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ARTICLE

Directors, Insolvency Practitioners and Third Parties Must Tread Carefully as New Pensions Offences Lie in Wait for the Unwary

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Synopsis

Since 1 October 2021, directors, lenders, investors, advisers and other parties to restructuring arrangements and corporate activity which may jeopardise the interests of a defined benefit (DB) pension scheme have faced the spectre of criminal prosecution. The new pensions criminal offences and other regulatory sanctions, which came into force just over a month ago, are broadly drafted and are likely to impact the approach to restructurings, transactions, intra-group finance arrangements, lending and security arrangements and other corporate activity which may negatively impact a DB scheme.

Three new pensions criminal offences form the most high profile part of a raft of new regulatory powers and sanctions designed to strengthen the pre-existing regulatory regime and afford greater protection to DB schemes and the Pension Protection Fund (PPF). Alongside the new offences, the Pensions Regulator (the Regulator) has been given the power to impose fines of up to £1 million in a wide range of circumstances, enhanced powers to require DB sponsors and related parties to make immediate payments into their scheme and extended information gathering powers.

The government is also planning to introduce new reporting requirements in relation to certain material corporate transactions and the granting of relevant security which will rank ahead of a DB scheme, in April 2022.[1] This is likely to mean corporates will be required to notify the Regulator (and their scheme's trustees) and to provide more detailed information about such transactions at a much earlier stage than is typically the case. Multiple notifications are also likely to be required in respect of the same transaction.

Going forwards, parties to restructuring arrangements and other corporate activity which may detrimentally impact a DB scheme need to ensure they have fully considered whether these new offences and regulatory sanctions may be engaged. The Regulator has published a criminal offences policy[2] in which it sets out how it will approach the enforcement of the offences of *causing a material detriment to a DB scheme* and *avoiding an employer debt*, and in what circumstances. Despite improvements having been made from the draft policy published for consultation in March, there is still significant uncertainty about how, and when, these offences will be enforced in practice, including:

- What will constitute a 'reasonable excuse' such that actions which are materially detrimental to a DB scheme will not be criminal?
- Could lenders, suppliers and other third parties (such as suppliers) be prosecuted for taking action which is in their own commercial interests where this is materially detrimental to a DB scheme?
- In what circumstances might insolvency practitioners and other professional advisers be in scope?
- How do these new offences and sanctions interact with directors' duties more broadly?

Although the Regulator has indicated that those involved in, what it considers to be, 'ordinary commercial activity' do not need to be concerned, given the uncertainty that still surrounds the scope and application of these new offences (and the other new regulatory sanctions) a nasty surprise may lie in wait for the unwary.

Background

Following a series of high profile corporate failures, the government has taken steps to strengthen the pensions regulatory regime to deter companies and other parties (such as lenders, investors and advisers) from taking action or implementing arrangements which, broadly speaking, are materially detrimental to a DB scheme.

Notes

1 https://www.gov.uk/government/consultations/strengthening-the-pensions-regulators-powers-notifiable-events-amendments-regulations-2021.

2 https://www.thepensionsregulator.gov.uk/en/document-library/strategy-and-policy/criminal-offences-policy

The new measures, which came into force on 1 October 2021, include:

- three new criminal offences, including offences for actions that are materially detrimental to a DB scheme and for avoiding or reducing an employer debt to a scheme
- new financial penalties of up to £1 million which apply in a wide range of circumstances
- two new contribution notice triggers, and
- enhanced information gathering powers, including the power to inspect company premises and the power to compel a person to attend an interview with the Regulator and to answer questions.

Criminal offences

The criminal offences introduced by the Pension Schemes Act 2021 with effect from 1 October 2021 are widely drawn. Consequently, they could potentially be engaged by a wide range of corporate activity. In particular, a criminal offence will be committed where a person does an act, fails to act or engages in a course of conduct:

- that detrimentally affects in a material way the likelihood of accrued benefits under a DB occupational pension scheme being received
- where the person knew or ought to have known that it would have that effect, and
- the person did not have a reasonable excuse for the act, failure or for engaging in the course of conduct.[3]

A criminal offence will also be committed where a person does an act, fails to act or engages in a course of conduct:

- that prevents the recovery of a debt that is due and payable under section 75 of the Pensions Act 1995 (which may arise, for example, where a sponsoring employer is sold out of its group or otherwise ceases to employ any active members in a DB scheme or where it becomes insolvent or where the scheme is wound-up), prevents such a debt becoming due or compromises, settles or reduces such a debt
- where the person intended the act, failure or course of conduct to have that effect, and
- the person did not have a reasonable excuse for the act, failure or for engaging in the course of conduct.[4]

These offences carry a maximum penalty of up to seven years imprisonment and/or an unlimited fine.

