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Over-promising Rescue: Pre-Pack Sales Under the New Insolvency Directive

Yiannis G Bazinas*[1]

Abstract

The new Directive harmonising certain aspects of insolvency law introduces pre-packaged sales ('pre-packs') as a two-phase mechanism to facilitate going concern sales of distressed businesses, with the stated aim of improving creditor recoveries and access to finance for European firms. This article argues that the Directive's pre-pack framework is flawed on two distinct but related grounds. First, as a matter of design, the procedure is ill-suited to achieve its own stated objectives. The Directive places excessive faith in the monitor's ability to police the integrity of the sale process, when the interests of potentially disadvantaged creditors would be better protected by facilitating their direct participation in, and ability to object to, the authorisation of the sale. In addition, requiring the monitor to certify the best-interests-of-creditors test in every case is disruptive in the context of an actual market sale, where competitive mechanisms already perform the valuation function it purports to serve; the test would operate more efficiently as a backstop, triggered only where creditors object to the authorisation of the sale. Secondly, as a matter of policy, the rationale for EU-level intervention is ambiguous, at best. The Directive's reliance on the ECJ's Heiploeg ruling conflates a narrow interpretative question about the TUPE Directive's bankruptcy exception with a broader structural problem, and its own provisions on the relationship between the two instruments are inherently contradictory and unclear. The policy objective of supporting European firms is equally unconvincing, as the characteristics of most European micro and small enterprises (MSEs) render them structurally ill-suited for pre-pack procedures. Finally, in a field as commercially sensitive as insolvency law, further legislative change, coming on the heels of the implementation Preventive Restructuring Directive, introduces legal uncertainty at precisely the moment when stability and predictability is most needed.

Keywords: Pre-packaged sales; Insolvency law harmonisation; Insolvency Directive; Monitor; Best-interests-of-creditors

* Managing Partner, Bazinas Law firm, Athens, Greece, ybazinas@bazinas.com.

1. Introduction

1. Despite appearances, things in Brussels move faster than an outsider would expect. When the European Commission first formulated a proposal for a new directive harmonising certain aspects of insolvency law in 2022,[1] the proposed provisions on pre-packs drew significant criticisms.[2] As if to give credence to these concerns, the chapter on pre-packs was not included in the first round of negotiations on a compromise text in late 2024,[3] a development that clearly did not bode well for its eventual adoption. However, less than a year later, in March 2025, things started moving fast in the other direction, as the respective provisions were again put on the table and formed part of the discussions at the European Council.[4] Eventually, the chapter on pre-packs (with notable improvements in form and language but with only minor edits affecting the substance of the original proposal), formed part of the final text of the new Directive harmonising certain aspects of insolvency law,[5] which was approved by the Council and the European Parliament on March 31st, 2026 (the 'Directive'). Thus, the pre-pack has quickly transformed itself from an unpropitious initiative into a core component of the new Directive that EU Member States will be required to transpose into their respective national laws by early 2029.
2. The pre-pack procedure is one of the several areas of the insolvency laws of Member States, which the Directive seeks to harmonise as a means to remove obstacles to cross-border investment and improve access to finance for European firms.[6] In broad brush, the pre-pack is structured as a fast-track liquidation proceeding, where the sale of the debtor's business to a third party is negotiated before the formal opening of insolvency proceedings and is then executed, in a speedy and streamlined manner, following the commencement of formal proceedings, under the supervision of the court. The main rationale behind this

1 Commission, 'Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law' COM (2022) 702 final.

2 Invest Europe, 'Position Paper on the European Commission's Proposal for a Directive on Harmonising Certain Aspects of Insolvency Law 2022/0408' <https://www.investeurope.eu/media/6578/insolvency-position-invest-europe-march-2023-final.pdf> accessed 27 August 2024; SME United, 'Reaction on the Proposal for a Directive Harmonising Certain Aspects of Insolvency Law' <https://www.smeunited.eu/publications/reaction-on-the-proposal-for-a-directive-harmonising-certain-aspects-of-insolvency-law> accessed 28 August 2023.

3 Freshfields, 'Harmonisation of EU Insolvency Laws Moving Closer to a Common Approach' (Lexology, 17 December 2024) <https://www.lexology.com/library/detail.aspx?g=6cbc6554-288a-456e-aa44-afb-31c4cdc3f> accessed 16 January 2024.

4 Bob Wessels, '2025-04-Doc1 The European Pre-Pack Is Slowly Being Unpacked'.

5 Directive (EU) 2026/799 of the European Parliament and of the Council of 30 March 2026 harmonising certain aspects of insolvency law [2026] OJ L.

6 Recitals (1)-(2) Directive.

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process is that the sale of a business as a going concern can generate additional value for creditors, as opposed to a standard insolvency procedure, where the business is effectively shut down and its assets are liquidated in a piecemeal fashion.[7] From that perspective, the sale of a distressed business in the context of a pre-pack aligns with the broader objectives of reducing the costs of business rescue, improving creditor recoveries and, by extension, improving access to finance for European businesses, especially MSEs.

3. However, all that glitters is not gold. As a matter of fact, there are various elements of the procedure that in fact hamper, as opposed to encouraging, the speedy and efficient sale of distressed businesses to third party buyers. Thus, even if we take the Directive's goals at face value, the provisions on pre-packs would need to be materially improved to achieve them. In addition, and more conceptually, the introduction of a harmonised procedure appears neither necessary nor adequate for facilitating distressed business sales in European economies, especially in the MSE sector. On the contrary, pre-packaged procedures, of the sort contemplated by the Directive, would be of very limited practical relevance for the vast majority of European MSEs in several Member States, due to structural economic factors, meaning that unless the proposed pre-pack provides firms with a particular regulatory advantage, its relevance and uptake is likely to remain very limited. This article will develop both of the arguments above in order to demonstrate that the Directive's provisions on pre-packs constitute yet another attempt to stimulate certain economic outcomes, by improving the law on the books across the board of EU Member States while ignoring the economic realities that influence recoveries and distressed outcomes in the MSE sector in most European economies.

2. Pre-packs 101

4. Before analysing and assessing the pre-pack procedure, as reflected in the Directive, it is important to first sketch out the role and benefits of pre-packaged business sales in the context of insolvency. It is well established that, when a firm is in a state of financial distress, its creditors face a collective action problem that resembles the proverbial prisoners' dilemma; each creditor has an incentive to enforce its claim against the debtor's assets, even though this leads to depletion of value for the creditor constituency as a whole.[8] Insolvency law addresses this sub-optimal outcome by instituting a collective proceeding, whereby creditors'

7 Recital (30) Directive.

8 Thomas H Jackson, The Logic and Limits of Bankruptcy Law (1st edn, Beard Books 2001) 10.

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private remedies are suspended and the firm's assets are placed under the control of a neutral party, the insolvency representative, who is tasked with liquidating the debtor's assets and distributing their proceeds to the various creditors, under a particular order of priority. By substituting the parallel exercise of multiple individual enforcement rights with a single process of collective enforcement, insolvency law thus minimises both the direct as well as the indirect costs of financial distress, ensuring an orderly process of liquidation and, by extension, increased recoveries for the creditors as a whole. Equally importantly, a collective proceeding, when compared to the "grab race" that would otherwise ensue, spreads the losses of default between the debtor's various creditors (at least those having the same priority), making creditors more willing to extent credit ex ante.[9] Therefore, according to this view, insolvency law's main contribution is that it enables a collective resolution of the debtor's financial distress reducing the costs associated with individual debt enforcement by multiple creditors.

