

# 2021 PRE-PACK REFORMS

## CHANGES AFOOT



Nat Baldwin writes:

At Hilco Valuation Services, we frequently provide valuation advice and SIP 16 compliant marketing processes for pre-packs in our role as agents. We provide these services across a whole spectrum of assets and industries and the expected pre-pack Administration reforms will centrally impact on our work with clients.

The start of 2021 is accordingly an excellent time to reflect on pre-packs and look at where we have come from, where we are heading and what the reforms will mean for those of us working with turnarounds. Note that these regulations only apply to Administrations and not Liquidations which also see assets sold to connected parties – the debate on the merits of the application of the rules to one form of process rather than the other are perhaps for another day.

## WHAT'S HAPPENING AND WHY DOES IT MATTER?

Firstly, a recap on events. Last October, the Government issued draft new regulations on pre-packs (processes that make up 29% of all administrations). These initial regulations were introduced to scrutinise pre-pack sales however, as a response to criticism the Government has released further amended draft regulations, on 24 February 2021, which will come into force by late April 2021.

The Government's main concern is said to be the transparency of pre-pack sales and whether they are always in the best interest of creditors. The key takeaway is that the new laws will require mandatory independent scrutiny of pre-pack administration sales to connected parties. Thus, an administrator will not be able to complete a sale of all or a substantial part of a company's assets to a connected party within eight weeks of a company entering administration (the term pre-pack doesn't have a legal definition as such, so the eight weeks create some kind of delineation) without obtaining either the approval of creditors; or an independent written report. It is thought likely that most parties will seek to go down the independent written report route as this will be speedier than the creditor sanctioned route.

## PRE-PACKS - WHAT HAVE WE LEARNT?

For those involved in turnaround work, the Government's 2020 report provides a useful insight into pre-packs and a run down on where we were in relation to the Graham Review. It readily reveals the perceived operational failure of the Pre-Pack Pool and the way that this has led to the current changes only a few years on - in 2019 only 9% of connected party sales were referred to the Pool.

The report is well worth a read for those interested in the area as there is plenty of statistical analysis of referral rates, reasons for using the Pool etc. Within that analysis a couple of interesting points are worthy of note here. The first concerns valuation price versus the eventual purchase price:



"Of the 163 connected person sales reviewed, 142 had the necessary information available to compare the valuations to the purchase price. Of these 88 (62%) were sold at or above the valuation, demonstrating that in the majority of cases the connected purchaser was willing to pay the valuation price or more to ensure the business continued to trade. This indicates that there can be benefits to a connected party sale where existing management may place a higher value on the business than an outside purchaser."

These findings highlight a point well known to all in the industry: that within UK insolvencies, where there is no US-style debtor in possession model, and where regulation has meant trading insolvencies are largely a thing of the past, "value" is often lost as third-party buyers are resistant to the risks involved in buying from insolvency.

In the past, of course, this known fact has been used by some parties to cut corners and even sell assets even below ex-situ/break up values and certainly, some regulation in the area is required to avoid this result. Many of the SIP 16 regulations are common sense (broadcast rather than narrow cast, publicise rather than simply publish etc.) but such controls are necessary given the quirks and conflicting drivers that insolvency professionals face. Indeed, within Pre-pack scenarios the Government Review states:

"The review of SIP16 statements found that marketing activity has increased for connected party pre-packs, from 49% prior to the introduction of the recommendations of the Graham Review, to 77% of sales in 2016."



# WHOSE OPINION MATTERS - THE EVALUATOR?

As explained above, the new regime will likely push administrators away from pursuing sign off from creditors and towards seeking an independent opinion from an “evaluator” who will need to assess whether the sale consideration and other relevant factors are reasonable or not.

Multiple reports can be sought, and the administrator can still proceed with the sale even if the report does not support it - as long as they provide justification for their decision. A copy of the opinion and Administrators’ reasoning will need to be sent to all the company’s creditors and lodged at Companies House (redactions or exclusions of commercially sensitive information may be made to the copy sent). This is a clear change from the current process and is designed to add more transparency to pre-packs.

With the initial regulations it was not certain who would do the evaluating, all that was known was that the evaluator must be an individual “who believes that they have the requisite knowledge and experience to provide the report” and that the Administrator also believes this to be the case. They also clarified who cannot provide the opinion (not the Administrator, the Company, the buyer, etc). Under the new regulations, the Government has implemented that an Evaluator is required to have Professional Indemnity Insurance. This suggests that an Evaluator will be involved in providing professional advice and therefore, are required PII to ensure confidence within the sales process.



However, there is still no further clarification under the new regulations regarding who may exactly qualify as an Evaluator. It will be interesting to see if the Pre-Pack Pool will continue to be used or whether other professionals such as accountants, lawyers, valuers etc. step into the role.

## IN CONCLUSION

The new regulations are of importance to insolvency professionals because they make up part of their professional responsibilities and also important to those transacting to ensure the pre-pack deal isn't challenged later down the road. The continued trend toward further regulation, transparency and oversight is favourable to us in the industry where, within the larger business community, public confidence matters. Some in the restructuring industry will be asking whether the measures are necessary as many of the complaints against pre-packs are made in the comments section at the bottom of the news blogs rather than more informed perspectives. There has been a long-standing view within the industry that this type of regulation is just attempting to weed out the rotten apples but, where perception is reality, the approach would seem to make sense.

Robust and top-quality advice is more important than ever in the current climate and we at Hilco Valuation Services already pride ourselves on such advice in the provision of valuations and recommendations as well as providing opinions on values against assets and commentary on offers received for assets. We will be at the forefront of delivering strong transparent advice to our clients and await with interest to see which parties will routinely be selected by insolvency professionals to act as evaluators.

A nighttime photograph of a modern, cylindrical skyscraper with many lit windows, situated in a city skyline.

For any advice on pre-pack asset valuations, disposals and accelerated business and asset processes please contact us.



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