

Pre-pack reform - have your say

May 2010

The Insolvency Service has issued a consultation paper on reforming the rules for pre-packaged administrations, which is open for comments until 24 June. Landlords may wish to respond to the consultation in the light of their experience.

Many landlords will have been affected by a pre-pack of a tenant. An Insolvency Practitioner (IP) lines up an advance purchaser for the profitable parts of a failing business and the company goes into administration simultaneously with the sale. Whilst it is argued that pre-packs help preserve the business to save jobs and achieve a better result for unsecured creditors overall, pre-packs for businesses such as Allied Carpets, Whittards and MFI have demonstrated that some creditors fare much better than others. Landlords often have to wait some time to discover what is intended for their premises. Who is now actually in occupation? Has the lease been assigned without consent? There is particular concern where the buyer is a "pheonix" company led by individuals from the management team of the insolvent company, whose decisions, it is presumed, contributed to the business failure. Are they just being allowed to dump debts and so obtain a competitive advantage?

To address complaints about the use of pre-packs, the Insolvency Service introduced a Statement of Insolvency Practice, SIP 16, on 1 January 2009. It requires IPs to disclose to creditors (preferably with notification of the administration) specific information to explain and justify why a pre-pack was undertaken, so creditors can be satisfied the administrator acted with due regard to their interests. The Insolvency Service also confirmed it would take action against directors who mis-use the pre-pack process and set up a hot line for complaints.

A review of the first 6 months operation of SIP 16 indicated that 35% of reports by IPs to creditors did not comply with it fully, although most non-compliance was neither significant nor suggested any misconduct by the IP or failure to act in the creditors best interests.

To deal with ongoing concerns over pre-packs, the consultation paper, [Improving the transparency of, and confidence in, pre-packaged sales in administrations](#), invites submissions on five proposals for reforming the procedure that applies to pre-pack sales.

The proposals are to:

- **Make no change to the existing regulatory framework.** Under this proposal, IPs would remain obliged to comply with SIP 16. In addition, new rules came into force on 6 April 2010 allowing administrators to recover "pre-appointment" costs from the insolvent estate if creditors approve. To obtain approval IPs will need to justify to creditors their work on the pre-pack.

Disclaimer: This briefing is not intended to be a complete coverage of the law in this area. Legal advice should always be taken in any particular case.

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- **Give the SIP 16 disclosure requirements statutory force, making non-compliance a criminal offence.** There would be an obligation to file the information at Companies House, making it publicly available after the event but creditors would still have no chance to challenge the pre-pack sale before it took place.
- **Make it compulsory for all pre-pack administrations to exit into compulsory liquidation** so that the Official Receiver can review the conduct of the directors and the administrator. This would not change the obligations to disclose information to creditors, but it would mean scrutiny of the directors' and IPs conduct after the event. Funds would have to be reserved for the extra cost of liquidation reducing the assets for distribution still further.
- **Require a different IP to take office as administrator, from the IP who negotiated the pre-pack sale.** This would avoid the perception of a conflict of interest where the IP advising on the pre-pack will also benefit from fee income from the administration if appointed as administrator. Again the use of two IPs may reduce dividends to creditors as there will be two sets of costs.
- **Subject all pre-pack sales to the prior approval of the court or the creditors** if the buyer is connected to the business of the company, to avoid the perception that the sale is at an undervalue for the benefit of the directors. Advance notice to creditors would of course result in the damage to the business which the pre-pack sale is designed to limit and the insolvent estate will have to meet the cost of a court application.

The consultation paper seeks views on questions arising out of those proposals as well as inviting respondents to give specific examples as evidence of the impact of pre-packs, whether on creditors, jobs or competitors.