Reforms to Address Corporate Misuse of the Fair Entitlements Guarantee Scheme

Submission

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Executive Summary

For the reasons advanced in this Submission, it is argued that, in certain circumstances, a pre-pack or a pre-positioned sale of a company's business can assist mitigate the misuse of the Fair Entitlements Guarantee Scheme whilst, at the same time, can be undertaken in an environment which avoids the sharp corporate practices which have been identified as facilitating that misuse. In essence, that environment is as follows:

(a) pre-packs should only be permitted when the value of the company's business is less than a prescribed amount, probably somewhere between $100,000 and $250,000;

(b) pre-packs can only be negotiated under the supervision of an independent insolvency practitioner drawn from a panel maintained by ASIC;

(c) the independent insolvency practitioner should be permitted to act as liquidator or administrator of the company in the event of a voluntary administrator being appointed or it being wound up;

(d) the independent insolvency practitioner should be required to provide creditors with a certificate containing the information detailed in paragraph 9 of the Statement of Insolvency Practice 16 issued by the UK Institute of Chartered Accountants which is **attached** as **Annexure 2**; and

(e) in addition, the independent insolvency practitioner should certify that the sale price was at least equal to the amount determined by an independent valuer of the assets which are the subject of the sale.

1. Background

1.1 The consultation paper dated May 2017 in relation to the Corporate Misuse of the Fair Entitlements Guarantee ("***FEG***") Scheme ("***Consultation Paper***") identifies the following issue of central concern:

> "*Costs of the FEG Scheme have been increasing due to the adoption of sharp corporate practices by select employers and parties associated with them, resulting in cost shifting to the Scheme and through it, to taxpayers.*"

1.2 Those sharp practices include, relevantly for the purposes of this submission, the following:

(a) utilising fraudulent or unlawful phoenix company activities and arrangements;

(b) the adoption of deliberate practices by certain company directors, company officers, and some advisors in seeking to unfairly manage an insolvency to the detriment of creditors.

1.3 The Consultation Paper identifies a number of law reform initiatives intended to discourage and penalise those activities. It is not necessary for the purposes of this submission to identify those initiatives in detail. It is sufficient to say that they are supported.

2. Additional Law Reform Initiatives

2.1 It is submitted that, in addition to the adoption of law reform initiatives which discourage the "*sharp corporate practices*" identified in the Consultation Paper, it is also appropriate to explore other law reform initiatives which will mitigate the effect of corporate failures on the FEG Scheme.

2.2 Such law reform initiatives may be as much concerned with creating a legislative environment which facilitates the preservation of either companies or their businesses and secures the ongoing engagement of the company's employees as discouraging and penalising those "*sharp corporate practices*".

2.3 It is submitted that one such law reform initiative was identified by the Productivity Commission in its report on the Inquiry into Barriers to Business Entries and Exits ("***Productivity Commission Report***"). Reference is made in this regard to Recommendation 14.3 of the Commission's Report:

> "***Recommendation 14.3:***
>
> *Provision should be made in the Corporations Act 2001 (Cth) ("**Act**") for 'pre-positioned' sales.*
>
> *Where no related parties are involved, there should be a presumption of sale such that administrators can overturn sales only if they can prove that the sale was not for reasonable market value (in accordance with s420A of the Act), or if it would unduly impinge on the performance of the administrators' duties. Administrators or liquidators should be able to rely on the pre-appointment sale process as evidence.*
>
> *If sales are to related parties, there is no presumption favouring sale and the administrator's or liquidator's examination of the sale process continues as normal. The administrator's review should include checks that the sale has met existing regulatory requirements for related party transactions.*
>
> *In both cases, s439A of the Act should be amended to include requirements to disclose information of the sale to creditors.*
>
> *Where the sale (whether given effect before or after the insolvency appointment) is the result of advice received under the safe harbour defence, that defence should also apply against voidable transactions actions from administrators or liquidators.*"

2.4 For the purposes of this submission, "*pre-positioned*" sales (which are also known as "*pre-packs*" and will be described in this submission in that way) are defined:

"*A process of arranging the sale of a company's business before the formal appointment of a liquidator, who will finalise the sale as soon as possible after their appointment.*"

2.5 The Australian Government did not support Recommendation 14.3 of the Productivity Commission for these reasons:

"*Currently, a liquidator or administrator will assess any contract for sale entered into prior to the administration but not yet completed, to determine whether it is in the interests of creditors to honour it. A liquidator may elect to honour a contract for sale, or to allow the counterparty to lodge a claim in the administration. Any presumption in favour of a sale would fetter the liquidator's ability to carry out this function.*

The Government does not believe that this would be a desirable policy outcome.

The Government notes also that the UK's non-legislative 'pre-pack' administration has attracted considerable criticism because of perceptions that it may facilitate fraudulent phoenix activity."

2.6 It is accepted that fraudulent or unlawful phoenix activity is both to be discouraged and that its practice brings the process of liquidating companies into disrepute. It is for that reason that the recommended law reform initiatives in the Consultation Paper are supported.

