Diving into the pre-pack pool: the revised SIP 16

In this article we consider the potential impact on pre-packaged administrations of the changes to the statement of insolvency practice 16 (SIP 16) which came into effect on 01 November 2015.

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**Pre-packs - why has a change come about?**

A “pre-pack” is a sale of a company’s business or assets by its administrator immediately on, or shortly after, the administrator's appointment, the terms of such sale having been negotiated and arranged in advance of the administration. Creditor concerns with this process, especially where the purchaser is the existing management team or owners, have attracted considerable media and political attention in recent years. However pre-packs often represent the best outcome for creditors, allowing a business to be sold for a reasonable price where a traditional trading administration or a sale negotiated post-administration would either result in a marked reduction in the purchase price achieved by the administrator or the inability to complete a sale at all.

In response to creditor concerns, the government commissioned an independent review of pre-packs. The resulting recommendations were published in June 2014 and have been largely implemented by the revision of SIP 16 which is the statement of insolvency practice insolvency practitioners are required to comply with regarding administration pre-packs. This attempt at voluntary regulation of the use of pre-packs has however been backed up by a stick under the Small Business, Enterprise and Employment Act 2015. This Act gives the government the power to issue regulations limiting or controlling pre-pack disposals to connected parties such as the management or owners of a failed company. Formal regulation is likely to be more onerous for insolvency practitioners and restrict the opportunity to use the pre-pack tool. If the insolvency industry wants to avoid this, it must embrace not only the letter, but the spirit of the revised SIP 16 which applies to appointments made on or after 01 November 2015.

**The revised SIP 16**

The aim of the revised SIP 16 is increased transparency regarding pre-packs and, as a result, increased confidence amongst the creditors that a pre-pack was appropriate in the circumstances. As well as setting out particular requirements, the overarching theme of SIP 16 for administrators is “comply or explain”: comply in full with the detailed requirements of SIP 16 or explain clearly to creditors why compliance did not occur.

Administrators will need to review their current preparation and reporting processes. SIP 16 requires them to:

- Differentiate any pre-appointment advisory role undertaken from their role as administrator and explain these separate roles to the directors and creditors. Encouragement to take independent advice should be given to the
directors or potential purchaser. Provide creditors with a “SIP 16 Statement” which includes a detailed narrative explanation and justification for the pre-pack and all alternatives considered, demonstrating that the administrator had due regard for creditors’ interests. Where the sale was to a connected party, it is likely that a greater level of detail and justification will be appropriate.

Make any potential purchaser connected with the company aware of their ability to approach the pre-pack pool (see below) for an opinion on the proposed pre-pack and the ability and potential effect of making a statement to creditors stating how the purchaser will survive for the next 12 months and what it would do differently to avoid a further failure of the business. This statement is called a viability statement.

Keep a detailed record as to why a pre-pack was carried out and all alternatives considered.

Advise the company that valuations obtained should be undertaken by independent valuers with adequate professional indemnity insurance. If an alternative valuation is relied on by the administrator, this must be disclosed along with reasons for doing so and why the administrator is satisfied with the valuation.

Undertake marketing:

- Marketing should be as wide as possible, proportionate to the nature and size of the business.
- The marketing strategy should be explained in the SIP 16 Statement.
- The administrator must be satisfied that sufficient independent marketing has been undertaken. Marketing prior to the insolvency practitioner’s involvement is not a justification to avoid further marketing.
- Marketing must be for an appropriate length of time and this must be explained to creditors.
- On-line marketing must be used and, if not, a justification given.

Provide the SIP 16 Statement (including any opinion given by the pre-pack pool and viability statement produced by the purchaser) to creditors with the first notification to creditors and within seven days of the pre-pack sale.

Seek approval for the administrators’ proposals as soon as practicable after the appointment, and ideally the proposals should be sent to creditors with the notification of the sale.

The pre-pack pool - what is it and how does it work?

The pre-pack pool is an independent body of experienced business professionals who offer an opinion on a proposed pre-pack to a connected party. An application, supported by information regarding the business involved, the purchaser and proposed transaction can be made by the purchaser through the pre-pack pool’s website and a fee of £800 (plus VAT) is payable. The application is allocated to a member of the pool who aims to issue an opinion within 48 hours. The opinion issued will be one of the following:

- nothing found to suggest that the grounds for the proposed pre-packaged sale are unreasonable
- evidence provided has been limited in some areas, but otherwise nothing has been found to suggest that the grounds for the proposed pre-packaged sale are unreasonable, or
- there is a lack of evidence to support a statement that the grounds for the proposed pre-packaged sale are reasonable.

No reasons will be given for the opinion issued and there is no mechanism for appealing an opinion issued.

The pool is monitored by an Oversight Group which reports to the Insolvency Service and the Department for Business, Innovation and Skills.

The application documents are not publicly available and are confidential, although applicants will be asked to give their permission for the opinion to be sent to any administrator appointed or proposed. The administrator will, in compliance with SIP 16, wish to include a copy of the opinion in the SIP 16 Statement provided to creditors following the pre-pack
Will the revised SIP 16 work?

Time will tell. Many in the industry will be watching whether the tougher SIP 16 requirements improve creditors’ confidence in pre-pack sales. There will be a particular interest, where the sale is to a party connected with the failed company, in how many applications are made to the pre-pack pool, the decisions it makes and whether those decisions influence creditor sentiment. Given the necessary confidentiality surrounding applications to the pool in light of the commercially sensitive nature of information these applications will include, it will take time for academics and commentators to get a sense of the impact of the pool process.

The media’s reporting will inevitably play a role in whether creditors gain confidence from the revised SIP 16 requirements and the pre-pack pool opinions. Underpinning confidence in pool opinion will be the quality of the individuals appointed to be members of the pool and the oversight of it.

With the revised SIP 16, the insolvency industry is being given an opportunity to voluntarily improve creditors’ confidence that pre-packs are only being used when appropriate - and not simply as a tool for business owners to avoid their debts and continue trading. The level of scrutiny, and therefore work, required of administrators is increasing and to some might feel bureaucratic. The alternative of formal regulations issued by the Secretary of State is unappealing - these are likely to be more restrictive and onerous for administrators. It would be a shame if, as a result of inappropriate use and media focus, the pre-pack tool becomes so regulated as to be unusable - there are many instances where a pre-pack is an extremely useful tool for preserving best value for creditors.

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