The third offence relates to the failure, without a reasonable excuse, to pay a debt due to the trustees of a DB scheme or the PPF under a contribution notice imposed in accordance with section 38 Pensions Act 2008.[5] Any such offence is punishable by way of a fine.

In most instances, it is expected any prosecution for these offences in England, Wales or Northern Ireland[6] would be brought by the Pensions Regulator. However, a prosecution may also be brought by other persons or bodies including, in England and Wales, by the Director of Public Prosecutions and, in relation to the offences of risking accrued scheme benefits and avoiding a section 75 employer debt, by the Secretary of State for Work and Pensions. In Scotland, a prosecution would need to be brought by the Crown Office and Procurator Fiscal Service.

Unlike the Regulator's powers to issue contribution notices and financial support directions, which can only be used against sponsoring employers and 'connected' or 'associated' persons, these new offences can be committed by *any person* who is party to a relevant act, failure to act or course of conduct (other than an insolvency practitioner acting in their capacity as such). This could include sponsors of DB schemes, directors of scheme sponsors, other group companies and their directors, as well as investors, lenders, trustees and advisers. Despite the carve out for insolvency practitioners, these offences could still apply to them, for example, in relation to pre-insolvency advice and pre-insolvency restructuring arrangements.

A criminal prosecution could also be brought against any person who aids or abets with the commission of an act or course of conduct which risks accrued scheme benefits or which is intended to avoid a section 75 employer debt.

There is no time limit on when the Regulator can bring a prosecution for any of the new pensions offences, unlike its power to issue a contribution notice which it can only exercise for up to six years after a relevant act or failure has occurred.

Degree of knowledge or intention

For the offence of risking accrued scheme benefits, the prosecution will need to show that any person whom it prosecutes 'knew or ought to have known' that their actions would have a materially detrimental effect on the relevant DB scheme. This involves both an objective

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3 Section 58B Pensions Act 2004
4 Section 58A Pensions Act 2004
5 Section 42A Pensions Act 2004
6 In Northern Ireland a prosecution could also be brought by the Department for Communities (Northern Ireland), or by (or with the consent of) the Director of Public Prosecutions for Northern Ireland

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and a subjective element, which means that a person will not escape prosecution merely because they did not put their mind to the potential impact of their actions on the scheme.

In relation to the offence of avoiding a section 75 debt, the prosecution will need to show that the person 'intended' to prevent the recovery of a section 75 debt, prevent the debt from becoming due or compromise, settle or reduce such a debt (as appropriate). Once again, even if a person did not have this outcome specifically in mind (for example, because they did not consider the impact of their actions on the scheme), they may still be guilty of an offence where it can be shown that the outcome was a natural consequence of their action(s) or their failure to act.

While it will ultimately be for the courts to determine the nature and extent of the knowledge or intent necessary to be found guilty of an offence, the thresholds that have been chosen suggest it will be a relatively low bar. It is notable that neither threshold requires a party to *desire* to cause a detriment to the relevant pension scheme, they simply require this to be the objective effect of the relevant act or failure. Millet J's (as he then was) seminal judgment in *Re M C Bacon*,[7] in which he considered whether a debenture should be set aside on the basis that the decision to grant the debenture was influenced by a desire to improve the bank's position in the event of the company's insolvency, highlights the significance of this:

> 'A man is taken to intend the necessary consequences of his actions, so that an intention to grant a security to a creditor necessarily involves an intention to prefer that creditor in the event of insolvency. The need to establish that such intention was dominant was essential under the old law to prevent perfectly proper transactions from being struck down. With the abolition of that requirement intention could not remain the relevant test. Desire has been substituted. That is a very different matter. Intention is objective, desire is subjective. A man can choose the lesser of two evils without desiring either.'

