

# Report on the First Six Months' Operation of Statement of Insolvency Practice 16



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## 1.0 Executive summary

In carrying out a review of the operation of Statement of Insolvency Practice 16 (SIP 16) on pre-packaged sales in administrations, we have examined both the operation of the SIP by insolvency practitioners and the outcomes of enforcement procedures in pre-pack cases. The decision as to whether a pre-pack is the appropriate course of action is a commercial judgement for the practitioner. The purpose of the SIP is to ensure that creditors are given sufficient information to understand the circumstances surrounding that decision and the reasons why the particular course of action was adopted by the practitioner.

Insolvency practitioners have been generally positive in their approach to the SIP and its aims, and in the majority of cases information has been provided in compliance with its requirements. However, we were disappointed to note that a significant number of the reports issued to date fall short of full compliance, often due to a failure to provide sufficient detail. Information relating to 370 out of a total of 572 companies in administration was compliant with the disclosure requirements of SIP 16, representing 65% of the total. It should be noted that failure to comply with the SIP does not imply misconduct in the pre-pack sale itself, a lack of good faith, or failure to act in the best interests of creditors. In many cases, apparent non-compliance may be attributed to early differences in interpreting the requirements of the guidance. However, in 17 of the cases reviewed the insolvency practitioners' conduct was such as to warrant it being referred to their authorising bodies so that it may be considered from a regulatory and disciplinary perspective. These referrals involved 29 insolvency practitioners and represent around three percent of the cases reviewed.

We have discussed our concerns with insolvency practitioners' authorising bodies, and additional guidance about the importance of complying with both the spirit and letter of SIP 16 has been issued to practitioners. Following this clarification we expect compliance to improve.

At present, only limited data is available regarding directors' misconduct in SIP 16 cases, as there is necessarily a period of time between the onset of any administration and the conclusion of an investigation into the directors' conduct. On the information available, misconduct does not appear to be significantly more prevalent in pre-packs than in other administrations.

We remain satisfied that SIP 16, when complied with, gives better information for creditors at an early stage, and a greater degree of transparency in pre-packs. As a result we believe its continued operation will increase confidence in the marketplace. Our ongoing monitoring of the operation of the SIP will be the subject of future reports and we will be looking, together with the authorising bodies, to see how the provisions of SIP 16 can be strengthened.

### 1.1 Main findings

There does remain significant room for improvement in the information provided in a good proportion of cases. In particular there are three areas where we would expect to see improvements in the compliance with SIP 16 going forward.

Firstly we turn to the timing of the statements. Although no specific timescale is set down by which SIP 16 information must be disclosed, given that all the relevant details would usually be known to the insolvency practitioner at the time of appointment, we would ordinarily expect that the information could be sent to creditors upon completion of the sale. In a minority of cases insolvency practitioners are not sending out information in a timely manner, which we regard as unacceptable.

Secondly we deal with the question of valuations and marketing. Failure to provide full details of a valuation or marketing exercise is a common weakness in the SIP 16 information, and of particular concern. Without details of the value placed on assets, it would usually be very difficult for creditors to determine whether the pre-pack sale was in their interests.

Thirdly while not a financial consideration, it is highly important that any connection between the insolvent company and the purchaser of its business be fully disclosed. Failure to do so may give rise to the perception that the directors and insolvency practitioner have colluded to withhold this information from creditors, with a consequent loss of confidence in the integrity of the sale and the insolvency regime as a whole.

In the course of the review, we have identified a number of areas where we believe the SIP might be refined and improved upon. These include amendments to ensure what is required is both explicit and clear, and a very few areas where we believe additional information may be beneficial to creditors: setting out a more explicit timescale for practitioners to provide the SIP 16 information; a formal requirement to provide the Secretary of State with a copy; requiring details of any security to which the company's assets were subject; and ensuring that both valuations and the directors' financial interests are fully disclosed. The Insolvency Service will, in conjunction with the authorising bodies, look to see how these amendments can be made to the SIP.

Underscoring any consideration of directors' conduct in pre-pack cases is the fact that The Insolvency Service already has in place an existing and robust enforcement regime incorporating an established culture of insolvency practitioner reporting and experienced case targeting, investigative and litigation functions. As described in section 2.4 of this report, in the year to 31 March 2009 1,252 directors were disqualified under this regime. This includes directors who had been guilty of misconduct associated with the failure of a company and subsequent creation of new "phoenix" company or had been involved in repeated company failures. We consider that the regime is already equipped to deal with incidences of director misconduct arising from the pre-pack process.

Supporting this, the observed trends within our review of directors' misconduct do not suggest a disproportionately high level of misconduct in pre-packs as compared to other administrations. This observation remains to be tested, however, due to the timescales required for insolvency practitioners to collate any evidence of misconduct and present it to The Insolvency Service; and for enforcement investigations to be carried out. The data presently available in this area is insufficient for firm conclusions to be drawn.

In conclusion The Insolvency Service is satisfied that SIP 16 does improve transparency for creditors and that, properly applied, the SIP will ensure creditors receive the information they need to decide whether any given pre-pack sale was in their best interests. It should be borne in mind that these are early days for the operation of SIP 16 and insolvency practitioners are still learning the full implications of the SIP for their reporting to creditors. We also have no evidence that the pre-pack process is being systematically abused by directors to materially disadvantage creditors. A further report on the operation of the SIP will be published in early 2010.

## 2.0 Background

### 2.1 Definition of a pre-pack

The term “pre-pack” describes any situation where the business of an insolvent company is prepared for sale to a selected buyer (“pre-packaged”), prior to the company’s entry into formal insolvency proceedings. The agreed sale is carried out by an authorised insolvency practitioner acting as office holder within the proceedings, shortly following their appointment.

While pre-packs are neither new nor exclusive to administration proceedings, it is the perceived increase in the use of pre-packs in administration which has attracted media interest and given rise to public concern.

For the purposes of Statement of Insolvency Practice 16 and this report, a pre-pack is defined as:

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.

