Conflicts of interest - administrators

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Matthew Ditchburn, a member of our panel of property experts, offers advice on pre-pack administration

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My tenant has just gone through a pre-pack sale to the company?s directors. It transpires that the administrator was advising the company before his appointment. How can I be sure that he has acted in the best interests of creditors?

A pre-packaged sale (or 'pre-pack') is one where all or part of the company's business or assets is sold by an administrator immediately on or shortly after their appointment. Negotiations for the sale take place before the administrator is appointed, often without any form of open marketing. The Insolvency Service recently estimated that 25% of all administrations used the pre-pack procedure and 80% of those sales were to existing management or another party connected with the company.

There is nothing unlawful about pre-packs, but an administrator's conduct can be challenged if they have not been used genuinely to further the purpose of the administration, or unfairly harm creditors' interests.

Lack of transparency is one of the major causes of concerns with pre-packs. Creditors, including landlords of insolvent companies, may wonder whether a better price or better terms ? including an agreement by the purchaser to take on more of the company's leasehold liabilities ? could have been achieved if the business had been openly marketed at arm's length.

It is not uncommon for an insolvency practitioner to advise the company in preparing for a pre-pack and then be appointed administrator in order to bring it into effect. Once appointed, the administrator becomes an officer of the court with a duty to act in the interests of creditors as a whole. This creates an obvious tension. On the one hand, the practitioner advises the company, in practical terms meaning the directors. On the other, if those directors buy the business, they have to get the best deal out of them to secure the most favourable result for creditors.

As a safeguard against possible conflicts of interest, Statement of Insolvency Practice (SIP) 16 was introduced by the Joint Insolvency Committee (made up of insolvency practitioners' regulatory bodies and the Insolvency Service) to make pre-packs more transparent and ensure that fair value is obtained for the sale. SIP 16 also provides guidance on how practitioners should conduct pre-packs, requiring them to be clear about the nature and extent of their role and relationship with the company's directors.

Administrators are required to provide creditors with a detailed explanation and justification of why a pre-pack was undertaken to satisfy them that they have acted in their interests. This should include:

- the source of the administrator's initial introduction
- the extent of the administrator's involvement prior to appointment
- any marketing activities conducted by the company and/or the administrator
- any valuations obtained of the business or the underlying assets
- the alternative courses of action considered by the administrator, with an explanation of the possible financial outcomes
- why it was not possible to trade the business, and offer it for sale as a going concern, during the administration
- details of the assets involved and the nature of the sale, including the price and terms of payment
- the identity of the purchaser, including the names of any directors or former directors who are involved in the management of the purchaser.

All creditors of a company going through a pre-pack administration should expect to receive this and other information in compliance with SIP 16 when the administrator first notifies them after appointment. If they are not, then the administrator should be asked to provide it without further delay. A form of questionnaire can be found on the British Property Federation website.

Unfortunately, the latest government figures show that in 32% of cases, information provided by administrators did not fully comply with SIP 16. In 7% of those cases, the breach was sufficiently serious for the practitioner to be referred to their regulatory body to consider disciplinary action. This further undermines confidence in the pre-pack process. The Insolvency Service has considered introducing a three day 'cooling off period' whereby administrators would be required to give creditors advance warning of a pre-pack sale, but this was abandoned. In the latest twist in the saga, the Insolvency Service launched a further review in July this year into how creditor confidence in pre-packs can be improved.

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Further information

Anyone wishing to complain about a pre-pack administration is advised to contact the Insolvency Practitioners Regulation Section of the Insolvency Service, tel: 020 7291 6772.

UPDATE: Conflicts of interest (1st edition, global RICS professional statement) published on 14 March 2017 and is effective from 1 January 2018.