

Prepacks- no evil is without good

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Introduction

Pre-packaged insolvency proceedings have been with us for some time now, but in the last decade or so the number of pre-packaged proceedings has increased dramatically across many jurisdictions in the European Union. From a debtor's perspective prepacks can be attractive for a wide range of reasons, for instance the process is quick, secret and inexpensive. On the other hand, from an apprehensive creditor's perspective, a variety of concerns arise primarily due to the lack of transparency of the process. However, notwithstanding the criticisms and concerns prepacks have repeatedly received support and ultimately validation as a helpful rescue tool.

In light of prepacks having been widely adopted by a number of European jurisdictions as a rescue tool, the aim of this paper is to provide a comparative analysis of the approach towards prepacks. The paper will consider the different approach adopted in the very creditor-friendly UK and compare it with the approach taken in the Netherlands. Particular emphasis will be placed on the role of secured creditors in the prepack process, banks in particular.

Moreover, the paper will briefly examine whether prepacks are proving to be a useful social policy tool. With particular regard to the UK, it could be argued that the preservation of employment and as a result the greater social prosperity is the explanation behind the support of prepacks. A comparison will then be drawn with the Dutch prepack regime and the paper

shall assess whether or not preservation of employment is also a driving force behind the increased endorsement of the prepack practice.

The rise of prepacks in the United Kingdom

In the United Kingdom prepacks fall within the context of administration proceedings. A prepack administration involves a pre-arranged sale of the distressed business, which will be executed immediately after the formal appointment of the administrator.

The Enterprise Act 2002 (hereafter EA)¹ strengthened the rescue ethos of the United Kingdom by streamlining the administration procedure and effectively making it a key restructuring tool. In particular, the Enterprise Act introduced revolutionary changes to what was previously a time-consuming, expensive and complex administration procedure. The Act contains a series of reforms designed to make administration an attractive restructuring device.

However, it is important to note that the Enterprise Act does not make specific reference to prepacks. Instead prepacks developed as a market technique to promote corporate rescue, but no legislation is directly applicable to them. A prepack typically involves a sale of a distressed business, seamlessly prepared outside of formal administration proceedings, which is executed immediately after the formal appointment of an administrator.

As previously stated, a prepack sale, albeit not expressly regulated by the relevant legislation, nevertheless falls within the context of administration proceedings. It is therefore important at this stage to provide a brief analysis of the applicable law.

¹Pursuant to the Enterprise Act 2002, Part II of the IA 86 has been replaced and a new Part II was inserted in its place, which gives effect to an additional Schedule B1.

The law regulating prepack administration proceedings:

A significant change introduced by the EA is the fact that it makes provision for two ‘out of court’ routes to administration. Under the old law, an administrator could only be appointed by an order of the court, on a petition by the company, its directors or any creditors.² However, under the EA 2002, a company is able to enter administration not only by means of a court order but also by a) an appointment by a floating charge holder or b) an appointment by the company or its directors.

The EA 2002 enables the holder of a floating charge to appoint an administrator, provided that their security has become enforceable³ and that their security interest relates to the whole or substantially the whole of the company’s property.⁴ The power to make an appointment must be specified by the instrument creating their security.⁵ The second gateway to administration is by virtue of an appointment by the company or its directors. It could be argued that, although directors can often be held responsible for the company’s difficulties, nonetheless, the rationale for granting them expedited appointment rights is to provide incentives (in the form of ‘sticks and carrots’) for them to take drastic action, when the company is in crisis.⁶ It is noteworthy that, although the floating charge holder does not initiate this process, he is still given the opportunity to appoint his own administrator, unless the court thinks otherwise.⁷ In addition, the floating charge holder must receive at least five days’ notice of the company’s intention to appoint an administrator⁸ and no appointment may

²Section 9(1), Insolvency Act 1986.

³ Paragraph 16, Schedule B1, Insolvency Act 1986.

⁴ Ibid, paragraph 14 (3).

⁵ Ibid, paragraph 14 (2).

⁶ J. Armour, & R. Mokal, “Reforming the Governance of Corporate Rescue: The Enterprise Act 2002” (2005) *Lloyd's Maritime and Commercial Law Quarterly*, pp28-64, at p. 32.

⁷ See paragraph 36, Schedule B1 Insolvency Act 1986.

⁸ Ibid, paragraph 26 (1).

be made until the notice period has expired or until the floating charge holder gives his written permission.⁹

A remarkable change introduced by the EA is with regards to the purpose of administration.¹⁰ The administrator must hierarchically perform his functions with the objective of ‘a) rescuing the company as a going concern, b) achieving a better result for the company’s creditors as a whole than would be likely if the company were wound up or c) realizing property in order to make a distribution to one or more secured or preferential creditors’.¹¹ Additionally, the administrator must perform his functions ‘in the interests of the company’s creditors as a whole’¹² and as ‘quickly and efficiently as is reasonably practicable’.¹³ In exercising his functions, the administrator acts as the company’s agent.¹⁴ Upon his appointment, the administrator has the power to do anything necessary or expedient in relation to the management of the affairs, business or property of the company.¹⁵ For instance, he may challenge undervalue transactions, preferences, extortionate credit transactions and certain floating charges.¹⁶

Further, the EA 2002 affords creditors enhanced participation in the administration proceedings. The Act requires the administrator to submit a statement of proposals for achieving the purpose of administration,¹⁷ which must be accompanied by an invitation to an

⁹ Ibid, paragraph 28.