### 2.2 Purpose of administration

In every administration<sup>1</sup>, the administrator must seek to achieve one of the following objectives, contained within paragraph 3 of schedule B1 to the Insolvency Act 1986:

- Company rescue (as a going concern) is primary.
- If that is not possible (or if it would clearly be better for the creditors as a whole), then the administrator should try to achieve a better result for the creditors than would be obtained through an immediate winding-up of the company.
- If neither of these objectives is possible, the administrator may realise property to make a distribution to secured and/or preferential creditors.

Whenever the administrator is working to achieve one of the first two objectives, he will be under an express duty to act in the interests of the creditors of the company as a whole. Where the administrator’s objective is to realise property in order to make a distribution to one or more secured or preferential creditors, he will still have to act in a way that does not unnecessarily harm the interests of unsecured creditors. The administrator will have to explain to all creditors in his statement of proposals why it was not reasonably practicable to pursue the first two objectives.

### 2.3 Explanation of concerns expressed

Although official statistics make no distinction between pre-packs and more traditional uses of the administration procedure, the increasing popularity of administration following the introduction of the Enterprise Act 2002 has coincided with a perceived rise in the number of pre-packs. Historically there has been no obligation upon insolvency practitioners to report pre-packs as such. However, between 2004 and 2008 the number of administrations rose from 1,602 to 4,822 a year, and the results of the last six months’ review would suggest that the number of pre-packs is likely to amount to approximately 1,250 this year.

<sup>1</sup> This refers to administrations carried out under provisions inserted into the Insolvency Act 1986 by the Enterprise Act 2002. In 2008, only two administrators were appointed under the pre-Enterprise Act provisions, which have been largely superseded.

The key attraction to the use of pre-packs is the speed with which the administration proceeds. With a buyer in place beforehand, it is not unusual for an insolvency practitioner to conclude the sale of the business on the same day that he or she is appointed as administrator. This in turn prevents the erosion of goodwill and value in the business which can occur once word of the insolvency spreads. Moreover, funding the continued trading becomes the responsibility of the purchaser. This can allow a practitioner to conduct a going concern sale where it would not otherwise be possible, maximising the financial return for the company's creditors while simultaneously rescuing the business and preserving all or some of the employees' jobs.

Despite the advantages that pre-packs offer, the media, businesses, members of the public and MPs have all expressed concerns regarding this process. Creditors have argued that they are presented with little chance to influence events and insufficient information with which to determine if the sale was in their best interests. As many pre-pack sales are to the owners or directors of the insolvent company, this lack of transparency can result in allegations that the procedure has been abused to benefit the purchaser at creditors' expense.

Such concerns do not arise to the same degree in other forms of administration. In every administration, regardless of whether a pre-pack is involved, the administrator will, generally speaking, present his proposals to creditors within eight weeks of their appointment. In cases where there is a prospect of some repayment, unsecured creditors will then be invited to attend a meeting to consider and vote on those proposals<sup>2</sup>.

Pre-packs achieve a shorter timescale through reliance on a series of cases<sup>3</sup> where courts have held that if the circumstances warrant it, an administrator has the power to sell assets without the prior approval of creditors or the permission of the court. By the time creditors receive the administrator's proposals, there is little for them to consider or vote on as the majority of the assets have already been transferred to the selected purchaser. Without detailed information to allay concerns, creditors may understandably conclude that they have been the victim of collusion between purchaser and insolvency practitioner.

It is important to appreciate that failure to achieve full repayment to unsecured creditors, or sometimes any payment at all, is not itself an indication of abuse: it is in the nature of insolvency that debts will go unpaid. It should also be borne in mind that where a company enters a formal insolvency procedure, unsecured creditors are not usually able to directly influence the sale of assets, whether that sale is undertaken through a pre-pack administration or otherwise. Government considers that pre-packs are a valuable tool for insolvency practitioners, and that a pre-pack can be the best way for an administrator to proceed.

Despite the benefits, we do recognise that pre-packs are capable of being abused by those intent on doing so, and we believe that creditors should receive sufficient information to make an informed judgement in each case. Robust measures are in place to deter misconduct by directors and insolvency practitioners:

<sup>2</sup> Limited exceptions are set out in s. 51 of schedule B1 to the Insolvency Act 1986

<sup>3</sup> 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)

- The UK has a rigorous and effective enforcement regime to deal with misconduct by directors, including any attempt to abuse insolvency procedures for personal gain. Ultimately this can lead to disqualification or criminal proceedings.
- Insolvency practitioners are highly regulated by their authorising bodies, and subject to strict guidance in the form of Statements of Insolvency Practice (SIPs).
- SIP 16, which concerns pre-packs, has introduced a requirement to provide creditors with critical information regarding the sale as soon as possible after it completes.

A brief summary of these measures is given below.

## **2.4 The disqualification process**

The legislative framework surrounding insolvency seeks to strike the right balance between the interests of creditors and the need to promote entrepreneurial activity. We are of the view that, taken with the robust enforcement regime we maintain, it achieves that end. The disqualification provisions, described below, are a particularly effective component of that regime.

When a company goes into administration, administrative receivership or insolvent liquidation, the administrator or other insolvency office holder has a duty to report to the Secretary of State if he forms the view that the conduct of any of the company's directors makes them unfit to be concerned in the management of a company. Reports must be made within six months of the commencement of the formal insolvency unless, exceptionally, an extension is sought. The Insolvency Service, acting for the Secretary of State, received 4,752 such reports in the year to 31 March 2009.

When a report is made, the Secretary of State has a discretionary power to seek to disqualify the directors concerned where he believes that would be in the public interest. Disqualification lasts for between two and fifteen years. In the year to 31 March 2009, 1,252 directors were disqualified for periods ranging from two to fourteen years and the average period of disqualification was nearly six and a half years.

Although a director who has been involved in a company failure is not precluded from trying again (provided they have not been disqualified from acting in the management of a company or prevented by some other legislative bar) the disqualification regime is used to address misconduct where it arises in connection with multiple failures. The continuation of previously failed businesses without a reasonable prospect of success is frequently associated with misappropriation of assets, transactions to the detriment of creditors and trading with knowledge of insolvency. In the year to 31 March 2009 these types of behaviour were found in 25 percent of all cases identified for disqualification action.

