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The Case for Mandatory Referrals to the Pre-pack Pool

Bolanle Adebola¹

Introduction

1-001.

This paper contributes to the debate on the future of the Pre-pack Pool ('Pool'), which has been remarkably underused since its establishment in 2015.² The Pool is a body of business experts introduced to improve the oversight of the pre-pack administration procedure ('Pre-pack').³ The Pre-pack is a variant of the administration procedure, which aims to facilitate the rehabilitation of distressed companies and/or their businesses. The Pre-pack has become the most utilised business rescue procedure in England and Wales.⁴ Its use has, however, drawn much criticism because of its opacity, propensity to exclude stakeholders and susceptibility to abuse.⁵ Such is the censure that it draws, that successive governments have since 2009 introduced reforms to improve its transparency and mollify the excluded stakeholders; culminating in the 2015 changes which ushered in the Pool. The Pool exercises oversight of Pre-pack sales to persons connected to distressed entities. These Pre-packs have attracted the worst criticisms from stakeholders, who believe that they are the most prone to abuse.⁶

Since its introduction, only a handful of eligible Pre-packs have approached the Pool.⁷ This has been attributed to the fact that applications to the Pool are voluntary and the failure to apply

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² Pre-Pack Pool, "Annual Review 2016" <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack%20Pool%20Annual%20Review%202016-17.pdf> [Accessed 1 March 2019], p.6; Pre-Pack Pool, "Annual Review 2017" <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack-Pool-Annual-Review-2017.pdf> [Accessed 1 March 2019], p. 4.

³ T. Graham, "Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP" (June 2014), <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], p.59.

⁴ P. Walton, C. Umfreville and P Wilson, "Pre-Pack Empirical Research: Characteristics and Outcome Analysis of Pre-pack Administration" <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], p.85, para 5.

⁵ P. Walton, "Prepackin' in the UK" (2009)18 Int.Insolv.Rev., 85-108, A. Sakoui and K. Stacey, "Investors call for 'pre-pack' changes" (Financial Times, 9 December 2008), J. Moulton, "The Uncomfortable Edge of Propriety-Pre-packs or Just Stitch-ups?" (2005) Recovery (Spring), 2 but see R Singh, 'Jon Moulton Makes U-Turn on Pre-Packs' (Accountancy Age, 18 June 2010).

⁶ House of Commons: Business, Innovation and Skills Committee, "The Insolvency Service" pp.22, paras 69-70; "Written Evidence Submitted by the Association of British Insurers" Ev.pp.51 (Sixth Report of Session 2012-13).

⁷ Pre-Pack Pool, "Annual Review 2017" [2018] <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack-Pool-Annual-Review-2017.pdf> [Accessed 1 March 2019], pp.2-3.

draws no penalty.⁸ When the numbers reduced from a trickle to mere drops in 2017, it prompted a government inquiry into the practice, as well as calls to make referrals to the Pool compulsory.⁹ As we await the outcomes of the government's investigations, this paper advocates the direction that should be adopted by policy makers. To that end, it calls for mandatory referrals to the Pool. This approach will halt selective applications to the Pool, as well as the selective disclosure of outcomes of applications to practitioners and unsecured creditors; both of which the voluntary referral approach permits. It argues, further, that mandatory referrals will ensure that the Pre-packs concerned receive appropriate oversight, which will provide comfort to the groups that have been the most concerned about them. Mandatory referrals will also ensure adequate oversight of business rescues at the small and micro end of the market. Finally, the insight obtained by the Pool will help improve our understanding of the abusive practices in the Pre-pack landscape, which is vital to improving its governance. Ultimately, the corollary to mandatory referrals would be an improved reputation for the Pre-pack which the cross-section of stakeholders desire.

The paper is divided into three sections. The first section sets out the context in which the Pool was proposed. The ensuing section examines the declining number of referrals to the Pool, to demonstrate the failure of the voluntary approach. The third section examines the case for and against mandatory referrals to the Pool, by critically examining the opinions of industry experts and academics. The conclusion reiterates the case for mandatory referrals to the Pool.

The Pre-pack Pool: Emergence in Pre-pack Regulation

1-002.

The Pool is an independent body of experienced business people, who could be approached to review a proposed Pre-pack, when it involves the sale of the business and/or assets to previously-connected persons.¹⁰ The Pre-pack refers to an administration process in which an insolvency practitioner is appointed to execute a pre-agreed sale of the distressed business

⁸ T. Graham, "Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP" (June 2014), <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], p.62, paras 9.10.

⁹ R3, "Government Pre-pack Review Opportunity for Improvement" (13 December 2017); "Calls for CVAs to be Referred to the Pre-pack Pool as Concerns Increase about their Use" <https://www.walkermorris.co.uk/publications/calls-for-cvas-to-be-referred-to-the-pre-pack-pool-as-concerns-increase-about-their-use/> [Accessed 1 March 2019].

