EXPLANATORY MEMORANDUM TO

THE ADMINISTRATION (RESTRICTIONS ON DISPOSAL ETC. TO CONNECTED PERSONS) REGULATIONS 2021

2021 No. 427

1. Introduction

1.1 This explanatory memorandum has been prepared by The Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument imposes conditions on disposals in administration to connected persons, namely, that an administrator must not proceed with a disposal of property of a company within the first 8 weeks of that company entering administration without either an independent opinion on the disposal, or approval of creditors.

2.2 The instrument only applies to administrations that commence on or after the date the instrument comes into force.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 This instrument is made using a revived power. The Small Business Enterprise and Employment Act 2015 (SBEEA 2015), created a reserve power for the Secretary of State to legislate if necessary, in respect of pre-packs. The reserve power was subject to a sunset provision and expired at the end of May 2020, but the Corporate Insolvency and Governance Act 2020 revived the power until June 2021.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The power under which this instrument is made covers Great Britain (see section 440 Insolvency Act 1986) and the territorial application of this instrument is not limited either by the Act or by the instrument.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England, Wales and Scotland.

4.2 The territorial application of this instrument is England, Wales and Scotland. In Wales, insolvency is fully reserved. In Scotland, insolvency is partially devolved. Personal insolvency and certain aspects of corporate insolvency are devolved, but other aspects (including administration), are reserved. Insolvency is fully devolved in Northern Ireland.

5. European Convention on Human Rights

5.1 The Minister for Climate Change and Corporate Responsibility, Lord Callanan has made the following statement regarding Human Rights:

"In my view the provisions of the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 are compatible with the Convention rights."

6. Legislative Context

6.1 This instrument imposes conditions that must be satisfied before an administrator of a company in administration is able to make a substantial disposal of company property to a person who has a connection with the company. The conditions are that the company's creditors must have considered and approved the proposed disposal, or, alternatively, that an independent and suitably-qualified person has provided a report to the administrator which considers whether the proposed disposal is reasonable in the circumstances. The instrument also requires that, if the report concludes that the proposed disposal is not reasonable, this must be disclosed to the company's creditors.

6.2 Under Schedule B1 to the Insolvency Act 1986 an administrator of a company in administration has a number of powers. One such power is the ability to sell or otherwise dispose of company property; that can include the sale of company property under so-called "pre-pack" arrangements where the sale of company assets is agreed prior to the company entering administration. Concerns have previously been expressed by various stakeholders as to whether such arrangements are in the best interests of the company's creditors; particularly where company property is sold to a person with a pre-existing connection with the company in administration.

6.3 The instrument accordingly places restrictions on the exercise of the administrator's ability to dispose of company property by requiring that, in specified cases, conditions must be satisfied before the disposal can be made. The instrument is not limited to disposals made under a "pre-pack" arrangement since that expression is not defined (or readily definable) in law. Instead, the instrument applies in any case where the administrator proposes to make a substantial disposal to a connected person. The expressions "substantial disposal" and "connected person" are defined in the instrument and the Insolvency Act 1986 respectively.

7. Policy background

What is being done and why?

7.1 Pre-pack administration is where a purchaser of an insolvent company's business is found prior to administration, with the sale executed at or shortly after the appointment of an administrator. In recent years there has been criticism and considerable media attention of pre-pack sales which occur before the creditors are given an opportunity to vote on the administrator's proposals to sell a company's business or assets. However, the speed with which the pre-pack sale takes place helps to preserve the value in the business and jobs. Concerns around pre-pack sales centre on the lack of transparency for creditors, and the fact that in many cases the business or assets are purchased by the same owners or other persons connected with the insolvent company.

7.2 Dame Teresa Graham was commissioned to undertake an independent review of pre-packs as part of the then Coalition Government's wider 'Transparency and Trust'

agenda and her recommendations were published in 2014[1]. The recommendations were voluntary measures intended to increase transparency and creditor confidence in pre-pack sales. The measures were implemented by industry in 2015 and included the formation of an independent panel of business experts, known at the Pre-Pack Pool, from which a connected person purchaser could seek an opinion on a pre-pack sale. A reserve power was also taken in the Small Business Enterprise and Employment Act 2015 to enable Parliament to regulate either to ban sales in administration to connected persons or to impose restrictions on such sales should the voluntary measures not have the desired impact.

7.3 The Government committed to Parliament that it would report on the effectiveness of the existing measure and the need for regulation. Government concluded in its report[2] published on 8th October 2020 that, while the measures have resulted in some improvement, there are still concerns about transparency and a legislative approach is therefore needed.

