UK Pension Regulator's overseas reach: storm in a teacup?

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Regular readers of this journal will be familiar with the UK Pension Regulator's ('Regulator') efforts to exercise its so-called 'moral hazard' powers against non-UK entities. This paper re-examines some of the cases to date and considers the implications of the latest developments; considers the import of the Regulator's recent statement on the manner in which it exercises its powers; and considers the impact on cross-border insolvency proceedings.

Regulator's powers

The Regulator was established under the Pensions Act 2004. One of its statutory functions is to 'reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund' ('PPF'). The PPF is the UK's equivalent of the US Pension Benefit Guaranty Corporation and pays compensation to members of underfunded DB pension plans following the insolvency of plan sponsors. The Regulator is also charged with protecting the benefits of members of workplace pension plans.

To this end, the Pensions Act 2004 provides the Regulator with numerous powers. So far, and as is relevant for this paper, these include:

Contribution notices

Under section 38 of the Pensions Act 2004, the Regulator has power to impose a contribution notice ('CN') on the plan employer or any person (corporate or individual) connected or associated with the plan employer where either:

- there has been a deliberate effort to prejudice the position of a plan regarding any statutory debt due or prospectively due from the employer to the plan; or
- action is taken which is materially detrimental to the likelihood of members receiving their benefits in full from the plan.

The Regulator can only issue a CN if, and to the extent, he/she considers it reasonable to do so in all the circumstances of the case. A CN creates a monetary debt of a specific amount due from the CN target to the plan.

Financial support directions

Under section 43 of the Pensions Act 2004, the Regulator has power to impose a financial support direction ('FSD') on the plan employer or any person (save in exceptional circumstances, excluding an individual) connected with the plan employer where the plan employer is a 'service company' (ie, its turnover is wholly or principally derived from the provision of the services of employees to group companies) or is otherwise 'insufficiently resourced' (a complex financial test comparing the value of the debt due or potentially due from the plan employer to the plan with entity value of the plan employer and the entity value of the plan employer's group). Again, the Regulator can only issue an FSD if, and to the extent, he/she considers it reasonable to do so. Unlike a CN, an FSD creates an obligation on the FSD target to provide support to the plan. The FSD stipulates neither the value nor the form of the support to be provided. Consequently, this has to be negotiated after the FSD is issued.

Cases to date

To date, the Regulator has exercised these powers just six times (four FSDs; two CNs). Whilst this may appear low, it is important to note that four of the cases involved non-UK targets, all involved some form of corporate insolvency (albeit the target has not always been undergoing insolvency proceedings), all are/were high value (in context) and several cases have settled prior to the conclusion of regulatory action.

In only one of the non-UK cases has the form and value of the support to be provided been agreed and implemented (*Sea Containers*) and, so far, the Regulator has not reached the point of enforcing any of its orders (whether in the UK or elsewhere).

Enforcement

It is of little use to a UK pension plan if, following action by the Regulator, it is unable to enforce the terms of the order. There follows an analysis of the enforcement status of Regulator orders in various jurisdictions.

US position

The most notable of the cases to date is that linked to the *Nortel Networks plan* as this has been the subject of court proceedings both in the US and the UK. The position in the US is now much clearer following the litigation which has taken place. By way of brief reminder, the global Nortel group entered into insolvency proceedings in Canada, the US and the UK (for the UK and other European affiliates) in 2009. In January 2010, the Regulator issued a 'warning notice' to the UK entities and various affiliates, including those in the US, that it was considering issuing an FSD and requesting submissions.

The PPF and the Nortel plan trustees (but not the Regulator) jointly filed contingent and unliquidated claims in the Chapter 11 proceedings. The US debtors, however, sought to enforce the automatic stay. Argument in the case centred on whether the 'police power' exception to the stay applied. The bankruptcy court, as well as the district and appellate courts, held that neither the Nortel plan trustee nor the PPF was a 'governmental unit' for these purposes and, furthermore, the lower courts held that even if they were governmental units, they would nonetheless be in breach of the stay because they were trying to collect a debt, as opposed to exercising police power. Significantly, on 25 June 2012, the US Supreme Court, without opinion, refused to hear an appeal by the Nortel plan trustee from the Third Circuit Court's decision. The Supreme Court ruling creates a major problem for enforcement of the Regulator's moral hazard orders by plan trustees and/or the PPF in the US and may also be influential in other common law jurisdictions. However, the judgment does not rule out the possibility of the Regulator itself taking action (pursuant to the police power) or of action being taken in the US against solvent companies.

The UK litigation is considered further below.