5. The obvious corollary of insolvency is that, since all of the debtor's assets are liquidated for the benefit of creditors, the business cannot continue operating. This may however be an undesirable outcome, if the debtor's business is still viable in operational terms. In such a scenario, creditors would presumably prefer for the business to continue operating and for them to retain a claim on its going concern value, as this would increase their recoveries in the long run. This outcome can be achieved through an exercise colloquially known as a restructuring. In the context of a restructuring, creditors agree to forego a portion of their claim against the debtor, in the form of principal write offs, interest reductions, debt-to-equity swaps or other similar measures, to ensure that the business stays operational and in exchange retain an interest in the business, in the form of either debt or equity.[10]
6. In game-theoretical terms, a restructuring could thus be said to involve the debtor and its creditors bargaining for the rescue of the business. Efficient bargaining however may be hampered as a result of strategic behaviour by parties seeking to capture as big a share of the pie as possible. In the context of restructurings in particular, individual creditors have an incentive to either avoid contributing to the firm's rescue entirely and attempt to retain the full value of their claim while letting other creditors bear the full costs of rescue[11] or hold out against a collectively beneficial agreement and bargain individually with the debtor for

9 Thomas H Jackson, The Logic and Limits of Bankruptcy Law (1st edn, Beard Books 2001), p. 14–15.

10 Anthony J Casey, 'Chapter 11's Renegotiations Framework and the Purpose of Corporate Bankruptcy' (2020) 120 Columbia Law Review 1709.

11 Mark J Roe, 'The Voting Prohibition in Bond Workouts' (1987) 97 The Yale Law Journal 232.

a better deal.[12] These types of conduct, known as free-riding and holding out,[13] can undermine a collectively beneficial arrangement and lead to a situation that largely resembles an anti-commons problem.[14]

7. In order to address these concerns, restructuring procedures replace the various bilateral bargaining streams with a single collective bargaining procedure, which takes place under the supervision of the court and frequently provides protection against individual creditor enforcement.[15] More importantly, restructuring tools enable the debtor to agree on the terms of business rescue with a qualified majority of its creditors and make such an agreement or plan binding on all creditors, by virtue of its approval by the court, provided that the agreement satisfies certain minimum requirements and does not abuse the rights of the dissenting minority.[16] Restructuring procedures thus provide mechanisms that help parties overcome instances of strategic behaviour in the context of collective contractual renegotiation, with a view of realising the going concern value of a distressed, yet viable, business.[17]
8. However, there may be instances, when such a traditional or *bona fide* restructuring cannot be implemented. For one thing, and despite the existence of majoritarian decision making, creditors may still be able to undermine a collectively beneficial agreement and form blocking coalitions (especially at the level of a particular "class" of creditors) in an effort to extract additional value from the debtor. In such a scenario, the restructuring would fail, unless the debtor can resort to cram-down, namely achieve the approval of the plan by the court

12 In game-theoretical parlance, free riding and holding out can be modelled as a 'game of chicken': see Richard H McAdams, 'Beyond the Prisoner's Dilemma: Coordination, Game Theory, And Law' (2009) 82 Southern California Law Review 209.

13 Lloyd Cohen, 'Holdouts and Free Riders' (1991) 20 The Journal of Legal Studies 351 <https://doi.org/10.1086/467890>.

14 This scenario resembles the problem of the anticommons: see Rolef de Weijs, 'Too Big to Fail as a Game of Chicken with the State: What Insolvency Law Theory Has to Say About TBTF and Vice Versa' (2013) 14 European Business Organization Law Review 201 <https://doi.org/10.1017/S1566752912001139>.

15 It has been pointed out that the stay on creditor enforcement actions shapes the parties 'exit options', forcing them to stay at the negotiating table: see Douglas G Baird and Randal C Picker, 'A Simple Noncooperative Bargaining Model of Corporate Reorganizations' (1991) 20 The Journal of Legal Studies 311.

16 Stephan Madaus, 'Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law' (2018) 19 European Business Organization Law Review 615 <https://doi.org/10.1007/s40804-018-0113-7>. All of these features of restructuring frameworks are envisaged in the PRD.

17 As pointed out by Casey, reorganization frameworks contain 'substantive and procedural guardrails that are intended to direct the parties toward an optimal bargain with minimal hold up': see Casey (n 11) 1751–1752.

over the dissent of certain creditor classes.[18] However, the application of cramdown tools is usually subject to the plan meeting additional requirements, such as the appropriate composition of creditor classes or the fair treatment of creditors, which inevitably entail disputes over intricate issues, such as the valuation of the business and the treatment of creditors in a restructuring as opposed to an alternative scenario.[19] These realities can make a *bona fide* restructuring an overly costly and complicated exercise. In addition, creditors often do not wish to remain in the debtor's capital structure, as usually happens in the context of *bona fide* restructurings, but rather prefer to cut their losses and extricate themselves from the distressed debtor. This is often the case with sophisticated financial creditors, who invest in distressed debt with the prospect of a quick return as opposed to a long-term commitment to the underlying business.[20] In short, even when a business is viable, the costs of implementing a court-supervised *bona fide* restructuring can prove fatal to the prospects of rescue.

9. In all of the above cases, the sale of the business as a going concern to a third party constitutes an alternative and potentially more efficient avenue to business rescue. The economic outcome of a sale is functionally similar to a *bona fide* restructuring; the distressed firm is recapitalised through an actual sale of its assets or business to a third party (as opposed to a hypothetical sale to its creditors),[21] whereas the business is deleveraged and can continue to trade, albeit under a different legal entity. Unlike *bona fide* restructurings however, the sale of the business as a going concern does not entail the costs associated with multi-party bargaining but merely involves a single bargaining stream between the debtor and the buyer. This simpler configuration of bargaining dynamics also means that a sale can potentially be consummated much more speedily, which is often crucial when the business is distressed. In addition, to the extent that the sale can be negotiated out-of-court and then be implemented once the firm is placed in insolvency, in the form of a pre-pack, the stigma that is associated

18 c.f. art. 11 PRD.

19 For instance, under an English restructuring plan, creditors, in a cramdown scenario, must receive, at least, the dividend that they would receive in the relevant alternative. The "relevant alternative" is whatever the court considers most likely to occur in relation to the company if the plan were not sanctioned: s. 901G(3)-(4) Companies Act 2006; Riz Mokal, 'The Two Conditions for the Pt 26A Cram Down' (2020) 37 Butterworths Journal of International Banking and Financial Law 730.

20 The increasingly important role of specialised distressed debt investors in the mechanics of corporate restructurings is analysed in Sarah Paterson, Corporate Reorganization Law and Forces of Change (1st edn, Oxford University Press 2020).

21 Douglas G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 The Journal of Legal Studies 127.

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with insolvency can be significantly reduced.[22] As a result, a pre-packaged sale can ensure the rescue and continued operation of the business without the attendant problems associated with *bona fide* restructurings. In fact, it has been observed that, over the past 20 years, sales, especially of the pre-packaged sort, have increased in relevance to the point where they now represent the majority of restructuring cases in many jurisdictions around the world.[23]

10. That being said, it is not immediately obvious why specific legal rules are needed for such an outcome to be achieved. After all, business assets as well as entire businesses are routinely sold outside insolvency under purely contractual arrangements, either in the form of a share deal, where the buyer acquires the shares in the legal entity that operates the business, or in the form of an asset deal, where the buyer acquires specific productive assets of the business.[24] In the insolvency context however, share deals, which merely result in a change of ownership of the firm, do little to alleviate the financial distress of the underlying business. In theory, the new owner may be able to inject additional liquidity to the company and thus to rescue it, but this is only a second order effect of the sale that is conditional on the new owner's financial resources. The sale of the entity running the business to a third party does not, by itself, amount to a rescue.
11. As far as the sale of all (or substantially all) assets of the firm to a third party buyer is concerned, contractual mechanisms may prove equally inefficient when the firm is distressed. First of all, asset sales are generally subject to "asset tainting"; a buyer acquires the assets with all prior liens and encumbrances, meaning that such assets cannot be put to productive use, unless all previous debts are paid off.[25] In addition to asset tainting, fraudulent conveyance doctrines, which are generally applicable outside insolvency, enable a creditor to reclaim assets that have been disposed by the debtor for less than reasonable value. The application of these rules under conditions of distress creates significant risks for potential buyers, which can preclude value maximising transactions.

