Buyer beware

Buying the business of an insolvent company

There may be bargains to be had in the current climate but, as **Partha Kar** of **Kirkland & Ellis International LLP** points out, there are a number of legal and commercial risks and issues that a prudent buyer should be aware of when buying the business of an insolvent company.

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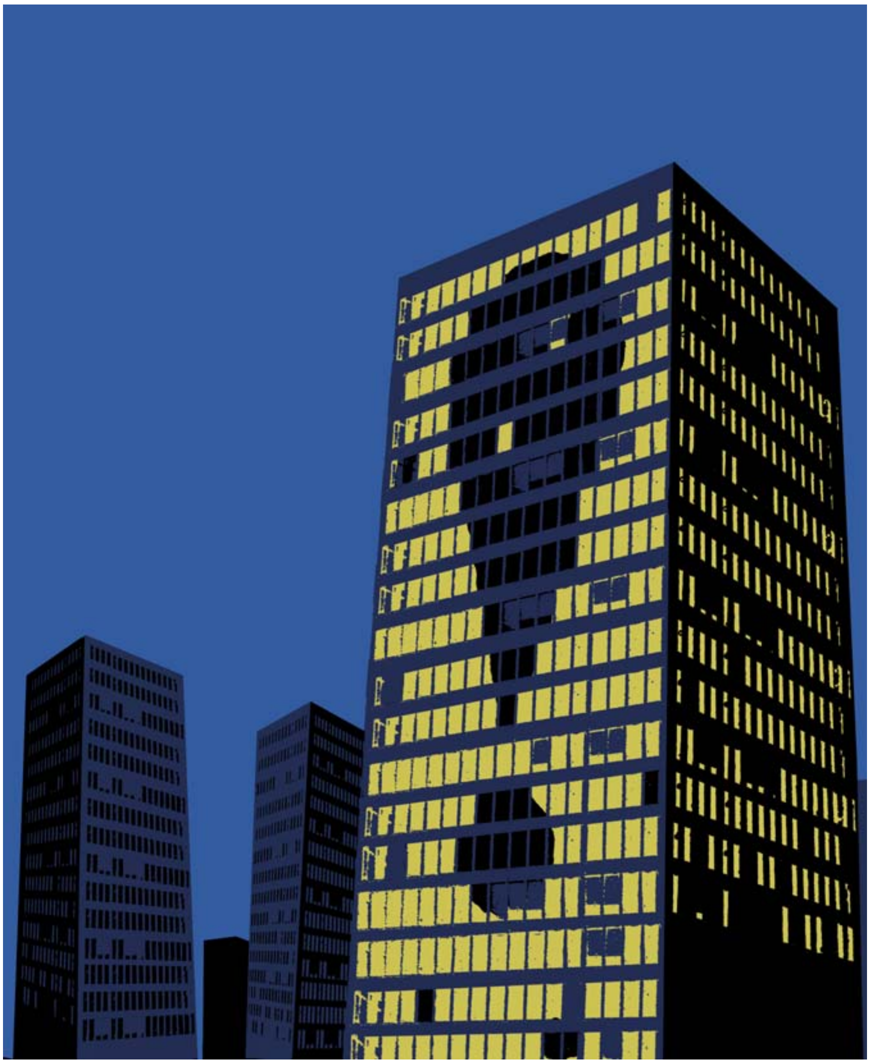

The global financial crisis has created opportunities for parties to buy businesses that are distressed or in an insolvency process (*see box "Insolvency basics"*). This article discusses the practical and legal issues that a prospective buyer needs to be aware of when buying the business of an insolvent company as a going concern and presumes that an English insolvency practitioner, most likely an administrator or a liquidator, has been appointed to an English corporate seller (*see box "Insolvency practitioner"*).

Many of the issues considered here could equally apply to a company that is in financial distress where there has been no formal appointment of an insolvency practitioner, although, in such a case a buyer may consider asking the seller to appoint an insolvency practitioner in order to deliver a sale while minimising any claw-back risk, such as using a pre-packaged administration sale (*see box "Pre-packs"*).

PRELIMINARY ISSUES

The preliminary practical steps will broadly follow those taken for the sale of a non-distressed business, with some differences.

Initial contact with interested parties

How the insolvency practitioner will contact prospective buyers will largely depend on the size of the case and business to be sold and also the number and type of prospective buyers he wants to contact.

Businesses may be advertised for sale through the local and national press as well as in trade publications. Brokers or investment banks may be used for larger businesses. Interested parties that have heard of the insolvency, such as those in the same industry, can contact the insolvency practitioner directly and ask to be involved.