EU position

Perhaps surprisingly, none of the Regulator, the PPF or a plan trustee has yet sought to enforce a Regulator order in another EU Member State. The Regulator, and, it is fair to say, many UK pensions professionals, has historically been of the view that it would be relatively straightforward for the Regulator to enforce a moral hazard order elsewhere in the EU. However, there is a growing view that the position is not clear.

Enforcement of judgments granted in one EU Member State in another EU State (or in a European Free Trade Association State) is governed by the Council Directive 44/2001, known as the Brussels Regulation (or by the Lugano Convention 2007). On the face of it, the process is simple. If judgment has been granted in a civil or commercial matter against a target which is domiciled in another EU/EFTA State and that judgment is registered in another EU State, the local court cannot reopen the substantive issues. However, close analysis of the requirements of the Brussels Regulation give grounds for doubt.

First, the Brussels Regulation applies to 'judgments'. Article 32 of the Regulation defines a judgment as 'any judgment given by a court or tribunal of a member state whatever the judgment may be called…'. The question therefore is whether the body which issues an FSD or CN is a 'court or tribunal'. For these purposes, the Regulator has dual personality. First, it has a regulatory personality. Regulatory officers will gather evidence and issue a warning notice of the Regulator's intention to exercise its moral hazard powers. The case is then heard before the Determinations Panel, which is the body which decides whether the case is met and that a regulatory sanction is appropriate. Strictly, the Determinations Panel is perhaps best characterised as an administrative committee within a statutory body so not self-evidently a court or tribunal. It is also possible for a regulatory target to appeal a decision to issue a FSD or CN. Appeal is to the Upper Tribunal, part of HM Courts and Tribunal Service. Procedurally, however, whilst the Upper Tribunal is undoubtedly a court, the only decision it can make is a direction to the Determinations Panel to modify its original decision. The Upper Tribunal itself does not impose any regulatory sanction. For these reasons it is not clear that an FSD or CN (even when appealed to a formal court) can be a judgment within the meaning of the Brussels Regulation.

A further issue is whether an FSD or CN is a 'civil or commercial' matter. Article 1 of the Brussels Regulation makes it clear that it applies only to judgments of a civil or commercial nature and goes on to make it clear that public law cases are excluded. The Brussels Regulation

does not contain a definition of 'civil' or 'commercial' but European Court of Justice jurisprudence gives clear guidance on how this is likely to be assessed. In short, there is a three stage test considering:

- the nature of the obligation under consideration (in this case an FSD or CN);
- whether the public body (the Regulator) can be considered to be acting in a private capacity; and
- considering whether a private person has the same sanction powers as the public body.

On all three tests, the Regulator could find itself in difficulty.

An FSD or CN is a regulatory (rather than a civil or commercial) obligation. In particular, as a requirement to reach agreement on the provision of support for a pension plan, an FSD does not even create a readily enforceable obligation. The same cannot be said for a CN which requires a defined sum to be paid to a plan (a CN is also available where there has been non-compliance with an FSD). The Regulator (or plan trustee or PPF) may therefore argue that as a CN creates a statutory debt, it becomes a civil or commercial obligation. However, this ignores the legal context in which the obligation was created.

Even if the Regulator wins on the first argument, there seems to be little doubt that when determining to issue an FSD or CN, the Regulator is not acting in a private capacity as it will be fulfilling one or other of its statutory duties to protect against compensation payments being made by the PPF or protect members' benefits.

The final test is also tough for the Regulator as the FSD and CN regime gives access to the resources of persons connected and associated with the plan employer that a private person (the plan trustees for these purposes) would not have access to.

For these reasons, whilst they are not yet tested in the courts, there are grounds to doubt the Regulator's ability to enforce FSDs and CNs even in the EU/EFTA.

Beyond EU/EFTA

Enforcement of FSDs/CNs elsewhere in the world will require a detailed country-by-country analysis which is not possible in this article. In general terms, the first point to check will be whether there are any bilateral treaties in place governing the enforcement of judgments. This will usually be the case with member states within the Commonwealth but there are many countries where no such treaty exists. In these cases, the matter will fall to be determined by private international law and the general principle is that the courts of one country will not enforce the public law of another country.

Regulator's statement

On 26 July 2012, the Regulator issued a statement entitled 'Financial Support Directions and Insolvency'. The background lies in the UK litigation concerning the *Nortel* and *Lehman Brothers pension plans*.

