

**Report on the Operation of
Statement of Insolvency
Practice 16**

July - December 2009

Contents

1.0	Executive summary.....	03
2.0	Results of the review.....	04
2.1	Regulation of insolvency practitioners.....	04
2.2	Method and scope.....	04
2.3	Number of pre-pack administrations during the period.....	05
2.4	Insolvency practitioners' compliance with SIP 16.....	07
2.5	Results of previous referrals to the RPBs.....	09
2.6	Further guidance issued to insolvency practitioners.....	09
3.0	Directors' conduct.....	11
3.1	Method and scope.....	11
3.2	Insolvency practitioner reporting under the Company Directors Disqualification Act 1986.....	11
3.3	Complaints received by Corporate Complaints Team.....	13
4.0	Further analysis.....	14

1.0 Executive summary

The Insolvency Service has continued to monitor the operation of Statement of Insolvency Practice 16 (SIP 16) following the publication of our initial report in July 2009. Comprehensive background information was provided in that report concerning the introduction of SIP 16 and the established regulatory mechanisms that are able to deal with misconduct in insolvencies. This report examines compliance with SIP 16 by insolvency practitioners, and the outcomes of enforcement procedures in pre-pack cases.

We have worked closely with the Recognised Professional Bodies during the period to ensure that insolvency practitioners are fully aware of the type of information that we expect to be disclosed in pre-pack cases. This resulted in the issuance of further guidance to all insolvency practitioners in October 2009 which all the Recognised Professional Bodies have agreed to consider when assessing complaints about members' compliance with the SIP.

During the period, we received SIP 16 information in relation to 497 companies where the business or assets were reported as being sold through a pre-pack transaction. Of those, information in relation to 309 companies was found to be fully compliant with the SIP, representing 62% of the total. Of the 188 cases, or 38% found to be not fully compliant, information relating to 36 cases involving 30 insolvency practitioners has been referred to the relevant Recognised Professional Bodies for consideration from a regulatory and disciplinary perspective.

In the majority of cases, the quality and timeliness of information being provided is significantly improved in comparison to the first six months of 2009.

Failure to comply with the SIP does not necessarily imply misconduct in the pre-pack sale itself, a lack of good faith, or failure to act in the best interests of creditors. Conversely, compliant SIP 16 information does not necessarily provide confirmation that a pre-pack transaction was in the best interests of creditors. The SIP is primarily concerned with the disclosure of information with a view to improving transparency.

From the information available, it remains the case that reported directors' misconduct does not appear to be any more prevalent in pre-packs than in conventional administrations.

Whilst it is encouraging to note the improved level of information being provided in the majority of cases, which we believe has led to a greater understanding of pre-packs on the part of creditors and others affected by the process, it is of serious concern that compliance overall did not improve in the latter part of 2009, despite the issue of further guidance.

2.0 Results of the review

The results of the review are divided into two areas: the findings that relate to insolvency practitioners, and those that relate to company directors.

2.1 Regulation of insolvency practitioners

The authorisation regime for insolvency practitioners in Great Britain was introduced by the Insolvency Act 1986, and provides that only individuals can be authorised to act as an insolvency practitioner. Similar legislation exists in Northern Ireland.

The Secretary of State is empowered to recognise professional bodies as being able to authorise and regulate their members to act as insolvency practitioners. These bodies are required to enforce rules to ensure that their members who are permitted to act as insolvency practitioners are fit and proper, and meet acceptable requirements as to education, practical training and experience. The Secretary of State can also directly authorise insolvency practitioners: The Insolvency Service exercises these functions on his behalf.

Each of the recognised bodies carries out regular monitoring visits to ensure that its practitioners are conducting their work in accordance with the guidance and to the required standards. Complaints regarding unprofessional, improper or unethical behaviour by an insolvency practitioner can be addressed to the appropriate authorising body, who will decide if sanctions should be imposed.

All of the bodies have been recognised since 1986 and are collectively referred to as the Recognised Professional Bodies (RPBs).

We would emphasise that The Insolvency Service expects practitioners to comply with the spirit of the SIP, as well as the letter. As with other regulation there is necessarily an element of interpretation in deciding whether the requirements have been met: we attach the highest importance to ensuring that creditors are provided with sufficient information to determine whether the sale of the company's business was in their interests, and our review of the operation of the SIP has been conducted accordingly.