In the early stages, the prospective buyers will receive little more information than the name and basic nature of the business of the seller and, if practical, even that may not be provided and the insolvency practitioner may provide a "teaser" only.

Confidentiality agreement

Negotiating and agreeing a confidentiality agreement with the insolvency practitioner is usually the start of the sales process and could prove an immediate challenge. The insolvency practitioner will be cautious when dealing with competitors of the seller or strategic buyers as the sales process is likely to involve divulging commercially sensitive information about the seller (for example, customer lists, prices and profit margins), and will be wary of financial buyers (such as private equity houses) that may be involved only to make opportunistic low bids to get the business "on the cheap".

This means that the insolvency practitioner is likely to require comprehensive non-solicitation provisions in relation to senior staff and customers, and restrictions on trading in the debt of the seller, and may include indemnities for breach.

Insolvency basics

Different tests to determine insolvency apply depending on the context in which the expression is used. The Insolvency Act 1986 (1986 Act) does not define insolvency but rather embodies the concept in the phrase "unable to pay its debts". Section 123 of the 1986 Act sets out when a company is deemed unable to pay its debts and includes failure to comply with a statutory demand for a debt of over £750, failure to satisfy enforcement of a judgment debt or proof that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

The main insolvency procedures for companies in financial distress are:

Administration. This is a procedure under the 1986 Act where a company may be rescued or reorganised or its assets realised under the protection of a statutory moratorium. The company is put into administration and an administrator is appointed. (*See also box "Pre-packs".*)

Company voluntary arrangement. This is where the company and its creditors come to some sort of agreement, which is implemented and supervised by an insolvency practitioner under Part I of the 1986 Act. It is used to avoid or to supplement other types of insolvency procedures.

Scheme of arrangement. This is where a compromise or other arrangement with creditors (or any class of creditors) or members (or any class of members) is made under Part 26 of the Companies Act 2006, which is binding if the appropriate majorities of each class of creditors/members agree. This is not an insolvency process but is commonly used in restructurings.

Administrative receivership. This is still relevant in a limited number of cases where secured creditors wish to enforce security entered into before 15 September 2003.

Liquidation. This involves the liquidation or winding up of the company. A liquidator is appointed who collects in and distributes the company's assets and dissolves the company. The company can also be put into provisional liquidation before a final winding up order is granted.

(*For more information on the UK corporate insolvency regime, see feature article "Corporate insolvency: from past to present", www.practicallaw.com/9-376-4270.*)

Sales process

In some cases, the due diligence material provided by the insolvency practitioner to prospective buyers, at least initially, may not be particularly comprehensive. This may be because the insolvency practitioner simply does not know much about the business or assets and has not had time to put together a detailed data room.

If a corporate finance adviser runs the marketing process for the insolvency practitioner, this should lead to a greater volume, better delivery and a higher quality of information. Even so, buyers will still be told to rely on their own inquiries and reach their own conclusions about the business, even in relation to critical issues such as title, encumbrances, condition of assets, financial performance, tax issues, litigation risks, and compliance with laws.

The sales process may include several stages, like a non-distressed sale, as the insolvency practitioner assesses how genuine the prospective buyers are and whether they can actually deliver a deal by asking for indicative bid terms, marked-up sale agreements and evidence of financing.

At each stage, the insolvency practitioner will create a progressively smaller shortlist, ensuring that the competitive tension of the process is maintained. The insolvency practitioner may also provide more information to the prospective buyers as the process moves through these stages.

Alternatively, the insolvency practitioner may use methods such as sealed bids or tender offers, a straight auction or a stalking horse bidder (where a sale is largely agreed with one prospective buyer and it is then up to other prospective buyers to offer better terms, which may include coverage of the stalking horse's break fee): essentially, whatever the insolvency practitioner believes will produce the best terms for the sale of the seller's business at that time.

A prospective buyer will have an advantage if it can move quickly (for example, by conducting reduced due diligence) and have minimal conditionality (for example, by ensuring that financing is already in place). A buyer will also be looked on favourably if it can show that it understands how insolvency sales work and what the market practice is. This is because an insolvency practitioner will want to complete as quickly as possible since the perception is that the longer the business is run by the insolvency practitioner, the more its value deteriorates.

SALE AGREEMENT

Key things to consider in relation to the sale agreement are:

Validity of appointment

The insolvency practitioner is usually party to the sale agreement so that he has the benefit of the extensive exclusion clauses (*see box "Typical exclusion clauses"*). Even if the insolvency practitioner is not a party to the agreement, he is likely to authorise the sale, so the buyer should verify that the formalities of appointing the insolvency practitioner have been complied with in full and, in the case of an appointment by a creditor, ensure that conditions for the appointment have been met.

