

UK INSOLVENCY REFORM – EVALUATING PRE-PACK SALES TO A CONNECTED PERSON

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UK Restructuring and Insolvency alert

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EXECUTIVE SUMMARY

A Pre-Pack Sale is the sale of all or substantially all of an English company's assets to a third-party purchaser immediately or shortly after the distressed company goes into a UK rescue procedure called administration. The attraction of a Pre-Pack Sale is the speed of the transaction, which helps preserve the value of the business and save jobs, as the company is able to carry on trading through the process. The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 (Regulations) will apply to any administrations starting from and including 30 April 2021, and they require further due diligence and scrutiny where the Pre-Pack Sale is proposed to be made to a connected person.

For a summary and brief history of Pre-Pack Sales and the draft Regulations, [please see our alert](#) published in October 2020.

INTRODUCTION

The Regulations will apply to any sale to a connected person of all or substantially all of an insolvent company's business completed within the first eight weeks of the start of an administration process.

CONNECTED PERSON

There is a wide definition of who may be considered a connected person (the Regulations specifically reference paragraph 60A of Schedule B1 to, and section 435 of, the Insolvency Act 1986). In reality, it is likely the connected person will be a director, shadow director, or shareholder of the insolvent company or someone with sufficient knowledge of the business to effectively manage existing client and supplier relationships. However, it is possible that secured lenders may also fall within this definition, especially if they control more than one third of the voting rights in the insolvent company.

The Regulations do not make allowance for ignorance as to whether the purchaser is a connected person. If the connection is not obvious, the administrators must conduct thorough due diligence on the potential buyer. The administrators also need to have no reason to believe that the evaluator is connected to the insolvent company.

THE PROCESS

If the conditions of a potential connected person Pre-Pack Sale are met from and including 30 April 2021, one of two pre-conditions must be met beforehand: either (i) the administrators must obtain creditor approval or (ii) the

connected person must obtain a confirmatory report from an evaluator (Report). As Pre-Pack Sales are generally utilised quickly and discretely to ensure the maximum value is obtained for the business with minimum disruption to employees and supply chains, obtaining creditor approval may be an unrealistic option. Therefore, more likely, the connected person will obtain a Report. The Report is not binding, and the administrators can choose to go against its findings, provided they can offer a justifiable reason for doing so.

CREDITOR APPROVAL PROCESS

To obtain prior creditor approval for the Pre-Pack Sale, the administrators will approach each creditor that they are aware of (other than those who have opted-out) with the proposal for making the disposal to the connected person. The creditors will then have 14 days to either approve the proposal or propose modifications for the proposal, which the administrators will then need to consent to. A majority (in value of amounts owed) of those creditors voting is required to consent to the Pre-Pack Sale to a connected person.

EVALUATORS

If the Report option is taken, an evaluator will need to be engaged. While there is no central register of evaluators and they require no professional qualifications, the evaluator must be an independent, solvent, sane individual who has not been disqualified to act as a director or a trustee. The industry's "big win" since the consultation in October 2020 is that the evaluator must have adequate professional indemnity insurance. This will effectively limit the pool of evaluators to those who are qualified to provide professional services—the thought being that they would not be able to obtain such insurance without being professionally qualified. However, the Regulations do not cater for a situation where an evaluator has been purposefully misleading about their qualifications; perhaps this will be addressed through the insurance market as well. The onus is on the administrators to ensure the evaluator has “*sufficient relevant knowledge and experience to make a qualifying report.*”

THE REPORT

The Report must be obtained by a connected person, made by an evaluator, and given to the administrators. The Report will be in writing, state the date that it was made, and be authenticated by the evaluator; authentication occurs by either having (i) the hard copy signed by the evaluator or (ii) the electronic copy include a statement identifying the evaluator where the administrators have no reason to doubt its authenticity.

Additionally, between commissioning the Report and issuing the Report, there should be no material changes in (i) the business being sold, (ii) the terms of the disposal, and (iii) the circumstances relating to the disposal. Therefore, a Report may not be issued prior to an administration commencing.

The Report will contain the following information:

- Confirmation that the person making the Report is an evaluator and the evaluator's knowledge and experience making them qualified to prepare the Report;
- Details about the evaluator's professional indemnity insurance;
- Details about the insolvent company's business being sold;
- The identity of the person commissioning the Report and how they are a connected person;

- The proposed consideration for the sale; and
- A conclusion that the evaluator is or is not satisfied that the consideration is reasonable (and their reasons for this statement, including a summary of the evidence).

As there has previously been concern about ensuring that the evaluator would remain independent despite being appointed by the connected person, new provisions in the Regulations help discourage the connected person from obtaining multiple Reports and “report shopping.” If it comes to the evaluator’s attention that the connected person has requested multiple Reports, the Report must also contain a copy of the previous Report(s). If a copy has not been provided to the evaluator, the Report must include a reason why the previous Report has not been incorporated (which can be a statement confirming that the connected person claims no previous Report exists) and state the steps the evaluator took to obtain a copy of the previous Report.

Administrators will need to be satisfied that the evaluator has sufficient knowledge and experience to make the Report. This may be difficult to ascertain since the Report is commissioned by the connected person instead of the insolvent company, so there may be limitations on the disclosure provided to the evaluator or connected person. An important point to remember is that the Report is not final; in the end, the administrators will make the final decision.

CONCLUSION

While the Regulations are a much better alternative than the UK government banning Pre-Pack Sales to connected parties outright, there is still room for improvement. The aims of the Regulations were to increase transparency in the Pre-Pack Sale process and ensure creditors feel more engaged. Administrators have the power to force through a Pre-Pack Sale against the Report, but they must provide sufficient reasons for doing so. As the administrators must justify their decision, this arguably increases transparency.

Pre-Pack Sales are normally completed quickly to ensure the best price can be obtained for an insolvent company or its assets. There is concern in the industry that going through the extra step (and cost) of obtaining a Report will delay the sale and diminish the insolvent company’s assets further. We will review the implementation of the Regulations in the market.

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