Pushing the Boundaries between Competition and Insolvency Law: Pre-packing in the UK

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Introduction

Competition law and insolvency law are clashing doctrines. On the one hand, competition policy, particularly on state aid, is often criticised for interfering with the restructuring process of distressed companies. On the other hand, a certain degree of distortion of competition is inherent to insolvency law, especially corporate rescue. Insolvent companies that go through a rescue procedure to get back on their feet often bypass general contract and labour law standards. This inevitably improves their market position and consequently gives them a certain competitive advantage over solvent competitors who cannot take the same route. A balance has to be struck between the conflicting interests of saving a struggling though viable company and the competitive advantages corporate rescue can bestow on such a company. With the advent of the ‘rescue culture’ in many European jurisdictions, through which more emphasis is placed on restoring struggling though viable companies to their healthy and profitable state, an attempt is made to overcome the

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3 Paulus (n 1) 76; cf Katarzyna Gromek Broc and Rebecca Parry (eds), Corporate Rescue: An Overview of Recent Developments (Kluwer Law International 2006) 2-3.
deeply-rooted European aversion towards failure. Consequently, the competition concerns traditionally ousted in the US may have crossed the Atlantic.

One form of corporate rescue that has received particular attention over the last decade is the ‘pre-pack’. This concept, originating in the US, is explored in various jurisdictions and knows several forms. On the European continent, the UK pre-pack is undoubtedly the most famous. Essentially, the UK pre-pack involves the sale of a company’s business as a going concern that is prepared with a prospective administrator before going into the formal insolvency procedure of administration and executed shortly after the out of court appointment of the administrator and without creditor approval. The attraction of this business sale pre-pack lies with its speed, low costs and consequent value preservation, notably since goodwill is not lost due to negative publicity. However, pre-packs are also faced with a vast amount of criticism from various platforms. Pre-packs allegedly leave unsecured creditors empty-handed and without a say in the plan, are liable for a lower price than would have been obtained were the business have been exposed to the market, and facilitate abuse of the management by making it possible, for instance, to dismiss employees easily.

To get to the crux of the matter, competitors also increasingly express concerns that pre-packs harm their market position. They feel unfairly prejudiced for they believe the pre-pack enables a near-insolvent competing business to shed all liabilities and restart with a clean slate without safeguards ensuring fairness and transparency. Similarly, the possibility to free the business from unfavourable contracts, notably with employees, is widely debated. Also, certainly when the business is transferred to a connected party, interested competitors have allegedly been unable to make a bid and thus evade the consequent anticompetitive harm. These criticisms have, to a

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5 See eg n 2.
6 Schedule B1 of the Insolvency Act (‘IA’) 1986 para’s 3(1) and (3), 14(1) and 22(1)-(2); as explicitly allowed ex eg Re T & D Industries Plc [2000] BCC 956 (Ch); see also DKLL Solicitors v Her Majesty Revenue and Customs [2007] EWHC 2067 (Ch).
7 Which is henceforth the definition of pre-pack used in this contribution.
8 Eg Vanessa Finch, Corporate Insolvency: Perspective and Principles (CUP 2009) 456-457.
9 See the research on pre-packs conducted for the UK government concluded in 2014; Teresa Graham, ‘Graham Review into Pre-pack Administration - Perspective and Principles (CUP 2009) 456-457.’
minor extent, been picked up by the legislature as well as in literature. Yet, it seems this recognition has so far had little influence on the development of the pre-pack.

This contribution investigates whether the pre-pack, as a flagship of business rescue, can distort competition to an unjustifiable extent to the effect that the balance between competition and insolvency law is jeopardised. First, the assessment framework is shaped. Then, the anticompetitive elements of the pre-pack are analysed. Afterwards, said findings and the discussed theoretical considerations on anti-competitiveness are brought together to conclude whether, and if so, to what extent, pre-packs can be disproportionately anticompetitive and jeopardise the balance between competition and insolvency law.

The Competition Framework

There are diverging theories on what constitutes anticompetitive behaviour and justifying factors. Crucially, much disagreement exists on what precise objectives should be pursued by competition law and to what extent governments should interfere in the natural competition process. On the one hand, the ordo-liberal school of thought advocates an ordered market in which the state plays an active role. The benefits of self-regulated markets are denied and social, democratic principles and humanist values such as fairness or even happiness are centralised. A degree of morally justifiable economic (and political) freedom is to be maintained and all citizens should have the freedom to compete. In this view, any corporate rescue procedure is anticompetitive. Improving the debtor’s ability to compete is inherent to corporate rescue. Consequently, at least from a ‘moral’ standpoint, so is


11 For an overview, see G Monti, EC Competition Law (CUP 2007) ch 2. The substantive (EU/UK) competition rules are not discussed here, as they do not form a safeguard against potentially anticompetitive pre-packs. Under the merger control rules, a high degree of market power is required for a concentration to be deemed to impede the Internal Market significantly (eg Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings [2004] OJ C031 (‘Horizontal Guidelines’) para 18). Even though the pre-packing or acquiring firm might hold a considerable market share when the pre-pack is effected, this is clearly not what the criticism is aimed at. It is aimed at using insolvency law to gain a competitive advantage by obtaining a clean slate under favourable terms.

12 This philosophy was established as a reaction to the totalitarian thinking of the Nazi regime. It has had a major impact, inter alia, on competition law globally; Angela Wigger, Competition for Competitiveness: The Politics of the Transformation of the EU Competition Regime (PhD Thesis, Universiteit van Amsterdam, 2008) 63-65.

undermining the competitive freedom of competitors. On the other hand, an ordo-liberal policy may also be inclined to safeguard the failing company’s freedom to compete. The crucial question would be whether, from a moral point of view, the corporate rescue procedure disproportionately incentivises rescue with too little regard for competitors. In the same vein, other public policies, such as social, employment and industrial policies, may also be taken into account in competition law. If such considerations are taken into account, the element of employment can be regarded as an important factor in deciding whether pre-packs are unjustifiably anticompetitive. Notably, if a competitor suffers economic losses because of the insolvent’s rise out of the ashes, the jobs lost with that competitor might outweigh or negate those preserved with the insolvent by the rescue procedure.

Alternatively, more or complete emphasis may be placed on economic considerations. This line of thought can for example be found in the illustrious Chicago School and advocates that the pursuit of welfare through economic efficiency should be the predominant or sole goal of competition law. The state should not interfere if companies acquire a high degree of market power solely for the sake of fairness, but only if this affects the relevant product market to the extent that it economically harms consumers and/or producers. Along the same lines, economically inefficient firms should not be protected if this is not in the interest of economic welfare.

As there appears to be no data on the economic effects of the pre-pack on competitors and/or consumers, the criticism of competitors seems to stem from a more ordo-liberal point of view. Nevertheless, it has been put forward that competitors on a market with overcapacity suffered economic harm due to a pre-pack, which is exemplified by the consequent employment losses suffered by those companies.