2.7 Further criticisms of pre-packs were identified by Teresa Graham CBE who undertook a review into pre-pack administrations for the British Government, the final report of which is dated June 2014 ("***Graham Review***"). The Report of the Graham Review concluded (at page 20), relevantly, that pre-packs suffered from the following "*negatives*":

"• *Pre-packs lack transparency*

• *Marketing of pre-pack companies for sale is insufficient*

• *More could be done to explain the valuation methodology*

• *Insufficient attention is given to the potential viability of the new company*

• *The regulation - and monitoring of that regulation - of pre-pack administration could be strengthened.*"

2.8 Against those criticisms, though, the Graham Review concluded that pre-packs delivered the following "*positives*":

"• *Pre-packs can preserve jobs*

• *Pre-packs are cheaper than an upstream procedure*

• *Deferred consideration is, by and large, paid (and in particular where it is due within 6 months) - old company creditors are not unduly harmed by the presence of deferred consideration in a pre-pack deal*

• *Where comparing like with like, pre-packed new companies are, on average, more likely to succeed than business sales out of trading administrations*

- *Pre-packs may bring some limited benefit to the overall UK economy from overseas companies relocating their pre-pack activity to the UK."*

2.9 It is to be noted that, in particular given the context of this submission, the Graham Review concluded that pre-packs can save jobs. As to that matter, the work of the Graham Review was supported by research undertaken by the University of Wolverhampton.

2,10 That research involved a sample of nearly 500 companies which entered into pre-pack administrations in 2010. In relation to the finding that pre-packs can preserve jobs, the Report of the Graham Review says (at 24-25):

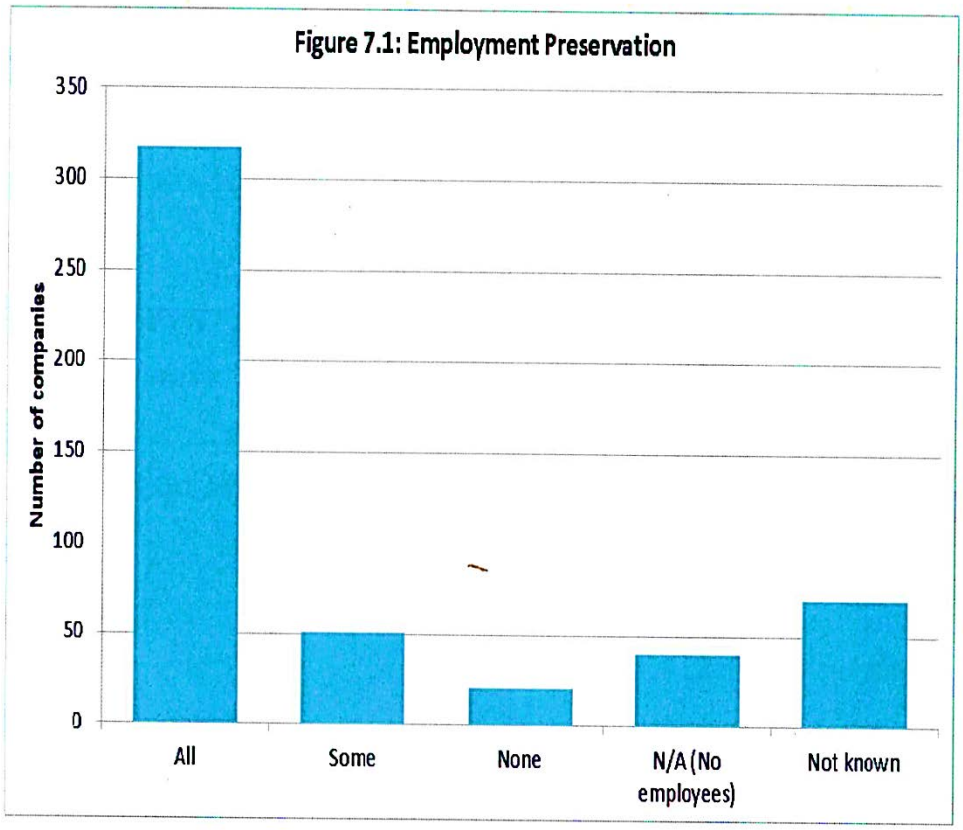
"***Pre-packs preserve jobs***

7.9 Employment preservation, however, is an area where I have been able to test the assertion that pre-packs are good for jobs. I was keen that the academic research should look at prospects for the old company employees of the sample companies.

7.10 A large number of SIP16 statements cited the preservation of employment as one of the reasons to pre-pack. The benefit is often reported by administrators as the preservation of the jobs themselves, but more usually as achieving a reduction in the likely preferential and unsecured creditor claims were the employees to be made redundant as a result of old company's insolvency. This may have been because the legislation does not cite 'saving jobs' as a statutory objective but does stress that the administrator must act in creditors' interests. Saving jobs is important for other creditors, including floating charge holders, as part of what the old company would otherwise have owed to its employees would be classed as preferential and so paid in priority to floating charge creditors and unsecured non-preferential creditors.

7.11 Despite this, the information regarding employment preservation reported in the SIP16 statements was often poor. It would appear that where all of the jobs had been saved, this was reported to creditors . However, where less than 100% employment preservation had been achieved, the information given in these statements became more opaque.

7.12 The veracity of these figures cannot be confirmed and neither can the length of the 'new' employment. It is not possible on the data presented to provide comment on the extent of employment preservation in the 51 cases categorised as 'some'. Nonetheless it appears that, the claim by proponents of pre-packs that they preserve jobs is a correct one.



2.11 If similar results could be achieved in Australia, then it is submitted that the principal policy objective identified in the Consultation Paper could be significantly advanced.

2.12 More recent analysis of the UK experience with pre-packs may be found in the 2016 Annual Review of the Pre Pack Pool which is **attached** as **Annexure 1**.

2.13 Beyond experience in the UK, it is to be noted that;

(a) pre-packs are possible under Chapter 11 of the US *Bankruptcy Code*;

(b) amendments were made to the New Zealand *Companies Act*, 1993 (ss386A, 386C, and 386,D) which facilitate pre-packs; and

(c) whilst the outcomes of its deliberations are not yet known, UNCITRAL has established Working Group V (Insolvency) to consider regimes appropriate for micro and small to medium enterprises.

