BULLETIN

PRE-PACKS UNDER ENHANCED SCRUTINY

Do the draft regulations serve to fix the perception of pre-pack sales or do they undermine a valuable business rescue tool?

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The Insolvency Service released its report on 8 October 2020 on the state of 'pre-pack' sales following the administration of UK Companies. The report provided a number of legislative proposals and draft regulations were published alongside it.

The Basis

A pre-pack administration is typically one where the business of a company is sold as soon as the company enters administration with the sale terms having been negotiated and agreed before the company entered into the insolvency process. The sale is effectively pre-packaged before the administration starts - hence its colloquial name.

Sales of this nature, especially where the business is sold back to the directors or persons connected with the administered company, often attract criticism and a perception of unfairness from unsecured creditors. In most cases the first that the creditors know of the pre-pack is when they receive notification from the administrators by which time it is a *fait accompli*.

The Government previously reviewed the structures in place under the Graham Review in 2014 which lead to the creation of the Pre-Pack Pool in 2015. The obvious criticism and need for further review was the fact that the Pre-Pack Pool has been rarely used. The Government accordingly concluded that there was continued concern surrounding pre-pack sales.

Whilst mandatory referral to the Pre-Pack Pool was contemplated a balance was sought to promote business rescue, especially in light of the Covid-19 pandemic, and to protect the interests of creditors.

Consent or Evaluation

The legislative amendments are proposed to be made under Paragraph 60A of Schedule B1 to the Insolvency Act 1986. The proposal provides that a sale of all or a 'substantial part' of a company's assets within the first 8 weeks of the administration will need either:
- creditor approval; or
- an independent written opinion provided by an 'Evaluator'.

The Evaluator's Opinion

In practice it is likely that an officeholder will prefer to take the opinion of an evaluator rather than commencing a decision process with the creditors. This written opinion however must be commissioned by the buyer and made available to the creditors and filed at Companies House.

The written opinion must provide a specific statement confirming the consideration, that the evaluator is satisfied that the consideration is reasonable, the reasonings for reaching this decision and the identity of the connected person and his connection to the company.

The Evaluator must not be the administrators or one of their associates and must not be connected to either the company or the connected person.

Time for Change

Whilst it is of course important to be conscious of the proposed change it cannot be understated that the parliamentary bandwidth is currently at capacity. Parliament has simply confirmed that the draft regulations will be considered before ***June 2021***, but there is no guarantee that the regulations will be considered or adopted within this timeframe.

Our Thoughts

The draft regulations have been drawn in a manner clearly designed to change the negative perception of pre-pack administrations and the use of an Evaluator is clearly meant to increase the transparency of the process and keep the administrator at arm's length from the sale. It is encouraging that the Government has focussed on this perception rather than blocking pre-pack administrations which remain a valuable business rescue tool.

There are some downsides though if the regulations are adopted as proposed. The proposals add a further procedural step to the pre-pack process which will have time and cost repercussions. The 8-week period clearly extends beyond the typical pre-pack administration which would be largely agreed before the company enters the process. Whether this additional process leads to a reduction in pre-pack administrations is yet to be seen.

The Evaluator's opinion is also not quite sacred. The administrators do have the option to ignore the Evaluator's suggestion. This may undo any comfort that creditors have in the new regime - however, it is difficult to reconcile an officeholder, who is after all an officer of the court, being comfortable to proceed with a sale in the face of an Evaluator's negative opinion.

The regulations do not provide any clarity on the liability of the Evaluator himself. There is the potential that the Evaluator could have a tortious liability to the creditors for the content of his report.

Insolvency Practitioners have been invited to comment on the draft regulations by 5 November 2020.

Getting Advice

Things haven't changed yet but AMB Law stands ready to assist. The Covid-19 Pandemic has placed exceptional strain on companies, Directors may be considering the future of their businesses (and critically their duties to the company). AMB Law has a proven track record of providing practical and precise legal advice to individuals, companies and practitioners. Our network of insolvency practitioners, accountants and other professionals allow us to refer you to the best as and when you need it. There really is no reason not to contact us first.

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