¹⁰ Pre Pack Pool, "Annual Review 2016" [2017] <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack%20Pool%20Annual%20Review%202016-17.pdf> [Accessed 1 March 2019], pp.4

shortly after appointment; without recourse to the general body of creditors.¹¹ Previously-connected persons are those with significant control powers in relation to the distressed company, including its directors and shareholders but excluding secured creditors who lend in the normal course of business.¹² Associates of these persons, whether natural or corporate, are also included in the definition.¹³ Thus, members of the Pool can be approached where the business is to be sold to those who had been in control of the distressed entity or their associates, without consulting the unsecured creditors.

1-003.

The Pre-pack has always sat uneasily in the insolvency system. Its merits include the speed and certainty through which the businesses and goodwill of distressed entities can be preserved.¹⁴ This ensures that the business survives and can continue to service its contracts without onerous changes to contractual terms, as would be the case if trading in administration.¹⁵ It saves the costs of practitioner trading and facilitates the retention of employees who might otherwise jump ship.¹⁶ At the same time, the Pre-pack has evoked much censure since it rose to the consciousness of the insolvency industry.¹⁷ The main criticisms have been the opacity of the negotiations. This tactic results in the exclusion and disenfranchisement of unsecured creditors, who are neither informed nor consulted during the process.¹⁸ They only become aware of the negotiations after the sale is in place. Such outcomes have led unsecured creditors to accuse secured lenders and practitioners of collusion.¹⁹ The allegation of collusion is made worse by

¹¹ Statement of Insolvency Practice 16, “Pre-packed Administrations”, https://www.r3.org.uk/media/documents/technical_library/SIPS/SIP%2016%20Version%203%20Nov%202015.pdf, [Accessed 1 March 2019], paras 1.

¹² Insolvency Act 1986, s.249; T. Graham, “Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP” (June 2014), <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], pp.60-61, paras 9.5-9.6.

¹³ Insolvency Act 1986, s.435.

¹⁴ S. Frisby, “The Pre-pack Promise: Signs of Fulfilment?” (2010) *Recovery* (Spring) pp.30; M. Parkhouse and K. Scott, “A Fair Deal?” <https://www.newlawjournal.co.uk/content/fair-deal> [Accessed 1 March 2019].

¹⁵ N. Khan, “Holding Rescue to Ransom” (2011) *Recovery* (Spring), pp.40.

¹⁶ R3, “Pre-packaged Sales” https://www.r3.org.uk/media/documents/publications/press/Pre-packs_briefing.pdf [Accessed 1 March 2019], pp.1.

¹⁷ P. Walton, “Pre-packaged Administrations – Trick or Treat?” (2006) 19 *Insolv.Int.*, pp.113-120; A. Sakoui and K. Stacey, “Investors Call for ‘Pre-pack’ Changes”, (*Financial Times*, 9 December, 2008); N. Craven and L. Mills, “‘Pre-pack’ Deals Risk Cheating Creditors: Private Equity Boss Warns of Abuse over ‘Quickie Bankruptcy’” (*This is Money*, 5 January 2009).

¹⁸ W. Lyons, “Pre-pack Administration: Winners and Losers” (2011) 2 *International Corporate Rescue*, pp.102 - 108, 106. For minority shareholder complaints, see: R. Lawson, “Pre-packs Dump Minority Shareholders Too” (*FT* 14 April 2017); House of Commons: Business, Innovation and Skills Committee, “Written Evidence Submitted by ShareSoc (UK Individual Shareholders Society Ltd), (Sixth Report of Session 2012-13), Ev.pp.84-85.

¹⁹ “Landlords Hit Out at Rise of Non-compliant Pre-packs (*Insolvency News*, 16 May 2012).

the fact that the directors or their associates may also be the purchasers of the business. Pre-pack sales to previously-connected persons have been excoriated by those who denounce it as merely an avenue through which directors and their associates rid the business of its debts, in circumstances in which its creditors have no say.²⁰ It has also been pilloried by the press; bringing the rescue system and profession to disrepute.²¹

1-004.

Policy-makers have responded to the criticisms of the Pre-pack by introducing measures to improve its governance. In 2009, Statement of Insolvency Practice 16 ('SIP 16') was introduced to address the information deficit.²² It requires practitioners to provide information about the decision to Pre-pack and the sale to unsecured creditors, as soon as practicable after the sale. It has undergone two revisions since its introduction; each aiming to improve on the transparency and management of the pre-pack process. The Insolvency Code of Ethics 2009 also directs practitioners on the values necessary for the fair and effective discharge of their responsibilities.²³ While these measures have been welcome, they have not fully satisfied the critics. Further legal reforms were however halted by mixed responses to consultations in 2010.²⁴ Given the continued buzz around the Pre-pack, an independent review was commissioned in 2013, to assess its impact stakeholders and the economy.²⁵ This became known as the Graham Review.