¹⁰ Phillips and Goldring argue that “this provision makes it expressly clear that administration is first and foremost about rescuing the corporate entity”, M. Phillips & J. Goldring, “Rescue and Reconstruction” (2002) 15(10) *Insolvency Intelligence*, pp. 75-76, at p.76.

¹¹ Paragraph 3(1) a-c, Schedule B1, Insolvency Act 1986.

¹² Ibid, paragraph 3(2).

¹³ Ibid, paragraph 4.

¹⁴ Ibid, paragraph 69.

¹⁵ Ibid, paragraph 59 (1).

¹⁶ See sections 238,239,244 and 245, Insolvency Act 1986, respectively.

¹⁷ Paragraph 49 (1), (3) & paragraph 49(4), (5), Insolvency Act 1986, which states that a copy of the proposals must be sent to all the members it applies to, no later than the end of 8 weeks from the commencement of administration.

initial creditors' meeting.¹⁸ However, no such meeting is necessary where the administrator believes that a) the company has sufficient property for each creditor to be paid in full,¹⁹ b) that the company has insufficient property to enable a distribution to be made to unsecured creditors other than by virtue of the statutory ring-fencing of fund for unsecured creditors,²⁰ or c) that none of the objectives for which the administration process was initiated can be achieved.²¹ Upon consideration of the proposals, the creditors can either approve or reject them. Additionally, the creditors may approve the proposals with modifications. However, the administrator must consent to each modification.²² Subsequently, if the administrator approves the proposed modifications and believes that they are substantial, he must call for a further meeting, where he will present the revised proposals or report any decisions to the creditors, and then report the matter to the court.²³ It should be pointed out that the requirement for administrators to set out proposals, which are in turn to be approved by the creditors at the creditors' meeting, is designed to enhance creditor participation in the re-organisation process. However, the objective of this requirement is arguably undermined by pre-packaged administrations, as, where such proceedings are involved, it is possible for the administrator to effect a prepack disposal of the company's business, or a substantial part of it, prior to a creditors' meeting.²⁴

Furthermore, although the administrator will consult with the company's secured creditors prior to a prepack (in fact it is impossible to give effect to a prepack sale without the bank's support), it could be argued that the rights of less powerful creditors will be overridden.

¹⁸ Ibid, paragraph 51(1), also 51(2) states that the meeting must be held as soon as is reasonably practicable but not later than the end of 10 weeks from the commencement of the administration process.

¹⁹ Paragraph 52 (1) (a), Schedule B1, Insolvency Act 1986.

²⁰ Ibid, para. 52 (1) (b).

²¹ Ibid, para. 52 (1) (c).

²² Ibid, para. 51(3).

²³ Ibid, para 54.

²⁴ A more detailed analysis of the pre-packaged administration technique and criticism over its use is offered below.

Frisby identifies that creditors' rights of participation are subjugated to commercial considerations in a prepack situation, and acknowledges that there is a strong possibility that the commercial advantages of a prepack, in the form of enhanced consideration for the business and a reduction in the costs of selling it, will probably not inure to the advantage of those creditors who are excluded from the decision-making process.²⁵

As mentioned earlier, the prepack is a restructuring method, whereby a sale is seamlessly prepared outside of formal insolvency proceedings, with a primary aim to preserve value. However, although the popularity of prepack has risen dramatically, the use of the procedure has not been free from criticism. In particular, it could be said that a significant criticism of the prepack process relates to the extent of control exerted by secured creditors, which arguably is not in line with the objectives of the Enterprise Act. An analysis of some of the key criticisms is offered below.

Prepacks and the role of secured creditors in the process

One of the key changes introduced by the Enterprise Act is the virtual abolition of the administrative receivership procedure, with the objective of replacing a somewhat 'selfish' proceeding with a somewhat more collective administration procedure. In other words it is no longer possible for a floating charge holder to appoint a receiver, who would primarily act in the interests of his appointor. Instead, following the reforms introduced by the Enterprise Act, the aim of which is to promote a more collective approach towards insolvency, the floating charge holder has an option to make an out of court appointment of an administrator,²⁶ whose

²⁵ S. Frisby, "Report on Insolvency Outcomes" (2006), p.72. Available at: <<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/InsolvencyOutcomes.pdf>>.

