

# English Pre-Packaged Corporate Rescue Procedures: Is There a Case for Propping Industry Self-Regulation and Industry-Led Measures such as the Pre-Pack Pool?

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## KEYWORDS

Pre-Pack Pool; Administration; England and Wales; Insolvency; Pre-Packs; Abuse of Law

## ABSTRACT

This work analyses the key issues raised by pre-packaged administration procedures ('pre-packs') in England and Wales, and the ability of the Pre-Pack Pool ('the Pool'), an industry-led body of experts introduced after the *Graham Review* into pre-packs, to deal with these risks by giving opinions on the purchase of a business and/or its assets by connected parties in pre-packaged sales.

This paper adopts a normative approach to investigate if regulatory reforms are needed to support the activity of industry-led bodies such as the Pool to deal with pre-packaged sales of distressed yet viable corporations.

This paper argues that the key issue raised by pre-packs is their abusive use. Abusive filings are determined by a close group of players who collusively act solely to sidestep or subvert other insolvency rules and extract value from and/or reduce liability towards the company, with the effect of causing "undue financial harm" to the creditors.

This paper demonstrates the potential of the Pool to avoid abusive filings. Nevertheless, the government needs to properly and actively support this industry-

led body of professionals to ensure that the Pool's promising results in the case mentioned above are carried out over a wider spectrum of circumstances.

As a result, this paper advocates that the government should put its weight behind expanding the powers and duties of the Pool, making referral to the Pool compulsory in any pre-pack sale, ensure adequate supervision over its decisions and not legislate to either ban pre-pack sales or abolish the Pool.

## I. INTRODUCTION

Changes in the nature of the businesses and their assets led to the development of innovative corporate rescue procedures, collectively known as pre-packaged sales ('pre-packs'). As it will be evidenced throughout this paper, pre-packs raise issues of transparency, accountability and fairness, as they are prone to be used in an abusive manner (i.e. to pursue individual rather than collective goals). For instance, in November 2019 *Bluegem Capital*, the private equity firm that owned *Mamas & Papas*, used a pre-pack to regain control and reduce the company's financial liabilities.<sup>1</sup> This caused the closure of further six stores and the loss of almost 100 jobs despite the fact that the *Mamas & Papas* underwent a restructuring procedure (a company voluntary arrangement or 'CVA') in 2014 to escape onerous rent bills. Lenders can also use the threat of a pre-pack to try to increase the sale price of a company. This is happening

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<sup>1</sup> L Harding, 'Mamas & Papas Closes Six Stores in Pre-Pack Administration' *The Telegraph* (London, 8 November 2019) <<https://www.telegraph.co.uk/business/2019/11/08/mamas-papas-closes-six-stores-pre-pack-administration/>> accessed 25 November 2019.

in the case of *Addison Lee*, the second biggest minicab company in London, despite the collective costs associated with formal insolvency procedures.<sup>2</sup>

This paper focuses primarily on the issues arising in pre-pack administrations in England and Wales. Recently, the UK government launched a study into pre-packs. The ensuing *Graham Review*<sup>3</sup> resulted in a series of recommendations for industry-led reforms, including the establishment of a Pre-Pack Pool ('the Pool'). In accordance to Graham's preference for deregulatory measures, the recommended measures required actions on the part of insolvency regulators and the insolvency profession rather than government. Nevertheless, with the Small Business, Enterprise and Employment Act 2015 ('SBEEA 2015'), the government reserved for itself until 25 May 2020 to introduce subsequent mandatory legislation should the industry-led, self-regulated measures fail to improve the transparency and marketability of pre-pack sales as well as their success rate.<sup>4</sup> Therefore, asking questions about one of the key recommendations of the 2014 review, i.e. the Pool, is particularly topical.

This paper is about identifying the key risk raised by pre-packs, i.e. the abusive use of insolvency laws for the promotion of individual, rather than collective goals. This paper is also about assessing the ability of the Pool, an industry-led body of experts introduced after the *Graham Review* into pre-packs, to deal with this risk by giving opinions on the purchase of a business and/or its assets by connected parties<sup>5</sup> in pre-packaged sales. In order to do this, this paper investigates the legality of pre-packs,

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<sup>2</sup> D Thomas and K Wiggins, 'Carlyle Aims to Sell Addison Lee Before Debt Deadline' *The Financial Times* (London, 15 October 2019) <<https://www.ft.com/content/247f889c-eea3-11e9-ad1e-4367d8281195>> accessed 25 November 2019.

<sup>3</sup> T Graham, 'Graham Review into Pre-pack Administration: Report to the Rt Hon Vince Cable MP' ('Graham Review') (The Insolvency Service, 16 June 2014) <<https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>> accessed 25 November 2019.

<sup>4</sup> S.129 SBEEA 2015.

<sup>5</sup> SIP 16 defines "connected party" with reference to s.249 and s.435 of the IA 1986 and art. 7 art. 4 of the Insolvency (NI) Order 1986. Directors, shadow directors, associate persons of the debtor, close family members, companies in the same group and anybody with significant prior connection to the debtor fall within the definition of connected party. However, SIP 16 contains a carve out for secured lenders over one third or more of the shares in the insolvent company.

offers a definition of abusive filings (section II) and analyses the extent to which existing and proposed mechanisms address the risk of abusive use of insolvency rules (section III).

The low uptake rate<sup>6</sup> of the measure analysed in this paper, i.e. the Pool, seems to suggest that the industry failed to regulate itself and that a statutory intervention is needed to limit the risks of strategic or abusive use of insolvency laws in pre-packs. The research question of this paper is to assess if the unsatisfactory number of referrals to the Pool is due to the Pool's inability to address the risk of abusive use of insolvency law raised by pre-packs or to the failure from the government to properly and actively support this industry-led body.

The theoretical considerations in this paper are addressed to develop the concept of "abuse of insolvency law". This work adopts a normative approach to investigate if regulatory reforms are needed to support the activity of industry-led bodies such as the Pool to deal with pre-packaged sales of distressed yet viable corporations. Existing instruments such as the Pool and proposed reforms are assessed and evaluated for their ability to prevent abusive filings.

This paper argues that the Pool is capable of addressing the risk of abuse in pre-packs<sup>7</sup> and that – as evidenced in section IV – the recognition of wider powers to the Pool is preferable to expanding the role and powers of the courts.<sup>8</sup> To the best knowledge of the author of this paper, no other study has investigated the role of industry-led measures to prevent abusive filings, as the focus has been on regulatory reforms and statutory changes. As a result, the paper recommends a series of

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<sup>6</sup> Pre-Pack Pool, 'Annual Report 2018' (London, 2019) 4  
<<https://www.prepackpool.co.uk/uploads/files/documents/Pre-Pack-Pool-2018-Annual-report-v4.pdf>> accessed 25 November 2019.

<sup>7</sup> Against, see: C Umfreville, 'Pre-packaged Administrations and Company Voluntary Arrangements: The Case for a Holistic Approach to Reform' (2019) 30(11) I.C.C.L.R. 581, 603 (arguing that as pre-packs are used by both large multinationals and sole traders, the Pool is ill-equipped to opine on such different transactions).

<sup>8</sup> In this regard, the paper goes beyond previous proposals of simply instating a mandatory referral to the Pool: B Adebola, 'The Case for Mandatory Referrals to the Pool' (2019) 32(2) *Inso. Int.* 71.

regulatory reforms for increasing the duties and responsibilities of the Pool and, therefore, curtail the abusive use of insolvency statutes in pre-packs.

The paper proceeds as follows. Section II outlines the importance of pre-packs in England and Wales and the risks associated with these procedures. It shows that the key risk in pre-packs is linked to their abusive or strategic use by key players. It also provides a dividing line between strategic and abusive filings and suggests that it is only the abusive use of the law in general (as rightly interpreted by English courts) and of pre-packaged administrations in particular that should be curtailed.

Section III discusses the role of the Pool in identifying and challenging abusive pre-packs and whether an early intervention of the Pool is preferable to an *ex post* scrutiny from the courts. This section ultimately demonstrates that the initiatives adopted by the government since the enactment of the SBEEA 2015 are failing to address the issue of abusive filings in pre-packs and, to a certain extent, are going in the wrong direction.

Section V suggests the changes that should be introduced in the law to limit the risk of abusive filings and discloses the most obvious limitations of this study, i.e. the narrow focus of this paper (pre-packs to connected parties) and the potential objections to regulatory reforms from the judiciary and insolvency practitioners. The conclusive section of this paper reiterates the research questions and objectives of this paper and shows the extent they have been addressed.

## **II. ROLE OF PRE-PACKS IN ENGLAND AND WALES AND PROBLEMS RAISED**

Pre-packs are a hybrid form of corporate rescue, a procedure which combines the benefits of informal workouts with the properties of formal procedures.<sup>9</sup> Pre-packs are arrangements under which the sale of all or part of the company's business or

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<sup>9</sup> B Xie, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* (Edward Elgar Publishing 2016) 28.

assets is negotiated with a purchaser prior to the filing for formal insolvency procedures. The sale is effected immediately on, or shortly after, their commencement.

Almost every corporate insolvency legislation in the world includes a rescue tool similar to pre-packs,<sup>10</sup> the most well-known being s.363 of the 11 U.S. Code. In England and Wales, pre-packs usually take place as administration procedures. In pre-pack administrations, the sale of the company or its business is arranged before the commencement of the insolvency procedure and it is effected shortly after the appointment of an administrator. In exceptional circumstances, courts can make an order to give liberty to the administrators to enter into pre-pack sales.<sup>11</sup> In the majority of cases, only the administration order will be made.

Pre-packaged administrations represent a small but significant percentage of corporate rescue procedures. According to recent statistics, out of 17,439 company insolvencies in the U.K. in 2018, only 1,464 (8.39 percent) were administrations.<sup>12</sup> Pre-packaged administrations represent an even tinier percentage, with studies suggesting they count for 2 percent of all corporate insolvencies.<sup>13</sup>

However, these numbers have been consistent in the past few years as no new procedures have been introduced in the law.<sup>14</sup> Additionally, the promotion of a rescue culture embraced by the legislator since 1986 on the basis of the

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<sup>10</sup> Xie (n 9) 29; A Kastrinou, 'An Analysis of the Pre-pack Technique and Recent Developments in the Area' (2008) 29 Co. Law. 259; Graham (n 3) 28 (for an outline of the processes available in other European Member States).

<sup>11</sup> *Re Hellas Telecommunications (Luxembourg) II SCA* [2009] EWHC 3199 (Ch); [2010] B.C.C. 295.

<sup>12</sup> The Insolvency Service, *Insolvency Statistics – October to December 2018* (29 January 2019) <[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/780233/Commentary\\_domain\\_update.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/780233/Commentary_domain_update.pdf)> accessed 25 November 2019.

<sup>13</sup> Pre-Pack Pool, *Annual Review 2017* (May 2018)

<<https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack-Pool-Annual-Review-2017.pdf>> accessed 25 November 2019.

<sup>14</sup> Statistics provided by the Insolvency Service are available here:

<<https://www.gov.uk/government/collections/insolvency-statistics>> accessed 25 November 2019. For an empirical analysis of connected party pre-packs commenced in 2013, see Umfreville (n 7) 591.

recommendations from the Cork Report<sup>15</sup> and, in a more convincing manner, since 2002/2003<sup>16</sup> led to increased rescue activity taking place at the pre-insolvency stage.<sup>17</sup> This suggests that the market for pre-packs is not likely to go away anytime soon.

These procedures are generally used by companies that are not in their infancy.<sup>18</sup> Pre-packs<sup>19</sup> are primarily used to: (i) rescue businesses in financial distress with no or limited adverse publicity;<sup>20</sup> (ii) preserve their going concern value and goodwill;<sup>21</sup> (iii) keep existing contracts; (iv) have rapid access to funds;<sup>22</sup> and (v) facilitate the retention of key employees.<sup>23</sup> However, as mentioned in the introduction, changes in the nature of the businesses and their assets, as well as lack of specific, binding rules

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<sup>15</sup> K Cork, *Report of the Insolvency Law Review Committee Insolvency Law & Practice*, Cmnd 8558 (1982).