If an economic approach is taken, the assessment of the pre-pack would depend on the type of welfare pursued. If consumer welfare is the standard, it has to be shown, on a case-by-case basis, that the pre-pack leads to consumer harm before it can be labelled as anticompetitive. If social welfare is pursued, the economic effects on consumers has to be balanced with those on producers. Moreover, the (long-term)
economic efficiencies of the acquisition can be brought forward to justify the initial anticompetitive effects. In this light, it must be noted that pre-packs can undoubtedly have a positive effect on the market and consumers. A known premise of competition law is that removing a firm from the market may upset the market structure to the extent that a merger would be less detrimental to the market, even if it leads to considerable market power.\textsuperscript{21} As a viable business is kept on the market, the competitor harm may constitute no more than a retention of or an increase in competition that leads to lower prices, consumer surplus and economic welfare. However, this is not by definition the case. Firstly, whereas the increased market power of the buyer may not be anticompetitive at the start, this may change in the long term. For example, in a market with few players a small player can quickly become dominant after the acquisition if he is innovative.\textsuperscript{22} A pre-pack can constitute the source of such innovation, as it enables a distressed player to continue with a clean slate with a business that is already established on the market.\textsuperscript{23} Secondly, an accessible business rescue procedure may incentivise or force other market players to do the same. Certainly on small markets or markets with overcapacity, competitors may have to resort to similar mechanisms to avoid their own market exit.\textsuperscript{24} If such impetus is given, the acceptance of failure may in the end overshadow the rewards of success. Furthermore, if a precedent is set for any firms suffering at the hands of their competitors to do the same, this may result in companies partaking in riskier behaviour, whilst simultaneously removing the incentive for directors to enhance the competitiveness of their companies. This would, ultimately, decrease competition and subsequently efficiency and welfare.\textsuperscript{25}

At this point in time, one can only speculate on these matters, as there is no data on the economic effects of pre-packs. Nevertheless, a third and arguably more substantial aspect in this regard is the future viability of the rescued business. Rescuing a business that lacks future viability goes against the Darwinian process of competition\textsuperscript{26} and is in line with neither ordo-liberal nor economic considerations. Consequent failure of a (pre-packaged) business is not only to the detriment of

\textsuperscript{21} See further the text to n 29–30 infra.

\textsuperscript{22} Also SH de Ranitz, ‘De voortzetting van de onderneming tijdens insolventie, nu en straks’, in NED Faber and others (eds), \textit{De bewindvoerder, een octopus} (Kluwer 2008) 192.

\textsuperscript{23} ibid 192–193.


\textsuperscript{25} Also De Ranitz (n 22) 99; Brad Johnson, BR Baliga and John D Blair, ‘Chapter 11: Strategic Advantage and Social Anathema?’ (1986) 5 Journal of Business Ethics 51, 59.

\textsuperscript{26} eg Finch (n 8) 456.
creditors who may be hit with a ‘double whammy’ and employees who may (again) be dismissed, but also to competition as the company, despite all concessions made and after potentially harming competitors, will leave the market and thus, normally, decrease competition.

Moreover, even if the outcome of a pre-pack is beneficial to consumers, there may have been an alternative solution that could have achieved the same gains but with less competitor harm. For example, the European merger control rules acknowledge that an anticompetitive merger may have fewer anticompetitive effects than the counterfactual of removing the firm from the market. Nevertheless, there are several conditions attached to this ‘failing firm defence’ that are interpreted strictly by the Commission. Notably, the failing firm has far-reaching responsibilities in researching whether a less detrimental merger is possible. Thus, while the benefits of a pre-pack may outweigh its anticompetitive effects at first glance, the availability of a less anticompetitive alternative may negate this justification.

As the main advantage of pre-packs is the preservation of value, it is submitted that the economic effects of the pre-pack on competition are predominant in discussing whether pre-packs can be unjustifiably anticompetitive. Therefore, the following three sections discuss to what extent pre-packs may give an economic advantage over competitors. The risk that the sale process leads to competitor harm is assessed first. Secondly, it is examined how ongoing contractual relationships may be dealt with. Thirdly, the special position of employees is examined. Finally, in this section it was argued that considerations of future viability and a comparison with the counterfactual are of great importance in deciding whether the market distortion can be justified. Before an answer is given to the central question, these elements are applied to the pre-pack as well.

The Risk of a Suboptimal Sale

The Relevance of the Sale Price

Undoubtedly the most often voiced criticism of the UK pre-pack is that the business is sold, without influence of the unsecured creditors and the court, for a suboptimal

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28 Walton (n 20) 7-8; BPIF Response (n 10) Q25.
29 Horizontal Guidelines (n 11) Section VIII; also see OECD Competition Committee, Roundtable on FFD of 21 October 2009, DAF/COMP(2009)38, Contribution of the European Commission (‘OECD Roundtable’) 183-188.
30 Ibid 184.
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price.\textsuperscript{31} This leads to a relatively high degree of debts being left behind and is consequently at the expense of the returns to the (unsecured) creditors.\textsuperscript{32} As said in the introduction, this is also to the detriment of competitors for several reasons. If the purchaser buys the business for a market-conforming\textsuperscript{33} price, there is in principle little to no market-distorting effect as the price paid represents the value of the business.\textsuperscript{34} However, if a going concern business, which is thus already active on the market,\textsuperscript{35} can be bought free of debt for a price that is not market-conforming and thus does not represent the value of the business, the purchaser is given a competitive advantage over its competitors as he does not have to maximally invest in the going concern.

The effect of being able to buy a business cheaply is particularly noticeable in connected-party\textsuperscript{36} sales. Under such a construction, not only does the same business re-enter the market free of debt, but also essentially the same company and possibly under the direction of the same management. Besides a potential lack of investment, the debts of essentially the same company are thus left behind and the company can continue with a clean slate. Consequently, the company is given a competitive advantage over its competitors who must continue to have to carry their own debts.\textsuperscript{37} This is also the focus of the criticism from competitors.\textsuperscript{38} Nevertheless, even if the sale is made to a connected party, if the purchaser pays a market-conforming price this reduces the market-distorting effect as the debts are (partly) paid off.\textsuperscript{39} The question is how much debt is left behind and this is thus influenced by the sale price.

Debts left behind can include sums payable to the Crown\textsuperscript{40} and fines received for, \textit{inter alia}, breaches of competition law. The shedding of such public debts constitutes a particular competitive advantage as this is normally impossible under general

\textsuperscript{32} eg Steven Davies, ‘Pre-Pack – He Who Pays the Piper Calls the Tune’ (2006 Summer) Recovery 16, 17.
\textsuperscript{33} This can also be referred to as going concern or market value; see further S Mason, ‘Pre-packs from the valuer’s perspective’ (2006 Summer) Recovery 19, 20.
\textsuperscript{35} As opposed to spare assets or a start-up company.
\textsuperscript{37} eg Brown (n 10) 41.
\textsuperscript{38} eg BEC Sixth Report 2008-09 (n 10) Ev 53.
\textsuperscript{39} Also Verstijlen (n 34) 27-28.
contract law. Moreover, in cases where a new company is set up for that purpose and the business is bought cheaply, the barriers to entry of the market are circumvented. Lastly, the competitor harm is strengthened further if those competitors did not have the opportunity to bid for the business and thus evade the consequent competitor harm.

Position of Secured Creditors and Connected-Party Sales

At the heart of the debt-shedding criticism lays the strong position of secured creditors in the UK pre-packing process that is given by the generally creditor-friendly UK insolvency system as well as in practice. Firstly, the consent of the secured creditors is necessary to sell the encumbered assets as the alternative route of seeking the court’s leave is too time-costly. Due to the over-collateralisation of assets, which entails that the value of the security given exceeds the value of the debt, such consent will often be required for (nearly) all assets. Moreover, the consent of the qualified floating charge holder will often be required to ensure it does not upset the company’s appointment of the administrator. Furthermore, the availability of funding throughout the process is crucial to the success of the pre-pack. Secured creditors, specifically banks, are generally willing to continue financing the business if there is a prospect that they will receive (nearly) all of the outstanding debts due to them and their full loan will be repaid in the end. Lastly, much of the work during the pre-administration period is carried out by turnaround professionals, who are, it appears, often appointed at the prompting of the banks. These considerations leave the secured creditors with a considerable level of control and assured returns, which

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42 On this, see further Jones and Sufrin (n 18) 85.
44 eg Finch (n 8) 277; for example, directors are distrusted and therefore the managerial and oversight functions are normally given to an IP and/or the court to ensure a fair and equitable process for all creditors.
45 Schedule B1 IA para’s 70-74.
47 WE Moojen, ‘Banken ook bij pre-pack bepalend voor uitkomst’ FD 18 September 2014.
48 Schedule B1 IA 1986 para’s 14, 26(1)(b); Armour (n 46) 16.
49 Also eg SV Vullings, A Comparative Analysis of the Pre-pack in the United Kingdom and the Netherlands (Celsius juridische uitgeverij 2015) 48.
50 Christopher Mallon and Shai Y Waisman (eds), The Law and Practice of Restructuring in the UK and US (OUP 2011) 237-238.
51 Vullings (n 49) 39.
makes the pre-pack a compelling rescue procedure for them. Consequently, it has been argued that, as a tool to enforce their security to gain maximum returns, banks may prompt the distressed company to research the pre-pack option.