2.2 Method and scope

The Insolvency Service has reviewed information disclosed by insolvency practitioners pursuant to the requirements of SIP 16 in relation to pre-pack administrations undertaken during the latter half of 2009. As indicated above, the primary purpose of SIP 16 is to improve the transparency of the pre-pack process by the provision of timely information to creditors. We have therefore concentrated our review on insolvency practitioners' compliance with the

disclosure requirements contained within SIP 16.

Wherever possible, we have also sought to consider the nature of the underlying transaction in order to inform our understanding of the drivers for pre-pack administrations and the impact on creditors. In assessing the information provided by insolvency practitioners, we have consequently sought to form a rounded view of the disclosures made in light of the particular circumstances of the insolvency as known to us and by reference to the specific requirements, and spirit, of SIP 16. However, given the nature of this type of information the assessment as to whether or not adequate disclosures have been made by insolvency practitioners in any particular scenario is to an extent a subjective test.

Where we have formed the view that the disclosures made by insolvency practitioners are insufficient to give a detailed explanation and justification of the reasons for the pre-pack sale in line with the requirements of SIP 16, we have recorded the information as non-compliant. On occasion we have also written to the insolvency practitioner concerned outlining the reasons for our view and to obtain further information so that we may consider the matter further.

We have also reported a number of insolvency practitioners to their authorising bodies where we believe that the disclosures made are such that they could give rise to concerns about the conduct of the practitioner or where the level of non-compliance is serious and substantive.

2.3 Number of pre-pack administrations during the reporting period

During the reporting period the Insolvency Service has received SIP 16 information from insolvency practitioners relating to 497 companies in administration. This figure includes all companies within group structures where there may be a large number of subsidiary or connected companies. In reality the actual number of business sales reflected by this figure will therefore be somewhat lower. A breakdown of the information received by month is indicated in Figure 1 below.

According to the official insolvency statistics, 1,823 companies entered administration during Q3 and Q4 of 2009, indicating that approximately 27% involved pre-pack sales during the period.

Over the whole of 2009, we have received SIP 16 information in relation to a total number of 1,190 companies in administration. Official insolvency statistics indicate that 4,161 companies entered administration during the year, giving an average percentage of 29% of pre-packs to total number of administrations. This figure remains the most reliable indicator of the number of pre-packs.

We continue to have some concerns that the Insolvency Service is not being sent SIP 16 information in all relevant cases, leading to an under-representation of the extent to which pre-pack sales are being undertaken.

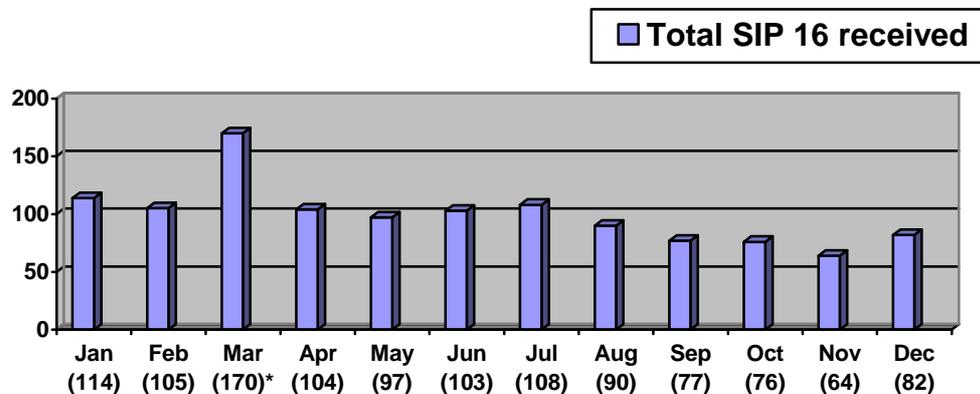
These concerns are based upon the following observations:

- There is presently no statutory or regulatory requirement for insolvency practitioners to send SIP 16 information to the Secretary of State (in practice the Insolvency Service)
- We have received information from third parties in a number of cases relating to pre-pack administrations undertaken during the period where we had not received SIP 16 information from the relevant insolvency practitioner(s)
- There is no statutory definition of what constitutes a pre-pack administration, leading to interpretative differences as to whether or not a business sale has been facilitated in this way

Whilst we are not able to accurately estimate the extent to which we are not being sent SIP 16 information, on the basis of the above it appears reasonable to assume that there is an under-representation of the number of pre-pack sales being undertaken.

Figure 1 indicates the number of companies for which SIP 16 information has been received by month.

