Global Restructuring Review

NEWS

UK announces connected pre-pack scrutiny laws

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The UK government has revealed plans to introduce independent scrutiny of pre-pack administration sales to connected parties, after promising a review this summer: a move that lawyers and practitioners tell GRR will improve transparency, but requires balance.

On 8 October, the government **announced** new laws that would require mandatory independent scrutiny of pre-pack sales where connected parties, such as a company's existing directors or shareholders, are part of the purchase.

The announcement, which came from the Insolvency Service, the Department for Business, Energy and Industrial Strategy (BEIS), and the minister for climate change and corporate responsibility Lord Callanan, said the new laws will improve transparency and confidence in pre-pack sales.

The government has yet to announce any details on what the scrutiny will entail, but said the laws would be introduced to parliament "in due course."

Pre-pack sales are a process in which a company agrees to sell its business or assets before entering administration, then completes the sale once an administrator has been appointed. They are seen as a fast way to sell a business that preserves its value and saves jobs.

The process has recently been used to sell the assets of various UK companies, including retailer **Bensons for Beds**, restaurant owner **Azzurri Group** and foreign exchange company Travelex.

But the government noted that concerns have been raised over whether they are always in the best interests of creditors, particularly when a connected party has a role in the purchase.

Last year, Frank Field, who was an MP and chair of the Work and Pensions Committee at the time, **criticised** the UK Pensions Regulator for not using its anti-avoidance powers over the pre-pack sale of publisher Johnston Press to its bondholders. He said the publisher's pre-pack sale was a "nasty little trick" that allowed it to "quietly jettison" its pension scheme onto the government.

An independent **review** carried out in 2014 found evidence that pre-packs led to less successful outcomes for business rescues where the sale was to a connected party.

Some companies voluntarily submit pre-packs for review by the Pre-Pack Pool, an independent body of 19 businesspeople that offers opinions on the reasonableness of pre-pack administration.

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But in May, the chair of the Pool's oversight group, Mike Sargeant wrote to the BEIS to warn that the Pool was in danger of being disbanded, as it was consulted so infrequently.

Following a debate in the House of Lords on the **Corporate Insolvency and Governance Bill**, which came into law in June, the government extended a sunset clause reserving it the power to review pre-packs until June 2021, and announced it would review the use of such sales.

Responding to the government's announcements, lawyers and insolvency practitioners have broadly welcomed the move as away of increasing confidence in UK pre-pack processes. But they warned there will need to be some carve-outs to ensure the process remains a viable way of rescuing businesses.

Howard Morris, senior of counsel at Morrison Foerster in London, tells GRR he recently spoke with Dame Teresa Graham, who led the 2014 review of pre-packs, and she had anticipated the new laws.

"The simple truth is that there's a limit to what the government can, perhaps even should, do to arrest the shock our economy is suffering," he says. "The public and company stakeholders, creditors, employees, often find a pre-pack to a connected party offensive; they wake up to find their debtor or employer has filed and its business and assets have already been sold and they have been left behind."

He compares this with the aftermath of the recession of the early 1990s, where banks were criticised for supposedly pulling the trigger on receivership too quickly. "True or not, we saw the end of receivership."

"Uninformed in many cases it may be but pre-packs to directors or shareholders generate a similar public distaste," he says. "Of course they're an important option for the restructuring industry and we now need all the options we can get. That's why the government is again looking at enabling a super priority debtor-in-possession lending market, so we have options."

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Morris notes that it remains unclear who will provide the mandatory independent oversight, and says the selection will be crucial to making the regulation work.

“It also remains to be seen how this mandatory scrutiny will be enforced and what impact this may have on what is otherwise a relatively swift and efficient process,” he adds.

Kirkland & Ellis partner **Kate Stephenson** in London says the reforms “come as no great surprise given the mood music”. She says that although the Pool will be the obvious source of independent written opinions, the light-touch eligibility requirements open the door to opinions from anyone considered to have the requisite knowledge and experience, provided they are independent.

“The reforms may mean some additional hurdles and analysis, and require more careful composition of newco boards, but we welcome measures to improve transparency and confidence in our insolvency processes,” she says.

But she adds: “We are concerned to ensure adequate carve-outs for pre-pack sales to secured creditors, in line with the Graham review, and will ask for these to be reflected in the final Regulations.”

Ropes & Grey partner **Matthew Czyzyk** in London also said the announcement is not a surprise, but is timely given the recent pre-pack sales of restaurant chains Côte and Byron. “It is expected that the pandemic will expedite other such transactions in the months ahead,” he added.

Advisory firms reacted in much the same way as their colleagues on the legal side of restructuring. R3 president **Colin Haig**, head of restructuring at Azets in London, broadly welcomed the decision to scrutinise pre-pack sales to connected parties without outright banning them, as he said 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,” he said.

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“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,” he added. “These reforms, while not perfect, should help to improve confidence in this important business rescue tool.”

KPMG’s head of restructuring, **Blair Nimmo** in Edinburgh, said that although the Pre-Pack Pool has played a useful role in ensuring transparency for creditors and shareholders, he hoped that that the new proposals will help improve confidence in a process that can sometimes appear opaque.

“The challenges and uncertainties posed by the current environment means that now more than ever, the pre-pack is an essential tool in the restructuring practitioner’s toolkit,” he said.

“The truth is that often, these transactions are the only basis by which a business is able to survive, and so play a key role in protecting jobs,” he added.

But Ashurst partner **Olga Galazoula** in London tells GRR the proposals may not make a huge difference at the top end of the market, where scrutiny already takes place. In Galazoula’s experience, “the top insolvency practitioner firms have been insisting upon the prospective buyer applying to the Pool as a condition to accepting an appointment and effecting a pre-pack sale.”

“It is undoubtedly true that the market as a whole has not embraced the Pre-Pack Pool, with the number of referrals steadily declining since its inception,” she says, but “I do not necessarily think that the new proposed changes will alter the situation dramatically on our end of the market.”

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