22 Adrian Thery, 'The Pre-Pack Regulation in the EU Commission Proposal for a Second Insolvency Directive' [2023] European Insolvency and Restructuring Journal 8 <https://doi.org/10.54195/eirj.18096> accessed 27 August 2024.

23 Barry Adler, 'The Creditors' Bargain Revisited' (2018) 166 University of Pennsylvania Law Review 1853; Aurelio Gurrea-Martinez, 'The Rise of Pre-Packs as a Restructuring Tool: Theory, Evidence and Policy' (2023) 24 European Business Organization Law Review 93 <https://doi.org/10.1007/s40804-022-00261-3>.

24 Vedran Alickovic and H-Ch Brauweiler, 'Mergers and Acquisitions: Share Deal vs. Asset Deal – Risks and Impediments' in Hans-Christian Brauweiler and others (eds), Digitalization and Industry 4.0: Economic and Societal Development: An International and Interdisciplinary Exchange of Views and Ideas (Springer Fachmedien Wiesbaden 2020) <https://doi.org/10.1007/978-3-658-27110-7_16>.

25 Vincent SJ Buccola, 'Bankruptcy's Cathedral: Property Rules, Liability Rules and Distress' (2019) 114 Northwestern University Law Review 705, 736.

12. Furthermore, the sale of a business as a going concern generally requires the prior approval of the firm's shareholders, as the residual claimants of the firm's assets. This configuration of decision-making authority however, while reasonable in ordinary circumstances, makes little sense when a firm is distressed, given that shareholders will ordinarily have no residual claim against the firm's assets in a distress scenario. This in turn creates an inexorable conflict of interest between creditors, who have an interest in maximising the value of the business, and shareholders, who have veto power over the sale but no incentive to enter into a value maximising transaction unless their own position is commensurately improved.[26]
13. Last but not least, the sale of a business as a going concern under conditions of distress is often complicated by the ever-present threat of creditor enforcement against the firm's assets. The risk that creditors may try to seize business assets and wreck the firm's going concern value can lead interested investors to undervalue the business or even altogether avoid entering into a beneficial sale. In short, under conditions of distress, the maximisation of the value of a business' assets through a sale encounters several obstacles.
14. Based on the above observations, insolvency frameworks can make several important contributions in facilitating going concern sales. First, the framework should allow a buyer to acquire the assets of the business free and clear of all pre-existing liabilities and liens. The business' liabilities, i.e. the claims owed to creditors, can then be satisfied by the proceeds of the sale thereby enabling the deleveraging of the business, which can thereafter continue operating with a healthier capital structure. That being said, it should be possible for the buyer to assume certain liabilities of the business, such as valuable contracts, if they can contribute to the business' future going concern value. Secondly, the sale of the business must be subject to the approval of creditors or, at the very least, take into account the interests of creditors, as the firm's residual claimholders.[27] This would place the decision-making authority for the sale in the hands of the parties that have an incentive to maximise the value of the firm's assets, thereby removing any conflicts of interest. In addition to the above, the framework must provide the debtor with the option to request protection from creditor enforcement actions during the negotiations stage, in order to avoid a reduction in the firm's value prior to the conclusion of the sale.

26 ibid 740.

27 The approval of the sale by creditors is in principle the most straightforward option but at the same time complicates bargaining as it reintroduces collective decision making at the creditor level, bringing the process structurally closer to a bona fide restructuring.

15. At the same time however, the framework must also include certain protections for creditors, since the ability of the buyer to acquire the business on more permissive terms than would otherwise be applicable under purely contractual mechanisms, exposes creditors to the risk of advantage taking by virtue of abusive schemes that seek to divert value away from them.[28] For that reason, the sale process must be supervised by a court, which can ensure that it meets certain minimum standards of fairness, transparency and good faith. These features constitute a very rudimentary efficiency benchmark, which can prove helpful in evaluating the merits of any framework that seeks to enable the sale of the business as a going concern.

3. Is the pre-pack efficient?

3.1 Overview

16. If one engages in an assessment of the pre-pack procedure, as reflected in the Directive, it becomes apparent that, at least on a cursory level of analysis, the procedure features many elements of an efficient pre-pack framework. In very broad terms, the procedure is structured in two successive stages, the 'preparation phase' and the 'liquidation phase'.[29] During the 'preparation phase', the debtor's management negotiates with interested third parties in order to select a buyer for the business.[30] In particular, the 'preparation phase' commences with the appointment of a monitor, who is a licensed insolvency practitioner,[31] and is entrusted with overseeing the buyer selection process by preparing (and later submitting to the court) a relevant report recommending, among other things, the sale to the best bidder.[32] During that stage, existing management remains in control of the business and continues to manage it, ensuring business continuity and avoiding potentially harmful and value-destructive operational disruptions.[33] If the debtor is insolvent or in a state of likelihood of insolvency, it may also benefit from a stay on creditor enforcement actions, thus ensuring that the business remains intact and operational until the sale is concluded.[34]

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28 Junior creditors are usually the victims of such value transfers: see Jordan Neyland and Kathryn St John, 'Hidden Wealth Transfers in Bankruptcy Asset Sales: A Real Option Analysis' (2022) 19 Berkeley Business Law Journal 46 <https://doi.org/10.2139/ssrn.3789763>.

29 Art. 2 §1(k) Directive.

30 Art. 2 §1(l) Directive.

31 Art. 23 Directive.

32 Art. 24 Directive.

33 Art. 21 §3 Directive.

34 Art. 25 Directive.

17. Once the buyer has been selected under this competitive process, the "liquidation phase" of the procedure, which constitutes an insolvency proceeding, is opened.[35] The aim of the liquidation phase is to approve and execute the sale of the debtor's business and to distribute the proceeds to the creditors.[36] The process of authorising the sale of the business during the liquidation phase is not however one-dimensional; in fact, the Directive provides that it can take several different forms, with each variant reflecting differently on the role and tasks of the monitor during the preparation phase. In particular:
    - In its most basic formulation, the sale is authorised by the court following the monitor's recommendation.[37] The monitor is therefore tasked with preparing a report justifying whether the preparation phase (essentially the negotiations between the owners/managers of the debtor and potential buyers) was fair, transparent, competitive and in line with market standards, recommending the best bid and confirming that, on the basis of its assessment, the recommended bid satisfies the best-interests-of-creditors test. If the court is satisfied that these requirements have been met, the sale to recommended bidder is authorised.
    - Alternatively (or even additionally),[38] the court may authorise the sale to a buyer that is selected by way of a public auction.[39] In that context, the monitor recommends a bid, submitted by a buyer during the preparation phase, which serves as the initial ('stalking horse') bid in the subsequent auction,[40] confirming that, on the basis of its assessment the selected bid satisfies the best-interests-of-creditors test. Still, the monitor may not be required to justify that the process be competitive, transparent, fair and meet market standards,[41] presumably because a competitive auction, by definition, satisfies those standards.

