Association of Business Recovery Professionals

8th Floor, 120 Aldersgate Street, London, EC1A 4JQ

Tel: 020 7566 4200
Fax: 020 7566 4224
Email: association@r3.org.uk

www.r3.org.uk

Paul Bannister
Head of Policy
Insolvency Service
1 Westfield Avenue
Stratford
London
E20 1HZ

Wednesday 11th November 2020

Dear Paul,

R3 feedback on the Government's 'Pre-pack sales in administration' report

I write as President of R3, to provide you with feedback on the proposed draft regulations that will give effect to the recently published outcome of the Insolvency Service's review of the 2014 industry reforms to pre-pack sales in administration.

Rather than set out detailed feedback on the draft regulations, which as we set out below do require some additional supporting guidance, we have focussed our comments in this response on two key areas: the scope of the reforms and the qualifying criteria of the Evaluator.

As a preface to these comments, we would like to highlight that the confidential nature of the Insolvency Service's review of the 2014 reforms has meant that until now it has not been possible to gather views on these measures from R3's members more widely. While the confidential discussion papers published during the review helped to provide some context to the Insolvency Service's thinking on each aspect of the proposed measures, last month's announcement was not accompanied by a similar note setting out the rationale or considerations that the Insolvency Service has taken into account when arriving at the final iteration of the proposals.

Such a document would have provided helpful background to the draft regulations and in turn helped members to provide more rounded feedback – as well as potentially answer some of the questions members have posed since the Government's announcement. We would urge the Insolvency Service to set out this information, either in a note or in guidance, as soon as possible, in order to aid understanding among the insolvency and restructuring profession, and wider stakeholder community, about the Insolvency Service's intentions regarding the applicability of these important reforms.

Overview

R3 has been clear throughout the review process that pre-packs are an important business rescue tool and has always recognised the need to ensure creditor and stakeholder confidence in this part of the insolvency and restructuring framework. We were pleased to see the Government's report acknowledge the former, and we broadly welcomed the package of measures as a way of achieving the latter:

> "Having agreed that it should be mandatory for sales to connected party purchasers in pre-packs to be referred for an independent opinion, we broadly welcome the Government's announcement. In particular, the Government's decision not to ban sales to connected parties in pre-packs is the right one.
>
> "Pre-pack administration sales involving connected parties are an important rescue tool as they are often the best way of preserving a business and maximising returns to creditors. The insolvency and restructuring profession is very sensitive to the impact of pre-packs on creditors, and there is a careful balance to strike in these situations between transparency, protecting creditor value, and business rescue, which these proposals support.

> "We welcome efforts to enhance confidence and transparency in pre-packs, but these efforts should be balanced against protecting the valuable role pre-packs play. These reforms, while not perfect, should help to improve confidence in this important business rescue tool."

That said, apart from a number of more technical, but minor, queries concerning the drafting of the regulations (which we hope to discuss with you separately), we believe there are two key issues with the proposals that need to be addressed before the regulations are introduced to Parliament. **Without these changes, we are concerned that these measures may in fact undermine, rather than enhance, confidence in pre-packs and by extension, business rescue – at a time when business rescue will be of critical importance to the UK economy.**

Scope of the proposals

We recognise that the SBEE Act grants the Government the power to impose requirements or conditions in respect of connected party administrations *as a whole*, rather than just connected party pre-pack administrations. The Insolvency Service is right to highlight the lack of a statutory definition of pre-packs as a significant problem in this regard.

That said, there is a clear distinction between the two that we feel can and should be reflected in the proposed regulations. While it is true that, notwithstanding the other regulatory requirements that an insolvency practitioner must adhere to, connected party pre-pack sales are negotiated and completed in advance of a formal insolvency appointment, which leads to creditor and stakeholder concerns about the lack of immediate transparency of such procedures.

However, ordinary connected party sales in administration normally take place post-appointment and at a time when creditors are aware of the company's entry into an insolvency procedure. When the insolvency of a company is known, some connected parties may view this as an opportunity to bid for certain elements of the business and/or assets of a company. Again, at this stage of a company's insolvency, creditors will be aware of the situation. Further, the profession's Statement of Insolvency Practice (SIP) 13, 'Disposal of Assets to Connected Parties in an Insolvency Process', requires insolvency practitioners to report to creditors on this type of transaction.

In addition, applying the regulations as drafted would raise another area of unnecessary complexity i.e. a creditors decision procedure being required, which we would like to discuss with you separately alongside the technical queries concerning the drafting of the regulations mentioned above.

Therefore, the concerns around the perceived lack of transparency in connected party sales in pre-pack administrations do not apply to those connected party sales that take place in administrations more generally (post-appointment). It is worth emphasising that the focus of the Graham Review, creditor and stakeholder concerns, as well as the Insolvency Service's own review, lay with the former rather than the latter.

We recognise the value to creditors and stakeholders of these regulations applying to connected party pre-pack administration sales, but do not believe any case has been made, other than the difficulty of drafting a more focussed application of the regulations in light of the lack of a statutory definition of a pre-pack, for applying these measures to *all* connected party administration sales (albeit with an eight week limit).

Conversely, we also recognise that not all pre-packs are completed on the same day as the appointment and therefore it would be appropriate to seek to include pre-packs sales which are negotiated prior to the administrator's appointment but not completed until after the commencement of the administration. An appropriate time period is considered to be 21 days to capture these arrangements.

