



Corporate Turnaround and Insolvency

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Pre-pack reforms delayed until 2012 - why all the fuss?

The Insolvency Service has announced that the planned reforms to pre-pack sales in insolvency situations are to be pushed back until 2012, in face of the strongly worded objections on a number of fronts. We can expect further consultation later in 2011, but what's all the fuss about and what is at stake?

Background

Pre-packs have, of late, become almost synonymous with administration, and have certainly made the headlines. From the point of view of insolvency practitioners and an insolvent company, they offer the advantages of speed and certainty, minimising the loss of value and goodwill endemic in trading insolvencies. The process involves the negotiation of the sale of the company's business and assets prior to appointment of an administrator, with contracts being concluded immediately on appointment, thus preserving creditor value and jobs and reducing the risk of detrimental action by disaffected creditors.

They have not been without controversy, however, and key objections from creditors (particularly unsecured creditors) include their perceived disenfranchisement – that they get no warning and so no opportunity to mitigate loss. The first many will hear about it is upon receipt of the first communication from the administrator – a *fait accompli*. Many have complained that pre-packs are a “stitch up” which allow the existing business owners to resurrect their failed businesses without personal consequence, leaving their disgruntled creditors behind. Added to which, there is often no marketing process to test true “market value”. The proposed administrator also has a perceived conflict of interests and lack of accountability, and such sales do not address whether the underlying business is a viable one, or whether a comprehensive review of the business model is needed.

The Insolvency Service consultation

To address some of these concerns, the Joint Insolvency Committee brought in its Statement of Insolvency Practice 16 (SIP 16) in January 2009 to provide some visibility to creditors on the detail of the pre-pack. Albeit this was still communicated after the event and was in the nature of professional guidelines rather than having the force of law.

Given the prevailing economic conditions and the increased use of pre-packs during the current recession, The Insolvency

Service (TIS) recently consulted on how to give further protection to creditors, with the original intention being to give SIP 16 the force of law and extend its ambit to provide for further information.

TIS eventually published The Insolvency (Amendment) (No.2) Rules 2011 (the Draft Rules) on 16 June 2011, and invited feedback from stakeholders on the proposed reforms.

The Draft Rules – what did they say?

The Draft Rules took SIP 16 and went further with its requirements. The key features of it were that:

- A new form of statement was required on form 2.2B (the nominated administrator's consent to act) that a pre-packaged sale is taking place and that the pre-pack will result in a better return for creditors than other options (reg 5).
- Where the sale is to a connected party (in all cases, not just where a pre-packaged sale was being used) without the assets first being made available for sale on the open market, 3 days' notice of the sale is to be given to creditors to allow time for “consultation” (regs 8 and 9).
- Information is to be provided to creditors about sales to connected parties (regardless of whether pre-packaged or otherwise) over and above that provided for by SIP 16.
- These controls would be extended to liquidations as well as to administrations (but not to receiverships).

The industry reaction

The reaction from industry stakeholders, on all sides, was swift and heated, and certainly beyond what TIS had anticipated. On 22 August, the Daily Telegraph published a story (which can be found [here](#))¹ that the row had forced a re-think of the approach to pre-packs and that legislation was likely to be pushed back until 2012 (later confirmed by TIS). So what were the objections?

Objections from the “pro” pre-pack camp

Objections from those in favour of pre-packs follow the line that the Draft Regulations neuter the advantages conferred by a pre-packaged sale for the sake of policy makers being seen to be “doing something about it”. Specific objections are that:

¹ <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8714578/Row-delays-crackdown-on-phoenix-companies.html>

- The new statement in Form 2.2B is so objective and the burden so high, that no IP in his right mind would sign it.
- The 3 day prior notification to creditors applies to all sales to connected parties with no exceptions (even where a court sanctions a pre-packaged sale). The danger is that newly enfranchised creditors will have time to take commercial or legal measures which may stymie any sale.
- When deciding whether assets have been offered for sale on the “open market” (in concluding whether creditors need to be pre-notified for a sale to a connected party), no definition of “open market” has been included, making it impossible to determine what level of marketing gets you in the clear.
- The obligation to provide information to creditors exceeds SIP 16’s requirements, and again there is no exception, even for reasons of confidentiality, public interest or even national security.
- The controls are extended to liquidations as well as to administrations, even though (i) in CVLs, a liquidator’s power of sale does not arise (in voluntary liquidations) until after the creditors’ meeting which affirms his appointment (Section 166(2) of the Insolvency Act 1986), (ii) in MVLs all creditors will be repaid in any event, and (iii) in compulsory liquidations, the courts will have oversight.
- The meaning of “connected party” (the defining factor in whether creditors need to be pre-notified of a sale) is extended beyond existing statutory definitions (and includes “associates” of any secured creditor) making the provision needlessly confusing and without exception – what happens if a connected party is missed through inadvertence?
- The 3 day “consultation” process does not state what should happen, to whom representations should be made, what role the court has to play or even whether the IP has to take account of creditor representations.
- It muddies the waters on TUPE as the statement in Form 2.2B makes it clear that the object of the administration from the outset is the liquidation of assets – and therefore re-opens the decisions in OTG v Barke and Others and the Oakland decision.
- As has been stated at several points above, no mechanism has been provided for situations where it may be necessary to deviate from the prescribed requirements.
- The regulations make no distinction between the SME market (where the most objectionable practices are to be

found, but where equally there are few alternative options) and the large corporate markets (where unsecured creditors rarely suffer).

Additional objections from the “con” pre-pack camp

Many of the criticisms raised by the “pro” camp have equally been raised by the “con” camp. Additionally, those opposed to pre-packs (largely creditors and creditor groups) have raised concerns that:

- The 3 day notification period is without teeth, since the Draft Regulations make no provision for recourse to the court to block the sale.
- Equally, the 3 day pre-notification period is of little practical use, given that it is almost certainly too short to raise a rival bid or gather sufficient evidence to obtain an injunction.
- The Regulations do not state the consequence of breach or non-compliance. Nor does it state what power the courts may have to order rectification. As drafted, it is unclear whether breach results in invalidity of the sale or invalidity of the appointment, or something else.

What does the future hold?

The implication of the various criticisms point to the fact that in seeking to cater for the interests of all parties, TIS has ended up in pleasing no-one. No doubt the Draft Regulations are undergoing a major re-think, however TIS are being remarkably tight-lipped on their thinking. As such it is difficult to judge where we go from here – we will learn more when the consultation resumes (possibly later this year). Watch this space!

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