35 Art. 22 §1 Directive.
36 Art. 2 §1(m) Directive.
37 Art. 21 § (a) Directive.
38 It is clear from the text of the Directive that a Member State can transpose more than one of those options: see Art. 29 §1 Directive. As far as the interplay between the standard variant and the auction is concerned, the Directive provides in particular that Member States may provide that a public auction be conducted where one or more creditors demonstrate that there is reasonable doubt as to whether the best bid recommended by the monitor reflects the fair market price: see art. 24 §3 Directive first sent.
39 Art. 29 §1(b) Directive. The Directive however does not mandate that a particular type of auction be held: see Thery (n 23) 11.
40 In this case, the preferred buyer will serve as a 'stalking horse' and may be remunerated by the debtor, if its offer is unsuccessful. Art. 29 §3 Directive.
41 Art. 24 §3 Directive second sent.

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- Finally, Member States may provide that the court authorise the sale of the business to a buyer recommended by the monitor, if such bid is also approved by creditors.[42] The monitor's role in this variant is similar to its role in the auction formulation: it shall prepare a report recommending the best bid and confirming that such bid satisfies the best-interests-of-creditors test but may not be required to justify that the process be competitive, transparent, fair and meet market standards.[43] Member States also have the option of eliminating court authorisation entirely and entrust the approval of the sale solely to creditors, without any court involvement.[44]

18. As is obvious, in all of the above variants, the protection of the interests of creditors is taken into account. In the main variant, even though the sale will need to be approved by the court, such ruling will depend in principle on a determination that the process was run in accordance with process-based safeguards (i.e. competitively, fairly, transparently and in accordance with market standards), which can ensure that the interests of creditors have been sufficiently protected. Similarly, if an auction is held to determine the buyer, the nature of the competitive bidding process protects (at least in theory) creditors from any abuses or advantage-taking by the firm's managers. Finally, where the creditors approve the sale themselves, in line with their position as the residual claimholders of the debtor's business, their protection is self-evident.
19. Notwithstanding the exact formulation of the liquidation phase, if the sale is authorised, the buyer acquires the debtor's business free of debts and liabilities, unless the buyer expressly consents to assume the debts and the liabilities of the business or part thereof.[45] In that regard, asset tainting is addressed and the buyer acquires clear title over all assets of the business. Importantly, the buyer can also assume executory contracts,[46] which are necessary for the continuation of the debtor's business, without the consent of the affected counterparty.[47] The proceeds of the sale are then distributed to creditors under the national rules applicable to the insolvency proceeding that constitutes the liquidation phase.[48] Importantly, although the order confirming the sale may be subject to

42 Art. 29 §1(c) Directive. It is for the Member States to decide whether the general meeting of creditors or the creditors' committee shall authorise the sale of the debtor's business, see Recital (43), Directive.
43 Art. 24 §4 Directive.
44 Art. 29 §2 Directive.
45 Art. 31 Directive.
46 This refers to contracts, under which the parties still have obligations to perform: see Art. 2 §1(g) Directive. This aligns with the PRD's definition of executory contracts: see art. 2(1)(5) PRD.
47 Art. 30 Directive.
48 Art. 21 §4 Directive.

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appeal, the appeal does not have a suspensive effect, which ensures that good-faith acquirers are, as a rule, protected against the risks of the entire transaction being upended.[49]

20. Overall, several features of the new pre-pack procedure can credibly support the Directive's objective of promoting a swift and cost-efficient sale of a distressed business to a third party, while safeguarding the interests of creditors. On a more granular level however, there are certain elements of the pre-pack that undermine this delicate balance. These will be analysed in turn.

3.2 The limits of the monitor's role

21. As already pointed out, pre-pack sales are often superior to *bona fide* restructurings since they allow debtors to sell a rapidly depreciating asset, namely the underlying business, without the costs, frictions and disputes (especially on the issue of valuation) that are normally associated with multi-party bargaining.[50] As a result, pre-pack sales can ensure the rescue of the business more quickly and, as a result, more efficiently compared to the process for the confirmation of a restructuring plan. Speed, however, comes at a price. A sale that is negotiated out-of-court, absent sufficient oversight, can provide managers with the opportunity to enter into 'sweetheart deals' with prospective buyers or related parties that shift value away from the rightful residual claimants, especially junior creditors.[51] This risk may not be sufficiently addressed by the subsequent authorisation of the sale by the court, since the urgency to consummate a deal that has already been agreed may put pressure to approve a sale, regardless of the actual integrity of the process leading up to it.[52]
22. The Directive appears cognisant of these risks and seeks to address them by requiring the involvement of a monitor during the 'preparation phase' of the procedure. From a policy perspective, the monitor's main task is to police the integrity of the bargaining process between the owners of the distressed firm and the potential buyers and ensure that negotiations meet certain standards of fairness, transparency, competition and efficiency. A process that meets those requirements can ensure (so the thinking goes) that the eventual sale reflects

49 Art. 32 Directive.

50 This is the justification that is frequently used in the US in respect of so-called '§ 363 sales' under the US Bankruptcy Code: see Douglas G Baird and Robert K Rasmussen, 'The End of Bankruptcy' (2002) 55 Stanford Law Review 751.

51 Elizabeth B. Rose, 'Chocolate, Flowers, and § 363(b):T he Opportunity for Sweetheart Deals Without Chapter 11 Protections' (2006), 23 Emory Bankruptcy Development Journal 249.

52 Whether the urgency is real or manufactured is however a different story: see in respect of '§ 363 sales' Alla Raykin, 'Section 363 Sales: Mooting Due Process?' (2012) 29 Emory Bankruptcy Developments Journal 92, 128.

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the best price possible for the business.[53] Importantly, the monitor's involvement is ubiquitous, regardless of the formulation of the subsequent liquidation phase, with only minor variations as regards its precise role during the preparation phase.

23. It is not however clear how the monitor's involvement actually ensures the protection of potentially disadvantaged parties. As a general principle, the Directive assumes that the monitor's report provides the court with sufficient and (crucially) impartial information to decide whether negotiations have been conducted properly and, by extension, whether the sale should be approved. Impartiality however may be more of an aspiration than a reality in pre-packs. First of all, although the monitor is framed as being independent from the debtor and other related parties (and potentially also creditors and equity holders),[54] the Directive is silent as to the manner of its appointment, leaving the issue to the Member States.[55] The manner of appointment is however a central component of independence; one can imagine that if the monitor is selected as a result of the input of the debtor or the prospective buyer, it would have little incentive to engage in a scrupulous assessment of the propriety of process and safeguard the protection of the rights and interests of junior creditors.[56] The monitor would be of course liable to creditors for any damage caused as a result of its failure to perform its obligations,[57] but this may be of little consolation in practical terms when a sale has already been consummated.
24. Even if the appointment process is completely neutral (e.g. random appointment by the court on the basis of a list or register), the monitor is still more likely to favour a sale than properly weigh the interests of creditors. Given that the Directive is completely silent on the nature or the structure of the monitor's fee arrangements, it would be reasonable to assume that, if the sale is successful, the monitor will probably be able to claim a higher fee, and potentially also a success fee.[58] Whatever those fees may be, the monitor will also have a better chance of claiming them successfully and more promptly, if a sale is authorized, given that, in such a scenario, its fees would not be borne by a distressed (and

53 Recital (40) Directive.
54 Art. 23 §2 Directive.
55 Art. 23 §1 Directive.
56 Riz Mokal and Alfonso Nocilla, 'Rehabilitating the U.K. Pre-Pack: A Critical Analysis and Proposals for Reform' (SSRN, 2023) 23 <https://doi.org/10.2139/ssrn.4565561> accessed 4 September 2026.
57 Art. 34 Directive.
58 It should be obvious that a straightforward success fee completely undermines the impartiality of the monitor: Adrian Thery, 'The Pre-Pack Regulation in the EU Commission Proposal for a Second Insolvency Directive' [2023] European Insolvency and Restructuring Journal 15 <https://doi.org/10.54195/eirj.18096> accessed 16 December 2024.

potentially already insolvent) debtor but instead covered out of a pool of funds comprising the proceeds of the sale. In short, incentives are already baked in the monitor's role that are likely to be favourable to the parties supporting a sale.

