**PRE-PACK REFORMS**

**The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021**

## INTRODUCTION

1. On 30.04.2021, the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 ("**the Regulations**") came into force. Primarily, the Regulations seek to improve the perception and transparency of Pre-Packaged Administrations ("**pre-packs**").[1]

2. Attempts at improving the perception and transparency of pre-packs have been made before.[2] Those attempts were not entirely successful though[3], and it remains to be seen whether the Regulations will achieve their objective. In this article, the author will discuss previous reforms and the legislative history of the Regulations. After discussing their content, the author will analyse whether the Regulations are likely to achieve their objectives.

3. I conclude that whilst the Regulations are a step in the right direction, they do not go far enough to address the concerns about perception and confidence. There are still possibilitiesfor abuse and other types of behaviour which can diminish creditor confidence andperception. Some of those issues could have been addressed by: (**i**) establishing more prescriptive requirements to act as an evaluator and establishing a central register of approved evaluators; (**ii**) requiring the relevant connected person to disclose previous reports which have assessed the potential sale and (**iii**) requiring the administrator to obtainthe relevant report from an evaluator. The extent to which the Regulations will achieve their objectives will therefore be compromised accordingly.

[1] The Insolvency Service: *Pre-pack sales in administration report* (08.10.2020)
[2] Palmer's Company Law: *Volume 4, Part 14 - Company Administrations, Receivership and Voluntary Arrangements Chapter 14.0* (14.039.et seq)
[3] N1

## PREVIOUS REFORMS

4. Pre-packs are legitimate.[4] They are 'a valuable part of the insolvency landscape'[5] because they can be used to rescue businesses, save jobs and preserve value.[6] They will be more important than ever for the UK as it begins to emerge from the Covid-19 pandemic.

5. But pre-packs have also attracted criticism and concern. Particularly in circumstances where the pre-pack sale is to existing management and other connected parties, because ofthe "apparent lack of transparency in the transaction"[7]. Which, in turn, has fuelled the perception that pre-packs are not always in the best interests of creditors. This perception can't have been helped by findings that pre-packs were frequently conducted with inadequate marketing and that little explanation was given to creditors of the methodology employed to value the business. Failure rates have also been important eye-openers; it hasbeen found that "insufficient attention was given to the potential viability of the new company and that there was a higher subsequent business failure rate where there was a sale to a connected party".[8]

6. In 2009 the Insolvency Service issued a Statement of Insolvency Practice – SIP 16, which set out principles, procedures and standards that were required to be met by officeholders[9] in relation to pre-packs and was intended "to give greater transparency to the operation of pre-packaged administrations by giving creditors improved information about the sale of a business."[10] In 2014, the "Graham Review into Pre-pack Administration"[11] ("**the Graham Review**") set out six recommendations which were designed to increase transparency, increase returns to creditors and reduce the failure rate of pre-packed new companies, as well as improving the perception of pre-packs more generally.

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[4] *DKLL Solicitors v Revenue and Customs* [2007] EWHC 2067 (Ch); [2007] B.C.C. 908, *Transbus InternationalLtd* [2004] EWHC 932 (Ch) *Innovate Logistics Ltd v Sunberry Properties Ltd* [2008] EWCA Civ 1321; [2009] B.C.C. 164; *Re Kayley Vending Ltd* [2009] EWHC 904 (Ch); [2009] B.C.C. 578; *Re Hellas Telecommunications* (Luxembourg) II SCA [2009] EWHC 3199 (Ch); [2010] B.C.C. 295; *Re Halliwells LLP* [2010] EWHC 2036 (Ch); [2011] B.C.C. 57.
[5] N1
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[7] N2
[8] N1
[9] https://insolvency-practitioners.org.uk/uploads/documents/5e680cfcf2e5c095e1057b526e8cf953.pdf (Accessed 09.05.2021)
[10] https://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/dearip/dearipmill/chapter1.htm#13 (Accessed 09.05.2021)
[11] The Insolvency Service: *Graham Review into Pre-pack Administration* (16 June 2014)

7. Those recommendations were:

(1) **Pre-pack Pool**. "On a voluntary basis, connected parties approach a 'pre-pack pool' before the sale and disclose details of the deal, for the pool member to opine on."[12]

(2) **Viability Review**. "On a voluntary basis, the connected party complete a 'viability review' on the new company"[13].

