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The sun is setting: is it time to legislate pre-packs?

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Abstract

This article provides a critical evaluation of the Graham Review recommendations concerning pre-packs; a timely review which is required to provide a benchmark against which it would be possible to assess the quality of any legislative initiatives which may be taken in the future.

Keywords: corporate insolvency; Graham Review; pre-pack pool; viability review; SIP 16; marketing; valuations

1 Introduction

Despite pre-packaged administrations (pre-packs) accounting for only a fraction of all insolvency procedures, they have received a considerable amount of attention that has perhaps not been fully deserved.[2] Often misunderstood at best, the key aspect of the pre-pack procedure permitting such a negative response, resides with the lack of transparency that surrounds the process.[3] This well-documented criticism is also associated with the way in which connected parties can purchase the old company, leaving many creditors frustrated with both the lack of information received[4] and the diminutive monies received from which they are owed.[5]

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2 In 2011, the Insolvency Service estimated that 25 per cent of the 2808 companies that entered administration in 2011 used the pre-pack procedure; and that nearly 80 per cent of pre-pack sales were to connected parties. It is expected that from a class of around 20,000 companies that enter an insolvency procedure every year, there are approximately 700–750 pre-packs per annum. See Insolvency Service, *Annual Report on the Operation of Statement of Insolvency Practice* 16, January/ December 2011.

3 Whilst the pre-pack process seems to have gained much exposure in recent years, it is by no means a new concept; it was often frequently used by administrative receivers, alas certainly not to the same degree of formalities as the US Chapter 11.

4 Often concerning the decisions made by the insolvency practitioner.

5 The latest empirical research shows that, in a case study of 497 companies, on average just over £500,000 is owed to unsecured creditors. See the final report to the Graham Review, April 2014, prepared by Professors Peter Walter and Chris Umfreville with the assistance of Dr Paul Wilson, *Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration* (University of Wolverhampton 2014) 30.

Due to the sustained criticism, pre-packs have received over the years,[6] Vince Cable MP commissioned Teresa Graham CBE to undertake an independent review of the pre-pack process,[7] as part of the government's wider 'Transparency and Trust' agenda.[8] The initiative behind the agenda was to detect weaknesses in the UK's company law framework and find solutions to ensure that the UK remained a competitive and attractive place to conduct business. To achieve this goal it was identified that there was a need for increased levels of trust and confidence within the system and this extends to the professionals who deal with companies when they go insolvent.[9]

The Graham Review (the Review) unequivocally reported that self-regulation would be a better option than to legislate, which in itself should be seen as the last resort. The Review made six recommendations, which have since become somewhat essential to its survival as a non-legislative procedure. Ministerial pronouncements have put the profession under notice that, unless it takes proper steps to produce substantial compliance with the Review's findings, then legislative power will be exercised.[10] To date, while there has been no official follow-up report assessing the measures taken by the profession, the Review appears to have attracted widespread support,[11] giving hope that the Review, which took nine months to complete, may see its recommendations adopted over the course of the next year or so.

Based on the intricacies of the recommendations, should they be implemented in full, this would lead to a drastic change in the way in which insolvency practitioners deal with distressed companies. The changes will redefine the pre-pack process, including the role of those who implement pre-pack strategies. The Review proposes non-legislative action, but it will be examined whether over time legislation will become inevitable. What is therefore required is a balanced evaluation and critique of the Graham proposals: one that is capable of providing some form of yardstick against which to test the quality of any legislative initiatives which may be taken in the future.

6 In 2010 the government consulted on improving transparency and confidence in pre-packaged sales in administrations. This work led to a proposal that creditors be given a short period of notice prior to sales going ahead. This proposal was withdrawn in early 2012, as the government was not convinced that the specific benefit of the proposal outweighed the overall benefit to business of keeping to the micro-business moratorium.

7 Graham Review into Pre-pack Administration, Report to the Rt Hon Vince Cable MP, June 2014 <www.gov.uk/government/publications/graham-review-into-pre-pack-administration>.

8 See Department for Business, Innovation and Skills. 'Transparency and Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business' (June 2013) 15, paras 43–44.

9 Ibid 43.

10 See Graham Review into Pre-Pack Administration (n 7), where the pronouncement is stated at the beginning of the Review (10, para 4.2) and then reiterated (67, paras 9.37–39). Quite interestingly, the last paragraph recommends that any such reserve power bestowed upon government by Parliament should be time-limited (a 'sunset clause'), leading one to conclude that these changes might actually occur instead of remaining a mere consultation exercise.

11 Key figures who have expressed support for the recommendations include: Business Minister Jenny Willott; Insolvency trade body R3 President, Giles Frampton; the Institute of Chartered Accountants in England and Wales' Executive Director, Professional Standards, Vernon Soare; and Matthew Fell, Director of Competitive Markets at the Confederation of British Industry. For a full review of their comments see <www.gov.uk/government/news/willott-announces-plans-to-clean-up-pre-pack-insolvency-deals>.