To this end, we would therefore suggest that the regulations be amended as follows:

Original

Application (substantial disposal)

4.— These Regulations apply to a substantial disposal by an administrator.

(1) "Substantial disposal" means 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.

(2) A substantial disposal includes one which is effected by a series of transactions.

Amended

Application (substantial disposal)

4.— (1) These Regulations apply to an arrangement under which a substantial disposal by an administrator was negotiated, brokered, arranged and/or discussed with a purchaser prior to an appointment the administrator.

(2) "Substantial disposal" means a disposal, hiring out or sale to one or more connected persons(a),during the period of 21 days 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.

(3) A substantial disposal includes one which is effected by a series of transactions.

The endorsement of the amended regulation would remove the requirement for an administrator to seek creditor approval for the disposal of assets which would be deemed to be 'substantial'. A report from the Evaluator would still be required and full disclosure under SIP 16 also would be made. However, disposals which did not involve any pre-appointment negotiations would not be affected.

The qualifying criteria of the Evaluator

Under the draft regulations, an individual will be qualified to act as an Evaluator if *"…the individual believes that they have the requisite knowledge and experience to provide the report*." We are very concerned that under this criterion, unqualified and inappropriate opinion providers will actually be deemed to be qualified, simply by dint of their assertion only. As well as undermining the entire point of these reforms, this approach risks bringing pre-packs and the wider regulatory framework into disrepute.

In our previous submissions to the Insolvency Service's review, we set out our view that ideally the Pre-Pack Pool, one way or another, should be the source of independent opinion providers: "This body was set up with the precise remit of providing such opinions, and it has a track record of delivering opinions in a timely and efficient manner."

We do recognise, however, that the Pool cannot be referred to in the regulations given its structure as a private limited company. We also recognise the difficulty the Insolvency Service has faced in identifying qualifying criteria that would ensure the integrity of the Evaluator role (such as being a Chartered Accountant, insolvency practitioner, auditor, etc), but that would also not be so restrictive as to prevent members of the Pre-Pack Pool (experienced directors) from carrying out that role in future. Unfortunately, we do not believe that the proposed regulations as currently drafted strike the right balance.

Noting the drafting difficulty mentioned above, R3 does wish to see the role of the Pre-Pack Pool maintained and improved as a result of these reforms. The Pool was set up, with the support of the Insolvency Service, the RPBs, R3, the wider insolvency profession and stakeholder community, following the outcome of a Government-commissioned independent review (the Graham Review), and it has already been carrying out this function for a number of years, providing a prompt and cost-effective service. In light of these considerations, we do not believe

it would be right for the Pool to effectively be cast-off as a result of these reforms. It is incumbent on the Insolvency Service, RPBs and the profession, to find a solution to this problem.

We would suggest that one method would be for the Insolvency Service to maintain a list of approved opinion providers – effectively just the Pre-Pack Pool, but not necessarily on a permanently exclusive basis – which should be referable in secondary legislation, thereby avoiding the aforementioned drafting difficulty. The Insolvency Service's 'Pre-pack stakeholder paper', of October 2019, stated that a similar suggestion had already been considered as part of its review: "Some stakeholders suggested a rota system akin to the current system used by the Pre-pack Pool and subsequent removal of the opinion provider from the rota as a potential sanction for wrong doing. However, establishing such a system is not within the scope of the SBEE Act power."

We do not believe that this suggestion would constitute a rota, as other than satisfying itself that the opinion providers are qualified to carry out the Evaluator role, the Insolvency Service would have no involvement in managing any of the administrative processes associated with a rota. This function could lie with the Pre-Pack Pool.

Further, it is not clear that the scope of SBEE Act power would prevent such a suggestion from being incorporated into the regulations: the "person of a description specified in the regulations", under (2)(c), paragraph 60A, schedule B1 of the Insolvency Act (1986), could simply be "a person approved by the Secretary of State", with subsequent decisions regarding the exact qualifying criteria being made on an operational basis by the Insolvency Service. The aforementioned legislation, (7)(b), also permits that "regulations under this paragraph may…make incidental, consequential, supplemental and transitional provision", providing additional legislative scope with which the Insolvency Service could use to implement this suggestion.

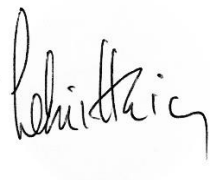
We consider this to be the only legislative solution that would ensure the integrity of the Evaluator role while also not undermining the role of the Pre-Pack Pool. This would also provide the Insolvency Service with the flexibility to update and amend the approved Evaluators list as times and circumstances change, without having to amend the regulations at a later date.

Should this not be possible, we would urge the Insolvency Service to speak with the RPBs to discuss the ways in which this outcome (the Pre-Pack Pool as, at least initially, the sole source of Evaluators) can be achieved through non-legislative means.

At the very least, a minimum requirement for the Evaluator should be the possession of Professional Indemnity (PI) insurance. Successfully obtaining this cover would suggest that an individual Evaluator was at least a 'serious' person. Pre-Pack Pool members have this coverage – as well as ten years of board level experience, which is exactly the type of experience the proposed Evaluators should possess.

We hope that this feedback is helpful and would welcome the opportunity to discuss this with you in more detail. Please contact R3's Head of Press, Policy and Public Affairs, James Jeffreys, at james.jeffreys@r3.org.uk or 020 7566 4220, should you have any queries.

Yours sincerely,



Colin Haig
R3 President