Figure 1 - SIP 16 received by month



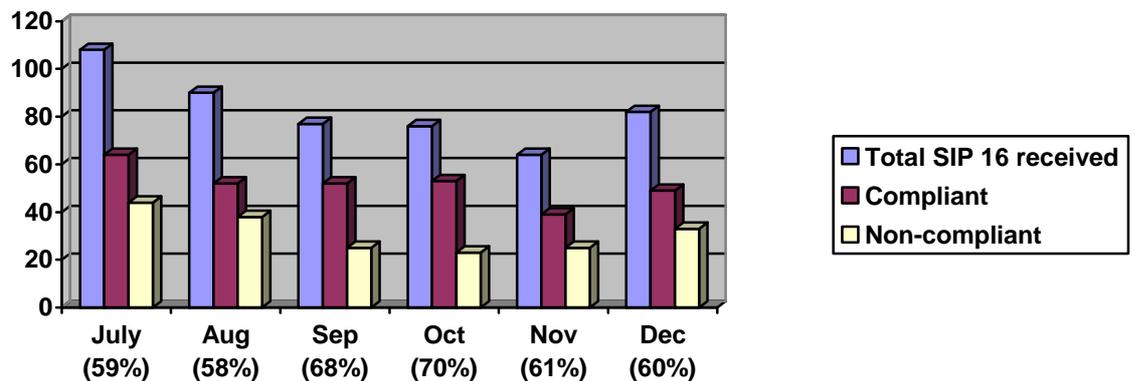
*The figure for March includes two separate group businesses comprising a large number of subsidiary and connected companies, representing 33 of the total.

The figures for January to June have been updated since publication of the last report to reflect the receipt of further SIP 16 reports.

2.4 Insolvency practitioners' compliance with the disclosure requirements of SIP 16

During the period, information relating to 309 out of a total of 497 companies in administration was in our view fully compliant with the disclosure requirements of SIP 16, representing 62% of the total. A breakdown of the information analysed by month is indicated at Figure 2 below.

Figure 2 – Percentage of compliant SIP 16 by month



Where we have formed the view that the nature of a deficient SIP 16 disclosure is serious and substantive, the matter has been reported to the relevant authorising body. This has in most cases been done without prior reference to the relevant insolvency practitioner(s). We have also considered other issues not confined to information disclosure when reporting matters to authorising bodies, such as the timeliness of the provision of information and any third party information, such as complaints.

We have reported 30 insolvency practitioners to their authorising bodies so that their SIP 16 disclosures may be considered from a regulatory and disciplinary perspective. These disclosures relate to 36 companies in administration and represent around 7% percent of the cases reviewed. The number of referrals made to each authorising body in relation to companies entering administration in the final six months of 2009 is indicated in Figure 3 overleaf.

Figure 3 - RPB referrals by Body

RPB (No. of authorised IPs as at 01.01.09)	No. of IPs referred
ICAEW - Institute of Chartered Accountants in England & Wales (679)	9
IPA – Insolvency Practitioners Association (403)	11
ACCA - Association of Chartered Certified Accountants (184)	4
LS - Law Society of England & Wales (151)	-
ICAS - Institute of Chartered Accountants of Scotland (112)	1
SoS – Secretary of State (92)	5
CAI - Chartered Accountants Ireland (45)	-
LSS - Law Society of Scotland (15)	-

The main areas of concern leading to SIP 16 information being marked non-compliant continue to be the issues associated with timing, valuations, marketing and asset details. These aspects were all specifically addressed in the further guidance issued to insolvency practitioners in October 2009, and The Insolvency Service is of the view that what should be disclosed, and when, is now clear.

We continue to receive SIP 16 information that is not being sent to creditors within an appropriate timescale. We believe that for SIP 16 to achieve its purpose of improving transparency it is imperative that creditors are provided with a timely, detailed justification and explanation for the pre-pack. We expect insolvency practitioners to adhere to the further guidance and issue SIP 16 information to creditors within a few days of appointment or upon completion of the sale. SIP 16 information that is sent to creditors more than 14 days after appointment or the completion of the sale without any explanation is therefore deemed to be non-compliant.

We also continue to see cases where insufficient information is provided concerning the valuation and marketing of assets. The nature of the assets and how values have been attributed to them is crucial in forming a proper understanding of the pre-pack transaction. The amounts attributed to the various asset categories, the basis of the valuation and terms upon which the valuer has been instructed are not always disclosed. In addition, the basis upon which substantial allocations are made to goodwill is not always explained.

More generally, in some instances no information is provided as to the nature of the business undertaken by the company or the reasons for it entering a formal insolvency procedure.

These factors are predominant in contributing to SIP 16 information that, taken as a whole, does not provide the detailed justification and explanation required and therefore is considered non-compliant.