2 Terms of reference and the main concerns

The details that the review team were given focused on improving transparency and creditor confidence in pre-packaged sales in administrations.[12] The terms are worth reiterating here for ease. The four terms were:

- to assess the long-term impact of pre-pack deals to form a view as to whether they encourage growth and employment and whether they provide the best value for creditors as a whole;
- to assess the usefulness of the pre-pack procedure in the context of business rescue generally, using international comparisons as and when appropriate;[13]
- to assess whether pre-packs cause detriment to any particular groups of creditors and specifically whether unsecured creditors are disadvantaged; and
- to assess whether there are any practices associated with pre-packs which cause harm.[14]

This article will refrain from specifically dealing with these terms. Instead, it will investigate the six recommendations that were proposed and whether, based on their intentions, they would constitute good legislative inputs, should this occur in the future. In terms of the research conducted for the Review, its overall contribution in providing statistical data remains limited. Whilst the pool of businesses studied as part of the Review is respectable in size,[15] further data in assessing pre-packs is required as this undertaking represents only a few of its kind.[16] It should be noted that the Review was limited in scope and neglects to consider any real alternatives to the pre-pack model. Instead, it has chosen to refurbish the process with some new fixtures in the hope that it can somehow help to silence the critics.

To determine the viability of the recommendations it is imperative that the basis for change is reviewed. It is well established that the positives, whilst few in number, do provide some justification for the continuance of the procedure.[17] The difficulties that thwart pre-packs, as the Review was careful to point out, were the negative preconceived ideas that surround the process. Whilst there has been some attempt at collating data on pre-packs prior to the Review, the publications were limited in scope and did not provide any support or undermine those preconceptions. The Review therefore represents the most in-depth scrutiny of pre-packs to date.

Why this Review and subsequent reports are critical is because it helps to increase awareness and understanding of a mechanism that permits business rescue – a process that is required in an efficient insolvency regime. Without such a procedure, many

12 See generally T Astle, 'Pack Up Your Troubles: Addressing the Negative Image of Pre-packs' (2015) 28(5) Insolvency Intelligence 72–74.

13 There has not been much research conducted on pre-packs in EU member states, but a fresh review on this area would provide for a fascinating read.

14 Graham Review into Pre-Pack Administration (n 7) 11.

15 A random sample of 499 companies that entered pre-pack administrations in 2010 was selected. 2010 was chosen as this allowed time for the new SIP 16 process to have become embedded and to allow the research team to monitor the success of the purchasing company for three full years following the sale.

16 The last major review of pre-packs would be that conducted by Sandra Frisby, see S Frisby, *Report to the Insolvency Service: Insolvency Outcomes* (Insolvency Service June 2006); S Frisby, *A Preliminary Analysis of Pre-Packaged Administrations, Report to the Association of Business Recovery Professionals* (August 2007).

17 To name but a few, pre-packs can preserve jobs, are usually cheaper than an upstream procedure, deferred consideration is, by and large, paid, and that the pre-pack procedure may bring some limited benefit to the overall UK economy.

companies will needlessly fail. This in turn would create a volatile commercial environment which contravenes the aims set out by the government's wider 'Transparency and Trust' agenda as mentioned above.

By accepting the necessity of pre-packs, the catechism is whether they should continue to operate as they are, be subject to less regulation, or whether the Government should legislate? The possibility of banning pre-packs or finding an alternative poses interesting questions which will be considered towards the end of this article.

To address the case for further regulation in a pre-pack the main criticism stems from the lack of transparency that surrounds the process. Other factors include the duration and quality of marketing of a pre-pack, the valuation methodology, and that no consideration is given to the future viability of the newly purchased company. These concerns were examined in the Review, which collectively formed the foundations for the six recommendations which would hopefully lead to improvements against the main criticisms of pre-packs.

3 The six recommendations

The Review was somewhat prejudiced against taking a legislative approach to pre-packs due to Teresa Graham's personal views.[18] It is likely that such a strong viewpoint will have invariably had a bearing on the outcome of the Review, including the form that the recommendations would ultimately take. Given the noted criticisms and the presented opportunity, the six recommendations are not as radical as they could have been. However, they do represent a turning point for insolvency practitioners. Furthermore, the Review is absolute in its intention to bring some change, no matter how sweeping, by providing an ultimatum that if the concerns are not addressed, legislation, whilst not desirable, would ensue. The viability of these proposals requires detailed review.

3.1 Pre-pack pool

The first key recommendation prescribes that on a voluntary basis, connected parties should approach a 'pre-pack pool' before the sale and disclose details of the deal for the pool member to opine on.

The purpose of this recommendation was to address the lack of transparency by offering a method which would keep most concerned parties informed, despite the clear feedback from stakeholders that secrecy is a strength of the pre-pack process. The data compiled by the University of Wolverhampton, which provided the Review with the key information on the characteristics of companies that entered pre-packs in 2010, makes for interesting reading. It is noted that the mean average, in which a company may enter a pre-pack, was 12.29 years.[19] There is a clear spike with companies that enter a pre-pack at between 5–7 years and then at 10–20 years, demonstrating that pre-packs are not generally companies in their infancy, but ones that have been operating for a number of years with possible strong affinities with the business and those that are controlling it.[20] This bond has caused many negative perceptions, with some creditors accusing pre-packs of favouring connected parties. The research conducted by the Review does nothing to quash this belief. On the contrary, it galvanises the premise that this negative preconception is well founded.

18 Graham Review into Pre-Pack Administration (n 7) 5.

19 See Walter and Umfreville (n 5) 12.

20 Graham Review into Pre-Pack Administration (n 7) 59.

The result is that creditors are less likely to receive a return when a connected party is involved than when they are not. The Review gauged exactly what the distribution range was for the returns that unsecured creditors could receive. It appears that again the negative preconception surrounding distribution has led many to believe that connectivity has an impact and, whilst in some limited sense it has, the reality is that in the majority of cases no distribution was made at all.[21] The percentage of companies that make no distribution rests at just over 60 per cent. When it is considered that around 15 per cent of companies have an unknown distribution, the figure could actually be enhanced, leading to speculation that as high as three-quarters of unsecured creditors are unlikely to receive any return.

