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Re Moss Groundworks Limited [2019] EWHC 2825 (Ch)

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Summary

In *Re Moss Groundworks Limited*, the High Court was asked to make an administration order in relation to Moss Groundworks Limited ('MGL') in connection with a proposed pre-pack sale of MGL's assets and business to a connected party. The court declined to make the order on the basis the evidence before the court, in the form of a report from the proposed administrators (the 'Report'), did not explain how the marketing essentials in Statement of Insolvency Practice 16 ('SIP 16') had been complied with.

The court also noted that, even though the proposed sale was to a connected party, there was no suggestion that the 'pre-pack pool' had been consulted, and that on the evidence before the court it was not possible to be satisfied that the case was not an abuse of the administration process.

The case serves as a reminder not to take the court's powers to appoint administrators for granted. It also comes at an interesting time, with the sunset date on government powers to legislate in this area ending on 26 May 2020.

The facts

MGL carried on a business as a civil engineering and groundworks contractor. Historically it had traded profitably, but for about a year before the administration application it recorded losses of about £96,000 on turnover of about £7 million. Following advice from insolvency practitioners (and ultimately the proposed administrators), the directors of MGL concluded that MGL was insolvent and that, without an immediate injection of cash, MGL would have run out of cash after 6 September 2019 (the day after the court hearing).

The court accepted, based on the most recent management accounts and the contents of the Report, that MGL was insolvent. The Report dismissed a going concern rescue of MGL or a CVA, and presented the proposed pre-pack administration as an option that would result in a better outcome for all creditors than the alternative, being a compulsory liquidation.

The proposed administrators' estimated outcomes statement in the Report showed that a compulsory liquidation would see £44,000 realised of MGL's £819,000 book debts, while none of its £219,000 work in progress would be realised. This would result in a deficiency of £1.7 million and, given preferential creditors and finance creditors in relation to plant and machinery, there would be no return to unsecured creditors.

The proposed pre-pack sale, in contrast, would involve the business and assets of MGL being bought by a company which was connected with the directors of MGL for £130,000. Of this, £25,000 would be paid in cash on exchange and £105,000 would be paid a month later. With estimated fees and costs of the administration of £85,000 and about £7,500 of preferential creditors, the dividend to unsecured creditors was estimated to be 1.5 pence in the pound.

The proposed pre-pack sale was presented in the Report as the product of an accelerated M&A process, and the process was reported as having conformed to the marketing essentials as set out in SIP 16.

The judgment

The court rehearsed some of the well-known advantages and disadvantages of pre-packs, in particular referencing *Re Kayley Vending Ltd* [2009] B.C.C. 578, including that:

- a pre-pack process enables a business to be sold quickly with the minimum possible adverse impact from either the public knowledge of its insolvency or the restrictions imposed by the insolvency process itself; and
- the speed and secrecy which give rise to the advantages claim for pre-packs may too easily lead the directors and the insolvency practitioner to arrive at a solution which is convenient for both of them and their interests, but which harms the interests of the general creditors because, among other things, it may not achieve the best price for the assets.

The court went on to note the high level of potential public interest in pre-pack sales, particularly to connected parties, and the important role that SIP 16 plays for an insolvency officeholder in demonstrating that he or she has been acting in the interests of the company's creditors as a whole.

Notwithstanding the purported compliance with SIP 16, the court found that the Report was 'wholly inadequate to explain how those marketing essentials in SIP 16 [had] been complied with'. In particular:

- MGL's business included assets with a book value of in excess of £1 million, which would have been available for unsecured creditors. These assets would be acquired by a company connected to MGL's directors for £25,000 in cash and a promise to £105,000 a month later;
- there was limited explanation as to why book debts and work in progress, with a book value of more than £1 million, were to be sold for £117,000, given there was not intended to be any cessation of trade as a result of the proposed sale (which was the reason for assuming only £44,000 of the book debts would be realised in a liquidation);
- the marketing process had been 'very truncated' (having been advertised on two websites for a maximum of 48 hours) and had only elicited one offer, from a connected party; and
- the proposed pre-pack sale was to a connected party and there was no suggestion that the pre-pack pool had been consulted.

Again referencing *Re Kayley*, the court explained that 'in exercising its discretion in pre-pack cases, the court must be alert to see, so far as it can, that the procedure is at least not being obviously abused to the disadvantage of creditors'.

