Section 89 Reports

Section 89 of the Pensions Act 2004 states that –

"Publishing reports etc
(1) The Regulator may, if it considers it appropriate to do so in any particular case, publish a report of the consideration given by it to the exercise of its functions in relation to that case and the results of that consideration.

(2) The publication of a report under subsection (1) may be in such form and manner as the Regulator considers appropriate.

(3) For the purposes of the law of defamation, the publication of any matter by the Regulator is privileged unless the publication is shown to be made with malice."

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UNIQ plc

UNIQ (Unigate Dairies) was a company listed on the UK stock exchange. Its share price had however been severely depressed by the pension debt. It needed an injection of fresh capital - but that was not practical given the weight of pension debt. The deficit funding solutions considered included a recovery plan spanning 40 years; however, the investment risks associated with such a plan were not attractive. An equity for debt swap was agreed with the pension scheme owning 90.2% of the Newco which also had the necessary injection of new money but no pension scheme burden. The residual 9.8% holding was left for the old majority shareholders. A S89 report was published in 2012.

Shortly after creation the new company was sold for £113m and this receipt was sufficient to take the pension scheme above the crucial S143 qualification level for Pension Protection Fund compensation and the scheme wound up in “normal” fashion with benefits above PPF compensation and no strain on PPF levy payers.

Bonas

This June 2011 report represented an unfortunate choice for the Pension Regulator's first test of its Contribution Notice powers. The initial Determinations Panel claim for £5.1m initially appeared to have struck an easy target of a pre-packed insolvency with plenty of adviser comments around the potential "dumping" of pension liabilities. The £5.1m claim however reflected the full buy out cost and somewhat unsurprisingly the shareholder pointed to some practical elements, like what unsecured creditors might have expected to receive if the insolvency had not been pre-packed. Mr Justice Warren, an experienced judge in pension cases, did not throw out TPR challenge but severely criticised the quantum of such. TPR subsequently settled for £60,000, allegedly as a contribution towards legal costs.

Great Lakes

July 2011, just a month after the Bonas case, the Pensions Regulator (TPR) had something more tangible to report. Negotiations with the US based Chemtura Group, owners of Chemtura Manufacturing UK Limited, sponsor of the Great Lakes Scheme, got meaningful after the issue of a Warning Notice – a sort of preliminary heads up or warning document of the intention to consider a Financial Support Direction.

Before things progressed to TPR Determinations Panel (equivalent to a public but specialist court), negotiations produced an improved funding package The package included £60m cash payable over 3 years and a US corporate guarantee. TPR regret is probably only that the result didn't come a month earlier.

UK Coal

This December 2012 case was interesting because of the two distinct parts of the business – the risky mining business and the less risky property business. The property portfolio held significant development potential – but crucially required new capital to finance the developments. UK Coal participated in the industry wide Coal Staff Superannuation and the Mineworkers Pension Schemes – both schemes are subject to the 1994 (privatisation) Protected Persons Regulations - which arguably involved employees having a defined benefit pension promise for life.

Although full details of the UK Coal pension funding was not provided, the accumulated pension assets of £451m were short of the S179 PPF threshold by a non-trivial £543m. Given the scale of the deficit, the deal unsurprisingly transferred the economic interest of the old shareholders to the pension schemes.

UK Coal (cont)

A deal was initially struck that involved ring-fencing the two separate businesses – property and mining. The mining company was free of bank debt and security obligations, apart from continuing the pension obligations. The pension debt was to be serviced by payments of £30m p.a. from 2014. Dividends were also restricted. The property company is owned 75.1% by the UK Coal Pension funds. The significant remainder of 24.9% was left with the old shareholders because of the specialist expertise of those shareholders in developing the property portfolio. In addition the pension scheme trustees paid £30m to the property company in order to release the development potential.

The coal business vulnerability was sadly reflected in a serious fire at Daw Mill colliery (February 2013) taking out over one third of the business and hence its viability. Reduced PPF compensation was therefore inevitable for members. Arguably this case was only temporarily "too big to fail" (TBTF).

Kodak

In September 2013, the Kodak Pension Plan (KPP) completed the acquisition of the Personalised Imaging and Document Imaging businesses from its former parent Eastman Kodak Company (EKC). EKC filed for Chapter 11 bankruptcy protection in the US in January 2012, with the UK pension scheme as the biggest single creditor in the bankruptcy -– with a claim for £1.8 bn. . This deal involved a massive debt for equity swap with a non trivial £419m cash contribution. The Pensions Regulator provided clearance for the acquisition of the two companies and the establishment of a new pension plan. The deal will be subject to ongoing monitoring and governance arrangements. The crucial factor in the deal was apparently the US parent guarantee of the UK scheme's liabilities. The UK scheme emerged with a viable sponsor and the prospect of full member benefits for Plan members.