<sup>16</sup> The Enterprise Act 2002 introduced the prohibition of the appointment of an administrative receiver over a company's assets where the charge by which those assets are secured is entered into on or after 15 September 2003, subject to exceptions for certain finance transactions. This led to an increased use of rescue-oriented formal insolvency procedures such as administration and CVAs.

<sup>17</sup> V Finch, 'The Recasting of Insolvency Law' (2005) 68(5) M.L.R. 713.

<sup>18</sup> Empirical data suggests that the majority of companies that file for pre-packaged administrations have been on the market for 5-7 and then 10-20 years: Graham (n 3) 59. See also: Umfreville (n 7) 591.

<sup>19</sup> For an outline of the merits (and challenges) of pre-packaged administrations in England see, among others: Xie (n 9) 35-36.

<sup>20</sup> K van Zwieten, *Goode on Principles of Corporate Insolvency Law* (5<sup>th</sup> edn, Sweet & Maxwell 2018) 494.

<sup>21</sup> S Frisby, 'The Pre-pack Progression' (2008) 21 *Insolv. Int.* 154, 158 (arguing that pre-packs appear to be developing in a constructive manner); S Frisby, 'The Second-chance Culture and Beyond: Some Observations on the Pre-pack Contribution' (2009) 3 *L.F.M.R.* 242; R Insall, 'Pre-packaged Administrations: Misguided or Misunderstood?' (2010) 3 *C.R. & I.* 99 (arguing that minor changes to the pre-pack process and education of potential creditors should help to improve transparency and confidence); S. Frisby, 'A Preponderance of Pre-packs?' (2008) 1 *J.I.B.F.L.* 23; S Frisby, 'The Pre-Pack promise: Signs of Fulfilment?' (Spr. 2010) *Recovery* 30; M Haywood, 'Pre-pack Administrations' (2010) 23 *Insolv. Int.* 17; Adebola (n 8) 72. Commentators generally agree on the fact that insolvency procedures may need to preserve the going concern value of the company, but they disagree on the allocation of that value among creditors: BE Adler, 'Financial and Political Theories of American Corporate Bankruptcy' (1993) 56 *Stan. L. Rev.* 311; DG Baird and RK Rasmussen, 'The End of Bankruptcy' (2002) 55 *Stan. L. Rev.* 751; LM LoPucki, 'The Nature of the Bankrupt Firm: A Reply to Baird and Rasmussen's The End of Bankruptcy' (2003) 56 *Stan. L. Rev.* 645; O Tene, 'Revisiting the Creditors' Bargain: The Entitlement to the Going Concern Surplus in Corporate Bankruptcy Reorganizations' (2003) 19 *Bankr. Dev. J.* 287. Some authors, however, suggest that the "sale era" may be ending soon: LM LoPucki and JW Doherty, 'Bankruptcy Fire Sales' (2007) 106 *Mich. L. Rev.* 1.

<sup>22</sup> V Finch and D Milman, *Corporate Insolvency Law: Perspectives and Principles* (3<sup>rd</sup> edn, Cambridge University Press 2017) 374ff.

<sup>23</sup> D Pollard, 'Pre-Pack Administrations – Employee and Pension Issues' (2010) *Int. Intel.* 37; C Umfreville, 'Review of the Pre-Pack Industry Measures: Reconsidering the Connected Party Sale before the Sun Sets' (2018) 31(2) *Insolv. Int.* 58, 59; E Vaccari, 'Pre-Pack Pool: Is It Worth It?' (2018) 29(12) *I.C.C.L.R.* 697, 701.

on pre-packs raise questions about their desirability and their improper use from the industry. In order to discuss opportunities for reform, this section identifies the key issues that need to be addressed when dealing with pre-packs.

## II(a). The Rise of Pre-Packaged Administrations

Pre-packs originated in the United States<sup>24</sup> to save the going concern value of distressed firms by means of a quick sale to a competitor or connected party. In England, since the 1950s schemes were devised by innovative firms to achieve the same results as s.363 sales.<sup>25</sup> However, it was only the publication of the Cork Report (1982) – and its emphasis on introducing rescue-oriented proceedings in a law until that point primarily focused on distribution of proceeds among creditors<sup>26</sup> – to lay the groundwork for a new framework where formal procedures could be used to facilitate business and company rescue.<sup>27</sup>

Pre-packs are strongly supported by the following key players. The debtor's management find pre-packs more attractive than traditional administration procedures because they retain extensive managerial control over the ailing company for the period leading to the filing. Sometimes, the debtor's management remain in place even during the procedure and after the sale had been agreed.<sup>28</sup>

Insolvency practitioners (and un-regulated turnaround professionals) also see these procedures with favour, as they can offer their advisory services not only during the formal insolvency procedure but also in the period leading to filing. Finally, by devising plans that are arguably designed in their best interest, financial creditors

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<sup>24</sup> Xie (n 9) 28; MS Kirschner et al., 'Prepackaged Bankruptcy Plans: The Deleveraging Tool of the '90s in the Wake of Old and Tax Concerns' (1991) 21 Seton Hall L. Rev. 643.

<sup>25</sup> K Cork, *Cork on Cork* (MacMillan 1988), in particular chapter 2 with the description of W.H. Cork Gully & Co.'s imaginative use of schemes to rescue businesses.

<sup>26</sup> K Cork, *Report of the Insolvency Law Review Committee Insolvency Law & Practice*, Cmnd 8558 (1982) ('Cork Report') Part 2, 173.

<sup>27</sup> IF Fletcher, 'UK Corporate Rescue – Recent Developments' (2004) 5(1) E.B.O.R. 119, 121.

<sup>28</sup> See, for instance, the recent case of *Johnston Press*, discussed in sub-section IV(a).



can make greater use of the early warnings of distress obtained in compliance with the warranties and covenants in the loan agreements.<sup>29</sup>

This section discusses some of the key issues raised by pre-packs, i.e. their legality, the claim that assets are regularly undervalued and the argument that creditors' rights are significantly restricted because the key players in pre-packs make an abusive or strategic use of insolvency laws.

## II(b). Are Pre-Packs Legal?

The rise of pre-packs<sup>30</sup> has not been met with universal approval. In particular, commentators have raised doubts on their legality *per se*.<sup>31</sup> In fact, pre-packs are not in principle capable of reaching the primary purpose of the administration procedure, i.e. to rescue the company so that it can continue trading as a going concern.<sup>32</sup>

In theory, administrators could perform their function without having regard to the first objective of administration *only* when it is not reasonably practicable to achieve such goal. However, this may not be the case in a pre-packaged sale, where the decision to sell the company or its business is taken before administrators are appointed or with the complicit support of the insolvency practitioner/advisor later appointed as administrator. Additionally, in pre-packaged deals the administrators sell the company before any creditors' meeting takes place.<sup>33</sup> However, in

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<sup>29</sup> Finch (n 17).

<sup>30</sup> For an outline, see: and IF Fletcher, *The Law of Insolvency* (5<sup>th</sup> edn, Sweet & Maxwell 2017) 501-504; Van Zwieten (n 20) 493-500.

<sup>31</sup> P Walton, 'Pre-packaged Administration: Trick or Treat?' (2006) 19 *Inso. Int.* 113; P Walton, 'Pre-packin' in the UK' (2009) 18 *I.L.R.* 85.

<sup>32</sup> Para.3(1)(a), Sch. B1, IA 1986.

<sup>33</sup> Under s.246ZE(3) IA 1986 as introduced by the Insolvency Rules 2016, creditors' meetings can only take place if requested by a prescribed minimum number of creditors. This threshold is currently set at 10% in value and number of creditors (s.246ZE(7) IA 1986). Despite that, administrators are still bound to seek creditors' approval on any plan or proposal by means of a qualifying decision procedure (s.246ZE(2) IA 1986).

“traditional” administration procedures, the sale is only possible after the meeting took place and the creditors approved the deal with the statutory majority.<sup>34</sup>

Despite these concerns, English courts have long accepted the legitimacy of this procedure because administrators have a statutory power to dispose of the debtor’s assets without leave of the court.<sup>35</sup> With the enactment of the Enterprise Act 2002 (‘EA 2002’), the legislator translated this trend into law. On that occasion, the legislator amended the wording of para.68(2), Sch. B1 Insolvency Act 1986 (‘IA 1986’) to clarify that administrators should comply with court’s directions only *if* the court gives such directions. The legislator, therefore, clarified that court’s directions are merely restrictive<sup>36</sup> and administrators have no obligation to obtain the court’s preliminary approval of a pre-packaged deal. This represents a welcome development in the law, in line with the insolvency law’s overarching objective of promoting the rescue of distressed yet viable businesses.<sup>37</sup>

Commentators have also observed that dismissing the use of pre-packs because they cannot reach the primary purpose of administration would amount to diminishing the role of insolvency practitioners and entitling senior creditors ‘to hold the administrator to ransom’.<sup>38</sup> However, courts have not given *carte blanche* to administrators. In *Consumer & Industrial Press*,<sup>39</sup> Gibson J was acutely aware of the risk of authorising a sale without the preliminary creditors’ approval. He concluded that administrators ‘should, if possible, not render nugatory the requirement that [they] should lay a statement of their proposals before creditors and should leave it

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<sup>34</sup> Paras.51-53, Sch. B1 IA 1986.

<sup>35</sup> *Re T&D Industries Plc* [2000] 1 W.L.R. 646; *Re Transbus International Ltd (In Liquidation)* [2004] EWHC 932 (Ch); [2004] 1 W.L.R. 2654; [2004] B.C.C. 401; *DKLL Solicitors v Revenue and Customs Commissioners* [2007] EWHC 2067 (Ch); [2007] B.C.C. 908; [2008] 1 B.C.L.C. 112; *Hellas* (n 11); *Re Kayley Vending Ltd* [2009] EWHC 904 (Ch); [2009] B.C.C. 578; [2011] 1 B.C.L.C. 114 as commented on by R Tett and others, ‘Pre-pack Administration: Court Considers Its Discretion and Pre-appointment Costs’ (2009) 22 *Insolv. Int.* 123; *Re Halliwells Llp* [2010] EWHC 2036 (Ch), [2010] 7 W.L.U.K. 920.

<sup>36</sup> Xie (n 9) 82.

<sup>37</sup> Cork Report (n 26), paras 191 – 198.

<sup>38</sup> S Paterson, ‘Market Organisation and Institutions in America and England: Valuation in Corporate Bankruptcy’ (2018) 93 *Chi.-Kent L. Rev.* 801, 828.

<sup>39</sup> *Re Consumer & Industrial Press (No. 2)* (1988) 4 B.C.C. 72.

to the creditors to take the final decision'.<sup>40</sup> Equally, in *T&D Industries*<sup>41</sup> Neuberger J (as he then was) held that in certain cases (e.g. a small number of creditors holding the majority of the claims against the debtor) the importance of the decision (to vote on the deal) means that the administrator should obtain these creditors' approval at least informally before authorising the sale.<sup>42</sup>

In reality, these decisions add uncertainty to pre-packs without granting additional protection to the parties, who did not negotiate the pre-pack deal. This is because the guidance given in *Consumer & Industrial Press* and *T&D Industries* is in no way prescriptive. How is it possible to determine with sufficient predictability if the creditors' approval has been rendered nugatory? How likely is that a pre-packaged deal has not been negotiated with the support or at least tacit approval of the major trading and secured creditors? These questions cannot be properly answered in the context of an *ex post* review in front of a judicial body, who is not likely to challenge the parties' business judgment. These questions show the opportunity to explore alternative approaches to abusive pre-packs, for instance by means of industry-led mechanisms.