The buyer can also ask the insolvency practitioner to provide a representation that he has been validly appointed, although this is likely to be forcefully resisted. If there is some reason for doubt and the buyer is not being unreasonable, the insolvency practitioner may consider providing a copy of a legal opinion on his appointment (most likely on a non-reliance basis) to the buyer or apply to court for directions to deal with this issue. In most cases, proof of validity of appointment is straightforward.

Warranties and indemnities

The insolvency practitioner and the seller will almost never provide any representations and warranties in a sale agreement. They will also resist being subject to any meaningful post-closing obligations (or at least significantly restrict them in scope). The insolvency practitioner will say the following as justification:

- He has only been appointed over the seller for a short period of time and does not know enough about it to provide any representations and warranties.

- He will need to use the sale proceeds to make a distribution to creditors so cannot provide post-closing or similar obligations that may create a requirement to return any of those proceeds.

Insolvency practitioners will also go further than merely avoiding liability and will add what have now largely become standard, extensive exclusion clauses (*see box "Typical exclusion clauses"*).

The buyer should note that the sale agreement will say that the seller will only sell "such right, title and interest" as it has in the assets being sold to avoid an implied warranty as to title; that is, the seller is not agreeing to sell the buyer those assets absolutely: it is only agreeing to sell to the buyer whatever title to those assets the seller itself has. This reinforces the need for the buyer to carry out proper due diligence on the ownership of, and any other interests in, these assets (for example, any security or encumbrances which the buyer must ensure are released at closing).

This also means that a buyer with pre-existing knowledge of the seller, such as a buyer that includes the seller's former management, is likely to have an advantage over buyers without such knowledge (*see "Directors' involvement" below*).

The insolvency practitioner will also ask for wide indemnities from the buyer where there is any chance of post-closing loss being suffered by the seller; for example, where the buyer operates contracts in the seller's name pending a formal assignment (such as a lease) (*see "Third party agreements" below*).

If there is a substantial potential post-closing exposure to the seller and the insolvency practitioner has issues about the creditworthiness of the buyer (which may be a newco), then he will ask for an appropriate guarantor to cover these potential obligations for the buyer.

Identifying the assets

The buyer should ensure that the sale agreement contains a definitive list of the assets being sold rather than general descriptions (for example, for chattels, a list is preferable to referring to all chattels at a specified location at closing). The sale agreement should also list the assets that are specifically excluded from the sale; in particular, identifying intangible assets such as claims, insurance, tax credits, value in leases, deposits and prepayments.

Delivery of assets

The buyer should have the seller agree in the sale agreement to deliver possession to the buyer of certain items in the possession of, but not owned by, the seller (such as leased assets (*see "Third party agreements" below*)). This ensures that all of the assets that are necessary for the operation of the business can be accessed by the buyer on closing so that it can run the business as a going concern from that day, although the insolvency practitioner will have his own specific re-

> **Insolvency practitioner**
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> An insolvency practitioner is a person acting as the company's liquidator, provisional liquidator, administrator, administrative receiver or as a supervisor of a company voluntary arrangement (*see box "Insolvency basics"*). Only persons qualified to act as insolvency practitioners under the Insolvency Act 1986 may act.
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> To qualify, an insolvency practitioner must be an individual who is authorised to act as an insolvency practitioner by a recognised professional body, which has practice rules specifying the matters to be taken into account in deciding whether a person is fit and proper to act as an insolvency practitioner. In practice, insolvency practitioners are almost always accountants.

Pre-packs

A pre-packaged administration (pre-pack) is where a company is put into administration and the sale of its business and assets takes place almost immediately on the appointment of the administrator (*see box "Insolvency basics"*). The pre-pack process has been criticised on the grounds that it lacks transparency and accountability, how the price was determined by the administrator is not clear, it gives little opportunity for creditors to raise objections before the sale and, as a result, may be abused at the creditors' expense.

In addition, there is a risk of conflict of interest because the proposed administrator is engaged and paid by the seller, negotiates and agrees the proposed pre-pack before his formal appointment and, afterwards, rubber stamps the very transaction he negotiated.

Pre-packs do have a positive side:

- They can provide a quick and relatively painless transition of a business from the seller to a buyer with the cleansing effect of an insolvency process (that is, reduced claw-back risk), which minimises business disruption and damage to supplier, customer, employee confidence and so on.
- The creditors left behind should be no worse off than in a normal post-insolvency sale because the administrator is under an obligation to get the best price for the assets.
- Pre-packs and the circumstances surrounding them are often disclosed to the judge when seeking an administration order where the seller believes it would be prudent to seek an order in court rather than out of court.
- Statement of Insolvency Practice 16 (SIP 16) sets out a detailed list of the information which an administrator should disclose to creditors where there has been a pre-pack. The Insolvency Service is closely monitoring pre-packs and compliance with SIP 16 (*see News brief "Pre-pack guidance: some room for improvement", www.practicallaw.com/1-422-4270*).