It is clear from the Regulator's criminal offences policy and associated guidance that the Regulator considers the *mens rea* (or mental) element of these offences to be a relatively easy hurdle to surmount. The examples given suggest the mental element will almost invariably be met where security is granted (or taken) in preference to a pension liability, or where a critical supplier refuses supply, as the guidance focuses on whether such conduct is criminal by reference to the reasonableness of the relevant acts rather than whether the requisite knowledge or intent is present. Whether the criminal courts, which will be the ultimate arbiter, are prepared to accept such a low bar in the context of these offences remains to be seen.

Reasonable excuse

Where a person has committed a relevant act or failure and is shown to have the requisite intent they will have committed a criminal offence unless they have a 'reasonable excuse' for their actions. In the first instance it will be for the relevant prosecuting authority to determine whether a person has a reasonable excuse. Ultimately, however, this will once again be a matter for the Court or, depending on the circumstances, a jury to decide.

In its criminal offences policy the Regulator highlights the following three factors which it says will be significant in determining whether a person has a reasonable excuse in the context of the offences of risking accrued scheme benefits or avoiding a section 75 debt:

- whether the detrimental impact on the scheme/likelihood of full scheme benefits being received was an incidental consequence of the act or omission, as opposed to a fundamentally necessary step to achieve the person's purpose
- the adequacy of any mitigation provided to offset the detrimental impact, and
- where no, or inadequate, mitigation was provided, whether there was a viable alternative which would have avoided or reduced the detrimental impact.

The Regulator may also take account of other factors including:

- a person's reasons for acting in the way they did, and the reasonableness of these
- the circumstances in which the act took place, including the person's duties, skills and experience and other relevant attributes and any time constraints they were subject to
- the timing, extent and openness of any communications with the scheme's trustees, the Regulator and, where relevant, the PPF
- in the case of a person who owes fiduciary duties to the scheme, whether they complied with those duties when doing the act or carrying out the course of conduct, and
- where the person was acting in a professional capacity, whether they acted in accordance with the applicable professional duties, conduct obligations and ethical standards.

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7 [1990] B.C.C. 78

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In relation to restructuring scenarios, the policy helpfully confirms that a person would generally be expected to have a reasonable excuse for their actions where they propose, or act in accordance with, a scheme authorised by a court under Part 26A of the Corporate Governance and Insolvency Act 2020,[8] or where a person proposes, or acts in accordance with, a company voluntary arrangement.[9] It is notable, however, that the policy does not provide the same reassurance where an application is made to enter into a corporate moratorium, which suggests that any such action by the directors of a company with a DB scheme is likely to be subject to greater scrutiny from the Regulator.

Was any detriment to the scheme central or incidental?

The Regulator gives the following examples of circumstances where the detriment to a DB scheme would be considered central to the parties' purpose:

– A key supplier terminates a supply contract with the employer with the purpose of bringing about its insolvency, so the supplier can buy the whole of the employer's business out of insolvency apart from the scheme.

– A sponsoring employer can only afford to pay minimal dividends due to the funding requirements of its scheme. Its parent instructs the employer to direct new business to a new group company, which is not a sponsor in relation to the scheme, rather than conduct it through the employer. The employer becomes unable to properly fund the scheme as a result.

Any viable alternative?

In assessing whether a person has a viable alternative which would have caused less detriment to the DB scheme, the Regulator offers the following examples of scenarios where there was a less detrimental viable alternative:

– An employer has breached its banking covenants, entitling its lender to withdraw facilities immediately, but an extension of facilities by one month is highly unlikely to risk the lender's interests because the employer is entitled to significant payments from debtors over that period. The one-month extension is likely to be a viable alternative.

– A parent company and its subsidiary (a DB scheme employer), each owning 50% of another group company, X, sell X to a third party. The entirety of the sale proceeds is remitted to the group treasury company to reduce the group's debt, with no mitigation provided to the scheme. The employer was dependent on income from X for its viability, and subsequently becomes insolvent. There is no pressing need to reduce the group's debt – the motivation is to maximise the group's liquidity ahead of a possible bid for another company, however, other sources of finance are available. The viable alternative is that the group could have sourced the funds from elsewhere.

– An employer is facing imminent insolvency, but its directors choose to declare a dividend shortly before appointing administrators. In administration, the scheme receives 20p in the £, as do the other unsecured creditors. The directors have breached their duty to have regard to the interests of the company's creditors as a whole. There was a viable alternative of not declaring the dividend, which would have been less detrimental to the scheme. However, we would not assert that a viable alternative involved paying the scheme a higher rate of recovery in administration than other unsecured creditors.