Insolvency Practitioners are also under a statutory obligation to report criminality to the Secretary of State in connection with the affairs of companies subject to insolvency proceedings. Such reports are considered by The Insolvency Service and those that contain prima facie evidence of an offence are referred to the relevant prosecuting authority usually the Department of Business, Innovation and Skills or the Police.

In 2008/9 The Insolvency Service referred 181 reports of possible criminality to prosecuting authorities for further consideration.

Of these 181 reports, 99 related to the unauthorised reuse of the same name as (or a similar name to) that of the insolvent company. Other types of criminality reported included accounting failures and allegations involving the fraudulent transfer or removal of the company's assets, commonly associated with the continuation of a failed business.

In addition to the investigation of insolvent companies described above, The Insolvency Service also carries out enquiries into the affairs of active companies. Companies Investigation Branch (CIB) has the responsibility for conducting investigations into companies using the statutory powers of enquiry contained in Part XIV of the Companies Act 1985 (as amended) – specifically section 447 thereof. Although CIB has the legal standing to investigate the affairs of companies which are subject to formal insolvency proceedings – a company in administration, for example – its main function is to use its powers to investigate concerns about the activities of 'live' trading companies.

CIB's powers of investigation are discretionary in nature and are exercised in the public interest, thereby providing a basis for targeting the most deserving cases for investigation. The latter include those cases where the directors responsible for the management of both the old and new companies are, or appear to be, essentially the same.

In relation to complaints regarding pre-packs this means that CIB is positioned, in appropriate cases (as identified through its vetting process), to investigate the affairs of both the company now in administration and the purchaser of its assets. Having conducted its enquiry, CIB will ensure that appropriate action is taken to deal with any misconduct discovered. This can include the issue of disqualification proceedings as described above.

## **2.5 Regulation of insolvency practitioners**

The authorisation regime for insolvency practitioners in Great Britain was introduced by the Insolvency Act 1986, and provides that only individuals can be authorised to act as an insolvency practitioner. Similar legislation exists in Northern Ireland.

The Secretary of State is empowered to recognise professional bodies as being able to authorise and regulate their members to act as insolvency practitioners. These bodies are required to enforce rules to ensure that their members who are permitted to act as insolvency practitioners are fit and proper, and meet acceptable requirements as to education, practical training and experience. The Secretary of State can also directly authorise insolvency practitioners: The Insolvency Service exercises these functions on his behalf.

The Joint Insolvency Committee, a body made up of each of the recognised professional bodies and The Insolvency Service, issues guidance with which all insolvency practitioners are required to comply. Compulsory guidance issued by the committee takes two forms: Statements of Insolvency Practice, and the Insolvency Code of Ethics. SIPs cover basic principles and essential procedures in specific areas such as remuneration, company records, and creditors' meetings. The Insolvency Code of Ethics provides more general ethical guidance which applies to practitioners and their staff both during insolvency appointments and when carrying out any work which may lead to an appointment.

Each of the recognised bodies carries out regular monitoring visits to ensure that its practitioners are conducting their work in accordance with the guidance and to the required standards. Complaints regarding unprofessional, improper or unethical behaviour by an insolvency practitioner can be addressed to the appropriate authorising body, who will decide if sanctions should be imposed.

In addition, practitioners who act as insolvency office holders are subject to the relevant legislation governing those insolvency proceedings. In administration, paragraphs 74 and 75 of schedule B1 to the Insolvency Act 1986 allow any creditor of the company to challenge the conduct of the administrator on the grounds that it unfairly harms their interests, and allow the court to adjudicate claims of misfeasance. The legal precedents referred to in section 2.3, which permit administrators to sell company assets without prior approval from creditors, do not preclude challenges to their conduct under these paragraphs.

The Insolvency Service has recently published an annual report<sup>4</sup> on the regulation of the 1,700<sup>5</sup> insolvency practitioners in England, Wales and Scotland. In 2008:

- 828 complaints were made about insolvency practitioners to their authorising bodies, 197 of which related to administration procedures (including both pre-packs and other administrations);
- Six practitioners were given warnings or cautions in respect of complaints made against them;
- Two gave undertakings or otherwise entered into agreements in respect of their conduct; and
- A further five practitioners were reprimanded and fined.
- Three practitioners' licenses were withdrawn following monitoring visits by their authorising bodies.

## **2.6 Statement of Insolvency Practice 16**

Statement of Insolvency Practice 16: Pre-packaged Sales in Administrations (SIP 16) was introduced on 1 January 2009, and is the newest SIP to be issued by the Joint Insolvency Committee.

The SIP sets out the standards required of practitioners when involving themselves in pre-packs, particularly concerning the disclosure of information to creditors. The SIP is intended to give creditors better and quicker access to relevant information, enabling them to make informed decisions when considering subsequent proposals or resolutions sought by administrators. The principles set out in the SIP are aimed at alleviating the concerns outlined above (please see 2.3), and in turn creating greater confidence in the marketplace regarding the use of pre-packs.

A link to the SIP can be found at:

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/iparea/sip.htm>

<sup>4</sup> Annual Review of Insolvency Practitioner Regulation, June 2009  
[http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/iparea/INS\\_Practitioners.pdf](http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/iparea/INS_Practitioners.pdf)

<sup>5</sup> 1,701 as at 1 January 2008; rising to 1,738 as at 1 January 2009.

## 2.7 Required standards

SIP 16 requires practitioners who are party to a pre-pack, whether as advisors or in the role of the appointed administrator, to be clear about their own relationship to the company and its directors. They must also have regard to the duties owed to those affected by the arrangement, including creditors and employees of the company.

The SIP affirms that it is important for creditors to receive a detailed explanation and justification of why a pre-packaged sale was undertaken. A significant requirement of the SIP is that any practitioner who acts as administrator to carry out a pre-pack must provide creditors with a prescribed list of information:

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

The information should be provided to creditors as soon as possible, usually with the administrator's first notification to creditors. If there are exceptional circumstances which prevent the disclosure of any of the information, the administrator must state these. Under most circumstances commercial confidentiality is not sufficient reason for failure to disclose

We would emphasise that The Insolvency Service expects practitioners to comply with the spirit of the SIP, as well as the letter. We attach the highest importance to ensuring that creditors are provided with sufficient information to determine whether the sale of the company's business was in their interests, and our review of the operation of the SIP has been conducted.