A buyer involved with a pre-pack needs to be aware that the controversy surrounding the process may affect the perception of the business after closing, especially if the buyer is associated with the seller. Pre-packs can also be time-consuming to prepare and have their own legal obstacles. The seller or the prospective administrator may have to obtain third party valuations or undertake a full marketing process in order to ensure that the administrator fully complies with its obligations to get the best price. Also, because the administrator is really the party taking most of the risk, this may increase his fee or require certain parties to provide indemnities. These issues are negotiated on a case-by-case basis but always need to be kept in mind.

quirements to ensure that there are no post-closing liabilities accruing to the seller or the insolvency practitioner and that they are adequately protected.

Price

The buyer will determine what price it should offer as it would in a non-distressed sale, but it will also need carefully to consider what the additional risks in the insolvency sale, usually pushed onto the buyer by the insolvency practitioner, mean to it and factor them into its determination of what terms (including price) to offer in the sale agreement. A prudent buyer should also consider how other potential buyers may view those risks and it may then consider adjusting its view on price as part of the competitive sales process.

(For an article looking at insuring against contingent risks associated with distressed sales, see Briefing "Reducing deal risk: how insurance can help in distressed sales", this issue.)

Other issues that may need to be provided for specifically in the sale agreement are considered in more detail below.

THIRD PARTY AGREEMENTS

During negotiations, a buyer will need to review and consider how to deal with the seller's agreements with third parties, many of which may be critical to the ongoing running of the business.

Customer and supplier contracts

If customer or supplier contracts are long term, then a prudent buyer should contact the top few customers or suppliers to ensure that they will continue trading with the business after the buyer has bought it and that any formalities required in relation to contracts, such as assignment or novation, will be dealt with promptly, ideally at closing (which gives the buyer the most certainty). This will require the insolvency practitioner's consent and assistance, and he will only provide this if he also agrees that these contracts are critical to the business. This should be balanced against the fact that a prospective buyer willing to take the risk and move quickly may be preferred (depending on the price it offers) over one who is not.

If the parties agree not to try to get the contracts assigned or novated at closing, then the insolvency practitioner may be willing to allow the buyer to operate as its agent or subcontractor for certain customer or supplier contracts pending a post-closing assignment or novation, which should happen within a specified time (and the seller should agree to assist). The insolvency practitioner will require a comprehensive indemnity from the buyer for that period as the contracts are still in the seller's name.

Plant and equipment leases

If the leased equipment is particularly important to the business, the buyer should have those leases assigned or novated at closing, which is likely to mean agreeing terms with the lessor beforehand.

If the leases cannot be assigned without the lessor's consent at closing and the parties agree not to get this consent before closing, the insolvency practitioner is likely to agree to leave possession of the equipment with the buyer as the seller's bailee on the basis that the buyer

Typical exclusion clauses

Below are typical exclusion clauses that a buyer could expect to see in a sale agreement prepared by the seller's lawyers:

Exclusion of warranties

All representations, warranties, conditions, guarantees and stipulations, express or implied, statutory, customary or otherwise in respect of the Transferred Assets or the Business or any of the rights, title and interests transferred or agreed to be transferred pursuant to this Agreement are expressly excluded (including without limitation warranties and conditions as to title, quiet possession, merchantable quality, fitness for purpose and description). Except as expressly set out in this Agreement any lists contained in any schedule or annexe are for guidance only and are not exhaustive or complete lists of the items in question and shall not constitute any warranty in respect of the Seller's ownership of the listed items or otherwise. Nothing in this Agreement shall limit or exclude any liability for fraud or fraudulent misrepresentation [or for death or personal injury arising from negligence].

Condition of Transferred Assets

The Transferred Assets are sold in their condition and locations at the Transfer Time and subject to all faults, liens, executions, distraints, encumbrances and claims of third parties; the expense of discharging which shall be met by the Buyer. Unless otherwise required by law (and then only to that extent) the Seller and the Administrators and each of them shall not be liable for any loss or damage of any kind whatever, consequential or otherwise, arising out of, or due to, or caused by any defect or deficiencies in, any of the Transferred Assets.

Buyer's acknowledgement

The Buyer agrees that the terms and conditions of this Agreement and the exclusions and limitations contained in it are fair and reasonable having regard to the following:

- That this is a sale by an insolvent company in circumstances where it is usual that no representations and warranties can be given by or on behalf of the Seller or the Administrators.

