ICAEW
REPRESENTATION 104/20

PRE-PACK SALES IN ADMINISTRATION

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ICAEW welcomes the opportunity to comment on the draft legislation and related report on Pre-pack sales in administration published by Insolvency Service on 8 October 2020, a copy of which is available from this link.

> We believe that several key areas of the draft legislation need further development if it is to increase public confidence in the regime. If matters such as qualification and accountability of the evaluator cannot be addressed more fully, government should consider alternative ways forward.

This ICAEW response of 5 November 2020 reflects consultation with its Insolvency Committee which is a technical committee made up of Insolvency Practitioners working in large, medium and small practices. The committee represents the views of ICAEW licence holders.

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KEY POINTS

1. We agree that pre-packs (including connected party pre-packs) are a useful route to good outcomes for stakeholders.
2. We believe that the existing regulatory framework is suitable for addressing breach of their duties by administrators in carrying out pre-packs. Adverse perception about pre-packs is not sufficient in itself to justify changing the underlying objective of administration (ie to achieve the best outcome for creditors as a whole).
3. We agree that the legislation should not cover viability statements. The administrator's duties are to maximise returns for the creditors of the insolvent company and, in that context, the prospects of the future business will be relevant only in limited cases (eg where there is deferred consideration).
4. As regards perception of pre-packs, we believe that some key questions arising from the draft legislation remain to be addressed and, if they cannot be, then alternatives should be considered
5. In government consultations last year, we suggested a non-legislative alternative involving a review by independent third party (ie pre-pack pool) of disclosures made by the administrator. We believed that this would meet the objective of increasing transparency without giving rise to the potentially complex issues that legislation would need to address (such as those highlighted below).
6. Another alternative would be to make use of the pre-pack pool, or equivalent, mandatory and we comment further on that below.
7. Regarding the draft legislation itself, we have the following principal comments:

COMMENTS ON DRAFT LEGISLATION

Application (substantial disposal) (s4)

8. The legislation provides for a 'substantial disposal', but leaves it to the administrator to decide what constitutes all or a substantial part of the company's business or assets (eg x% of a realisable value which may be uncertain)? This does not seem best designed to provide creditors and others the comfort they seek from involvement of a person who is independent of the administrator.
9. We believe that Parliament should provide definition on this and not leave it for government guidance or regulators to fill in the gaps.
10. The legislation only applies to substantial disposals in administrations. While the public focus may currently be on connected party pre-packs (and phoenix companies), similar concerns can arise in connect party Company Voluntary Liquidations and we think CVLs are likely to become more prevalent. Government should anticipate this in any legislation and apply a consistent approach to all relevant disposals having regard also to proportionality (eg likely costs in relation to small CVLs).
11. As the regulations only apply to substantial disposals, we suggest that their title be changed to Administration (Restrictions on Substantial Disposal etc. to Connected Persons) Regulations 2020 to avoid any perception that the restrictions apply more widely (Schedule B1 of the Act already refers to disposals).

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The report (7)

Administrator reasons to believe (s7(f)(g))

12. We are not clear how the phrase 'the administrator has no reason to believe' should be interpreted.
13. If it is limited to actual knowledge of the administrator, it would be relatively unproblematic (except when applied in relation to the knowledge and experience of the evaluator). In that case, we suggest it be changed to 'did not believe'.
14. On the other hand, if it includes matters that the administrator should or could have known by making enquiry, the question then arises so to whether, and to what extent, the administrator should conduct due diligence (the cost of which would be added to the costs of administration borne by creditors).
15. The requirement in s7(g) for the administrator to have no reason to believe that the evaluator did not have the 'requisite' knowledge and experience to provide the report' is problematic.
16. It does not refer to the s9 test of knowledge and experience required, perhaps with good reason. Under s9, evaluators do not need to have any knowledge or experience, only a belief that they have it. It is not reasonable to expect an administrator to believe (or have no reason not to believe) in someone else's state of mind.
17. That begs the question what test of knowledge and experience the administrator is meant to apply. We do not believe that this should be left to the administrator to determine. Rather, Parliament should set out express criteria and any requirements for an administrator to verify should be limited to matters of fact that can be established without undue work (and related cost).
18. Regardless of definitional issues, it is unclear to us why an administrator should not be allowed to proceed merely because he or she does not believe that the evaluator has sufficient knowledge or experience. We suggest that the outcome should be the same as would be the case if a suitably knowledgeable and experienced evaluator gave a 'case not made report' and that the administrator should give reasons for proceeding.