Furthermore, due to the negative effects of public marketing, the buyer is regularly found in a connected party such as a secured creditor or the existing management, which is thus regularly done in collaboration with (or at the prompting of) the financiers. A new company (‘NewCo’) is often set up for the purpose of buying the business that is the same as the old company (‘OldCo’) all but in name and generally led by the same management. Moreover, although independent valuation is common to the pre-pack, this is usually no more than a desk-top valuation, i.e. with limited information, only. Furthermore, in a connected-party sale the purchase price often exactly matches this figure. Consequently, the valuation and the resulting sale price have been found to be merely an indication of the price the connected party is willing to pay, or even to constitute an equation with the amount of secured debt. Interestingly, Graham indeed found that returns to unsecured creditors were indeed lower in case of connected-party sales.

However, it is recognised that connected-party sales can be commercially and economically justifiable. An alternative buyer may simply be unavailable. For example, as Xie notes, if the distress is due to industry-wide factors, competitors might also be affected and not desire to expand. Moreover, connected parties, especially the management, might be willing to pay a higher price due to the business

52 Alexandra Kastrinou, ‘An Analysis of the Pre-Pack Technique and Recent Developments in the Area’ (2008) Company Lawyer 262; Moojen (n 47); cf Peter Walton, ‘Pre-packaged Administrations – Trick or Treat?’ (2006) 19(8) Insolvency Intelligence 113, 116, 121, who argues this leaves the secured creditors with more control than was possible even under the old-style administrative receivership procedure; also see the statistics in this regard in Sandra Frisby, ‘The Pre-pack Promise: Signs of Fulfillment?’ (Spring 2010) Recovery 30.
53 The bank will want to avoid direct association with the failing company; Vullings (n 49) 49.
54 eg Davies (n 32) 17.
55 See text to n 8 supra.
56 Also known as ‘management buy-outs’ (‘MBOs’); Graham finds that 63.3% of pre-packaged sales were to a connected party in 2010; Graham Report (n 9) 37; similarly Sandra Frisby, ‘Insolvency Law and Insolvency Practice: Principles and Pragmatism Diverge?’ (2011) 64 Current Legal Problems 349, 377.
57 Though a definite resemblance is often seen to retain brand identity; see s216 IA 1986 and Rule 4.228 Insolvency Rules 1986 with regard to the use of a ‘prohibited name’, i.e. a name that is the same or very similar to the name of the insolvent company; Frisby (n 56) 382-383.
58 Graham Report (n 9) 48.
60 Kastrinou (n 43) 104-105; Crispin Daly and Sarah Wakely, ‘Impacts of the Graham Review into Pre-pack Administration in the UK’ [2015] ICR 403, 405; Graham Report (n 9) 48.
61 Moojen (n 47); Graham Report (n 9) 48.
62 Graham Report (n 9) 40.
having special value to them or their knowledge and human capital adding value to the business, which may also facilitate the attraction of funding.\(^64\) In that light, if the cause of the failure cannot be attributed to them, the retention of the existing management can be desirable.\(^65\) Nevertheless, other potential buyers factor the risk coming with the lack of information, mainly due to the inability to value the goodwill, in the price.\(^66\) Therefore, the contention that connected parties are often willing to pay the highest price is unsurprising and no insurance that the highest value has been obtained. Moreover, statistics show that unsecured creditors do not on average fare worse in a pre-pack than in a 'standard' business sale out of administration.\(^67\) However, the issue does not lay with the low returns for unsecured creditors, as this is inherent to insolvency,\(^68\) but with the fact that unsecured creditors do not share in the added value generated by the pre-pack (the 'pre-pack surplus').\(^69\) As secrecy and subsequently such a surplus is one of the big advantages of the pre-pack, this surplus should be reflected in the sale price. However, if the business is undersold, the (likely connected party) purchaser obtains the pre-pack surplus in the form of a discount. Also, the secured lender may demand a fee for the restructuring. This fee is then factored in the new loan, representing the lender’s share of the surplus.\(^70\) Thus, it is submitted that the inherence to insolvency of low returns for unsecured creditors does not silence the criticism. Moreover, the stance of the banks may put the transferring parties in a better position to secure credit from existing or new lenders, albeit at higher rates, as the transferred business, having disposed of the (unsecured) debts, has a clean slate.\(^71\) This leads to another competitive advantage. Furthermore, transferring the pre-pack surplus from the creditors to the purchaser or its financer(s) gives the purchaser another competitive advantage. This is further discussed below.

**Role of the Administrator**

It follows from what was discussed above, and because court supervision is normally absent in the UK pre-pack,\(^72\) that the role of the (prospective) administrator is crucial

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\(^64\) Armour (n 46) 16; Frisby (n 56) 384-385.


\(^67\) Frisby (n 52) 30; Graham Report (n 9) 32.


\(^69\) Armour (n 46) 18-19.

\(^70\) Idem.

\(^71\) eg S Sherman, ‘Bankruptcy’s Spreading Blight’ (1991) 11 Fortune 123.

\(^72\) See (n 13). This is unique in Europe and may explain why the criticism from the competition side is particularly present in the UK pre-pack.
in ensuring a fair and equitable pre-pack process for all creditors.73 However, among other concerns as regards his position,74 doubts have been expressed as regards the influence of the (prospective) administrator in the pre-pack process. Administrators often justify the pre-pack by referring to the benefits of connected-party sales.75 They often also point to the lack of funding, which seems to indicate that secured lenders can pressure the administrator to choose a pre-pack. In the interests of creditor wealth maximisation,76 the administrator will then have no choice but to agree to the sale, as the alternative, without the cooperation of the secured creditors, is liquidation.77 Consequently, the administrator may not always be in a position to research whether an alternative route, for example a different purchaser or a normal marketing process with open market exposure, is more suitable.78 This is also the main reason that public policy considerations – including potential competition considerations – currently do not, and in practice cannot, play a substantial role in the considerations of the administrator.79

Nevertheless, the dominant position of the secured creditors in the pre-pack process does not leave the administrator wholly powerless.80 The requirements of the practice rules as laid down in Statement of Insolvency Practice (‘SIP’) 16 aim to ensure (and often reassure) the unsecured creditors that their rights have not been prejudiced and that the business has been sold at the highest reasonably possible price.81 SIP 16 obliges the administrator to disclose, within seven days after the completion of the sale, a specific set of information to all creditors. Importantly, this information has to disclose in detail how the valuation was conducted, why the price was the highest reasonably obtainable and how marketing was conducted, or, if there was no marketing or valuation, a justifying explanation. Notably, this may constitute ammunition for creditors to challenge the pre-pack or the actions of the management or the administrator.82 Since the first iteration of SIP 16 in 2009, familiarity of

