

23 February 2010

Dear Sir/Madam

Statement of Insolvency Practice 16 – pre packaged sales in administrations

It is now a little over a year since Statement of Insolvency Practice 16 – pre packaged sales in administrations (SIP 16), came into force. Pre packs remain a high profile and controversial subject, and elicit strong views from both within and outside of the insolvency profession.

The Joint Insolvency Committee, which commissioned the production of the SIP, is now seeking your views on whether SIP 16 is achieving its primary purpose, i.e. that:

creditors are provided with a detailed explanation and justification of why a pre-packaged sale was undertaken, so that they can be satisfied that the administrator has acted with due regard for their interests.

We will also be seeking your views on whether the SIP provides sufficient guidance for insolvency practitioners who are a party to a pre packaged sale.

Since SIP 16 came into force, the Insolvency Service has been monitoring SIP 16 reports produced by insolvency practitioners. The findings of their review¹ led the Insolvency Service to issue further guidance in October 2009 in the form of a Dear IP letter to insolvency practitioners (Dear IP 42). The Insolvency Service believes that the SIP should be amended in line with that guidance, so the JIC's consultation also seeks your views on those proposed amendments.

For the avoidance of doubt, we are not asking whether you believe pre packs are an appropriate use of insolvency legislation or whether their use should be restricted in some way.

Attached to this letter is a questionnaire for your completion. I would be grateful if you could complete and return this questionnaire by 21 May 2010. A copy of Dear IP 42 is attached and it would be helpful if you could refer to this when completing the questionnaire. This consultation is being sent to all insolvency practitioners and to others identified as having an interest in insolvency (see list below). If you think there are others whose views we should be seeking, please let us know.

Yours faithfully



Tracy Stanhope
Secretary to the Joint Insolvency Committee

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Documents attached; 1) consultee list, 2) SIP 16, 3) Dear IP 42

¹ <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/sip16-final.pdf>

The members of the Joint Insolvency Committee represent the bodies that regulate the practice of insolvency in Great Britain: The Association of Chartered Certified Accountants; Chartered Accountants -Ireland; The Insolvency Service; Insolvency Practitioners Association; ICAEW; The Institute of Chartered Accountants of Scotland; The Law Society of Scotland; Solicitors Regulation Authority.

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JOINT INSOLVENCY COMMITTEE

List of consultees

Accountant in Bankruptcy
Advice UK
Asset Based Finance Association
Association of British Insurers
Bank of England
Bankruptcy Advisory Service
Bankruptcy Association
British Bankers Association
British Printing Industries Federation
British Property Federation
CBI
CBI (Scotland)
CCCS
Citizens' Advice
Citizens Advice Scotland
Civil Court Users Association
Committee of Scottish Clearing Banks
Compliance on Call
Consumer Credit Association
Consumer Voice
Council of Mortgage Lenders
Council of Mortgage Lenders (Scotland)
Credit Services Association
DWP
EEF
Energy Retail Association
Federation of Small Businesses
Finance & Leasing Association
Financial Ombudsman Service
Forum of Private Businesses
Freshfields Bruckhaus Deringer LLP
FSA
Hammerson Plc
HMRC
HMRC(Scotland)
IFT
Insolvency Lawyers Association
Institute of Credit Management
Institute of Directors
Institute of Directors (Scotland)
Institute of Money Advisors
Insolvency Practices Council
Land Securities Group PLC
Law Society of England and Wales
Law Society of Scotland
Loan Market Association
Local Government Association
Max Recovery
Money Advice Scotland
NARA
National Consumer Federation
OFT
Pension Protection Fund
R3
Scottish Policy Unit, Federation of Small
Businesses
TDX
The Notaries Society
TUC
Water UK

STATEMENT OF INSOLVENCY PRACTICE 16 (E & W)

PRE-PACKAGED SALES IN ADMINISTRATIONS

INTRODUCTION

This Statement of Insolvency Practice (SIP) is one of a series of guidance notes issued to licensed insolvency practitioners with a view to maintaining standards by setting out required practice and harmonising practitioners' approach to particular aspects of insolvency.

SIP 16 is issued under procedures agreed between the insolvency regulatory authorities acting through the Joint Insolvency Committee (JIC). It was commissioned by the JIC, produced by the Association of Business Recovery Professionals, and has been approved by the JIC and adopted by each of the regulatory bodies listed below:

Recognised Professional Bodies:

- The Association of Chartered Certified Accountants
- The Insolvency Practitioners Association
- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants in Ireland
- The Institute of Chartered Accountants of Scotland
- The Law Society
- The Law Society of Scotland

Competent Authority:

The Insolvency Service (for the Secretary of State for Business, Enterprise and Regulatory Reform.)