As with most of the examples included in the Regulator's criminal offences policy, the scenarios above are somewhat contrived. However, the first is notable because it is one of very few examples included in the policy which suggests that a third party, such as a lender, risks committing a criminal offence in circumstances where it takes a decision in their own commercial interests.

On its face, this example suggests there may be circumstances in which the new criminal offences could act as a significant fetter on the rights of a party which is unrelated to a DB scheme to act in its own interests or that of their shareholders and to enforce its contractual rights. If that is how these offences are applied in practice, it would mark a significant departure from pre-existing principles of English corporate law. In essence, this would require a party to consider the impact of its actions on the pension scheme of an unrelated commercial entity and to consider potential alternative courses of action before it took steps to protect its commercial interests or enforce its own contractual rights.

In practice, it is unlikely any decision to extend facilities by another month would be so clear cut and present no (or very low) risk to the lender, particularly where it is dealing with a distressed business. Indeed, other examples included in the policy indicate that where harm is caused to an entity's business as a result of action

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8 We presume this should be read as a reference to a scheme under Part 26A of the Companies Act 2006.

9 See Appendix 2 to the Regulator's criminal offences policy

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taken by an unrelated third party (such as a supplier or customer terminating a business relationship or a lender revising or terminating a lending arrangement), that is unlikely to constitute a criminal offence on the basis that the third party is likely to have a reasonable excuse. Nevertheless, this raises the question of what steps lenders and suppliers should take when they are considering whether to bring their relationship with a distressed business which has a DB scheme to an end, or to significantly alter its terms. Going forwards, lenders and suppliers would be well advised to maintain written records of their assessments of the risk involved in maintaining the relationship on its existing terms and the rationale for any decision they take to alter or terminate the relationship.

The second scenario also raises a number of questions. The policy refers to there being 'no pressing need' for the group's debt to be reduced. But what if there is a contractual obligation to do so or if it is necessary to meet group liquidity needs for other reasons (for example, because otherwise there might be a risk of breach of a banking covenant)? This type of group restructuring is not uncommon, but, once again, it is unclear if the duty of directors to have regard to their company's own interests and that of its shareholders is sufficient to justify the action taken or whether the Regulator would consider the detriment to the scheme to have been unnecessary and, therefore, unreasonable.

Another concern that arises in this context is the question of how far a company's directors and third parties need to go in exploring and exhausting potential alternative solutions. Helpfully, the Regulator's policy recognises that the amount of time available to consider alternatives, and the capacity to incur the costs of doing so, may be limited, particularly in distress scenarios where events move at pace and decisions need to be made quickly to avoid material destruction of value in a way that would be detrimental to all stakeholders, including the pension scheme creditor. Consequently, the extent to which alternatives could and should be explored will be context-specific. Although this does suggest that, where more time and resources are available, directors will be expected to spend more time exploring and exhausting alternative courses of action. Presumably, the more serious the consequences for the DB scheme, the more extensive these enquiries should be.

The Regulator has also given an assurance that it will not use hindsight when considering whether a viable alternative could have avoided or reduced the impact on the scheme. For example, the directors of a distressed company may identify a number of alternative restructuring proposals, but assessing the relative detriment between those alternatives may involve a judgement as to how events will play out in the future. This could include the success of the company's turnaround, whether key customer contracts will be renewed or how the wider economy performs. The directors may not be certain which option will cause the least detriment to the scheme. In this scenario the Regulator has said that its assessment of the directors' actions will take account of their knowledge (including their reasonable expectations and forecasts) at the time they made their decision, had they made reasonable enquiries.

While this assurance is welcome, the acid test will be how this is applied in practice and whether the Regulator is able to resist the temptation to judge with the benefit of hindsight, particularly when (as is inevitable) it comes under pressure from politicians and the media who have given no commitment to show such restraint. Again, this highlights the need for directors, insolvency practitioners and advisers to ensure clear and accurate records of the decision making process are retained and that clear and robust advice is received when companies are in positions of stress and distress, so it is clear how and why key decisions have been made.