(3) **SIP 16**: "that the Joint Insolvency Committee considers, at the earliest opportunity, the redrafted SIP16 in Annex A"[14].

(4) **Marketing**: "that all marketing of businesses that pre-pack comply with six principles of good marketing and that any deviation from these principles be brought to creditors' attention"[15].

(5) **Valuations**: "SIP16 be amended to the effect that valuations must be carried out by avaluer who holds professional indemnity insurance."[16]

(6) **SIP 16**: "that the Insolvency Service withdraws from monitoring SIP16 statements and that monitoring be picked up by the Recognised Professional Bodies".[17]

8. The Graham Review also recommended introducing a reserve legislative power should the concerns raised about pre-packs continue.[18] The recommendations above were adopted by the coalition government in 2015.[19] Moreover, s.129 of the Small Business and EnterpriseAct inserted paragraph 60A into Schedule B1 of the Insolvency Act 1986 ("**IA**") which gave the Secretary of State power to impose restrictions, control, and conditions in relation to sales of company property to connected persons. Paragraph 60A(10) of Schedule B1 IAhowever provided that that power was to be exercised within 5 years of its creation and it expired at the end of May 2020.

9. On 8 October 2020, the Government published its report ("**the Report**") on the findings and recommendations following its review of the measures introduced by the Graham Review. The Report acknowledged that concerns still exist about whether pre-pack sales

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are always in the best interests of creditors, particularly where the sale is to a connected person. More topical concerns were raised as well; during the parliamentary debates on the passage of the Corporate Insolvency and Governance Act 2020 ("**CIGA**") it was highlighted that there might be a significant increase in the use of pre-packs during the pandemic to the detriment of creditors and that the ease of pre-packs may well undermine the rescue measures imposed by CIGA.[20]

10. The Report concluded, inter alia, that:

**(1)** "Over a third of the cases reviewed were sold for less than market valuation"[21], which lent weight to the perception that pre-packs were not in the best interests of creditors, despite how the sale might have been the "best offer on the table"[22];

**(2)** the 'comply or explain' approach in relation to marketing has shown that explanations sometimes lack detail;

**(3)** the viability report which is required to be attached to the SIP16 statement has been unsuccessful – "only 28% of 163 connected party pre-packs provided a statement"[23] which was significant given that in 72% of the connected party pre-packs that were reviewed there was an element of deferred consideration;

**(4)** of the cases reviewed, at least 1 in 5 of SIP 16 statement is non-compliant.[24]

11. Overall, whilst the evidence indicated that there had been some positive impact as a result of the voluntary measures, the Report did not find convincing evidence that pre-pack reforms have changed "behaviours sufficiently in line with expectations."[25] The Report concluded that further regulation and use of the power in paragraph 60A of Schedule B1 to the IA was justified to ensure that "pre-pack sales are subject to a measure of independent scrutiny"[26]. The legal basis for doing so arises out of how s.8 of CIGA revived the power to impose legislative measures in paragraph 60A of Schedule B1 and replaced sub-paragraph 10 of the same with June 2021 as the date of expiry.

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**THE REGULATIONS**

*The purpose of the Regulations.*

12. The Regulations seek to achieve the following objectives:

**(1)** provide stakeholders with more assurance that a pre-pack sale is appropriate;

**(2)** "improve transparency and creditor confidence in the pre-pack process;

**(3)** promote viable business rescue whilst balancing the rights of those affected by failure"[27] and will supposedly "contribute to leading the country's economic recovery from Covid-19"[28].