²⁶ Paragraph 14(1), Schedule B1, Insolvency Act 1986.

statutory duty to perform his functions in the interests of the company's creditors as a whole.²⁷

It could be argued that although the legislature's intention was to promote a more collective insolvency procedure than administrative receivership, the manner in which prepack administration operates in practice is such that it closely resembles the administrative receivership procedure, effectively reviving the abolished procedure. In particular, some critics argue that prepacks have effectively replaced administrative receivership, as the procedure of choice for the secured lender as appointor.²⁸

The aim of the Enterprise Act to promote corporate rescue and a collective approach towards insolvency is clearly reflected in paragraph 3 of Schedule B1 IA 86, where it is stated that 'the administrator of a company must perform his functions hierarchically with the objective of –

- (a) rescuing the company as a going concern, or
- (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
- (c) realising property in order to make a distribution to one or more secured or preferential creditors.

Therefore, with particular regard to the statutory purpose of administration, it could be argued that prepacks defy the intentions of the Act, as with a prepack the emphasis is no longer on rescuing the company as a going concern. Instead, since as part of a prepack sale an agreement to sell the business is concluded prior to the administrator's formal appointment, it could be argued that a prepack fails to achieve the primary objective of administration. It is

²⁷ Paragraph 3(2), Schedule B1, Insolvency Act 1986.

²⁸ S. Davies, "Pre-pack" (2006) *Recovery* (Summer) 16.

therefore apparent that the prepack is designed to achieve either the second or third objective of administration, where the emphasis shifts to the protection of the secured creditors' interests.

Although it appears that prepacks undermine the statutory objectives of administration in practice and that the significant control exercised by secured lenders is retained post Enterprise Act, one could nevertheless argue that prepacks could in the right circumstances constitute the most appropriate course of action. For instance, in circumstances where an insolvent company cannot be sold as a going concern, the prepack constitutes a great 'value-preservation' tool, as it facilitates a discreet and quick sale of the business.²⁹ In particular, the prepack could prove to be a very valuable tool where a business has a strong brand or intellectual property, the value of which could decrease dramatically by even a hint of a formal insolvency.³⁰ Furthermore, a prepack minimises the erosion of customer confidence, reduces any damage to relationships with key employees, especially in service based companies.³¹

Whilst there is a clear advantage to be gained from concealing the troubles of a company from the general public, where a prepack sale is involved, looking at the process from an apprehensive unsecured creditor's perspective, it could be said that the lack of transparency within the prepack process makes it very difficult to determine how a deal was struck (arguably, the prepack-sceptic unsecured creditor is predisposed to believe that secrecy translates into a willy-nilly arrangement to benefit the secured creditors) and whether the administrator has properly conducted all the necessary enquiries as well as complied with his

²⁹ The sale is negotiated and prepared prior to entering into formal administration proceedings and is executed immediately after the appointment of the practitioner. Therefore the process is quick and confidential and as a result the value of the business assets is preserved.

³⁰ M. Ellis, "The thin line in the sand: pre-packs and Phoenixes", (2006) *Recovery* (Spring) 3.

³¹ Davies, see note 28 above.

statutory duties.³² Furthermore, whilst unsecured creditors would be kept in the dark, a prepack cannot be completed without the involvement of the secured creditors, often banks or other financial institutions. The debtor needs the secured creditor to provide a release on the encumbered assets or else they cannot be sold. The creditors on the other hand need the administration procedure to take recourse on their secured assets. Therefore, the secured creditors are always involved in the process, whereas unsecured creditors are not.

However, it is submitted that banks benefit from successful prepack proceedings and have interest to ensure that there has not been an abuse of process. In addition, although safeguards (such as the Statement of Insolvency Practice 16) are in place, so as to ensure that insolvency practitioners act in accordance with their duties, it is rather unlikely that an administrator would willingly jeopardise his reputation (and hence his livelihood) and risk losing his licence, so as to benefit a particular creditor.

Furthermore, although prepacks appear to be a ‘controlled way forward’ for banks, one could argue that banks are very well-placed, due to their experience and vast range of resources, to provide advice on the viability of a rescue business plan and to positively influence the outcomes of a prepack administration proceeding.³³ It is submitted that banks benefit from successful prepack proceedings and have interest to ensure that there has not been an abuse of process.

The lack of transparency which surrounds prepack administration gives rise to further criticisms relating particularly to the marketing and the valuation of the business prior to a sale. It could be argued that a proposed prepack sale is not subjected to the competitive forces of the market, which ultimately is likely to lead to the business or assets within the business

³² Importantly, the administrator must perform his functions in the interests of the company's creditors as a whole and as quickly and efficiently as is reasonably practicable.

