Insight

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The Pensions Regulator shows its teeth

The Pensions Regulator has come of age and recent months have seen more use of the draconian powers given to it under the Pensions Act 2004. Is the Pension Regulator a force for good in restructurings or will the increased use of its powers stifle restructuring and lead to more formal insolvencies?

INTRODUCTION

When the Pensions Regulator (the 'Regulator') was first created under the Pensions Act 2004 (the 'Act'), its powers caused a good deal of concern to companies and their advisers as well as to insolvency professionals. The Regulator's powers under ss 38 to 51 of the Act allowed the Regulator to pierce the corporate veil by passing liability due from the employer of a defined benefit pension scheme for that scheme to individuals and other companies without any primary liability.

In the years that followed the creation of the Regulator on 6 April 2005, the threat of these powers diminished as the Regulator appeared to be unwilling to use them. In fact, several advisers suggested that the Regulator's powers were not to be taken seriously as there was no political will to apply them. In actual fact, the Regulator has routinely used the existence of its powers as a tactic to obtain concessions from companies and shareholders to avoid the need to use them directly.

However, recent developments have shown a sharp increase in the use of the powers, particularly in the restructuring world. Inevitably, in a restructuring situation, the ability of the parties to negotiate with the Regulator and of a company to agree to take on a financial liability on behalf of another group company is severely limited. Necessarily then, restructuring situations have given rise to a number of cases where the Regulator's powers need to be used, not merely threatened, before the parties involved are able to act. This article examines the use of those powers and what this indicates for the Regulator's attitude and appetite for controversy.

THE REGULATOR'S POWERS

The particular powers that are of interest in these circumstances are the Regulator's ability to issue contribution notices and financial support directions. These may be issued to any party which is associated or connected (as defined in ss 435 and 259 of the Insolvency Act 1986 respectively) with the entity which is the employer of the pension scheme.

A financial support direction ('FSD') may be issued where the employer itself is considered 'insufficiently resourced' for its pension liabilities or to be a service company providing employees to other group companies but without significant underlying assets. A FSD may not be issued against an associate of the employer whose only association is by virtue of employment (broadly, an office holder who is not a shareholder). The effect of a FSD is to require the recipient to provide financial support of the type and level satisfactory to the Regulator in respect of the employer's liabilities. If the recipient does not comply with the FSD he will be subject to a notice requiring him to make a payment into the pension scheme.

A contribution notice ('CN') can be issued against any associated or connected party where that party has taken part in an act which either had, as one of its main purposes, a reduction of the debt due to the pension scheme or the chances of that debt being paid or has otherwise materially reduced (whatever the intention) the chances of that debt being paid in full. This is a more punitive measure and its effect is more direct. A recipient is required to make a payment of the amount set out in the notice to the pension scheme. The requirement under the CN may be enforced as an ordinary unsecured debt of that recipient to the pension scheme.

The issue of a CN or a FSD involves quite a complex process starting with a warning notice indicating the Regulator's intention to use its powers, which is followed by representations and if necessary an appeal process, first to the determinations panel of the Regulator and then to a tribunal. It is only after a decision of the determinations panel (which if an oral hearing is requested may be many months or even years after the first warning notice is issued by the Regulator) that the CN or FSD itself may be issued.

SEA CONTAINERS AND NORTEL

The well-publicised case of *Sea Containers* started with action by the Regulator in October 2006 to seek a FSD against Sea Containers Limited ('SCL'). SCL was the Bermudan parent of a UK company, and was in Chapter 11 proceedings in the US by the time the FSD was issued. After a long and drawn out use of the Regulator's appeals process, SCL reached agreement with the Regulator and applied to make an appropriate payment to the pension scheme. The Chapter 11 proceedings of course required that this was approved by the Delaware Bankruptcy Court, which gave its approval and the payment was permitted.

This was the Regulator's first FSD and it had been ambitious to issue it against an overseas parent which was itself in financial trouble. The Regulator could be forgiven for feeling pleased with itself for succeeding in these circumstances, particularly given the Chapter 11 proceedings surrounding SCL. However, its next approach was significantly less successful.

The Regulator issued FSDs in relation to the Nortel Group in both Canada and the USA hoping to continue its Sea Containers success. There were a number of marked differences in these circumstances. In particular, the UK company, which was the employer of the pension scheme, was itself in insolvency proceedings. This meant that any debt that became due as a result of Regulator action would be enforceable not by the trustees of the

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Biog box

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pension scheme but by the Pension Protection Fund ('PPF') which eventually assumes the liabilities of underfunded pension schemes when the employer becomes insolvent. Under the provisions of the Act, the PPF acts as creditor for pension schemes on the insolvency of the employer even before that scheme then enters the PPF. As the PPF is a statutory body there is clearly politically, if not legally, a different perception on an approach to an overseas company to effectively ask for funding for a body connected with the UK government.