As with previous reviews of the Pre-pack process, the Graham Review found that the Pre-pack played a potentially useful role in the economy. It facilitates the preservation of jobs and businesses.²⁶ It found that Pre-packs typically resulted in sales to previously-connected

²⁰ House of Commons: Business, Innovation and Skills Committee, "The Insolvency Service" pp.22, paras 69-70; "Written Evidence Submitted by the Association of British Insurers" Ev.pp.51 (Sixth Report of Session 2012-13); A.Brown, "Printers, Pre-packs and Practitioners' Fees" (2014) *Recovery* (Winter), pp.41.

²¹ T. Webb, "Crackdown on 'Phoenix' Insolvency Deals", (*Guardian*, 19 March 2010); L. Haddou and J.Cumbo, "Companies Use 'Pre-packs' to Dump £3.8bn of Pension Liabilities" (*FT*, 9 April 2017).

²² R3, "Pre-packs and SIP 16" (March 2010) pp.3.

²³ The Insolvency Service, "Insolvency Code of Ethics: Background and Overview" <https://www.gov.uk/government/publications/insolvency-practitioner-code-of-ethics> [Accessed 1 March 2009]

²⁴ G Ruddick, "Pre-pack Administration Overhaul Dropped" (*Telegraph* 26 January 2012). Insolvency Service, "Improving the Transparency of, and Confidence in, Pre-packaged Sales in Administration" Summary of Consultation Responses (March 2011)

²⁵ T. Graham, "Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP" (June 2014), <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], pp.4.

²⁶ *ibid*, pp. 23 – 28.

persons, which helped give a second chance to entrepreneurs.²⁷ Still, the Review recognised that the Pre-pack had governance challenges, such as insufficient marketing, as well as the poor valuation methods employed to determine the value of distressed business. The Graham Review also noted that the procedure was characterised by a general lack of transparency and poor oversight.²⁸ Finally, it observed that inadequate focus was paid to post-rescue viability. This, it believed, resulted in Pre-packs sales to previously-connected persons failing twice as often as sales to their unconnected counterparts.²⁹ It concluded that these practices have left unsecured creditors feeling short-changed, with good reason.³⁰

1-005.

To remedy the poor Pre-pack practices, the Graham Review proposed a menu of reforms including guidance on marketing and valuation which were subsequently incorporated into SIP 16.³¹ It also made recommendations aimed solely at Pre-pack sales to previously-connected persons. It proposed that the previously-connected persons obtain a business viability statement whenever they were to purchase the business through a Pre-pack. More radically, it added a layer of independent oversight by creating the Pool.³² The Pool operates as a limited liability company comprising 19 members drawn from various industries, to whom cases are allocated on strict rotation basis.³³ To qualify to become a member of the Pool, a person must have had at least 10 years board experience.³⁴ Some of its members have belonged to associations which have been critical of the Pre-pack, and could be expected to be aware of the practices to watch out for.³⁵ To avoid conflicts of interest, practising insolvency practitioners cannot join the Pool; though their retired counterparts may be accepted.³⁶ Its operation is monitored by the Oversight

²⁷ P. Walton, C. Umfrville and P Wilson, “Pre-Pack Empirical Research: Characteristics and Outcome Analysis of Pre-pack Administration” <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], paras A.2.1.

²⁸ T. Graham, “Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP” (June 2014), <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], p.51.

²⁹ *ibid* p.37

³⁰ *ibid* pp.29-51.

³¹ *Ibid* pp.64-66.

³² *Ibid* pp.59-62.

³³ G. Hindle, “Pre-packs – The Latest Attempt at Transparency” [Lexology- December 7 2015], pp.1.

³⁴ P. Dutton and L. McAuley, “Addressing Concerns About Pre-packs – The ‘pre-pack Pool’” [Lexology – March 24, 2016], pp.1

³⁵ Duncan Grubb, the Pool director was former chair of the British Property Federation’s insolvency committee.

³⁶ G. Hindle, “Pre-packs – The Latest Attempt at Transparency” [Lexology- December 7 2015], pp.1.

Group comprising interested professional bodies through a service agreement.³⁷ Its secure online portal was open to receive applications from the 2nd of November 2015.³⁸

Ms Graham believed that the introduction of the Pool would inject additional transparency into the Pre-pack process, whilst maintaining the speed and confidentiality of the process. Also, that the independent oversight would give the body of creditors the assurances they sought that their interests would be carefully considered during the Pre-pack. The changes were introduced amidst mixed reviews. There was a mood of cautious optimism that the additional transparency would improve the process and reduce the noise around Pre-packs.³⁹ A parallel view criticised the utility of the Pool.⁴⁰ The main criticisms included how to pull together a Pool of suitable business experts and how to ensure their efficiency. Commentators also criticised the voluntary approach and the fact that the Pool did not have to account for its opinion.⁴¹ The next section examines the success of the pool, so far.

