

How can we make Pre-packs work more efficiently?

Agnieszka Cybulska-Bienioszek, Paweł Kuglarz and Mateusz Kaliński share their thoughts on the European proposals on pre-pack sales, especially from a Polish perspective



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Pre-pack proceedings or pre-pack sales are a way to introduce some restructuring into the insolvency law framework by the transfer of the business, in whole or in part, to an acquirer in such a way that all or part of the business can continue to operate as an economically productive unit. In some countries, pre-pack frameworks are provided for by law, while in others they result from practice or informal agreements on how pre-packs should function.

In most instances, pre-packs allow a quick sale of all or part of the debtor's business (or sometimes key assets) at the brink of insolvency, because the sales' terms and conditions are agreed prior to the filing of a petition. In most cases, the court approves the sales conditions in the same order declaring bankruptcy.

The EU Proposal

In December 2022, the European Commission published a Proposal for a Directive of the harmonising certain aspects of insolvency law ("Proposal"), in which pre-pack proceedings are regulated in Articles 19–35.

The Proposal aims to promote going-concern sales in liquidation to generate more value than so-called piecemeal liquidations. To ensure the competitiveness, transparency, fairness and (logically) effectiveness of the sales process, an insolvency practitioner (the "monitor") will supervise proceedings. From the Polish perspective, this could include the Temporary Court Supervisor, appointed by the bankruptcy court

upon the filing of a petition (usually) by the debtor. There is also a possibility of choosing the pre-pack model with a speedy public auction after the opening of the liquidation phase of formal proceedings.

The Proposal offers the possibility of a stay of individual enforcement actions to ensure the safety of negotiations of the transaction. It is also possible to assign the executory contracts which are necessary for the continuation of the debtor's business. Moreover, as the liquidation phase of pre-pack proceedings can be considered insolvency proceedings instituted to liquidate the assets of a transferor under the supervision of a competent authority, the exception in Article 5 of the TUPE Directive can apply.

The pre-pack will involve recourse to the "best-interest-of-creditors" test, meaning that no creditor would be worse off under in pre-pack proceedings than would be the case if the normal liquidation priorities were applied in the event of a piecemeal liquidation.

Procedural phases

Pre-pack proceedings consist of two phases – a private and (usually) confidential phase as well as a public phase – after negotiations or within the auction process. Member States can decide on options within the model they choose.

The first (preparatory) phase is initiated by appointment of the Monitor. The procedure usually involves finding an investor, carrying out simplified due diligence (as the sale takes effect as

an enforcement sale), appraisal and filing for bankruptcy together with other actions by the monitor. Approval of the pre-pack conditions ends the preparatory phase and commences the (public) enforcement phase.

A Polish assessment of the Proposal

From the points of view emitted by various stakeholders as well as speakers and participants in the "The Art of Pre-Pack" panel at the INSOL Europe Eastern Europe Countries Conference in Krakow (13-14 June 2024), some insight may be given and suggestions made to improve the Proposal.

There are many problems within the Polish pre-pack frameworks with many things needing change. First, it is possible to sell via pre-pack not only all or part of the business, but also a group of assets (which need not be connected or even have particular value). In other words, it is possible to use pre-pack sales to perform piecemeal liquidation. It is even possible to use pre-pack sales in personal bankruptcy, where there is no business to be saved. This fact might be surprising, because it is in total opposition to the idea of a pre-pack as such.

Another problem is that Polish pre-packs take very long. The insolvency practitioner appears too late in the procedure and there is no official preparatory stage. They are appointed after the petition has been filed and, therefore, after terms have been negotiated and agreed between the petitioner and the potential buyer. At this late stage, the insolvency practitioner has to check the transaction



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thoroughly and find out whether it meets, *inter alia*, the statutory conditions. This takes time. As the insolvency practitioner is often not involved in the preparation of transactions, their terms may run contrary to the law.