3 Benefits from Pre-packs

3.1 To put the prospective benefits to be derived from pre-packs into context, an important consideration is in the analysis of the results of the current insolvency regimes.

3.2 Taking the most recently available data from ASIC, in 2015 – 2016:

(a) 9,465 companies entered external administration;

(b) of that number, 8,168 had assets of less than $100,000;

(c) of that number, 2,381 had assets of between $20,000 and $100,000;

(d) of that number, a further 519 had assets of between $100,000 and $250,000; and

(e) of that number:

(i) 6,202 had less than 5 FTE staff; and

(ii) a further 1,253 had between 5 and 19 FTE staff.

3.3 A study conducted by Mark Wellard; "*A Sample Review of Deeds of Company Arrangement Under Part 5.3A of the Corporations Act*" which was published in 2014 reviewed a number of voluntary administrations conducted in 2012 and 2013. That study concluded:

> "*The typical cost (in insolvency practitioner fees) of a voluntary administration which precedes a "small company" DOCA [Deed of Company Arrangement] is around $31,500, while a typical amount of remuneration charged by a Deed Administrator for the administration of a DOCA is $28,700.*" [A small company DOCA is described as a Deed under which assets of a value of less than $1.5 million are administered]

3.4 In these circumstances, it is reasonable to conclude that, if a voluntary administration followed by a DOCA is the approach adopted for restructuring a company and either preserving the company or its business, a very substantial proportion of the proceeds of realisation of its assets will be applied to satisfy both the remuneration of the administrator as well as the costs and expenses associated with the administration. Accordingly, it is submitted that, if a company or its business is to be restructured and its employees provided with continuing employment rather than being made redundant and the associated costs being imposed on the FEG Scheme, a less expensive process than that involved with voluntary administration is required.

3.5 Such a process was identified by the Productivity Commission in Recommendation 15.1 and Recommendation 14.4 in its Report which read:

> **"*Recommendation 15.1*:**
>
> *The Corporations Act 2001 (Cth) should be amended to provide for a simplified 'small liquidation' process.*
>
> - *this would only be available for those companies with liabilities to unrelated parties of less than $250,000.*
> - *to access small liquidations, directors should be required to lodge a petition to the Australian Securities and Investments Commission (ASIC) and verify that their books and records are accurate.*
> - *the primary role of the liquidator would be to ascertain the funds available to a reasonable extent, given a reduced timeframe. Requirements for meetings, reporting and investigations should be*

reduced accordingly.

- *the pursuit of unfair preference claims should be limited to those within three months of insolvency and material amounts. The duty to pursue unfair preference should be explicitly removed unless there is a clear net benefit and it will not impede conclusion of the liquidation.*

- *creditors would be able to opt out of the process and into a standard creditors' voluntary liquidation, and ASIC would be able to initiate further investigation if it has concerns of illegality.*

Liquidators for these processes would be drawn from a panel of providers selected by tender to ASIC. Panel membership would be for a period of up to five years, with ASIC able to conduct tenders at regular intervals to ensure that demand can be met.

ASIC should be empowered to hear complaints of practitioner misconduct and if the complaint is upheld, replace the liquidator. ASIC should be enabled to take disciplinary action, if warranted, against the discharged liquidator, including the suspension from participation in the panel or revocation of their registration."

Recommendation 14.4

"*The small liquidation process detailed in recommendation 15.1 should include provision for small pre-positioned sales, consistent with recommendation 14.3.*

In the context of small businesses, the requirements of s420A of the Corporations Act 2001 *(Cth), and investigations of related parties, should be applied proportionately in relation to determining the relevant market for the sale, advertising effort and reasonable price.*"

4 Pre-packs; Should they be a Policy Concern?

4.1 It is submitted that, in the context of the principal issue being addressed by the Consultation Paper, it is appropriate to test whether balance can be struck between the benefits which can be reasonably calculated to be available from permitting pre-packs; particularly saving jobs, with the "*costs*" associated with the possibility of facilitating fraudulent phoenix activity and the other negatives identified by the Graham Review.

4.2 Those costs need to be calculated having regard to:

(a) the law reform initiatives proposed in the Consultation Paper which are advanced as mitigants to such activities; and

(b) the legislative environment which could be adopted to support pre-packs.

4.3 It is submitted that, in addition to the adoption of the Productivity Commission's Recommendation 14.3, consideration should also be given to the adoption of its Recommendation 15.1. If that Recommendation were adopted and it was only pre-packs which:

(a) involved a sale whether to a party related to the company's directors or a third party;

(b) are undertaken under the supervision of an insolvency practitioner drawn from the panel contemplated by Recommendation 15.1;

(c) concern the assets of a company whose total assets are valued at a prescribed amount being somewhere between $100,000 and $250,000 and

(d) are at a price at least equal to an independent valuation of the assets being sold which was obtained by that insolvency practitioner

to which Recommendation 14.3 of the Productivity Commission (in its legislative form) applied, that would also militate against fraudulent or unlawful phoenix activity or, at the very least, mitigate its adverse effect given the limitation on the value of the assets (however ascertained) involved and the process of determining the minimum sale price.

4.4 Where a pre-pack is undertaken in that way and for so long as the insolvency practitioner's involvement is limited to:

(a) advising as to the options available to the company, given its financial circumstances;

(b) the supervision of the sale process; and

(c) obtaining the independent valuation

that person should be able to act as liquidator or voluntary administrator for the company as the case requires.

