difficult to change them to reflect changed business circumstances.

6. We therefore doubt the merits of giving statutory force to the disclosure requirements However, if it is decided to proceed down this route, it will be important to ensure that penalties are proportionate to the relevant breach and there is no risk of draconian sanctions for minor infringements.

Option 3 – Restricting exit to compulsory liquidation

7. It appears that the aspect of pre-packs that creditors dislike the most is where there is a sale to a connected party. We can therefore see some justification for independent scrutiny of the transaction after the event in such cases. Such scrutiny would best be carried out by a liquidator appointed following the administration. In order to demonstrate independence where there has been a sale to a connected party, the administrator should not be able to take the dissolution exit route or be allowed to act as liquidator unless creditors are content for this to happen. However, we see no reason to restrict the exit route in such cases to compulsory liquidation. This is often not the best option for creditors because of the effect of the Secretary of State fees, and we would also allow exit through creditors’ voluntary liquidation.

8. We think there is a case for increasing creditor involvement by amending the Insolvency rules to require the administrator to explain the proposed exit routes to the creditors, and obtain their approval shortly prior to the end of the administration. Currently, administrators’ proposals tend to leave the exit route to the administrator’s discretion.

Option 4 – Require different insolvency practitioners to undertake pre- and post-appointment work

9. We can see no benefit in this. The only reason there can be for undertaking a pre-pack is that it is in the best interests of the creditors. If one insolvency practitioner reaches this conclusion after undertaking the necessary preliminary work, we cannot see what useful purpose is served by having a different practitioner complete the sale and doing the rest of the post-appointment work. Any delay in completing the sale, or decision to abort it, is only likely to be harmful to the business and will undoubtedly duplicate costs.

Option 5 – require the approval of the court or the creditors for pre-pack sales to connected parties

10. The courts have made it clear on a number of occasions that they are

unwilling to make commercial decisions or question commercial judgements made by insolvency practitioners. It is hard to see what a judge would be expected to do when confronted by a statement from an insolvency practitioner that the proposed pre-pack is in his judgement the best option for the creditors, especially in the absence of any argument to the contrary.

11. In most cases, negotiations for a pre-packaged sale have to be carried out in confidence, and by definition the process takes place in the period before the company enters formal insolvency. If the strategy is to be successful and the business is to survive, it is crucially important to avoid precipitate action by creditors. Requiring the approval of creditors to the proposed pre-pack is likely to lead to just such an outcome, and for this reason we think this is an unrealistic option.

Conclusion

12. It is a fact of commercial life that in order to achieve the best return for creditors an accelerated sale through a pre-pack will sometimes be the best option. Any measures taken to impede this are likely to be to the detriment of creditors. Although the consultation document is aimed at pre-packs generally, the main focus should be where there is a sale to a connected party, as this is the principal cause of creditor discontent. We remain of the view that increasing transparency and strengthening creditor participation is the best approach to this problem as exemplified by SIP16 and the amendments to the Insolvency Rules.

Association of Business Recovery Professionals
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