Hazard warning

THE PENSIONS REGULATOR HAS WIDE "MORAL HAZARD" POWERS TO FORCE COMPANIES TO MEET THEIR PENSION FUND RESPONSIBILITIES. IN THIS ARTICLE, THE FIRST OF TWO, **DAVID POLLARD**, **DAWN HEATH** AND **LARISSA HOWARD** EXAMINE THE FOUR PUBLISHED CASES WHERE IT HAS EXERCISED THOSE POWERS.

Under the Pensions Act of 2004, the Pensions Regulator (TPR) has powers to prevent companies from avoiding pension debt or their obligations to defined benefit pension schemes. Called "moral hazard" powers, they allow TPR to issue a contribution notice (CN) or financial support direction (FSD) if a company activity is seen as threatening the security of a pension scheme. First, though, TPR must refer the case to its determinations panel (a separate body from TPR's investigatory function), which must also consider it reasonable for a CN or FSD to be issued. This article analyses four determinations (i.e. the decisions reached by the determinations panel) published by TPR to identify the factors that contributed to those decisions.

SEA CONTAINERS In February 2008 TPR confirmed it would issue two FSDs on Sea Containers, a Bermudan company in US bankruptcy proceedings. TPR had initially sought to issue the FSDs in June 2007 but Sea Containers had appealed, causing a delay.

The FSDs required Sea Containers to provide financial support for two pension schemes sponsored by its London-based UK subsidiary Sea Containers Services (SCS). Sea Containers was clearly associated with SCS. The financial test for an FSD was met. TPR argued it was reasonable to issue FSDs against Sea Containers because:

- SCS (the principal employer of the schemes) was wholly owned and controlled by Sea Containers;
- SCS is a service company employing much of the group's management;
- Sea Containers received benefits from SCS;
- Sea Containers was closely connected to the pension schemes and many of its officers acted as trustees; and
- SCS was insufficiently resourced whereas Sea Containers had substantial assets.

In deciding that Sea Containers had received benefits from SCS, TPR interpreted benefits to include services Sea Containers received from SCS that it was not required to repay within any prescribed time. It also included the benefit that Sea Containers received from the group structure (Sea Containers was able to trade from Europe through SCS but retained tax advantages from the Bermudan tax regime). The panel stated that it did not consider Sea Containers' entry into insolvency proceedings in the US as a reason not to issue the FSDs.

BONAS GROUP PENSION SCHEME In June 2010, TPR confirmed it had issued its first CN, against a Belgian company, Michel Van De Wiele (VDW), the parent company of Bonas UK, which sponsored the Bonas Group pension scheme. The CN was issued under the "main

purpose" provision of the Pensions Act 2004 (it related to actions before changes to CNs were made in 2008).

VDW had arranged for Bonas to go into administration and then for the administrators to sell the business to another VDW subsidiary. In TPR's view, VDW had used the pre-pack sale to retain Bonas's business "while avoiding the pensions liability… and had not engaged openly with pension trustees or the regulator".

However, TPR's determination panel refused to issue a CN against an individual who was managing director of Bonas and chairman of VDW because he had acted as a director for VDW rather than in a personal capacity and was personally concerned with ensuring the continuation of employment of Bonas staff. The panel may have thought it unreasonable to target the individual, who did not personally receive a benefit from VDW's decisions (as opposed to receiving a benefit through VDW).

The panel accepted that VDW fell within the CN provisions in the Pensions Act 2004 by walking away without engaging openly with the trustees or regulator, and retaining the business while avoiding the pension liability. It concluded that VDW had implemented the pre-pack sale of Bonas with the aim of retaining Bonas's business but in a new company that had no liability towards the scheme, and that VDW had withheld knowledge of the pre-pack from the trustees and avoided informing them or TPR of the sale to avoid the risk of a CN or FSD being swiftly imposed.

The panel was satisfied that a CN could be issued because VDW's purpose was to minimise the amount it would have to pay into the pension scheme, either quickly or at some later date.

By not engaging with the trustees or TPR, VDW had denied them the opportunity to seek mitigation as part of any clearance application or to ask TPR to issue an FSD or CN. The panel considered this as equivalent to preventing the recovery of some or all of a section 75 debt that might become due.

Finally, the panel was satisfied it was reasonable to issue a CN against VDW for £5.089m because this was the amount needed to take the scheme up to a position of solvency on the Pension Protection Fund (PPF) basis. In its view, VDW had taken its action to avoid having to fund the scheme up to PPF funding level. TPR had asked the panel to impose a CN to cover the (probably larger) buy-out deficit of the scheme, rather than the deficit calculated on the PPF basis, but the panel refused.