4.5 The protection against fraudulent or unlawful phoenix activity would be further fortified if the supervisory regime contemplated by Recommendation 15.1 extended to ASIC being able to conduct audits of the matters conducted by insolvency practitioners on the panel.

4.6 Beyond those possible law reform initiatives which could be taken to mitigate the risk of fraudulent or unlawful phoenix activity, there is the regime for reviewing the conduct of external administrators established under the Insolvency Practice Rules (Corporations) 2016 which provides adequate opportunity for ASIC, either on its own motion or at the request of, say, a creditor to review a pre-pack transaction.

4.7 It is submitted that these initiatives taken collectively are calculated and can be reasonably expected to militate against fraudulent or unlawful phoenix activity. It is further submitted that those initiatives can mitigate the policy "*costs*" of which it is apprehended might have to be borne if pre-packs facilitate that activity. The reasons are that:

(a) there is the requirement for the involvement of an independent insolvency practitioner;

(b) those independent insolvency practitioners can only be selected from a panel established by ASIC;

(c) their activities can be effectively scrutinised;

(d) pre-packs would only be permitted when the value of the company's business is less than a prescribed amount, probably somewhere between $100,000 and $250,000 and when it has been negotiated under the supervision of an independent insolvency practitioner;

(e) the sale of that business would be required to be undertaken at a price which is at least equal to the value of the assets being sold as determined by an independent valuer and certified as such by the independent insolvency practitioner; and

(f) the independent insolvency practitioner should be required to provide creditors with a certificate containing the information detailed in paragraph 9 of the Statement of Insolvency Practice 16 issued by the UK Institute of Chartered Accountants which is **attached** as **Annexure 2**.

In this environment it is also submitted that there can be no sensible objection, in the ordinary course, to the independent insolvency practitioner acting as, say, voluntary administrator of the company and either its liquidator or as the administrator of any deed of company arrangement which it undertakes.

4.8 It is accepted that the use of a valuation to test price may be less rigorous an approach to establishing "*true*" value than a marketing process. However, when undertaking the appropriate cost benefit analysis, if pre-packs are only available in the case of sales when the assets being sold are valued at less than, say, $100,000, the deficiency, in terms of the adverse impact on creditors, would be minimal. Moreover, for reasons explored below, it is possible that creditors may receive a better return than would be the case if, say, there was a voluntary administration followed by the execution of a Deed of Company Arrangement. Without there being at the same time a pre-pack.

5 Conclusion

5.1 For the reasons explored above, it is submitted that it would be possible to further alleviate the burden on the FEG Scheme of the redundancy of employees consequent upon the liquidation of their employer by permitting pre-packs to be undertaken:

(a) under the supervision of an independent insolvency practitioner;

(b) in the context of "small to medium sized companies";

(c) at a price which is no less than the independently determined value of the assets being sold; and

(d) otherwise, subject to the "checks and balances" described in this submission.

ANNEXURE 1

PPP Pre Pack Pool

ANNUAL REVIEW 2016

March 2017

Foreword

'Pre-pack' administrations constitute a small fraction of insolvency procedures in a given year. Yet it is pre-packs that are responsible for a significant proportion of attention given to the UK's insolvency framework by the media, politicians, and creditor groups.

2016 key facts about the pool

- **53** referrals to the Pool (1 November 2015 – 31 December 2016)
- **34** 'case for the pre-pack is not unreasonable' opinions
- **13** 'pre-pack not unreasonable but limited evidence' opinions
- **6** 'case for the pre-pack is not made' opinions
- **28%** of eligible pre-packs submitted to the Pool for review
- The proportion of pre-packs involving a connected party purchase has fallen from previous years. In 2010, **72%** of pre-packs involved a connected party; in the Pool's first 14 months, **51%** involved a connected party.

Although relatively few in number, pre-packs are an important part of the UK's restructuring landscape. They help rescue businesses and jobs and they are an effective means of generating the best possible return for creditors when a company becomes insolvent. But these positives are often overshadowed by concerns about the transparency of the procedure: creditors will only find out about a pre-pack after it has taken place. While the speed and discretion involved in a pre-pack are required to protect a company's value (and potential returns to creditors), creditors will understandably seek reassurance that a pre-pack represents the 'best deal', especially when a 'connected party' purchase is involved.

As a result of these concerns, pre-packs were the subject of the 2014 Graham Review (see p5-6 for more detail) which made a series of recommendations for improving trust and transparency in the pre-pack process. The Pre-pack Pool was set up in response to one of these recommendations.

The Pool is a voluntary process for connected parties purchasing a company's business or assets through a pre-pack administration. The Pool is an opportunity to assure creditors that the sale has been reviewed by independent business experts and that the case for a pre-pack has been made.

Assessing the success of the Pre-pack Pool in its first year is a difficult proposition. Just over one-in-four eligible pre-packs were referred to the Pool in its first 14 months (the period covered by this review), which, while a lower proportion than expected, is still encouraging for a new, voluntary step in a long-established insolvency procedure. Use of the Pool accelerated as the first year progressed as awareness increased among the insolvency, creditor, and business communities.

It is worth noting that, given the figures reported by the insolvency regulators, the number of cases eligible for referral to the Pool is well below what might have been expected based on earlier pre-pack statistics. In 2010-11, over one-in-four administrations involved a pre-pack, while seven-in-ten of these involved a connected party. In the Pool's opening 14 months, just over one-in-five administrations involved a pre-pack and just one-in-two of these involved a connected party. Alongside other factors, it may be that the introduction of the Pool and the wider post-Graham reforms have deterred some connected party pre-packs from being proposed in the first place.