³³ In particular the London Approach suggests an influence on restructurings dating back to the 1970s.

being sold at a value significantly lower than it would, had it been properly exposed to the market for an appropriate period. With particular regard to instances where the sale of the business is to a connected party, even where the deal offered by the connected party is the best one available in all the circumstances, unsecured creditors in particular perceive the sale to be inherently unfair. The Graham Report,³⁴ which offered an overview of the criticised prepack elements and proposed reforms to improve the procedure, suggested that the creation of a ‘pool of independent experts’³⁵ would effectively address problems raised by the limited marketing of the business and would provide extra checks and balances to the process. The Graham report recommends that in connected sales, the connected party should voluntarily take the opportunity to present outline of the deal, together with the reasons why it is necessary to proceed in a particular way to an independent member of the ‘pool’ prior to administration. This would create independent scrutiny of the sale, whilst retaining the much desired secrecy before the event. Nevertheless, it could be argued that the creation of a pool of experts only partly addresses the issue of limited marketing of a business, as it only applies to the case of a sale to a connected party. In addition, in the case of connected sales, it remains to be seen as to whether or not the creation of a pool of experts will operate effectively or instead add to the existing ‘comply or explain’ bureaucracy insolvency practitioners are faced with. Finally, one has to question whether the Graham report recommendation will serve its genuine purpose or simply amount to a mechanism that alleviates insolvency practitioners from liability.

The Dutch pre-pack: an alternative on the rise?

³⁴ T. Graham, ‘Graham Review into Pre-pack Administration June 2014’, Report to the Honourable Vince Cable MP.

³⁵ The ‘pool of experts’ became operational on 2 November 2015.

As part of the revision of the Dutch Insolvency Act, the Dutch have introduced a legislative framework for their prepack practice in the *Wet Continuïteit Ondernemingen I*.³⁶ The Dutch prepack derives from English practice, but is different on many levels.

In the Netherlands the prepack falls within the context of the “faillissements” procedure (hereafter: liquidation), which focuses on the winding up of the company. However, in practice the liquidation procedure is also used as the most important instrument for the reorganisation and continuation of businesses in financial difficulties.³⁷ A big advantage of this procedure can be found in the rules governing employment contracts. Importantly, since the liquidation procedure is aimed at the winding up of the company, the Acquired Rights Directive (hereafter: ARD)³⁸ excludes the automatic transfer of employment contracts upon the transfer of the business.³⁹

Though at first sight the Dutch Insolvency Act (hereafter: ‘DIA’) does not seem very rescue-orientated, the liquidation procedure can be used quite effectively for restructuring purposes. The liquidation procedure gives two possible routes for the continuation of the business or company. First there is an option for liquidation compositions. The liquidation composition must be offered to all ordinary creditors who can adopt the proposal by a simple majority that together represent at least half of the debts.⁴⁰ The proposal often consists of an offer to partially pay the debts after which the total amount of these debts will be discharged.⁴¹ A major advantage of this procedure is the court approval and the binding on a dissenting minority of ordinary creditors. After the court approval the liquidation procedure comes to an end without liquidating the company (Article 161 DIA). Therefore, the liquidation

³⁶ Kamerstukken II 2014/15, 34 218, 2.

³⁷ N.E.D. Faber and others (eds), *Commencement of Insolvency Proceedings* (2012, Oxford University Press, Oxford), p. 427.

³⁸ 2001/23/EC of 12 March 2001.

³⁹ Article 5 (1) ARD; Article 7:666 section 1 Dutch Civil Code (hereafter : ‘DCC’).

⁴⁰ Articles 138 and 145 DIA; an exception can be made under the conditions mentioned in Article 146 DIA.

⁴¹ Groenewegen and Van Buren-Dee, *Tekst & Commentaar Insolventierecht* (2014, Kluwer, Deventer), art. 138 DIA, aant. 4.

composition gives the possibility to restructure the debts within the same legal entity.⁴² However, these liquidation procedures are used very rarely in practice. The fact that the composition only works against the unsecured creditors is a major drawback.⁴³

The second route involves the asset transaction in liquidation, also known as ‘restarts’. The Dutch prepack derives from such restarts. As part of a restart the assets of a company are sold followed by the liquidation of the corporate entity as an ‘empty shell’.⁴⁴ The big advantages of this asset sale by the trustee are the speed of the procedure and the privacy of the sale.⁴⁵ In contrast to the composition plan, the asset sale does not require public voting at a creditors’ meeting. The consent of the supervisory judge is required and so is the permission of key secured creditors to sell the encumbered assets which are secured by their security rights.⁴⁶ Most restarts of business are based upon these asset transactions followed by liquidation.

The lack of transparency that surrounds the prepack process is often criticised both in the UK and the Netherlands. Particularly, the concerns in the UK are focussed on ‘connected party sales’, the potential conflict of interest of an insolvency practitioner, as well as the lack of involvement of the unsecured creditors. Instead, in the Netherlands the main concern has been the applicability of the ARD.

As part of the proposed Dutch prepack, a debtor who approaches insolvency, but is not yet insolvent,⁴⁷ can request the court to appoint an intended trustee. This intended trustee is an insolvency practitioner who is likely to be appointed as trustee in case of impending

⁴² J.A.A. Adriaanse, *Restructuring in the shadow of the law: Informal reorganisation in the Netherlands* (2005, Kluwer, Deventer), p.16.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ L. Kortmann, “Improved pre-packs: going Dutch”, (2012) *Corporate Rescue and Insolvency*, p. 225.

⁴⁶ Ibid, p. 226.