*Summary of the Regulations.*

13. Broadly, the Regulations mean that an administrator will be unable to make a substantial disposal of a company's assets to a person connected with the company within the first 8 weeks of the administration without either the approval of creditors or an independent written report, see s.3 of the Regulations. The connected party purchaser will be required to obtain the written report and the author of that report must be independent from the connected party purchaser, the company and the administrator as well as being required tomeet certain eligibility and competency requirements. The Regulations only apply to administrations that commence on or after 30th April 2021, see s.1(2) of the Regulations.

*The creditor approval route.*

14. Firstly, what is a 'substantial disposal'? According to s.3(3) of the Regulations, a substantial disposal means:

a) a disposal, hiring out or sale to one or more connected persons, during the period of 8 weeks beginning with the day on which the company enters administration, of what is, in the administrator's opinion, all or a substantial part of the company's business or assets, and

b) includes a disposal which is effected by a series of transactions.

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15. The creditor approval route is provided for in s.3(1)(a) of the Regulations. By s.4 of the Regulations, the approval of creditors is obtained in accordance with the Regulations if the administrator has: **(i)** included proposals for making the disposal (in the statement of administrator's proposals referred to in paragraph 49 of Schedule B1; and **(ii)** subsequently sought a decision from the company's creditors as to whether they approve the proposal; and the company's creditors approve the proposal—without modification, or with modifications to which the administrator consents.

*The qualifying report route.*

16. An administrator can make a substantial disposal after obtaining a qualifying report. By s.5 of the Regulations, a qualifying report is a report whose: **(i)** contents the administrator has considered, and **(ii)** which the administrator is satisfied meets the requirements specified in s.6 of the Regulations, and includes the content specified in s.7 of the Regulations.

17. The requirements in s.6 of the Regulations are that the report is: **(i)** obtained by a connected person, **(ii)** made by an individual who is an evaluator and who meets the requirements in paragraph (2) of s.6 of the Regulations and (**iii**) given to the administrator.

*Who is an evaluator and what requirements must they meet?*

18. Broadly, s.10 of the Regulations defines an evaluator and the requirements which they must meet: an evaluator is an individual who is satisfied that their relevant knowledge and experience is sufficient for the purposes of making a report on a potential sale; who is not excluded from being an evaluator by s.13 of the Regulations, for example, an associate of the administrator or prior convictions for an offence involving dishonesty; meets the independence requirements in respect of the parties involved in the sale by s.12 of the Regulations and has professional indemnity insurance in force, by s.11 of the Regulations.

19. Moreover, the evaluator must also meet the requirement in paragraph (2) of s.6 of the Regulations. Which is that the administrator, having regard to the date on which the qualifying report was made, is satisfied that the individual making that report had sufficient

relevant knowledge and experience to make a qualifying report. So in short, the administrator must also be satisfied about the competency of the evaluator.

*What form should the report be in and what should it include?*

20. The report must be in writing, state the date on which it was made and be authenticated bythe evaluator, s.6(1)(b) of the Regulations. As set out above, the report must also include the content specified in s.7 of the Regulations. According to s.7 of the Regulations (which should be consulted in full) the report must, *inter alia* contain the following:

**(1)** a statement that the person making the report is an evaluator within the meaning given by Part 3;

**(2)** a statement as to what relevant knowledge and experience the evaluator has to make the report;

**(3)** the information specified in regulation 8(3) or, as the case may be, a statement that the evaluator is satisfied that regulation 8 does not apply;

**(4)** a statement as to the nature of the consideration that is to be provided for the relevant property and the value of that consideration expressed in sterling;

**(5)** identification of the connected person and a statement as to their connection to the company;

**(6)** a statement that either—(the evaluator is satisfied that the consideration to be provided for the relevant property and the grounds for the substantial disposal are reasonable in the circumstances or, as the case may be, the evaluator is not satisfiedthat the consideration to be provided for the relevant property and the grounds for the substantial disposal are reasonable in the circumstances (a "**case not made opinion**"); and

**(7)** the evaluator's principal reasons for making the statement in sub-paragraph (h)(i) or (ii) and a summary of the evidence relied upon.

