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Regulations to scrutinise pre-pack sales to connected parties

KEY POINTS

- Legislation introducing conditions for sales by administrators to connected parties has now been approved by Parliament.
- The pre-pack pool, introduced to review and consider proposed pre-pack sales to connected parties, will be replaced by a requirement either:
  - that the buyer obtains an independent opinion as to whether the terms of the sale are reasonable; or
  - that the administrator obtains prior creditor approval for the sale.
- In the event that the opinion concludes that the terms of the sale are not reasonable, the sale can still proceed on the basis that the administrator provides a statement to support his or her decision.
- The conditions will apply in respect of administration sales to connected parties of all or substantially all of the company's assets in the first eight weeks of the administration.

On 23 March 2021 legislation to regulate and scrutinise pre-pack sales to connected parties was approved by Parliament. The regulations require that, in relation to a sale or disposal of all or substantially all of an insolvent company's business or assets to a connected party, either the administrator obtains the prior approval of the company's creditors or the buyer obtains an opinion from an independent evaluator as to whether the terms of the sale are reasonable. Following a consultation period, the draft statutory instrument of the regulations was published on 24 February 2021 and was approved by Parliament in quick succession.

A 'pre-pack sale' is a sale of an insolvent company's business and assets by its administrator where the terms of the sale are agreed and documented prior to the appointment of the administrator. The sale is concluded immediately following the appointment of the administrator. The benefit of a 'pre-pack' is that it preserves the value of the business by enabling a seamless transition of the trading enterprise. Pre-pack sales occur in circa 30% of all administrations.

However, whilst a pre-pack sale may ensure the survival of the business and the retention of employees, the creditors of the seller company often criticise such sales for a lack of transparency (as they will only find out about the sale after the event) and, often, the business will have been subject to limited marketing. Furthermore, creditors are usually particularly concerned when the pre-pack sale is to a party connected to the seller (for example, existing management, shareholders, or relatives). It is estimated that approximately half of all pre-pack sales are to connected parties.

THE EXISTING REGIME

The regulations will replace the current voluntary regime which was introduced in November 2015 and pursuant to which connected buyers can refer a proposed sale to the 'pre-pack pool'. The pre-pack pool is a group of independent experts, set up by the insolvency industry, who review the sale proposal and determine whether it is reasonable. However, the pre-pack pool is not currently widely used by buyers. It is estimated that only 10% of eligible cases were referred to the pre-pack pool in 2019.

THE REGULATIONS

The intention behind the regulations is to increase both transparency for the creditors and confidence in administration sales to connected parties. The obligations set out in the regulations will be mandatory in the case of any disposal of all or substantially all of a company's business or assets to a connected person which occurs within eight weeks of the company's entry into administration. Therefore, the regulations will apply to both pre-pack sales and those which occur shortly after the commencement of the administration. The regulations apply in respect of a disposal, sale or hiring out of all or substantially all of the company's assets. This can be one transaction or a series of transactions. It is for the administrator to determine if the assets subject to the disposal constitute all or substantially all of the company's business or assets.

Under the regulations, prior to completion of a sale or disposal to a connected party, either:

(i) The administrator must obtain the approval of creditors. Such approval must be given by a simple majority of the creditors based on the value of their claim in the administration. However, the approval will not be effective if 50% or more of creditors not connected to the company vote against it; or

(ii) The buyer must obtain a written opinion from an independent evaluator as to whether the proposal is reasonable.

CONNECTED PARTIES

A 'connected person' for the purpose of the regulations is as defined in para 60A(3) of Sch B1 of the Insolvency Act 1986. Therefore, any common directors, shareholders, and controlling entities (or their associates) would be considered connected. This differs from the definition of parties considered 'connected' for the existing pre-pack pool regime. In particular, the existing regime excludes certain secured lenders who hold security with

Biog box

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related voting rights. It is not clear currently whether such lenders would be considered 'connected' for the purposes of the new regulations.

THE EVALUATOR

It is not specified who can (or cannot) act as an evaluator. However, both the evaluator and the administrator must consider that the evaluator is independent from the administrator, the company and the buyer and has the requisite knowledge and experience to opine on the proposed sale.