### II(c). Dealing with the Inherent Shortcomings of Pre-Packs Sales

Moving on from the issue of legality, it has already been observed elsewhere<sup>43</sup> that pre-packaged administrations raise four significant issues. Two of them, lack of transparency and inadequate marketability of the distressed debtor, are to a large extent inherent to the nature of pre-packaged procedures themselves.

If the sale of all or substantially all of the business is authorised shortly after the commencement of an administration procedure, non-participating claimants will

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<sup>40</sup> Ibid 73.

<sup>41</sup> *T&D Industries* (n 35).

<sup>42</sup> Ibid 658.

<sup>43</sup> Graham Review (n 3) paras 3.8–3.13.

always be presented with a *fait accompli*.<sup>44</sup> In fact, whilst an administrator is still required, as is ordinarily the case, to seek a decision from the creditors within 10 weeks of the company entering administration,<sup>45</sup> in a pre-pack scenario the assets have already been sold. Because the sale of the company's business and assets has taken place before the presentation of the proposal to the company's creditors, the creditors' approval is rendered nugatory. As the compelling reasons mentioned above suggest that pre-packs should be allowed, little can be done to mitigate this issue.

The pre-packs' lack of transparency and accountability gives rise to concerns of "phoenixism" as the company which bought the debtor's assets usually continues to operate in the same sector, premises and with a similar name as the now defunct debtor.<sup>46</sup> They also give rise to concerns of collusion,<sup>47</sup> because the debtor is sold to a party, often connected with the lender, for a fraction of the company's liabilities on the basis of negotiations occurred behind closed doors. It has also been remarked that pre-pack businesses are not marketed in a competitive manner,<sup>48</sup> which may lead to undervalue sales<sup>49</sup> that are short-term fixes to write off liabilities, thus failing to ensure the long-term viability of the company.<sup>50</sup>

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<sup>44</sup> V Finch, 'Pre-packaged Administrations: Bargains in the Shadow of the Law or Shadowy Bargains?' (2006) J.B.L. 568, 583; V Finch, 'Pre-packaged Administrations and the Construction of Property' (2011) J.C.L.S. 1, 19. It has been observed that, with pre-packs, '[t]he first that stakeholders learn is not of insolvency, but of rescue'—T Astle, 'Pack Up Your Troubles: Addressing the Negative Image of Pre-packs' (2015) 28 *Insol. Int.* 72, 72.

<sup>45</sup> Para.51(2), Sch. B1, IA 1986.

<sup>46</sup> This would be the continued use of a failed company's name, or a similar one, by a director who is also a director in a successor company: Kastrinou (n 10) 262.

<sup>47</sup> S Frisby, 'A Preliminary Analysis of Pre-packaged Administrations' (R3 August 2007) 8–9.

<sup>48</sup> D Flynn, 'Pre-pack Administrations—A Regulatory Perspective' (Summer 2006) *Recovery* 3; Frisby (n 47) 49 (stating that in only 7.9 percent of pre-packs was the company marketed, compared to a figure of 55.6 percent for corporate sales without pre-packs).

<sup>49</sup> J Moulton, 'The Uncomfortable Edge of Propriety—Pre-packs or Just Stitch-ups?' (Autumn 2005) *Recovery* 2; S Davies, 'Pre-pack—He Who Pays the Piper Calls the Tune' (Summer 2006) *Recovery* 16, 17 (arguing that a small number of professional bad apples tend to operate via pre-packs to facilitate phoenix trading); Walton (n 31). It has been observed, however, that the issue of undervaluation is not limited to pre-packs, as it affects all companies undertaking a formal corporate rescue procedure: LoPucki and Doherty (n 21); MT Roberts, 'The Bankruptcy Discount: Profiting at the Expense of

However, some of these claims are based on anecdotal evidence<sup>51</sup> and may not necessarily highlight disconcerting issues. Lower valuations can be justified if they result in the retention of larger number of workers and in additional investments in the ailing company, thus reducing the impact of corporate failures on local communities. Additionally, it has been observed that there is nothing unlawful or objectionable in phoenixism, especially if consideration is appropriate and creditors and clients are not deceived.<sup>52</sup> The issue at stake is, once again, avoidance of abusive filing (as suggested in this paper), not phoenixism itself.

This paper, therefore, focuses on the arguments that businesses are frequently undervalued and creditors' rights are significantly restricted because the key players in pre-packs abuse insolvency laws. These players can act in this manner because they exercise a disproportionate control over the procedure,<sup>53</sup> thus sidestepping the procedural and substantive protections granted by the IA 1986.<sup>54</sup>

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Others in Chapter 11' (2013) 21 Am. Bankr. Inst. L. Rev. 157 (study limited to mega-bankruptcies, i.e. corporate filings of firms declaring more than \$1bn of assets as of the petition date); E Vaccari, 'Broken Companies or Broken System? Promoting Fairness in English Insolvency Valuation Cases' (2020) I.I.R. (article accepted for publication). Other empirical studies have also questioned the existence of collusion, conflict of interests and undervaluation of assets: A Polo, 'Secured Creditor Control in Bankruptcy: Costs and Conflict' (13 Sept. 2012) <<https://ssrn.com/abstract=2084881>> accessed 25 November 2019. Finally, the conclusion that pre-packs lead to undervalue sales has been criticised for being anecdotal as empirical studies do not show significant differences from other formal insolvency procedures in the return rate to creditors: Frisby 'Pre-pack Progression' (n 21) 157.

<sup>50</sup> Empirical data seems to support this claim as it had been observed that, where just over 5 percent of all pre-packs failed within 12 months from the completion of the sale, the figure rose to around a quarter if the horizon was extended to 36 months. In the same period, just fewer than 20 percent of businesses sold out of trading administration failed, noticeably less than from pre-packs: Graham Review (n 3) 33–35.

<sup>51</sup> For a de-mystifying view on pre-packs, see: Frisby (n 47).

<sup>52</sup> Frisby 'Pre-pack Progression' (n 21) 156. See also: M Ellis, 'The Thin Line in the Sand – Pre-packs and Phoenixes' (Spring 2006) Recovery 3; Y Rotem, 'Small Business Financial Distress and the 'Phoenix Syndrome' – A Re-evaluation' (2013) 22 I.I.R. 1.

<sup>53</sup> S Harris, 'The Decision to Pre-pack' (Winter 2004) Recovery 26, 27.

<sup>54</sup> Nevertheless, creditors can challenge the decision to pre-pack by submitting a misfeasance application under para.75, Sch.B1 IA 1986 and claiming that the administrator acted unfairly to harm the interest of the applicant under para.74(1), Sch.B1 IA 1986 or requesting the removal of the administrator pursuant to para.88, Sch.B1 IA 1986: Haywood (n 21) 21.

In other words, this paper argues that the key risk raised by pre-packs is that of their improper use. As a result, the government should be concerned with preventing the abusive use of pre-packaged sales. However, should “strategic” and not simply “abusive” use of insolvency procedures be curbed by the legislator? Is it possible to distinguish these two circumstances? These questions are addressed in the next section.

#### II(d). The Divide between Strategic and Abusive Filings

Some American scholars adopt a hard stance towards strategic filings. They argue that insolvency law is being used in a “strategic” manner whenever the following two conditions are met:

- (1) The filing is used as a corporate strategy to achieve goals never predicated by doctrinal views of the law;<sup>55</sup> and
- (2) The law is used as a political instrument that can elevate one group’s interests at the expense of those of other groups<sup>56</sup> as it happened in the cases outlined below.

Scholars,<sup>57</sup> particularly in the U.S., have deeply criticised strategic filings because of their negative impact on the creditors who did not participate in the negotiation of the deal and, consequently, suggested their ban. Cases like *A.H. Robins* (to discard

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<sup>55</sup> LH Mayhew, ‘Institutions of Representation: Civil Justice and the Public’ (1975) 9 L. & Soc’y Rev. 401; FH Zemans, ‘Framework for Analysis of Legal Mobilization: Decision-Making Model’ (1982) 4 Am. B. Found. Res. J. 989. U.S. courts have made this point in several judgments: see, among others, *Solow v PPI Enters. (U.S.), Inc.* (In re *PPI Enters. (U.S.), Inc.*), 324 F.3d 197, 211 (3d Cir. 2003).

<sup>56</sup> KJ Delaney, *Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 to their Advantage* (University of California Press 1992) 160/161; K O’Rourke, ‘Valuation Uncertainty in Chapter 11 Reorganizations’ (2005) Colum. Bus. L. Rev. 403, 414.

<sup>57</sup> Ibid; FR Kennedy, ‘Creative Bankruptcy? Use and Abuse of the Bankruptcy Law – Reflection on Some Recent Cases’ (1985) 71 Iowa L. Rev. 199; RM Jackson, ‘Responding to Threats of Bankruptcy Abuse in a Post-Enron World: Trusting the Bankruptcy Judge as the Guardian of Debtor Estates’ (2005) Colum. Bus. L. Rev. 451.

tort claims),<sup>58</sup> *Johns Manville Corp.* (to deal with asbestos-related tort claims),<sup>59</sup> *Continental Airlines* (to break rivals and defy unionised workers),<sup>60</sup> *Texaco* (when a solvent company filed for Chapter 11 to defy rivals)<sup>61</sup> have all been condemned for being strategic and, consequently, unfair towards key stakeholders (competitors, employees, tort claimants, unsecured creditors and suppliers, etc.).

Other noticeable examples of strategic filings include *Wilson Foods* (1983) to break unionized labour cost, *Dow Corning* (1995) to deal with injury claims filed by hundreds of thousands of women who used its silicone breast implants when a global settlement broke down, *Turner & Newall* (2001) to deal with asbestos liabilities and the deficit in the pension fund, *General Motors* (2009) to deal (in part) with the ignition switch scandal and its related tort claims, *Takata* (2017) to deal with liabilities associated with defective air bag inflators. Certain pre-insolvency sales, such as the transfer of *BHS* (2015) from its previous owner to a former racing driver and bankrupt entrepreneur, may also be considered as strategic attempts to postpone insolvency filing, avoid director's liability and secure otherwise voidable transactions.

It might be true that in all these cases, the dominant players elevated their interests at the expense of those of other groups, with the result that the benefits they received from the insolvency procedure were disproportionate when compared to the relative value of their claims against the debtor. However, it is submitted that the vast majority of corporate insolvency procedures are, at least to a certain degree, "strategic".

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<sup>58</sup> For a detailed analysis of the *A.H. Robins* Chapter 11 saga: RB Sobol, *Bending the Law: The Story of the Dalkon Shield Bankruptcy* (The University of Chicago Press 1991); Delaney (n 56) 60-81.

<sup>59</sup> For a detailed analysis of the case: Kennedy (n 57).

<sup>60</sup> For an insight on Texas Air's attempt to take over *Continental*, the complexity of takeover battles in the U.S. airline industry of the Eighties and the takeover defences raised by the management (search for a 'white knight') and employees (creation of an Employee Stock Ownership Plan – 'ESOP') of *Continental*: ME Murphy, *The Airline That Pride Almost Bought: The Struggle to Take Over Continental Airlines* (F. Watts 1986); and Delaney (n 56) 82-125.

<sup>61</sup> For a detailed analysis, see: Delaney (n 56) 126-159.

Much like the student who wants to get the highest mark in an exam with the least effort, creditors (and shareholders) aim at the highest return on investment with the least expense, even if this means prioritising their interests over those of competing claimants. There is nothing inherently wrong in bending the rules,<sup>62</sup> provided that parties are not using collective insolvency procedures for achieving individual purposes. This would be equivalent to contracting out of insolvency and, as explained below in this sub-section, in direct breach of the country's public policy. This is why it is important to distinguish strategic from abusive filings.

In all corporate filings, individual creditors do not have a selfless interest to maximise the returns to the insolvent estate unless this course of action would result in higher returns for themselves.