21. S.8 of the Regulations also imposes additional requirements in circumstances where a previous report has been obtained.

*The administrator's obligations in relation to the report & notification requirements.*

22. Assuming the above is satisfied and the report is given to the administrator, by s.6(1)(c) of the Regulations, the administrator must also be satisfied that there have been no material changes since the date on which the report was made to: the relevant property; the terms ofthe disposal or any circumstances relating to the disposal.

23. S.9 of the Regulations also provide important notification requirements where an administrator seeks to make a substantial disposal following receipt of a qualifying report. The administrator is required to send a copy of the report to the registrar of companies and every creditor of the company (apart from opted out creditors) of whose claim and address the administrator is aware at the same time as the administrator complies with the requirement in paragraph 49(4)(a) and (b) of Schedule B1 to send a copy of the statement of their proposals to the registrar of companies and to creditors.

24. Curiously, it appears that an administrator may still make a substantial disposal in circumstances where there is a case not made opinion. But in such circumstances the administrator must send to the creditors and the registrar of companies his reasons for proceeding with the sale, see s.6 of the Regulations.

**COMMENTARY**

25. If the creditor approval route is used then that should address concerns regarding the transparency of pre-packs and how creditors are usually kept in the dark until the sale has concluded. In theory, therefore, the Regulations provide a clear mechanism for creditors to become engaged in the process[29]. Though of course, the creditor approval route might not be used. Directors may be less willing to obtain creditor approval and simply go down the qualifying report route. Indeed, as others have indicated, a director might not want to risk a creditor disagreeing with the proposed sale and so might just short circuit the process.[30] Arguably, this cuts against the extent to which creditors will be engaged in the process, at least in comparison to the creditor approval route.

26. But even if the creditor approval route is not used, it may still be of comfort to creditors, administrators, and company directors that an independent report has been obtained. Froman administrator's perspective, this is because it might reduce the extent to which

[29] https://www.stewartslaw.com/news/does-new-pre-pack-administrations-rules-spells-good-news-for-creditors (Accessed 02-03.05.2021

[30] https://gateleyplc.com/insight/quick-reads/proposed-reform-to-pre-pack-sales-in-administration/ (Accessed 02-03.05.2021)

the administrator can be challenged or otherwise criticised for allowing the sale to go through.As others have observed, from a creditor's perspective, this is because (in theory) it will add an element of objective and independent legitimacy to the process, which might reducethe perception that the deal was not in their interests.[31] In short, it might foster creditor confidence in the pre-pack process which is what the Regulations are trying to achieve.

27. Also, given that creditors need to be provided with the report, there is still visibility over the process. Depending on the contents of the qualifying report, that might help meet the Regulations objective of providing stakeholders with more assurance that a pre-pack sale is appropriate, as well as improving transparency over the pre-pack process – again, anotheraim of the Regulations.

28. But what good is there in having visibility over the process if an administrator can still proceed with a sale despite their being an unfavourable report provided by the evaluator? The evaluator does not have the final word. This caused considerable concern during the parliamentary debates; Lord Foulkes went so far as to say that this feature of the Regulations made the evaluator's role "impotent".[32] It is also unlikely to shift theperception that pre-packs are not always in the interests of creditors, given that this attitudewas in part due to how assets were sold for less than market value (which might be the particular reason why an evaluator gives a case not made opinion):

> "However, our review has found that some connected party pre-packs are still a cause for concern for those affected by them and there is still the perception that they are not always in the best interests of creditors. The fact that evidence available indicates that over a third of the cases reviewed were sold for less than the market valuation lends weight to this perception, notwithstanding that in some cases the sale may have been the best offer on the table."[33]