The Ineffectiveness of the Voluntary Approach

1-006.

To receive the opinion of the Pool, previously-connected persons must make an application which cost £950 plus VAT from the 1st January 2019.⁴² They would be informed of the availability of the Pool by the insolvency practitioner but the decision to apply is made voluntarily by the purchaser.⁴³ The practitioner is to inform the body of creditors, through the SIP 16 statement, whether the previously-connected purchaser approached the Pool. The practitioner is to furnish the unsecured creditors with the Pool's opinion, where provided a

³⁷ Ibid, pp.1.

³⁸ Ibid, pp.1.

³⁹ The Insolvency Service, "Willott Announces Plans to Clean Up 'Pre-pack' Insolvency Deals" (Press Release 16 June 2014).

⁴⁰ B. Burch, "The Graham Pre-pack Review – Why is Everyone Cheering?" <https://complianceoncall.blogspot.com/2014/07/the-graham-pre-pack-review-why-is.html> [Accessed 11 March 2019]; F. Coulson, "Graham Pre-Pack Report: Review and Comment" <https://www.moonbeever.com/comment/807-graham-pre-pack-report> [Accessed 1 March 2019]; R. Crump, "Key Pre-pack Measures are Unworkable" <https://www.accountancyage.com/aa/analysis/2352078/key-pre-pack-measures-are-unworkable> [Accessed 1 March 2019].

⁴¹ P. Dutton and L McAuley, "Addressing Concerns about Pre-packs – the 'Pre-pack Pool'" (March 24, 2016); S. Jones, "The Pre-pack Pool – Problem-prone, Time-consuming, Costly and Pointless?" (Accountancy Age, 8 April 2016).

⁴² Hitherto, £800 plus VAT. Pre-Pack Pool, "Questions & Answers about the PrePack Pool" <https://www.prepackpool.co.uk/questions-answers> [Accessed 1 March 2019].

⁴³ Statement of Insolvency Practice 16, "Pre-packed Administrations", https://www.r3.org.uk/media/documents/technical_library/SIPS/SIP%2016%20Version%203%20Nov%202015.pdf, [Accessed 1 March 2019], paras 9.

copy by the applicant.⁴⁴ Failure to apply attracts no legal penalty. A reputational penalty was envisaged instead, as the creditors would be informed of the failure to consult the Pool. As a result, they would scrutinise the deals more closely than they may otherwise have done.

Upon receipt of the application, the Pool member returns an opinion within 2 business days.⁴⁵ It may make any one of the following statements: *the case for the pre-pack is not unreasonable*; *the case for the pre-pack is not unreasonable but there are minor limitations in the evidence provided*; or *the case for the pre-pack is not made*.⁴⁶ To avoid cost and delay, the Pool member does not provide reasons for the opinion; though anecdotal reports state that the Pool does communicate reasons, where requested.⁴⁷ There is no appeal from the Pool's opinion but a negative opinion does not prevent the Pre-pack from going ahead. The ultimate decision to execute the Pre-pack lies with the administrator, who would have to explain why the sale proceeded despite a negative opinion. This will be communicated to unsecured creditors through the SIP 16 statement.

1-007.

In the period since its introduction, the greatest challenge of the Pool has been the abysmal record of referrals. In the first 14 months of the pool's existence, (1st November 2015 – 31st December 2016), there were 371 recorded Pre-packs; 188 (51%) involved a sale to previously-connected persons, making them eligible for referral. Of these, only 53 cases were referred to the Pool; constituting a mere 28% of the eligible cases.⁴⁸ In the succeeding 12-month period (1st January – 31st December 2017), there were 356 Pre-packs, with 203 (57%) involving a sale to previously-connected persons; making them eligible for referral. There was a sharp decline in the percentage of referrals, however; with only 11% (23 cases) referred to the Pool.⁴⁹

The sharp drop in referrals testifies to the fact that the voluntary approach has failed and a change in policy direction is required. Though the Pool is invested in raising awareness about

⁴⁴ Ibid, Appendix.

⁴⁵ Pre-Pack Pool, "Questions & Answers about the Pre Pack Pool" <https://www.prepackpool.co.uk/questions-answers> [Accessed 1 March 2019].

⁴⁶ Pre-Pack Pool, "Annual Review 2016" <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack%20Pool%20Annual%20Review%202016-17.pdf> [Accessed 1 March 2019], pp.4.

⁴⁷ Discussed at the February 2019 Reviewer's Meeting.

⁴⁸ Pre-Pack Pool, "Annual Review 2016" <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack%20Pool%20Annual%20Review%202016-17.pdf> [Accessed 1 March 2019], pp.6.