M F Global

This October 2013 S89 report followed an earlier Warning Notice regarding the use of the Pension Regulator's (TPR) Financial Support Direction (FSD) "moral hazard" powers. TPR clearly thought they were well positioned to challenge the 2011 (£35m) S75 buy-out debt of the M F Global UK Pension Plan. Two weeks before the end of the FSD deadline, a deal was done, resulting in a significant payment into the Pension Scheme to allow the trustees to secure all accrued benefits. The exact amount was not specified by TPR, it was "commercial sensitive information", but a bulletin from pension specialist Pinsent Masons suggested a payment of £52m was made. The increased amount involved in the settlement (over the initial buy-out deficit) presumably reflects the increased cost of securing member benefits with reducing interest rates over the two years 2011-2013.

GEC Marconi; Telent

The Pension Regulator's (TPR) S89 report involves the position of the GEC 1972 Pension Plan. The General Electric Company, GEC, became Marconi, which collapsed in the telecoms bubble of the late 1990s, the residual business was sold on leaving only a very large pension scheme and a £514m escrow account to top up any pension scheme shortfall. The pension scheme was effectively bought by the Pensions Corporation. The S89 report covers the role of TPR since autumn 2007.

TPR was apparently contacted by the GEC Plan trustees over concerns about the investment of the Plan. In particular there were concerns about conflicts of interest in respect of appointing trustees, setting investment strategy and appointing investment managers. The end result involved –

GEC Marconi; Telent

G.E.C.

- An Undertaking by Pensions Corporation not to dabble in trustee appointment for the Plan and to use "best endeavours" to duplicate this approach in other pension schemes that it controls.
- A 3:3:3, independent trustee: MNT: employer appointed trustee Board to run the Plan.
- Preparing a Conflicts Protocol to formally identify and manage conflicts of interest going forward.

This initially appeared to be a comprehensive victory for the Pensions Regulator and may bring into question the business model of Pensions Corporation. This appears to be an example of quick and decisive regulatory action.

A bonus of having trustees, MNTs, trust law and a Regulator?

Sea Containers

In early 2008, bankrupt US transport group Sea Containers settled “out of court” with the UK Pension Regulator (TPR) in respect of a $200m deficit on two pension schemes it operated before it filed for Chapter 11 bankruptcy.

TPR had used its Financial Support Direction “moral hazard powers” in this case for the first time. TPR approach forced the company to support the two schemes. The fight over the pension fund deficit had been between two sets of creditors - the company's two pension funds and a number of bond holders. The deal over the pension deficit covered the $200m deficit on the two schemes and a $69m reserve for the settlement of potential liabilities relating to an age equalisation claim on the schemes. Some form of parental guarantee was understood to have been in place.

Dawson International

The July 2012 demise of knitwear icon Dawson International made sad but arguably predictable reading. One of the world's leading cashmere businesses had a very large pension scheme with a very large deficit - serviced by a significantly smaller on-going corporate entity. The company proposal, involving the Pension Protection Fund (PPF) assuming responsibility for the pension schemes, in return for a cash payment, a loan note and equity stake in the on-going pension free company, was rejected by the PPF.

Without inside knowledge (or as the company note, a slice of the reputed £1.4m adviser fees surrounding the situation) it is impossible to comment further on the offer or the rejection. The PPF decision criteria is however very clear - insolvency must be inevitable and a non trivial shareholding difference (10% v 33%) applies depending on whether new shareholders are currently involved in the business.

Readers Digest

The Pensions Regulator (TPR) vetoed a restructuring plan of the UK arm of Readers Digest and it went gone into administration. 117 employees in Swindon and Canary Wharf were affected but many more ex employees were affected with the pension scheme deficit of £125m.

The normal Pension Protection Fund (PPF) restructuring requirement of cash + 33% of the equity of the new company (see June 2009 guidance) was apparently not justified. It is not known how the case compared with the other transatlantic case at the time - Sea Containers. There may have been debate over the ongoing v insolvency value of assets.

TPR's tough job of protecting member benefits <u>and</u> the PPF was clearly highlighted.

British Midland BMI

The April 2012 purchase of loss making British Midland (BMI) by International Airlines Group (IAG, British Airways and Iberia) involved valuable landing slots at Heathrow. A significant proportion of the sale price, £84m to be precise, however went to supplement the BMI Pension Fund as it fell into the Pension Protection Fund (PPF).

The PPF “compensation” is subject to a monetary cap and many higher paid staff (like pilots) would have lost out with only PPF compensation. The £84m was allocated to a separate fund to top up the PPF compensation. Even with that top up, significant benefits were lost, along with numerous jobs.

