

# EUROPEAN RESTRUCTURING WATCH ALERT

## CONNECTED PARTY PRE-PACKS: THE NEW RULES

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On 24 February, the Government published draft regulations that, if implemented, will impose new restrictions on pre-pack administration sales to connected parties. For all 'substantial disposals' (which will include 'pre-pack' sales) to connected parties, taking place within eight weeks of the administrators' appointment, the administrators will either need creditor consent or a report from an independent 'evaluator'.

### Context

A 'pre-pack sale' typically refers to the process where (i) the terms of a sale of a company's business or assets are agreed with the proposed buyer prior to the appointment of administrators; and (ii) the sale is concluded on, or very shortly after, the appointment of administrators.

That process gives rise to two contextual points. First, the sequencing means that unsecured creditors will often not know about the pre-pack until after it has completed. Second, it is common for the purchaser to be a connected party. This is because they will already know the underlying business / assets and, as such, are not deterred by the 'warranty light' nature of administration purchases. They are also often the best placed to continue running the business given their knowledge and/or relationships with key customers, suppliers and employees.

A combination of those and other factors has led to criticism of pre-packs for, amongst other things, lacking transparency. There have been a series of industry-wide reviews and recommendations to try to improve the pre-pack process. For example, the 2014 Graham Report recommended the creation of the 'Pre Pack Pool' i.e. an independent body established to review a proposed pre-pack. The decision to refer to the Pre Pack Pool is voluntary and the scheme has seen limited take up since its inception. The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 (the "**Draft Regulations**") outline further measures designed to try to remedy the concerns around pre-pack sales.

### The Effect of the Draft Regulations

An administrator appointed after the Draft Regulations come into force must not make a 'substantial disposal' unless they have (i) approval from the company's creditors (to be sought as part of the administrator's proposals, requiring approval of a majority in value of creditors voting on the proposals); or (ii) a report from an 'evaluator' (the "**Report**") appointed by the connected proposed purchaser (the "**Connected Party**").

The definition of 'substantial disposal' has several elements:

- i. it covers a "disposal, hiring out or sale";
- ii. the counterparty must be one or more connected persons, including a director or other officer, shadow director, or shareholder ('connected' has the meaning given in paragraph 60 (A) (3) of Schedule B1 of the Insolvency Act 1986 ("**IA86**") which, in turn, includes 'associates' as defined in section 435 of the IA86);
- iii. the proposed transaction must take place in the eight week period beginning with the day on which the company enters administration;
- iv. the proposed transaction must concern what is, in the administrator's opinion, all or a substantial part of the company's business or assets; and
- v. includes a disposal "which is effected by a series of transactions."

SIP16 provided that lenders holding security over one-third or more of shares with voting rights were not to be treated as 'connected'. As such, the additional reporting requirements set out in SIP 16 did not apply. It is not clear whether that same exclusion will apply to the Draft Regulations.

### The Evaluator

Similar to referrals to the pre-pack pool, the onus is on the Connected Party to obtain a Report. The Connected Party can obtain more than one report (although the conclusions from any earlier reports will need to be disclosed).

The provider of the Report (i.e. the "**Evaluator**"):

- i. must not be connected or an associate (defined in sections 249 and 435 IA86) of the administrator, company in administration or the Connected Party. They must also not be connected with a company with which the administrator is connected (again, as defined in section 249 IA86); and
- ii. must "[believe] that they have the requisite knowledge and experience" to provide the Report. The administrator must also have no reason to believe that the Evaluator does not have the requisite knowledge and experience. There are further exclusionary items sets out in the Draft Regulations (e.g., an individual cannot be the Evaluator if they are subject to a disqualification order under the Company Directors Disqualification Act 1986) and

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a requirement that the Evaluator obtains professional indemnity insurance.

As currently drafted, the above requirements may create some uncertainty in practice.

For example, the Connected Party is responsible for instructing the Evaluator but the administrator must have no reason to believe that the proposed Evaluator lacks the requisite knowledge and experience to provide the Report. As such, there will presumably need to be a discussion between the administrator and the Connected Party about the identity of the Evaluator. There is, however, no objective guidance in the Draft Regulations on what constitutes sufficient experience or qualification. This may make it harder for the parties to reach a consensus.

### The Report

The Draft Regulations prescribe the contents of the Report. Most importantly, the Evaluator must confirm whether they are satisfied that the proposed consideration and the grounds for the substantial disposal are reasonable in the circumstances (a 'case made opinion'), or not (a 'case not made opinion'). The Evaluator's Report is not required to comment on the future viability of the business.

If the administrator makes a substantial disposal via the Report route, they must send a copy of it (and any previous reports) to the company's creditors and Companies House. There is nothing in the Draft Regulations to stop an administrator from carrying out a substantial disposal despite receiving a 'case not made opinion'. However, in that scenario, the administrator will also need to send the

creditors a statement detailing their reasons for proceeding with the substantial disposal.

### Timing

The Draft Regulations should be welcomed in light of the prevalence (and public perception) of pre-pack sales. Nonetheless, it is clear that parts of the Draft Regulations require clarification. For example, given the Evaluator's importance to the proposed regime, it is important to understand what experience and qualifications they should possess. This point, and others, have already been raised by industry bodies.

The Draft Regulations will now be debated in both Houses of Parliament and, subject to modification / approval, are likely to come into force on 30 April 2021.

If you would like more information about the topics raised in this briefing, please speak to the London Restructuring practice Co-Heads, your regular contact at Weil or to any of the authors listed below.

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