The impact that connected parties have on pre-packs is quite startling, even though the data only goes to prove that the negative preconceptions were actually true. The data shows limited benefit to unsecured creditors and – as expected – a better faring for secured and preferential creditors. In administration the prescribed part would assist unsecured creditors to a degree, but the difficulties arise where there are no funds to distribute at all. It appears that whether it is by pre-pack or by the upstream process (administration), unsecured creditors have very limited scope for expecting a return. Therefore, whether the pre-pack process was opened to a screening pool, it begs the question: what benefit would this have? It is clear that a comparison between classic administration and pre-packs shows that there is little to be gained from further transparency and a lot to be lost by removing the secrecy that surrounds the process.

3.1.1 Connected parties

In terms of the connected sales, something which the pre-pack pool recommendation aims to address, the statistics, whilst confirming some of the adverse preconceptions, should not be seen as something entirely negative. It is vital that it is made clear that creditors do not lose money when a company pre-packs – at this point the money has already been lost.[22] It is likely that the anger vented from unsecured creditors is in frustration of not knowing what was happening to the company. This is in addition to the likely premise that the old management, which may or may not have been responsible for the demise of the company, is permitted to have a second chance to purchase the company at a discount, thereby benefiting at a cost to other creditors. The Review shows that, out of a possible 499 companies that entered a pre-pack, 316 were connected sales and 182 were not connected, proportioned at 63.3 per cent and 36.5 per cent respectively.[23] This figure is somewhat of a decrease on the statistics obtained a few years ago with a review by the Insolvency Service in 2011 stating that the connected sales figure was as high as 80 per cent,[24] but it is a slight increase on the Association of Business Recovery Professionals' statistics published in March 2010 which was at 59 per cent.[25] Whatever the figure may actually be, there will be disagreements as to the criteria that need to be satisfied for a person to be deemed 'connected' to the old company.[26]

21 For a breakdown of the dividends (pence in the pound) distribution, see ibid 31–33.

22 Ibid 37.

23 Data for one business was unknown.

24 See Insolvency Service (n 2).

25 The Association of Business Recovery Professionals in March 2010 put the figure at 59 per cent, see <www.r3.org.uk/media/documents/policy/policy_papers/corporate_insolvency/Pre_packs_and_SIP_16_March_2010.pdf>.

26 Further research with insolvency practitioners is required and RPBs should be encouraged to assist in this pursuit. It remains baffling how reviews can be submitted without obtaining full details from the profession.

Setting the criteria for what amounts to a 'connected sale' is critical to understanding not only what happens to a distressed company when it enters a pre-pack, but also to determine who the likely purchasers are. It is imperative to clarify this point as pre-packs have to be designed with an end result in mind;[27] the procedure is only effective if it is utilised. If the pre-pack works successfully on the basis of operating in a secret format, the recommendation of a pre-pack pool may be severely counterproductive.

It is worth noting that, since the Review published its final report, a fall-back provision has been included in the Small Business, Enterprise and Employment Bill (June 2015) which will enable the Secretary of State to make regulations restricting the ability of an administrator to make disposals to persons who are connected with the company.[28] This is clearly aimed at the most controversial type of pre-pack. One suspects that, should abuse be evident, then the use of the pre-pack will not be controlled by self-regulatory mechanisms.[29] This presents a solid advancement for what has been the rhetoric position for so long.

The Review provides for a much wider definition of what is a connected party than that contained in the Insolvency Act 1986.[30] The Review states that a connected party is any individual who had control of the insolvent company and exercises control over the new company. This is a wide definition that may refer to business sales where an individual is a director of either company, or where a company exercises control both in the old company and new company because of its level of share capital. This definition is devised with the ingenuity of those who would implement pre-packs in mind. It has been created as a means to close any possible loopholes on what amounts to a connected party for the purposes of a pre-pack. There can be no question that minor technicalities would be exploited for the purpose of ensuring that a company could avoid complying with any provisions that the insolvency practitioner deems counterproductive to his or her overall objective. What, however, would be the case if connected members of the old company formed a new company, which in turn made a pre-pack deal for the old business? A consortium made up of connected parties could well hide amongst the shadows of a new company and, by doing so, avoid the potential scrutiny under the pre-pack pool as suggested under recommendation number one. Consideration of this matter would require a review of s 435(10), Insolvency Act 1986, which states that in determining whether any person or company has control of a company, sales to secured lenders who hold security for the granting of the loan (with related voting rights) as part of the lender's normal business activities over one-third or more of the shares in both the insolvent company and the new company are not included.

This slight amendment regarding the lender's normal business activities is to prevent the aforementioned group companies forming to bring themselves into this exception by making a consortium loan and taking security. Whether this would address the most unscrupulous of group company consortiums remains to be seen, but it should not come as a surprise if what is proposed in the Review is abused.

27 Namely, where possible, to save the company/business as a going concern. See Schedule B1, Insolvency Act 1986.

28 See cl 129 of the latest version of this Bill. The wording is: 'The Secretary of State may by regulations make provision for: (a) prohibiting, or (b) imposing requirements or conditions in relation to, the disposal, hiring out or sale of property of a company by the administrator to a connected person in circumstances specified in the regulations.'