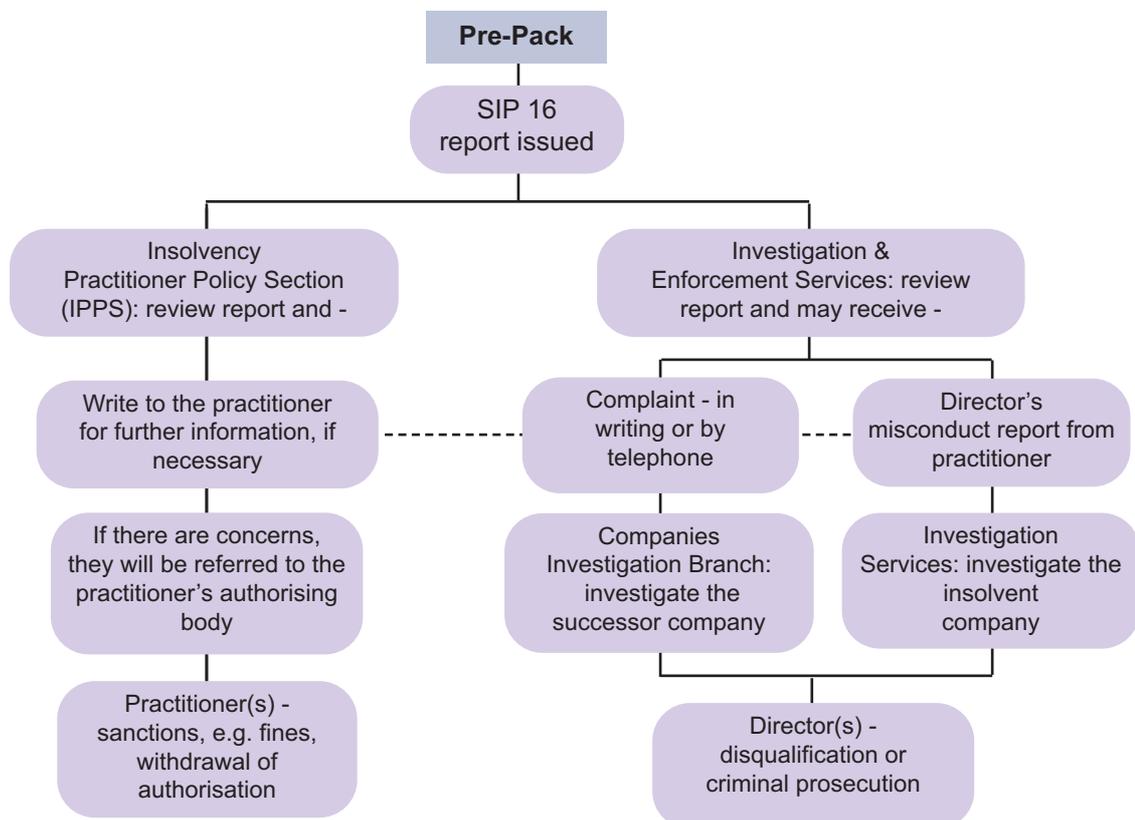
## 2.8 Review of compliance

This review of the operation of SIP 16 encompasses the directors of insolvent companies which undergo pre-packs; the purchasers; and the insolvency practitioners involved.

Figure 1 summarises the information received by The Insolvency Service in relation to each of these groups, and the possible enforcement action which may follow. Information is received through three main channels: SIP 16 reports from practitioners conducting pre-packaged sales, being the same information they have provided to creditors; their reports on the conduct of the directors<sup>6</sup>; and complaints from members of the public, received through our Hotline telephone service and in writing. Where allegations of directors' misconduct lead to the conclusion that the insolvency practitioner concerned may have fallen below the standards expected, or vice versa, any further actions necessary will be undertaken in parallel.

This is The Insolvency Service's first review into the operation of SIP 16: the results of the review, and our conclusions, are presented below. A further report on the operation of the SIP will be issued in the New Year.

**Figure 1**



<sup>6</sup> Required under section 7(3) of the Company Directors Disqualification Act 1986

## **3.0 Results of the review**

The results of the review are divided into two areas: the findings that relate to insolvency practitioners, and those that relate to company directors.

### **3.1 Insolvency practitioners**

#### **3.1.1 Method and scope**

The Insolvency Service has reviewed information disclosed by insolvency practitioners pursuant to the requirements of SIP 16 in relation to pre-pack administrations undertaken during the first six months of 2009. As indicated above, the primary purpose of SIP 16 is to improve the transparency of the pre-pack process by the provision of timely information to creditors. We have therefore concentrated our review on insolvency practitioners' compliance with the disclosure requirements contained within SIP 16.

Wherever possible, we have also sought to consider the nature of the underlying transaction in order to inform our understanding of the drivers for pre-pack administrations and the impact on creditors. In assessing the information provided by insolvency practitioners, we have consequently sought to form a rounded view of the disclosures made in light of the particular circumstances of the insolvency as known to us and by reference to the specific requirements, and spirit, of SIP 16.

Where the disclosures made by insolvency practitioners are insufficient to give a full picture of the reasons for the pre-pack sale in line with the requirements of SIP 16, we have written to the insolvency practitioner concerned to outline our concerns and to obtain further information so that we may consider the matter further. While the level of disclosure required may very occasionally be open to interpretation in light of the particular circumstances, we believe that this approach has assisted in providing insolvency practitioners with a greater understanding of our expectations in this regard. We would therefore expect the quality of information being provided to improve in future periods.

We have also reported a number of insolvency practitioners to their authorising bodies where we believe that the disclosures made could give rise to concerns about the conduct of the practitioner or where there appears to be a clear regulatory breach. In some instances this has been done without prior reference to the insolvency practitioner(s) concerned where we have formed the view that the breach is so unambiguous or serious that it warrants immediate consideration by the relevant authorising body.