What is a 'pre-pack'?

A 'pre-pack' administration is where the sale of all or parts of a business is arranged before it enters administration. The sale is completed shortly after an administrator is appointed.

What is a 'connected party' pre-pack?

A 'connected party' pre-pack is where an entity connected to the insolvent company (e.g. its directors) purchases the company's business or assets.

It is important to remember that responsibility for using the Pool lies with the connected party purchaser and not with the insolvency practitioner or creditors. That said, the insolvency profession and creditors have important roles to play in ensuring connected party purchasers are informed of the option to use the Pool and putting pressure on them to do so.

The insolvency regulators have provided welcome support for the Pool and have ensured that insolvency practitioners comply with their obligations in relation to awareness of the Pool. Similarly, creditor bodies, including the British Property Federation and Chartered Institute of Credit Management, have given invaluable support for the Pool at an institutional level, although responses to the Pool from individual creditors have been more muted. In feedback sought from creditors by the Pool, creditor awareness of the Pool has been low and few have taken the time to read through administrators' reports. This is not necessarily a surprise: low creditor engagement with insolvency procedures is a perennial problem. Those connected party purchasers who have used the Pool have said it has been an important step in building credibility and trust in the 'NewCo' among creditors.

As part of the 2015 Small Business, Enterprise and Employment Act, the Government gave itself a reserve power to ban any connected party administration purchase. As the Graham Review itself says, pre-packs do benefit the UK economy. It would be a shame to lose them: fewer business rescues, more job losses, and lower returns to creditors are possible outcomes in such a scenario.

The Pool is a key part – although not the only part – of the post-Graham reforms and widespread use of the Pool may help reassure creditors about the pre-pack process and would help protect the procedure's place in the insolvency framework. Hopefully referrals to the Pool will increase in 2017 as stakeholders become more familiar with the way it works and the reassurance it provides.

About the Pre-pack Pool

The Pre-pack Pool was launched on the 1st of November 2015 following the recommendations of the Graham Review of 'pre-pack' administrations.

The aims of the pool are to increase the transparency of connected party pre-packs and to provide assurance for creditors that independent business experts have reviewed a proposed connected party pre-pack transaction before it is completed.

The Pool is a body of experienced business people who will provide an opinion on the proposed sale of a company and/or its assets to a connected party. This opinion may be made available to creditors at a later date. One member of the Pool will review any application and they will offer one of three opinions on the proposed sale:

1. The case for the pre-pack is not unreasonable;
2. The case for a pre-pack is not unreasonable but there are minor limitations in the evidence provided;
3. The case for the pre-pack is not made.

What is 'SIP16'?

The Statement of Insolvency Practice 16 is part of the insolvency regulatory framework that dictates what insolvency practitioners should do when a pre-pack has been proposed. The report to creditors following a pre-pack is known as a 'SIP16' report.

The Pool's opinion can be made available to creditors as part of a 'SIP16' report. It is the responsibility of the connected party purchaser to submit an application to the Pool. Use of the Pool is not compulsory.

When a pre-pack sale to a connected party is proposed, an insolvency practitioner should inform the purchaser of their ability to approach the Pre-pack Pool. The insolvency practitioner should then include statements in a SIP16 report to explain whether the Pre-pack Pool has been approached by the purchaser or not, and that, if there is one, a copy of the Pool's opinion has been requested from the purchaser. If a copy of the opinion is provided by the connected party, it should be included within the SIP16 statement. Ordinarily this will be provided to the insolvency practitioner directly through the on-line Pre-pack Pool portal.

Views from insolvency practitioners

"The speed with which the process was dealt with helped to enable an orderly and rapid sale of the business. Our proposals were also subsequently approved by the major creditors which included a substantial number of landlords." – *Neil Bennett, Leonard Curtis*

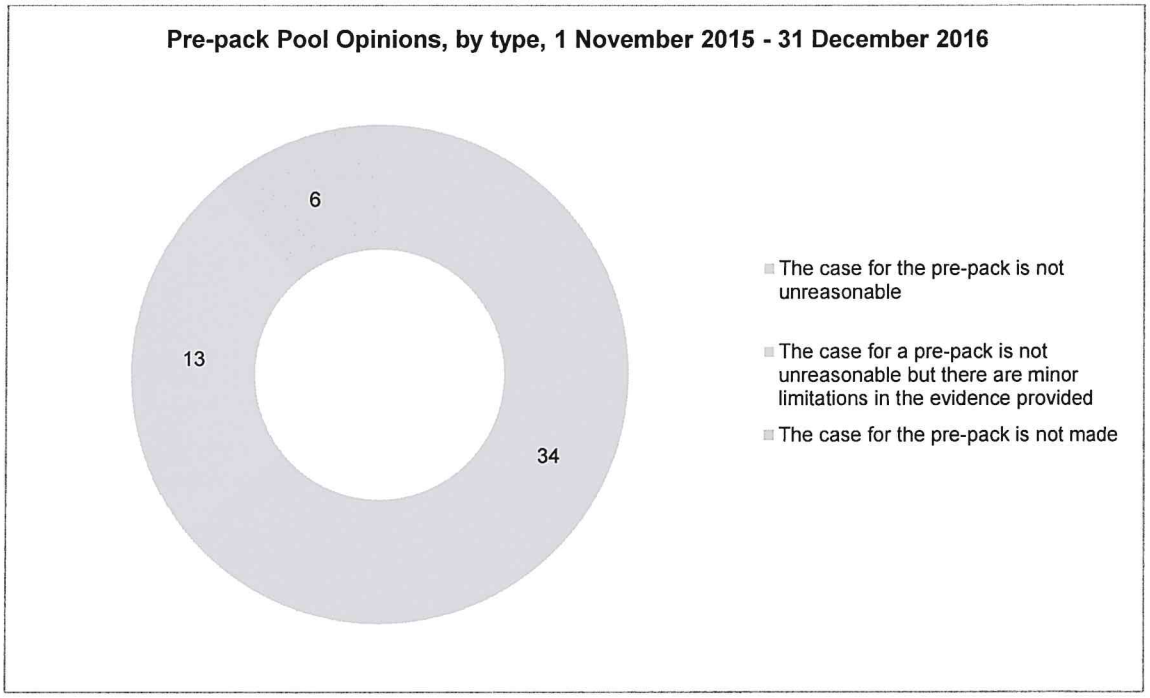
As well as going to creditors, SIP16 reports must be sent to an insolvency practitioner's Recognised Professional Body (RPB). There are five RPBs: the Association of Chartered Certified Accountants (ACCA), the Chartered Accountants Regulatory Board (CARB), the Insolvency Practitioners Association (IPA).the Institute of Chartered Accountants in England and Wales (ICAEW), and the Institute of Chartered Accountants Scotland (ICAS).