73 eg Kastrinou (n 52) 262; see eg Vullings (n 49) 38 on who can be an administrator.
74 See generally eg Xie (n 31) 93, Frisby (n 27) 2, and Graham Report (n 9) 39.
75 Frisby (n 56) 388-389.
76 Which is the interest he has to serve, Schedule B1 IA 1986 para 3(2).
77 Armour (n 46) 17; Frisby (n 56) 389.
78 This is further discussed below.
79 For example, an administrator refusing to sanction a market-conforming, going concern sale on the basis that there would be a considerable distortion of competition would run the risk of being held liable by the creditors of the OldCo; cf Vanessa Finch, ‘Corporate rescue: who is interested’ (2012) 3 Journal of Business Law 190, 212.
80 See generally the fiduciary duties of directors with regard to self-dealing, which are complied with if certain disclosures have been made; ss175(3) and 177 CA 2006.
81 SIP 16 para 17; preferably on the first notification prior to the creditors’ meeting; Re Hellas Telecommunications (Luxembourg) II SCA [2009] EWHC 3199 (Ch); [2010]BCC 295; SIP 16 has been amended considerably since its coming into existence in 2009 and the practice conditions are arguably still in their infancy.
82 This is further discussed below.
administrators with the system has visibly grown and one may optimistically conclude that, in the majority of pre-packs, the given statements comply with the requirements.\textsuperscript{83} For example, online marketplaces are used to contact potentially interested parties.\textsuperscript{84}

However, several criticisms have been cast over this system of \textit{ex post}-transparency. In general, it gives the administrator a lot of freedom during the silent process as he is merely obliged to ‘comply or explain’ and only after the sale has been effected. This aligns with the flexible approach of the UK that leaves companies the freedom to use the approach that best suits them and to thus deviate from general principles if necessary, as long as they explain why.\textsuperscript{85} Due to the inherent complexity of insolvency situations, this flexibility is hard to scrutinise. For example, the administrator is obliged to give clarity about the alternative options considered in his SIP 16 report.\textsuperscript{86} As aforementioned, he can easily justify the choice to pre-pack by referring to the bank’s stance on the matter. Similarly, SIP 16 obliges the administrator to explain he acted within the purpose of administration.\textsuperscript{87} It has been argued that the first statutory objective of administration, entity rescue, is never contemplated by the administrator; he has worked for weeks on the pre-pack and when coming into office he is unlikely to consider entity rescue.\textsuperscript{88} This duty too seems complied with when the secured lenders make clear no further funding will be available for the OldCo.\textsuperscript{89}

Secondly, as aforementioned, the independent valuations common to a pre-pack are usually desk-top valuations only, and in a connected-party sale the purchase price often exactly matches this figure. Graham found there were rarely any explanations as to the valuation methods used. Crucially, whereas the preservation of value of intangible assets was often used to justify the pre-pack, she found that most valuations were limited to certain tangible assets and did not involve intellectual property or goodwill of the business.\textsuperscript{90} Therefore, it is arguably hard to prove the pre-pack has in fact retained the value of these publicity-sensitive intangibles.

\textsuperscript{83} For the development of these rates see Nils Elner, ‘The End of Pre-packs? An Analysis of the Legal Landscape in which Pre-packs Operate and the Failures of Graham’s Proposals – Part Two’ (2016) ICR 165, 167-169.
\textsuperscript{85} SIP 16 para 16.
\textsuperscript{86} ibid para 9.
\textsuperscript{87} Graham Report (n 9) 12.
\textsuperscript{88} Walton (n 52) 116; cf Kastrinou (n 52) 259.
\textsuperscript{89} Armour (n 46) 20.
\textsuperscript{90} Graham Report (n 9) 48.
Thirdly, Graham found that administrators often wholly refrain from marketing and in cases where marketing was carried out there was often no evidence for when marketing was carried out nor for how long.\footnote{Graham Report (n 9) 45-47; see also Daly and Wakely (n 60) 405.} Moreover, in several pre-packs no other potential buyer other than the existing management or secured lenders had been sought, by both the management and the administrator.\footnote{eg Frisby (n 27) 71.} Even though she acknowledges that transparent marketing is simply not a possibility in some cases,\footnote{Graham Report (n 9) 44.} Graham recognised a vivid danger in the administrator relying solely on the information provided by the management and thus possibly the buyer.\footnote{Idem.}

Due to these criticisms, further valuation and marketing requirements were introduced. Notably, the ‘pre-pack pool’, consisting of a group of experienced businessmen, was installed to ensure independent scrutiny of the pre-pack before its execution but with minimal harmful public exposure.\footnote{The pool became effective on 2 November 2015, one day after the latest SIP 16.} The administrator has to encourage a connected party to approach the pool before the sale. The pool subsequently issues a statement on the proposed sale after scrutinising whether the sale in all its aspects is reasonable.\footnote{Graham Report (n 9) 59.} Its task thus includes assessing whether the connected party is reasonably the best buyer and the intended sale price is reasonably the highest obtainable sale price. The statement is not binding and the decision to pre-pack remains with the administrator, though the usual ‘comply-or-explain’ rule applies.\footnote{ibid 62; Daly and Wakely (n60)406.} The inaugural report from the pre-pack pool indicates that one-in-four connected-party pre-packs is now submitted for independent scrutiny by the pool. Moreover, since the instalment of the pool the number of (connected-party) pre-packs have dropped, even when compared to the drop in administrations generally.\footnote{Pre Pack Pool Annual Review 2016, March 2017, <https://www.prepackpool.co.uk/> accessed 26 September 2017, 5-6.}

Thus, the reforms introduced in 2015 may have decreased the popularity of the (connected-party) pre-pack. Nevertheless, the effectiveness of the new valuation and marketing requirements, specifically the pre-pack pool, remains widely debated. The idea of further enhancing marketing obligations is criticised as the possibility to deviate from these general principles continues to exist and explanations to that effect remain hard to scrutinise.\footnote{Daly and Wakely (n 60) 407.} The same goes for the pre-pack pool and it is feared that the ‘bad apples’ will simply not approach the pool.\footnote{Philip Reynolds and Lee Manning, ‘Pre-packaged Sales in Administrations: Statement of Insolvency Practice 16 (‘SIP 16’)’ (2016) ICR 1, 3.} As only one out of four
connected-party pre-packs are currently referred to the pool, this possibility cannot be ruled out. Moreover, the authority of the pool is questioned, as the participants are not necessarily experienced with pre-packs and only have half a day to consider the irksome balance between effective rescue and creditor protection. Therefore, the scrutiny of the pool may not be as intrusive as it seems. On the other hand, approaching the pool may prove more compulsory as it seems and the advice of the pool might turn out to be binding in practice. The UK Government has granted itself the power to enact regulations covering, inter alia, pre-packs to connected parties. Consequently, it may ban such pre-packs if Graham’s recommendations are not followed to a satisfactory extent. This may cause administrators to feel obliged to reject the pre-pack if there is no pool clearance. Alternatively, this may be another incentive for connected parties not to approach the pool at all, inter alia because negative advice may constitute strong legal ammunition for unsecured creditors.

The working of the pool can thus develop in several ways that may prove crucial for the further development of the pre-pack in the UK, and this should therefore be closely monitored.

Legal Protection

Besides the existence of safeguards in the pre-pack process, it is also of importance to assess whether, if the (unsecured) creditors believe their interests have been disenfranchised, these safeguards can be successfully enforced to ensure the highest reasonably possible value has been obtained. If the transaction can be reversed, this nullifies the competitor harm. If liability can be imposed on either the management or the administrator, this is an incentive for the management and the administrator to pursue an optimal sale price. Only the most relevant grounds of liability are discussed here.

Firstly, creditors may file for a breach of duty of the administrator to act in the interests of the creditors as a whole or on the basis of unfair harm to one or more creditors if they believe the sale price was not reasonably the highest obtainable. However, the court, which is not specialised in insolvency cases, is generally unwilling to interfere with the business judgments of administrators.