25. In addition, it is very unclear whether the information provided by the monitor is actually sufficient for the court to determine whether the process meets the integrity safeguards envisaged by the Directive. Consider the case, where the buyer is selected via a public auction. All auctions share a common characteristic, as a result of the fact that they rely on competitive bidding; they can generate, if properly designed, the highest possible value for the asset under disposal.[59] As a result, the main features of an efficient auction are structural and involve the provision of adequate information to the parties and the removal of any obstacles for effective bidder participation. Yet, the monitor will ostensibly have no say as far as these issues are concerned, which will fall within the competence of the court that will actually run and supervise the auction; in fact, the monitor's report need not even include a justification that the process has been conducted competitively, fairly and transparently. Instead, the monitor's only contribution in that scenario will be the submission of a report to the court that merely validates that the stalking horse bidder has been selected properly. This is not entirely without value[60] but seems overall redundant[61] and, more importantly, has little bearing on the more fundamental question of whether the sale to the highest bidder should be authorised by the court. Thus, the information furnished by the monitor may, in some cases, be neither adequate nor pertinent to the court's decision of whether a sale should proceed.
26. The bigger problem highlighted by the above observations is not that the monitor's involvement is, as a whole, counterproductive but rather that the Directive places excessive faith in the monitor's ability to police abuses during the negotiation stage. However, instead of relying on the input of a single actor to safeguard the interests of all potentially disadvantaged constituencies, it would be more effective to enable those vulnerable parties to contest the outcome of the process by voicing their objections to the authorisation of the sale to a third-party buyer. This would require, at a minimum, that dissenting parties have the

59 Yaad Rotem and Omer Dekel, 'The Bankruptcy Auction as a Game—Designing an Optimal Auction in Bankruptcy' (2013) 32 The Review of Litigation 323.

60 The 'stalking horse' mechanism generates a baseline bid that reduces subsequent bidders' due diligence costs, which promotes competitive bidding, particularly in thin or distressed markets where the risk of auction failure and time sensitivity is highest: Yi Chen and Zhe Wang, 'Optimal Sequential Selling Mechanism and Deal Protections in Mergers and Acquisitions' (2023) 78 The Journal of Finance 3151

61 Thery (n 23) 17.

opportunity to be heard and to raise objections, whether as to the integrity of the process or the valuation of the business before the court that is tasked with authorising the sale. Though the Directive does not preclude Member States from formulating the pre-pack in such a manner, there is no guidance on that point; as a matter of fact, the ability of creditors to object to the sale is only contemplated in the variant, where the authorisation of the sale depends on prior creditor approval. Rather than being the norm, giving creditors a voice appears to be the exception.

27. That being said, even if creditors are afforded the opportunity to be heard, they are often at an informational disadvantage compared to the transacting parties. As a result, they may not have sufficient information to formulate a well-founded objection to the authorisation of the sale.[62] One way to assist creditors in effectively exercising their own rights would be to mandate that the monitor's report be made public or at least communicated to the debtor's known creditors. Although the Directive is silent on that point, the provision of adequate information would ensure that any right of creditors to appear and object to the sale would be rendered effective. In that context, the monitor's role would remain important but, critically, shifts from a guardian of the creditors' interests to a conduit of information. This would reflect the more plausible premise that creditors, as the residual claimholders of the debtor's business, are the better judges of their own interests and would ensure that the monitor's involvement be productive.

3.3 The best-interests-of-creditors test and the question of valuation

28. One of the fundamental and essential elements of the monitor's report is a statement that, on the basis of its assessment the best-interests-of-creditors test is satisfied.[63] This test refers to the requirement that the sale of the business must not place any creditor in a worse economic position than it would have been in the event of a piecemeal liquidation of the firm's assets or, where Member States so provide, the next-best alternative scenario.[64] This requirement essen-

62 This is also the case in the US: see Raykin (n 57) 93.
63 Art. 24 §2(c) Directive.
64 Art. 2 §1(h) Directive.

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tially defines the counterfactual, against which the creditor recoveries from the sale of the business to a third party should be measured and assessed.[65]

29. Leaving the specific formulation of the test aside, it should be pointed out, as a first remark, that the Directive envisages that the application of this requirement does not necessarily require the monitor to engage in a valuation of the debtor's business,[66] unless the prospective buyer is a party closely related to the debtor or the court or the creditors (depending on who is responsible for approving the sale) suspect that the best bid does not satisfy the best-interests-of-creditors test.[67] It is however unclear how a monitor can justify such an assessment, if not by conducting a full-fledged valuation, with all the attendant costs in the first place. Given that neither the nature of this test nor the means to ascertain its application are clear, it is very likely to increase the uncertainty as to what exactly the monitor should do in respect of this requirement at the preparation stage. It is however not unreasonable to assume that the monitor will treat this requirement as a "box-ticking" exercise.
30. In addition, there is the more conceptual question of why this test is necessary in the context of pre-pack sales. The best-interests-of-creditors test is in reality a concept borrowed from *bona fide* restructurings. In that context, the test is used, as a means to ensure that dissenting creditors are not deprived of their recoveries in the event of piecemeal liquidation (or the next-best alternative) as a result of the confirmation of the plan.[68] This is necessary since a *bona fide* restructuring only involves a hypothetical sale of the business to its creditors, which necessitates a judicial determination of the value of the firm; as long as the firm is considered to be worth more than its value in piecemeal liquidation or the next-best alternative scenario, the going concern surplus can be freely disposed of by majority vote. In this context, the court is comparing the actual and the liquidation value of the debtor's business, both of which are computed in the abstract (i.e. hypothetically) without reliance on market mechanisms.
31. However, when there is an actual sale of the business, as is the case in going concern sales, the court is not required to hypothesise about the value of the firm

65 The meaning or nature next-best alternative scenario is not fleshed out by the Directive; however, in the context of the pre-pack, the next-best alternative can only refer to the restructuring of the business by way of a restructuring plan. Thus, it is open for Member States to require, as a condition of the pre-pack that the sale of the business to a third party be a superior alternative, in terms of creditor recovery both compared to a piecemeal liquidation as well as a bona fide restructuring. This is the case under US bankruptcy law as elaborated in In re Lionel Corp., 722 F.2d 1063, 1070-71 (2d Cir. 1983).

66 Recital (38) Directive.

67 Art. 29 §4 Directive.

68 Art. 10(2)(d) PRD.

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because this has already been determined by the mechanisms of the actual sale. As long as the process is competitive, fair and in accordance with market standards, the price fetched as a result of the sale should be considered, at least in principle, to reflect the true value of the business. Thus, the determination of the liquidation value of the business, in the abstract, appears to be superfluous. This is even more so, when the court runs a public auction in the liquidation phase, considering that an auction is generally considered as the most reliable method for determining accurate and reliable asset values. Since pre-packs under the Directive already provide for elaborate mechanisms to police the process of the sale, including an additional substance-based test to police the outcome does not appear justified in the vast majority of cases.