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[32] Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 Volume 811: debated on Monday 22 March 2021 https://hansard.parliament.uk/Lords/2021-03-22/debates/87DECC35-1F39-40FB-BB3D-2F80B6C26E7E/Administration(RestrictionsOnDisposalEtcToConnectedPersons)Regulations2021 (Accessed 02-03.05.2021)

[33] N1

29. It is difficult to see how creditors will have confidence in the pre-pack process or feel that a pre-pack sale is appropriate if the administrator has the ability to proceed with a sale despite there being an unfavourable report. On the contrary, in this regard they may well treat the involvement of an evaluator as a hollow and inconsequential gesture, which is hardly likely to improve creditor confidence and perception. Given that the costs of obtaining a report and the time spent by the administrator in considering the report will add a further layer of expense to the administration,[34] creditors may well feel short-changed by this new requirement.

30. However, we should not lose sight of how it is the administrator who is required to act in the best interests of the creditors as a whole.[35] Not the evaluator. The administrator has thefinal say because he is responsible for the conduct of the administration. It is no different from other professions which involve advising individuals – the final say lies with the recipient of that advice. There is an important safeguard as well – the administrator will have to provide reasons for proceeding with the disposal in such circumstances. An administrator is unlikely to proceed with a sale lightly – he will be aware that his reasons for proceeding may well be subject to challenge in the future if they are not properly considered. That might soothe the loss of confidence brought about by this particular feature of the Regulations. Ultimately, though, whatever reassurance the creditors might have felt from having an evaluator involved is likely to diminished somewhat.

31. Also, even if an unfavourable report is given by an evaluator, it may be the only offer that is on the table, and in such circumstances the bigger picture might be that it is in the best interests of the creditors as a whole to proceed. It is important therefore, that the administrator is free to proceed as he sees fit by reference to his professional and legal obligations. In such circumstances, it will be down to the administrator to ensure that creditors fully understand why the sale is going to proceed. If the reasons are comprehensive and logical, (in theory) one might argue that creditors are more likely to feel satisfied that the sale was appropriate or at the very least understand why it had to occur and that the pre-pack process has been more transparent. This requirement may also be a reflection of the government seeking to promote viable business rescue whilst

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balancing the rights of those affected by failure. But are creditors really going to think like that? Arethey not going to simply conclude that, despite an evaluator having given a case not madeopinion, the sale is going to proceed whether they like it or not?

32. The Regulations do not prescribe any specific qualifications or experience which the evaluator must possess. Without any clear guidelines, there is a risk that individuals who are unsuitable to act as evaluators perform this role, which of course can reduce creditor and market confidence in the independent report route. The Regulations have been strengthened since they were released in their draft form by including the requirement that the evaluator possess professional indemnity insurance. Arguably, the risk of "underqualified people….taking advantage of the rather vague rule"[36] is reduced somewhat, but not entirely.[37]

33. As others have pointed out, the requirement that an administrator be "satisfied that the individual making that report had sufficient relevant knowledge and experience to make a qualifying report" places the onus on administrators to ascertain whether the evaluator is suitable. Administrators are not likely to find this difficult, but the Regulations do not deal with the scenario where the evaluator intentionally misleads the administrator about his suitability or qualifications. Who does the administrator report such an evaluator to? How does one make such a complaint? How will other officeholders be made aware of rogue evaluators?[38] There are gaps, essentially, and these pockets of uncertainty will do little to foster creditor confidence and improve the perception of pre-packs. Indeed, it will all depend on trust, which is slightly ironic given that trust issues are part of what prompted reform in the first place.