- That the Buyer has relied solely upon the opinions of itself and its professional advisors concerning the Transferred Assets; their quality, condition, description, fitness and/or suitability for any purpose, the possibility that some or all of them may have defects not apparent on inspection and examination, and the use it intends or proposes to put them to.

- That the Buyer has agreed to purchase the Transferred Assets "as seen" in their present state and condition for a consideration which takes into account the risk to the Buyer represented by the parties' belief that the said exclusions and limitations are or would be recognised by the Courts.

- That the Buyer, its representatives and advisers have been given every opportunity it or they may wish to have to examine and inspect all or any of the Transferred Assets and all relevant documents relating to them.

No rescission

The Buyer acknowledges that if the Seller does not have title or unencumbered title to any or all of the Transferred Assets, or if the Buyer cannot exercise any right conferred or purported to be conferred on it by this Agreement, this shall not be a ground or grounds for rescinding, avoiding or varying any or all of the provisions of this Agreement, or for any reduction or repayment of any part of the consideration.

Administrators' liability

The Administrators act as agents for the Seller and neither they, their firm, nor their representatives shall incur any personal liability whatever in respect of any of the obligations undertaken by the Seller; or in respect of any failure on the part of the Seller to observe, perform or comply with any such obligations; or under or in relation to any associated arrangements or negotiations; or under any document or assurance made pursuant to this Agreement. The Administrators have entered into this Agreement in their personal capacities solely for the purpose of obtaining the benefit of the provisions in their favour.

acknowledges that it: does not have title to the equipment; will return the equipment if requested; and will maintain the equipment pending its return or assignment or novation of the lease (which the insolvency practitioner should agree to assist with).

This will also require the buyer to provide a wide-ranging indemnity to the insolvency practitioner and the seller.

Leases of premises

For premises leases that cannot be assigned without the landlord's consent at closing and where the parties agree not to get this consent before closing, the insolvency practitioner may agree to allow the buyer to occupy the leased premises under a bare licence for a short period to allow it to continue trading from the leased premises and give it time either to agree the assignment or novation with the landlord or find alternative premises.

The licence will be restrictive and will require the buyer to cover at least the rent payable by the seller and, again, provide a wide-ranging indemnity to the insolvency practitioner and the seller.

Such arrangements, although commonplace in insolvency sales, may not be particularly secure for the buyer if the lease, as is typical, requires the landlord's consent to any assignment, sublease or licence. Having the seller in administration as the tenant, however, may prevent a landlord from exercising its rights if doing so impedes the purposes of that administration, although this will need to be considered on a fact-specific basis (*Innovate Logistics Limited (in administration) v Sunberry Properties Limited [2008] EWCA Civ 1261*).

Again, if the lease is critical to the business, the buyer should consider having it assigned or novated, with the landlord's consent if necessary, at closing. If this is done post-closing, the buyer will need to provide a wide-ranging indemnity to the insolvency practitioner and the seller. (*For more information, see feature article "Tenant insolvencies: going through the roof?", www.practicallaw.com/8-384-9166*.)

Licences

Licences that are important to the business, such as intellectual property licences or regulatory licences or permissions, also need to be reviewed in the same way but paying special attention to the specific effect of insolvency on those licences (*for more information, see feature article "Impact of insolvency on IPR: considering the options", www.practicallaw.com/5-500-1412*).

In a regulated business, licences can be critical to the ability to run the business, which means that they should be assigned or reissued to the buyer at closing.

OTHER PRACTICAL CONCERNS

A prospective buyer also needs to consider the following during negotiations:

Retention of title

A seller will often be in possession of stock which it does not own because it has not paid for it yet, so the seller is subject to retention of title (RoT) or other conditional terms in favour of its supplier. The insolvency practitioner will usually notify the buyer of all RoT claims made and allow the buyer to take possession of the stock on the basis that the buyer acknowledges that it does not have title to the stock, will return it if requested and will provide a wide-ranging indemnity to the insolvency practitioner and the seller.

In the sale agreement, the parties should agree to notify each other of any new RoT claims they become aware of after closing and one party (often the buyer as it takes possession of the stock) will typically agree to deal with the RoT claims. The parties may also agree on a formula for adjusting the purchase price or paying out any money held back or put into escrow, depending on how the RoT claims are resolved.

The commercial reality is that, after closing, RoT claims are the buyer's problem so the buyer should undertake as much due diligence as possible and push the insolvency practitioner to solicit notice of any RoT claims from at least the seller's largest suppliers before closing. Any agreement by the insolvency practitioner to refund part of the purchase price is likely to last for a short time only (three months, say) so it is important that the buyer use this period to determine as many of the RoT claims as possible.