One of the goals of insolvency law is to establish a mandatory system of checks and balances that avoids undue or excessive exploitation of collective procedures for the benefit of a limited number of individuals.<sup>63</sup> Outrightly preventing "strategic" filings would result in restricting the autonomy of the parties and in thwarting pre-packs, with the ensuing loss of viable businesses and jobs. Such an approach would go against one of the bedrocks of English commercial law, i.e. freedom of contract.<sup>64</sup>

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<sup>62</sup> Against: Sobol (n 58).

<sup>63</sup> E Vaccari, 'The *Ammanati* Affair: Seven Centuries Old, and not Feeling the Age' (2018) 93(3) Chi.-Kent L. Rev. 831.

<sup>64</sup> *Associated Japanese Bank (Int'l) Ltd v Credit du Nord SA* [1989] 1 W.L.R. 255 (HC/QB) 257 where Steyn J held that '[t]hroughout the law of contract two themes regularly recur – respect for the sanctity of contract and the need to give effect to the reasonable expectations of honest men'. Similarly, in *Re Collins' Application* [1975] 30 P&CR 527, 531 the Lands Tribunal (Mr Douglas Frank QC) - in weighting the balance between public interest and private rights - considered that 'for an application to succeed on the ground of public interest it must be shown that that interest is so important and immediate as to justify the serious interference with private rights and the sanctity of contract'. See also: F Toubé and J Rumley, 'A Brave New World? Should the UK Ban *Ipso Facto* Clauses in Non-Executory Contracts?' (2018) 31(3) *Insolv. Int.* 78, 78 (arguing that banning *ipso facto* clauses has never been on the regulatory agenda because it conflicts with the fundamental principle of freedom of contract). See also: Collins LJ in *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services* [2011] UKSC 38, [2012] 1 A.C. 383.



Freedom of contract represents a pivotal principle of public policy. In *Printing and Numerical Registering Co v Sampson*,<sup>65</sup> Sir George Jessel, the Master of the Rolls, stated that '[...] if there is one thing more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of Justice. Therefore, you have this paramount public policy to consider – that you are not likely to interfere with this freedom of contract'. More recently, in *Prime Sight Ltd v Lavarello*,<sup>66</sup> Toulson LJ held that 'parties are ordinarily free to contract on whatever terms they choose and court's role is to enforce them'. An outright ban on pre-packs would be hardly compatible with the country's legal culture and heritage.

Additionally, the history of business reorganisation is full of cases where innovative and creative techniques have been used to achieve the intended objectives and policies of a particular statute.<sup>67</sup> It is, therefore, respectfully submitted that challenging the legality and desirability of all pre-packs solely on the basis that insolvency rules are not being used to achieve the intended statutory purposes would be in direct breach of English public policy.

While the majority of corporate insolvency procedures are strategic, some of them may be "abusive". This paper posits that it is only abusive filings that should be contrasted by both the law and all corporate insolvency players, including insolvency practitioners and courts. Preventing abusive filings is the only course of action that would ensure that the purposes of the law are achieved without unduly restricting the pivotal principle of freedom of contract. However, what filings are truly "abusive"?

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<sup>65</sup> (1874-75) LR 19 Eq. 462, at 465 Ct of Chancery.

<sup>66</sup> [2013] UKPC 22, [2014] A.C. 436 [47].

<sup>67</sup> JM Czarnetzky, 'Time, Uncertainty, and the Law of Corporate Reorganizations' (1999) 67 Fordham L. Rev. 2939, 2969. In the U.K., see: Cork (n 25).

It is to be acknowledged that ‘abuse of law is a concept derived from civil law jurisprudence, which is unknown to English common law but has been adopted by the law of the European Union’.<sup>68</sup> A detailed analysis of the case law on the notion of “abuse of law” falls outside the scope of this paper which, therefore, focuses on the most recent debate in English courts and academic papers.

It is pertinent to observe that courts adopt a narrow definition of “abuse of law”. In *Vedanta*,<sup>69</sup> a case on the potential abuse of EU law, the Supreme Court held that it is not sufficient to show that a provision has been misused or circumvented, but also that this improper use is the result of a collusive decision of the parties designed to subvert other statutory provisions.<sup>70</sup> Additionally, in *Pendragon* the Supreme Court recognised that ‘the potential for abuse consists in the method chosen to achieve the commercial purpose’,<sup>71</sup> meaning that a legitimate commercial purpose may not justify a method designed to subvert the law.

Abusive filings are more likely in “phoenix” purchases.<sup>72</sup> For instance, pre-packaged administrations have been used by holding companies to discharge pension liabilities<sup>73</sup> or re-purchase the profitable parts of their subsidiaries, which had been stripped out of assets by way of management charges and then placed into administration.<sup>74</sup> In this manner, the holding company could leave behind unwanted assets (including shop leases), retain control of the subsidiary and place the burden of the rescue procedure on the creditors.

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<sup>68</sup> *Pendragon Plc v Revenue and Customs Commissioners* [2015] UKSC 37, [2015] 1 W.L.R. 2838, [5].

<sup>69</sup> *Vedanta Resources Plc v Lungowe* [2019] UKSC 20, [2019] 2 W.L.R. 1051.

<sup>70</sup> *Ibid*, [36].

<sup>71</sup> *Pendragon* (n 68), [12].

<sup>72</sup> *Kastrinou* (n 10) 262.

<sup>73</sup> C Sumner, ‘Rescue, Recovery & Renewal’ (2017) 10(3) C.R. & I. 115. See, also, the case of *Johnston Press*, discussed in sub-section IV(a) of this paper.

<sup>74</sup> D Grubb, ‘Diving in at the Deep End’ (Spr. 2016) *Recovery* 32.

Despite earlier calls for an agreed definition of “abusive filings”,<sup>75</sup> several commentators<sup>76</sup> had not investigated the circumstances that make a pre-packaged administration “abusive” despite blaming their abusive nature.

By looking at those papers where such a definition has been offered, the author has noticed an evolution towards the adoption of a more restrictive understanding of this concept. In the past, the hard stance towards pre-packs, especially those to connected parties, was quite apparent. Writing almost a decade before the *Graham Review*, Moulton suggests that basically any pre-pack sale to connected purchasers is designed to sell a business at undervalue. This is because directors and purchasers are in a clear conflict-of-interest situation and the company’s creditors who are not part of the deal lack economic incentives and information to challenge the sale.<sup>77</sup> In his view, all connected pre-pack sales are abusive because of their lack of transparency and the prioritization of individual creditors’ interests over the benefit of all other parties involved in the procedure.

Nowadays, the majority view is that pre-packs ‘cannot be seen as “abuse by itself”’.<sup>78</sup> It has been suggested that abusive behaviours are generated by lack of transparency

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<sup>75</sup> A Katz and M Mumford, ‘Study of Administration Cases’ (Oct. 2006) 44, observing that ‘there is no agreed definition of abuse and we recommend clearer definition [...] to some extent abuse is in the eyes of the beholder and a major concern is that there appear to be quite widely differing definitions of abuse [...] both by observers and regulators of insolvency practice’.

<sup>76</sup> Jackson (n 57); A Bloom and S Harris, ‘Pre-packaged Administrations – What Should be Done Given the Current Disquiet?’ (2006) 19(8) *Insolv. Int.* 122; Tett and others (n 35); S Frisby, ‘All Go on the Pre-pack Front’ (2009) 259 *Co. L.N.* 1-4; Haywood (n 21); P Cranston, ‘Fearful Silence’ (2011) 24(2) *Insolv. Int.* 32; P Okoli, ‘Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act’ (2012) *I.C.C.L.R.* 61; K Creighton-Selvay, ‘Pre-packed Administration: an Empirical Social Rights Analysis’ (2013) 42(2) *I.L.J.* 85; JM Wood, ‘The Objectives of Administration’ (2015) 36(1) *Comp. Law.* 1; Adebola (n 8).

<sup>77</sup> Moulton (n 49). See also: LM LoPucki, *Administration of Large Business Bankruptcy Reorganizations: Has Competition For Big Cases Corrupted The Bankruptcy System?* (2004) 108<sup>th</sup> Cong. 6 (Hearing Before the Subcomm. On Commercial and Administrative Law of the House of Comm. On the Judiciary), arguing that pre-pack sales are fraught with abuse because of the lack adequate disclosure, ability to circumvent creditor approval and potential conflict of interests of the parties involved in the sale.

<sup>78</sup> J Klein, ‘Pre-pack Administration: A Comparison between Germany and the United Kingdom: Part 1’ (2012) 33(9) *Comp. Law.* 261, 265. See also: L Qi, ‘The Rise of Pre-packaged Corporate Rescue on both Sides of Atlantic’ (2007) 20(9) *Insolv. Int.* 129, 134.

and disclosure.<sup>79</sup> In line with this approach, some commentators substantiate their criticisms to certain aspects of the pre-packaged and – more generally – the administration procedure. For instance, Ellina warns of the risks that unscrupulous directors may file notices of intention to appoint an administrator continuously, with the aim of obtaining a long-term moratorium for the company, thus giving rise to ethical issues.<sup>80</sup> These scholars, therefore, encourage the legislator to address the issues that increase the chances of abusive filings. Unlike Moulton, they do not suggest that all pre-packs are abusive.

The case law follows the evolution in the scholarly debate. On the one hand, English courts have consistently dismissed petitions for administration orders in case of “abuse of process”, i.e. whenever the administration order is sought not to achieve one of the statutory purposes of administration<sup>81</sup> but some other collateral purpose.<sup>82</sup> On the other hand, courts had never adopted a hard stance towards pre-packs. As a result, it was held that no abuse can be found in cases where a company transfers its centre of main interest to the U.K. shortly before the filing only to make use of its rescue-friendly framework.<sup>83</sup> This conclusion holds even if the connected purchaser in a pre-pack sale was given an advantage in terms of the information provided during the bidding procedure, provided that the connected purchaser’s bid is the

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<sup>79</sup> Klein (n 78), 311-312.

<sup>80</sup> S Ellina, ‘Administration and CVA in Corporate Insolvency Law: Pursuing the Optimum Outcome’ (2019) 30(3) I.C.C.L.R. 180, 185.

<sup>81</sup> Para.3, Sch. B1 IA 1986.

<sup>82</sup> *Re Holliday (A Bankrupt)* [1981] Ch. 405 (where the bankrupt had presented his own petition solely to prevent his wife from obtaining a property adjustment order in divorce proceedings); *Re West Park Golf & Country Club* [1995] B.C.L.C. 20; *Re Dianoor Jewels Ltd (Set Aside)* [2000] 6 W.L.U.K. 636 (granting the application as the defendant was potentially insolvent and there was no basis to establish the existence of an abuse of process); *British American Racing (Holdings) Ltd* [2004] EWHC 2947 (Ch), [2005] B.C.C. 110; *Doltable Ltd v Lexi Holdings Plc* [2005] EWHC 1804 (Ch), [2005] 6 W.L.U.K. 231 (rejecting a request for an administration order because the prime purpose of the application was to use the moratorium on enforcing the rights of secured creditors to get a higher sale price); *Thomas v Frogmore Real Estate Partners GP1 Ltd* [2017] EWHC 25 (Ch), [2017] Bus. L.R. 1117. Against: *Whig v Whig* [2007] EWHC 1856 (Fam), [2007] 7 W.L.U.K. 675, holding that Irrespective of a bankrupt’s motives in petitioning for bankruptcy, an application to annul the bankruptcy order failed because, at the time of the bankrupt’s petition, the debtor was insolvent. On the topic of abuse of administration, see: C Brockman, ‘Abuse of process – Part 4’ (2007) 20(1) *Inso. Int.* 13.