32. The only defensible rationale for retaining the test is that it can operate as a straightforward backstop for those cases, where there are indicia of a non-competitive process yielding an artificially low, below-market bid. The Directive appears to acknowledge as much, since it requires a valuation to be conducted only where the court or the creditors (depending on which body is responsible for authorising the sale) suspect that the best bid does not satisfy the best-interests-of-creditors test.[69] Even in that residual role, however, the application of the test is not costless, given that a judicial valuation of a distressed firm (which is essentially the only way that the test can be established) is a notoriously complicated proposition.[70] In addition, creditors have inherently opposite interests as far as valuation is concerned; senior claimants have incentives to undervalue the business, since that enables them to claim a greater proportion of its post restructuring value, whereas junior claimants have corresponding incentives to overvalue it.[71] As a result, parties often take very adversarial positions on valuation, which increases the costs of the process and can cause delays that undermine the prospects of business rescue.[72]
33. With that in mind, the role of the best-interests-of-creditors test, as a condition, the application of which must be certified by the monitor in every pre-pack, should be re-evaluated. Considering that the monitor will not be able to engage in a valuation of the debtor's business during the preparation phase, the test would operate more efficiently as a ground of objection available to creditors during the

69 Art. 29 §4 Directive.

70 Stuart C Gilson, Edith S Hotchkiss and Richard S Ruback, 'Valuation of Bankrupt Firms' (2000) 13 The Review of Financial Studies 43.

71 Lorenzo Stanghellini and others, Best Practices in European Restructuring - Contractualised Distress Resolution in the Shadow of the Law (2018) 63.

72 Donald S Bernstein and Douglas G Baird, 'Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain' (2006) 115 Yale Law Journal 1930.

liquidation phase. This formulation would be similar to the PRD's approach on the issue of valuation,[73] triggering a valuation only when creditors object to the authorisation of the sale on the that ground.[74] Such an approach would balance the protection of creditor interests against the costs of conducting a valuation to police the outcome of sales, which have been conducted appropriately and raise no issue of prejudice or value shifting. In that sense, establishing whether the best-interests-of-creditors is satisfied or not should not be a burden of the monitor, who should remain responsible for policing the preparation phase, but rather a ground of objection, to be claimed by creditors.

34. More notably, the same rule should also apply to related-party bids. Under the terms of the Directive, where a related party bids to acquire the debtor's business, the monitor is required to engage in a full-scale valuation to determine whether the bid satisfies the best interests of creditors test.[75] The increased scrutiny to which such transactions are subject to is not wholly unjustified, as they can enable existing owners to take advantage of the pre-pack to 'shed liabilities', especially towards workers and junior creditors.[76] That being said, related parties transactions remain subject not only to the same process-related safeguards that apply to every transaction (i.e. the monitor's involvement in the preparation phase) but also to additional such requirements, which include disclosure obligations of their related-party status to other potential bidders.[77] Thus, by mandating that, on top of that, a valuation should be conducted in every related-party case, the Directive adds only costs, delays and complications to such transactions. Given that a policy decision has been made to allow these transactions, a valuation should only be necessary if creditors object on the ground that the bid leaves them worse off than in insolvency or the alternative scenario. Overall, one could therefore argue that the Directive strikes the balance between enabling distressed pre-pack sales and policing potential abuses in a manner that heavily overcorrects in favour of the latter.

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73 Art. 14 §1 PRD.

74 There are some who argue however that the market determination of value should not be second-guessed judicially by reliance on expert evidence. This was pointed out by Baird in relation to creditor objections to the sale of the business in the Chrysler bankruptcy case: see Douglas G Baird, 'Car Trouble' [2011] John M. Olin Program in Law and Economics Working Paper No. 551 11 <http://ssrn.com/abstract=1833731>. In short, there is little value in an abstract valuation of the business in liquidation; what matters most is that the sale process is structured in such a way, so as to ensure competitive bidding and the reflection of real market value.

75 Art. 35 §1(c) Directive.

76 Rolef de Weijs and Ratti, 'Insolvency Doctor Knock: Not Prozac but Related Party Pre-Packs (RPPP's)' (Corporate Finance Lab, 8 December 2025) <https://corporatefinancelab.org/2025/12/08/insolvency-doctor-knock-not-prozac-but-related-party-pre-packs-rppps/> accessed 21 April 2025.

77 Art. 35 §1(a), (b), (d) Directive.

4. Is the pre-pack necessary?

4.1 Employee protection and the TUPE Directive

35. In laying out how the Directive's provisions fail to reach a proper balance between facilitating pre-packs and protecting creditor interests, the foregoing analysis has assumed, for the sake of argument, that the introduction of the pre-pack was actually necessary to serve a particular policy objective. However, this does not appear to be self-evident. In fact, it is unclear why the Commission had to take action at the EU level to introduce a uniform procedure enabling the sale of distressed businesses to third party buyers as opposed to leaving the matter to the competence of Member States.
36. When the first proposal on the Directive was published, it was generally assumed that the main impetus behind the Commission's harmonisation effort was the need to address the consequences of the ECJ's interpretation of the so-called "bankruptcy exception" of the TUPE Directive.[78] In general, the TUPE Directive protects employees against dismissal when a business is transferred as a going concern, by stipulating that employees automatically transfer to the new buyer.[79] These protections however do not apply when the transferor is the subject of bankruptcy proceedings or other analogous proceedings which have been instituted with a view to the liquidation of the assets of the transferor and are under the supervision of a competent public authority.[80] Traditionally, this provision has been construed as exempting from the scope of the TUPE Directive business transfers that are concluded in the context of statutory insolvency proceedings, but it had long remained unclear whether the exception also covered asset sales in the context of pre-packs.
37. The ECJ considered this exact question in two successive judgments. In *Smallsteps,*[81] the ECJ found that a pre-pack sale of the business to a company owned by the same shareholder was not 'aimed at liquidation' and therefore did not qualify for the bankruptcy exemption of the TUPE Directive. Subsequently, in *Heiploeg,*[82] the ECJ ruled that a transfer of an undertaking that takes place in the context of a pre-pack, where the sale is negotiated out-of-court but concluded

78 Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses [2001] OJ L82/16.

79 Art. 3 TUPE Directive.

80 Art. 5(1) TUPE Directive.

81 C-126/16 Federatie Nederlandse Vakvereniging and Others v Smallsteps BV.

82 C-237/20 Federatie Nederlandse Vakbeweging v Heiploeg Seafood International BV, Heitrans International BV.

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after the commencement of insolvency proceedings, can fall under the "bankruptcy exception" provided however that such process governed by statutory or legal provisions and is not merely a creature of case law or judicial practice. This last allusion in the court's ruling was viewed as the trigger prompting the Commission to intervene in order to provide Member States with harmonised rules on pre-packs that can qualify as 'analogous proceedings' for the purposes of the bankruptcy exemption.[83]