The FSDs were issued again to both the Canadian and the American companies but in both cases the attempts to enforce them against those companies (which were themselves in insolvency proceedings) failed. In particular, the Regulator and PPF sought to pursue the *American* case, taking comfort from the judgment in the *Sea Containers* case where the judge had indicated that the Regulator's actions may be enforceable in Chapter 11 proceedings. However, the Delaware Bankruptcy Court chose to distinguish the *Sea Containers* case, not least because in the *Sea Containers* case SCL itself had been in favour of the payment and was seeking approval, rather than the Nortel situation where the trustee and the PPF were seeking enforcement. This was appealed to the District Court which confirmed the lower court's position and, in particular, its distinguishing of the facts from those in the *Sea Containers* case.

As a result, Nortel has curtailed the effects of the earlier *Sea Containers* case and suggested that the Regulator's ability to enforce overseas is somewhat limited. However, Nortel does demonstrate the Regulator's interests in pursuing these types of situations.

Contribution Notices and Bonas

The Regulator has taken much longer to issue its first CN. CNs, unlike FSDs have a degree of fault ascribed to them. They are supposed to be punitive measures to discourage others from carrying out similar activities. As a result, they have been much more easy to use as a threat to ensure appropriate behaviour.

The first contribution notice was issued in May of this year, again to an overseas company. In this case, it was issued to the Belgium company, Michel van de Wiele N.V. ('VDW'). This followed an appeal to the determinations panel of the Regulator after an earlier warning notice to issue CNs against both VDW and Mr Charles-Lambert Beauduin, Chairman of VDW, and Managing Director of its UK subsidiary, Bonas UK Limited ('Bonas'). The panel overturned the proposal to issue a CN against Mr Beauduin personally.

Bonas had been a subsidiary of VDW since 1998 by which time this has had a defined benefit pension scheme for over ten years. During the whole of the ownership period, Bonas was continually loss making and therefore supported financially by VDW. In October 2006, VDW decided that it wished to put Bonas into administration leading to a decision by the board of Bonas to resolve to put Bonas into administration in December that year. The business and assets of Bonas to transfer the same day to a new company owned by VDW.

This was clearly a pre-packaged administration. However, there is no suggestion that the administration was carried out improperly in any sense. It is of course clear that as a result of the pre-pack, VDW now holds the business and assets of Bonas but without the pension liability which has moved into the PPF. It therefore suggests that the Regulator's objection is to the concept of the pre-pack and the ability for VDW to retain the assets without the pension liabilities.

It is also clear from the Regulator's determination notice that both Bonas and VDW had been in correspondence with the trustees. There had been a number of attempts to look at alternatives and steps were taken that suggested that a transaction would be carried out involving clearance from the Regulator (as is often obtained for pre-packs). In the end, the cost of this appeared to be too high.

There was in existence a note of advice (which, in retrospect, was rather unfortunate for VDW) which discussed the options the Regulator would have should VDW and Bonas cease to engage in negotiations and simply put through a pre-pack. The Regulator clearly objected to this and felt that this may constitute a challenge to its authority.

The decision is presently under appeal and it will be interesting to see what the appeal tribunal (as a body more independent from the Regulator) thinks of this decision. The Regulator may well argue that it would not be possible for them to operate as they have done in the past, if parties are aware that if the clearance cost is too high they could simply break off discussions and state that administration is inevitable. Having said that, it appears surprising that a company that has acquired a UK subsidiary, repeatedly shored it up through several years of loss-making and received no benefit from ownership, should then become liable for a pension liability within that company.

There appears to be no suggestion that VDW mis-managed Bonas or benefited in any way from Bonas' failure to become profitable or pay for its pension liabilities. On this basis, the Regulator's actions suggest a swing from attacking those who profit from an income stream that an employer could otherwise have used for the pension scheme, to attacking those that have simply refused to take on another company's liabilities.

THE FUTURE

So what does the increase in activity suggest about the future? Anecdotally, it appears that the Regulator is becoming more willing to issue CNs and FSDs with several warning notices allegedly in preparation or issued. However, inevitably the increased boldness of the Regulator has made enforcement more difficult. The effect of Nortel has been clearly to limit the potential threat of the Regulator in the US and Canada. The *Bonas* case suggests that the Regulator is willing to throw its net much wider when attacking employers' groups, and the decision on the appeal of this case will be vital in understanding the strength of the Regulator. Should the Regulator win, this will make any pre-pack with the sale to a shareholder or other associated or connected party very unadvisable without Regulator clearance. Should the Regulator lose, then its power to issue CNs will be significantly reduced. ■