29 D Milman, 'Corporate Insolvency in 2015: The Ever-Changing Legal Landscape' (2015) Company Law Newsletter 1, 2.

30 See also P Bailey, 'Pre-Packs Report Published but Fights Shy of Legislative Reform' (2014) Company Law Newsletter 1, 3.

The details that surround the pre-pack pool reveals a novel idea. The proposition includes a pool of experienced business people which should be formed to enable independent scrutiny of a connected party pre-pack deal. The Review is not clear on the exact details that surround such an unprecedented concept in UK insolvency practice, but it does provide some guidance on the design of the structure.

3.1.2 Members of the pool

In terms of who would administer the pool, it is envisaged that a small secretariat would be involved, which would control membership of the pool; including responsibility for selection, training, monitoring[31] and evaluation. Such a secretariat, and its pool members, could be compared with the structure and role of the recognised professional bodies (RPBs) and it would be of no surprise if the Review sought inspiration for such from the professional bodies. Closer inspection of the selection process would be critical to ensure that independence is maintained. It is highly unlikely that the independent value in terms of knowing a particular party would be achieved in all cases since the experts will be chosen for their familiarity with the type of company in question. Instead the pertinent objective should be to promote independence, ensuring that the pool members are not influenced, against better commercial judgment, to accept a pre-pack proposal when it should be rejected. The distribution of cases is expected to rotate when approached by a connected party. However, it is inevitable that, whilst all pool members may have a sufficient level of expertise, some may possess specialised knowledge that places them in a better position to make a decision on a proposed pre-pack. Such occurrences may be quiet rare. This is because most companies fall under a similar structure. However, the key point here is for the Review to insist on a strict rotation basis that adds an unrealistic burden on the process.

It is important to clarify that the independent aspect of the pool can only be achieved if the pool is free from the influence of any of the RPBs and, as such, be seen to operate as a separate body that simply reviews pre-pack proposals and reports directly back to the connected party in question. How this will be addressed in practice was not made clear in the Review. Instead, the Review chose to emphasise that the pool concept was a new idea. It is worth exploring this notion in more detail. To ensure that the pool concept works in practice would be reliant on leaving the administrator, to a large degree, with the task of approaching the pre-pack pool association and asking them to put together a professional group that would be competent to assess any pre-pack proposal that the company would be likely to receive. Despite the pool members poached for their skills from a range of industries and disciplines, members are likely to be nominated to the secretariat by professional organisations, such as the Confederation of British Industry, EEF (The Manufacturers' Organisation) and the Institute of Directors, and this will be subject to availability. A process subject to availability of resources ensures that quality has to be compromised.

Furthermore, if members can be nominated to the secretariat, not all will be familiar with the process or the expectations placed upon them. As with any professional position, there is a tendency to provide reams of information on how something should be done. This, along with the time restraint of half a day to review a proposal, adds pressure on members to make a decision, which may or may not be justifiable. Given the nature of pre-packs, time is of the essence; in an environment where speed will often trump all

31 The secretariat would monitor performance standards for the pool based on: turnaround time; positive bilateral feedback from directors; unsolicited feedback from professionals involved, or creditors. See Graham Review into Pre-Pack Administration (n 7) Annex H.

other concerns, there is some apprehension that too much expectation is being placed on members. It is unlikely that liability will not be wilfully attached to any pool member. Yet, it is difficult to say just how such a case would unfold if a connected party pursued a claim against a pool member for having overlooked or intentionally weakened the 'hold harmless' position in the letter sent to the member at the beginning.[32]

The publication of the details regarding the opinion of the pool and viability review pose a number of interesting questions. To what extent the publication would reveal details surrounding the pre-pack remains irresolute. It clearly would not be able to reveal any sensitive information that may prevent future amendments to failed proposals, which subsequently could be accepted. The value of such reports would depend and vary according to the input of different pool members. Whilst transparency may take a closer step to being realised, a consistent approach to reviewing pre-pack proposals submitted by connected parties would become a key concern.

If the pool were used, it is clear that there would be inconsistencies across the pre-pack spectrum. The Review suggests that there would be no prescription as to what material the pool member would require in order to comment on the deal – this would be for the party approaching them to decide. This wide discretion is coupled with a time restriction in that the pool member will spend no more than half a day reviewing such contents. To allow for standardised practice and to allow pool members to review proposed pre-packs in a consistent manner, it is vital that the submissions follow a best practice guideline – a pre-pack proposal document should be considered. In terms of the response that pool members should give, the Graham Review included at Annex I a specimen form of what could be included.

Since the pre-pack pool will not be applicable to unconnected parties, any method employed to render a person or a group as unconnected will be exploited. The matter is further complicated by the proposal that the pre-pack pool only be conducted on a voluntary basis. The suggestion would be that this should be made compulsory, since the process involving deals can remain secret within the pool.

3.2 Viability review[33]

Recommendation number two provides that, on a voluntary basis, the connected party completes a 'viability review' on the new company.

Determining the viability of pre-pack proposals attempts to address the criticism that there is no quality check for these future plans that often fail. Permitting these non-viable business plans to re-enter the market degrades the rescue culture. It also gives a false impression that the new company had any realistic chance of successfully trading again. This is particularly true in relation to pre-pack deals conducted by connected parties, something which the empirical data mentioned above in section 3.1 has illustrated. There is no doubt that the figure is high for connected parties. Yet, it should be considered that this may be the case because connected parties, rather than those who are unconnected, are more willing to purchase these failed businesses and take the risk in reviving the company's fortunes.

