

Global Focus: Solvent Restructuring of Dana's U.K. Pension Liabilities

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Ohio-based, 102-year-old automobile parts manufacturer Dana Corporation and 40 of its subsidiaries filed for chapter 11 protection in the U.S. in March 2006. Dana's operations, however, extend well beyond the borders of the U.S. — the company has 46,000 employees in 28 countries. Integrating a complex restructuring of Dana's U.S. operations in chapter 11 with Dana's extensive operations and obligations abroad has posed some unique challenges to Jones Day's restructuring professionals. One of these involved the successful solvent restructuring of Dana's businesses in the U.K., completed in April 2007. The restructuring, by way of a company voluntary arrangement, or "CVA," allowed an otherwise healthy business to deal with overwhelming liabilities to its pension plans. The process demonstrates the opportunities within the U.K. for consensual, management-led restructuring, but also shows the growing problems that groups attempting to restructure U.K. businesses have with respect to pension liabilities.

Company Voluntary Arrangements

The U.K. insolvency regime (largely using the Insolvency Act of 1986) offers many different methods for dealing with insolvencies and restructurings. A CVA in particular is a consensual arrangement, by which, if at least 75 percent of creditors by value agree to the company's proposal, the arrangement succeeds and dissenting creditors are crammed down. Secured creditors may not be prejudiced by a CVA, so it is a more viable option where there are few or no secured creditors. In essence it is a contract between the company and its creditors that, if

accepted, and provided the terms of the CVA proposal are complied with, allows the company to continue in business, having compromised and dealt with its existing debts. The main reason CVAs have not been used more widely is that there is no moratorium at the outset preventing creditors from taking enforcement action against the company. Also, unlike schemes of arrangement, a procedure under the Companies Act of 1985 enabling a compromise or arrangement between a company and its creditors, its members, or any class of them, subject to ratification by the court, there are no provisions for different classes of creditors.

Pensions Regime

The pensions regime in the U.K. has been significantly overhauled by changes to legislation in 2003 and 2004. One of the most substantial changes has been a significant increase in the liabilities that a company is compelled to pay upon the termination of a defined-benefit pension plan, or in the event that an employer leaves a multi-employer plan, which are now calculated on the annuitized “buy out” liability basis, usually giving rise to a deficit several times greater than the ongoing liability presented on a balance sheet. This means that the termination, or even the freezing of accrual, of such plans has become increasingly rare, and purchasers frequently refuse to acquire pension liabilities when acquiring UK businesses. Larger groups of companies with a history of acquisition and disposal commonly find themselves with significant liabilities relating to businesses that have now been sold, which are therefore disproportionate for the remaining businesses.

Further, any attempt to restructure by divestiture can be hampered because of the liabilities that would become due when a company is either sold or loses all its employees in a business sale. It is very common for this liability to exceed the business value, effectively causing the seller to

lose money in the sale. Attempts to structure a disposal to avoid this liability will fall afoul of anti-avoidance legislation, which, as discussed below, can give rise to personal liability for officers, and liability to wider groups of affiliated companies.

The new regime also includes the Pension Protection Fund, or “PPF,” modeled on the U.S. Pension Benefit Guaranty Corporation (“PBGC”), which provides pensions, up to certain limits, for members of defined benefit pension plans whose benefits have not been fully funded following the insolvency of the sponsoring employer. In order to protect the PPF from unnecessary claims, the same legislation created a regulator, the Pensions Regulator, which has a number of powers in relation to preserving the funding of U.K. pension plans.

The most notable of the powers of the Pensions Regulator are its so-called “moral hazard” powers. These are the power to issue contribution notices, requiring an immediate payment into the plan, against the sponsoring employer of a defined-benefit plan or against any group company or officer, for any action taken that adversely impacts the full funding of the plan, and the power to issue a financial support direction to demand further contributions or support from a group company if the plan’s actual sponsor is deemed “insufficiently resourced.”