It is expected that this approach will achieve the aim of improving the transparency of the process whilst ensuring that those insolvency practitioners who are clearly not complying with the SIP 16 disclosure requirements are reported to their authorising bodies for consideration from a disciplinary perspective.

#### **3.1.2 Number of pre-pack administrations within the reporting period**

During the reporting period The Insolvency Service has received SIP 16 information from insolvency practitioners relating to 572 companies in administration. This figure includes all companies within group structures where there may be a large number of subsidiary or connected companies. In reality the actual number of business sales reflected by this figure will

therefore be somewhat lower. A breakdown of the information received by month is indicated in Figure 2.

We have received SIP 16 information in relation to 376 companies which entered administration in the first three months of the reporting period. According to the official insolvency statistics, 1,311 companies entered administration during that quarter, indicating that approximately 29% were pre-pack sales. This calculation remains the most reliable indicator of the proportion of administrations involving pre-packs.

Although the above provides an initial indication that just over one in four administrations are pre-pack sales, a more reliable calculation will be possible once we have been able to compare SIP 16 information received against official insolvency statistics over a longer period.

We also have some concerns that The Insolvency Service is not being sent SIP 16 information in all relevant cases, leading to an under-representation of the extent to which pre-pack sales are being undertaken. These concerns are based upon the following observations:

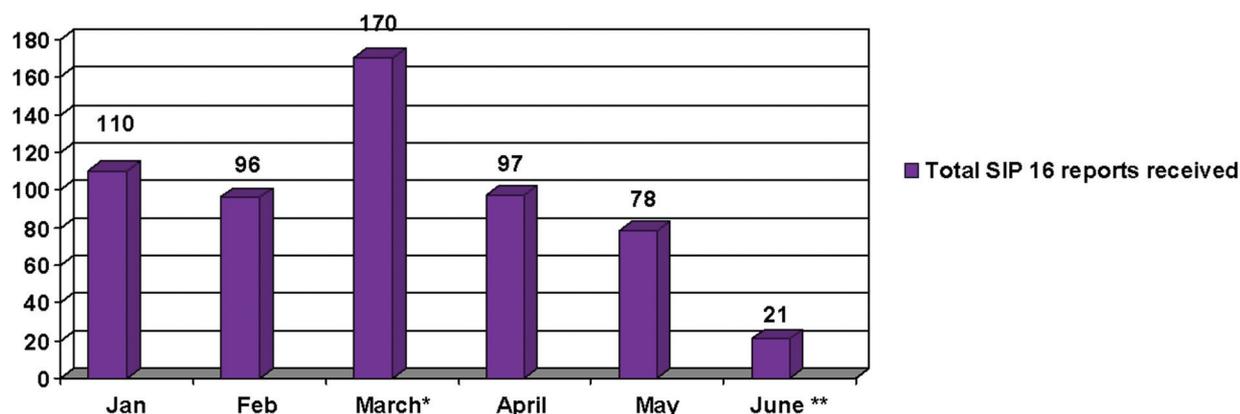
- There is presently no statutory or regulatory requirement for insolvency practitioners to send SIP 16 information to the Secretary of State (in practice The Insolvency Service)
- A survey undertaken by R3 (the Association of Business Recovery Professionals), indicates a significantly higher number of pre-pack administrations were undertaken by their members during March than have been notified to us
- This anonymous survey also indicated that a small number of insolvency practitioners have not sent any relevant SIP 16 information to The Insolvency Service
- We have received information from third parties in a number of cases relating to pre-pack administrations undertaken during the period where we had not received SIP 16 information from the relevant insolvency practitioner(s)
- There is no statutory definition of what constitutes a pre-pack administration, leading to interpretative differences as to whether or not a business sale has been facilitated in this way.

Whilst we are not presently able to accurately estimate the extent to which we are not being sent SIP 16 information, on the basis of the above it appears reasonable to assume that there could be a 10 to 20% under-representation of the number of pre-pack sales being undertaken.

We will look to see if SIP 16 should be strengthened by adding a mandatory requirement to provide the Secretary of State with a copy of the information.

Figure 2 indicates the number of companies for which SIP 16 information has been received by month.

**Figure 2 - SIP 16 reports received by month**



\*The figure for March includes two separate group businesses comprising a large number of subsidiary and connected companies, representing 33 of the total.

\*\*The figure for June is under-represented due to the time lag in the receipt of SIP 16 information in relation to administrations entered into during the month.

### **3.1.3 Insolvency practitioners' compliance with the disclosure requirements of SIP 16**

Assessing whether or not specific information disclosed is compliant with the requirements of SIP 16 requires consideration of the particular circumstances of the underlying insolvency, and we recognise that interpretative differences do arise as to precisely what information constitutes a full disclosure.

We also recognise that non-compliance with SIP 16 does not necessarily indicate that the pre-pack administration was an inappropriate course of action in the circumstances, nor does a compliant statement indicate that the pre-pack was necessarily in the best interests of creditors. Our focus has been to assess and improve transparency, and to identify and report any regulatory breaches.

During the period, information relating to 370 out of a total of 572 companies in administration was in our view compliant with the disclosure requirements of SIP 16, representing 65% of the total. A breakdown of the information analysed by month is indicated at Figure 3.

The Insolvency Service has written to 180 insolvency practitioners in respect of the SIP 16 information provided for 202 companies, which was considered non-compliant. In most of these cases we have requested further information from the practitioner, in order to ascertain the reasons why certain information was not disclosed and to assess whether or not the matter should be reported to the appropriate authorising body.