Desmond & Sons Limited

The Pensions Regulator's "moral hazard" powers were applied in respect of the Desmond & Sons Limited 1975 Pension & Life Assurance Scheme. In April 2010 TPR published a Determinations Notice concerning the issue of two Contribution Notices (CNs) to two former directors of the Scheme sponsor. The case is notable as the events took place before the Pensions Act 2004 became law.

Two directors faced a total penalty of £1m in respect of the sponsoring employer allegedly dumping its pension scheme before the full S75 liability rules came into full force. The route for this escape was a Members' Voluntary Liquidation (MVL) with pension debt assessment under the old Minimum Funding Requirement (MFR). There was a known gap in the legislation and the company, with household name professional advisers and Counsel's Opinion, took the opportunity to secure the lower MFR pension debt. A S75 pension shortfall of £10m+ with a higher amount returned to shareholders. The case still subject to appeal.

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ITV

The Pensions Regulator issued a potentially landmark determination against Granada (which became ITV) in respect of the Box Clever Pension Scheme -

- The new company was formed in 2000 by Thorn and Granada as a joint venture in a highly leveraged deal.
- The key events challenged by the Pensions Regulator (TPR) occurred well before the Pensions Act 2004 became law. The legislation did not explicitly cater for such retrospective views to be taken, but neither did it exclude the possibility.
- The Financial Support Direction (FSD) only needs to be “reasonable”, no misconduct is alleged or is necessary.
- TPR has looked at the (shareholding) influence of ITV and the involvement of ITV directors on its board.

Unsurprisingly with trail blazing developments and a £62m deficit, ITV are appealing the case.

Pittards

Equestrians will immediately recognise the name of one of the UK's oldest and most prestigious saddle makers. The 180 year old leather goods group and formerly AIM listed plc, became insolvent in March 2006. A substantial restructuring was apparently made involving £2m of new equity. With the December 2004 accounts showing "net assets" of £18m, a £10m loss in 2005 was clearly going to be a problem even before addressing the FRS17 deficit of approximately £33m.

The Pension Protection Fund (PPF) is quickly becoming a big insolvency player, and like the clearing banks when debts can't be paid, equity is taken. In lieu of the pension debt, the PPF will generally take 10% of the equity in a "phoenix company" (with new money coming in) or 33% (with no new money, a "roll over"). The Pittards stake is 18.5% and this appears to mark a bit of a half-way house. Without confidential details of the case it is impossible to comment further, however, security over company property again featured in this compromise.

M G Rover

The Department for Business Innovation & Skills (BIS) formally reported on the affairs of Phoenix Venture Holdings Limited, MG Rover Group and 33 other companies. The report by BIS Inspectors, Gervase MacGregor FCA and Guy Newey QC, appointed by the Secretary of State for Trade & Industry (under the Companies Act 1985), is damning.

The report's 19 pages of conclusions provide excellent commentary on human greed, corporate governance (or more precisely the lack of it), professional and other advisers, saving jobs and pensions. Most of MG Rover's pension schemes entered the Pension Protection Fund (PPF) after the company administration on 8th April 2005 - 3 days after the PPF was established (probably no co-incidence). Other interesting elements of the 897 page BIS report on the include –

- A £10 purchase price, a £75m dowry and £400m of loans from BMW.
- Net assets of £740m in May 2000 becoming an administration deficit of £1,289m in April 2005.
- Unreasonable remuneration of 4 x £9m for four directors, £5.7m for a fifth (over 2000-05).

M G Rover (cont)

- A personal computer hard drive being “cleaned” the day after the appointment of the Inspectors.
- An Eversheds partner, Sue Lewis, being “roundly ticked off” for judging the morality of director remuneration. Apparently, Eversheds were “not anybody’s moral guardians”
- Misrepresentation of directors’ personal investment and risks taken in the business.
- The MG Rover pension schemes being 47% funded on a buy-out basis in late 2004, a £410m shortfall.
- Poor corporate governance with various other payments being criticised.

No evidence was found that the independence of the auditors, Deloitte, had been influenced by the £30.6m of fees earned in the period. Other criticisms, a subsequent £15m fine and general perceptions may however paint a different picture. There is a lot we can learn from this report. Reduced pensions are just one of the consequences of greed, uncontrolled corporate losses and poor governance.

SR Technics

SR Technics

February 2013; The SR technics UK pension scheme has been wound up after coming out of a Pension Protection Fund (PPF) assessment period. There is provision for schemes to end up with more than sufficient funds to cover the PPF compensation. The actuarial valuation (under S143, is similar to the S179 levy assessment) but pension schemes rarely cross this funding Rubicon or adequacy threshold. For SR Technics it appears that the professional trustee involved was instrumental in preparing for just such an eventuality and very careful matching of assets and liabilities was undertaken. A £200m buy out was secured with the Pension Insurance Corporation (now owned by Goldman Sachs). SR Technics grew out of the technical department of Swissair, it was declared insolvent in January 2011 following a reconstruction of the global business. Exact funding details are not available but it is certain that members received benefits above PPF compensation levels, however, the exact sharing between generations of members and high and low earners is not known.