⁴⁹ Pre-Pack Pool, "Annual Review 2017" <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack-Pool-Annual-Review-2017.pdf> [Accessed 1 March 2019], pp. 4.

its role, it is important to read the writing on the wall.⁵⁰ The government has signalled its intention to act - rather than to wait to see if referrals will pick up - by commissioning a review.⁵¹ The industry is also keenly aware that the government has powers to legislate on Pre-packs. These powers were reserved in 2015 but are set to expire in 2020.⁵² So, as is typically the case with the Pre-pack and its regulation, there is a buzz in the air. It is therefore important to consider the next steps the government should take. Accordingly, the next section examines the case for and against mandatory referrals to the Pool.

The Case for and Against Mandatory Referrals to the Pool

1-008.

The abysmal referral figures discussed above have triggered a debate amongst those who support the voluntary referral approach and those who prefer to introduce a mandatory referral approach. Ms Graham, who recommended the reforms, advocates sticking with the voluntary referral approach. She notes that the dip in Pre-packs and Pre-pack sales to previously-connected persons in the first 14 months of the Pool's existence suggests that those seeking to execute bad Pre-packs may have been discouraged by the idea of external scrutiny.⁵³ Thus, she asks for more time for the Pool to grow into its role.⁵⁴

It is important to recognise that Ms Graham is a self-confessed deregulator.⁵⁵ Nonetheless, there is evidence to suggest that Pool members are improving their oversight function. In the first 14 months of its existence, 64% of the applications returned a *not unreasonable* finding.⁵⁶ Only 25% returned a *not unreasonable but limitations in evidence* finding; with 11% returning a *case not made* finding.⁵⁷ In 2017 however, the number of *not unreasonable* responses dropped to 48%; with 35% receiving a finding of *not unreasonable but limitations in evidence*

⁵⁰ C. Warmroll, "Unpacking the Pre-pack Pool", (Accountancy Age, 6 July 2016) pp.2.

⁵¹ Insolvency Service, "Review of the Pre-pack Industry Measures" <https://www.gov.uk/government/news/review-of-the-pre-pack-industry-measures> [Accessed 1 March 2019].

⁵² Small Business, Enterprise and Employment Act 2015, s129 inserts Insolvency Act 1986, Sch B1, para.60A(10).

⁵³ D. McCance, "Debate Over Mandatory Pre-pack Pool Referral" <https://economia.icaew.com/news/may-2017/debate-over-mandatory-pre-pack-pool-referral> [Accessed 1 March 2019].

⁵⁴ Ibid.

⁵⁵ T. Graham, "Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP" (June 2014), <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], pp.5.

⁵⁶ Pre-Pack Pool, "Annual Review 2016" <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack%20Pool%20Annual%20Review%202016-17.pdf> [Accessed 1 March 2019], pp. 5.

⁵⁷ Ibid, 5.

and 17% returning a finding of *case not made*.⁵⁸ Though the total figure of referrals is small – 23 – and should be cautiously interpreted, anecdotal comments from Pool reviewers support the inference that the kid gloves are coming off and the Pool is scrutinising deals more stringently, as it grows into its role.⁵⁹ A more effective Pool sends excellent signals to the market.

1-009.

In spite of the foregoing, it must be recognised that the volume of Pre-packs as a percentage of administrations recovered from its dip to 22% in 2016, to 28% in 2017. This outcome takes us back to the 2010/2011 levels.⁶⁰ Similarly, the volume of Pre-pack sales to previously-connected persons recovered from its temporary dip from 51% in 2016, to 57% of sales in 2017.⁶¹ While the 57% is lower than the over 70% levels of 2010/2011, the recovery suggests that pre-packers have quickly recognised the limited ambit of the Pool's reach.

Ms Graham has also suggested that the Recognised Professional Bodies should help encourage their numbers to embrace the reforms, by broadcasting its positive impact.⁶² Perhaps then, practitioners would persuade previously-connected persons to make applications with a lot more conviction. This route may take considerable time, as some practitioners' comments suggest that they need a lot of convincing.⁶³ Indeed, the system would work better where associations like the Institute of Credit Management, the Association of British Insurers, British Property Federation and others encouraged their numbers to remain alert for the Pool's opinion. However, in the absence of actual notification of the Pre-pack while the Pool may still be approached, there is no way that unsecured creditors can influence applications to the Pool. A threat of seeking legal redress cannot succeed either, as there is no penalty for a failure to approach the Pool.

⁵⁸ Pre-Pack Pool, "Annual Review 2017" <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack-Pool-Annual-Review-2017.pdf> [Accessed 1 March 2019], pp. 4-5.

⁵⁹ Presentation at February Reviewer's Meeting.

⁶⁰ Pre-Pack Pool, "Annual Review 2017" <https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack-Pool-Annual-Review-2017.pdf> [Accessed 1 March 2019], pp. 4-5.

⁶¹ Ibid, pp. 4-5.

⁶² D. McCance, "Debate Over Mandatory Pre-pack Pool Referral" <https://economia.icaew.com/news/may-2017/debate-over-mandatory-pre-pack-pool-referral> [Accessed 1 March 2019].