The purpose of SIPs is to set out basic principles and essential procedures with which insolvency practitioners are required to comply. Departure from the standard(s) set out in the SIP(s) is a matter that may be considered by a practitioner's regulatory authority for the purposes of possible disciplinary or regulatory action.

SIPs should not be relied upon as definitive statements of the law. No liability attaches to any body or person involved in the preparation or promulgation of SIPs.

STATEMENT OF INSOLVENCY PRACTICE

1. In this Statement of Insolvency Practice the term 'pre-packaged sale' (or 'pre-pack') refers to an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on, or shortly after, his appointment.

2. Practitioners who are party to a pre-packaged sale, whether as adviser to the company before the appointment, as the appointed administrator, or both, should bear in mind the duties which they, and those who act on their advice, owe to parties who might be affected by the arrangement, and should have regard to the associated risks. They should keep a detailed record of the reasoning behind the decision to undertake a pre-packaged sale, and should be able to explain and justify why such a course of action was considered appropriate.

The legal authority for pre-packaged sales

3. In a series of cases² the courts have held that, where the circumstances of the case warrant it, an administrator has the power to sell assets without the prior approval of the creditors or the permission of the court. However, it should be borne in mind that reliance on such authority does not protect administrators from potential challenges to their conduct under paragraph 74, or claims for misfeasance under paragraph 75, of Schedule B1 to the Insolvency Act 1986. In order to avoid the risk of such exposure, care should be taken to ensure that such power is only exercised in genuine furtherance of the purpose of administration.

Preparatory work

4. The preparation for a pre-packaged sale highlights a number of issues which arise in other contexts, but which are thrown into sharper focus in the particular circumstances of a pre-pack.

5. Practitioners should be clear about the nature and extent of their role and their relationship with the directors in the pre-appointment period. Where they are instructed to advise the company, they should make it clear that their role is to advise the company and not to advise the directors on their personal position. The directors should be encouraged to take independent advice. This is particularly important if there is a possibility of the directors acquiring an interest in the assets in the pre-packaged sale.

6. Practitioners should bear in mind the duties and obligations which are owed to creditors in the pre-appointment period. They should be mindful of the potential liability which may attach to any person who is party to a decision that causes a company to incur credit and who knows that there is no good reason to believe it will be repaid. Such liability is not restricted to the directors.

7. When considering the manner of disposal of the business or assets, administrators should bear in mind the requirements of paragraphs 3(2) and 3(4) of Schedule B1 to the Insolvency Act 1986. These provide that:

- the administrator must perform his functions in the interests of the company's creditors as a whole, and
- where the objective is to realise property in order to make a distribution to secured or preferential creditors, the administrator has a duty to avoid unnecessarily harming the interests of the creditors as a whole.

Administrators engaged in a pre-packaged sale should therefore be able to demonstrate that they have considered the above.

Disclosure

8. It is in the nature of a pre-packaged sale in an administration that unsecured creditors are not given the opportunity to consider the sale of the business or assets before it takes place. It is important, therefore, that they are provided with a detailed explanation and justification of why a pre-packaged sale was undertaken, so that they can be satisfied that the administrator has acted with due regard for their interests.

9. The following information should be disclosed to creditors in all cases where there is a pre-packaged sale, as far as the administrator is aware after making appropriate enquiries:

- The source of the administrator's initial introduction
- The extent of the administrator's involvement prior to appointment

² *T&D Industries Plc* [2001] 1 WLR 646; *Transbus International Ltd* [2004] EWHC 932 (Ch), [2004] All ER 911; *DKLL Solicitors* [2007] EWHC 2067 (Ch)

- Any marketing activities conducted by the company and/or the administrator
- Any valuations obtained of the business or the underlying assets
- The alternative courses of action that were considered by the administrator, 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
- Whether efforts were made to consult with major creditors
- The date of the transaction
- Details of the assets involved and the nature of the transaction
- The consideration for the transaction, terms of payment, and any condition of the contract that could materially affect the consideration
- If the sale is part of a wider transaction, a description of the other aspects of the transaction
- The identity of the purchaser
- Any connection between the purchaser and the directors, shareholders or secured creditors of the company
- The names of any directors, or former directors, of the company who are involved in the management or ownership of the purchaser, or of any other entity into which any of the assets are transferred
- Whether any directors had given guarantees for amounts due from the company to a prior financier, and whether that financier is financing the new business
- Any options, buy-back arrangements or similar conditions attached to the contract of sale

10. This information should be provided in all cases unless there are exceptional circumstances, and if this is the case, the reason why the information is not provided should be stated. If the sale is to a connected party it is unlikely that considerations of commercial confidentiality would outweigh the need for creditors to be provided with this information.