⁴⁷ Proposed article 363 sub 1 DIA; The debtor may not yet be insolvent since he has to be able to pay the salary of the intended trustee as well as the debts that fall due in short term.

liquidation proceedings.⁴⁸ Following the debtor's request, it must be proven that the appointment of the intended trustee will provide "added value". Added value can be shown in at least two cases: when the debtor can show that the preparation by an intended trustee can limit the damage for the stakeholders in the case of a potential liquidation procedure, or when he can show that the preparation in secrecy can increase the value and job preservation to such an extent that this preservation outweighs the fact that the preparation is conducted in secrecy and lacks certain aspects of transparency.⁴⁹ Where the court is convinced that added value is present, an intended trustee can be appointed for a maximum of two weeks.⁵⁰ Furthermore, the court can make the appointment of the intended trustee subject to certain conditions, such as the involvement of the representatives of the employees or the unions.⁵¹

The role of unsecured creditors in prepacks

In most prepacks unsecured creditors are 'out of the money' and receive very little, if anything at all, from the empty shell distributions.⁵² The statutory priority of claims in respect of distributions in insolvency places the unsecured creditors almost at the bottom of the list both in the UK and the Netherlands.

In the Netherlands the intended trustee and the intended supervisory judge are involved in the process to supervise the debtor and ensure that the interests of the unsecured creditors and employees are not neglected.⁵³ Since most of the creditors are not involved in the preparation process, the responsibility on the intended trustee and intended supervisory judge is even

⁴⁸ Proposed article 363 sub 1 first sentence DIA.

⁴⁹ Proposed article 363 sub 1 third sentence DIA.

⁵⁰ Proposed article 363 sub 3 DIA. For the extension of the period the debtor has to prove once again that the appointment will have added value. Before the extension of the period, the court will hear the intended trustee and the intended supervisory judge.

⁵¹ Proposed article 363 sub 4 DIA; *Kamerstukken II* 2014/15, 34 218, 3, at 14 (MvT).

⁵² 'Out of the money' meaning that after the expenses and return to the preferential and secured creditors, there will be no return for the unsecured creditors.

⁵³ *Kamerstukken II* 2014/15, 34 218, 3, at 7 (MvT).

greater than would be in the event of an ‘ordinary’ liquidation procedure.⁵⁴ The intended trustee and intended supervisory judge must ensure that the interests of all affected parties are taken into account and this is very significant as unsecured creditors and employees are not involved in the process. In addition to the interests of creditors as a whole, the intended trustee should keep in mind the ‘interest of the society as a whole’, which could include preservation of employment knowledge and the productivity.⁵⁵

The role of secured creditors in prepacks

Secured creditors have a very significant role to play in the prepack process both in the UK and the Netherlands. However, neither the Graham Report nor the Dutch proposed legislation explicitly examine the role that might be played by secured creditors in a prepack.⁵⁶

It has been argued that it is the degree of certainty and control for the secured creditors in a prepack that makes the procedure so attractive and successful.⁵⁷ It could be argued that, as long as key lenders, such as the banks, do not suffer too much from the insolvency of the company, they are quite keen on keeping the lending in place for the NewCo.⁵⁸ It stands out that most of the critical literature is focused on the lack of transparency or the role of the unsecured creditors and it seems that the role played by the secured creditors is relatively untouched.

Contrary to the position in the UK, an out of court appointment of an intended trustee is not possible in the Netherlands. This could indicate that there might be less influence of the secured creditors on the insolvency practitioner. Moreover, the Dutch proposed prepack

⁵⁴ Ibid.

⁵⁵ Ibid, p. 18.

⁵⁶ ‘Secured creditors’ and ‘banks’ will be used as exchangeable terms from here on.

⁵⁷ S. Harris, “The Decision to Pre-Pack” (2004) *Recovery* (Winter), p. 27.

⁵⁸ W.E. Moojen, “Banken ook bij pre-pack bepalend voor uitkomst” *FD* 18 September 2014.

cannot be commenced by any party other than the debtor himself.⁵⁹ However, this does not necessarily mean that the banks will not have influence in the process. The banks in the Netherlands that have security rights on the assets of the debtor will have a position as a ‘*separatist*’ in liquidation procedures.⁶⁰ This essentially means that, at any moment of default, either during or outside liquidation, the pledgees and mortgagees may exercise their rights as if there was no liquidation procedure.⁶¹ They may exercise these foreclosure rights without having to obtain a court approved enforcement order. This provides the secured creditor with a very strong bargaining position, since the debtor and trustee will always have the threat of the secured creditor taking recourse at the assets when the debtor is in default. The secured creditor thereby has the possibility to block the going concern sale of the business.⁶² Moreover, post-petition financing shall only be provided by these banks if they are optimistic about the continuation of the business. Therefore, it can be argued that there is in fact little power in the hands of the debtor or the trustee.⁶³ It should be noted that the banks are within the group that have expressed their support in the development of the Dutch prepack.⁶⁴

It has been stated that the reason that banks have so much influence is that the Dutch as well as the English businesses are often over-collateralised.⁶⁵ The process of over-collateralisation essentially entails the posting of more collateral than is needed to obtain or secure financing. Therefore, the banks will have security on (almost) everything owned by the debtor and when the insolvency of a debtor occurs, it is the secured creditor who obtains almost everything and very little, if any, is left for the unsecured creditors. Banks often prefer to provide the NewCo

⁵⁹ It is of course possible that banks will exercise pressure on the debtor to start a procedure.