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101 See Shuttleworth (n 36) 63 and ibid 2-3.
102 See the Small Business, Enterprise and Employment Act 2015.
103 Elner (n 83) 170-171.
104 cf Armour (n 46) 19; Frisby (n 56) 390.
105 For an overview see ibid 9, 19-25.
106 Schedule B1 IA 1986 para 3(2), 75(3)(c); Re Charnley Davies Ltd (No 2) [1990] BCLC 760, 775.
107 Schedule B1 IA 1986 para 74.
108 Rebecca Parry, Corporate Rescue (Sweet & Maxwell 2008) 46; Re T & D Industries (n 6); Re Transbus International Ltd [2004] EWHC 932 (Ch); see recently Capital For Enterprise Fund A LP and another v Bibby Financial Services Limited [2015] EWHC 2593 (Ch); also cf Re Bellas (n 81) [7].
Consequently, such challenges are regarded as having little chance of success unless there is clear undervalue; there appears to be no record of an administrator ever being held liable for his actions in a pre-pack. As noted above, administrators can justify this with relative ease by referring to the stance of the banks. Moreover, as this is framed as a subjective duty, the administrator enjoys a great margin of discretion. Consequently, it is extremely hard if not impossible to challenge the transaction itself. Similarly, a creditor filing for a breach of duty of the directors to act in the interests of the creditors has to prove his returns in the pre-pack were worse than would have been if a different route than the pre-pack would have been pursued. Moreover, undervalue must still be shown, as well as a tangible interest in the company. This entails that the going concern value must surpass the amount of (secured) debt, which is unlikely.

Paragraph 88 of Schedule B1, under which a removal application for the administrator can be made, does arguably provide unsecured creditors with some power. In Clydesdale v Smailes, the court considered that the administrator had been too intimately involved in the negotiations and was therefore unable to conduct an independent review. Nevertheless, such cases are rare and support of informed, secured creditors seems necessary for such a removal prior to the sale. Moreover, the new administrator will have even less time to get to know the business, which arguably only enhances the odds he will agree with a ready-made deal.

All in all, unsecured creditors seem to enjoy little legal protection against pre-packs. Nevertheless, as noted above, the newest SIP 16 requirements, specifically the involvement of the pre-pack pool, may provide the creditors with strong ammunition. However, due to the hesitance of the court to intervene with the commercial practices of administrators, SIP 16 reports have not been of much help to unsatisfied creditors so far. Therefore, a change of approach of courts is arguably necessary before SIP 16 will effectively play a role in supporting creditors’ claims as an incentive to reach an optimal sale price. Alternatively, disciplinary...
actions against the administrator may be requested. Such action may follow from a serious breach and can result in either a fine or withdrawal of the license of the administrator. Following one of Graham’s proposals, the supervision of SIP 16 statements has been transferred from the Insolvency Service to the insolvency practitioner’s Recognised Professional Bodies (‘RPBs’), to which complaints can be made. This is a necessary alternative to the costly court route and has been argued to increase the likelihood of disciplinary actions for administrators who fail to comply. Yet, it will have to be seen in practice whether this gives unsecured creditors a more realistic chance of enforcement and is thus an effective deterring mechanism.

Interim Conclusion

The risk that in a pre-pack the business is not sold at the highest reasonably possible price continues to exist. The fact that the returns to unsecured creditors do not seem lower than in a normal business rescue and that connected parties may be willing to offer the highest price, are no indication of value-optimisation. This, combined with the powerful position of the secured creditors, the risk that not all information is available and the statutory duties of the administrator makes it hard for the administrator to form a substantiated judgment on whether the sale price is as high as reasonably possible. Moreover, interested competitors may not be involved in the process where this might have been possible, which also likely affects the price. Lastly, even if creditors were to successfully mount a challenge, this does not affect the transaction and competition still loses out. One may consider that the pre-pack pool is a necessary addition to this system of ex post transparency. Similarly, the stance of the RPBs may prove a crucial incentive for the administrator to act innovatively and independent of the transferring parties. As of yet, however, the effectiveness of these measures remain to be seen. Consequently, the sale process in the UK pre-pack may lead to the purchaser being given a (considerable) competitive advantage.

Cherry-Picking Ongoing Contracts

When a company is liquidated all contracts with the company, such as supplier and customer contracts and leases, automatically come to an end. Moreover, the liquidator has the power to disclaim onerous property, which normally includes such

contracts. Furthermore, as novation is necessary, contracts that were previously unfavourable can be re-negotiated, possibly to the benefit of the insolvent party. It has been argued that in a pre-pack, the (connected-party) purchaser is able to ‘cherry-pick’ beneficial contracts and terminate those that are unfavourable. This gives the purchaser a competitive advantage over solvent competitors who have to deal with their counterparties on the basis of general contract law.

Though being able to include ongoing contracts in restructurings can be said to be a cornerstone of corporate rescue in the UK, the pre-pack indeed seems to enable riding roughshod over the interests of these long-term creditors, thereby upsetting the balance between the interests of the debtor and those of these creditors. Notably, many contracts provide for automatic termination or the right to terminate in the event an administrator is appointed or a scheme of arrangements or company voluntary arrangement is proposed. Such *ipso facto* clauses are valid under UK law and, as they concern variation rights, are unaffected by a moratorium. Consequently, if the administrator wishes to avoid termination he will usually need to discharge accruing liabilities as they fall due, which is heavily criticised for hampering any rescue attempt. However, this crucial safeguard is bypassed in the pre-pack as the clause cannot be effectively triggered since the business is sold immediately after going into administration. Consequently, even if the *ipso facto* clause provides for automatic termination of the contract when the administration procedure is commenced, the pre-pack takes away the possibility for counterparties to ensure a beneficial result; the upper ground to negotiate the terms of novation lays with the debtor that is no longer in economic distress. Similarly, the burdensome route for administrators to terminate ongoing contracts as agent of the company in

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122 s178(3) IA 1986.
123 eg *Aktion Maritime Corp of Liberia v S Kasmas and Brothers* [1987] 1 Lloyds Rep 283 (QBD).
124 De Ranitz (n 22) 192-193.
125 eg BPIF Response (n 10) Q26 and BEC Sixth Report 2008-09 (n 10) 11-12; cf Onno Tacoma and Caroline Weebers-Vrenken, ‘The b(1)ackside van een pre-pack faillisement’ (2013) 6 Vastgoedrecht 170, 172-173.
126 It must be noted that this criticism does not seem to be on the forefront in the UK when compared to, for example, the Netherlands. Nevertheless, it may be seen whether a similar risk exists in the UK.
129 cf *Re David Meek Plant Ltd* [1993] BCC 175 (Ch); ibid 131.
131 Also ibid 3.
132 cf Tacoma and Weebers-Vrenken (n 125) 175.
the normal administration process is evaded,\textsuperscript{133} and the same applies to the costly classification of claims accrued in administration as expenses of the administration in case of affirmation.\textsuperscript{134}

However, it must be noted that, generally, trade creditors and important customers hold a strong position in any restructuring, as their contracts are often crucial to the continuation of the business in distress. Such creditors often demand ransom payments and/or payment in full for the contract to continue.\textsuperscript{135} The administrator often has to make an effort to ensure these contracts are novated as this will normally be a necessary part of the deal for the buyer.\textsuperscript{136} This decreases the risk of anticompetitive cherry-picking. However, as the important leverage of \textit{ipso facto} clauses of creditors is absent in a pre-pack, this places the creditor in a more precarious position than the now healthy debtor, since declining to novate the contract would cause them to lose a viable customer that is perhaps hard to replace. For example, landlords are often unable to find a better tenant and are therefore normally willing to novate the lease with a NewCo.\textsuperscript{137} Moreover, it is relevant to note that the decision to start such negotiations lies with the debtor; if the pre-pack would inevitably lead to the loss of crucial contracts, the pre-pack may simply not be considered.\textsuperscript{138}

Concluding, the prospect of being worse off in liquidation seems particularly true for normally well-placed\textsuperscript{139} long-term creditors if confronted with a pre-pack. Therefore, the pre-pack may give a definite competitive advantage over solvent competitors through the possibility to cherry-pick or renegotiate ongoing contracts to the detriment of the long-term creditors, though the way the bargaining positions of the creditors and the debtor fit in with each other will likely depend on the specific circumstances of a case. Moreover, this may have another negative consequence on competitors, as the suppliers may tighten credit terms to all companies on the downstream market to protect themselves from similar losses in the future.\textsuperscript{140} In any case, the risk of a suboptimal sale price is certainly not the only issue for competitors.\textsuperscript{141}

\textsuperscript{133} See eg Bork (n 127) 188-190.
\textsuperscript{134} See Rule 2.67(1)(a) Insolvency Rules 1986; ibid 191-192.
\textsuperscript{135} R3 Report (n 130) 1-3.
\textsuperscript{136} eg Hyde and White (n 65) 135.
\textsuperscript{139} cf Bork (n 127) 191.
\textsuperscript{140} BPIF Response (n 10) Q26.
\textsuperscript{141} cf Verstijlen (n 34)28.
As noted in the introduction, it is alleged that pre-packing parties can deal with employees more flexibly than solvent competitors who are bound to the regular provisions of labour law, which gives the purchaser another competitive advantage. Moreover, the claims of the employees left behind are largely taken over by the public funds to which those competitors contribute.