The viability review, as suggested by the Review, would require a plan showing how the new company is to survive for at least 12 months from the date of statement. It is interesting to note that 12 months was chosen as the relevant time period. The empirical

32 This is in fact addressed in Annex I which provides a statement suggesting that the administrator will be responsible for making the decision. See ibid 93–94.

33 Ibid 62, para 9.11.

data contained in figure 7.3 of the Review contains statistics demonstrating the failure rates of new companies (illustrating pre-packs and trading administration) and figure 7.5 shows the failure rates by connected sales – both illustrating that the point of failure is at its highest between 12–24 months. Within three years, 29 per cent of connected pre-packs subsequently failed, compared to 16 per cent for those that were unconnected. Clearly, by year three almost a third of pre-pack purchasers to connected parties have failed again. Taking the period of 12–24 months into account, the rate of failure is at 14 per cent, with a cumulative figure (taking into account those failures within the first 12 months) at just over 20 per cent.

The viability review detailing what the new company would do differently from the old company to prevent failure does not in any way guarantee future success. What this review achieves is to ignore the more complex reasons why companies fail. The narrative within the review can have the best intentions, but ultimately it is just a proposal stating what is hoped to be achieved. If the intention is to make connected parties think about what they are going to do, rather than just blindly purchase the company, then it is possible that this could lead to better business plans being drafted, which in turn may have better chances of success. This unfortunately fails to make a distinction between the purchasers' own business plans and sharing the finer details in a viability review with the creditors. The two viability reports would clearly be different, not to mention that they may contain confidential elements as to what the purchasers intend to do with the new business. It must be considered as to whether the viability review will add anything to reduce the noise that surrounds pre-packs.

The proposed specimen wording for pool members' statements has been provided in Annex I of the Review. It is a simple overview that does much to distance itself from the decisions made by the administrator. The statement leaves little to the imagination in terms of embracing the ideas and makes it explicitly clear that the pool member has no view on whether the new company will remain a going concern in the near future. This no doubt intends to remove potential negligent liability claims from materialising. However, a statement merely reflecting on whether the proposal is reasonable surely lacks what the public had hoped for in order to quash the suspicions that surrounded the process?

The voluntary nature of this narration goes some way to illustrate its weakness and likelihood that it would rarely be ratified, given the lack of any incentive. This is witnessed in the apparent lack of commentary that the administrator can input when attaching, if available, the viability review to the Statement of Insolvency Practice (SIP) 16 before sending it to the creditors. Whether the market will come to expect these viability reviews remains to be seen, but this would be the only way, barring making the review compulsory, that would encourage the take-up.

3.3 SIP 16 – REDRAFT[34]

Recommendation number three states that SIP 16 should be redrafted and that the Joint Insolvency Committee should consider the draft SIP 16 contained in Annex A of the Graham Review.

SIP 16 was revamped in November 2013 and, with little surprise, in light of recommendations one and two, it is recommended that it should be redrafted again. A copy of the redrafted SIP 16 is contained within Annex A, which simply aims to improve the perception of pre-packs as well as tightening up the language used. With the original

34 Ibid 63, para 9.20.

wording of SIP 16, it is a welcome sight that additional assistance could be given surrounding the marketing and valuation process.

Following a comparison with the existing SIP 16, the original 13 paragraphs largely match with the Review's 17, albeit with a few adjustments. The changes commence with paragraph three, which incorporates an element of fairness into the process by ensuring that both unsecured and secured interests are considered and that the insolvency practitioner can demonstrate this. The practitioner does have a duty to creditors as a whole, but it is questionable whether fairness can enter the debate.[35]

Paragraph 4 introduces a new awareness principle that an insolvency practitioner should consider when dealing with a pre-pack, especially when the purchasers happen to be connected parties. It is not clear as to what insolvency practitioners should do by recognising the high level of interest that surrounds such a deal, other than to ensure that they complete their duty in accordance with the related insolvency provisions and practice statements. It is foreseeable that the real purpose behind this paragraph is to make insolvency practitioners aware that their actions will be scrutinised by creditors and the public alike and that they should, where possible, reduce the noise that may surround such a deal. Whether this may influence the way that they conduct the pre-pack and in turn breach at least one of the five fundamental principles[36] remains highly probable. Furthermore, there is a possibility that the 'influence' may lead to intimidation threats. These may occur when an insolvency practitioner may be deterred from acting objectively by threats, actual or perceived, due to the negative publicity that the pre-pack may induce.

Paragraph 10 presents new ground by insisting that valuations are obtained by independent valuers carrying professional indemnity insurance (PII). It is hoped that making the process more transparent and assigning the valuation to professionals would provide come comfort to at least some of the classes of creditors that the most beneficial valuation has been obtained. This is further enhanced by paragraph 11 which states that any deviation from paragraph 10 must be explained to creditors in the pre-pack statement. Given the importance of marketing and valuation, these new additions to SIP 16 will be considered separately.

3.4 Marketing[37]

Recommendation number four focuses on marketing and that all businesses should comply with the six principles of good marketing and that any deviation from these principles be brought to creditors' attention.

