

# Pre-pack report: the good, the bad and the ugly

Yesterday the independent Graham Review into Pre-pack Administration was published. Whilst the Report has been carried out on an independent basis, it is part of Vince Cable's Trust and Transparency agenda, recognising that business rescue is a key element of an efficient insolvency regime, and that confidence in that regime will support lending, which in turn will support growth. Iain White, partner in our restructuring and insolvency group welcomes the recommendations, he says *"This latest review provides a measured response to the legitimate use of pre-packs in the UK market. It also sends a shot across the bows of those who seek to abuse the process for their own gain – they will face greater scrutiny in the future"*.

The Report concludes that there is a continued place for pre-packs in the UK insolvency framework, but suggests improvements on how they are administered. The report does not suggest further legislation but sets out six recommendations which it believes will help preserve jobs, contribute to the UK economy as a whole, and assist it in its emergence from the recession.

## Connected party recommendations

The recommendations fall into two main categories, those that will apply where the purchaser is a connected party and those that will apply to all pre-packs. For these purposes, connected parties are to include those involved in the management of the insolvent seller (i.e. its directors or company officers, shadow directors and their associates) who are also involved in the management of the new company, as purchaser of the insolvent business and assets.

Secured creditors who hold security

for the granting of a loan as part of a lender's normal business are not included as connected parties in this respect.

The two recommendations affecting connected parties are:

1. a voluntary referral process to a "pre-pack pool" of independent experienced business people who will review the terms of the proposed pre-pack and opine on the reasonableness of the administrators' statements/strategy; and
2. a voluntary viability review.

## Pre-Pack Pool

It should be noted that this recommendation applies to any sale of all or part of the business in all circumstances before creditors are made aware of the sale, i.e. a sale at any time. If the expert in the pool issues a negative statement in relation to the pre-pack, it may still go ahead but the statement will be

## Key issues

- No legislation for pre-packs
- Six recommendations:
  - pre-pack pool of experts
  - Voluntary viability review
  - Six principles of good marketing
  - Valuation by professional
  - Changes to SIP 16
  - Insolvency Service to be replaced in monitoring role for pre-packs

referred to in the statutory information to be produced in accordance with the Statement of Insolvency Practice 16 – Pre-packaged Administrations ("SIP 16"). In terms of the pool itself whilst Annex H of the report includes "as a starter for 10" some suggestions for the organisation and operation of the pool, there is little detail other than the pool members being experienced business people selected from a wide

range of industries and disciplines. The pool members are to consider papers selected for them by the connected part applicants and will have no more than half a day to consider the pre-pack. The Report suggests that the cost of the pool should be funded by the fees paid by the applicants and that no legal liability should attach to the pool member in respect of any opinions they provide on the pre-pack. Details of how this will work in practice will need to be fully worked out.

#### Viability Review

This recommendation involves the making of a voluntary statement by the connected party indicating that they have formed the opinion that the new company will remain a going concern for at least 12 months. It is also recommended that within the voluntary viability review there is a short narrative explaining what the new company will do differently from the old company in order to ensure its continuance.

The remaining four recommendations have in part been pre-empted by the revisions already made to SIP 16 in November. The changes in the Report are suggested with a view to "tightening" further the language and also to reflect the new voluntary pool review and viability statement proposals.

#### Principles of Good Marketing

Perhaps the most significant recommendation other than the voluntary processes suggested in respect of connected parties is the introduction of six principles for good marketing in relation to the pre-pack process. It is recognised however that there may be cases where marketing is not possible or that marketing will harm the creditor's prospects of recovery, and since November 2013

there has been a requirement that in SIP 16 an explanation in appropriate cases as to why there was no marketing has to be included. In cases where marketing is appropriate the good marketing principles include:

1. Broadcast rather than narrow cast (ie market as widely as possible, albeit proportionate to the nature and size of the company)
2. justify the media used (explaining the strategy and reasons behind it)
3. ensure independence (the insolvency practitioner cannot just rely on previous marketing by the company)
4. publicise rather than simply publish (for an appropriate length of time)
5. connectivity (which includes on-line communications, justify why the internet is not used to market, if this is the case)
6. comply or explain (the insolvency practitioner must explain his marketing strategy to achieve the best outcome for creditors).

#### Valuation

The other key area which is the subject of recommendation in the Report is in relation to valuation. The recommendations suggest that valuation should be carried out by a valuer who holds professional indemnity insurance. The reason for this is that PI providers impose more stringent checks on valuation professionals seeking cover. In instances where the administrator chooses not to use such a professional, he will need to explain why he has taken this approach.

#### Monitoring Insolvency Practitioners

The final recommendation relates to the monitoring of insolvency practitioners and their adherence to the disclosures required by SIP 16. The Report suggests that the Insolvency Service who currently monitors this process should be replaced with the relevant recognised professional bodies who are already responsible for the general monitoring of insolvency practitioners.

#### What happens next?

If the recommendations are not adopted by the market it is suggested that the government should consider legislation and that a reserve legislative power could be the best way of encouraging the proposals.

Philip Hertz, partner in the restructuring and insolvency group comments "*the report is an appropriate response to the challenges faced by the industry. It seeks to introduce measures to address the mischief of certain pre-packs which do not adhere to the current best practice for transparency and may be contrary to the interest of creditors. At the same time, by resisting the calls for legislation, Teresa Graham has recognised the value that legitimate pre-packs add to the UK restructuring market and the economy generally. The recommendations send a clear message to those who may think that the system can be taken for a ride. For connected party transactions in particular, poor and inappropriate practices will be the subject of much greater scrutiny. As such the recommendations will go some way to distinguish the good pre-packs, from those that are quite simply bad or just plain ugly*".

## What is a Pre-pack?

A pre-pack strategy involves the negotiation of an agreement for the sale of some or all of the business and assets of an insolvent company prior to the instigation of formal insolvency proceedings which is executed immediately following the appointment of the insolvency officeholder.

### Report Conclusions

#### Positives about pre-packs

- They can preserve jobs
- They are less costly than schemes of arrangement or trading administrations
- Deferred consideration is recovered in 90% of the cases
- They benefit the overall UK economy

#### What needs improving about pre-packs

- Transparency
- Insufficient marketing
- Explanation of the valuation methodology
- No consideration on the future viability of the new company

#### Six Recommendations

- Pre-pack pool review
- Viability review
- Six principles for Good Marketing
- Valuation by professional
- Changes to SIP 16
- Insolvency Service to be replaced by RPB to monitor pre-packs

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