⁶³ S. Jones, "The Pre-pack Pool – Problem-prone, Time-consuming, Costly and Pointless?" (Accountancy Age, 8 April 2016); S. Moppett, "An IP's Perspective of the Pre Pack Pool", <http://krecre.co.uk/an-ips-perspective-of-the-pre-pack-pool/> [Accessed 1 March 2019]; B. Robson, "Less Pre Packs Likely Due(sic) Greater Regulation" <http://www.bridgenewland.co.uk/administration-news/sip16-changes-leading-to-less-pre-packs> [Accessed 1 March 2019].

1-010.

The available figures therefore suggest that it will likely take a long time to get to the situation in which the preponderance of previously-connected persons feel inclined to approach the Pool voluntarily. We are more likely to see selective use of the Pool, which will see its members approached by those who choose, personally, to adhere to the ethos of the reforms or whose Pre-packs are above board. Others who consider the Pool ‘problem-prone, time consuming, costly and pointless’ will not apply for Pool scrutiny.⁶⁴

Previously-connected persons have added incentive to avoid the Pool, as applications come with a chance of obtaining a *case not made* opinion. Practitioners have indicated concern with the inability of parties to challenge the opinion of the Pool or perhaps to ask for a review of the opinion.⁶⁵ They state how such an outcome may prejudice the deal before the unsecured creditors. Although there is general creditor apathy, the *case not made* opinion, together with the rewards of the additional scrutiny that it may trigger, could serve as the basis for an application to replace the administrator. Such an outcome would lead to time and cost delays, even if unsuccessful.⁶⁶ While it is absolutely right that a *case not made* should trigger additional scrutiny of the deal, it is important that careful consideration be given to the right to challenge the opinion of the Pool. Such an approach would introduce a balance between the interests of previously-connected persons and those of unsecured creditors.

A worrisome alternative would be for previously-connected persons to choose not to disclose the opinion of the Pool to the administrator, as that would prevent the opinion from being communicated to the unsecured creditors. Presently, previously-connected persons are not compelled to release the opinion. SIP 16 merely instructs the administrator to forward the opinion to unsecured creditors, where made available by the previously-connected persons. The administrator has no duty to request a copy of the opinion directly from the Pool and the Pool has no right to insist on the communication of the opinion to the unsecured creditors. In February, a Pool member discussed a case in which the SIP 16 report indicated that the Pool

⁶⁴ S. Jones, “The Pre-pack Pool – Problem-prone, Time-consuming, Costly and Pointless?” (Accountancy Age, 8 April 2016).

⁶⁵ S. Moppett, “An IP’s Perspective of the Pre Pack Pool”, <http://krecre.co.uk/an-ips-perspective-of-the-pre-pack-pool> [Accessed 1 March 2019]; Unpacking the Pre-pack Review (Slaughter and May Briefing, June 2014) <https://www.slaughterandmay.com/media/2057664/unpacking-the-pre-pack-review.pdf> [Accessed 11 March 2019].

⁶⁶ *Clydesdale Financial Services v Smailes* [2009] EWHC1745 (Ch)

had been approached but did not include the outcome of the application.⁶⁷ The opinion had been that the case for the Pre-pack was not made. As a result of the failure to disclose the opinion, the unsecured creditors had been prevented from knowing the outcomes of the application. As a corollary, they had possibly been prevented from scrutinising the deal more closely.

1-011.

From the fore-going, it is clear that the voluntary referral approach permits both selective applications to the Pool, as well as selective communication of the Pool's opinion to insolvency practitioner and unsecured creditors. This outcome sabotages the spirit and goals of the reforms. It can be eliminated by introducing a mandatory referral approach. Mandatory referrals will provide creditors with the comfort that attends the introduction of external oversight. A mandatory approach can also accommodate a system of reviewing or challenging a *case not made* outcome, to ensure a fair procedure for all concerned. Also in support of a mandatory referral approach, is Sir Vince Cable, who commissioned the Graham Review. Sir Vince has stated his disappointment in the abysmal referral figures and called for additional reforms.⁶⁸ His view is supported by R3, the Association of Business Recovery Professionals, and the British Property Federation, which consider mandatory referrals to be a step in the right direction.⁶⁹

There is however a split amongst those calling for mandatory oversight; between those who propose a qualified mandatory referral approach and those who do not. Sir Vince suggested that a threshold should be set; above which referrals should be compulsory.⁷⁰ Vaccari, also in support, argues that the threshold should be set at a transaction value of £500,000.⁷¹ This figure is based on the average value of deals presented to the Pool in its first year.⁷² In the alternative,

⁶⁷ D. Blair, "Case Study – A Reviewer's Perspective" [presented at the Reviewers' Meeting, February 2019].

⁶⁸ A. Ralph, "Company Purchasers Ignore Voluntary 'Safety Net' For Pre-pack Administrations", (The Times, 20 August 2018).