THE EVALUATOR'S OPINION

The evaluator's opinion will set out whether, in light of the circumstances, the proposed sale is reasonable. The opinion must contain a statement from the evaluator which sets out his or her relevant knowledge and experience to reach the opinion. The administrator must be satisfied that the evaluator had sufficient relevant knowledge and experience as at the date of the opinion to make a qualifying report under the regulations. Furthermore, there must be no material changes to the relevant property, the terms of the disposal or the circumstances surrounding the disposal since the date of the opinion.

The evaluator is required to set out the assets subject to the sale and the value of the consideration. The opinion will also identify the purchaser and set out their connection to the company. The opinion will set out whether, in the circumstances, the terms of the disposal are reasonable, which will be supported by the evaluator's reasons.

The opinion must also contain details of the evaluator's professional indemnity insurance. The insurance must cover the evaluator in respect of potential liabilities to the administrator, the connected buyer, the company's creditors or any other person, as a result of, or arising from, any matter stated by the evaluator in their opinion.

There is no limit on the number of evaluator opinions which the buyer can obtain (although, there may be time and cost constraints in obtaining more than one opinion). When a buyer is procuring more than one opinion for a disposal which is the same or substantially the same, the previous opinion(s) should be provided to the evaluator. Furthermore, the evaluator is required to consider whether, contrary to any representations by the buyer, a previous opinion for the sale has been obtained. The evaluator must state whether copies of the previous opinion(s) have been provided to him and, if so, enclose either a copy of the previous opinion(s) or details from the opinion(s). Where an earlier opinion is not provided to the evaluator, the evaluator must set out the reason why and the steps taken in order to try to obtain a copy of the opinion.

FILINGS AT COMPANIES HOUSE

Each opinion (whether favourable or not) must be sent to the seller company's creditors and filed at Companies House (excluding any information that, in the administrator's opinion, is confidential or commercially sensitive). The opinion(s) must be sent at the same time as the administrator circulates and files his or her statement of proposals. In addition, it is still possible for a sale to proceed even where the evaluator's opinion is that the proposed sale is not reasonable (a 'case not made opinion'). In circumstances where the administrator decides to proceed notwithstanding a case not made opinion he or she must provide a statement justifying their reasons for doing so.

THE EFFECTIVE DATE

The Corporate Insolvency and Governance Act 2020 (CIGA) revived and extended the power of the Secretary of State to introduce conditions in relation to sales by administrators. Under CIGA, the Secretary of State is required to exercise this power by 30 June 2021. As a consequence, the legislation will be effective from 30 April 2021. The regulations will only be applicable in relation to administrations which commence on or after 30 April 2021.

CHANGES TO SIP 16

The Statements of Insolvency Practice set out the procedures and practice which insolvency practitioners, including administrators, must follow. SIP 16 addresses pre-pack administration sales. SIP 16 recognises that an administrator will apply their commercial judgment in considering whether a pre-pack sale should be undertaken. However, SIP 16 requires that creditors are provided with sufficient information regarding the terms of the sale, the circumstances leading to the sale and the administrator's appointment in order to better understand the administrator's rationale for conducting a pre-pack sale. The level of disclosure required to be provided to creditors is greater when the sale is to a connected party.

It is understood that the Joint Insolvency Committee intends to publish a revised SIP 16 which will incorporate the changes made by the regulations. It is anticipated that the revised SIP 16 will be published prior to the regulations coming into effect. It is also expected that the revised SIP 16 will require that further detail regarding a sale or disposal of the company's assets to a connected party is provided to the creditors.

IMPACT OF THE REGULATIONS

It is not yet known who will typically take the role of evaluator. It is anticipated that it will be an insolvency practitioner from another firm to that of the administrator. The seemingly wide range of parties who could act as an evaluator is considered to be a fundamental weakness in the regulations. Once the regulations become effective, buyers (and administrators) will need to factor in both the time and cost of such evaluation when planning a pre-pack sale. It is clear that the intention of the regulations is not to prevent sales to connected parties but, in such instances, to increase the information to and involvement of the creditors of the company. ■

Further reading

- *Latest pre-pack reforms: independent opinion required for administration sales to connected persons* – (2020) 6 CRI 209
- Pre-packaged business sales: *Tolley's Insolvency Law Service* [A5011]
- Statement of Insolvency Practice (SIP) 16 – pre-packaged sales in administration; LexisPSL Restructuring & Insolvency; The office-holder; Roles, powers, duties and functions of an insolvency office-holder