



JONES DAY
COMMENTARY

SPREADING THE PAIN: THE EXTENDED POWERS OF THE PENSIONS REGULATOR

The Pensions Act 2008 (the “2008 Act”) received Royal Assent on 26 November 2008. The 2008 Act will significantly extend the powers of the Pensions Regulator (the “Regulator”) to issue contribution notices to entities and individuals connected with a defined benefits pension scheme. This will increase the Regulator’s ability to pierce the corporate veil and require people and businesses that are not directly responsible for pension schemes to pay for them.

THE PRESENT LAW

Under the Pensions Act 2004 (the “2004 Act”), the Regulator has the ability to issue a contribution notice to all parties associated or connected with an employer of a defined benefit pension scheme, demanding that they contribute an amount decided by the Regulator to that scheme. At present the

Regulator may only issue contribution notices to any person who was party to an act (or a failure to act) that occurred on or after 27 April 2004 where, in the reasonable opinion of the Regulator, a main purpose of that act (or failure to act) was to prevent or reduce the recovery of or amount of any debt payable by the employer to the scheme. The payments that may be demanded under a contribution notice can be substantial and are intended to be punitive.

The risk of a contribution notice may be extinguished by obtaining a clearance statement from the Regulator. Clearance is a voluntary process that allows employers and others to obtain a statement from the Regulator that it will not use its powers in relation to a particular event. Once given, the clearance statement is binding on the Regulator, provided that the information given to the Regulator is not materially different from the actual circumstances of the case.

ABOLITION OF 'GOOD FAITH' DEFENCE

The 2004 Act provided that the Regulator could only issue a contribution notice on the basis that the main purpose of the act (or the failure to act) was to prevent the employer's liability becoming due or to reduce the amount of the liability, if the act (or the failure to act) was carried out 'otherwise than in good faith'. The 2008 Act abolishes this defence; it will no longer be of value to show that the act was carried out in good faith.

THE 'MATERIAL DETRIMENT' TEST: NEW FOCUS ON EFFECT, NOT PURPOSE

Under the 2004 Act, to reasonably conclude that a 'main purpose' of the act (or the failure to act) was to reduce or remove the liability of an employer to the scheme, the Regulator necessarily had to establish the likely intent and objectives of those involved.

However, the 2008 Act expands the power of the Regulator to issue a contribution notice, enabling it to assess a transaction without having to look at the intentions of the parties. The Regulator will be able to issue a contribution notice when an act or a failure to act has, in its opinion, detrimentally affected in a material way the likelihood of accrued scheme benefits being paid in full. Thus, entities and individuals will be at risk of a contribution notice despite a lack of intention to avoid or reduce an employer's liabilities towards the scheme.

In deciding whether to issue a contribution notice under the material detriment test, the 2008 Act prescribes a list of factors that the Regulator must consider (if relevant). These include looking at the value of the assets and liabilities of the scheme and the effect of the act (or the failure to act) on those assets and liabilities, and the extent that a person can discharge any liabilities or obligations to the scheme. The list is termed 'non-exhaustive', so that the Regulator is not debarred from considering other factors.

THE STATUTORY DEFENCE

The 2008 Act provides a statutory defence against contribution notices issued on the basis of the material detriment test. The defence is applicable if the Regulator is satisfied:

1. the party gave prior due consideration (after making diligent enquiries) to the extent to which material detriment may arise;
2. in any case where it was considered that the act might cause material detriment, all reasonable steps were taken to eliminate or minimise the potential detriment; and
3. having regard to all relevant circumstances, it was reasonable to conclude that material detriment would not then arise.

In practice, financial due diligence by a professional may well provide this defence, to avoid the need for clearance. However, because all three tests must be met, if there is any suggestion in the due diligence that there is a risk of a material detriment, then the test will not have been met, and clearance will be the only remaining option.

TIMETABLE FOR THE CHANGES

The main provisions of the 2008 Act, including the abolition of the good faith defence, came in force when it obtained Royal Assent. However, the provisions of the 2008 Act establishing the new material detriment test will not come into force until the Regulator publishes a code of practice in relation to the test. This will be a statutory code of practice for the circumstances when the Regulator expects to use its powers under this new test. A formal written consultation (with interested groups and experts) on the Regulator's draft code of practice is expected to take place shortly, after which the code (as amended) will be approved by the Secretary of State for Work and Pensions and laid before Parliament before it comes into force.

Once in force, the Regulator will be able to issue contribution notices on the new basis in respect of any act from 14 April 2008, the date on which the amendments were proposed. The removal of the good faith defence also has retrospective effect in respect of acts occurring on or after that date.

CONSEQUENCES

The move from an intention-based test to a fact-based test brings the legislation in line with current Regulator guidance. This extension of the Regulator's powers will widen the net of the Regulator. In addition, the removal of the good faith requirement hurdle will make it easier for the Regulator to issue contribution notices under the original main-purpose test. The effect will be to further reduce the effectiveness of the corporate veil and leave those connected or associated with employers of a scheme more vulnerable to a contribution notice.

Whilst the new statutory defence may be a viable option in some instances, it is likely to be a time-consuming process, likely to require professional assessment of the transaction. As such, the amendments significantly increase the range of circumstances in which clearance should be sought on corporate transactions and the risk that the Regulator will take actions.

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