

## NEW REGULATIONS TO RESTRICT DISPOSALS TO CONNECTED PERSONS IN INSOLVENT ADMINISTRATIONS

From 30 April 2021, an administrator of an insolvent company may not make a substantial disposal within the first eight weeks of an administration to anyone connected to the insolvent company unless he has either the creditors' consent or an independent evaluator's report provided by the purchaser. The report must provide that the evaluator is satisfied that the consideration provided for the property and grounds for the disposal are reasonable in the circumstances (referred to as 'case made opinion'). If the report indicates that the evaluator is not satisfied as to the consideration and basis for the disposal, an administration may still proceed with the sale, but the administrator must explain why the sale has gone ahead and include that explanation when sending a copy of the report to creditors.

### MANDATORY REFERRAL REGIME

The change arises as a result of the government resurrecting a previously expired power from the Small Business Enterprise and Employment Act 2015, which could potentially have been used to prohibit connected party pre-pack sales altogether. The change forms part of the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 (the "**Regulations**"). The Regulations do not prohibit pre-pack sales altogether. They are instead intended to improve transparency and increase confidence in sales to parties connected with the insolvent company. The Regulations effectively replace the existing voluntary referral mechanism where purchasers could apply to the pre-pack pool (an independent body of experienced chartered directors, accountants, lawyers and former insolvency practitioners) to independently review a proposed purchase. That voluntary referral system was little used in practice. Instead, the Regulations impose a mandatory referral obligation to seek an independent evaluator's report on all substantial disposals taking place within the first eight weeks of an administration, where the sale is to a connected party (i.e. not just pre-packs). The purpose of the Regulations is:

- to ensure transparency in respect of such transactions,
- to guard against those with previous involvement with the insolvent business using the pre-pack sale as an artifice to continue operations

#### Key issues

- Regulations effective from 30 April 2021
- Applies to all sales to connected parties within the first eight weeks of an administration
- An administrator cannot make a disposal unless he has either creditors' consent or an independent evaluator's report
- The evaluator must be satisfied of their own qualification, skills and experience
- Intended to increase transparency and promote confidence

using the business and assets purchased out of the insolvency process, and

- to ensure that the connected party purchaser pays a reasonable price.

Eyebrows have been raised about the fact the choice of evaluator rests with the connected party purchaser, who of course will have a vested interest in the sale going ahead and the price it is offering being deemed 'reasonable'. However, in addition to the requirements that the evaluator be independent and free of conflicts, the ultimate creditor safeguard remains the fact the decision to proceed with the disposal rests with the administrator, who must also be satisfied with the choice of evaluator. The administrator is an independent and professionally qualified practitioner under a duty to act in the best interests of creditors and ensure that any realisations are made for the best price reasonably obtainable.

## **NOT JUST PRE-PACKS, AND WIDE DEFINITION OF CONNECTED PARTIES**

The Regulations capture pre-pack sales (which usually occur on the day of the appointment of an administrator), but also cover any sales to connected parties taking place within the first eight weeks of an administration. The scope of the definition of connected parties not only includes directors and managers of the pre-administration company and their relatives, and companies associated with the failed company, but also anyone who is in control of the company, which includes any person entitled to exercise or control one third or more of the voting power at the general meeting of the company or of another company which has control of it. This means that secured creditors with share security, who may be looking to enforce their security, and as part of that process take ownership of the substantial property, could be deemed connected parties for the purposes of the Regulations. The previous voluntary regime had a special exemption for secured creditors, and despite representations being made to continue this exemption, the Regulations do not provide for a specific carve out. In such cases, however it may be possible for the creditor consent route to be pursued (noting that applicable notice periods may be problematic in urgent cases), although in practice even when the regime was purely voluntary, certain secured creditors preferred to make a voluntary referral to the pre-pack pool in any event.

## **WHO CAN BE AN EVALUATOR?**

Although the Regulations effectively displace the present voluntary referral mechanism to the pre-pack pool, we understand that the pool will remain in operation and members of the pre-pack pool may be available to take on the role of the evaluator in addition to other suitably qualified professionals. Evaluators must be independent and are to 'self-certify' that they have the requisite knowledge, skill and experience to provide the report, but little else is prescribed in terms of their qualifications. As well as a general requirement that the evaluator must not have a conflict of interest, there is a specific carve out prohibiting advisers from acting as evaluators if in the 12 months before the date of the report they have provided advice to the company or group in connection with the company's corporate rescue, restructuring or preparations for insolvency filings. They are also required to have professional indemnity insurance.

## **WHAT WILL THE CHANGES MEAN IN PRACTICE?**

The Regulations have no impact on disposals made to ordinary commercial third parties. They can still take place on pre-pack basis without any referral being made to an evaluator or the consent of creditors being sought. Even for sales to connected parties the referral regime only applies to disposals made within the first eight weeks of the administration.

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