Adequate mitigation

The Regulator's policy also includes examples where the Regulator considers that the mitigation provided *might* be considered adequate. These are where:

- An employer that is legally supported by the covenant of a wider group of companies is sold to a buyer, terminating the wider support arrangements. A combination of part of the sale proceeds being paid to the scheme and the provision of guarantees from suitably strong entities in the new employer group fully compensate for the loss of the seller group support.
- An employer grants security for the benefit of entities outside the direct covenant, but the security provided is subordinated to all present and future liabilities of the scheme.
- An employer makes cash transfers to a treasury company within its wider group as part of a routine cash sweep arrangement, but the employer is given an enforceable right to demand repayment at any time, and the treasury company is suitably strong enough to meet any such demands.

Once again, these seem somewhat contrived and it is concerning that the policy leaves open the prospect that the mitigation provided in these examples *might not* be considered adequate. It is difficult to see how that could be the case.

When discussing mitigation, the policy also states that 'mitigation provided at an early stage is more likely to provide a reasonable excuse than mitigation after a lengthy period'. This suggests that the Regulator will look more favourably on mitigation provided at the time of the relevant act, or shortly afterwards,

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compared with mitigation provided some time later and, potentially, after much arm twisting.

Financial penalties

Alongside the criminal offences, the Regulator now also has the power to issue financial penalties of up to £1 million[10] in a wide range of circumstances, including in circumstances similar to those covered by the new criminal offences. In particular, the Regulator will be able to impose a fine on a person who is a party to an act or deliberate failure to act (or a series of acts or failures):

- that detrimentally affects in a material way the likelihood of accrued benefits under a DB occupational pension scheme being received (where the person knew or ought to have known it would have that effect),[11] or
- the main purpose, or one of the main purposes of which, was to prevent the recovery of a section 75 debt that is due and payable from an employer, to prevent such a debt becoming due or to compromise, settle or reduce the amount of such a debt,[12]
- where, in either case, it was not reasonable for the person to act or fail to act in the way they did.

Once again, a fine under these new powers can be imposed on *any person* who is party to a relevant act, failure to act or course of conduct (other than insolvency practitioners acting in their capacity as such) and on *any person* who knowingly assists in a relevant act, failure or course of conduct. However, the Regulator will need to show that it was not reasonable for the person to act or fail to act in the way they did.

The Regulator will also be able to impose a fine of up to £1 million where a person:

- knowingly or recklessly provides false or misleading information to the Regulator or a scheme's trustees
- fails to report a notifiable event to the Regulator, without a reasonable excuse (this applies to both scheme-related and employer-related notifiable events)
- fails to submit a notification and 'accompanying statement' in respect of a material corporate transaction or the granting of security (once these new requirements are in force, which is expected to be from 6 April 2022), or
- fails to make a payment due under a section 38 contribution notice, without a reasonable excuse.

As with the criminal offences, there is no time limit on when the Regulator can impose a fine under these new powers.

In most circumstances it is likely to be easier for the Regulator to impose a financial penalty on a relevant person using these powers (as opposed to securing a criminal conviction) on the basis that this would be subject to the lesser civil standard of proof.

New contribution notice triggers

The Regulator has also been given extended powers to issue a contribution notice to require a DB scheme sponsor or a connected or associated party to make an immediate cash contribution into a scheme. In addition to the existing triggers (which are engaged where there is a material detriment to a DB scheme or by the avoidance of an employer debt), these new triggers mean that the Regulator is able to issue a contribution notice where, in its opinion, broadly:

- a relevant act or failure would have materially reduced the amount a DB scheme would stand to recover on the hypothetical insolvency of a scheme sponsor, or
- an act or failure has reduced the resources of a scheme sponsor to a material extent.

Unlike the existing material detriment contribution notice trigger, the new employer insolvency and employer resources triggers involve more objective, point in time tests which are designed to make it easier for the Regulator to establish that a relevant trigger event has occurred.

As well as showing that a relevant act has occurred, the Regulator also needs to show that it is reasonable to impose a contribution notice in the circumstances. A statutory defence may also be available where a person can show that, broadly, they have considered the impact of their actions on the scheme and taken all reasonable steps to mitigate any detriment to the scheme.