Book debts

The parties will usually agree who will collect the seller's book debts. The insolvency practitioner may consider that it would be easier for the buyer to collect them as it will be dealing with the seller's former customers after closing. The buyer may also prefer this to ensure that its new customers are not unduly harassed by the insolvency practitioner, who only wants to recover payment and has no ongoing relationship to protect.

The buyer should charge a commission for collecting the seller's book debts and the sale agreement should regulate this agreement (for example, any money paid to the buyer by a customer indebted to both the seller and the buyer will be deemed to repay the debts due to the seller first; and the buyer cannot compromise the seller's book debts without the seller's consent).

If the buyer does not collect book debts for the seller, then the buyer may want the insolvency practitioner to agree to give the buyer notice before suing for recovery of any book debt against a customer after closing and possibly an option to buy that book debt to avoid litigation. The parties will also need to agree to forward promptly to the other party any payment made to it in error when the payment should have been paid to the other party.

If the buyer wants to buy the seller's book debts, these are usually bought at less than the face value. When pricing these book debts, the buyer will need to consider their recoverability as they are payable to an insolvent company and issues such as whether a customer may be able to set off an outstanding book debt against any loss that it may have suffered as a result of the seller's insolvency.

Real property

Real property may be the most valuable of all the assets being bought so it is essential to undertake thorough due diligence. The buyer should take specialist property advice, especially if there are potential issues with title or documents, as the insolvency practitioner and the seller will not give representations on title and may not be able to provide much background information.

Since the property may be of substantial value, the buyer can push the insolvency practitioner to provide some sort of warranty that is less than a covenant as to title; for example, that the insolvency practitioner is not aware of any competing claims (including security interests) over the real property and that he has not, since he has been appointed, sold, disposed of or encumbered the real property on the seller's behalf.

The buyer can expect any such request for representations to be strongly resisted. The parties will usually agree to sell real property on the terms set out in a schedule to the sale agreement.

Employees

Employees' rights and related obligations can represent substantial contingent or actual liabilities, which will usually be taken on by the buyer as part of the business. The Transfer of Undertakings (Protection of Employment) Regulations 2006 (*SI 2006/246*) (TUPE 2006) are likely to apply if the seller is subject to "relevant insolvency proceedings", with certain exceptions.

The meaning of "relevant insolvency proceedings" is not entirely clear, although current thinking (supported by guidance) is that it is likely to apply to administrations, voluntary arrangements and administrative receiverships (which are "non-terminal" insolvency proceedings), but not liquidations (which are "terminal") (*see box "Insolvency basics"*) (*www.practicallaw.com/5-204-0558*).

It may be that even an administration that was conducted with a view to the liquidation of the company's assets would be viewed as terminal and so TUPE 2006 may not apply; however, each case will be determined on its specific facts and legal developments at the time so the buyer needs to be extremely cautious and take specialist advice.

If TUPE 2006 does apply then the buyer needs to consider the following matters:

Deemed transfer of employment contracts. There is a statutory novation of the employment contracts of all relevant employees who transfer to the buyer under TUPE 2006, but note the following:

- Some pre-existing debts owed to transferring employees (for example, arrears of wages and/or outstanding holiday pay) will be paid, up to a cap, by the state so this liability is not transferred. The buyer will be liable for any outstanding employment costs over and above the amounts met by the state.

- It is possible for the parties to agree certain variations of employment contracts when: the sole or principal reason for the variation is the transfer itself, or a reason connected to it; and the variation is designed to safeguard employment opportunities by ensuring the business's survival. These permitted variations must be agreed with appropriate employee representatives.

Protection against dismissal. The buyer needs to review information about any recent terminations of employment to see if there is a risk that they will be deemed to be automatically unfair dismissals (because they are by reason of, or connected to, the TUPE transfer). This would be the case if, for example, the dismissals were to make the business more attractive to a prospective buyer, rather than for the seller's genuine business reasons. If so, it may be a significant liability that the buyer takes on automatically. The buyer should note that it may be difficult for the insolvency practitioner to provide information about this if the dismissals took place before he was appointed.

In addition, any dismissals of transferring employees by the buyer after the transfer will be automatically unfair if they are by reason of the transfer, or connected to the transfer where there is no economic, technical or organisational reason entailing a change in the workforce. Despite this, the buyer will usually be able to make redundancies after the transfer if these are for genuine business reasons.