These powers can extend to any group company with a one-third or more interest or common interest in the voting stock or board of the sponsoring employer and, so far as the U.K. legislation is concerned, to a company in any jurisdiction. Whether and to what extent these powers are enforceable in non-U.K. jurisdictions against those companies has yet to be seen, but they would certainly be enforceable against their U.K. assets, and to date most companies have

seen the risk as significant enough that they have tended to negotiate with the Pensions Regulator to ensure that they are not at risk.

The Pensions Regulator has the power to issue preclearance in relation to actions and circumstances, confirming that it will not use its moral hazard powers unless circumstances change, or have not been fully disclosed. A large number of these are given each year, and any restructuring involving a group that sponsors a defined benefit pension plan in the U.K. will be advised to seek clearance.

On June 18, 2007, the Pensions Regulator issued its first financial support direction in an order against Sea Containers Limited, a Bermuda company in chapter 11 in the U.S., in relation to its subsidiary's sponsorship of two U.K. defined-benefit pension plans. Enforceability is likely to be tested in the coming months.

The Dana Experience

The Dana U.K. companies sponsored four defined benefit plans which had varying profiles of members, benefits and liabilities. Without these liabilities, the business of the Dana U.K. companies was solvent. With them, the disposal of any U.K. businesses as part of a global restructuring was prohibitively expensive. The pension liabilities represented the overwhelming majority of the creditors of the U.K. by value. There were no secured creditors, and the Dana U.K. companies were maintaining payments to the trade creditors.

Unlike in the U.S., where the PBGC takes on an early role, the PPF cannot take over a pension plan until the occurrence of an “insolvency event”— here, the filing of the CVA proposal. As a

result, negotiations were carried out over a long period with all four pension plans, with valued assistance from the PPF. The agreement of the PPF as well as the four plans was necessary for the CVA. (As an aside, it was not possible to restructure using a scheme of arrangement as this is not an “insolvency event” for purposes of the PPF).

It was also necessary to obtain the agreement of the Pensions Regulator. Because the purpose of the CVA is to compromise the liability to the pension plans, it falls within the circumstances where the Pensions Regulator can issue a contribution notice, and therefore a clearance statement from the regulator was a necessary prerequisite to the CVA on behalf of all group companies and the U.K. company officers.

Negotiating with the Pensions Regulator presented a different challenge than the other constituencies. The PPF has the concerns of a creditor and is primarily concerned with maximizing its returns. The Pensions Regulator, by contrast, has broader concerns, and, whereas it is concerned about the return to and solvency of the PPF, it is also concerned with the wider issues of protecting pensions and preserving jobs.

Negotiations also involved many other interested parties, such as union representatives, lenders to the wider group of companies and those interested in the chapter 11 cases of Dana and its U.S. subsidiaries. As a result, the negotiations were extremely complex and delicate.

Structure of the Restructuring

Following the case of *L. v. M*, which was decided by the U.K. courts in late 2006, it became clear that it was possible to achieve a restructuring by way of a CVA in a special purpose vehicle to

which had been allocated the pension liabilities of other group companies. The advantage of having the CVA in a special-purpose vehicle, leaving the rest of the U.K. companies untainted, is clearly significant.

This structure is still relatively new for pension liabilities, and the Dana circumstances were unusual and probably unique in two aspects. First, the existence of four separate plans that needed to allocate liabilities to the special purpose vehicle involved complex negotiation and technical processes. Second, the short period of time in which the allocation took place required amendments to the four plans and the consent and cooperation of all involved.

Conclusion

This case demonstrates a number of trends in the U.K. The need to negotiate with the U.K. Pension Regulator and PPF has become a necessary part of any restructuring where there is any exposure to U.K. defined-benefit pension plans. The use of the special-purpose vehicle is likely to become a common method of dealing with these liabilities, now that the PPF, the Pensions Regulator and the courts have all signaled their approval.

CVAs have not often been used for larger restructurings due particularly to the lack of a moratorium, but they can be a very effective “out of court” restructuring tool, and it is likely that we will see an increase in their use in the more complex workouts.

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