Section 89 Reports

The S89 report list doesn't include Sea Containers, Reader's Digest and Dawson International. There are two other notable reports - for G P Noble and the Hugh Mackay Retirement Benefits Scheme.

- The G P Noble case involved criminal fraud - a sum of £52m was involved. The key individual involved was given a jail sentence of 5 years. A large portion of the £52m was recovered. Somewhat embarrassingly for the Pensions Regulator, G P Noble appeared on their list/panel of independent trustees.
- The Mackays case involved speculative and leveraged property investment with a very large proportion of the scheme funds – thereby flouting investment Regulations. The three individual trustees were deemed not to be "fit and proper persons" to be trustees and an independent professional trustee was appointed with sole powers.

PPF Insolvency Guidance

The Pension Protection Fund (PPF) has issued two sets of guidance to insolvency practitioner. The first guidance in September 2005 was mainly procedural but perhaps crucially outlines the S137 legislative requirement that the PPF takes up the pension debt enforcement and any negotiation or compromise on behalf of the Pension Scheme Trustees. In practice this relieves the Scheme Trustees from potentially onerous and difficult negotiations but arguably also introduces the key threshold of protecting the PPF at a level below full Scheme benefits.

The Guidance of June 2009 adds significantly to the focus of this paper with the outline in sections 5.3 and 5.4 of the circumstances in which the PPF will entertain a compromise of the pension debt.

PPF Insolvency Guidance (cont)

5.3 "We will therefore only ever participate in a restructuring or rescue if:-

- *Insolvency is inevitable (i.e. we are going to get the pension scheme debt whatever happens). If this hurdle is not overcome, the employer should be discussing a scheme specific funding proposal with the Pensions Regulator;*

- *The scheme receives consideration which is significantly better than the dividend which would be received if the company went into an ordinary insolvency (i.e. the scheme will be better off) ;*

- *What is offered is fair given what the other creditors and shareholders are to gain as a consequence of the rescue*

PPF Insolvency Guidance (cont)

- *The scheme is given **10%** of the equity where the future shareholders are not currently involved with the company and **33%** if the parties are currently involved. (We take non voting equity.) (This is a form of anti embarrassment protection.)*

- *•A Contribution Notice or a Financial Support Direction from the Pensions Regulator would not generate more money for the scheme than the deal we have negotiated (we would not want to settle for a lesser sum that could be obtained for the scheme);*

- *The Pensions Regulator is prepared to clear the deal; and the other party pays both our and the trustees' legal fees for documenting and executing the deal.*

5.4 Deals must ultimately be approved by the PPF and Pension Regulator Boards.

Insolvency Realities

The anti-embarrassment Pension Protection Fund (PPF) shareholding percentages initially caught most headlines and restructuring focus. The individual circumstances of each case will however dictate the structure and such situations often involve some blunt questions, for example - Who gets what? What is practically possible? Who brings what to the table?

With insolvency having to be inevitable, there is rarely a “magic bullet” or key element that makes PPF compromise a viable option. This is particularly the case when it is considered that the purchase of key assets may be less expensive via the insolvency route. New money on the table generally requires a very good reason. Balance sheet goodwill is rarely valuable. Staff and management may however be crucial to the business going forward and not all employees will have the same “haircut” of pension loss when falling down to PPF compensation levels.

From my own experience there is nothing to be gained from piecemeal negotiation; it justifiably gets labelled “the latest final offer”. It only provides a continuing cost drain on dwindling resources; professional fees could be better spent.

Insolvency Guidance (Pre-Packs)

A “SIP” a Statement of Insolvency Practice, #16 to be precise, provides guidance to licensed Insolvency Practitioners (IPs) in respect of “pre-packaged” sales in administrations. A “pre-pack” is an arrangement under which the sale of part or all of a company’s business or assets is negotiated with a purchaser prior to the formal insolvency event and the sale takes place immediately or shortly after the IP’s appointment. Some previous pre-packs have been viewed as a bit of a stitch up, but in any case the perceptions can be as damaging as any underlying truth. There is legal authority for such deals but careful preparation is necessary for example in ensuring that the interests and conflicts of directors, shareholders, advisers and secured and unsecured creditors are all addressed.

With pension deficits becoming more significant in company survival, there is an increasing likelihood of pension scheme trustees and advisers becoming involved with IPs. It is inconceivable that any pension debt would be compromised without the involvement and assistance of the Pensions Regulator. Trustees and their advisers may however be constrained by their Trust Deed & Rules. The specialist and experienced advice of an IP may be very useful. SIP16 will be just a small step toward greater transparency and accountability.