Meaning of material change (s7(d))

19. S7(d) requires the administrator to form an opinion on whether changes in the terms of disposal etc are 'material'. If they are material, it will be necessary to obtain a new report, which could have significant implications. Timing of pre-pack sales is often critical. Any delay can impact creditor returns and the prospects of the business for the purchaser.
20. Connected party purchasers are likely to obtain the relevant reports as early as practicable to minimise impact on the transaction. There are frequently last-minute changes to transactions. For example, a different purchasing entity may be proposed by the stakeholders from one previously contemplated shortly before intended time of completion. A change like this may be 'material' to one person, but not to another and it is unclear from the legislation what factors administrators should consider in forming their opinion on materiality.
21. We suggest that the provision be more narrowly defined so that the opinion is on whether there would be to material impact for creditors. This would be aligned with the administrators' own objectives and therefore something that would be in their contemplation in the ordinary course.

The requirements as to qualification and associated matters

Qualification of the evaluator (s8(1) and s9)

22. The draft legislation currently provides that a person who 'believes that they have requisite knowledge and experience' is suitably qualified.

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23. If Parliament accepts this, it will be responsible for creating an unregulated, unsupervised industry in the insolvency sector and we do not see how that would promote trust in the regime.
24. However, defining what qualifications would be required presents some challenges and will depend on the nature of the report the evaluator is producing.

The report (s8(3))

25. Under s8(3)(f) the evaluator is required to state whether he or she is satisfied (or not satisfied) that 'the consideration to be provided for the relevant property and grounds for the substantial disposal are reasonable in the circumstances'.
26. It is unclear what an evaluator is meant to assess regarding 'grounds of disposal'. Are the grounds the same as those an administrator has for making the disposal (ie is in the best interests of creditors as a whole)?
27. If so, then the evaluator will, presumably, need to have the knowledge and experience of an administrator and the best qualified person is most likely to be an insolvency practitioner. We do not believe that the public interest would be best served by requiring this.
28. Whether the consideration payable for property is 'reasonable' could depend on various factors, including the nature of the property, expert valuations obtained and offers or expressions of interest made to purchase it.
29. It is unclear whether evaluators are meant to consider all these factors in reaching their conclusion on reasonableness or are to have a more limited role.
30. If the role is more limited, eg akin to a valuer, there is a risk of duplication of effort and expense because IP's are required to obtain valuations already (and the government's report identifies that in 91% of cases, independent valuations were obtained).
31. If it is intended that the evaluator should have a broader role, eg to assess the reasonableness of the administrator's decision on consideration payable, it may be necessary for the evaluator to have access to information obtained by the administrator. This could include, for instance, expert valuations, offers and expressions of interest (beyond those of the connected party), or absence of them.
32. The existence and value of competing offers is fundamental to an administrator's assessment of what is in the best interest of creditors in the circumstances. But the evaluator owes no duties to creditors and is engaged by the connected party. If the connected party becomes aware of valuations obtained by the administrator, it may offer less for the assets than might otherwise have been the case and this would be counterproductive. A valuer engaged by the administrator may not allow a third party (eg an evaluator) to rely on his or her valuation without agreed terms (and payment).
33. The legislation does not appear to require administrators to disclose information of this kind to connected parties (or direct to evaluators) so that it appears that the evaluator's role is a relatively narrow one. It may, however, be helpful to make this clearer.

Liability

34. It seems that an evaluator will be liable (breach of contract, negligence etc) only to the connected party purchaser. If that is right, we find it somewhat difficult to see why the public should take comfort from the evaluator's report.
35. If the evaluator does potentially have responsibilities to others (and resulting liability), then we suggest that the legislation should provide some mechanism to ensure that the evaluator has reasonable substance to meet liabilities that might arise, or insurance.
36. We note that administrators are regulated, required to have insurance and can be personally liable.

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Definition of 'connected person'

37. As we mentioned in earlier consultations, if "connected person" is intended to have the meaning given to it in the Insolvency Act, we suggest it is made explicit that sales to secured lenders who hold security for the granting of the loan (with related voting rights) should be carved out (as in SIP 16 following the findings in the Graham Report).

Northern Ireland

38. The legislation does not extend to Northern Ireland. We can see no reason why different laws should apply in the different jurisdictions in this respect and trust that law will be amended in Northern Ireland at the same time as implementation in the rest of the UK.

USE OF THE PRE-PACK POOL

39. The report notes that during debate of the Corporate Insolvency and Governance Act there were a number of calls to implement mandatory referral to the Pre-Pack Pool as an immediate measure, but that this was not the intention when the enabling power was created.
40. We query whether the current draft legislation is what Parliament intended when the enabling power was created and whether legislation of this nature should be left to enabling powers at all. We think that the issues involved might best be introduced though primary legislation (if legislation is required).
41. While the pre-pack pool was not much used, we believe that it did function effectively when it was used. It provides a framework under which those providing opinions must be insured and terms of appointment etc.
42. Having seen the draft legislation, we believe that, if use of the pre-pack pool cannot be mandated, government should at least identify a pool of experts from which the appointments can be made and set minimum standards at least equivalent to those applying to the pre-pack pool. This may not fully address all the questions arising as outlined above but could mitigate some of the concerns.

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