2.5 Results of previous referrals to the Recognised Professional Bodies

In our report on the first six months operation of SIP 16, we indicated that 29 insolvency practitioners had been referred to their relevant authorising bodies in order for potential regulatory breaches to be considered. The actions taken by the authorising bodies so far in relation to the complaints made are indicated below:

Insolvency Practitioners Association (IPA)

2 Consent Orders issued with £250 fines and £250 costs
8 Formal reminders of duty to comply with SIP 16 and to focus on paragraph 8 of the SIP
2 Warning letters for failure to comply with reminder to focus on paragraph 8 of the SIP
1 Not upheld – firms procedures for pre-pack issued after appointment with appropriate controls now in place

Institute of Chartered Accountants in England & Wales (ICAEW)

4 Technical breaches – no regulatory action taken as creditors were not significantly misled

Secretary of State (SoS)

1 Upheld. Warning letter issued. To be taken into account when considering future authorisation.
1 Partially upheld. Warning letter issued. To be taken into account when considering future authorisation.

2.6 Further guidance issued to insolvency practitioners

As a result of the findings indicated in our report on the first six months operation of SIP16, we have proactively engaged with the insolvency profession in order to identify those areas where we believe information being provided is insufficient to provide a detailed explanation and justification for the pre-pack transaction.

We have worked closely with the recognised professional bodies resulting in the publication of further guidance to all insolvency practitioners. The guidance gives further details about the type of information that we expect to be disclosed, particularly in relation to valuations, marketing and assets. It also clarifies that in the majority of cases we expect SIP 16 information to be sent to creditors within a few days of the practitioner's appointment or upon completion of the sale.

The guidance is available on The Insolvency Service website in Chapter 1, Article 14 of “Dear IP”, at the link below:

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/dearip/dearipmill/chapter1.htm>

In addition, The Insolvency Service has given a series of presentations to insolvency practitioners around the country at a number of R3 breakfast briefings. The presentations sought to draw attention to the new guidance and provide further details as to the disclosure requirements of SIP 16.

The Recognised Professional Bodies have agreed to have regard to the guidance when considering possible failures to comply with SIP 16 by practitioners authorised by them.

3 Directors' Conduct

3.1 Method and scope

A continuous review of SIP 16 information was also undertaken by the Conduct and Complaints Directorate of The Insolvency Service's Investigations and Enforcement Services in order to identify potential conduct matters in respect of directors. From 1 July to 31 December 2009 594 cases were reviewed and 15 complaints were received in respect of 24 companies, through the Insolvency Service Hotline.

A number of complaints – from creditors, employees and investors – about individual pre-pack cases have also been made direct to the Corporate Complaints Team (CCT) of the Conduct and Complaints Directorate (see 4.2.2 below). These were recorded and reviewed and those that gave rise to apparently legitimate concerns were enquired into further.

To date, the reviews of director conduct carried out by the Conduct and Complaints Directorate have focused on pre-pack sales to connected parties (in practice directors and shareholders). The reviews can be divided into three categories: reviews of SIP 16 information without an accompanying complaint; cases where the review of the information is undertaken in the presence of a complaint about the pre-pack; and reviews of directors' conduct following the insolvency practitioner's report required by the provisions of the Company Directors Disqualification Act.

In addition, complaints about limited companies which offer prospective clients pre-pack facilitation services (an activity which is not in itself 'illegal') but whose advertising literature is, demonstrably, 'inappropriately' worded – usually to give the impression that pre-packs are the best option for dumping the insolvent old company's liabilities whilst ensuring that new company is able to continue the business with the core assets intact – are also carefully reviewed.

3.2 Insolvency practitioner reporting under the Company Directors Disqualification Act 1986

Under the provisions of the Company Directors Disqualification Act 1986 insolvency practitioners acting as administrators have an obligation to report to The Insolvency Service, acting on behalf of the Secretary of State, within six months of the date of the administration order, on the conduct of the company directors. Where potential matters of misconduct have been identified the administrator will report these using a conduct return known as a D1. The Insolvency Service has discretion to investigate the directors of companies in which a D1 return has been submitted.

The administrator may also report that no matters of misconduct have been identified and this conduct return is known as a D2. The Insolvency Service's "Report on the First Six Months' Operation of Statement of Insolvency Practice 16" noted that insufficient time had lapsed between the introduction of SIP 16 on 1 January 2009 and administrations during the period to enable The Insolvency Service to draw any reasonable conclusion as to whether reported director misconduct would be higher in respect of pre-pack administrations than ordinary administrations. However, we have now received a sufficient number of returns relating to administrations during the first six months of 2009 to enable us to review, and draw conclusions from the profile of conduct returns received in both pre-pack and ordinary administrations.