<sup>83</sup> *Hellas* (n 11).

only one, which could command the consent of the creditors entitled to consent to a sale.<sup>84</sup>

Equally, the opposition of the principal creditor is not in itself sufficient to qualify a pre-packaged deal as abusive<sup>85</sup> because it is in the nature of each creditor to prioritize their return over the interests of the creditors (and other stakeholders) as a whole. Courts have also found no evidence of abuse when the prospective purchaser required for the transaction to take place in court, as part of an administration procedure, and after a period of exclusivity in the negotiations.<sup>86</sup>

Finally, there is evidence that applicants face an uphill probatory battle whenever the practitioners submit to the court the information required by SIP 16.<sup>87</sup> For instance, in *Bibby* the High Court held that in the context of an unlawful means conspiracy whereby a company was sold to another entity controlled by the same director as part of a pre-packaged deal, no abuse could be identified if the creditor was unable to prove its *claim for loss* (and not simply 'a loss') arising from the conspiracy.<sup>88</sup> In other words, while the creditor proved in the instant case that a conspiracy took place and that this conspiracy caused loss or damage to him, the lack of any prospect of the debtor company being sold to a third party purchaser within a time frame that would have enabled the creditor to recover its outlay meant that the court could not block the agreed deal.

In yet another case, the court held that while the balance of advantage in a pre-packaged administration appeared to lie heavily with the management and not the

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<sup>84</sup> *Ibid.*

<sup>85</sup> *DKLL Solicitors* (n 35).

<sup>86</sup> *In the matter of Hibernia (2005) Ltd* [2013] EWHC 2615, [2013] WL 4411378. The administration order was perfectly intelligible as it was linked to concerns over liability to VAT on the purchase price. No comprehensive ulterior motive had been suggested.

<sup>87</sup> *Kayley Vending* (n 35); *Halliwells* (n 35).

<sup>88</sup> *Capital for Enterprise Fund a LP v Bibby Financial Services Ltd* [2015] EWHC 2593 (Ch); [2015] 9 W.L.U.K. 525.

creditors, the appropriate remedy was simply for the court not to have pre-appointment costs treated as administration expenses.<sup>89</sup>

What filings, therefore, are not merely strategic but also “abusive”? The view of English courts is that some seriously negligent behaviour needs to be proven, as in the case of *Philbin*.<sup>90</sup> Here, the court found the existence of an abusive behaviour where the respondent took possession of the properties as mortgagee and sold them for £2m to a company he owned and controlled. The sale was conducted on the basis of the low estimates for fire sales valuations in the Christmas period “without vacant possession”. The mortgagee took no effort to properly market the properties or check if the tenants were willing to peacefully vacate them. The applicant produced valuations of £4.8m to £5.5m for the same properties if these were sold at an auction under normal market conditions.

This is a sensible approach, broadly in line with the cases decided by the Supreme Court (and the Court of Justice) mentioned at the beginning of this section. This approach would restrict judicial intervention only to cases of almost fraud, where parties misused the freedom granted by the law and breached the public policy principle established in the case law<sup>91</sup> that parties cannot contract out of insolvency law. Accordingly, in *Pension Regulator v Michel Van De Wiele NV*,<sup>92</sup> while expressing serious reservations about the sustainability of the amount demanded in the notice, the Upper Tribunal refused to strike out the Pensions Regulator's case where the Pension Regulator was able to prove a deliberate failure on the debtor to act pursuant to the letter and purpose of the law. In that case, it was proven that a holding put a subsidiary into administration and sold it on a pre-pack basis to another company of the same group with the sole purposes of avoiding the pension

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<sup>89</sup> *Re Johnson Machine and Tool Co. Ltd* [2010] EWHC 582 (Ch), [2010] 3 W.L.U.K. 514.

<sup>90</sup> *Philbin v Davies* [2018] EWHC 3472 (Ch), [2018] 6 W.L.U.K. 695.

<sup>91</sup> *British Eagle Int'l Airlines Ltd v Cie Nationale Air France* [1975] 1 W.L.R. 758; *Belmont Park* (n 64), 396.

<sup>92</sup> [2011] 1 WLUK 190; [2011] Pens. L.R. 109.

scheme deficit and manipulating the insolvency process to strip out the business without the burden of the pension scheme liability.

The broad definition of “strategic” filing advocated by Delaney and O’Rourke and reported at the beginning of this sub-section would result in an undue restriction of the autonomy of the parties, as suggested by the voluminous list of U.S. cases mentioned above that would fall within that meaning. The narrower definition of “abusive” filing adopted by English courts and later commentators seems more capable of preventing *only* those filings that ought not to have place in the insolvency system.

Unfortunately, the hard stance originally suggested by commentators like Moulton has recently received fresh support from the government. In the Autumn Budget 2017<sup>93</sup> and Spring Statement 2018,<sup>94</sup> the government announced that it would explore ways to tackle those who deliberately *abuse* the insolvency regime in trying to avoid or evade their tax liabilities, including through the use of phoenixism.

The government’s proposal on tackling tax abuse in insolvency (discussed below in section III(b)) is a rather unwelcome evolution in the policy debate. It relies on the introduction in the law of a broad definition of “misuse/abuse” and in empowering the HM Revenue & Customs (‘HMRC’) to enforce these provisions. As a result, there is the concrete risk that parties would steer away from the use of pre-packs, thus resulting in an increase of late filings and corporate liquidations.

The author, therefore, suggests that – in line with the approach suggested by English courts and scholars described above – a narrower and more nuanced definition of “abuse” should be used for insolvency purposes.

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<sup>93</sup> HM Treasury, ‘Autumn Budget 2017’ (London, November 2017) <[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/61583/autumn\\_budget\\_2017\\_print.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/61583/autumn_budget_2017_print.pdf)> accessed 25 November 2019.

<sup>94</sup> Available here: <<https://www.gov.uk/government/speeches/spring-statement-2018-philip-hammonds-speech>> accessed 25 November 2019.

As evidenced recently in another paper, there is yet no unified and commonly accepted theory of the abuse of law or rights,<sup>95</sup> despite the fact that the concept of abuse of law can be found in many laws and jurisdictions.<sup>96</sup> Nevertheless, there is consensus that ‘behaviour is considered to be abusive in cases where it is in compliance with the formal wording of the legal norm, but violates its purpose’<sup>97</sup> and the deviation from the statutory purpose is deliberate.<sup>98</sup>

The paper suggests a narrow definition of “abusive filings” as only a small minority of companies make an improper, abusive use of insolvency procedures to pursue individual, as opposed to collective goals.<sup>99</sup> It is, therefore, necessary to introduce a definition that will impact only on those companies that do not comply with the general goals of the system. Any wider definition has the potential of discouraging companies and their directors from undertaking timely corporate rescue procedures and it would contrast with the approach suggested by the Court of Justice in *Centros*.<sup>100</sup>

Accordingly, it is posited that the following conditions should to be met for a filing to be “abusive”:

1. The filing is determined by a close group of players (usually key shareholders, directors and institutional creditors);
2. These players collusively act solely to sidestep or subvert other insolvency rules and extract value from and/or reduce liability towards the company;

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<sup>95</sup> T Troup and A Frössel, ‘Abuse of Principles of Creditor Autonomy in Insolvency Proceedings’ (2017) 4 *European Rev. of Private Law* 727, 730.

<sup>96</sup> H Eidenmüller, ‘Abuse of Law in the Context of European Insolvency Law’ (2009) 6 *ECFLR* 1.

<sup>97</sup> Troup and Frössel (n 95) 730. See also: W Schön, ‘Abuse of Rights and European Tax Law’ in JA Jones and others (eds), *Comparative Perspectives on Revenue Law – Essays in Honour of John Tiley* (CUP 2008); Eidenmüller (n 96) 9.

<sup>98</sup> Eidenmüller (n 96) 10.

<sup>99</sup> HMRC, *Tax Abuse and Insolvency: A Discussion Document* (11 April 2018)

<<https://www.gov.uk/government/consultations/tax-abuse-and-insolvency>> accessed 25 November 2019.

<sup>100</sup> Case C-212/97 *Centros v Erhvervs-og Selskabsstyrelsen* [1999] ECR I-01459.



3. The actions cause “undue financial harm” to the creditors who should have approved the proposed plan in a formal insolvency procedure;
4. The filing fails the “next best alternative” valuation standard, which suggests that dissenting creditors would be better off with a different course of action *and* that that alternative course of action could have been undertaken in an equally short time frame.

### II(e). Findings

Abusive insolvencies amount to cheating, to breaking the rules. As cheating is not allowed in universities, neither it should be permitted in insolvency. Strategic insolvencies only amount to bending the rules. There is nothing inherently wrong in bending, but not breaking rules, provided that parties are not using collective insolvency procedures for achieving individual purposes. It is the abusive, not the strategic use of pre-packaged administrations that should be curtailed as abuse of insolvency law for the promotion of individual, rather than collective goals represents the key threat raised by pre-packs.

### III. EXISTING SOLUTIONS AND GOVERNMENT’S PROPOSALS TO ADDRESS ABUSIVE FILINGS

The Pool<sup>101</sup> is an independent body and a limited liability company constituting of experienced business people who are selected following a public recruitment exercise.<sup>102</sup> It is one of the innovations introduced by the SBEEA 2015 to improve the oversight of pre-packaged administrations and curtail their misuse. Even before its

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<sup>101</sup> Van Zwieten (n 20) 499-500.

<sup>102</sup> For a list of these people, see "About the Pool: Who are the Pool members?" <<https://www.prepackpool.co.uk/about-the-pool>> accessed 25 November 2019.

establishment, it has been at the centre of much debate both among academics<sup>103</sup> and professionals.<sup>104</sup> The SBEEA 2015 was enacted to address the issues associated with pre-packs<sup>105</sup> pursuant to the recommendations<sup>106</sup> included in the *Graham Review*.<sup>107</sup>

The Pool was launched on 2 November 2015. Its members offer an opinion on the purchase of a business and/or its assets by connected parties<sup>108</sup> to a company; the pre-packaged sale should be proposed within an administration procedure to fall under the Pool's scrutiny. The Pool is approached on a voluntary basis by the prospective purchaser of the business and/or assets.<sup>109</sup> It represents an innovative instrument to tackle the issues associated with pre-packs, as no equivalent body of experts exists under U.S. law. At the same time, its voluntary nature and the lack of governmental support for the Pool undermines the efficacy of the instrument itself, as outlined below.

After a submission is made, the members of the Pool assess the desirability of the sale on the basis of the documents submitted by the applicant. These documents usually include: (i) a summary of the events that led to the situation of corporate

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<sup>103</sup> JM Wood, 'The Sun is Setting: Is It time to Legislate Pre-Packs?' (2016) 67(2) N.I.L.Q. 173; Vaccari (n 23); C Umfreville, 'Taking a DIP into the Pool: Should the Pool be Extended to CVAs?' (2018) 11(5) C.R. & I. 158; Umfreville (n 23); D Milman, 'Insolvency Office-Holders: Recent Developments and Future Possibilities' (2018) 412 Co. L.N. 1; Adebola (n 8).

<sup>104</sup> P Whalley, 'Should Pre-Pack Sales to Phoenixes be Banned?' (Sum. 2015) Recovery 7; Grubb (n 74); M Jukes, 'An Interview with... Sarah Albon' (Sum. 2016) Recovery 50; J Hillman and J Snowdon, 'Testing the Waters' (Aut. 2016) Recovery 40; Sumner (n 73); S Jones, 'The Pre-Pack Pool: Is It Working?' (2017) 10(4) C.R. & I. 138.

<sup>105</sup> For a comprehensive review of these issues and of the literature and cases in the field, see: Vaccari (n 23) 699ss. See also above, sub-section II(c) of this paper.

<sup>106</sup> The other recommendations included: (i) a viability review of the new company completed by the connected party; (ii) a revised draft of SIP16 based on the proposal in Annex A of the Graham Review; (iii) making marketing compliant to 6 principles of good marketing and ensuring that any deviation from these principles be brought to creditors' attention; (iv) requiring valuations to be carried out by valuers who hold professional indemnity insurance; and (v) transferring the monitoring over compliance on SIP16 statements from the Insolvency Services to the Recognised Professional Bodies.