38. It is not however clear whether the Directive, in its final version, truly exempts the pre-pack from the scope of the TUPE Directive. In fact, the respective provisions of the Directive appear outright contradictory. On the one hand, they provide that the Directive is without prejudice to the provisions of the TUPE Directive. On the other hand, they also state that for the purposes of the 'bankruptcy exception' of the TUPE Directive, the liquidation phase of the pre-pack shall be considered to be 'bankruptcy proceedings or any analogous insolvency proceedings instituted with a view to the liquidation of the assets of the transferor under the supervision of a competent public authority'.[84] One possible way to decipher this inconsistency, is to take the more cynical approach and conclude that the Directive, despite explicit assurances to the contrary, indeed prejudices the rights of employees by placing pre-packs firmly within the bankruptcy exception. A different view would draw attention to the Directive's introductory recitals, which refer explicitly to the ECJ's judgment in *Heiploeg,* qualifying the application of the bankruptcy exemption on the pre-pack having as primary objective 'to satisfy the claims of creditors to the greatest extent possible whilst preserving employment as much as possible'. This wording could be read as suggesting that the Directive does not materially affect the application of the TUPE Directive post- *Heiploeg,* which effectively means that pre-packs will be assessed on a case-by-case basis to determine whether they fall within the ambit of the bankruptcy exception.[85] Simply put however, the current state of affairs is far from clear.
39. If we consider (at least for the sake of argument) that the Directive's main objective was indeed to provide a pan-European safe harbour for business transfers

83 Thery (n 23) 4.

84 Art. 22 §2 Directive.

85 Rolef de Weijs, Luca Ratti and Johan Zwemmer, 'Employees' Protection under the EU Pre-Pack Directive after the Trilogue: Employees' Protection under TUPE Is Alive and Employees Will Still Transfer in Case of Related Party Pre-Packs!' (Corporate Finance Lab, December 2025) <https://corporatefinancelab.org/2025/12/18/employees-protection-under-the-eu-pre-pack-directive-after-the-trilogue-employees-protection-under-tupe-is-alive-and-employees-will-still-transfer-in-case-of-related-party-pre-packs/#_ftnref10> accessed 21 April 2025.

in the context of pre-packs, this is problematic on multiple fronts. First, it would provide bad faith parties with considerable room for gamesmanship, enabling them to structure business sales as pre-packs to circumvent their obligations of maintaining their employees.[86] In addition, from a policy perspective, it is unclear how *Heiploeg* can justify the Commission's intervention, on the basis of the principle of subsidiarity, which mandates that the EU does not take action, unless such action is more effective than action taken at the level of the Member States.[87] The fact that the ECJ identified a blind spot in the application of a particular provision of a directive does not seem to justify the introduction of a uniform pre-pack procedure that pre-empts policy decisions, which should be taken at the level of Member States.[88] Rather than addressing a structural problem affecting the common market, the Directive would seem to essentially be forcing the hand of the Member States in one particular direction as regards an intricate policy question.

40. Finally, even if one does not consider subsidiarity as a strict obstacle to the introduction of the Directive, the view that the pre-pack is an 'antidote' to *Heiploeg* is probably reading the ECJ's judgment wrongly. If *Heiploeg* indeed flagged an issue, this was probably not the absence of formal insolvency procedures enabling the transfer of businesses as going concerns. After all, such proceedings are ubiquitous in the laws of most Member States. Instead, *Heiploeg* and its progeny merely drew attention to the fact that the TUPE Directive's binary reference to "bankruptcy or other analogous proceedings" makes little sense in an increasingly complex legal landscape, which includes insolvency proceedings, restructuring frameworks, hybrid and preventive tools and a great deal of in-between. As the lines between distressed and non-distressed business sales have become blurrier, drawing a line as to when the bankruptcy exception applies has become increasingly difficult. Even if offering a bright line rule is indeed a task to be taken up at the EU level, this is a serious policy question that requires a balancing act between the rights of investors and employees. That policy debate does not appear to have taken place in the context of the Directive's introduction. Therefore, even if the questions posed by *Heiploeg* remains open, the Directive's provisions on pre-packs appear to be an unjustified and imperfect intervention..

86 'European Harmonisation of Pre-Packs_ Initiating a European Race to the Bottom at the Expense of Employees – Corporate Finance Lab.Pdf'.

87 Art. 5(3) TEU.

88 This of course calls into question the decades-old question of whether the principle of subsidiarity can actually ensure the balance between the competences of the EU and the Member States: see Gareth Davies, 'Subsidiarity: The Wrong Idea, in the Wrong Place, at the Wrong Time' (2006) 43 Common Market Law Review 63 <https://doi.org/10.54648/COLA2005083>.

4.2 The Limited Relevance of Pre-packs for European MSEs

41. If one puts the question of the interplay between the Directive and the TUPE Directive aside, the reason behind the pre-pack's introduction remains equally obscure. As already pointed out, the main justification behind the introduction of the Directive (at least as this is laid out in the introductory recitals) is that the absence of harmonised insolvency regimes across the EU would hamper the free movement of capital and create inefficiencies in the proper functioning of the internal market. This seems like a no-brainer but at the same time reveals little about the initiative's underlying motives; it is obvious that a harmonised regime can ensure greater integration of the common market and remove obstacles to the free movement of capital, but if this was sufficient, every area of the law of the Member States would be harmonised. The abstract benefits of harmonisation as opposed to fragmentation cannot explain why the EU chose to harmonise that particular area of the law of Member States.
42. Interestingly, the original Proposal for the Directive[89] provides a small measure of insight in that respect. In particular, in justifying the Commission's initiative, the Proposal cites, in its introductory part, a benchmark assessment by the European Banking Authority, which describes how recovery rates for lenders vary across Member States.[90] This assessment identifies, among other things, the availability of pre-packaged procedures for MSEs as one of the main determinants of higher recovery rates. In that regard, the Directive seems to be, at least implicitly, motivated by the need to ensure that pre-packs are widely available to European MSEs and thus can assist in improving creditor recoveries and by extension access to finance for such firms.
43. There is some empirical and anecdotal evidence that pre-packs are indeed used by MSEs, especially in jurisdictions that do not provide attractive restructuring frameworks for MSEs.[91] That being said, it is not straightforward that pre-packs are a good fit for MSEs across the board. There are several reasons for this. For one thing, the transfer of a business as a going concern presupposes that a potential buyer or bidder has access to reliable and adequate information about the firm's operational and financial condition. Given the difficulties inherent in

89 Commission, 'Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law' COM (2022) 702 final.

90 European Banking Authority, 'Report on the Benchmarking of National Loan Enforcement Frameworks' (2020) EBA/Rep/2020/29 <https://www.eba.europa.eu/sites/default/files/document_library/About%20Us/Missions%20and%20tasks/Call%20for%20Advice/2020/Report%20on%20the%20benchmarking%20of%20national%20loan%20enforcement%20frameworks/962022/Report%20on%20the%20benchmarking%20of%20national%20loan%20enforcement%20frameworks.pdf> accessed 16 January 2025.

91 Gurrea-Martinez (n 24).

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the valuation of distressed assets and the informational asymmetries that are often generated as a result, the absence of information can lead to the undervaluing of the business and bargaining breakdowns, thus undermining the prospects of business rescue.[92] Existing creditors or insiders may already be privy to such information, but outsiders are likely to be able to acquire it (at a reasonable cost) only in the case of larger and publicly traded firms. Considering that the Directive views insider bids with considerable suspicion, it is questionable whether MSEs are actually in a position to credibly attract alternative- outside bidders.