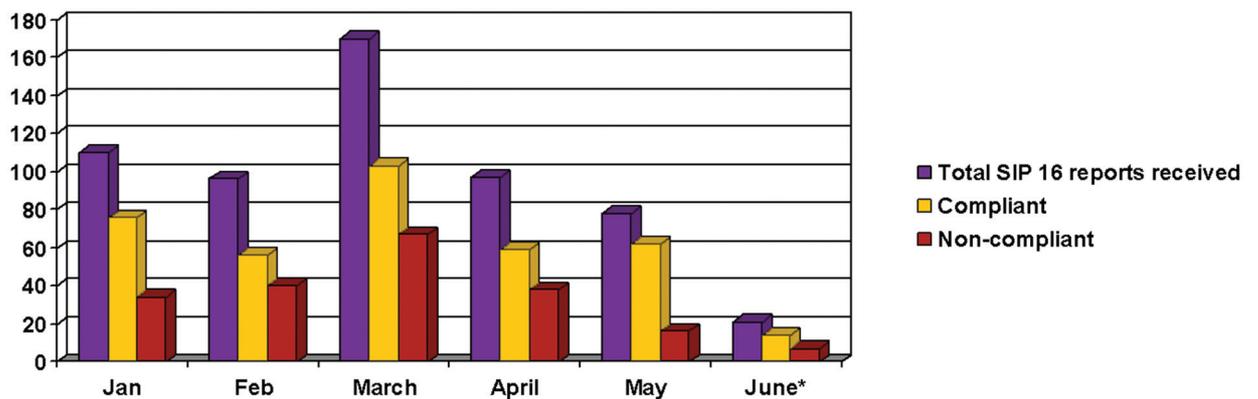
Where the information disclosed is clearly inadequate to comply with the requirements of SIP 16, the matter has been reported to the relevant insolvency practitioner's authorising body.

This has in the most serious cases been done without prior reference to the relevant insolvency practitioner(s). We have also considered other issues not confined to information disclosure when reporting matters to authorising bodies, such as the timeliness of the provision of information and any third party information, such as complaints. Any pattern of persistent breaches by a particular insolvency practitioner has also been reported.

In 17 of the cases reviewed the insolvency practitioners' conduct was such as to warrant it being referred to their authorising bodies so that it may be considered from a regulatory and disciplinary perspective. These referrals involved 29 insolvency practitioners and represent less than three percent of the cases reviewed.

Given the large number of cases where we have initiated further enquiries with insolvency practitioners and where those enquiries remain outstanding, it is likely that the number of insolvency practitioners reported to their authorising bodies will increase in relation to those cases reviewed during the reporting period.

**Figure 3 - Compliant SIP 16 by month**



\*The figure for June is under-represented due to the time lag in the receipt of SIP 16 information in relation to administrations entered into during the month.

### 3.1.4 Specific disclosure observations

#### 1. Timing of provision of SIP 16 information

We have some concerns about the provision of information to The Insolvency Service. In several cases we became aware that we had not received a copy of the SIP 16 report: however, in all but one of those cases the required information had been provided to creditors. Although it is noted that no specific timescale is set down by which SIP 16 information must be disclosed, given that all the relevant details would usually be known to the insolvency practitioner at the time of appointment, we would ordinarily expect the information could be sent to creditors, and the Insolvency Service, upon completion of the sale.

We are generally satisfied that information is being provided, if not on completion of the sale as we would expect, then in an otherwise timely manner. It is noted that in some cases insolvency practitioners are providing full administration proposals, including SIP 16 information, within a very short timescale.

However, it is also noted that in a minority of cases insolvency practitioners are not sending out information in a timely manner, which we regard as unacceptable. We will look to see what amendments should be made to SIP 16 to set out a specific timescale for the provision of information.

## **2. An explanation and justification of why a pre-pack sale was undertaken**

We are concerned that in a large minority of cases insolvency practitioners are not providing any background to the circumstances surrounding their appointment, or any explanation as to why the company needed to enter administration. In many cases the insolvency practitioner has given no indication that the pre-pack sale has been facilitated other than purely at the request of the directors, and it has not been made clear whether, or why, the company is insolvent. It is incumbent on insolvency practitioners to consider the financial position of the company and to determine the correct course of action to their own satisfaction. It is not always clear from the information being provided that this is happening, which is a matter for concern.

It is noted that many insolvency practitioners have elected to present information by reference to the bullet points disclosure requirements listed in paragraph 9 of SIP 16, whereas the requirement to provide a detailed explanation and justification of why a prepack was undertaken is contained separately within paragraph 8. This may to an extent explain the lack of information provided in this regard.

## **3. The source of the administrator's initial introduction**

Information being provided in this regard is generally satisfactory.

## **4. The extent of the administrator's involvement prior to appointment**

We are concerned that in a small minority of cases it is not always clear what role the insolvency practitioner has played in the period leading up to the administration appointment, especially in cases where the practitioner is advising, or acting on behalf of, a floating charge holder. In such circumstances we would expect proper context to be given regarding the purpose of the insolvency practitioner's involvement, in order that unsecured creditors are given a full understanding of the circumstances giving rise to the appointment.

In addition, where the insolvency practitioner has been advising the company prior to appointment, either with a view to achieving a business sale or restructuring, we would expect that the basis upon which that advice had been sought to be disclosed.

In all cases, we would expect information concerning the extent of the insolvency practitioner's prior involvement to include details of when that involvement commenced, which at present rarely appears to be disclosed.

#### **5. Any marketing activities conducted by the company and/or the administrator**

We are satisfied that, in cases where marketing has been undertaken by either the company or the administrator, this is being disclosed. However, we are concerned that in a large minority of cases this information merely confirms that some marketing has taken place, without any indication as to how this was undertaken or what the results were.

We would expect the nature of any marketing activities to be disclosed, along with details to be provided of any offers received for the business or assets of the company. In some cases it is not clear that the final offer accepted by the insolvency practitioner was the best that was received.

#### **6. Any valuations obtained of the business or the underlying assets**

Where valuations are obtained, we are concerned that in a majority of cases insolvency practitioners are not disclosing the amounts attributed to either the business as a whole, or to individual classes of asset. We believe that for creditors to appreciate whether best value has been obtained for the business or assets, it is imperative that they are given early information about the value attributed to them by an independent third party.

We also note that in a large minority of cases, no valuations appear to have been sought in relation to certain assets that were subsequently sold for a relatively substantial amount of consideration. This is especially the case in relation to intangible assets, such as goodwill, which it is recognised are often difficult to value reliably. However, in such circumstances it may be possible to demonstrate that best value has been obtained for goodwill and other intangible assets by exposing them to the market.