Obligation to inform and consult. The buyer needs to ensure that its own and the seller's information obligations and, where appropriate, consultation obligations have been complied with before closing (*regulation 13, TUPE 2006*). There is no specific consultation timetable, but certain required information must be provided long enough before the transfer to enable consultation (if required) to take place. The buyer must also inform the seller of any measures that it envisages taking in relation to any of the seller's affected employees (that is, any employees of the seller or buyer who may be affected by the transfer or by measures taken in connection with it (*regulation 13*)).

Failure to inform and consult where required may result in substantial financial awards for the affected employees, payable by the seller and/or the buyer.

Provision of employee liability information. Helpfully for the buyer, TUPE 2006 requires the seller to provide employee liability information to the buyer at least 14 days before closing (that is, who the transferring employees are, their terms and conditions of employment; and any disciplinary action, grievances or employment claims within the last two years) (*regulation 11*).

This may be difficult for the insolvency practitioner to provide in the circumstances. As the buyer would have a claim against the seller if this obligation were not complied with, the issue should be dealt with as part of the sale agreement (either in pricing or other terms).

(*For more information, see feature article "Insolvency and employees: hanging them out to dry?", www.practicallaw.com/6-376-6497.*)

Pension schemes

The position for the buyer will depend on what type of pension rights, if any, are provided by the seller:

Occupational schemes. Although occupational pension scheme liabilities do not transfer in full under TUPE 2006 (the pensions exclusion) (*regulation 10(1)*), employees who are in an occupational pension scheme before a TUPE transfer (or in a waiting period for membership) must be offered at least a minimum level of replacement pension provision post-transfer. This minimum level must take the form of access to stakeholder arrangements, to which the new employer (that is, the buyer) offers to match employee contributions (up to a maximum employer contribution rate of 6% of salary), although, of course, more generous pension provision may be made if the employer so wishes (*Transfer of Employment (Pension Protection) Regulations 2005*) (*SI 2005/649*).

In addition, following two European Court of Justice decisions, it is now understood that liability for some occupational pension rights (effectively, early retirement rights) may be capable of passing to the new employer (*Beckmann v Dynamco Whicheloe Macfarlane Limited [2002] All ER (EC) 865, www.practicallaw.com/9-101-7590; Martin and others v South Bank University [2003] 85 PBLR, www.practicallaw.com/3-102-5480*). This is a complex area so, if encountered (or likely to be encountered), the prospective buyer will need to seek specialist pensions advice.

Personal pension schemes. The pensions exclusion does not apply to personal (or stakeholder) pension scheme rights, which are capable of passing under TUPE 2006; however, the right most likely to transfer is the obligation to pay employer contributions at the rate(s) in force immediately before the transfer, and this is seldom a contentious issue.

Pensions Regulator's anti-avoidance powers

The Pensions Regulator (the Regulator) has wide-ranging powers to intervene in the running of occupational pension schemes and has specific powers which it may use against parties who try to avoid their financial obligations to defined benefit schemes. A buyer of an insolvent business which has a defined benefit scheme in deficit is mostly likely to be wary about the Regulator's ability to issue:

- A financial support direction (FSD) which (broadly speaking) requires the target entity to put in place arrangements of financial support for a particular scheme.

- A contribution notice (CN) if a target entity has not paid any debt attributable to it arising under section 75 of the Pensions Act 1995 (section 75 debt), or if an action (or failure to act) has occurred resulting in a defined benefit pension scheme suffering a "material detriment" to its ability to provide the requisite benefits (*sections 38-67, Pensions Act 2004*) (PA 2004).

The FSD or CN may be issued to entities that are "associated" or "connected" to the employer (*as defined under sections 249 and 435 of the Insolvency Act 1986*). Generally, this will include all entities that are in the common control of the ultimate shareholder of the employer, or an entity that is deemed to be controlling the employer, but it may include other parties.

An FSD can only be issued where an employer is a service company or is insufficiently resourced; that is, if the value of its resources is less than 50% of the estimated section 75 debt which would be owed by that employer if the debt were to be triggered at the time of the assessment and there is a connected or associated company (or companies) which has or have resources which, when added to those of the insufficiently resourced company, total more than 50% of the estimated section 75 debt (*sections 44(2) and (3), PA 2004*).

If a buyer of a business from an insolvent company is or may be an associated or connected party of the seller, the buyer may consider that there is a risk that the Regulator may issue an FSD or CN against it after it buys the business from the seller. If the buyer is not in fact associated or connected, it is likely to be less concerned about the possible intervention of the Regulator; the seller (and other members of the seller's corporate group) may, however, have grounds for concern.