The Pool is a limited company and independent of the government and insolvency and restructuring profession.

2016 Pool Statistics

Cases reviewed – responses

Between 1 November 2015 and 31 December 2016, a total of **53** proposed connected party pre-pack purchases were submitted to the Pool for review. Of these, **34** (64%) received a 'not unreasonable' opinion, **13** (25%) received a 'not unreasonable but limitations to evidence' opinion, and **6** (11%) received a 'case not made' opinion.

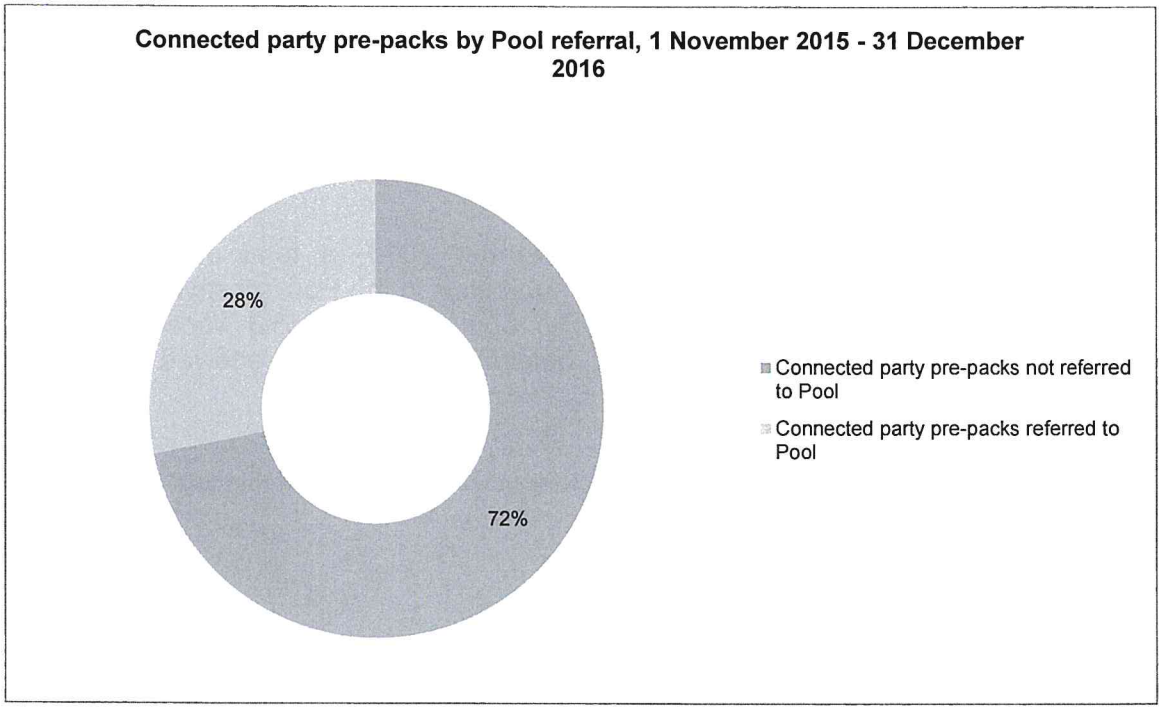


Note: 4 of the 6 'case not made responses' relate to a group of connected companies

Cases reviewed – share of all pre-packs

Following any pre-pack administration, the insolvency practitioner must send a copy of the SIP16 report to their RPB. According to the RPBs, between 1st November 2015 and 31st December 2016 **371** SIP16 reports were filed. Of these, **188** involved a purchase by a connected party (51%).

The 371 pre-packs reported in the period covered by this review represents **22%** of the **1,689** administrations that took place over a similar time period (1 October 2015 - 31 December 2016).



Cases reviewed – 'success' rate of reviewed sales

Views from the creditor community

"The CICM actively supports the objectives of the Pre-Pack Pool and the increased transparency that it delivers. The progress to date has been encouraging, but the laudable aims of The Pool will only be realised if The Pool is more widely promoted.

"All parties and stakeholders, including the CICM, business bodies, the insolvency profession, and the Government need to make a concerted effort to promote The Pool and its positive role in bringing greater confidence to the Pre-Pack process." – Philip King, Chartered Institute of Credit Management

34 proposed sales referred to the Pool between 1 November 2015 and 31 December 2016 a 'not unreasonable' opinion. Of these sales, the Pool is aware of just **one** company that has later entered another insolvency procedure.

