

Pre-pack guidance

Some room for improvement

The Insolvency Service's recent report (the report) on the first six months' operation of Statement of Insolvency Practice 16 (SIP 16), the guidance for insolvency practitioners (IPs) on the use of pre-pack sales in administrations, should allay some of the concerns that have been raised about the potential for misconduct in the pre-pack process (*see box "Pre-pack administration"*).

SIP 16

The pre-pack process has been criticised on the grounds that it lacks transparency, gives little opportunity for creditors to raise objections and, as a result, may be abused to benefit the buyer at the creditors' expense. Cases which involve a sale of the business or assets to the management of the insolvent company have come in for particularly heavy criticism.

SIP 16, which was introduced on 1 January 2009 with the aim of improving transparency in the process, sets out the standards required of IPs involved in pre-packs (www.practicallaw.com/8-385-0975). In particular, any IP who acts as administrator and who carries out a pre-pack sale must provide creditors with a prescribed list of information, including, for instance:

- Details of marketing of the business or assets conducted by the company and/or the administrator.
- Any valuations obtained.
- The alternative courses of action that were considered, with an explanation of possible financial outcomes.
- Why it was not appropriate to trade the business and offer it for sale as a going concern during the administration.
- Details of requests made to potential funders to fund working capital requirements.

Pre-pack administration

A pre-pack is the process by which a company is placed into administration and all or part of its business or assets are immediately sold to a buyer on terms negotiated by the insolvency practitioner before his appointment as administrator. Such sales are usually conducted without the prior approval of the creditors or the permission of the court.

Pre-packs are not new and their use in appropriate circumstances has been endorsed by the courts. One key advantage of a pre-pack is that it enables the business of the insolvent company to be realised quickly, preventing the erosion of goodwill and the value of the business which may occur once news spreads that the company has entered administration.

Preserving the business in this way may also help to retain jobs. In many cases, a pre-pack may be the only viable option if there is no source of working capital to allow the business to continue to trade in administration while a buyer is found.

- Whether efforts were made to consult with major creditors.
- The consideration for the sale, terms of payment and any condition of the contract that could materially affect the consideration.
- The identity of the purchaser and any connection between the purchaser and the directors, shareholders or secured creditors.

Information should be provided to creditors as soon as possible after the sale. There may be exceptional circumstances which prevent the disclosure of certain information to creditors, in which case they must be stated. However, in most cases, commercial confidentiality would not be a sufficient reason for withholding information from creditors.

The report's findings

The report concluded that IPs have been generally positive in their approach to SIP 16 and its aims and, in the majority of cases, information has been provided in compliance with its requirements. However, 35% of the reports issued by IPs to creditors fell short of full compliance with SIP 16, typically due to:

- Failure to send out information to creditors in a timely manner.
- Missing out details of a valuation or marketing exercise.
- Missing out details of a connection between the insolvent company and the buyer of the business.

3% of the cases reviewed were referred to the IP's authorising body to be considered from a regulatory and disciplinary perspective.

The report, however, emphasises that any failure to comply with SIP 16 does not imply misconduct in the pre-pack sale itself, or a lack of good faith or failure by the IP to act in the creditors' best interests. In many cases, apparent non-compliance may be attributed to early differences in interpreting the guidance.

Although the introduction of SIP 16 places additional requirements on the use of pre-packs, the report emphasises that the government considers that they are a valuable tool and that they can constitute the best way for an administrator to proceed. A further report is due in early 2010.

Footnote

The purpose of SIP 16 is to ensure that, after the event, creditors have sufficient information to understand the reasoning behind the IP's decision to use a pre-pack. It is not the aim of SIP 16 to enable creditors to take steps to prevent the pre-pack from going ahead and it remains the case that it is difficult for them to do so.

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