

OUR GUIDE TO THE PRE-PACK REGULATIONS

What is a “pre-pack” sale?

A “pre-pack sale” relates to a sale, out of Administration, of all or part of a company’s business and assets. The sale is negotiated with the buyer, usually with the active participation of the proposed Administrator, prior to the company entering Administration. The sale then completes either immediately following the Administrator’s appointment or a short time afterwards.

Pre-packs are useful when attempting to rescue a business as a going concern. They can maximise the value in a company’s assets, for the benefit of creditors, whilst also saving jobs. However, pre-packs occasionally receive a bad press, particularly when the business and assets are sold back to one or more of the company’s directors, shareholders or another business where those parties are involved.

Often that bad press is as a consequence of the Administrator not sufficiently explaining the rationale for the sale and allowing the perception that something untoward has gone on to fester with creditors.

Selling a business out of Administration

An Administrator has always had the power to sell a business and its assets, without the need to seek the permission of creditors. That sale, based upon the Administrator’s assessment of achieving the best outcome for creditors, could take place after a period of trading on whilst seeking a buyer, or immediately upon appointment if sufficient due diligence has taken place beforehand.

After a review of pre-packs in 2015, the Government introduced the “pre-pack pool” to try and alleviate creditors’ concerns. This allowed a proposed pre-pack sale to a connected party to be reviewed by an independent person within the “pool” to provide an opinion on whether the proposed sale was reasonable. However, as the “pre-pack pool” was not compulsory, referrals to it were low.

What has now changed?

Following a review of the procedure, the Government has introduced the Regulations¹ that will provide a new legal framework for pre-packs from 30 April 2021.

The Regulations apply to Administrations:

- which commence on or after 30 April 2021; and
- where the Administrator seeks to dispose of all or a substantial part of the company’s assets to:
 - a *connected* person;
 - within 8 weeks of the commencement of the Administration

In those circumstances, either:

- the Administrator must obtain the approval of creditors before the sale can complete; or
- the buyer must obtain a written *qualifying report* from an *Evaluator* on whether the grounds and consideration (the sale price) for the disposal are reasonable.

What is a connected person?

The definition of a connected person² includes directors, shadow directors or other officers of the company, as well as “connected companies”. If the Administrator is in doubt about whether the purchaser is a connected person, the prudent approach will be to ask the purchaser to obtain a report.

¹ The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 (“the Regulations”)

² Paragraph 60A(3) of Schedule B1 to the Insolvency Act 1986

Creditor approval

A pre-pack sale is an accelerated transaction designed to maximise asset values and business continuity. If an Administrator wishes to seek prior creditor approval for the proposed pre-pack sale, then they will need to refer to the intended sale within their proposals to creditors (which are to be sent to creditors within 8 weeks of the Administration commencing) and seek creditor approval of those proposals before the sale can complete.

This route will, therefore, require the Administrator to be confident that they can distribute their proposals to creditors promptly upon appointment, that the business can trade profitably pending the creditors' decision and that the creditors are likely to support the sale on a commercial basis.

In many cases this option will not be practical.

The Evaluator

In the majority of cases, therefore, the proposed buyer will need to obtain a written *qualifying report* from an Evaluator. The Regulations provide that an Evaluator must have relevant knowledge and independence and have professional indemnity insurance in place.

It is likely that the Evaluator will be a solicitor, accountant or another insolvency practitioner. The Evaluator must state in their report if they consider the grounds, and the proposed consideration, to be reasonable or not.

A negative report does not prohibit the proposed Administrator from completing the intended pre-pack sale to the connected party. However, the Administrator will need to exercise their independent skill and judgement in determining to proceed with a pre-pack sale in those circumstances.

Whilst the buyer selects the Evaluator, the proposed Administrator will wish to have confidence in the person chosen to prepare the report and that they meet the criteria set out in the Regulations.

What is a substantial disposal?

This is not defined in the Regulations. It is, however, a term used in insolvency legislation.

When considering whether a disposal is substantial or not the Administrator will take into account the value of the assets, the percentage of the business/ assets that are being sold as part of the disposal and whether goodwill is included as part of the disposal. If the Administrator is in doubt about whether the sale amounts to a substantial disposal, the prudent approach will be to ask the purchaser to obtain a report.

In cases where there is more than one sale, a report or creditor approval is required for each sale that amounts to a substantial disposal, to a connected person within the first eight weeks of the administration. Where there are multiple sales to the same connected person, one report covering all sales is sufficient.

What does the qualifying report need to say?

The Regulations set out certain information that must be contained in the report, including:

- details of the property that is to be disposed of;
- the consideration to be paid;
- whether (or not) the Evaluator is satisfied that the consideration and grounds for the disposal are reasonable; and
- how and why they have reached that conclusion.

The report must be in writing, but the format and structure of the report is left to the Evaluator, who must date and authenticate it.

If you would like specific guidance for you or your company, talk to Sadlers today.