The statistics have changed somewhat dramatically over the last few years as greater research has been conducted in this field. For example, in 2007, Sandra Frisby in her research suggested that only 18 of the 227 businesses (7.9 per cent) of the whole pre-pack database were marketed in the appropriate way.[38] This should now be contrasted with the Final Report to the Review completed in April 2014,[39] which shows that from a class of 497 pre-packs, 303 businesses (60.9 per cent) involved marketing activity whilst

35 A discussion on what amounts to fairness, whilst interesting, is beyond the scope of this article.

36 The five fundamental principles are: integrity; objectivity; professional competence; confidentiality; professional behaviour.

37 See Graham Review into Pre-Pack Administration (n 7) 64, para 9.23.

38 Frisby (n 16) *A Preliminary Analysis of Pre-Packaged Administrations*, 30, 49.

39 Walter and Umfreville (n 5) 22.

103 businesses (20.7 per cent) received none at all.[40] The Final Report warrants further attention. Of the businesses that were subject to a market period, 118 were unknown, leaving data available for 190 businesses. Less than 20 were subject to longer than six months' marketing and 65 businesses received less than two weeks' marketing. The remaining figures show that around 55 businesses were on the market for between two weeks and a month; just over 40 businesses received between one month and three months, leaving around 10 businesses being on the market for three to six months.[41]

Exactly what equates to the optimal or reasonable marketing period is dependent on the nature and size of the business. What is clear is that some form of marketing is present. However, further research into the type of media exposure administrators are utilising is required to show whether certain methods result in better results.

The noticeable change in how administrators implement marketing strategies is without question due to the introduction of the original SIP 16 statement in January 2009, which has since been amended in the 2013 version. The Review, whilst observing the redesigned 2013 edition, has incorporated in its own redesigned SIP 16 a number of paragraphs. These refer to marketing and how this can be better conducted with the creditors in mind. The original SIP 16 has been criticised for being poorly drafted and having no requirements on administrators to explain why a type of marketing has taken place, if any. Improvements were made in the November 2013 redraft, which did require administrators to explain situations where no marketing had been conducted. The reality is that there are still wide discrepancies across the profession on how such SIP 16 statements should be compiled. There is a hope that, since November 2013, there have been improvements. Yet it must be said that there has not been enough research in this area to state otherwise.

To address the marketing concerns, six principles of good marketing were suggested by the Review. Whether the principles would lead to better marketing remains speculation, but it is worth exploring to see whether they show any promise in potentially improving creditors' perceptions that they are getting the best deal available.

3.4.1 The six good principles of marketing

i Broadcast rather than narrowcast

Marketing the business as widely as possible, proportionate to the nature and size of the company, in order to maximise the pool of potential purchasers is not as simple as it may sound. The Review suggests that different methods of media may be adopted to achieve this outcome. Yet it leaves the choice to the discretion of the administrator, reverting the process back to its arbitrary confinements. Administrators are apt in the art of making commercial judgments, but a deep comprehension of media techniques and exposure may not be one of them. It is perhaps prudent for the RPBs to conduct training for their members in this field if this first principle is to be maximised.

ii Justify the media used

Following on from the broadcast principle, the statement to creditors should explain the reasons underpinning the marketing and media strategy adopted. To what extent media strategies will have to be explained remains elusive and will no doubt fail to satisfy all of

40 Of those cases which involved no clear evidence, this was determined by reviewing the SIP 16 Reports. Additionally nine cases were inconclusive due to no information available.

41 Walter and Umfreville (n 5) at 23.

those concerned. The data available to justify using one particular classified section in a newspaper over another may result in pedantic disputes, but it does raise the real possibility of complaints materialising over the methods and media adopted. Whether such complaints would be justified would depend on the justification provided by the administrator. In the case that a complaint emerged, principle two, as it would be attached to the SIP 16 statement, would fall to the respective RPB to determine. However, given how current complaints by RPBs are dealt with, it is unlikely that many breaches would be found.

iii Ensure independence

It is hoped that administrators have conducted their own marketing of the business without simply relying on others (namely the business) to do it for them. The Review quite rightly applies some common sense and reminds administrators that they need to satisfy themselves that the marketing undertaken has been adequate. To satisfy that such marketing efforts have been sufficient will require proof that could be included in the SIP 16 statement. The level of detail would be dependent on the company, but it will be important that the administrator provides clear evidence that independent work has been implemented by itself.

iv Publicise rather than simply publish

Justifying the period of time in which a business has been marketed leaves the possibility that marketing strategies may simply be subjected to standard period slots to remove the prospect of creditors insinuating that businesses have received insufficient marketing timeframes. Naturally, timeframes will be susceptible to the nature and size of the company. However, informing creditors of the reason for the length of time settled upon may undermine the commercial expertise that administrators possess. It is inevitable that a trade-off between the desires of the creditors and the commercial prudence of the administrators has to be kept in check. Ultimately, the administrator is instructed to deal with the company and he or she will make their decision based on the facts and not be influenced by factors that are not relevant to the company obtaining its optimal potential.

v Connectivity

Despite the flexibility promoted in the first few principles, the principle of connectivity aims to encourage the use of online communication – accepting that the internet offers the widest population of any medium. It will naturally depend on the nature and size of the company, but it does encourage administrators to be more mindful about the extent of exposure the business is subjected to. Simply putting an advert in the local paper would, in most cases, be deemed to be insufficient and lack any reasonable justification for keeping the marketing so narrow. Whether any breaches to administrators' professional codes would occur if they fail to adhere to this principle would depend on a holistic look at the marketing effort that has been undertaken. In this day and age, it is imagined that almost all, if not all, administrators are familiar with the internet and this principle is included on the basis of transparency rather than encouraging administrators to act in a different way.