<sup>107</sup> Graham Review (n 3).

<sup>108</sup> On the negative preconceptions surrounding pre-pack sales to connected parties, see: Wood (n 103) 177.

<sup>109</sup> On the hopes and uncertainties surrounding the Pool before its launch, see: T Astle, 'To Boldly Go': Are Pre-Packs Heading into Unchartered Territory?' (2015) 12(6) Int. C.R. 363.

distress; (ii) the details of the offer to be made to the administrator; (iii) an outline of the reasons for approving the pre-pack sale; (iv) a list of the people expected to be advantaged and disadvantaged from the sale; (v) the factors that suggest that the business will still be operational twelve months after the sale.<sup>110</sup> This list is not prescriptive.

The submission is reviewed by one member of the Pool, who can issue any of three statements:

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

In any circumstance, the Pool has no power to block a pre-pack sale from going forward, not even when the case for the pre-pack appears unreasonable to the Pool's member. This represents a significant limitation of the Pool's powers and it seriously undermines the ability of this body of experts to limit the abusive use of pre-packs to connected parties. More in general, it can be observed that the duties of the Pool do not include pre- or post-judging the work of the insolvency practitioner or assessing the viability of the new company. The Pool is only concerned in determining if a case for a pre-packaged deal is made on the basis of the circumstances of each case.

As the uptake rate among purchasers in connected party sales is quite low<sup>111</sup> due to the voluntary nature of applications and to the absence of penalties for failure to apply,<sup>112</sup> commentators have been questioning the opportunity to have the Pool and to reform it. Some have been arguing for extending the Pool's remit<sup>113</sup> and/or making

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<sup>110</sup> See 'Guidance documents': <<https://www.prepackpool.co.uk/guidance-documents>> accessed 25 November 2019.

<sup>111</sup> Pool (n 13) 4.

<sup>112</sup> Adebola (n 8) 71.

<sup>113</sup> This is in reality the view of the British Property Federation: Umfreville, 'Taking a DIP' (n 103). This is also the position of R3, the Association of Business Recovery Professionals: 'Government pre-

referrals mandatory<sup>114</sup> (at least for connected pre-packs). Others dismissed such ideas,<sup>115</sup> out of concern that this would dissuade parties from proposing pre-pack deals.

At the time of writing, the Insolvency Service is undertaking a review of the voluntary measures introduced in the wake of the *Graham Review*.<sup>116</sup> This is because the SBEEA 2015 gave the government until 25 May 2020 to introduce subsequent mandatory legislation should the industry-led, self-regulated measures fail to improve the transparency and marketability of pre-pack sales as well as their success rate.<sup>117</sup> It is submitted that, should the government find that abuses of pre-pack sales to connected parties continue to be evident, it will legislate to either prohibit or regulate these procedures.<sup>118</sup>

The main purpose of this paper is to assess if the unsatisfactory number of referrals to the Pool is due to the Pool's inability to address the risk of abusive use of insolvency law raised by pre-packs or to the failure from the government to properly and actively support this industry-led body. This will be done by discussing the powers, achievements and shortfalls of the Pool and by comparing them with alternative proposals to avoid tax elusion and evasion by means of formal insolvency procedures.

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pack review: opportunity for improvement' (13 December 2017)

<<https://www.r3.org.uk/index.cfm?page=1114&element=31163>> accessed 25 November 2019.

<sup>114</sup> Wood (n 103) 188 (stressing the need to insist on strict confidentiality clauses around the process); Umfrefille (n 24), 62; Vaccari (n 23); Adebola (n 8).

<sup>115</sup> P Bailey, 'Pre-Packs Report Published but Fights Shy of Legislative Reform' (2014) 357 Co. L.N. 1; Jones (n 104) 139; Milman (n 103) 5. This is also the view of the godmother of the Pool, Teresa Graham: D McCance, 'Debate over mandatory Pool referral' (*ICAEW*, 3 May 2017)

<<https://economia.icaew.com/news/may-2017/debate-over-mandatory-pre-pack-pool-referral>> accessed 25 November 2019.

<sup>116</sup> The Insolvency Service, *Review of the Pre-Pack Industry Measures* (12 December 2017)

<<https://www.gov.uk/government/news/review-of-the-pre-pack-industry-measures>> accessed 25 November 2019.

<sup>117</sup> S.129 SBEEA 2015.

<sup>118</sup> D Milman, 'Corporate Insolvency in 2015: The Ever-Changing Legal Landscape' (2015) Co. L.N. 1, 2.

### III(a). Pre-Pack Pool and Abusive Filings

With reference to the ability to deal with abusive filings, it has already been argued that making the referral to the Pool compulsory would improve the understanding of abusive practices in the pre-pack landscape.<sup>119</sup> Mandatory referrals would also bolster creditors' confidence that a fair price is being paid for the business. Some practitioners even went as far as suggesting that where the parties are conscious that the transaction is reviewed by an independent third party, directors may consider increasing the transaction price.<sup>120</sup>

Such conclusions seem to be supported by empirical evidence. Since its establishment, the Pool has gradually yet constantly increased the number of qualified<sup>121</sup> or negative<sup>122</sup> opinions on whether a case for a pre-pack sale to a connected party is made, thus prompting some commentators to observe that 'the kid gloves are coming off'.<sup>123</sup> However, the key question of this paper is whether the Pool is actually able to detect abusive filings.

In this respect, the author is aware of at least one case discussed at a recent meeting of Pool members,<sup>124</sup> where the pre-packaged sale was carried out by a solvent business to avoid tax liabilities. The Pool gave a negative opinion to the sale. However, because the Pool's opinion was not disclosed to the creditors and the court, the sale to the connected party went unchallenged. This is not an isolated case. In other instances, Pool members were aware that companies were using pre-packs

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<sup>119</sup> Adebola (n 8) 71.

<sup>120</sup> Snowdon and Hilman (n 104) 41.

<sup>121</sup> The percentage of qualified opinions rose from 24.5 percent for the period Nov. 2015 – Dec. 2016 (Pre-Pack Pool, *Annual Review 2016* (March 2017) 5 <<https://www.prepackpool.co.uk/uploads/files/documents/Pre-pack%20Pool%20Annual%20Review%202016-17.pdf>> accessed 25 November 2019) to 34.7 percent for the period Jan. – Dec. 2017 (Pool (n 13) 4).

<sup>122</sup> The percentage of negative opinions rose from 11.3 to 17.3 percent over the same period.

<sup>123</sup> Adebola (n 8) 74.

<sup>124</sup> DM Blair, 'Pool: Case XXX – August 2018' (Pool Reviewer's Meeting, London, 5 February 2019).

to avoid tax liabilities but could do nothing to prevent the sale from going forward.<sup>125</sup>

It might seem, therefore, that the Pool is able to detect abusive filings. If the problem is simply about the availability of reliable, independent reports, then this issue could be sorted out by making the disclosure of the Pool opinion compulsory. Unfortunately, this *de minimis* solution is open to at least four criticisms.

First, it is not clear why if one party (the Pool) has the instruments and knowledge to assess the abusive nature of a transaction, the final decision on that transaction is to be given to a third party (the court), thus adding costs and delay to a process chosen for its quickness and lower costs over other formal proceedings. It might be objected that the Pool's decision is not taken in an adversarial procedure. However, this is unlikely to affect the soundness of the decision. In any circumstance, the ability to appeal the Pool's decision should dispel any fear of unfair treatment.

Secondly, referral to courts is generally possible *after* the transaction has taken place. As the cases of *Brewer*<sup>126</sup> and *Philbin*<sup>127</sup> prove, courts do not have the power to void a pre-packaged sale that had already taken place. *Ex post*, they can only impose liabilities on rogue directors and practitioners. The courts themselves recognise that compensatory remedies are 'not [...] satisfactory' and 'far from effective'<sup>128</sup> for the parties affected by the sale.

Additionally, litigation does make sense only if conducted against in-money parties, a circumstance which restricts further the ability of affected creditors to seek justice. On the contrary, a negative opinion of the Pool (subject to appeal to the court) would prevent the proposed pre-packaged sale from taking place.

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<sup>125</sup> J Cumbo, 'Companies Abusing Insolvency Pre-packs, Independent Panel Says' *The Financial Times* (London, 25 November 2018) <<https://www.ft.com/content/0fee6146-f0bb-11e8-ae55-df4bf40f9d0d>> accessed 25 November 2019.

<sup>126</sup> *Brewer et al. (as joint liquidators of ARI Digital UK Ltd) v Iqbal* [2019] EWHC 182 (Ch), [2019] P.N.L.R. 15.

<sup>127</sup> *Philbin* (n 90).

<sup>128</sup> *Hibernia* (n 86) at [25] – [26].

Thirdly, a deeper scrutiny from courts was suggested in a consultation in 2010.<sup>129</sup> However, that idea was dismissed due to the perceived impact on cost and duration of the procedure, as well as on the fact that '[w]hile the Chancery Division is blessed with a fine bench, it is not a specialist insolvency court akin to the Bankruptcy Courts in the US'.<sup>130</sup> Since 2010, the judiciary has not been subject to radical reforms as to suggest that the reasons behind the rejection of the 2010 proposal are no longer actual and accurate.

It is also to be considered that, in the pre-EA 2002 regime, administrators were appointed by the courts and had to submit independent reports for the court to check whether the appointment was "expedient". Even in those circumstances, however, courts would usually only accept the view expressed by the practitioner, as judges did not have the expertise to challenge the administrator's judgment.<sup>131</sup> In the current regime, most appointment are made out of courts and the documents submitted do not include any information about the affairs of the company. This makes it virtually impossible for the court to determine whether the procedure is being abused.<sup>132</sup> There is clearly no appetite in England for deeper scrutiny of the courts on pre-packaged administrations.

Fourthly and finally, it is submitted the courts' scrutiny should result in an interference of the directors' and practitioners' business judgment. As courts do not appear ready to do so, this is a further element that militates against their ability to spot and prevent abusive filings.

Therefore, it seems that the Pool is capable of identifying abusive filings where courts fail or would fail to reach the same assessment and/or have no power to halt a pre-packaged sale to a connected party. This is a remarkable outcome, which speaks

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<sup>129</sup> The Insolvency Service, *Consultation/Call for Evidence: Improving the Transparency of, and Confidence in, Pre-packaged Sales in Administrations* (March 2010).

<sup>130</sup> *Umfreville* (n 23) 61-62.

<sup>131</sup> *Kayley Vending* (n 35) at [14].

<sup>132</sup> See the Pool case no. XXXX/2018.

highly of the professionalism and experience of the Pool's members, as the Pool is currently not allowed to consult the independent valuation of the debtor's assets obtained by the insolvency practitioner. This is an aspect that ought to be changed should the effectiveness of the Pool's scrutiny be improved. It suggests that the unsatisfactory results achieved by the Pool so far are primarily due to the failure from the government to properly and actively support this industry-led measure by making the referral to the Pool compulsory.

These considerations, therefore, suggest that the Pool has the ability to address the risk of abusive use of insolvency law raised by pre-packs, and that it is the government's failure to properly and actively support this industry-led body to have negatively affected the number of referrals.

### III(b). Government's Proposal to Deal with Abusive Filings

Not only has the government failed to appreciate the role that the Pool can play to curtail abusive filings and to actively support it. The government also has suggested measures that, in the author's view and pursuant to the findings of this study, would exacerbate the problem of abusive filings. One of these measures is, as evidenced below, the proposal on tackling tax abuse in insolvency, first mentioned in section II(d).

On 11 April 2018, the HMRC published a discussion document seeking views on how to tackle taxpayers who *abuse* the insolvency regime to try and avoid or evade tax, including through phoenixism.<sup>133</sup> Later that year, in the *Budget* the Chancellor reiterated the government's intention to legislate on this matter with Finance Bill 2019/20.<sup>134</sup> The government acknowledged that only a small minority of taxpayers

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<sup>133</sup> HMRC (n 99).