The buyer may consider it prudent to seek clearance from the Regulator that it will not use its anti-avoidance powers against the buyer after closing. It is important to appreciate that the Regulator will not grant "blanket clearance". Obtaining clearance will generally involve negotiations with trustees and the Regulator and reaching an arrangement that places the scheme in a better position than it would have been in if no business transfer/rescue were to occur. (*For more information, see feature article "Pensions and corporate insolvencies: issues for pension funds", www.practicallaw.com/0-380-2115.*)

No pension scheme. As there is currently no underlying obligation on an employer to make contributions to any pension scheme for its employees (this may change after 2011), the buyer may decide not to provide any pension scheme to which it will contribute if the seller does not provide one; however, depending on the size of its workforce, it may be required to provide access to stakeholder pension schemes.

Pension deficit

Another concern for a prospective buyer is if there is a large pension deficit in the seller's defined benefit scheme. The buyer will need to consider what structure to put in place to ensure that that deficit is not transferred to it after closing and be aware of the Pension Regulator's rights to intervene in these situations (*see box "Pensions Regulator's anti-avoidance powers"*).

Tax

Tax considerations for the buyer include:

VAT. As in a non-distressed business sale, any assets sold on a going concern basis should qualify for exemption from VAT. The sale agreement is likely to require the buyer to pay any VAT that becomes due and to indemnify the insolvency practitioner and the seller for any loss they suffer as a result.

Generally, the buyer will not elect to take over the seller's VAT registration to avoid inheriting any of the seller's VAT liabilities and its reporting and compliance obligations. The insolvency practitioner will usually retain the seller's VAT records for six years so the parties will usually agree the basis on which the buyer can access these records if necessary (*see "Books and records" below*).

As real property may be one of the most valuable assets being bought, the buyer will need to determine the existence of any relevant "option to tax" as VAT liabilities will arise if property which has historically been "opted" is not "opted" by the buyer by closing (a timescale strictly adhered to by HM Revenue & Customs).

Hive down. Hive downs (where the assets of the seller are transferred to a newly-incorporated subsidiary of the seller and that new subsidiary is sold to the buyer) may, in some circumstances, be a tax-efficient way of transferring a business from an insolvent seller.

The main potential tax advantage is the ability to preserve unused tax losses in the business for the buyer; however, any liabilities left with the seller will restrict the losses available for the buyer and, accordingly, this structure is not commonly used where substantial liabilities are left with the seller (which typically happens if the seller is in an insolvency process).

Books and records

As the buyer is buying assets of the seller rather than the legal entity itself, it will not obtain the statutory books and records of the seller which, along with the work product of their staff, will re-

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main with the insolvency practitioner. The buyer will want to ensure that it takes possession at closing of, or has access after closing to, all relevant books and records, including critical business documents such as customer lists, contracts and pricing information.

This should not be controversial unless there is some reason that the insolvency practitioner wants to keep some of the non-statutory records (for example, to prepare tax returns). In this case, the parties will usually agree, for a limited period, to give each other access to the relevant records in each other's possession after closing.

DIRECTORS' INVOLVEMENT

The involvement of the sellers' directors can give a prospective buyer a substantial advantage in due diligence and determining risks in certain aspects of the target business; however, the seller's directors need to consider any confidentiality obligations that they would still have to the seller and other conflict issues. In addition, the following legal considerations may be relevant:

Company name

Section 216 of the Insolvency Act 1986 restricts the reuse of a company's name or a similar name in circumstances where that company has gone into insolvent liquidation and a director of the insolvent company is associated with a new company that wants to use the insolvent company's name or a similar name.

The restriction applies to the director personally rather than the new company and lasts for five years unless leave of the court is obtained. There are three exceptions to this rule:

- Where the new company buys the business of the insolvent company and, within 28 days after closing, the relevant director gives notice of his involvement in the new company to every creditor of the insolvent company ascertainable to that director.

- Interim protection is provided while a court application is being made.

- The new company, which is not dormant, has been known by the prohibited name for at least 12 months before the insolvent company goes into insolvent liquidation.

Substantial property transactions

A transaction of a requisite value between the company and one of its directors, or a director of that company's holding company (or an entity connected to that director), will be voidable unless the arrangement has first been approved by the company's shareholders and, in the case of a director of the holding company, the holding company's shareholders (*section 190, Companies Act 2006*) (section 190).

Requisite value is defined as any transaction in connection with the non-cash asset whose value is the lower of 10% of the company's asset value or £100,000. Section 190 does not apply to a non-cash asset with a value of less than £5,000. A company's asset value is defined as the company's net assets determined by the accounts in respect of the preceding financial year or, if no such accounts have been prepared, the amount of the company's called-up share capital. There are some exceptions to this provision, the most important of which is that it does not apply to a company being wound up (except a solvent winding up) or if the company is in administration.

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