44. At the same time, MSEs, especially on the smaller end of the scale, often have a lower degree of asset specificity, meaning that keeping their assets together, as an operational business unit, may have a lower marginal value when compared to larger firms. The assets of MSEs, which are, as a rule, mainly comprised of human capital and intangible assets (such as contracts and IP) can easily be redeployed even if the firm is liquidated piecemeal. This suggests not that the rescue of MSEs is inherently pointless, but that any going concern surplus such firms possess is often so modest that it cannot justify the costs of a rescue process.
45. In addition, larger firms are more likely to exhibit a separation of ownership and control, when compared to MSEs. Thus, the value of an MSE is often tied to the owners or founders of the firm.[93] As a result, the displacement of existing ownership, which is almost always the outcome of a sale, has the potential of being more detrimental for the future value of an MSE as opposed to a larger firm. Relatedly, MSEs usually exhibit, as a result of their size, scale of business and financing structures, a closer degree of connection between financial and operational distress.[94] Since an SME is less likely to be distressed and, at the same time, viable, the prospects of its rescue become significantly more challenging.
46. One must point out that the above conditions do not necessarily hold in respect of all MSEs across Europe. Still, they are disproportionately characteristic of the MSE sector in the European periphery and most notably southern Europe. For instance, the MSE cohort in South Europe is overwhelmingly comprised of micro-enterprises, which are family controlled and family managed,[95] suggesting that any going concern value that the firm may have is effectively "locked in" with

92 William Samuelson, 'Bargaining under Asymmetric Information' (1984) 52 Econometrica 995 <https://doi.org/10.2307/1911195>.

93 Jackson (n 9) 222.

94 Horst Eidenmüller, 'Contracting for a European Insolvency Regime' (2017) 18 European Business Organization Law Review 273, 284–285 <https://doi.org/10.1007/s40804-017-0067-1>.

95 Marcelo Ortiz, 'The Prevalence of Private Family Firms in Europe' (Universitat Pompeu Fabra 2025) White Paper No 5.

existing ownership and cannot easily be transferred to a third-party buyer. In addition, most MSEs in Southern and Eastern Europe operate in less capital-intensive sectors, such as retail or services, implying low asset specificity.[96] This is further exasperated by the weak integration that MSEs in these regions have with corporate (i.e. large enterprise) ecosystems, which suggests that any going concern surplus these firms may have can be redeployed with relative ease and without the need to engage in a full-scale rescue.[97] Furthermore, south- European MSEs face, on average, tighter and more short-term financing conditions,[98] compared to similar firms in Northern Europe, which is in turn reflected in a shorter time period between distress and failure. The absence of a specialised SME financing ecosystem does not only impact financing conditions but also means that, once distress hits, there are fewer available and ready buyers to acquire the business as a going concern, a reality that is further exasperated by lower information disclosure and weaker accounting standards.[99] Overall therefore, there are many Member States, where the structure of their economy and their MSE ecosystem suggests that pre-packs are unlikely to have any meaningful effect in improving creditor recoveries or access to finance, as envisaged by the Directive.

47. If low creditor recoveries in several Member States can be better explained by broader economic structures (as opposed to the low utilisation of traditional restructuring proceedings and absence of alternative and accessible rescue tools), it should be evident that the adoption of a novel pre-pack framework will do little to move the needle in improving rescue prospects for distressed MSEs. Still, one could argue that introducing pre-packs as on option, even for the handful of firms that are likely to utilize it, has some value and, in any event, will certainly not be detrimental. This position, though not entirely without merit, assumes however that the costs of legal reform are either close to zero or are, at the very least, counterbalanced by the benefits of harmonisation. Indeed,

96 European Commission. Joint Research Centre. and European Commission. Directorate General for Internal Market, Industry, Entrepreneurship and SMEs., Annual Report on European SMEs 2024/2025: SME Performance Review 2024/2025. (Publications Office 2025) <https://doi.org/10.2760/7714438> accessed 3 August 2026; Raya Kanazireva, 'A Country–Sector Framework for SME Economic Contribution: Evidence from Central and Eastern Europe' (2026) 20 Proceedings of the International Conference on Business Excellence 2542 <https://doi.org/10.2478/picbe-2026-0194>.;

97 Eurostat, 'SMEs - independent and in enterprise groups' (Statistics Explained, April 2025) <https://ec.europa.eu/eurostat/statistics-explained/index.php?title=SMEs_-_independent_and_in_enterprise_groups> accessed 3 August 2026

98 European Central Bank., Firm-Bank Relationships: A Cross Country Comparison. (Publications Office 2023) <https://doi.org/10.2866/505807> accessed 4 August 2026.

99 Markus Demary, Joanna Hornik and Gibran Watfe, 'SME Financing in the EU: Moving beyond One-Size-Fits-All' (College of Europe).

harmonisation has significant economic benefits, primarily by reducing information and other transaction costs in cross-border transactions. However, legal reform in itself is not a frictionless process,[100] even under the 'minimum harmonisation' model envisaged by the Directive. On the contrary, legislative initiatives, especially the introduction of novel principles and legal processes, may increase uncertainty in the short term.[101] At the same time. Member States have often varying degrees of institutional competence to absorb successive cycles of reform and there is reason to believe that constant meddling with the same area of law can have diminishing returns over time.[102]

48. The question of whether legal rules can achieve specific economic outcomes is wide ranging and transcends the scope of the present article. Suffice it to say however that the Directive assumes that all Member States can handle the harmonisation process with equal competence and underestimates the potential costs that the harmonisation effort may generate, especially on the backfoot of another major reform of Member States' restructuring frameworks, in the context of the implementation of the Preventive Restructuring Directive. Considering that the marginal costs of reform will be greater in those Member States, where utilisation of pre-packs will be lowest, it is doubtful whether, for those Member States, the costs of reform are, as a matter of policy, justified by its benefits.

5. Concluding remarks

49. The above analysis operates on two distinct levels that should not be conflated. At the level of design this article has argued that, if the pre-pack is to operate at all, the mechanism for the protection of potentially disadvantaged parties should be recalibrated, shifting the burden away from the monitor and instead facilitating actual creditor participation in the authorisation of the sale. At the level of policy, the main contention advanced by the analysis, is that the pre-pack is an unnecessary and unwarranted initiative by the EU Commission, which mistakes a symptom of underlying economic structures (low creditor recoveries and limited rescue activity by MSEs), as a defect of legal architecture. As a result,

100 We refer here to the direct costs of introducing and applying new legal norms and rules and not to the efficiency losses that result from the absence of regulatory competitions: see Helmut Wagner, 'Costs of Legal Uncertainty: Is Harmonization of Law a Good Solution?' Modern Law for Global Commerce (2007) 4.

101 Michael P Van Alstine, 'The Costs of Legal Change' (2002) 49 UCLA Law Review 789, 822.

102 Yiannis G Sakkas and Yiannis G Bazinas, 'The Greek Insolvency Code: An Over-Reformed Law' (2018) 14 Pratt's Journal of Bankruptcy Law 222.

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the Directive's provisions on pre-packs are unlikely to meet their stated policy objectives of increasing creditor recoveries and improving access to finance for European MSEs.

50. It is true that the latter strand of critique paints a rather bleak picture of the effectiveness of any reform that is aimed at improving the insolvency and restructuring framework for SMEs. Such a reading however would be fallacious. This article is not meant to express the belief that the situation is hopeless but merely to highlight the inherent interplay between any legal reform and the economic and institutional environment in which the products of such reform will need to operate. In the field of insolvency and restructuring law in particular, too little attention has been placed on this aspect of the reform process, with the EU producing successive harmonisation instruments, with each new procedure purporting to yield the results that the previous failed or could not deliver. These procedures are not intrinsically ineffective, but their introduction should be backed by a clearer understanding of the various divergences in the economic and institutional environment of Member States. It is hoped that by stripping away the veneer of the pre-pack, these lessons will be learned in Brussels at the next juncture, when a new harmonisation effort will be considered.

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