Statistics show that the pre-pack has a relatively high level of employment preservation, though Graham expresses caution with regard to the veracity of these numbers. Like the unsecured creditors, employees are given notice of the pre-pack as a fait accompli. The information and consultation obligations (currently) flowing from EU law are consistently ignored by the administrator, taking for granted the consequent protective awards due to time constraints and necessary confidentiality. Moreover, as the worker protection regime in the UK is generally seen as conflicting with the rescue regime, in a business rescue employers normally want to limit employee liabilities as these are factored in the purchase price. Consequently, despite the relatively high degree of employment preservation, concerns have been expressed over the degree of employee protection in the UK pre-pack. The employee regime applicable to the pre-pack may yet constitute a competitive advantage over solvent competitors who – even in a business transfer – do not have the same tools to deal with surplus or unwanted employees. Therefore, this paragraph examines the veracity of these criticisms.

The possibilities of dismissal are examined. Then, the regime on contract variations is discussed.

142 cf Salem and Martin (n 2) 98-99.
144 Frisby (n 27) 70-71; Graham Report (n 9) 24-25.
146 Regulations 15(11), 16(3) TUPE; cf Parry (n 108) 20.
149 eg Creighton-Selvay (n 147) 91.
150 Parts of this paragraph have been published by the author in (2017) 2 ICCLR 65.
Tactical Dismissals

The employment contracts of all employees will normally automatically transfer with the business due to the (current) applicability of the Acquired Rights Directive (‘ARD’), as implemented in the Transfer of Undertakings (Protection of Employment) Regulations (‘TUPE’), which aims to ensure that employees do not find themselves in a less favourable position by reason of a business transfer. The main insolvency exception of the ARD, which allows Member States to disapply the rules on automatic transfer and unfair dismissal to insolvency proceedings instituted with a view to the liquidation of the assets (the ‘liquidation exception’), does not apply to pre-packs (and administration generally). Therefore, a dismissal for which the sole or principal reason was the transfer itself is automatically unfair, except where the dismissal is for an ‘economic, technical or organisational reason entailing changes in the workforce’ (‘ETO-reason’). This can be interpreted as a genuine business reason or redundancy. Prior to the 2014 amendments, reasons connected with the transfer also fell under this dismissal regime.

It has been argued that this degree of protection gives employees necessary protection, as the purchaser would otherwise be able to cherry-pick the employees wanted, clear of accrued rights. On the other hand, as abovementioned, this regime may yet give the pre-packing parties a competitive advantage. Firstly, as the first mechanism of compensation for disapplying the liquidation exception to, inter alia, pre-packs, which is thus unavailable to solvent companies, the ARD limits the employee claims that transfer to the purchaser. Secondly, the provisions of TUPE can allegedly be constructed creatively to create other possibilities to get rid of unwanted employees in light of a transfer, crucially to increase the value and

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153 SI 2006/24.
156 Art 4(1) ARD; Regulation 7(1)-(3) TUPE.
158 See David Pollard, Corporate Insolvency: Employment and Pension Rights (5th edn, Bloomsbury 2013) 498; cf Gant (n 143) 192.
159 Art 5(2)(a) ARD; Regulation 8(3)-(6) TUPE.
VAN SCHADEWIJK: Pre-Packing in the UK

attractiveness of the business. These criticised provisions concern pre-transfer dismissals and dismissals for ETO-reasons.

Firstly, transferring parties and the administrator may escape the scope of TUPE by effecting dismissals prior to the transfer. After a lingering debate, the CJEU ruled that any dismissal by reason of the transfer, regardless of its timing, was to be ineffective. This was codified in TUPE 2006 by extending the coverage to employees who would have been employed immediately before the transfer were it not for an unfair dismissal under Regulation 7(1). This resulted in a storm of cases in which the UK courts have been unable to give unequivocal guidance on when a pre-transfer dismissal falls under the scope of TUPE. In a business rescue it would depend on the (often unclear) facts of a case whether the transfer or a reason connected to the transfer would be deemed to be the sole or principal reason, or whether the dismissal was deemed to be part of the general, cost-minimising restructuring carried out by the administrator. However, as said, the ‘gold-plating’ threshold of transfer-connectivity has been removed, thereby arguably also removing the greatest protection of employees against unfair dismissals. It is envisaged that employees may have a hard time proving a pre-transfer dismissal was effected by principal reason of the transfer instead of by a general restructuring reason. Notably, whereas dismissals effected before the identification of a buyer have been ruled to be for a reason connected to the transfer, it has been doubted that such dismissals will be deemed to principally be by reason of the transfer. Crucially, in a pre-pack employees may struggle to prove, on the basis of SIP 16 reports only, that a purchaser was found at the time of the dismissal.

Secondly, as aforementioned, employees may be validly dismissed if there is an ETO-reason. A crucial question is how this concept is interpreted in case of a business rescue and thus a pre-pack. Both the ARD and the CJEU have given little guidance on this concept. It has been argued that the UK courts have, on occasion, been judicially creative to ensure that the award for compensation for unfair

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160 eg Etukakpan (n 148) 250 and Gant (n 143) 192-193.
161 Case C-101/87 Bork ECLI:EU:C:1988:308.
162 Regulation 4(3) TUPE.
164 Pollard (n 158)502.
165 Meaning that this provision gave more protection than required by the ARD; McMullen (n 157) 153.
166 Etukakpan (n 148)233.
167 cf Pollard (n 158)500.
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dismissal was avoided where this would have disproportionately affected the functioning of the undertaking post-transfer.\(^{169}\) However, over the last years it has been ruled reasonably consistently that, in circumstances where rescue is envisaged, the ETO-reason must be to continue conducting the business, not a desire\(^ {170}\) or necessity\(^ {171}\) to achieve a sale.\(^ {172}\) Nevertheless, the prospect of rescue has played a role in some instances. For example, the court explicitly took into account the future conduct of the business in Thomson in dismissals related to overstaffing and inefficiency.\(^ {173}\) However, this does not change that, generally, there must be a genuine economic reason.\(^ {174}\) Therefore, although the court is known to accept corporate rescue ideals over employment claims at times, it seems that the ETO-defence does not specifically endanger the position of employees in a pre-pack.

Variation of Contract

Lastly, brief mention may be made of the possibility to alter the contracts of employees after the transfer. As said, the reproach has been made that, even though employment is preserved, the purchaser of the business may be able to force the employees to work under altered, less favourable working conditions, similar to the way general ongoing contracts may be changed.\(^ {175}\) Normally, an employee-unfavourable variation of contract connected to or by reason of the transfer is void, except if for an ETO-reason. This leads to substantial protection of transferred employees.\(^ {176}\) As the second compensation measure for applying the ARD to insolvent business transfers, a special regime, which is thus unavailable to (solvent) competitors, on contract variation applies. Employee-unfavourable contract variations by reason of the transfer are allowed if agreed on by the transferor, the transferee or the insolvency practitioner, and the relevant employee representatives, and if they are designed to safeguard employment by ensuring the survival of the business.\(^ {177}\)


\(^{172}\) cf Wyn Derbyshire and Stephen Hardy, TUPE: Law & Practice (4th edn, Spiramus 2014) 64-66.