The question in that case was to determine the proper status of an FSD when issued after the start of insolvency proceedings. In essence, the interaction (or rather lack of it) of pensions legislation and insolvency legislation, when considered with case law, meant that there were only three possible interpretations available, that is, that the FSD:

- ranks as an 'expense' of the administration ranking ahead of all but fixed chargeholders;
- ranks as a 'provable debt', that is, having the same status as other unsecured creditors; or
- is neither an expense nor a provable debt and so is of no effect at all in an insolvency (the 'black hole' analysis).

The High Court and the Court of Appeal rejected the black hole analysis and ruled that an FSD is an expense, leading to the suggestion that FSDs have 'super-priority' status when issued after the start of an insolvency. The case is now scheduled for hearing in the Supreme Court in spring 2013.

The progress of the case through the courts has met with significant concern from insolvency practitioners and representative bodies who feared that a post insolvency FSD's super-priority status would stifle the rescue culture, inhibit bank lending, lead to administrators being unable to be paid and the Regulator using its powers to 'scoop the pool', leaving nothing for unsecured creditors.

The Regulator's position is that the case changes nothing and that the fears that have been expressed are 'unlikely to be realised' – a form of words which, it must be said, gives the Regulator room for manoeuvre should it feel necessary. The Regulator details some of the various matters that it will take into account when deciding whether the form and amount of support in a particular case are reasonable:

- the position under insolvency law had the FSD been issued before the insolvency event;
- the financial circumstances of the target (in three of the four FSD cases to date, the target has been insolvent);
- the interests of directly affected parties, including the FSD target; and
- where the FSD target is insolvent, the claims of other unsecured creditors. The Regulator 'expects that this will result in … broad equity between the trustees of the scheme and unsecured creditors of the FSD recipient'.

The statement is clearly designed to calm the fears of rescue and restructuring practitioners and lenders.

This is reinforced by the Regulator's assurance that it will not delay the issue of an FSD to take advantage of 'super-priority' status and the rather more surprising statement that the Regulator will positively argue for the 'provable debt' analysis in the Supreme Court hearing in the *Nortel/Lehman Brothers* litigation (rather than adopt a neutral stance).

Impact on cross-border restructuring/insolvency

Whilst recent developments in the *US Nortel* litigation and the Regulator's statement have addressed some of the uncertainties which are inherently present when a cross-border case involves a UK defined benefit pension plan, a number remain.

COMI proceedings

As readers will know, the EU Insolvency Regulation is designed to simplify the administration of insolvencies involving two or more EU jurisdictions by focussing proceedings on the debtor's centre of main interest. This preserves value and enhances recoveries for creditors. Where the COMI is the UK and there is a defined benefit plan in existence, creditors elsewhere in the EU have the right to bring secondary proceedings in their local courts. This will enable the creditor to deploy the sorts of arguments outlined above when the trustees of the plan/the PPF/the Regulator attempt to enforce against local assets.

The Regulator's statement goes some way to dealing with concerns which had been raised in some quarters about the UK as a COMI jurisdiction. However, as highlighted above, the statement does leave the Regulator some room for manoeuvre. Notably, it only applies to FSDs; it does not apply to CNs. Further, the Pensions Act 2004 is not prescriptive as to the factors that the Regulator can/must/must not take into account when deciding whether to issue an FSD so, whilst influential, the statement has no determinative legal effect. The statement is also silent on how the Regulator will approach cross-border insolvencies involving multiple estates. The Regulator may, for instance, consider it reasonable to apply an uplift to the level of support required from a UK (COMI) estate if it is going to be unable to make the recoveries it considers it reasonably could have secured from a US estate. The Regulator's statement therefore does not make it any easier for creditors to decide whether to file secondary proceedings or not.

Stay proceedings

The *US Nortel* litigation confirms that the automatic stay in Chapter 11 proceedings operates to defeat plan trustees and the PPF when asserting claims in the estate. The case may be influential in other common law jurisdictions when or if attempts are made to pursue claims in insolvent estates in those jurisdictions. However, there is no one-size-fits-all answer so it is likely to take many years to build up a clearer picture in respect of the key global jurisdictions.

Conclusions

Although the Regulator has had its moral hazard powers now for several years, we remain at a very early stage in building up a picture of the enforceability of FSDs and CNs outside of the UK. For as long as there is uncertainty, there will be differences in approach between debtors faced with a Regulator order. Some (like Sea Containers) will seek to reach a negotiated solution in order to achieve certainty as quickly as practicable. Others (like Nortel) will prefer to stay out of the Regulator's proceedings and rely on stays of proceedings with the uncertainty that can bring. Given the difficulty that the Regulator is experiencing in cross-border cases, it may now look to change its regulatory approach to being more proactive about using its powers before insolvency occurs.