

UK Reforms to Heighten Scrutiny of Pre-Pack Administration Sales to Connected Parties

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At a Glance

New laws will require mandatory independent scrutiny, or advance creditor approval, of pre-pack administration sales to connected parties – such as the insolvent company’s existing directors or shareholders. The Government plans to enact regulations as soon as Parliamentary time allows, and in any event before the end of June 2021 (when the relevant legislative power would otherwise lapse).

The existing Pre-Pack Pool will be the obvious potential source of independent written opinions – although light-touch eligibility requirements open the door to opinions from anyone with the “requisite knowledge and experience” (provided they are independent).

The reforms may mean some additional hurdles and analysis, and require more careful composition of newco boards, but we welcome measures to improve transparency and confidence in our insolvency processes. We are, however, concerned to ensure carve-outs for pre-pack sales to secured creditors and will ask for these to be reflected in the final Regulations.

[What is a pre-pack?](#)

A 'pre-pack', in the UK, is an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on, or shortly after, appointment. Administrators must be licensed insolvency practitioners.

Background

The UK Insolvency Service conducted a review of the impact of industry measures on pre-pack sales in administration, in order to inform a decision on whether statutory regulation is required. Existing industry measures, adopted in 2015, include:

- enhanced disclosure requirements;
- provisions regarding marketing and valuation of the business (to ensure the best available consideration is obtained on the sale); and
- additional provisions where the sale is to a connected party, which apply on a "comply or explain" basis:
 - approaching an independent body of individuals, known as the "pre-pack pool", for an opinion on the proposed transaction; and
 - a viability review by the connected purchaser, stating how the purchasing entity will survive for at least 12 months post-sale.

The latest reforms come as no great surprise, following:

- continued concerns around transparency of pre-pack sales to connected parties;
- a lack of evidence that the 2015 reforms described above – most of which operate on a voluntary, "comply or explain" basis – have changed behaviours sufficiently;
- in particular, concern that the pre-pack pool has been little-used since its foundation – although, in Kirkland's practice, we have seen many insolvency practitioners refer cases to the pre-pack pool, which we understand has been utilised efficiently where required; and
- the revival, in the Corporate Insolvency and Governance Act 2020, of the reserve power to regulate (or ban) sales in administration to connected persons. (This power expired in May 2020 but, in June 2020, was extended to the end of June 2021; the power allows the Secretary of State to regulate connected party pre-packs by way of statutory instrument, rather than going through the full process usually applicable to primary legislation.)

Key aspects of reforms

Restrictions will apply where there is a disposal in administration of all or a substantial part of a company's assets. An administrator will be unable to make a "substantial disposal" of the company's assets to a person connected with the company within the first eight weeks of the administration, unless either creditor approval or an independent written opinion has been obtained. See below for consideration of who constitutes a "connected party".

- Creditor approval
 - The requisite approval is, as a rule of thumb, a simple majority of creditors (although detailed provisions governing decision procedures are provided in the Insolvency Rules).
 - The ability to seek creditor approval in lieu of an independent written opinion is welcome, but raises timing issues.

- Written opinion
 - The connected party purchaser will be required to obtain a written opinion, which must state whether or not the case is made for the disposal. Where a report states that the case is not made for the disposal, the administrator can still proceed with the disposal but will be required to provide a statement setting out the reasons for doing so.
 - The administrator will be required to send a copy of the report(s) to creditors of the company and to Companies House (excluding confidential/commercially sensitive information).
 - Who can provide a written opinion?
 - The provider of the opinion must be independent of the connected party purchaser, the company and the administrator; they must not have provided restructuring advice to the company (or connected companies) within the 12 months before the date of the report.
 - The obvious potential source for such a report will be the pre-pack pool – although this is not explicitly required.
 - No particular qualification is required to provide the opinion – the threshold is that "the individual believes that they have the requisite knowledge and experience to provide the report". The administrator must have no reason to believe that the opinion provider is not independent of the connected party or does not have the requisite knowledge and experience to provide the report.
 - A connected party purchaser may obtain more than one report.

- Non-legislative measures

The Government also announced plans to work with the industry to prepare guidance to accompany the regulations and to strengthen the existing regulatory requirements to improve the quality of information provided to creditors in pre-pack administrations.

- What about pre-pack sales to creditors? A footnote in the Government's long-form report suggests that this reform should not capture pre-pack sales to "secure [sic] lenders with voting rights in the normal course of business of a third or more". However, the draft Regulations make no adjustment to the definition of connected parties for that purpose.

We are concerned to ensure adequate carve-outs for pre-pack sales to secured lenders, in line with the Graham Review, and will ask for these to be reflected in the final Regulations, as the draft progresses.

Who is a connected party?

Complex definitions apply and must be considered on a case-by-case basis. Broadly, connected parties are those with a significant prior connection to the insolvent company – including directors, shareholders and companies in the same group.

- Newco is an associate of Oldco if the same shareholders have "control" of both, which includes where shareholders are entitled to exercise $\geq 1/3$ of voting rights.
- Particular care must be taken with board composition of Newco, as Newco and Oldco will be connected if any director of Oldco is also a director of Newco (irrespective of Newco's shareholders).
- Newco's jurisdiction of incorporation is not relevant (the definition of "company" includes foreign companies).
- We consider that secured creditors who hold security for the granting of a loan (with related voting rights) as part of the secured creditors' normal business activities ought to be specifically excluded – but this is not provided in the current draft Regulations, and remains to be clarified.

Further resources

- [Government announcement](#)
- [Report](#)
- [Draft Regulations: Administration \(Restrictions on Disposal etc. to Connected Persons\) Regulations 2020](#)

Author

Kate Stephenson

Partner / London

Related Services

Practices

- [Restructuring](#)

Suggested Reading

- 25 September 2020 Kirkland Alert Major Positive Changes in the German Restructuring and Insolvency Landscape – Preventive Restructuring Process & Changes to the Insolvency Code
- 24 September 2020 Kirkland Alert European Credit Derivatives Outlook
- 24 September 2020 Kirkland Alert UK Temporary Restructuring/Insolvency Measures – Certain Extended, But No Extension to Wrongful Trading Adjustments

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