\(^{173}\) Thomson v SCS Consulting Ltd [2001] IRLR 801 (EAT).

\(^{174}\) cf Derbyshire and Hardy (n 172) 64-65; Etukakpan (n 148) at 254.

\(^{175}\) Creighton-Selvay (n 147) 90-91.

\(^{176}\) Regulation 4(4)-(5) TUPE; for collective agreements see Regulations 4(5)B, 5 TUPE; see further McMullen (n 157) 160; cf Parkwood (n 168).

\(^{177}\) Art 5(2)(b) ARD; Regulation 9(1)-(2) TUPE.
The potential of this bargaining mechanism, which is undoubtedly present, is submitted to be limited by the weak UK framework of employee representation. The aforementioned representatives can either be representatives of the recognised trade unions or, when there is no such union, those chosen by the employees. Besides the time-costly ad hoc arrangements reducing the time available for actual consultations, the independence and expertise of those elected is questionable as there are no restrictions on who can be elected, which is especially problematic in complicated insolvency situations. Therefore, this approach, which is unfortunately usually applicable due to the decline in unionism, seems to render the possibility of ‘concession bargaining’ ineffective. This causes the majority of leverage and control to be left with the employer and is said to incentivise abuse. Thus, certainly when contrasted with the strict regime on contract variations after a ‘normal’ transfer outside of insolvency, the possibility to alter contractual terms may give the transforee another competitive advantage that is unavailable to solvent competitors.

Interim Conclusion

Even though TUPE applies to pre-packs, several possibilities remain through which the transferring parties can rid themselves of unwanted employees in ways that non-insolvent business transfers cannot, thereby giving the former a competitive advantage. Although the general ETO-shield does not seem to currently form a danger, the potential of early dismissal seems real, as it appears the dragging debate on whether and when early dismissals fall under the scope of TUPE has taken a turn towards rescue. Moreover, even if employees cannot be dismissed, there is arguably a legitimate risk that employers can pressure employees into accepting less favourable terms of employment via the ‘concession bargaining’ derogation. Therefore, although not evident at first sight, it is submitted that, as regards employees, the pre-pack, like administration generally, is likely to give another and potentially considerable competitive advantage that is unavailable to solvent companies. Moreover, whether the UK will review the TUPE-provisions post-Brexit remains to be determined. Due to the influence of EU law in this field, if the UK

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178 Armour and Deakin (n 149) 461.
179 Also idem; Geva (n 163) 351.
180 Regulation 13(3) TUPE; see Regulation 14(1) TUPE for the election requirements.
181 Etukakpan (n 148) 288.
182 Armour and Deakin (n 149) 461.
183 Geva (n 163) 348.
184 Etukakpan (n 148) 274.
185 Armour and Deakin (n 149) 460-461.
186 eg Geva (n 163) 347-348.
does return to more employer-friendly times the anticompetitive elements of business rescue, and consequently the pre-pack, will surely increase.

**Counterfactual Analysis and Consequent Failure**

It was found above that a lack of alternative, less anticompetitive routes of action in case of insolvency as well as the future viability of a business sold are important considerations in deciding whether the competitive advantages may lead to unjustifiable competitor harm. Therefore, these two elements are applied to the pre-pack. For the sake of this contribution, the counterfactual entails a ‘normal’ business rescue out of administration.\(^{187}\)

**Counterfactual Analysis**

It is stressed that many characteristics of the pre-pack stem from the generic administration procedure or even corporate rescue in general. Therefore, the competitive advantages are, to some extent, the same regardless of the rescue procedure chosen.\(^{188}\) However, with regard to the risk of a suboptimal deal a crucial difference between the pre-pack and the counterfactual can be found in the secrecy and consequent lack of market exposure. While such a prepared, private sale is also a possibility in a normal business rescue, the pre-pack is the designed procedure for this course of action.\(^{189}\) It was explained above that, since the value of the business does not plummet due to this secrecy and consequent lack of public exposure as is the case in a normal restart, the pre-pack should generate added value over a normal restart that should be reflected in the sale price. However, it was also found that, as an inherent risk of this secrecy, this may not occur optimally or at all and this surplus is then received by the purchaser or another connected party. Thus, whereas a public bidding process in principle leads to a market-conforming price,\(^{190}\) however low it may be, this is less certain in a pre-pack. Therefore, it may be argued that, as regards the sale process, the pre-pack has a higher risk to be anticompetitive than a normal business rescue subject to open market exposure.

The different level of secrecy also influences the bargaining position of the debtor as regards ongoing contracts. It was discussed that, as the business is only in administration very briefly, there is no issue as regards balancing the need to

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\(^{187}\) Though interesting, discussing more rescue procedures would go beyond the scope of this contribution. Moreover, it is submitted that, though a certain de-stigmatisation of insolvency is taking place in the UK (cf text to n 4), companies will avoid insolvency procedures, including the pre-pack, if they are not indeed insolvent.

\(^{188}\) Examples are the liquidation element, a lack of transparency, creditor voice and possibilities to challenge the sale.

\(^{189}\) As explained above, this may notably be so due to the stance of banks.

\(^{190}\) See further Mason (n 33) 20.
continue the contracts and the costs of doing so. This issue does exist in a normal business rescue as the administrator is only confronted with the business after the formal insolvency procedure has been opened. Moreover, it was explained that, as opposed to a normal business rescue, guarantees and insolvency clauses of long term creditors are made largely ineffective by the pre-pack, which weakens the bargaining position of the counterparties. Similarly, though it is submitted that little difference exists with regard to employees when comparing the procedures, the administrator does not have to make difficult decisions concerning keeping on or dismissing employees due to the super-priority of their salary post-filing as the negotiations on the sale do not take place during the formal insolvency procedure. 191

Lastly, it must not be forgotten that, even if many aspects of the pre-pack and the counterfactual are the same, the pre-pack is undoubtedly a more effective procedure in many scenarios, which is hence the reason of its popularity. As was seen, effects on competition are inherent to corporate rescue. The simple increase in usage and effectiveness of this corporate rescue procedure thus leads to increased relevance for competition.

On the basis of these considerations, the pre-pack is likely to carry more competitive advantages than its ‘normal’ business rescue alternative. Moreover, while pre-packs can undoubtedly have added value over these alternatives,192 there are also scenarios in which a normal business rescue would lead to a similar or even more beneficial result for the stakeholders. 193 For example, a public process has not been found to be detrimental in all sectors. 194 Consequently, following the rationale of the failing firm defence as discussed above, much of the justifying effect of the pre-pack, on both the stakeholders and the market, may be invalidated if a pre-pack is pursued when a normal business rescue is also possible. Above, it was found that this risk indeed exists. Secured creditors may prompt the debtor into researching the pre-pack in practice, whereby the administrator, due to his statutory duties, may not be in a position to effectively research whether a normal business rescue would be more appropriate as without the cooperation of the secured lenders the company would likely end in liquidation. Moreover, the decision to pre-pack is not scrutinised by the pre-pack pool. 195 These considerations lead to the conclusion that, depending on the specifics of a particular pre-pack, the alleged justifying benefits of the pre-pack for the market and/or the stakeholders must be nuanced.

191 See further Geva (n 163) 346; Nyombi (n 169) 421-422.
192 eg Graham Report (n 9) at 6.
194 Finch (n 8) 457.
195 Graham Report (n 9) 93.
Consequent Failure

As explained above, the future viability of the pre-packed business is an important consideration for competition, as the initial positive effect of a pre-pack on the market is negated if the company goes on to fail again. Graham found that, statistically, connected-party sales have an appreciably higher chance to subsequently fail than non-connected sales. Moreover, the failure rates of pre-packs were found to be higher than normal business rescues due to the relatively high level of connected-party sales and deferred consideration payments. Graham notes that it is not the pre-pack itself that leads to the higher level of failure, but the self-standing characteristics associated with failure of connected-party sales and deferred consideration. Nevertheless, one could argue that these elements are factual characteristics of the pre-pack and thus do make pre-packs stand out significantly with regard to consequent failure. Moreover, Graham found that, for various reasons, deferred consideration is often not paid in full. This may give the purchaser yet another competitive advantage.