In relation to pre-packs notified to us during the period 1 January to 30 June 2009, The Insolvency Service has received 663 corresponding conduct returns from insolvency practitioners. Of these, 196 were D1s (unfitted conduct) and 467 were D2s (fitted conduct), representing 29% and 71% of pre-pack administrations.

In comparison 2,784 companies entered administration during the period in respect of which 2525 conduct returns have been submitted to The Insolvency Service by insolvency practitioners. D1 submissions for all administrations made total 777 and D2 submissions total 1748, representing 31% and 69% respectively.

Further, the misconduct identified by the D1 returns is not, in the majority of cases, connected directly to the events surrounding the pre-pack itself, but rather is of a nature that is likely to have been evident whether or not a pre-pack had occurred.

Consequently, there is no evidence that the level of reported director misconduct in pre-packs (at least those reported under SIP 16) is any greater than the overall level of misconduct reported by insolvency practitioners generally. Nor is there any evidence in conduct reported by insolvency practitioners to support the view that pre-pack administrations have been cynically manipulated by directors in the vast majority of cases.

In respect of other potential misconduct identified, The Insolvency Service has an established and robust investigations process to target and disqualify directors who may have otherwise abused the privilege of limited liability. The identification and subsequent investigation of enforcement cases necessarily takes some months and at the time of publication, therefore, the investigation of director misconduct in SIP 16 cases is still ongoing. Consequently there are no reported disqualification cases in respect of SIP 16 pre-pack administrations to date.

3.3 Complaints received by Corporate Complaints Team (CCT)

Once a complaint about the conduct of a pre-pack has been considered and accepted for investigation by Corporate Complaints Team (CCT), it is passed to Company Investigations (CI)

CI has responsibility for conducting investigations into companies using the statutory powers of enquiry contained in Part XIV of the Companies Act 1985 (as amended) – specifically section 447 thereof. Although CI has the legal standing to investigate the affairs of companies which are subject to formal insolvency proceedings, for example, a company in administration, its primary function is to use the powers to investigate concerns about the activities of 'live' trading companies.

In relation to SIP16 and pre-pack complaints this means that, in practice, CI is positioned to investigate the affairs of both the old company 'oldco' (i.e. the company now in administration) and the new company 'newco' (being the purchaser of oldco's assets under a pre-pack arrangement).

CI's powers of investigation are discretionary in nature and are exercised where there is 'good reason' in the public interest, thereby providing a basis for targeting the most deserving cases for investigation. The latter include those cases where the directors (however described) responsible for the management of both oldco and newco are, or appear to be, essentially the same persons and where there are indications that the pre-pack sale may have been arranged, or otherwise contrived, to improperly benefit management at the expense of others. This includes cases where there are reasonable suspicions of collusion between a company's directors and the responsible insolvency practitioners appointed as administrators.

In the latter half of 2009 CCT received 50 complaints about pre packs of which 16 (involving 42 companies) have, on review, been identified for further enquiry. Three of these cases have been investigated by CI under the provisions contained in section 447 of the Companies Act. Whilst those investigations have not, to date, given rise to any follow up action which is notifiable i.e. has come into the public domain – for example, the winding up of a company following the presentation of a public interest petition, or the taking of proceedings for the disqualification of one or more of the responsible company directors - regulatory disclosures are under consideration in one, whilst in another the suitability of the grounds for follow up action are currently being reviewed.

Whilst most complainants have raised the possibility of pre packs being approved in dubious circumstances, often following a perceived collusion between the directors and the relevant insolvency practitioners, more detailed enquiry has failed, to date, to substantiate this type of allegation.

4 Further analysis

In order to further inform our understanding of the nature of pre-pack transactions, we have carried out an analysis of the SIP 16 information received in relation to companies entering administration during the reporting period, in respect of:

- Sales to connected parties
- Whether the administrator undertook any marketing
- Whether any element of the sale consideration was obtained on a deferred basis

In relation to the information reviewed, the following was found (figures in brackets relate to the figures for the first six months of 2009):

- **76%** of pre-pack sales were to parties connected with the insolvent company (81%)
- Administrators undertook some marketing in **34%*** of cases (50%)
- An element of the sale consideration was deferred in **69%** of cases (49%)

***does not include marketing that may have been undertaken by the company prior to the involvement of the insolvency practitioner**