<sup>134</sup> HM Treasury, *Budget 2018* (October 2018) 52 at [3.88]

<[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/752202/Budget\\_2018\\_red\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752202/Budget_2018_red_web.pdf)> accessed 25 November 2019.



abuse the insolvency regime to avoid or evade tax liabilities. A case decided by the Pool in August 2018<sup>135</sup> shows that there is some truth in this assessment. Stuart Hopewell, the co-director of the Pool, also acknowledged that business may have used pre-packs to sidestep tax bills and that the Pool was unable to stop those sales from going forward (due to lack of powers).<sup>136</sup> However, the government did not clearly identify the scale of the problem,<sup>137</sup> as no empirical study was commissioned to determine to what extent insolvency procedures – and, in particular, pre-packs – are “misused”.

Irrespective of that, the government suggested the adoption of a very hard stance against these conducts by recommending that the words “misuse” and “abuse” should be used as synonyms to identify equally reprehensible behaviours. This suggests that any extraction of value from the company<sup>138</sup> through tax avoidance, tax evasion and phoenixism would represent behaviours to be prohibited by general and insolvency law.

To enforce this prohibition, in its response the government announced that it is planning to extend joint and several liabilities to directors, company officers and other relevant parties involved in tax avoidance, evasion or phoenixism where there is a risk that the company may deliberately enter insolvency or potential insolvency, to act as a deterrent for non-compliance with tax rules.<sup>139</sup> On 11 July 2019 draft legislation was published to target these practices and introduce these changes in the

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<sup>135</sup> See above sub-section III(a).

<sup>136</sup> Cumbo (n 125).

<sup>137</sup> The same issue was raised by some respondents to the consultation: HMRC, *Tax Abuse and Insolvency: A Discussion Document – Summary of Responses* (7 November 2018) 4 at [2.5] <<https://www.gov.uk/government/consultations/tax-abuse-and-insolvency>> accessed 25 November 2019.

<sup>138</sup> HMRC (n 133) 6.

<sup>139</sup> HMRC (n 137) 7.

law.<sup>140</sup> Despite the apparent narrow scope of the problem, the draft legislation is quite wide drafted.

The legislation is intended to deter the use of tax avoidance and evasion by influencing the behaviour of those taxpayers who see insolvency as a way of avoiding their tax liability. This legislation will become effective from the Royal Assent of Finance Bill 2019/20 and the measure will apply to all tax periods ending, and to facilitation penalties determined and issued, after that date (likely to be April spring 2020).

This course of action is the most disruptive that the government could adopt to tackle the problem. While it sets out detailed conditions that must be met before an authorised HMRC officer may issue a “joint liability notice” to an individual, it also adopts a very broad definition of “insolvency procedure” (as it includes schemes of arrangements under part 26 CA 2006 and striking-off under s.1000-1003 CA 2006). Additionally, joint liability notices could be issued, according to the draft bill, if there is a serious possibility that the company will become subject to an insolvency procedure,<sup>141</sup> but no definition is provided of the meaning of “serious possibility of insolvency”, thus increasing the risks of legal challenges. Additionally, the draft bill seems to use the terms “potential insolvency”<sup>142</sup> and “serious possibility of insolvency” as synonyms, thus raising concerns of poor drafting quality.

Alternative suggestions included making better, greater use of existing powers,<sup>143</sup> transferring the liability to the directors or other officers responsible for the abuse<sup>144</sup> or introducing director security bonds.<sup>145</sup> The course of action preferred by the

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<sup>140</sup> HMRC, ‘Draft Finance Bill 2019-2020’

<[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/816293/Joint\\_and\\_several\\_liability\\_of\\_company\\_directors\\_etc.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816293/Joint_and_several_liability_of_company_directors_etc.pdf)> accessed 25 November 2019.

<sup>141</sup> Schedule 1, paras s.2(3)(b) and 5(3)(b) of the Draft Finance Bill.

<sup>142</sup> Schedule 1, para 1(1) of the Draft Finance Bill.

<sup>143</sup> HMRC (n 137) 6, [2.16].

<sup>144</sup> However, it was correctly observed that in case of transfer, the company would no longer have liability, which would be removed in full and placed upon the transferees: HMRC (n 137) 6, [2.12].

<sup>145</sup> *Ibid* 6 [2.15].

government amounts to give HMRC preferential status in prioritising all government debts ahead of other creditors, at a time in which the government has already set out plans to re-introduce from April 2020 a preferential status for taxes<sup>146</sup> paid by third parties which are being held temporarily “in trust” by companies in an insolvency procedure.<sup>147</sup>

The proposed implementation of this reform is, therefore, prone to criticism. Respondents to the consultation on *Tax Abuse and Insolvency* warned that, should the government go ahead with the proposed changes, safeguards need to be set out in the law to ensure that taxpayers and other creditors’ rights are protected. They also recommended the introduction of a right of appeal to the Tribunal against any HMRC decision, as well as the use of precise definitions to identify the people who would be held liable for tax avoidance, elusion or phoenixism.<sup>148</sup>

The government agreed in principle with the respondents.<sup>149</sup> However, it also suggested that the measure (i.e. the establishment of joint liability) would apply whenever HMRC ‘considers that avoidance or evasion has taken place, or where they have evidence of phoenixism’.<sup>150</sup> *De facto*, the government is giving HMRC the power to determine when a filing is abusive and the recommendations suggested by the respondents would not address the main issue in the government’s proposal, i.e. the lack of justification for giving such power to the HMRC.

This marks a significant departure to the approach followed by the government in other circumstances. For instance, in replying to a previous consultation on whether insolvency practitioners should be given the power to designate some contracts as

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<sup>146</sup> These are VAT, PAYE Income Tax, employee NICs, and Construction Industry Scheme deductions.

<sup>147</sup> HM Treasury, *Budget 2018* (n 134) 52 at [3.87]. The government is currently seeking views on how to implement the measure: HM Revenue & Customs, *Protecting your Taxes in Insolvency* (26 February 2019) <<https://www.gov.uk/government/consultations/protecting-your-taxes-in-insolvency>> accessed 25 November 2019.

<sup>148</sup> HMRC (n 137) 7 [2.23] – [2.25].

<sup>149</sup> *Ibid* [2.26].

<sup>150</sup> *Ibid* [2.31].

essential,<sup>151</sup> the government agreed that recognising such power to the insolvency practitioners would have been too weighted in favour of the debtor company. Such a solution would have been prone to *abuse*,<sup>152</sup> and would have resulted in more litigation and infringement of suppliers' rights.<sup>153</sup> What elements suggest that recognising the same power to the HMRC would not lead to equally undesirable outcomes? As a result, the government's proposal lacks sound justifications and risks of unduly expanding the notion of "abusive" practices in insolvency.

### III(c). Summary

The business attitude of the Pool members can be valuable to spot abusive filings. Therefore, the Pool appears more promising than courts in curbing the misuse of pre-packaged deals, provided that the Pool members are given the necessary powers and discretion to comprehensively evaluate these transactions. The unsatisfactory results achieved by the Pool are primarily due to the failure from the government to properly and actively support this industry-led body of professionals.

The alternative approach suggested by the government to deal with taxpayers who *abuse* the insolvency regime is flawed for a number of reasons. It is submitted, therefore, that the government should focus on addressing the shortcomings of the Pool rather than exploring alternative approaches to tackling abusive filings.

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<sup>151</sup> The Insolvency Service, *A Review of the Corporate Insolvency Framework – A Consultation on Options for Reform* (May 2016) 19-21

<[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/525523/A\\_Review\\_of\\_the\\_Corporate\\_Insolvency\\_Framework.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf)> accessed 25 November 2019.

<sup>152</sup> Department for Business, Energy & Industrial Strategy ('BEIS'), *Insolvency and Corporate Governance* (20 March 2018) 59 at [5.90] <<https://www.gov.uk/government/consultations/insolvency-and-corporate-governance>> accessed 25 November 2019.

<sup>153</sup> *Ibid* 60 [5.94].

#### IV. WAY FORWARD: A NOVEL APPROACH TO DEAL WITH ABUSIVE FILINGS AND PROPPING INDUSTRY SELF-REGULATION

This work adopted a normative approach to investigate if regulatory reforms are needed to support the activity of industry-led bodies such as the Pool to deal with pre-packaged sales of distressed yet viable corporations.

This paper argued that the key issue raised by pre-packs is their abusive use. Abusive filings are determined by a close group of players who collusively act solely to sidestep or subvert other insolvency rules and extract value from and/or reduce liability towards the company, with the effect of causing “undue financial harm” to the creditors.

This paper also demonstrated the potential of the Pool to avoid abusive filings. Nevertheless, the government needs to properly and actively support this industry-led body of professionals to ensure that the Pool’s promising results in the case mentioned above are carried out over a wider spectrum of circumstances.

This section suggests the regulatory reforms that are needed to expand the powers of the Pool and ensure adequate supervision over its decisions. It also highlights the limitations of this study.

##### IV(a). Recommendations

With reference to the scope of the Pool’s supervision, recent cases showed that abusive filings are not limited to sales to connected parties. For instance, the pre-packaged administration of (solvent) *Johnston Press* (16-17 November 2018) occurred only two days before an employer contribution of £885,000 was due to the pension scheme. The company was sold to *JPI Media*, a consortium of *Johnston Press*’s secured lenders, and the pension liabilities were “dumped” onto the Pension Protection

Fund ('PPF'). The company directors remained the same, but the ownership of the new company passed to the lenders.

As, according to the law, *JPI Media* was not a connected party,<sup>154</sup> there was no scope for a referral to the Pool. Additionally, the Pension Regulator ('TPR') could not use its avoidance powers because such powers can be used only in cases of parties that are "associated or connected" with the scheme's employer as defined in the IA 1986.

This case was covered extensively in the news<sup>155</sup> and prompted a request of clarifications to the parties involved, mainly the Pool and TPR, by means of a series of letter from Rt Hon Frank Field MP, the Chair of the Work and Pension Committee.<sup>156</sup> More importantly, this case is not isolated. Other large businesses such as *Interserve* and<sup>157</sup> *Polestar*<sup>158</sup> have recently been sold to lenders as part of a pre-packaged administration. It is likely than many more cases involving SMEs simply do not make the news.

Lender-led pre-packs are emerging as the latest trend in the industry. In lender-led pre-packs, the directors of the old company generally keep their jobs in the new company and the sale is orchestrated by institutional creditors. However, they do not fall within the remit of the Pool, despite the absence of significant differences with other "connected" pre-packaged deals.

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<sup>154</sup> See above ftn 5.

<sup>155</sup> See, among others, the coverage given by the *Financial Times*: <<https://www.ft.com/search?q=johnston+press>> accessed 25 November 2019. In an article published on 18 November 2018, the journal voiced the concern of one of *Johnston Press*'s old investors, who argued that the pre-pack was 'not so much as a corporate rescue as a blatant corporate theft': M Garrahan, 'JPI Media moves to keep former 'Johnston Press' running' *The Financial Times* (London, 18 November 2018) <<https://www.ft.com/content/9a402588-eb56-11e8-8180-9cf212677a57>> accessed 25 November 2019.

<sup>156</sup> <<https://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/johnston-press-sale-letters-17-19/>> accessed 25 November 2019.

<sup>157</sup> G Plimmer, 'Interserve taken over by its creditors' *Financial Times* (London, 16 March 2019) <<https://www.ft.com/content/8f209dac-471f-11e9-b168-96a37d002cd3>> accessed 25 November 2019.

<sup>158</sup> J Francis, 'Polestar pre-pack leaves huge shortfall' *PrintWeek* (London, 27 April 2016) <<https://www.printweek.com/print-week/news/1157023/polestar-pre-pack-leaves-huge-shortfall>> accessed 25 November 2019.

