

# The big stick

SOMETIMES THE PENSIONS REGULATOR CAN FORCE AGREEMENT ON A PENSION FUND DEAL BY THREATENING TO ISSUE A CONTRIBUTION NOTICE AND FINANCIAL SUPPORT DIRECTION, AS **DAVID POLLARD, DAWN HEATH AND LARISSA HOWARD** REPORT IN THE SECOND PART OF THEIR INVESTIGATION INTO THE REGULATOR'S USE OF ITS MORAL HAZARD POWERS.

**T**he Pensions Regulator (TPR) has extensive "moral hazard" powers to make connected and associated parties liable to fund a pension scheme in some circumstances.

The first part of this article, which appeared in the April 2011 issue of *The Treasurer*, summarised the four published decisions on moral hazard powers to date by TPR's determinations panel. This concluding article looks at some threatened exercises of these powers.

In addition to the four cases outlined in part one (Sea Containers, Nortel, Lehman and Bonas), there are examples of TPR threatening to use its moral hazard powers and others of parties reaching an agreement (usually in the form of an additional contribution or guarantee to the pension scheme) on the basis that TPR stops pursuing the matter. Threatened uses of power are not generally made public, so it is difficult to obtain the full set of facts and circumstances (the analysis here is based on media reports and press releases).

**DUKE STREET CAPITAL** In September 2008, media reports suggested that TPR was seeking to use its powers to recover a pension fund deficit from private equity owner Duke Street Capital following the latter's sale of the Focus DIY business to Cerberus Capital Management in June 2007. TPR did not formally issue a contribution notice (CN) or financial support direction (FSD) against Duke Street Capital but it is believed to have threatened to do so, and withdrew action only when Duke Street Capital agreed to pay £8m into the Focus DIY pension fund.

Duke Street was targeted, it is thought, rather than the then owner, because of the way in which it refinanced the Focus DIY business – paying itself a dividend on a leveraged recapitalisation some time before the sale. It is not clear whether a view was taken in the circumstances that it was best to complete the sale of Focus DIY and to address TPR's issues subsequently.

**READER'S DIGEST** It has been reported that in February 2010 TPR rejected a compromise that had been proposed by the Reader's Digest Association on the liabilities the company owed to its underfunded defined benefit pension scheme and that Reader's Digest has now entered administration.

TPR said it was "considering its next steps, including use of its powers". It is presumed that TPR's rejection of the compromise was based on an expectation that either the pension fund trustees will be able to get better recovery proving for the section 75 debt in the administration or that TPR will be able to exercise its moral hazard powers to recover more than what was offered as part of the compromise from other group companies.

Previously TPR has indicated its preference for parties reaching agreement between themselves, rather than exercising its powers. However, this case represented a direct rejection of an agreement reached between the other parties (presumably on the basis that an exercise of powers may prove more fruitful).

**VISTEON** Following the insolvency of Visteon UK, which was the sponsoring employer of the Visteon UK pension plan, the latter's trustees are reported to have lodged a contingent claim in May 2010 against the US parent entities in Chapter 11 proceedings, on the basis that an exercise of TPR's moral hazard powers would result in a provable debt for the trustees in the Chapter 11 proceedings.

However, the trustees withdrew their contingent claim after reports that the parent company had provided net financial benefits to Visteon UK. It is not possible to determine whether this purported net flow of benefits towards the sponsoring employer was the reason for the withdrawal of the contingent claim or whether there were difficulties with other elements of the purported claim, such as an inability to satisfy the insufficiently resourced test.

**CAPARO AUTOMOTIVE/  
ARMSTRONG GROUP**

The determinations panel's approach in the Bonas case (see the first part of this article) contrasts with its decision not to seek a CN or FSD in the case of Caparo Automotive. Details of this case were published as a report of the parliamentary ombudsman in June 2010 (there has been no report by TPR).

In the Caparo Automotive case, a pension scheme member made a complaint to the parliamentary ombudsman that TPR had failed to exercise its discretion reasonably in declining to issue a CN or FSD against Caparo Group, the relevant parent company. The member's complaint was that this was maladministration by TPR. It was argued that TPR should have made a CN or FSD on the basis that:

- the parent company had received benefit from the pension scheme because the employer company had taken a contribution holiday and by implication had accepted responsibility for the debt by making a compromise offer, which had been refused;
- the parent company had deliberately sought to avoid the debt by placing the employer into an insolvency process in order to buy back the employer's assets (free of the pension deficit); and
- the parent company had substantial assets.

The parliamentary ombudsman found that there was no evidence that TPR had failed to exercise its powers properly. Although it was not possible for the parliamentary ombudsman to set out any detailed reasoning for this (because the evidence that had been considered was still subject to the confidentiality restrictions applicable to information provided to TPR), she noted that the reason TPR had given to the trustees for its decision was that "the overwhelming flow of benefit had been from Caparo Group Limited to the participating employer rather than vice versa".

The trustees had considered bringing a judicial review against TPR, but decided not to proceed with this after TPR gave the trustees a summary of its analysis that underpinned its reasons for not taking regulatory action.

**ANTI-AVOIDANCE AND CLEARANCE: THE BIGGER PICTURE** In 2005 TPR published an article (Anti-avoidance and Clearance: The Bigger Picture) that gave two examples of situations where it had refused clearance (i.e. confirmation that it would not issue a CN or FSD). The examples show circumstances in which TPR has considered it might be reasonable to issue a CN or FSD (but presumably did not).

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TPR's article explained: "In one of these cases, an arm's-length management buy-in, the relatively robust position of the pension creditor (which had previously ranked pari passu with all other creditors) was considerably diluted by a 'money out' deal financed by a bank debt secured by fixed and floating charges. The regulator took into account a report from the trustees' financial advisers, who were unable to recommend acceptance

of the proposed transaction, and noted that the trustees were affected by a conflict of interest which had not been resolved. Ultimately, the lack of mitigation (for example, through a reduced period for eliminating the deficit, or the provision of good security) meant that the regulator was not totally satisfied that it would be unreasonable to issue a contribution notice or financial support direction.

"The second case was a complex restructuring and sale transaction in which a number of employers and schemes were involved. In summary, the affected schemes were not offered immediate cash payments toward the reduction of deficits; the only security offered to trustees was dependent on the future success of the restructured group. At the same time, an exceptional dividend was to be paid to some shareholders, and a certain amount of secured debt was to be paid down."

It seems that since the downturn TPR has been taking an increasingly tough position about the extent of its moral hazard powers and when to invoke those powers.

The amounts at stake for pension scheme are potentially very large. The regulator's powers are very wide and we can expect further cases to arise. Each case will depend greatly on its own facts, but some patterns may emerge. The tribunals and courts are likely to be increasingly involved in setting the limits of TPR's powers.

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*For further details of the parliamentary ombudsman's report on Caparo Automotive/Armstrong Group, see: <http://bit.ly/emKRRJ>*