vi Comply or explain

The final principle of comply or explain is aimed at satisfying all creditors that the marketing strategy adopted achieved the best outcome for all creditors. Whether this would lead to administrators releasing their marketing research and findings would pose interesting questions regarding the competency of their skills and whether the administrators had, through the implementation of their duties, satisfied the creditors that they had achieved the best result. By diverting such information, which may or not be sensitive, there would have to be some model of best practice developed by the RPBs. It would be vital to ensure that the reports compiled by administrators were not only consistent, so as to promote consistency across the profession, but it would also be imperative to ensure that a level of confidence be instilled into the process to show the creditors that all that can be done, is being done. To satisfy this end it is therefore necessary that under this principle clear explanations must be provided to justify the action. If not, doubt will prevail as to whether the best marketing strategy has been undertaken.

3.5 Valuations[42]

Recommendation number five states that SIP 16 be amended to the effect that valuations must be carried out by a valuer who holds PII.

One of the main preconceptions that creditors tend to quote as a dislike with the pre-pack process is the way in which a business or assets have been valued. Valuations are clearly imprecise by nature and can change from day to day. However, the concern is not so much with the value, but in knowing that the best price has been obtained by the administrator. To achieve this, the request for an independent valuation makes complete sense and, in practice, should have been the norm anyway. The data from the Final Report shows that, from 497 businesses, an overwhelming majority of 453 cases (91 per cent) sought an independent valuation.[43] Determining the discrepancies, if any, between a possible valuation calculated by an administrator and one by an independent valuer would make for a fascinating read. It must be acknowledged that this test would be the only real way to determine whether the creditors' preconception that administrators undervalue businesses or assets could be proven. Given the lack of research in determining the difference in valuations, it illustrates that the marketing recommendation as stated in the Review is nothing more than an attempt to appease creditors and comfort them with a process that is hoped to be more transparent. But it should be noted that, by proposing such a recommendation, the Review has inadvertently added fuel to the fire and insinuated that the creditors' fear may be justified and that such tasks like valuation should be moved to another professional body that is more experienced in that field.

The Review recommended one important factor in relation to the independent valuer. Part of the requirement for the valuation to be conducted by a valuer with PII was due to providers of such implementing their own stringent checks on those who applied for cover. It was in this knowledge that this would provide some comfort to creditors knowing that the valuation process is executed by someone who is competent and would represent a fair value for the business/its assets. It would therefore be essential, should the administrator choose a valuer without PII, to justify why this is the case; it is likely that this course of action would lead to more PII appointments so that administrators can demonstrate that they have considered the creditors' best interest as a whole.

3.6 SIP 16 – Insolvency Service withdrawal from monitoring SIP statements[44]

Recommendation number six states that the Insolvency Service should withdraw from monitoring SIP 16 statements and that the monitoring be picked up by the RPBs.

42 See Graham Review into Pre-Pack Administration (n 7) 66, para 9.27.

43 Walter and Umfreville (n 5) 23.

44 See Graham Review into Pre-Pack Administration (n 7) 67, para 9.32.

Whilst the Review commends the work conducted by the Insolvency Service over the five years since monitoring commenced, it believed that the review of SIP 16 statements is now best left to the RPBs. The Review was careful to state that the Insolvency Service has shed light onto much of the way in which administrators completed SIP 16 statements. However, going forward it could become more streamlined if the administrators' own professional body monitored the process, thereby developing a closer working relationship. This approach should be adopted with caution. There are already concerns regarding the complaint procedure and how it is perceived that RPBs protect their members from adverse acts, usually initiated by disgruntled creditors. If the RPBs gain the responsibility to review their members' SIP 16 statements, then transparency will be absolutely critical to ensure there is trust within the system. It is acts such as this that could further undermine the pre-pack process, rather than reinvent it as a process. A way to address the fear would be for the RPB to regularly publish details relating to the statements received and, if necessary, make its decisions available for scrutiny.

4 Future implications

4.1 Regulation

The preference for regulation, even if reduced, is highly favoured by the Review. Much of this rests with the desire to take non-invasive action against a profession that is deemed to be quite capable of regulating its own business and members. Whilst the Review provided a pronouncement to the insolvency profession that, if it did not address the concerns, legislation would more than likely follow, the real problem is implementing the required changes across the different RPBs. For instance, many professions have one professional body, such as the Institute of Civil Engineers which regulates 86,000 members from 150 countries around the world. By contrast, there are eight RPBs that regulate 1735 insolvency practitioners.[45] A solution that addresses the recommendations and ensures a consistent approach is implemented across all insolvency work would be to merge the RPBs to create one professional body accountable for regulating all insolvency practitioners. Greater unity between those who work in the profession could only lead to a more transparent system. The structure of how they operate could probably remain the same, whilst recognising that Scotland and Ireland may have some slight differences. All members could ultimately come under one body that could possibly be named the Association of Responsible Insolvency Professionals (ARIP).