We are satisfied that where valuations have been obtained, the identity of the valuer is being disclosed in the vast majority of cases.

#### **7. The alternative courses of action that were considered by the administrator, with an explanation of possible financial outcomes**

We are satisfied that in the majority of cases adequate information has been disclosed regarding the possible alternative courses of action considered by administrators. However, only in a very small number of cases is any attempt made to quantify alternative outcomes in financial terms.

#### **8. Why it was not appropriate to trade the business, and offer it for sale as a going concern, during the administration**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard.

## **9. Details of requests made to potential funders to fund working capital requirements**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard. However, we are concerned that in some instances no disclosures have been made about any attempts to obtain further funding from lenders or shareholders.

## **10. Whether efforts were made to consult with major creditors**

We note that in the majority of cases where insolvency practitioners have obtained prior agreement for the pre-pack with secured creditors this has been disclosed. However, we note that on the basis of the disclosures made, it is apparent that rarely is any attempt made to discuss the pre-pack sale with major unsecured creditors.

## **11. The date of the transaction**

We are satisfied with the information provided in this regard.

## **12. Details of the assets involved and the nature of the transaction**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard. However, we are concerned that in a minority of cases the nature of the assets is not disclosed. In cases where a business sale is achieved through a pre-pack and there is a multi-company group structure we note that on occasions assets are not attributed to each separate entity. This is not always material but should be disclosed where the profile of creditors within the group differs.

In cases where a material amount of the business sold comprises goodwill, we would expect some indication to be given as to why this asset has value attributed to it, given that the company is likely to have been loss-making. It is accepted that value may attach to a brand name even if the company itself is loss-making: however, this should be made clear.

Where a company's assets are subject to security, we are of the view that in order for unsecured creditors to properly understand the nature of the transaction and how the value attributed to the assets may affect them, it is important that they are given information concerning the amount owed to the secured creditor(s). However, we recognise that this is not presently a requirement under SIP 16. In conjunction with the authorising bodies, we will look to see whether SIP 16 could be strengthened by adding a suitable requirement.

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

We are satisfied that in the majority of cases adequate information has been disclosed in this regard. However, we are concerned that in a small minority of cases the amount of consideration obtained for the business or assets is not disclosed. In addition, in a large minority of cases there does not appear to be any detail or rationale provided as to the apportionment of sale consideration between asset categories.

We note that in a significant proportion of cases (please see 3.1.5), an element of deferred consideration forms part of the sale terms. Where this is the case, we would expect the full terms of any such arrangement to be disclosed, along with any security obtained by the insolvency practitioner for payment. We are concerned that where conditional consideration has been obtained (which appears to be rarely), details of the terms of any such arrangement are often not disclosed.

**14. If the sale is part of a wider transaction, a description of the other aspects of the transaction**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard. However, we note that in circumstances where the pre-pack sale is the outcome of some other financial or legal process and no related background or explanatory information is provided, it is difficult for creditors to understand the justification for the pre-pack administration.

**15. The identity of the purchaser**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard. However, we note that in a small minority of cases, no effort is made to identify the individuals involved with a purchasing corporate entity, which is often material and should be disclosed where they are connected to the directors or shareholders of the insolvent company.

**16. Any connection between the purchaser and the directors, shareholders or secured creditors of the company**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard. However, we are concerned that in a small minority of cases where the purchaser is connected to the shareholders or secured creditors of the insolvent company, full disclosures are not always made.

**17. The names of the 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**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard.

**18. 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**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard.

Where directors have given guarantees for amounts due from the company to a prior financier, in order for creditors to properly understand the nature of the transaction, it is

important that they are given information concerning the amount due under any such guarantee to a prior financier. However, we recognise that this is not presently an explicit requirement under SIP 16.

### **19. Any options, buy-back arrangements or similar conditions attached to the contract of sale**

We are satisfied that in the majority of cases adequate information has been disclosed in this regard. However, we are concerned that where conditional consideration or options obtained (which appears to be rarely), details of the terms of any such arrangement are often not disclosed.

#### **3.1.5 Further analysis**

In order to further inform our understanding of the nature of pre-pack transactions, we have carried out an analysis of the SIP 16 information received in relation to 375 companies entering administration during the reporting period (or 66% of the total), in respect of:

- Sales to connected parties
- Whether the administrator undertook any marketing
- Whether any element of the sale consideration was obtained on a deferred basis.

In relation to the information reviewed, it was found that:

- 81% of pre-pack sales were to parties connected with the insolvent company
- Administrators undertook some marketing in 50% of cases
- An element of the sale consideration was deferred in 49% of cases.

## **3.2 Directors**

### **3.2.1 Method and scope**

SIP 16 information is also reviewed by the Enforcement Directorate of The Insolvency Service's Investigation and Enforcement Services in order to identify potential director conduct issues. So far we have reviewed 292 SIP 16 reports for director conduct issues, and 50 complaints have been received through The Insolvency Service Hotline and other sources in respect of 33 companies which engaged in pre-packs.

To date, the reviews of director conduct carried out by the Enforcement Directorate have focused on pre-pack sales to connected parties (in practice directors and shareholders – 191 of the 292 sets of SIP 16 information considered). The reviews can be divided into three categories: reviews of SIP 16 information without an accompanying complaint; cases where the review of the information is undertaken in the presence of a complaint about the pre-pack; and reviews of directors' conduct following the insolvency practitioner's report required by the provisions of the Company Directors Disqualification Act.

In addition, The Insolvency Service's Companies Investigation Branch (CIB – please see 2.4) carries out enquiries in response to complaints referred to them. As well as Hotline complaints forwarded by the Enforcement Directorate, a number of complaints about pre-packs have been made direct to CIB. Complaints are recorded and reviewed, and those that give rise to apparently legitimate concerns are the subject of further enquiry.

The identification and subsequent investigation of enforcement cases necessarily takes some months, whether the initial information is obtained by an insolvency practitioner and passed to Investigation Services, or by CIB in response to a complaint. At the time of publication, therefore, the investigation of SIP 16 cases is at an early stage.