⁶⁹ R3, "Government Pre-pack Review Opportunity for Improvement" (13 December 2017); "Calls for CVAs to be Referred to the Pre-pack Pool as Concerns Increase about their Use" <https://www.walkermorris.co.uk/publications/calls-for-cvas-to-be-referred-to-the-pre-pack-pool-as-concerns-increase-about-their-use/> [Accessed 1 March 2019].

⁷⁰ A. Ralph, "Company Purchasers Ignore Voluntary 'Safety Net' For Pre-pack Administrations", (The Times, 20 August 2018).

⁷¹ E. Vaccari, "Pre-pack Pool: Is It Worth It?" (2018) 29 ICCLR, pp.697-712, p.707.

⁷² Based on Hopewell and Kerr, "Unpacking the Pre-Pack" [November 2016] Credit Management 13, cited in E. Vaccari, "Pre-pack Pool: Is It Worth It?" (2018) 29 ICCLR, pp.697-712, p.707.

he argues that the mandatory application procedure should apply to medium and large companies.⁷³

1-012.

This article departs from that view because such an approach would exclude majority of the companies which use the Pre-pack from the mandatory referral scheme, and by so doing, undermine the effectiveness of the Pool's oversight role. The 2014 empirical study on pre-packs indicated that majority of the companies which use the Pre-pack process are micro or small.⁷⁴ Similarly, Polo found that companies involved in Pre-pack sales to previously-connected persons tend to be comparably smaller in size than their counterparts who go into traditional administration or sell their businesses to unconnected persons.⁷⁵ Banks have also indicated that there is heavy use of Pre-packs at the lower end of the market.⁷⁶ They suggest that many of such Pre-packs may be better off in a liquidation procedure.⁷⁷ Thus, limiting mandatory oversight to medium or large companies would enable majority of the companies using the Pre-pack to avoid the oversight provided by the Pool, if they so choose. Yet, the excluded majority are perceived to be susceptible to abuse.⁷⁸

What's more, such an approach would undermine the comfort which the Pool's oversight clearly provides to unsecured creditors.⁷⁹ Such is the comfort it provides, that creditor groups have asked for its remit to extend to the Company Voluntary Arrangement procedure.⁸⁰ An informed observer would point out that trade creditors are generally unaffected by large company Pre-packs. It is the restructuring of micro and small entities that potentially harm their interests.⁸¹ Thus, any attempt to exclude micro and small Pre-packs from mandatory referrals

⁷³ E. Vaccari, 'Pre-pack Pool: Is It Worth It?' (2018) 29 ICCLR, pp.697-712, p.707.

⁷⁴ P. Walton, C. Umfreville and P. Wilson, 'Pre-Pack Empirical Research: Characteristics and Outcome Analysis of Pre-pack Administration' <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], pp. 12, paras A1.2

⁷⁵ A. Polo, 'Secured Creditor Control in Bankruptcy: Costs and Conflict' http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2084881 [Accessed 1 March 2019], pp. 20.

⁷⁶ Insolvency Service, 'Improving the Transparency Of, and Confidence In, Pre-Packaged Sales in Administration: Summary of Consultation Responses (March 2011), pp.17, paras 3.52

⁷⁷ Ibid, pp.17, paras 3.52.

⁷⁸ Ibid, pp. 7, paras 2.8; pp.11, paras 3.13.

⁷⁹ J. Hillman and J. Snowdon, 'Testing the Waters: Two Professionals Reveal their Experiences with the Pre-pack Pool to *Recovery*' (2016) *Recovery* (Autumn), pp.40-41.

⁸⁰ "Calls for CVAs to be Referred to the Pre-pack Pool as Concerns Increase about their Use" <https://www.walkermorris.co.uk/publications/calls-for-cvas-to-be-referred-to-the-pre-pack-pool-as-concerns-increase-about-their-use/> [Accessed 1 March 2019].

⁸¹ Insolvency Service, 'Improving the Transparency Of, and Confidence In, Pre-Packaged Sales in Administration: Summary of Consultation Responses (March 2011), pp. 16, paras 3.47.

would be met with resounding criticism from already vocal critics of the practice. It would also perpetuate the general lack of confidence in the Pre-pack procedure. Clearly, companies at each end of the insolvency spectrum deal with different sets of challenges and potentially abusive practices. The Pool should provide oversight of large Pre-packs, which may facilitate the avoidance of tax and pension liabilities.⁸² Likewise, it should provide oversight of micro and small company Pre-packs, which are susceptible to the abusive practices recorded by the Graham Review.⁸³ It is therefore imperative to ensure that potential abusers of the Pre-pack at both ends of the market cannot avoid the oversight provided by the Pool.

1-013.