11. Unless it is impracticable to do so, this information should be provided with the first notification to creditors. In any case where a pre-packaged sale has been undertaken, the administrator should hold the initial creditors' meeting as soon as possible after his appointment. Where no initial creditors' meeting is to be held and it is impracticable to provide the information in the first notification to creditors it should be provided in the statement of proposals of the administrator which should be sent as soon as practicable after his appointment.

12. The Insolvency Act 1986 permits an administrator not to disclose information in certain limited circumstances. This Statement of Insolvency Practice will not restrict the effect of those statutory provisions.

Effective from 1 January 2009

DEAR INSOLVENCY PRACTITIONER
Issue 42 – October 2009

*Message from Stephen Leinster
Director of Policy – Technical, Legislative
and Professional Regulation*

Dear Insolvency Practitioner

Attached is a special edition of Dear IP which provides guidance on SIP16 (Pre-packaged sales in administrations).

The guidance, produced in consultation with the Recognised Professional Bodies, has been framed in the light of The Service's experience of reviewing SIP 16 disclosure information during the course of 2009. I hope that you find the guidance useful in ensuring that your SIP16 disclosure statements to creditors provides them with a detailed explanation and justification of why pre-packaged sales are undertaken.



CUSTOMER SERVICE EXCELLENCE



INVESTOR IN PEOPLE

A BIS SERVICE

14. Statement of Insolvency Practice 16 – Guidance for Insolvency Practitioners

The following guidance has been produced in consultation with the Recognised Professional Bodies (RPBs) and has been issued to all insolvency practitioners by the Insolvency Service. The guidance has been framed in the light of The Service's experience of reviewing SIP 16 disclosure information during the course of 2009. The purpose of the guidance is to assist practitioners in complying with the disclosure requirements of Statement of Insolvency Practice (SIP) 16 when undertaking pre-packaged sales in administrations. The RPBs have seen this guidance and have agreed to have regard to it when considering possible failures to comply with SIP 16 by practitioners licensed by them.

INTRODUCTION

Practitioners are reminded that the key principle of SIP 16 is contained in Paragraph 8 of the SIP:

It is important that [creditors] are provided with a detailed explanation and justification of why a pre-packaged sale was undertaken, so that they can be satisfied that the administrator has acted with due regard for their interests.

Practitioners should note that the experience of the Insolvency Service in reviewing SIP 16 statements submitted shows that giving a short response to the bullet point disclosure requirements listed in paragraph 9 of the SIP alone is unlikely to provide the detailed explanation and justification required by paragraph 8.

Practitioners should aim to provide sufficient information to ensure that creditors do not need to ask further questions of the practitioner about the justification for the pre-packaged sale and details of it.

Practitioners should satisfy themselves that the information disclosed provides the detailed explanation and justification required. It should be remembered that not all creditors will be familiar with the trading activities of the company and they may be unaware that the company has been experiencing financial difficulties. Sufficient background information should be provided for creditors to be able to ascertain the context in which the practitioner has been appointed, including following:

- What the company did
- What financial pressures the company was under and the primary cause of the company's insolvency
- In the case of a qualifying floating charge appointment how the company was in default and in all other cases why the company was insolvent
- Where relevant, why the pre-packaged sale has been used as a vehicle for some form of corporate restructuring (e.g. debt/equity swaps etc.)

- Any issues which have necessitated a speedy sale of the assets / business.

In some situations practitioners may consider it undesirable to disclose certain information (e.g. because it might hamper further realisations and thus not be in the interests of creditors). Specific provision is made for this in paragraphs 10 and 12 of the SIP; however, where information is being withheld the reason for this should be disclosed in all but the most exceptional of situations.

TIMING

Paragraph 11 of the SIP provides that unless it is impracticable to do so the relevant information should be sent with the first notification to creditors.

One of the fundamental purposes of the SIP is to make it clear to creditors at an early stage why a pre-packaged sale has been carried out, shortly following appointment, and that the practitioner has acted with regard to their interests. This purpose would be defeated if the SIP 16 disclosure was simply to be included in the administration proposals several weeks after appointment.

It is expected that in the majority of cases SIP 16 information should be sent to creditors within a few days of the practitioner's appointment or upon completion of the sale. *In all but the most exceptional of cases SIP 16 information should be sent to creditors within 14 days of the completion of the sale.* If practitioners have been unable to meet this requirement they should explain the reasons for the delay in their disclosure.