⁶⁰ Article 57 DIA.

⁶¹ Articles 3:248; 3:268 DCC and Article 57 DIA.

⁶² J.M. Hummelen, “Het verkoopproces in een pre-packaged activatransactie” (2015) 2 *TvI*, p. 14.

⁶³ J.H.S.G.K. Timmermans, ‘De curator en het boedelkrediet’ in: J.G. Princen and A. van der Schee (eds), *De ondernemende curator* (2011, Kluwer, Deventer) p. 68.

⁶⁴ M.H.F. van Vught, “De Nederlandse pre-pack: time-out, please!” (2014) 1 *F.I.P.* 26, p. 26.

⁶⁵ Moojen, note 58 above.

with credit when this offers perspective that their full loan will be repaid in the future. With the intensive care departments of banks, permanent control is kept on the loans and finance of the debtors. It can be questioned what the consequences of these high stakes and over-collateralisation are for the influence of the banks in the prepack.

An essential part of the prepack in both the UK and the Netherlands is the continuation of finance after the liquidation or administration procedure has started. It seems that, as long as the banks receive (almost) all of their outstanding credit out of the business sale, they are willing to continue financing in the NewCo.⁶⁶ Without this new credit from either the secured creditor or a new investor, the NewCo will be doomed to fail. It has been argued that, because the banks are willing to continue the financing as long as their debts are fulfilled, the purchaser will be able to buy the assets at ‘rock-bottom’ value and nothing will be left for the unsecured creditors.⁶⁷ As long as a purchaser is found and the secured creditor is satisfied, it is likely that insolvency practitioner will agree with the sale.⁶⁸

If one compares the position of the separatist in the Netherlands to the floating charge holder’s in the UK, it can be argued that the Dutch secured creditors have a more powerful position. The Dutch secured creditors may simply ignore the liquidation procedure and enforce their foreclosure right without using the court or a formal insolvency procedure.⁶⁹ However, there is the possibility of a moratorium for the maximum period of four months ordered by the supervisory judge.⁷⁰ In this period the secured creditors will not be allowed to take recourse to the assets of the debtor without the approval of the supervisory judge. In

⁶⁶ C. Mallon and S.Y. Waisman (eds), *The Law and practice of restructuring in the UK and US* (2011, Oxford University Press, Oxford), pp.237-238.

⁶⁷ Moojen, note 58 above.

⁶⁸ *Ibid.*

⁶⁹ Article 57 DIA.

⁷⁰ Article 63a DIA.

neither of the jurisdictions the prepack can be executed without the release of the banks. In the UK, the enforcement of the floating charge has to be executed via the administration procedure, giving the banks a major degree of leverage in both jurisdictions. One could say that the banks in the UK have a major influence on the prepack since an out of court administrator is often appointed at the prompting of the banks. However, the banks strive to avoid being directly associated with a failed company. Therefore, it will most likely be the company or directors that appoint the administrator, *albeit* at the prompting of the banks. In the Netherlands on the other hand, the banks have a very strong position and a lot of influence in the process as separatist. However, the court, intended supervisory judge and intended trustee are involved in the procedure to provide the necessary checks and balances. However, in general, the blessing of the banks is required in both jurisdictions since the secured creditors have to release their assets for the sale. Therefore, a prepack seems to be impossible in the UK as well as the Netherlands without the blessing of the secured creditors.

It has been argued that the fact that under the proposed Dutch legislation it is the debtor, and no one else who can request for the appointment of an intended trustee, can be seen as an advantage over the English procedure.⁷¹ Where the English out of court appointed administrator might create the perception of a bias towards the secured creditors or management, the Dutch intended trustee is court appointed and subject to control of the intended supervisory judge. This difference in manner of appointment and the degree of court control can create the perception that the Dutch intended trustee is less biased. However, the secured creditor will always be at the table together with the debtor, purchaser and insolvency practitioner.⁷² Neither in the UK nor in the Netherlands the position of the secured creditor is subject to much discussion at the moment. The qualified floating charge holder in the UK has

⁷¹ P.J. Frölich, “Redding en sanering: monomaan of modern paradigma? Over de pre-pack en dergelijke” (2015) AA 192, p. 197.

⁷² J.M. Hummelen, “Het verkoopproces in een pre-packaged activatransactie” (2015) 2 TvI, p. 14.

an important role to play through the out of court appointment of the administrator and the post-petition financing of the debtor. The Dutch secured creditors will always be involved at a certain stage of the process since they have the possibility to take recourse on the assets at any moment of default. Without the consent of the banks, there is no way the debtor will be able to sell the assets, let alone the business in a prepack. The first and far most reason being that in both jurisdictions the secured creditor has to provide a release in respect of the assets being sold.⁷³ In combination with the over-collateralisation, this means that the bank will have to provide a release on (almost) all assets of the debtor. Therefore, the banks will always be involved in the process.