Even if, for the sake of argument, a threshold is agreed, the appropriate threshold must be carefully considered, as it may result in the artificial deflation of transaction values to avoid the qualifying limit. Such an outcome would be potentially detrimental to unsecured creditors, who could miss out on recoveries as a result. A transaction value in the range of £500,000 would exclude many Pre-packs which should ideally come under the oversight of the Pool. The directors of the Pool have noted that majority of the companies that approach them have a transaction value of £200,000 to £300,000.⁸⁴ Further, when we examine the 8 transactions reviewed by one of the Pool members, we find that 5 have been in relation to transactions worth less than £500,000 in value.⁸⁵ Thus, setting a value of £500,000 would exclude 62.5% of those cases from review.

It may be pointed out that £500,000 was chosen because it was the mean value. The response is that it is ill-advised to hinge the qualifying limit on the mean value. We may find a large disparity between the median and the mean values; as the mean value is likely to have been influenced upwards by a few large transactions. This will therefore artificially exclude many companies that ought to be included in the mandatory referral scheme. An examination of the case load of the Pool member discussed above is, again, instructive. The mean value for the entire case load was £414,285; yet 57% of the cases fell below that value.⁸⁶ The median value

⁸² J. Cumbo, 'Companies Abusing Insolvency Pre-packs, Independent Panel Says' (FT, 25 November 2018); L. Haddou and J. 'Cumbo, Companies Use 'Pre-packs' to Dump £3.8bn of Pension Liabilities' (FT, 9 April 2017).

⁸³ T. Graham, "Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP" (June 2014), <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], pp.52-54; Insolvency Service, 'Improving the Transparency Of, and Confidence In, Pre-Packaged Sales in Administration: Summary of Consultation Responses (March 2011), pp. 16, paras 3.47.

⁸⁴ C. Warmroll, "Unpacking the Pre-pack Pool", (Accountancy Age, 6 July 2016) pp.2.

⁸⁵ D. Blair, "Case Study – A Reviewer's Perspective" [Presented at the Reviewers' Meeting, February 2019].

⁸⁶ Ibid.

was £300,000, while the mode was £200,000. Both these values fall within the £200,000 - £300,000 range identified by the Pool directors.⁸⁷ Thus, chasing the mean value may, again, exclude majority of the cases which ought to be mandatorily reviewed.

On a final note, it is important to be guided by the goal of the reforms. They respond to the susceptibility of the Pre-pack sale to previously-connected persons to abuse.⁸⁸ It is this fact that undermines the reputation of Pre-pack sales to previously-connected persons. Thus, both the voluntary and qualified mandatory referral approach would likely attenuate the effectiveness of the Pool's oversight function. Both approaches would also limit the ability of the Pool to gather important information about Pre-pack practices across the range of companies. This information is vital to improving Pre-pack governance. As the Pool can only perform its functions and contribute to improving the governance of Pre-pack sales to previously-persons where referrals are made, there is a need for a mandatory referral approach.

Conclusion

1-014.

The Pool is an important addition to the innovative practices aimed at improving Pre-pack governance. It responds to the call for the introduction of independent assessment of Pre-packs, particularly where sold to previously-connected persons. As this has been a recurring request from unsecured creditors groups, it sends the right signals to the market that abusive practices will not be tolerated. Also, that the interests of unsecured creditors matter. Such signals provide comfort to unsecured creditors, which is important to the reputation of the system. It is unfortunate that only a fraction of eligible referrals has been made to the Pool. This outcome sends a worrisome message to excluded stakeholder groups and indeed, the public.

The paper has argued that the continued slowdown in referrals is evidence of the failure of the voluntary approach. Therefore, a mandatory approach should be instated. It demonstrates also, that the voluntary approach creates a system in which previously-connected persons can selectively approach the Pool and selectively disclose the opinion of the Pool reviewer to unsecured creditors and insolvency practitioners; thereby undermining the very fabric of the

⁸⁷ C. Warmroll, "Unpacking the Pre-pack Pool", (Accountancy Age, 6 July 2016) pp.2.

⁸⁸ T. Graham, "Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP" (June 2014), <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration> [Accessed 1 March 2019], pp.52-58.

reforms. Avid critics of the system have indicated their interest in mandatory referrals; likewise, professional bodies and unsecured creditor groups. Additional reasons for mandatory referrals include the fact that information gathering has been at the heart of improved Pre-pack governance. Thus, a mandatory approach will ensure that the Pool effectively becomes a repository of vital insight into Pre-pack practice. This insight can be regularly harvested, to improve its governance. For that reason, this paper argues that the mandatory approach ought not to be qualified, either in relation to the size of companies or the value of the transaction. It accepts that there are changes that must be made for the Pool to execute its functions effectively. Therefore, it argues that policy-makers should consider introducing a mechanism through which previous-connected persons can challenge the opinion of the Pool reviewer, where an opinion of *case not made* is received. It maintains, however, that such a system could work effectively within a mandatory referrals approach. **It is expected that the injection of the suggestions made by the paper would improve the oversight function of the Pool and ultimately, the governance of the Pre-pack.**