A further problem is that, in many cases, Polish pre-pack sales are prepared only by reference to parties' names, as the minimum conditions for a pre-pack are mentions of the potential buyer and the price. This means that all other terms of the transaction will be agreed upon after the filing of the petition. As such, a quick sale is simply not possible.

Another fundamental problem arises from the fact that pre-pack petitions may be filed not only by the debtor, but by any entity entitled to file for bankruptcy, in most cases the creditor. As a result, various competing pre-pack sales petitions concerning various combinations of the debtor's assets may be filed simultaneously. This makes it necessary for the insolvency practitioner and the court to analyse many different transaction options, rather than one well-thought-out best-case scenario for the bankruptcy estate.

Moreover, in Polish pre-packs, there are auctions involving potential buyers. However, when there are differences in the assets subject to the sale, it is simply not possible to hold an auction. Furthermore, this auction is not public and is carried out only between the buyers submitting individual pre-pack petitions. Other problems include appeals aimed at extending the procedure, the violation of secured creditors' rights, sales at an undervalue (given there is no limit to price reductions), too narrow a definition of related parties, the automatic transfer of employees (the exception in Article 5 of the TUPE Directive not applying here), the assignment of executory contracts without the consent of the counterparty not being possible, the non-public nature of the auction and the lack of a "stalking horse" bidder (initial bidder) and the protection this confers.

Given these problems, it is important to recognize that there are many good and reasonable ideas in the Proposal. However, there are also some issues which, from a Polish perspective, could be highly problematic. Some provisions are also unclear. The most serious doubts relate to Article 33, especially its part which deals with the credit bid and interim financing.

Credit bids and interim financing

It is not clear whether Member States can opt out of introducing the credit bid system. There are also doubts whether the provision refers to security interests established only over the whole business or also over some of its parts. Furthermore, it uses a very vague and unclear term regarding the permissible ratio of the value of the claim to the value of the business. Moreover, from a Polish perspective, at the stage when the credit bid would take place, it is not possible to determine the value of claims definitely.

It is not even certain at this point whether the person claiming to be a secured creditor is definitely so and whether their claim exists in the amount they declare. This is because the process of establishing the list of claims and, thus, verifying the declared claims, will certainly end after the date on which the fast public auction takes place.

At the same time, it is possible to imagine a situation in which the trustee (within the liquidation phase) does debtor's recognition of unjustified or excessively high contractual penalties. In addition, the complications can be greater than the potential utility of the credit bid. In most cases, the secured creditors are banks, which are not able to acquire businesses as a going concern, given that the objects of a bank's activity are strictly defined and regulated by Polish law.

It also seems that the introduction of the right to set off the claim resulting from interim financing granted and the absolute priority of satisfaction of the

creditor who provided such financing may give rise to an opportunity for abuse in Polish pre-packs. It is conceivable that the application of these mechanisms in practice will cause harm to secured creditors whose secured claims will not be properly protected. The situation will be further complicated, if the entity granting the interim financing is the debtor's counterparty, which in the course of the proceedings receives payment for the performance of the contract, covered by funds from the interim financing, and then acquires the debtor's business, offsetting the purchase price against the claim resulting from the financing. It appears that such a counterparty will be doubly privileged to the detriment of secured and unsecured creditors.

The fate of the Proposal

More recently, on 29 November 2024, news has come regarding the exclusion of pre-pack proceedings from the Proposal, as a result of compromise within the European Council of Ministers.

In the authors' opinion, pre-pack proceedings are beneficial for the economy and have proved to be (in general) an effective and efficient way to sell the business bearing in mind the principles of insolvency proceedings. This is certainly true in some Member States and, to a certain extent, in Poland before the 2019-2020 reform. In Poland, we have had both good and bad experiences in this regard, but, overall, pre-packs have maximized value for all involved parties and thus should be promoted.

As such, we are of the view that pre-packs should be reintroduced to the Proposal before further work is carried out by the European Parliament. We also hope that, during the Polish EU Presidency, some compromise will be achievable. ■



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