4.2 Legislation or compromise

Creating the necessary framework that would legislate pre-packs would in some ways mirror the provisions that govern administration. If the profession fails to adhere to the Review and adopt the six recommendations, there will be some trepidation as to what would happen next. It has been stressed in the Review that legislating pre-packs is not the desirable outcome, therefore a compromise is likely to follow. A best practice approach would involve recommendations one and two giving way, particularly since they are only recommended on a voluntary basis, for the certainty that recommendation four is addressed urgently. If the marketing of businesses complies with the six principles of good marketing, it is entirely possible that this could be incorporated in either SIP 16, or some additional guidance code that insolvency practitioners must follow. It is again likely

45 See Association of Business Recovery Professionals (R3) 'The Future of Insolvency Practitioner Regulation' <www.r3.org.uk/media/documents/policy/policy_papers/insolvency_industry/The_future_of_insolvency_practitioner_regulation.pdf>.

that, even if a compromise was struck, further amendments to the adopted recommendations would be likely as, for example, the marketing and valuation principles, due to their new nature, will require some tweaking.

4.3 Ban on pre-packs

Prohibiting the use of pre-packs would only lead to another model developing, likely reflecting the original model in all but name. The truth is that pre-packs serve a purpose and fill the void when administration cannot assist. Preconceptions that surround pre-packs, whether true or not, have resulted in an unfair amount of negative attention. This has invariably tarnished the reputation of a procedure that above all else tries to procure a better result for the troubled company than would likely be achieved through administration. The reality is that administration is not a process that suits all companies and so another, alternative, system is required to ensure troubled companies do not needlessly fail.

5 Alternatives?

If the main concern about accepting the recommendations is that the value of the company may be diminished if secrecy is not maintained, then it should be emphasised that the justifications and reasons for the sale to connected parties must be made available after the process has been implemented. A cooling-off period of 14 days could be introduced which would allow the proposals to be reviewed by members to ensure that the deal is sufficient. This is not too dissimilar to recommendation one, except that this still allows the deal to go ahead in secrecy, albeit in the knowledge that, if a bad deal is submitted, then it will be discarded within the 14 days and the potential opportunity will be lost, unless a compromise on the original deal can be met.

6 Conclusion

The six recommendations put forward by the Graham Review go some way to alleviating the stigma that presently surrounds the pre-pack process. Existing professional guidance from the RPBs in the form of SIP 16 does set out a number of principles to assist administrators in implementing pre-packs, but it does not address a number of key issues such as marketing and valuation. These two principles alone would help to appease creditors, knowing that the company has been properly evaluated and accurate values have been placed on the company. The inclusion of these two principles in a newly drafted SIP 16 would demonstrate that the profession was serious about operating in a more transparent environment.

It should be noted that the criticisms surrounding pre-packs have been around for some time and the lack of any real attempt to deal with them has caused the negative perceptions to grow. The absence of solutions, or the will to address the concerns, has raised the possibility that the perception of abuse is perhaps greater than the actual occurrence of it. However, according to the data compiled by Wolverhampton University, some of the creditors' fears are essentially substantiated – namely that most pre-packs do involve the sale to connected parties.

If the sale to connected parties remains the biggest concern, the implementation of the six principles as recommended by Graham will make no difference to appeasing the creditors. The reality is that, on the whole, connected parties offer a better deal for the company than an outside investor. In some cases this deal is the only option available for the company and hence a lifeline for employees and businesses that rely on it. By endorsing the six principles, the process will still permit the sale to connected parties. If creditors can accept this, but argue it is not the outcome that they challenge but the process in which it is achieved, then the Graham principles may be successful.

As to whether the endorsement of the six principles would be enough to prevent eventual legislation is probably wishful thinking. This is evident for a number of reasons.

Firstly, the voluntary nature of the pre-pack pool and the viability review remains a serious concern. If purchasers do not wish to participate, there are no incentives to encourage them to change their minds and, in turn, there are no consequences for pursuing a strategy outside of the pool. Whilst the logic of having two options available tries to compromise on allowing secrecy to be maintained where required to assist a deal, it begs the question of just how many purchasers would subject their deal to the pool? The better solution would be to submit all potential deals to the pool and insist on strict confidentiality clauses around the process.

Secondly, the viability review itself is nothing short of an optimistic business plan with a hope that things will work out. No guarantees can be given about future success so it is questionable whether a good business plan is any better than a bad one? A good plan can perhaps sell an idea, give a better forecast, but ultimately the market in which the company operates will decide its fate and this is something that cannot be that easily predicted, as many companies have found out since the collapse of British bank Northern Rock.

Thirdly, alternatives to legislation either result in an increase in regulation or the position remaining the same. Since no change is likely to result in legislation, additional regulation would only serve to bring pre-packs one step closer to being legislated. It appears from this position that legislation is imminent. To ban the process would result in the realisation that the pre-pack process is actually needed, which brings us to the more pertinent question: what is the main benefit of the pre-pack? The answer rests with the flexibility it affords administrators in completing a deal to save a business without having to adhere to the stringent processes that classic administration possesses. Based on this, should the profession reject the Graham Review recommendations and stand firm against any change? It is unlikely that it will have a choice – change is coming whether the profession likes it or not. On a final point, what the Review fails to acknowledge is that it is not the pre-pack process itself that is the problem, but *the environment in which business is conducted*. There is a general mistrust in the UK when it comes to a company suffering financial troubles. Whilst it may be the case that the management may have caused these, the fear of malicious abuse being involved often materialises. This, combined with pre-packs allowing old management to buy back the company, creates an unsavoury taste for creditors who suspect, perhaps wrongly, that the management has somehow benefited at their expense. In order for the Graham Review to have teeth, there perhaps needs to be an additional recommendation that creditors' attitudes to insolvency proceedings need to informed and realistic.