INSOLVENCY
COMMENTARY

All-change for Pre-Packs: New Regulations restricting business and asset sales by Administrators

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Introduction

Always beware new Regulations with Explanatory Notes that conclude "*An impact assessment has not been produced for this instrument as* ***no, or no significant, impact on the private, voluntary or public sector is foreseen***" (emphasis added). These words are found at the end of the Explanatory Note to *The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021* (SI 427 of 2021), which come into force on 30 April 2021. I suspect they will have rather more impact than those words suggest.

Summary

The Regulations impose a new requirement on administrators who seek to dispose, hire out or sell a company's property to one or more "connected persons" (hereafter a "disposal"). The Regulations are **not** restricted to pre-packs; any such disposal in the first eight weeks of the administration is affected, including disposals effected by a series of transactions, as long as "all or a substantial part of the company's business or assets" is to be transferred (Regulation 3). Note "business **or** assets": a disposal of a substantial part of the assets alone is covered. Note also that small companies are not excluded from the Regulations.

The new requirement is to obtain either:

a) Advance creditor approval for the disposal by including it in the Statement of Proposals under paragraph 49, and obtaining creditor approval to it (Regulation 4); or
b) A report from an "evaluator" (an independent person with relevant knowledge and experience (Regulation 10) and insurance in place (Regulation 11)) that gives an opinion on whether the consideration and grounds for the disposal are "reasonable in the circumstances".

The connected buyer may obtain a second evaluator's report, but the first report should be disclosed to the second evaluator (Regulation 8).

The administrator may proceed with the disposal even after a negative evaluator's report, but must set out to creditors his reasons for doing so (Regulation 9).

The evaluator's report(s) must be sent to creditors and Companies House (with the ability to redact confidential information) (Regulation 9).

History

The Regulations have some history. The Graham Report into prepack sales in administration that was published on 16 June 2014 recommended changes to increase transparency and improve public confidence in pre-packs, as well as to increase the chances of the business surviving after the sale. The changes included creating a "pool" of independent professionals able to scrutinise proposed prepack sales to connected parties. It was recommended that use of the pool be voluntary, but a power to regulate disposals to connected persons should be introduced in case of need. This became paragraph 60A of Sch B1 to IA86.

The Joint Insolvency Committee consulted on a revised SIP 16 from January 2015 and in July 2015 the Pension Protection Fund published Guidance Note 2, raising concerns that pre-packs were being used to dump pension scheme liabilities. The PPF considered there was insufficient scrutiny of pre-packs to connected parties.

A revised SIP 16 was issued on 1 November 2015 and the Pre-Pack Pool was launched the next day. However use of the pool has been low, and in December 2017 the Insolvency Service announced a review into the impact of the voluntary measures introduced in 2015. The PPF revised its Guidance Note in June 2018, recognising that "to an extent" the insolvency profession had "gone some way" to address its concerns through revising SIP 16. However it maintained its view that prepacks were being presented as a given to creditors such as the PPF. In the meantime cases such as *Re Moss Groundworks Ltd* [2019] EWHC 2825 (Ch) showed that SIP 16 was still not being fully complied with.

The Government review led to draft regulations being published in October 2020 and, after consultation, a draft Statutory Instrument being published in February 2021. The Regulations were made on 29 March 2021.

Issues

Whether to get creditor approval?

It appears unlikely that the first route to satisfying the requirement, i..e obtaining creditor approval, will often be used. This route requires the disposal to be proposed in a Statement of Proposals under Para 49, and approved using the provisions in paragraph 53 of Sch B1 to IA 86 and Insolvency Rules 15.8ff. Thus the Proposals must be drafted, 14 days' notice is needed, a majority in value of those voting must support it, and 50% of unconnected creditors must not vote against it.

Confusingly, this is not the same test of "connected" as is used to identify whether a buyer is "connected" to the company for the purposes of the Regulations. Instead s.249 & s.435 IA 86 apply. It may be necessary to treat as "connected" the registered shareholders of 33% or more of voting shares, but also those entitled to decide how voting rights in such shares would be exercised (*Granada UK Rental & Retail Ltd v Pensions Regulator* [2019] BPIR 1121). Where a transaction is effected in stages, with disposal of shares as a late stage, the shareholder will be treated as "connected" under s.249 during the earlier stages even if the purpose of the whole transaction was to sell the shares (*Darty Holdings SAS v Carton-Kelly* [2021] EWHC 1018 (Ch)).

Is the proposed buyer "connected" for the purposes of the Regulations?

The definition of a "connected" buyer is in para 60A of Sch B1. It includes the obvious categories such as directors, other officers, and their associates (otherwise by virtue of an employment relationship). It includes shadow directors, who may by definition be more problematic to identify. It also includes those entitled to exercise, or control the exercise of 33% or more of the company's voting power, as to which see the cases cited above. Oddly, former directors and shareholders do not appear to be connected. Finally it includes companies where any of the above individuals are or have been directors, officers, 33% shareholders etc. The net is drawn wide.

Evaluators

The Regulations are silent on a number of important matters. To whom will evaluators owe a duty of care? What insurance must they hold? What test will they apply in deciding whether the consideration and / or grounds for the disposal is "reasonable in the circumstances"? Can a buyer (or administrator) make further representations to an evaluator if they consider he has reached an incorrect view?

Consequences of breach?

The Regulations say nothing of the consequences of an administrator making a disposal without satisfying the new requirement. Such action would be ground for a misfeasance finding, and perhaps have other professional consequences, but there is no suggestion that the disposal itself could be undone.

Other concerns

The current PPF guidance on pre-packs dates from December 2018. The PPF's stated practice is to assess the degree of consultation with pension scheme trustees / PPF prior to an administrator's appointment and, where there remain concerns over the pre-pack, to resolve to appoint an alternative IP to act as CVA supervisor or liquidator as the exit route. It remains to be seen if the new Regulations alter this.

Buyers should also take account of the new Pension Schemes Act 2021, with powers for the Pensions Regulator to seek financial contributions from persons connected to

the employer who are party to acts that materially reduce the value of the resources of a pension scheme's employer. That Act also introduces financial penalties and criminal offences for intentionally preventing the recovery of a debt due or contingently due to a pension scheme under s.75 of the Pensions Act 1995, or intentionally risking the likelihood of promised pensions not being paid, in either case without a reasonable excuse.

Meanwhile IPs should be alert for the publication of a revised SIP16, which may clarify a way through some of these uncertainties.

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