In light of the points above, the court was not satisfied that the case was not an abuse of the administration process, and therefore refused to make the requested administration order.

The court did however allow an adjournment to give MGL and the proposed administrators the opportunity to reconsider the evidence, the process of marketing which had taken place and their compliance with SIP 16, so that they might satisfy the court that it would be appropriate to make an administration order at a subsequent hearing. The administration application was approved by the court at a subsequent hearing (*Re Moss Groundworks* [2019] EWHC 3079 (Ch)), following further evidence to address the court's concerns raised at the initial hearing. This included further information regarding the need for a truncated marketing process, further valuation evidence and a revised (and SIP 16 compliant) report of the proposed administrators.

The court also reiterated the point, previously made in *Re Hellas Telecommunications* [2010] B.C.C. 295, that in the majority of cases, even if the court were to make an administration order, it is very unlikely that that order should be seen in any way as indicating that the court has blessed the terms and substance of the proposed pre-pack (a point that was also noted in the judgment granting the administration order in the subsequent hearing).

Comment

The case highlights some of the known issues with the use (and sometimes abuse) of pre-pack administrations, and the balancing act the court must undertake when considering whether to exercise its discretion to make an administration order in the context of a proposed pre-pack transaction. It is clear that the court expects insolvency officeholders at the very least to take a 'comply or explain' approach in relation to SIP 16 (particularly in the case of sales to connected parties), and that evidence supporting such compliance must be adequate. It is further clear that the making of an administration order should not be taken for granted and, if the order is made, it should not be construed as a verdict on the merits of an ultimate sale.

The case is also an example of the type of transaction which the pre-pack pool was designed to assist with. The pre-pack pool was set up in response to a series of recommendations contained in the 2014 report by Teresa Graham CBE into pre-packaged administrations (the 'Graham Report') – the Graham Report itself being a response to the 'brickbats thrown at pre-packs' and a general perception that pre-packs were open to abuse. The Graham Report sought to make recommendations that would improve the perception that third parties have of pre-packs, while not unnecessarily adding to the rules and regulations that already govern insolvency procedures. The resulting pre-pack pool is an independent body of experienced business people that connected parties can approach on a voluntary basis for an opinion on a proposed pre-pack transaction, with the aim of inserting a degree of independent scrutiny of the transaction while retaining overall secrecy before the event.

On the express recommendation of the Graham Report, references to the pre-pack pool are voluntary only. The intention was that the market would come to expect the pre-pack pool's involvement in connected party pre-packs, thereby ensuring a meaningful take-up of the proposal. It was noted at the time that if compliance was low then government regulation may be necessary. To facilitate this, a reserve power was included in section 129 of the Small Business, Enterprise and Employment Act 2015 (the 'Reserve Power'). The Reserve Power amended Schedule B1 of the Insolvency Act 1986, giving the government the power to make provision for prohibiting, or imposing requirements or conditions in relation to, pre-pack administration. In particular, such regulations may require the approval of, or provide for the imposition of requirements or conditions by: (i) creditors of the company, (ii) the court, or (iii) a person of a description specified in any regulations. The Reserve Power has a sunset date of 26 May 2020.

It is clear the pre-pack pool has not had the impact it was intended to: according to the Pre-Pack Pool Report 2018 (noting that at the time of writing the 2019

report is not yet available), throughout 2018 only 24 referrals were made to the pre-pack pool, out of 239 pre-packs to connected parties. Consistent with this trend, no referral to the pre-pack pool was made in connection with *Moss Groundworks*, and the case will add support to arguments that legislation is required to compel referrals to the pre-pack pool if it is to have the intended market take-up.

In its 2018 Review of Insolvency Practitioner Regulation, published in May 2019, the Insolvency Service stated: 'We have carried out a review of the impact of industry measures on pre-pack sales in administrations in order to inform a decision on whether statutory regulation is required in this area. [...] The Government hopes to be able to publish the findings and outcome from the review shortly.' At the time of writing the findings and outcome of the review are yet to be published, but it would not be surprising if the government does take the opportunity to legislate in this area before the Reserve Power falls away. If it does, this is likely to mean a more significant change to the pre-pack regime than the incremental changes to SIP 16 and the introduction of the voluntary pre-pack pool regime that have been favoured in recent years.

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