Background to the Pool

The Insolvency Landscape

The number of cases reviewed by the Pool should be seen in the context of falling insolvency numbers since the last recession. Compared to the peak in 2008 (4,808), administration appointments had fallen 72% by 2016 (1,349). Pre-packs have become much rarer over the last five years.

Data on historical pre-pack numbers is limited but some figures are available for 2010 and 2011 in the Insolvency Service's reports on the operation of SIP16 for those years. Compared to the 2010 and 2011 data, the numbers of both pre-packs and connected party pre-packs were lower than might have been expected in the Pool's first year of operation.

In 2010-11, 26-27% of administrations were pre-packs, of which over 70% involved a connected party purchase. Not only have pre-pack numbers fallen faster than the overall decline in administrations, but connected party purchases have fallen, too.

	2010*	**2011***	**1 November 2015 – 31 December 2016**
Total administrations	2,835	2,808	1,689
Total pre-packs	769**	723	371
Pre-packs as a % of administrations	27%	26%	22%
Total pre-packs with a connected party purchase	554 (approx.)**	571 (approx.)	188
% of pre-packs with a connected party purchase	72%**	79%	51%
Total pre-packs without a connected party purchase	215 (approx.)**	152 (approx.)	183
% of pre-packs without a connected party purchase	28%**	21%	49%

**Numbers are from the Insolvency Service's reports on the operation of SIP16 for 2010 and 2011. NB. Total administration figures in these reports differ to those given in the Insolvency Service's official quarterly insolvency statistics.*

***Research carried out by the University of Wolverhampton for the Graham Review found that, based on a sample of 499 2010 pre-packs, there were 316 connected party sales (63%)*

2015 Graham Review

In July 2013, the government commissioned Teresa Graham to lead an independent review into pre-pack administrations and their economic impact.

The Graham Review noted that pre-pack numbers are relatively small but that a perceived lack of transparency around the process meant pre-packs attracted a disproportionate level of attention and criticism.

The review concluded that 'there is a place for pre-packs in the UK's insolvency landscape' and that 'the benefits that pre-packing brings to the UK's insolvency framework mean that reform of the process is worthwhile.' The review also stated that pre-packs can preserve jobs and that they are cheaper than other insolvency procedures. However, the review also found that pre-packs 'lack transparency' and that the marketing and valuation of potential pre-pack companies needed to be improved, and that more consideration should be given to the future viability of a company once it has been through a pre-pack.

The review made six recommendations for reforming pre-packs:

1. Pre-pack Pool. On a voluntary basis, connected parties approach a 'pre-pack pool' before the sale and disclose details of the deal, for the pool member to opine on.
2. Viability Review. On a voluntary basis, the connected party complete a 'viability review' on the new company.
3. SIP 16: that the Joint Insolvency Committee considers, at the earliest opportunity, the redrafted SIP16 in Annex A.
4. Marketing: that all marketing of businesses that pre-pack comply with six principles of good marketing and that any deviation from these principles be brought to creditors' attention.
5. Valuations: SIP16 be amended to the effect that valuations must be carried out by a valuer who holds professional indemnity insurance.
6. SIP 16: that the Insolvency Service withdraws from monitoring SIP16 statements and that monitoring be picked up by the Recognised Professional Bodies.

Views from the business community

"The Pre-Pack Pool is an important step in de-stigmatising the pre-pack administration regime, which in many cases represents by far the best outcome for creditors of distressed businesses.

"Creditors of a business which has undergone a pre-pack to a formerly connected party (usually a director or directors) will be able to draw comfort from a positive opinion from the Pool.

"The IOD has been supportive of this initiative from its original concept and is pleased to see it in action." – Oliver Parry, Institute of Directors

The reforms recommended by the Graham Review, including the Pre-pack Pool, were introduced in 2015.

Appendix 1: Pool Members and stakeholder representatives

Members of The Pool (Reviewers)

Alec Sanderson BA, C Dir,FBCS, CEng
Colin Coghlan C Dir
David Abbott MSc,FCA,AMCT,
David Blair MA,FCA,MBA
David Newman C Dir,MBA
Dr Simon Chapman C Dir
Kevin Mouatt C Dir
Len Jones BA(Hons),FCA,MBA,MSc
Paddy Campbell FCA
Philip Gardner BA(Hons),FCA, CDir,DipM
Philip Long FCA
Philip Oatley FCA,BA(Hons)
Philip Walter BSc(Hons),C Dir,FCMI
Rodney Hare FCA
Simon Willis C Dir,BSc
Tim Rose C Dir,MBA
Tony Sanderson FCA, BA(Econ)
Tony Wilkinson FCMA

Oversight Group (stakeholders)

Association of Chartered Certified Accountants (ACCA)
British Printing Industries Federation (BPIF)
British Property Federation (BPF)
Chartered Institute of Credit Management (CICM)
Insolvency Practitioners Association (IPA)
Institute of Chartered Accountants in England and Wales (ICAEW)
Institute of Chartered Accountants of Scotland (ICAS)
Institute of Directors (IOD)
R3
The Insolvency Service

Appendix 2: Pre-Pack Pool Limited.

Directors, Duncan Grubb MCICM Stuart Hopewell FCICM

Company Registration No. 09471155

Registered Office: 3 Greystones Road, Bearsted, Maidstone, Kent ME15 8PD

THE INSTITUTE OF CHARTERED ACCOUNTANTS

ANNEXURE 2 (2)

STATEMENT OF INSOLVENCY PRACTICE 16

PRE-PACKAGED SALES IN ADMINISTRATIONS

ENGLAND AND WALES

Effective from 1 January 2009.

