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Pre-Packs

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Pre-packs

Summary and Implications
This note provides a short summary of pre-packs and covers some of the most frequently asked questions. Each pre-pack is different and what follows is a general overview. Specific advice should be taken in individual cases.

What is a pre-pack?
A pre-pack is an agreement for the sale of an insolvent company's assets which is devised in advance of the company entering into a formal insolvency process. They are frequently used in conjunction with administration. In most cases, the deal will have been agreed before the Insolvency Practitioner ("IP") is appointed and will usually be executed by the IP shortly after appointment.

Are pre-packs legislated for?
There are no specific provisions in insolvency legislation which deal with pre-packs. IPs who execute pre-packs are regulated both by statute and the codes of practice of their professional bodies. If a court subsequently found an IP had acted improperly in entering into a pre-pack, he might be liable for misfeasance. Equally, he could be subject to disciplinary proceedings.

Pre-packs are not a new phenomenon. They have been used over many years to sell businesses where commercial pressure dictates that urgent action is required. Pre-packs have become a "hot topic" in recent times with a series of high-profile businesses, including Leeds United Football Club, Whittard of Chelsea Limited, Land of Leather Limited and Cobra Beer and most recently, Wind Hellas, all being disposed of as part of pre-pack arrangements. Critics sometimes point to a greater degree of regulation by the courts in other jurisdictions, however the Statement of Insolvency Practice 16 ("SIP16") which took effect on 1 January 2009, seeks to redress this. SIP16 sets out guidelines for IPs who are involved in pre-packaged sales. It is intended to provide greater transparency for creditors, by providing them with detailed information about the terms of the sale, the buyer of the business and with more visibility into the formal insolvency process generally. In additional to SIP 16, IPs are required to follow the Code of Ethics for Insolvency Practitioners (the
Creditors inevitably feel they are being presented with a “done deal” in circumstances where they have not been kept informed of developments or been able to influence the process in any way.

Why are pre-packs used?
In certain circumstances, a pre-pack may be the best method of maximising realisations for a financially distressed company to the advantage of all stakeholders. By agreeing the deal in advance of a formal insolvency, the business is often sold without the same level of negative publicity. Another justification for a pre-pack is that a formal insolvency process followed by a period of trading may destroy value and lead to a loss of business and staff. They are frequently used in the case of “people” businesses or other businesses which cannot be traded in insololvency. They have become increasingly common in recent years in situations where there is a lack of available funding to keep a business trading through an insolvency process.

Disadvantages of a pre-pack
The main criticism of pre-packs is a lack of transparency in the process. Although marketing may take place in advance of a pre-pack being entered into, it is not necessarily visible. Creditors inevitably feel they are being presented with a "done deal" in circumstances where they have not been kept informed of developments or been able to influence the process in any way. IPs are under a duty to secure the best outcome for the creditors and a pre-pack will frequently be justified as the best way of achieving this. SIP16 should also help satisfy creditors that the IP has acted with due regard to their interests.

Judicial commentary
Notwithstanding their use over the years, pre-packs have not attracted significant judicial commentary. The case of *Kayley Vending Limited [2009] BCC 578* gave the court an opportunity to comment on a pre-pack prior to the company entering into administration and prior to the pre-pack deal being effected. The court said that for an application to court seeking an administration order, there should be full disclosure, as required by SIP16, of any intention to effect a pre-pack.

The principle laid down in Kayley Vending Limited, was adopted and expanded on in the recent case of *Hellas Telecommunications (Luxembourg) II SCA*, commonly referred to as “Wind Hellas”. Wind Hellas is important as it was the first case where the court expressly gave positive support to a specific pre-pack strategy. A key aspect of the Wind Hellas administration strategy was for a pre-pack sale to another company within the group (“Weather”) to take place...
immediately following the company entering into administration. Prior to the appointment of the administrators there had been a lengthy sales process but Weather was the only bidder left. The senior lenders who would need to consent to any sale outside of liquidation had made it clear that the offer from Weather was the only bid they were prepared to sanction. It was held that the guidance for proceeding with a pre-pack in SIP16 had been fully complied with and express permission was therefore given to the administrators to enter into the proposed pre-pack sale with Weather.

In both Kayley Vending Limited and Wind Hellas, the court held that the merits of the proposed transaction is a matter for the officeholders to consider once they are appointed and that they should comply with their obligations under SIP16. Should any creditor feel aggrieved by the pre-pack agreement, then they have the right to challenge the administrators’ conduct. If the court was faced with a proposed pre-pack where it felt the agreement could constitute an abuse, then the court could refuse to make the administration order. If the proposed pre-pack appeared to the court to be the only viable way to proceed, then the court could give a direction that the administrators are given liberty to enter into the proposed transaction. However, the court acknowledged that there will be many cases where the position will not be as clear cut, and in those circumstances, no such direction to proceed should be given.

**Opportunities to challenge a pre-pack**

Pre-packs can potentially be challenged in a number of ways. Possible lines of attack against the IP include:

- a misfeasance application;
- an application alleging conduct by the IP which is unfairly harmful to the interests of the applicant;
- an indirect route by challenging the remuneration of the IP;
- an application to remove the IP; and
- a challenge brought by a third party who asserts that the IP has in some way infringed his contractual or proprietary rights.

Whether one or more of the above grounds has any merit would need to be assessed on a case by case basis by reference to the relevant facts.

Other possible avenues to explore include the ability to challenge the directors who were complicit in the pre-pack deal. This could potentially involve a wrongful trading action by a subsequently appointed liquidator and/or misfeasance claims alleging breach of fiduciary duties or breach of the newly codified Companies Act 2006 duties.

Successful challenges to pre-packs, whether before or after the event, are notoriously difficult. Recent case law arguably makes a successful challenge even harder. A number of commentators would nonetheless argue it is only a matter of time before a successful challenge is
mounted. In the meantime, it is essential that each situation is carefully assessed on the relevant facts and information available.