The convenience of the practitioner should not be a factor in considering what may be impracticable and a failure to have collated the information or undertaken adequate preparatory work will not justify late disclosure.

It is envisaged that practitioners will be collating the requisite information from the moment the decision to execute a pre-packaged sale is taken to enable them to provide the information to creditors in accordance with the timescale above.

GUIDANCE ON SPECIFIC DISCLOSURE REQUIREMENTS

The following three requirements of paragraph 9 of the SIP relate to how the practitioner became involved in the negotiations and the marketing activities undertaken, which led to the pre-packaged sale. The information provided should be sufficient to enable the creditors to readily understand the extent of the work undertaken by the practitioner before their appointment as administrator and the process that led to the decision to sell to the eventual purchaser.

The source of the practitioner's initial introduction

The name of any introducer and their relationship to the company and/or the directors, and the circumstances leading to the referral, form an integral aspect of the detailed explanation required for creditors to understand the circumstances leading to the pre-

packaged sale and the context in which the practitioner became involved. These details should, therefore, be disclosed under this heading.

Practitioners should also disclose the date of their formal engagement by the company when detailing their involvement.

The extent of the practitioner's involvement prior to appointment

Sufficient information should be provided by practitioners to identify any previous relationship between the practitioner (which should include the practitioner's firm) and the company and/or directors.

Many creditors will have only a limited understanding of formal insolvency proceedings and an explanation that the practitioner, not the directors, has undertaken the sale negotiations with the prospective appointment of an administrator in mind, may help to avoid misunderstandings.

Any marketing activities conducted by the company and/or the practitioner

In order for creditors to understand the circumstances leading to the pre-packaged sale, the practitioner should disclose details of the process that led to the decision to sell to the eventual purchaser. It is recognised that the degree of marketing will vary on a case by case basis and that practitioners will have considered many factors in reaching the decision to conduct any marketing exercise or, in some cases, not to market the business.

Details of the nature of any marketing activities that were carried out by the company and/or practitioner should be provided or alternatively an explanation provided as to why it was decided not to undertake any marketing. If the business was marketed, and a number of expressions of interest and/or offers were received, it is important that summary information about the outcome of the marketing (such as the number of offers received, the range of consideration offered and the fact that the best offer was accepted) are disclosed, so that the outcome of the marketing exercise is clear.

INFORMATION REGARDING ASSETS

The following three requirements of paragraph 9 of the SIP relate to the description, valuation and sale of the assets of the company. This information should be disclosed showing the various categories of assets of the company in a comprehensible format, so as to allow the creditors to readily understand the values of the assets within the company and how these have been sold.

Any valuations obtained of the business or the underlying assets

Practitioners will be aware of the importance of ensuring that independent valuations are carried out wherever possible. The level of detail that practitioners will be able to provide will depend upon the type of valuation that has been carried out and nature of the assets, but generally:

- valuations should be disclosed with sufficient detail for creditors to understand the values placed upon the various categories of assets. Where it is otherwise unclear, information should be provided as to how any value attributed to goodwill has been determined.
- the basis upon which the business has been valued. This may include valuations on a going concern or break up basis, and any valuations of the underlying assets of the business, whether in-situ or ex-situ.
- the name of the valuer used should be included in all cases.

Where valuations have not been obtained by the practitioner an explanation should be provided as to why not. Alternatively information should be provided as to what reliance, if any, has been placed on valuations previously obtained by the company or its lender(s), such information being in the same format as above.

Details of the assets involved and the nature of the transaction

Practitioners should provide details of the assets by reference to categories as noted above and provide other related information regarding assets sold whose value is complex or not readily ascertainable (e.g. rights of action or a sale of shares in a subsidiary).

Details should also be provided of significant assets not included in the sale agreement.

The consideration for the transaction, terms of payment and any condition of the contract that could materially affect the consideration

Practitioners should ensure that disclosure of the sale consideration is broken down by asset category as noted above; asset categories should, wherever possible, correspond to the categories used to report any valuation obtained, allowing creditors to compare realisations with valuations. In the case of group companies, creditors should be able to understand how the consideration is being apportioned between companies within the group if it is relevant.

When there is a significant difference between the valuations and realisations practitioners should provide an explanation why that is the case.

In circumstances where an element of the consideration has been deferred, or where the level of consideration is dependent upon the future performance of the purchaser, however so defined (e.g. turnover, profits, the achievement of particular targets or the outcome of negotiations with third parties), the structure and timescale of any such payment should be made clear.

Details should be disclosed of any security obtained for deferred consideration, or alternatively confirmation should be provided that no security has been obtained.

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