It seems that it is in fact ‘he who pays the piper that calls the tune’.⁷⁴ The prepack provides the banks with an assured return and a high level of influence in the procedure.⁷⁵ It can be argued that banks exert significant control over prepack sales and it is highly unlikely that a sale could be given effect in the absence of the secured creditors’ support.⁷⁶ Nevertheless, as argued above, although banks have a vested interest to ensure that a prepack sale is successfully completed; at the same time it is in their best interests to ensure that there is no abuse of process and that the legality of the prepack process shall not be questioned.

A comparison of the Anglo-Dutch prepack

The economic crisis has prompted a move towards a more debtor friendly oriented insolvency regime in the European Union. The concept of rescue itself is being revisited⁷⁷ and business rescue is ranked at the top of the European insolvency law related agenda. The

⁷³ C. Mallon and S.Y. Waisman, see above note 66, p. 232.

⁷⁴ S. Davies, note 28 above.

⁷⁵ A. Kastrinou, “An analysis of the pre-pack technique and recent developments in the area” (2008) *Company Lawyer*, p. 262.

⁷⁶ P. Walton, “Pre-packaged administrations – trick or treat?” (2006) 19 (8) *Insolvency Intelligence*, p.121.

⁷⁷ P.J. Omar, “Upstreaming rescue: pre-insolvency proceedings and the European Insolvency Regulation” (2014) 25(1) *International Company & Commercial Law Review*, p. 20.

European Commission published a recommendation on a new approach to business failure and insolvency ‘to encourage Member States to put in place a framework that enables the efficient restructuring of viable enterprises in financial difficulty’ and to ‘give honest entrepreneurs a second chance’.⁷⁸ The Dutch have followed this route set out by the European Union and are moving their insolvency regime from the traditional ‘pay what you owe’ towards ‘business rescue’ by introducing the prepack in their insolvency regime.⁷⁹ With the prepack, the Dutch are introducing a procedure that is already heavily criticised in the country of origin.

A prepack procedure in the UK cannot be completed without the involvement of the secured creditors, often banks or other financial institutions. The debtor needs the secured creditor to provide a release on the encumbered assets or else they cannot be sold. The creditors on the other hand need the administration procedure to take recourse on their secured assets. Therefore, the secured creditors are always involved in the process. A ‘prepack pool’ comprised of independent experts, as recommended in the Graham Report, might provide extra checks and balances to the process.⁸⁰

The Dutch prepack is essentially an adapted version of the asset transaction in liquidation, also known as a ‘restart’. In the practice of an ordinary restart, the debtor will prepare the sale of the business, together with his own advisors, before filing for “faillissement”. In the proposed prepack, the debtor has the opportunity to formally involve an intended trustee and

⁷⁸ All the EU member states were invited to implement the principles of the recommendation. In the evaluation of this recommendation of the 30 September 2015 the Member States were asked to communicate to the Commission, on a yearly basis, data concerning the insolvency procedures. This evaluation can be found on <http://ec.europa.eu/justice/civil/files/evaluation_recommendation_final.pdf> last accessed: 22 March 2016.

⁷⁹ P.J. Frölich, “Redding en sanering: monomaan of modern paradigma? Over de pre-pack en dergelijke” (2015) AA 192, p. 193.

⁸⁰ L. Conway, House of Commons Briefing Paper January 2016, p. 3.

an intended supervisory judge in the process of preparing the business sale.⁸¹ Since the intended trustee and intended supervisory judge are involved early in the preparation, they will not be confronted with a prepared asset transaction at the moment of the formal appointment as trustee and supervisory judge in liquidation.

The Dutch intended trustee is court appointed and therefore it can be argued that his independence is guaranteed.⁸² The appearance of a biased trustee might therefore not, or at least to a lesser degree than in the UK, be part of the Dutch procedure. However, the Dutch secured creditors do have a powerful position in the prepack because of their position as *separatist*. The secured creditors in the Netherlands can take recourse to their encumbered assets as if there is no liquidation procedure. To protect the intended trustee and the debtor from the powerful secured creditors, the Dutch intended trustees are appointed by the court and the secured creditors do not have influence on the appointment itself or on the person who is going to be assigned as intended trustee. The intended trustee is supervised by the intended supervisory judge from the moment of appointment and his appointment can be made subject to certain conditions.

Finally, a key difference between the Dutch and the UK prepack is in relation to the protection of employment contracts and in particular, the application of the Acquired Rights Directive (ARD).⁸³ Although it could be argued that it is difficult to facilitate corporate rescue through a prepack and at the same time protect the employees' interests, one of the main justifications in favour of the prepack in the UK is the fact that it often results in the preservation of jobs. In fact, SIP 16 statements cite the preservation of jobs as one of the

⁸¹ *Kamerstukken II* 2014/15, 34 218, 3, at 7 (MvT).