7.4 It is considered that further relevant non-legislative measures would not be appropriate since as already noted, purchasers are able to seek independent scrutiny on a pre-pack sale on a voluntary basis. However, the number of referrals to the Pre-Pack Pool for independent scrutiny of connected person sales has been considerably lower than anticipated, meaning that the voluntary measures have not had the desired effect of improving transparency. In 2019 there were 260 connected person pre-pack sales but only 23 referrals to the Pre-Pack Pool.

7.5 This instrument will require that where a person intends to acquire a business or assets from a company in administration within the first eight weeks of administration, and that person is connected to the insolvent company, they must seek an independent opinion on the purchase, unless creditors have approved the sale. Mandatory referral to an independent third party will provide creditors with greater assurance that such a sale is appropriate in the circumstances of the insolvency.

7.6 The evaluator providing the opinion will be required to make a statement that either the "case is made" for the sale or that the "case is not made". This will be based on whether the evaluator is satisfied that the consideration and grounds for the sale are reasonable in the circumstances. Where the "case is not made" an administrator will still be able to proceed with the sale to the connected person but will need to provide an explanation of why they have proceeded despite a "case not made" opinion.

7.7 One of the objectives behind the SBEE Act was to enhance transparency of UK companies in terms of their ownership and ensure the UK is a fair place to do business. This instrument (and in particular the policy of mandatory independent scrutiny of certain transactions for which is provides) is consistent with the SBEE's aims. The policy is intended to target only those sales in administration that are to connected persons, rather than all pre-pack sales in administration. On average, the policy will affect less than 2% of total corporate insolvencies per year.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

[1] https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration
[2] https://www.gov.uk/government/publications/pre-pack-sales-in-administration

9. Consolidation

9.1 Not applicable

10. Consultation outcome

10.1 The Government's review carried out in 2018 of the impact of the industry measures consulted many stakeholders, including the creditor community. Due to the limited impact of the policy (pre-packs represent a small percentage of overall corporate insolvencies) a targeted consultation was undertaken between June and October 2019 to develop the policy for the proposed regulatory framework. This took the form of two separate discussion papers. All key stakeholders were consulted including the Recognised Professional Bodies which regulate insolvency practitioners, the Chartered Institute for Credit Management, the British Property Federation, Her Majesty's Revenue and Customs, the Pension Protection Fund, the directors of the Pre-pack Pool and the insolvency trade body, R3. There was widespread support from creditor representatives and R3 to mandate referral of pre-pack sales to an independent body. The Recognised Professional Bodies had reservations about the need for regulation but engaged with the consultation process and the development of policy. Respondents were broadly supportive of the proposal that legislation should require that an independent opinion be obtained. To the extent that there were reservations, they concerned the specifics of who should be authorised to provide the opinion. It is expected that many connected person purchasers will use the Pre-Pack Pool to obtain the independent opinion required by the instrument. A further consultation was undertaken in October 2020 following publication of an earlier draft of regulations. Comments received by stakeholders (including the Recognised Professional Bodies, R3, PPF) were centred on the qualification requirements of the evaluator and concerns about disclosure of previous reports obtained by the connected person. This led to alteration and strengthening of the regulations which will ensure they have the desired impact. Changes to the regulations include provisions aimed to disincentivise a person obtaining multiple reports in the hope that one would be favourable and strengthening the requirements for acting as an evaluator by including an obligation to obtain suitable insurance.

11. Guidance

11.1 The Department proposes to work with stakeholders to issue guidance in relation to this instrument to assist those eligible to provide an opinion in the exercise of their responsibilities in that role. The intention is that this will be available to coincide with the coming into force date.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 An Impact Assessment has not been prepared for this instrument because the level of impact on business is assessed as being below £5M.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small business.

13.3 The basis for the final decision on what action to take to assist small businesses has been guided by evidence which indicates that more than half of connected person sales are undertaken by SMEs. Smaller transactions are viewed by creditors as being more susceptible to abusive practices. The legislation therefore applies to businesses of all sizes equally and no specific exemption has been made for small businesses. However, the wording of regulation 3(3)(a) of the instrument has the effect of excluding sales that in the administrator's opinion do not form a substantial part of the company's business or assets, thereby ensuring that the legislation has proportionate effect.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is that no specific monitoring arrangements are needed. Government will however continue to engage with stakeholders to gauge the impact of the measures.

14.2 The regulation does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 Lord Callanan has made the following statement:

"The Department of Business, Energy and Industrial Strategy does not currently plan to undertake a review of the measures introduced in this instrument, as the impact is expected to be less than £5m and there are no factors that would make it desirable to include a review clause."

15. Contact

15.1 Judith Marsden at the Insolvency Service Telephone: 03003041727 or email: Judith.Marsden@insolvency.gov.uk can be contacted with any queries regarding the instrument.

15.2 Angela Crossley, Director of Strategy and Change at the Insolvency Service can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Minister for Climate Change and Corporate Responsibility, Lord Callanan at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.