NORTEL In July 2010, the panel published a determination to issue an FSD against 25 companies in the Nortel group in Canada, the US, Europe and Africa. In practice, the decision here is less strong than in other cases. The Nortel companies refused to appear at the oral hearing held by the panel, after insolvency courts in Canada and the US had confirmed that the TPR proceedings were invalidated by

The four cases		
Sea Containers	FSD issued	June 2007
Bonas Group pension scheme	CN issued	May 2010
Nortel	FSD issued	June 2010
Lehman Brothers	FSD issued	September 2010

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those countries' stay on legal proceedings.

The panel concluded it would be reasonable (based solely on the evidence submitted by the trustees and TPR) to impose the FSD. The employer of the Nortel Networks UK (NNUK) pension plan had entered administration in January 2009, along with several other entities worldwide. NNUK was found to be insufficiently resourced – a required test for an FSD. The panel based its test on the financial information available on 30 June 2008 (before the Nortel group entered insolvency proceedings in January 2009).

An important aspect of the determination was evidence (uncontested because the Nortel companies did not appear) that from the early 1990s the Nortel group had been run as a single global entity, with the Canadian parent companies having effective control of NNUK. This, it was found, included control of the amounts contributed to the pension plan, which had been "woefully inadequate" to repair its deficit, which stood at £2.1bn on a buy-out basis at the time NNUK entered administration.

The panel accepted that the Nortel group derived significant benefit from NNUK's R&D, management, sales and marketing activities, for which NNUK was not adequately compensated, and further benefited from a growing interest-free loan (reaching a peak of £467m by late 2007), which NNUK was obliged to enter into by its immediate Canadian parent company to deal with unpaid transfer pricing adjustments.

THE PANEL CONCLUDED THAT VDW HAD IMPLEMENTED THE PRE-PACK SALE OF BONAS WITH THE AIM OF RETAINING BONAS'S BUSINESS BUT IN A NEW COMPANY THAT HAD NO LIABILITY TOWARDS THE SCHEME.

LEHMAN BROTHERS Following an oral hearing, the panel determined in September 2010 to issue an FSD against six companies in the Lehman Brothers group following the entry of most of the group into insolvency in September 2008. The six companies were the three main UK operating companies and three of the holding companies of the main employer, Lehman Brothers Ltd (LBL). TPR dropped claims against 29 other group companies before the hearing and the panel refused to issue an FSD against a further 38 group companies because of the lack of specific evidence involving them.

The panel determined to issue the FSDs based on the integrated relationship of the six companies with LBL.

LBL was a service company that employed the majority of the UK employees, which were seconded to three operating companies (which tended not to have any direct employees). The panel considered that the three operating companies had benefited from the services of the employees (there were cost-sharing arrangements but no uplift for LBL in some cases and payments due under the arrangements were left outstanding) and that the operating companies were the employers for all practical purposes.

The group had operated a general cash sweep of all group accounts into the holding company's account. There had also been some benefit to the operating companies through provision by LBL of directors, and use of LBL as property and an asset holding company.

Although the ultimate holding company had given a limited guarantee to the pension scheme, the panel considered that it had benefited (perhaps indirectly) from the arrangements between LBL and the operating companies and had been the ultimate source of funding for the contributions to the scheme.

The two intermediate holding companies were considered to have been operated as conduits for money and control, but took benefits by virtue of their ownership of the operating companies. The panel considered this enough to determine that an FSD be issued but expressly noted there was no allegation that the Lehman group acted in any way improperly or even poorly towards the LBL pension scheme.

SUMMING UP As noted above, the justification for the reasonableness of issuing an FSD in the Sea Containers determination turned significantly on the level of corporate benefit obtained by the parent company from the employers to the scheme, without sufficient support given to the pension scheme.

The reasoning was similar in the subsequent Nortel determinations. The Nortel companies were seen to draw a net benefit from the UK employer and there were accusations that Nortel used its position as ultimate owner to divert cash away from the UK employer and so away from the pension scheme.

The rationale supporting the reasonableness of issuing a CN in relation to the Bonas Group UK pension plan appears to be based on the history of support by the parent company for the subsidiary (and indirectly the pension scheme) and the subsequent removal of that support. The panel clearly considered the failure to consult with the trustees or TPR as a further reason to issue the CN.

From the Bonas determination it seems much easier than previously thought for TPR to convince the panel that a CN or FSD should be issued.

The Lehman determination shows clearly that an integrated group is often likely to have benefits flowing round the group. Third-party terms may not work without a suitable uplift (and only if the cost is paid and not left outstanding). It will be a struggle to displace the presumption of the panel that an FSD is appropriate to protect the interests of members. Lehman also indicates that holding companies will be seen to benefit simply by owning their subsidiaries. This seems to be going too far.

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The second part of this article will look at threatened exercises by TPR of its moral hazard powers. For more on the cases in this article, go to:
http://bit.ly/eqXFpn *(Sea Containers)*
http://bit.ly/hKjKgU *(Bonas)*
http://bit.ly/fsRX7w *(Nortel)*
http://bit.ly/foTIqD *(Lehman Brothers)*