As the risk of abuse of insolvency provisions looms over all pre-packs (and not only over sales to connected parties), this paper argues for extending the scope of the Pool's supervision to all pre-packaged administrations. A conclusion further justified by the fact that the Pool has showed clear potential for bolstering the creditors' trust and confidence in pre-packs to connected parties.<sup>159</sup>

With reference to the procedure, responsibility for referring a pre-packaged deal to the Pool should be passed to insolvency practitioners. Referrals should also be made compulsory<sup>160</sup> to avoid not only selective applications, but also selective communication of the Pool's opinions to insolvency practitioners<sup>161</sup> and creditors. Calls for other de-regulatory approaches, such as restricting post-application funding where the pre-pack is not referred to the Pool, appear unpersuasive as usually funding is in place before the filing and it is provided by the (connected) purchaser itself.

This paper also advocates for some reforms to the Pool's powers and duties, as the new powers needed to prevent abusive filings without unduly restricting the use of pre-packs have to be balanced with the need that the Pool's members are accountable for their increased responsibilities.

A corollary to the extension of the Pool's scope is an extension of its powers. The Pool should be able to consult the independent valuation obtained by the insolvency

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<sup>159</sup> Snowden and Hilman (n 104).

<sup>160</sup> See also: Adebola (n 8) 76. This solution was first advocated by Vince Cable (who, as Secretary of State, commissioned the *Graham Review*) in an article appeared in May 2017 on *The Times*: A Ralph, 'Firms avoiding attempts to tackle pre-pack abuse; Less than a third of cases referred to voluntary scheme; Tighten rules on pre-packs, ministers told' *The Times* (London, 2 May 2017) <[https://0-www-nexis-com.serlib0.essex.ac.uk/results/enhdocview.do?docLinkInd=true&ersKey=23\\_T28701964230&format=GNBFI&startDocNo=0&resultsUrlKey=0\\_T28701964232&backKey=20\\_T28701964233&csi=10939&docNo=3](https://0-www-nexis-com.serlib0.essex.ac.uk/results/enhdocview.do?docLinkInd=true&ersKey=23_T28701964230&format=GNBFI&startDocNo=0&resultsUrlKey=0_T28701964232&backKey=20_T28701964233&csi=10939&docNo=3)> accessed 25 November 2019.

<sup>161</sup> There is no obligation on the applicant (the prospective purchaser) to communicate the opinion to the administrator. However, the administrator has the obligation to ask the connected party if the Pool has been approached and – in case of a positive answer – to include the opinion within the SIP 16 statement:

<[https://www.r3.org.uk/media/documents/technical\\_library/SIPS/SIP%2016%20Version%203%20Nov%202015.pdf](https://www.r3.org.uk/media/documents/technical_library/SIPS/SIP%2016%20Version%203%20Nov%202015.pdf)> accessed 25 November 2019.

practitioner and the pre-packs should not be allowed *unless* in case of a positive or qualified opinion (*rectius*: decision).

With reference to duties, the Pool members should continue to return decisions within two business days, as pre-packs need to be completed as quickly as possible. However, on the one hand, in large or complex cases the Pool should be given enough time to evaluate the proposal.<sup>162</sup> On the other hand, in case of urgency, the Pool should be allowed to authorise the sale upon application and later issue a decision on the pre-packaged arrangement.<sup>163</sup> This course of action should address the concerns of those commentators, who rightly argue that increases in cost, duration and complexity might dissuade parties from proposing a pre-packaged deal in the first instance.<sup>164</sup>

Should the Pool's decision be made mandatory and binding, it is necessary to transform the Pool into an authority independent of both the government and the profession<sup>165</sup> but funded by the public purse. The Pool should be subject to the supervision of the courts and a system for challenging the Pool's decision should be introduced. Preferably, the Pool's decision should be appealed under the same grounds and within the same time frame established by s.6 IA 1986 for challenging the approval of a company voluntary arrangement. This also means that, unlike what happens nowadays, the Pool member shall provide a short explanation for the decision.

As a result, creditors could challenge the approval of a pre-packaged administration: (i) within 28 days of the Pool's decision; or (ii) in the case of a creditor who was not

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<sup>162</sup> As advocated by the Chair of the Pool in a letter to the Chair of the Work and Pension Committee dated 30 November 2018: <[https://www.parliament.uk/documents/commons-committees/work-and-pensions/PPP-Frank-Field-17-19\\_Redacted.pdf](https://www.parliament.uk/documents/commons-committees/work-and-pensions/PPP-Frank-Field-17-19_Redacted.pdf)> accessed 25 November 2019.

<sup>163</sup> This should address the fears of those like Milman who are rightly concerned about the negative impact that mandatory referrals may have on pre-packaged numbers and job preservation: Milman (n 103) 5.

<sup>164</sup> Jones (n 104) 139.

<sup>165</sup> On the importance that the Pool is free from influence of any of the insolvency practitioners' regulatory bodies, see: Wood (n 103) 179.



given notice of the administration procedure, within 28 days of the day on which the creditor became aware of the decision. Appeals against approved pre-packs could be possible only if one of the two following conditions are met: (i) the pre-packaged administration unfairly prejudices the interests of a creditor, member or contributory of the company<sup>166</sup>; or (ii) there has been some material irregularity in relation to the decision and there is a substantial chance that the creditors would have not approved the proposed pre-pack sale if the arrangement had been presented in the correct manner and form to the Pool.<sup>167</sup>

Other recommendations made by this paper include a call for a standardised list of documents to be submitted as part of the Pool's review. Referrals should not be qualified by a minimum threshold,<sup>168</sup> as 'companies at each end of the insolvency spectrum deal with different sets of challenges and potentially abusive practices'.<sup>169</sup> Applicants should only be charged a small administrative fee for the Pool's opinion.<sup>170</sup>

It is suggested that these changes should not be enacted by the Secretary of State in the upcoming review of the measures introduced with SBEEA 2015, as these recommendations exceed the scope of the powers recognised by s.129(4)(1) of the Act. A consultation may be appropriate to test the views of all the stakeholders involved in pre-packaged administrations, voice any concerns from the industry and address the limitations of this study.

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<sup>166</sup> *Prudential Assurance Co. Ltd v PRG Powerhouse Ltd* [2007] EWHC 1002 (Ch), [2007] B.C.C. 500.

<sup>167</sup> *Re Trident Fashions Plc (No. 2)* [2004] EWHC 293 (Ch), [2004] 2 B.C.L.C. 35.

<sup>168</sup> In a previous paper, the author suggested a threshold of £500k as an *interim* measure: Vaccari (n 23) 707. Additionally, that suggestion was premised on the Pool expanding its powers not nearly as much as currently suggested in this paper.

<sup>169</sup> Adebola (n 8) 76.

<sup>170</sup> Since 1 January 2019, any application to the Pool is subject to an application fee of £950 + VAT: <<https://www.prepackpool.co.uk/questions-answers>> accessed 25 November 2019.

#### IV(b). Limitations

As mentioned in the introduction, the findings and recommendations of this paper are based on a study of pre-packaged administrations in England and Wales. The paper highlighted the key risk raised by pre-packs, i.e. the abusive use of insolvency laws for the promotion of individual, rather than collective goals.

Pre-packs are important rescue tools but represent a tiny percentage of all corporate insolvencies.<sup>171</sup> Therefore, further study is needed to check if similar findings apply across the whole corporate spectrum and to determine whether the Pool's remit should be extended to company voluntary arrangements, a solution discussed by other commentators and advocated by part of the industry.<sup>172</sup>

Any reform proposal should not take place in isolation. If the company which entered into a pre-packaged sale has no or insufficient funding to keep trading – which used to be the most common reason for the adoption of a pre-pack strategy<sup>173</sup> – the Pool could do little to maximise the return to creditors. There would be no time to market the company or its assets. Evidence should be collected in the years following the implementation of these reforms to check on the parties' behaviour.

There are risks that the Pool might not be able to reach an informed decision on the case. Due to timing and confidentiality issues, the Pool – much like courts – would rely on the professionalism of the applicants and their legal advisers to ensure that it receives sufficient but not excessive information. Insufficient disclosure may affect the Pool's judgment.

The Pool should exercise its discretion pursuant to the established case law on abusive filings. The Pool's scrutiny should not, in itself, result in the adoption of a notion of "abusive" filing that differs from the one suggested by this paper. The

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<sup>171</sup> See above section II of this paper.

<sup>172</sup> This would be the British Property Federation (BPF): Umfreville, 'Taking a DIP' (n 103).

<sup>173</sup> Frisby (n 47) 32.

purpose of empowering the Pool of this task is to provide the creditors with *ex ante*, efficient mechanisms to deal with arguably exceptional cases.

It is only practice (and referrals) that can determine if the Pool members are truly capable of identifying abusive filings in the short time frame for issuing an opinion and on the basis of the documents submitted by the parties. What this paper evidenced is that its members have the expertise and access to the information needed to make such assessment and that the government has so far failed to appreciate this fact. This, therefore, makes the Pool members more suitable than courts to assess the risk of abusive behaviour in pre-packaged procedures.

Finally, this work advocates for a much-reduced role of courts and insolvency practitioners in corporate rescue procedures. This is likely to face the opposition of the representatives of the profession and the judiciary. The author is, therefore, aware that further research is needed to facilitate industry support for the proposed changes.

## V. CONCLUSION

The purpose of this paper was to determine the key risks associated with pre-packs and to discuss the most appropriate strategies to deal with them.

This paper showed that pre-packs raise a number of concerns, the most known being the lack of transparency of the procedure, the insufficient marketing of pre-pack companies, valuation issues and lack of proper consideration for the going concern value of the distressed debtor.<sup>174</sup> This paper submitted that the biggest concern raised by pre-packs is the abusive use of insolvency laws for the advantage of selected players, usually the debtor, its directors and institutional creditors.

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<sup>174</sup> Graham (n 3) 8-9.

With few exceptions,<sup>175</sup> the concept of “abusive filing” in insolvency has been largely overlooked in academic papers. Yet, the cases mentioned in the paper and recent governmental consultations<sup>176</sup> show that the problem of abusive use of insolvency procedures and particularly of pre-packs is actual and relevant.

The paper suggested that a clear definition of “abusive” use of insolvency law would be beneficial for identifying the pre-pack sales that should not be permitted under the law.

In light of the existing case law and most recent scholarly debate, it is posited that the following conditions should to be met for a filing to be “abusive”:

1. The filing is determined by a close group of players (usually key shareholders, directors and institutional creditors);
2. These players collusively act solely to sidestep or subvert other insolvency rules and extract value from and/or reduce liability towards the company;
3. The actions cause “undue financial harm” to the creditors who should have approved the proposed plan in a formal insolvency procedure;
4. The filing fails the “next best alternative” valuation standard, which suggests that dissenting creditors would be better off with a different course of action *and* that that alternative course of action could have been undertaken in an equally short time frame.

This paper also observed that the interests of the parties affected by an abusive use of pre-packs are best served if these sales are not allowed to take place, i.e. by means of an early intervention from the Pool rather than an *ex post* intervention from the courts. Pool members are more suitable than courts to assess the risk of abusive behaviour in pre-packaged procedures.

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<sup>175</sup> Delaney (n 56); Eidenmüller (n 96); Troup and Frössel (n 95).

<sup>176</sup> HMRC (n 137).

The paper assessed if the unsatisfactory number of referrals to the Pool is due to the Pool's inability to address the risk of abusive use of insolvency law raised by pre-packs. In light of recent cases and commentaries, it concluded that the Pool's low uptake rate should be attributed to the failure from the government to properly and actively support this industry-led body.

As a result, this paper advocated that the government should put its weight behind expanding the powers and duties of the Pool, making referral to the Pool compulsory in any pre-pack sale, ensure adequate supervision over its decisions and not legislate to either ban pre-pack sales or abolish the Pool.