In its updated contribution notice Code of Practice[13] the Regulator summarises circumstances in which it might expect to issue a contribution notice using its new or pre-existing powers. This includes:

- where sponsor support is removed, substantially reduced or becomes nominal
- where a DB scheme's creditor position is weakened

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10 Under section 88A Pensions Act 2004
11 Section 58D Pensions Act 2004
12 Section 58C Pensions Act 2004
13 Code of Practice 12: Contribution notices

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- some instances of paying a dividend or a return of capital by the sponsoring employer, and
- payments favouring other creditors of the employer over the scheme where no such sums are then due to those creditors.

In the accompanying Codes-related guidance,[14] the Regulator builds upon this setting out a series of more detailed examples of actions which it considers could trigger the imposition of a contribution notice under one or more of the material detriment test, the employer insolvency test, or the employer resources test. This includes:

- the substitution of a moderately profitable company as a sponsor of a DB scheme with a large deficit with a shell company with no assets
- the sale of a profitable part of a sponsoring employer's business to another group company which does not have a legal obligation to support the DB scheme, where the consideration due to the sponsor for the sale is passed to the parent company by the declaration of a dividend, resulting in a material reduction in the employer covenant standing behind the scheme
- the highly leveraged acquisition of a group's parent company by a private equity fund which reduces the parent's ability to stand behind its guarantee to the group's DB scheme
- the transfer of the ownership of a subsidiary, which generates substantial profits and holds significant property assets, from the sponsor of a DB scheme to another group company as part of a group restructure, where the consideration owed to Employer L is settled by way of an intercompany debt which is unsecured, non-interest bearing and has no repayment date and where there is evidence of liquidity constraints within the group that calls into question whether the intercompany debt would be repayable if required
- the management team of an otherwise viable and solvent company take steps to manufacture its unnecessary insolvency to buy its business out of administration without the scheme
- as part of a group restructure, all companies within a corporate group agree to be responsible for the group's increased borrowings, including a company that sponsors a DB scheme which provides a new first-ranking charge over each of its main assets in support of the borrowed funds
- a DB scheme sponsor is acquired by new owners, which subsequently raise a substantial amount of debt secured on its business and assets to finance a dividend to the new owners
- a scheme sponsor pays a significant dividend to its parent company which has a material impact on the employer covenant and the company's ability to support the scheme, and
- a scheme sponsor makes a repayment of an unsecured intercompany loan, before it is contractually due, when it is facing financial difficulty and has diminishing financial headroom, and where its DB scheme has a substantial deficit.

Impact in practice

The Regulator has indicated that 'the vast majority of people do not need to be concerned' as it does not intend to prosecute behaviour which it considers to be 'ordinary commercial activity'. Instead it only intends to investigate and prosecute 'the most serious examples of intentional or reckless conduct that were already within the scope of our [contribution notice] power, or would be in scope if the person was connected with the scheme employer'. Given how sparingly the Regulator has used its existing contribution notice powers this suggests that prosecutions for these new offences are likely to be rare. Despite this given the breadth of the offences and the uncertainty, which still surrounds their application, there are likely to be many scenarios in which advisers will find it difficult to give definitive advice on whether proposed corporate activity will constitute lawful activity or not.

Having said that, in practice, directors of companies and groups with DB schemes are likely to be most concerned about the extension to the Regulator's contribution notice powers given that these have been introduced with the intention of making it easier for the Regulator to establish that a relevant trigger event has occurred. While assurances have been provided that the new criminal offences are likely to be reserved for circumstances in which significant harm has been caused to a DB scheme, no such assurances have been provided in relation to the new contribution notice triggers (or indeed the new financial penalties). Like the new financial penalties, the contribution notices triggers are also subject to the lesser civil burden of proof. Consequently, where they are all in play, it is likely these powers will be viewed by the Regulator as a sliding scale with contribution notices issued most frequently; followed by financial penalties and; with criminal prosecutions reserved for the most egregious acts. The Regulator will also have the option of combining contribution notices with one of the other two

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14 https://www.thepensionsregulator.gov.uk/en/document-library/consultations/code-of-practice-12-consultation/draft-code-12-guidance

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penalties (but not both) should the circumstances so warrant.