34. During the parliamentary debates it was asked why there was no central register of evaluators or a body responsible for training and registration and assessment of their operational effectiveness etc. Apparently, R3 suggested a register of evaluators being maintained by the Insolvency Service. If there was such a register, that would go a long way towards addressing the competency concerns as well satisfying stakeholders that

[36] N32
[37] N32
[38] https://www.r3.org.uk/press-policy-and-research/r3-blog/more/29819/evaluating-pre-packs-an-uneasy-compromise/ (Accessed 03.05.2021)

a right of recourse would be readily available. But ultimately, there is no such register andthe extent to which creditors have confidence in pre-packs is compromised accordingly.[39]

35. According to the parliamentary debates, the government considered that a list of approved evaluators would impose an "unnecessary administrative burden on government at a time when public resources and expenditure are under severe pressure".[40] But of course, Covid-19 was part of the rationale for the Regulations. Given that the efficacy of business rescue is of vital import to the economy as a whole (and all the more so during a pandemic) one might think that this 'administrative burden' and the expenditure was justified. Even if the author is wrong to think that, it is not all bad news - one hopes that a time will come when the government is not under such severe pressure, so the Regulations may be strengthenedin the future in this regard.

36. The merits of having a list was also taken into account: "A person whose knowledge and experience are suitable in one context might be unsuitable in a different context. A list would not therefore remove the need to consider whether a person's knowledge was sufficient on a case-by-case basis."[41] Possibly, but the list might, at the very least, indicate that there is a minimum standard which the evaluator has met. From a practical perspective, it might also address the concerns raised by others about the challenges in finding a truly independent evaluator who is willing and able to provide a report quickly.[42]

37. Relatedly, others have observed that the evaluator will (presumably) take his instruction from the connected party, which raises obvious concerns as to the accuracy of whatever information the evaluator is provided with.[43] The implications for creditor confidence and perceptions are clear. Again, it will all depend on trust.

38. Further, there is still room for opinion shopping. In this context, obtaining reports from more than one evaluator but making only the most favourable available to an administrator.[44] As others have pointed out, the problem is that the connected person is under

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no positive obligation to provide any previous reports to the administrator and/or the evaluator or to state that they have not sought or obtained any such report.[45] S.8 of the Regulations seeks to address this issue, because, broadly, it provides that where an evaluator becomes aware of a previous report or believes that a previous report has been obtained by the connected person, the current report must include details of that previous report. Or, if the previous report is not given to the evaluator, this must be stated within the current report.[46]

39. The downside to all of that is best captured by Lord Vaux of Harrowden:

> "However, the onus lies with the evaluator to find any previous report. If the connected person is not open about it, there is little the evaluator can do."[47]

Again, it will come down to trust, and again, that is in short supply.

40. But in reality, how likely is it that opinion shopping will occur? A qualifying report will not be provided for free. There may well be time constraints involved as well, so query howlikely it is that connected persons will be able to exhaust considerable time and cost in an attempt to 'game' the system. Indeed, time and cost may well prove to be an effective safeguard here. Admittedly, that is not a complete answer because there is likely to be some who will try and so this potential for abuse and therefore threat to the confidence and perception held by creditors is very much a live one.

During the parliamentary debates, it was queried why "the regulations do not make the administrator responsible for obtaining a report at the connected party's expense". That would have gone a long way towards addressing the concerns about opinion shopping. Thiswas rejected on the basis that: "As the vast majority of pre-pack sales are arranged prior toan administrator's appointment, with the sale completed on day one, placing a requirementon the administrator to be responsible for obtaining the opinion would cause a delay to thesale, which would increase costs and potentially hinder the business rescue."[48] But query whether that is a complete answer; why couldn't a director simply factor this possible delayin to his organisation of the sale before he approaches the administrator?

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[47] N32
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**CONCLUSION**

41. On balance, the Regulations are a step in the right direction. But they are unlikely to have a dramatic impact on the way in which pre-packs are perceived and the confidence which is placed in their viability. Because the Regulations do not go far enough – they will need to be strengthened in certain respects, such as establishing more prescriptive requirements to act as an evaluator and establishing a central register of approved evaluators; requiring the relevant connected person to disclose previous reports which have assessed the potentialsale and requiring the administrator to obtain the relevant report from an evaluator.

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**Please Note**