The U.K. Pensions Regulator–Will Its Powers Be Limited?

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Ever since the establishment of the U.K. Pensions Regulator (the "Regulator") by the U.K. Pensions Act 2004 (the "Act"), the Regulator's exercise of its authority has been of major importance to the U.K.'s restructuring and rescue business. The first judicial review of the Regulator's powers, however, hints that some of the procedures it has adopted may be curbed in the future.

The Pensions Regulator and the Restructuring Environment

The increasingly large size of pension liabilities has made such liabilities central in any restructuring where there is a defined-benefit pension plan. Such a plan is usually the largest unsecured creditor by far, holding claims that in pure value often dwarf all other liabilities. The Regulator's powers to pierce the corporate veil and extend pension liabilities to group companies and shareholders have increased the importance of those liabilities and generally guarantee the Regulator a seat at the negotiating table.

The Regulator's powers include the authority to issue a contribution notice requiring a payment to the pension plan by any shareholder or director who omits to take action designed to reduce either pension plan obligations or the likelihood that such obligations will be paid in full. These powers are often relevant in a restructuring, particularly where existing shareholders plan to take the business and assets through a prepackaged administration (a "prepack"), leaving the pension plan behind in the insolvent shell company.

As a result, it is now common practice to seek clearance from the Regulator concerning the terms of a prepack and other business rescues. The Regulator's powers are set forth in the Act, but there is very little detail as to how the Regulator should reach its decisions, and as a result, the Regulator has been forced to develop its own processes and methods of analyzing cases brought before it. In particular, the Regulator expects the trustees of the pension plan to have been consulted beforehand and to agree to the terms of the prepack; it also expects that some payment (referred to by the Regulator as "mitigation") will be made under the plan to reduce pensioner losses, together, in many cases, with an allocation to the plan trustees of an equity stake in the remaining business.

Criticism of the Regulator's Procedures

The first judicial review of the Regulator's powers in this regard indicates that the courts may be skeptical of the Regulator's procedures and that, in fact, the necessity of applying to the Regulator for approval of restructuring arrangements may be significantly curtailed.

The first contribution notice issued by the Regulator, on May 14, 2010, was against Michel van de Wiele NV ("VDW"), a Belgian company, following the insolvency of its subsidiary, Bonas UK Limited ("Bonas"), which had a defined-benefit pension plan in the U.K. VDW had owned Bonas for a number of years, and following a long period of losses, Bonas filed for a prepackaged administration, from which VDW bought the Bonas business and assets, leaving the pension plan behind.

VDW's appeal of the Regulator's decision to issue the contribution notice has been filed in the U.K. Upper Tribunal, and a full hearing is expected later this year. However, an application for a barring order—providing, effectively, that the Regulator's decision should be overturned without a full hearing—was heard in October 2010. The Upper Tribunal's judgment on that application was recently handed down. It examines in some detail the Regulator's exercise of its powers and suggests that the Regulator's procedures may need to be changed.

The particular criticism of VDW made by the Regulator, which gave rise to the contribution notice, was that VDW and Bonas failed to consult and negotiate with the plan trustees. The Regulator deduced that the failure to do so was an attempt to avoid having to make a payment to the pension plan, which the trustees and the Regulator would have demanded as part of the negotiation.

The Tribunal's ruling suggests that the Regulator, when arguing that VDW's actions reduced the payments to the plan, could not consider whether Bonas would have made a payment to the plan if VDW and Bonas had negotiated with the trustees or sought clearance from the Regulator. Effectively, the Tribunal determined, the act of failing to seek clearance was not relevant when considering whether to issue a contribution notice. The financial condition of Bonas was such that its insolvency was inevitable, and the pension plan, as an unsecured creditor, was not likely to obtain any payment.

A Change to the Regulatory Environment?

Although the Tribunal's ruling is just preliminary, it is a strong indication of the likely view of the court. If its ultimate judgment is decided along similar lines, the ruling may require a change

in the Regulator's procedures. In particular, the Regulator's present focus on trustee consent and distributions of cash and equity to the pension plan may be revised. Applications for clearance in restructuring situations may become less common, particularly where the pension plan is unlikely to obtain any payment in the insolvency proceeding. Under the Tribunal's recent ruling, the Regulator would not have grounds in that circumstance to issue a contribution notice.