### **3.2.2 Review of SIP 16 information without accompanying complaint**

It must be stressed that SIP 16 is aimed at improving the transparency of the pre-pack process, not at disclosing potential misconduct by directors. Further, SIP 16 information is required to be submitted at an early stage of an insolvency practitioner's dealing with an administration, so that the insolvency practitioner's enquiry into, and consideration of, the conduct of the directors will, inevitably, be at a very early stage. Consequently, when the review was commenced we did not anticipate that SIP 16 information, in the absence of anything else, would provide a fruitful source of information about potential director misconduct, and this has proved to be the case.

As part of the review by the Enforcement Directorate we have sought further information from insolvency practitioners as necessary, and in 100 of the 292 SIP 16 reports examined indications of potential director misconduct has been noted. However, it is important to emphasise that (i) the potential misconduct identified is not, in most cases, apparently connected directly to the events surrounding the pre-pack itself, but rather is of a nature that is likely to have been evident whether or not a pre-pack had occurred and (ii) the relative incidence of potential misconduct identified is of the same level as the general level of misconduct previously reported by insolvency practitioners in all administrations (and all insolvencies dealt with by insolvency practitioners generally) in the year to 31 March 2009.

Consequently, there is no initial evidence that the level of director misconduct in pre-packs (at least those reported under SIP 16) is any greater than overall level of misconduct reported by insolvency practitioners generally.

### **3.2.3 Review of SIP 16 information with accompanying complaint**

Complaints have been primarily received through The Insolvency Service Hotline although a small minority have also arrived direct to the Enforcement Directorate from other sources. Companies Investigation Branch have also received a smaller number of further complaints direct to them (dealt with further below). The Insolvency Service Hotline is an important avenue for anyone who feels that they may have been disadvantaged by the pre-pack process and it is clearly and specifically identified in this connection on The Insolvency Service's website. The website explains how to contact Companies Investigation Branch in instances where a company is still trading (as opposed to one subject to formal insolvency proceedings) is involved.

The companies which are the subject of the complaints received so far represent 5% of the total number of SIP 16 reports notified to The Insolvency Service. A large proportion of the complaints received relate, at least in part, to the conduct of the insolvency practitioner and to wider concerns about the operation of pre-packs generally and at least a third were exclusively about these issues. Of the remainder, many centred on the directors' general involvement in the pre-pack procedure rather than identifying particular matters of misconduct that might lead to early further investigation by The Insolvency Service. However, a small minority of the matters raised did appear to have sufficient validity and one of those cases is currently under investigation by the Investigations Directorate of The Insolvency Service's Investigation and Enforcement Services following submission of a conduct report by the insolvency practitioner. Other valid complaints are also being dealt with by Companies Investigation Branch (see 3.2.5).

### **3.2.4 SIP 16 and insolvency practitioner reporting under the Company Directors Disqualification Act 1986**

As mentioned above at 2.4, insolvency practitioners are not required to report potential matters of misconduct until six months after the commencement of the formal insolvency (in this case the date the administration commenced). A high proportion of the reports which identify misconduct are received at the six month point. Given that the SIP 16 requirements were introduced at the beginning of January 2009 it is inevitable that only a very small number of conduct reports have been received in administrations where there has also been a pre-pack reported under SIP 16.

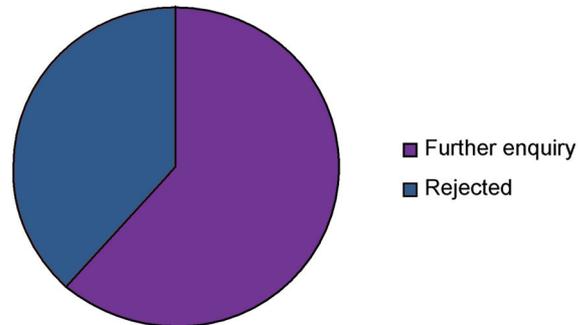
In fact, in respect of the 292 sets of SIP 16 information reviewed by Enforcement Directorate, only 17 reports indicating misconduct have been very recently received from insolvency practitioners. Most of these are still under consideration as to whether to target for further investigation although three have been assessed as not being in the public interest to investigate further.

Consequently, sufficient time has not elapsed and there is not a sufficiently large body of pre-pack administrations in which insolvency practitioners have also carried out all their enquiries and made final reports on the directors' conduct, for substantive conclusions to be drawn about the incidence of director misconduct in pre-packs. Further, the speculative assessment carried out to date (i.e. the 100 cases identified during the review of SIP 16 information as showing indications of potential misconduct) does not suggest that there is likely to be a higher incidence of misconduct than in the wider population of insolvencies. For the reasons given above, any assessment in this area at this stage should be treated with extreme caution.

### **3.2.5 Complaints received by Companies Investigation Branch**

To date Companies Investigation Branch has received 31 complaints regarding pre-pack cases, of which 19 (61%, as shown in Figure 4) have been identified for further consideration. Three of these have been authorised for statutory investigation under section 447 of the Companies Act.

**Figure 4 - complaints processed by CIB**



Whilst to date CIB's investigations have not given rise to any follow-up action which is notifiable (i.e. has come into the public domain – for example, the winding up of a company following the presentation of a public interest petition, or the taking of proceedings for the disqualification of one or more of the responsible company directors) a number of regulatory disclosures have been made, including a report to an insolvency practitioner's authorising body.

As the investigation process can take up to two years to complete (although 90% of cases are completed within six months), the outcome of current investigations will not be known for some time. The cases received by CIB can be quite complex. In one of the cases accepted for investigation, for example, in addition to concerns about the bona fides of a pre-pack sale of assets by the insolvent company's administrators, there were additional concerns that the identities of those responsible for the purchasing company's management and control were being wilfully concealed. There were also wider concerns about the serial failure history of the one of the directors – with specific allegations that he routinely abused insolvency procedures to enable companies under his control to undercut the prices charged by competitors (by not paying their creditors: competitors' prices more fully reflecting the true costs of production, distribution and marketing etc).





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