Due to these high rates of consequent failure, Graham recommended the instalment of a voluntary viability review in connected-party sales in the ‘comply-or-explain’ system of SIP 16, in which the administrator has to encourage the connected party to draw up a ‘viability review’ on the new company, explaining how it will survive for at least 12 months. It aims to reduce the amount of unviable businesses re-entering the market or the same management or business plan failing yet again. However, there seems to have been little use of the viability reviews up to now, which may be attributed to the fact that it is unclear what exactly it should comprise and when it should be employed. Notably, the broadly-framed requirements allegedly require no more than a simple business plan, which does not give any guarantees on future viability. Moreover, after 12 months most subsequently failing businesses are still viable. Furthermore, the viability review suffers from the same deficit as the UK pre-pack generally: any justification on why such a statement was not issued is hard to scrutinise and to challenge. As such, the effectiveness of the viability review is questionable. Similarly, though Graham

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196 ibid 39-41, 50-51.
197 ibid 35, 51; deferred consideration entails that the purchaser pays for the business over a period of time, rather than on the date of the transfer.
198 Idem; also see Verstijlen (n 34) 24.
199 Also Finch (n 79) 207.
200 Graham Report (n 9) 42.
201 ibid 62-63; see SIP 16 para 9 and Appendix.
202 Also Reynolds and Manning (n 100) 2.
203 Wood (n 121) 8-9.
204 Graham Report (n 9) 39; also ibid 9.
205 Also Wood (n 121) 8-9.
states that (the lack of) the viability statement can be used as ammunition for directors’ liability if the NewCo fails,\textsuperscript{206} the deterring effect thereof on connected-party sales remains doubtful.

**The Balancing Act Revisited**

*Synthesis*

Due to the flexibility enjoyed by pre-packing parties as regards the sale price, ongoing contracts and employees, a pre-pack can place the rescued business in a competitively advantageous position and consequently have considerable negative effects on competitors. Moreover, due to their specific working, pre-packs carry the risk of being more anticompetitive than their respective ‘normal’ business rescue alternatives, crucially due to the consequences of a wholly private sale process as opposed to a more public, market-conforming one. In this regard, the competitors’ concerns are justified. However, the question remains whether this harm outweighs the gains of a pre-pack. It is recognised without a doubt that the pre-pack can be an effective means to restructure an insolvent business. Furthermore, as is in alignment with the failing firm defence rationale, a successful pre-pack is likely to have a positive effect on the market and the consumer. This is notably due to the preservation of a viable competitor on the market. Yet, when reading the working of the pre-pack in light of the theoretical framework provided in this contribution, several worrisome observations can be put forward. Firstly, pre-packs do not by definition benefit the market and the consumer. Though it is hard to make such statements without economic research, a legitimate concern for the new creditors, the employees as well as the market is present when the company goes on to fail again. This is found to be a substantial issue. Secondly, the ever-looming ‘bad apple’ cases, where the business is sold (far) below market value, are likely to be seriously detrimental to competitors and possibly also consumers. This is due to the improvement of the market position of the purchaser as a result of the lack of required investment in combination with, in the likely case of a connected-party sale, a high degree of debt-shedding. Notably, even if liability can be imposed, the competitor harm cannot be remedied. Thirdly, if the viable route of a less anticompetitive alternative has not been taken, this negates, to some extent, the justifying effect for both the economic stakeholders and the market. On the basis of these considerations, it is submitted that, in theory, a pre-pack can be unjustifiably anticompetitive.

\textsuperscript{206} Graham Report (n 9) 63.
The Way Forward

This conclusion does not automatically mean pre-packs distort the balance between competition and insolvency law. A few potentially bad apple cases do not condemn the pre-pack and the identified competition issues do not alter this. Therefore, it is submitted that research on the economic effects of pre-packs on competitors and the market is desirable. Such research would grant a better insight into how many pre-packs genuinely economically harm competitors, and on what kind of markets. This would also give more clarity on the likelihood of pre-packs having a positive effect on the market and the consumer. For example, Graham found that small companies are the predominant users of the pre-pack, which may affect both the degree of competitor harm and consumer welfare. Additionally, economic research would shed more light on how the found anticompetitive elements weigh in against each other, as there is no guarantee that a pre-pack that has several severely anticompetitive elements is anticompetitive in all its aspects. Moreover, this could indicate whether perhaps only the often problematic connected-party pre-packs form a genuine concern for competition. Lastly, finding that competitors suffer considerable economic harm in a substantial amount of cases could ignite a discussion on the anticompetitive effects of other business rescue procedures, or even corporate rescue in general.

Final Thoughts

Blatantly concluding that pre-packs are a form of unjustifiable anticompetitive behaviour would ignore the difficult though inherent relation between the insolvency and competition doctrines. Yet, this contribution aims to have shown that more awareness should be had of the competition side-effects of pre-packs. Preferable, steps are taken to research the economic effects of pre-packs on both competitors and the market. Only then can more substantial conclusions be drawn on the impact of pre-packs – or corporate rescue generally – on the balance between competition and insolvency law. Moreover, decreasing the number of potentially anticompetitive pre-packs can be achieved, inter alia, via emphasising crucial, existing safeguards as identified in this contribution. Prominent examples are the pre-pack pool and the viability review. On a more general note, scrutinising pre-packs from the point of view of competition has emphasised the need for safeguards. This goes for several areas already central to the pre-pack discussion, such as the sale process and the

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207 cf Elner (n 83) 171.
208 cf Paulus (n 1) 75 and BEC Sixth Report 2008-09 (n 10) 11-12.
209 cf Walton (n 20) 8-9.
210 Graham Report (n 9) 23.
211 For suggestions on altering existing or introducing new safeguards, such as the ‘stalking horse’ bidding procedure, see eg Vullings (n 49) 59, 63.
position of employees. Yet, areas that are less in the spotlight are also pinpointed, such as the treatment of ongoing contracts, the decision to pre-pack and the future viability of the going concern. With regard to employees, the competition dimension moreover encompasses an extra warning to closely scrutinise the treatment of employees by the UK insolvency regime post-Brexit.

The development of the rescue culture, with the pre-pack as a preeminent example, has undoubtedly shifted the scales between the doctrines of competition and insolvency law. In light of the European-wide ‘restructuring euphoria’212 competition implications of corporate rescue are more relevant than ever. One should be wary of creating a business environment in which corporate rescue can be used as a ‘business tool’ that circumvents the Darwinian process of competition. The anticompetitive effects of the procedure may become its object and this irksome balance may be forgotten altogether. If business rescue continues to grow in popularity, companies may, for example in a future financial crisis, try and use business rescue as a strategic business tool and perhaps even relocate to the most easily approachable jurisdiction for that purpose.213 Alternatively, the trust in the insolvency system may be lost and the system may fall into disrepute and misuse.214 In any case, it should be remembered that ‘competition is not only the basis of protection to the consumer, but is the incentive to progress’.215

212 Horst Eidenmüller, ‘A New Framework for Business Restructuring in Europe: The EU Commission’s Proposals for a Reform of the European Insolvency Regulation and Beyond’ (2013) 20 MJ 133, 136. It is not envisaged that Brexit will alter this trend in the UK, as the UK has always evolved rather independently in this field.

213 Though with regard to the UK this conclusion may be unlikely due to Brexit.

214 cf B Wessels, De onafhankelijkheid van de faillissementscurator (Uitgeverij Paris 2013) 79.