STATEMENT OF INSOLVENCY PRACTICE 16 (E & W)

PRE-PACKAGED SALES IN ADMINISTRATIONS

INTRODUCTION

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

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

Recognised Professional Bodies:

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

Competent Authority:

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

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

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

STATEMENT OF INSOLVENCY PRACTICE

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

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

undertake a pre-packaged sale, and should be able to explain and justify why such a course of action was considered appropriate.

The legal authority for pre-packaged sales

3. In a series of cases[1] the courts have held that, where the circumstances of the case warrant it, an administrator has the power to sell assets without the prior approval of the creditors or the permission of the court. However, it should be borne in mind that reliance on such authority does not protect administrators from potential challenges to their conduct under paragraph 74, or claims for misfeasance under paragraph 75, of Schedule B1 to the Insolvency Act 1986. In order to avoid the risk of such exposure, care should be taken to ensure that such power is only exercised in genuine furtherance of the purpose of administration.

Preparatory work

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

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

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

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

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

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

Disclosure

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

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[1] 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)

they can be satisfied that the administrator has acted with due regard for their interests.

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

- The source of the administrator's initial introduction
- The extent of the administrator's involvement prior to appointment
- Any marketing activities conducted by the company and/or the administrator
- Any valuations obtained of the business or the underlying assets
- The alternative courses of action that were considered by the administrator, with an explanation of possible financial outcomes
- Why it was not appropriate to trade the business, and offer it for sale as a going concern, during the administration
- Details of requests made to potential funders to fund working capital requirements
- Whether efforts were made to consult with major creditors
- The date of the transaction
- Details of the assets involved and the nature of the transaction
- The consideration for the transaction, terms of payment, and any condition of the contract that could materially affect the consideration
- If the sale is part of a wider transaction, a description of the other aspects of the transaction
- The identity of the purchaser
- Any connection between the purchaser and the directors, shareholders or secured creditors of the company
- The names of any directors, or former directors, of the company who are involved in the management or ownership of the purchaser, or of any other entity into which any of the assets are transferred
- Whether any directors had given guarantees for amounts due from the company to a prior financier, and whether that financier is financing the new business
- Any options, buy-back arrangements or similar conditions attached to the contract of sale

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

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

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

Effective from 1 January 2009

A Supervision of registered liquidators

Key points

This section details the work we undertook and the outcomes we achieved in supervising registered liquidators during the reporting period. Our work is focused on the following areas:

- inquiries and reports of alleged misconduct (see paragraphs 17–27);
- formal investigation and enforcement action (see paragraphs 28–34); and
- surveillance (see paragraphs 35–62).

Inquiries and reports of alleged misconduct

17 Reports of alleged misconduct arising from external administrations conducted by registered liquidators remained stable, at 3% of the total reports we received during financial years 2013–14 and 2014–15: see ASIC's *Annual report 2014–15*, p. 73.

18 However, inquiries made to ASIC, and reports of alleged misconduct involving registered liquidators, continue to fall—from 446 in 2013 and 384 in 2014 to 364 in 2015.

Categorisation of inquiries and reports

19 Our Misconduct and Breach Reporting team receives and conducts an initial assessment of all inquiries and reports of alleged misconduct against registered liquidators.

20 An initial assessment by the Misconduct and Breach Reporting team categorises the inquiries and reports as follows:

(a) *Conduct related* (15%): The information provided to ASIC suggested a serious breach of the Corporations Act, which could be seen as deliberate.

(b) *Procedural based* (13%): Although serious, the information provided to ASIC suggested the misconduct may have been inadvertent.

(c) *Educational* (72%): These matters involved circumstances where the outcome or resolution of the inquiry or allegation of misconduct was educating the person (usually a creditor) about the applicable law or practice, or providing information about the normal practice of the insolvency process.

Note: Percentages shown in this report are rounded to the nearest unit. This means that percentages may not add up to 100%.

(4)

NICHOLAS CROUCH
OFFICIAL LIQUIDATOR TRUSTEE IN BANKRUPTCY

www.crouch.com.au

From: Adrian Brown [mailto:Adrian.Brown@asic.gov.au]
Sent: Thursday, 25 August 2016 11:23 AM
To: Nicholas Crouch <Nicholas@crouch.com.au>
Subject: Re: Proposed Regulatory Guide: Prepacks [SEC=UNCLASSIFIED]

Dear Mr Crouch

I refer to your email of 18 August.

Attached is an extract of commentary and recommendations from the Productivity Commission's report that are relevant to the matter you raise. The Productivity Commission's report and recommendations remain with Government to respond to. In light of this, and noting the wording of recommendation 15.7, it is premature, and, at this stage, inappropriate, for ASIC to undertake what you suggest. ASIC awaits the Government's response to the report and its recommendations. If Government is minded to proceed with the recommendations, ASIC anticipates that the usual public consultation concerning new legislation would ensue.

ASIC continues with its programs and activities which reflect the current legislation and which, inter alia, aim to curb illegal activity - including illegal phoenix activity.

Kind regards

Adrian Brown [illegible] ASIC [illegible]
adrian.brown@asic.gov.au

M▪NEY

Nicholas Crouch <Nicholas@crouch.com.au>
"ASIC Adrian Brown (Adrian.Brown@asic.gov.au)" <Adrian.Brown@asic.gov.au>,
18/08/2016 11:11 AM
Proposed Regulatory Guide: Prepacks

Dear Adrian

Would it be possible for us to have a chat regarding the productivity commission recommendation that ASIC issue a regulatory guide on prepacks