⁸² Frölich, above note 79, p. 197.

⁸³ 2001/23/EC of 12 March 2001.

primary reasons to prepack. Furthermore, in the early case of DKLL⁸⁴ the court expressed its support, or at least accepted that there is a legal justification for the prepack process, primarily because of its effect on preservation of employment. Furthermore, the Graham report⁸⁵ found that in most cases (almost) all jobs are preserved after the use of a prepack.

Although, the prospect of administration or liquidation is rarely well conceived by the employees, it might nevertheless be comforting for English employees that the prepacks do not constitute insolvency proceedings within the meaning of the ARD, effectively meaning that the protection afforded to employment protection rights under the ARD, applies to the prepacks.⁸⁶

The Dutch on the other hand, have taken a different view with regard to the applicability of the ARD on their procedure. Although the best practice rules of Insolad⁸⁷ and the explanatory memorandum also point out the possible preservation of jobs as a justification for the prepack,⁸⁸ the applicability of the ARD was subject to a lot of discussion in the period of drafting the Dutch legislation. It has been argued that the ARD provisions do not apply to the prepack.⁸⁹ Since what will happen to the undertaking (i.e. continuation or dissolution) only becomes apparent *after* the company entered into the liquidation procedure in a prepack procedure, Articles 7:662-7:666 DCC implementing the ARD do not apply to the proposed prepack procedure.⁹⁰

⁸⁴ *DKLL Solicitors v Revenue and Customs Commissioners* [2007] EWHC 2067 (Ch); [2007] B.C.C. 908 (Ch D)

⁸⁵ See note 34 above.

⁸⁶ The ARD was implemented in the UK by means of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006 246).

⁸⁷ Insolad is the Association of Dutch insolvency lawyers.

⁸⁸ *Kamerstukken II* 2014/15, 34 218, 3, at 27-30 (MvT).

⁸⁹ *Kamerstukken II* 2014/15, 34 218, 3, at 34-37 (MvT).

⁹⁰ *Ibid.*

A decision has to be reached in the Netherlands as to whether the procedure is aimed at liquidation *or* at the continuation of the business.⁹¹ In the English administration procedure this distinction only becomes apparent when the administrator declares what statutory objects he is following. Since the outcome only becomes apparent when the proposals are filed, the Court has opted for an ‘absolute’ rather than a ‘fact based’ approach in order to increase the legal certainty and ensure the easy approach of the procedure. It was held in *OTG*⁹² that the line between the procedures aimed at liquidation and at continuation in the UK is a less clear cut than the difference between liquidation and suspension of payments in the Netherlands.⁹³

The UK court chose the ‘absolute’ approach because it is otherwise too difficult to take a ‘fact based’ approach in determining the outcome of every different case.⁹⁴ One could argue that such an absolute approach should also be applied in the Netherlands and that therefore the ARD should not apply to any case of liquidation. However, when one looks at the Dutch liquidation procedure, the ‘fact based’ result will be different from the formal goal of the liquidation procedure in many cases, especially prepacks. Looking at the Dutch practice and the possibilities for a trustee, most of the time the liquidation procedure is the only possibility, within the insolvency laws, to truly achieve corporate rescue. The suspension of payment procedure has not proven to be a successful restructuring mechanism. This does not mean that every time the liquidation procedure is used, it is used to restart the company. It is however not uncommon that the liquidation of the company (the corporate shell) is the result, but the procedure was in fact aimed at the rescue of the business and not the liquidation of the company.

⁹¹ *Ibid.*

⁹² *OTG Ltd v Barke* [2011] B.C.C. 608.

⁹³ The court hereby refers to the *Abels*-case, where the Dutch suspension of payments structure was held to be aimed at the continuation but the Dutch liquidation procedure was not. *OTG Ltd v Barke* [2011] B.C.C. 608 [8.4].

⁹⁴ See note 92 above.

Conclusion

In light of the significantly different treatment of employees' rights in insolvency in the two creditor-friendly jurisdictions, one cannot fail but to consider the possibility of whether or not such critical differences shall put the Netherlands on the map as a worthy competitor of the traditionally attractive and successful UK prepack regime⁹⁵ and whether the inapplicability of the ARD in the Netherlands will result into more restructurings taking place in the Netherlands and in an increase of insolvent companies shifting their centre of main interests there. Arguably, it remains to be seen whether or not the Dutch prepack will prove to be a key competitor of the UK prepack. Without a doubt, the UK has been proven to be a very attractive restructuring destination in the past, so it remains to be seen whether the fact that the Dutch prepack enables the debtor to evade the protection rights afforded to employees under the ARD, will make the Dutch model even more attractive.

⁹⁵ See for instance Hellas Telecommunications, which resulted in the UK's biggest pre-pack administration. Interestingly, the forum shopping of big enterprises towards the UK has been identified by the Graham report as a source of 'inward investment' and, according to Graham, should be perceived as a positive advantage to the economy.