Therefore, even if most directors and other parties to corporate restructurings and other corporate activity or arrangement which may negatively impact a DB scheme are unlikely to face criminal prosecution, it is critical they fully consider:

- the potential impact of the activity or arrangement (and any related activities) on the scheme and whether any of the new offences and sanctions could be engaged
- the extent to which any material detriment to the scheme can be avoided or mitigated
- the rationale for their actions and whether this is likely to amount to a reasonable excuse
- when and how to engage with the scheme's trustees, the Regulator and the PPF (where this is necessary), and
- whether it may be appropriate to seek clearance from the Regulator in relation to the proposed activity or arrangement.

The Regulator expects any person it investigates to explain their actions and put forward sufficient evidence of any matters that might amount to a reasonable excuse. It also expects the basis for any reasonable excuse to be clear from contemporaneous records such as minutes of meetings, correspondence and written advice. Therefore, in the context of restructuring and corporate transactions and also in relation to day-to-day corporate decision-making, where this has the potential to impact a DB scheme, it will be important for corporate decision-makers and other parties to maintain records of:

- the decision making process
- their assessment of how the scheme may be impacted and the adequacy of any mitigation that is offered/provided
- any engagement with the scheme's trustees and/or the Regulator, and
- any advice received.

Corporate restructuring

From a broader restructuring perspective, there are a number of practical questions which remain unanswered which we hope will be clarified in due course by the Regulator.

Notwithstanding the Regulator's recognition of the speed of restructuring situations, it is not clear how far the Regulator really recognises the practical reality of situations where a company is running out of money and how limited the ability of the directors to search for alternative financing, undertake due diligence and document such searches will be.

Secondly, the policy recognises there will be situations where it is legitimate for lenders to charge a yield that is higher than conventional bank debt, where the new debt is critical for the survival of a business. However, it also suggests lenders are expected to act reasonably and on commercial terms – i.e. there is potentially a restraint on the ability of lenders to act purely in their own self-interest. It is not clear how this will impact distressed lenders who may find themselves having to consider the reasonableness of their approach to negotiations and the interest rates they levy as well as the risk that the Regulator may subsequently impugn any enforcement of their contractual rights in the event of default. It would plainly be an unintended and undesirable consequence if these criminal offences impact on the availability and expense of distressed lending to companies and groups with DB schemes. As it stands, it appears lenders may be required to consider alternative courses of action before seeking to exercise their contractual rights.

Finally, one of the questions raised by the recent judgment in *Re Virgin Active Holdings Limited* [2021] EWHC 1246 was whether restructuring plans could be used to compromise a DB pension scheme.[15] Although the issue has not yet been decided by a Court, as a matter of principle, it seems to us likely that pension liabilities (both the requirement to make ongoing contributions and the contingent section 75 debt) are capable of being restructured/compromised by way of a restructuring plan (subject to the approval of the Courts) using the cross-class cramdown mechanism. The confirmation contained in the Regulator's policy that where a party proposes a restructuring plan which is subsequently approved by the Court they will likely not fall within the ambit of the criminal offences removes one of the key hurdles to compromising pension liabilities in this way. However other hurdles, such as circumventing the broad powers available to the scheme's trustees, persuading the Court that this is appropriate and the threat posed by the Regulator's anti-avoidance powers more generally remain.

Impact on directors' duties

One of the challenges raised by these new offences is reconciling them with directors' general legal duties.

Notes

15 Samantha Brown, John Whiteoak and Philip Lis, 'Virgin Territory: What are the Implications of Restructuring Plans for Defined Benefit Pension Schemes?', (2021) 18 *International Corporate Rescue* 269.

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In the ordinary course of business, directors are required to make decisions for the benefit of their company's shareholders having regard to factors such as the long term success of the company, the interests of employees and the need to foster business relationships with suppliers, customers and others. It is only in an insolvency scenario that the duties of directors switch to acting in the interests of the company's creditors. However, even in that scenario, directors are required to consider the interests of the company's creditors as a whole and not act in the interests of any one particular creditor.

In its criminal offences policy, the Regulator recognises the new offences do not change the creditor status of the scheme. While this is technically correct it fails to recognise that, in practice, these new offences and regulatory sanctions will mean that directors are likely to pay much closer attention to the impact of their decisions on a DB scheme (where relevant), particularly in distress scenarios. In that sense, these measures mean, in effect, that DB schemes have been given *pseudo-preferential status* compared with their sponsor's other unsecured creditors, creating a clear tension in how directors consider competing interests in times of stress and distress for a relevant company.

Conclusion

After the publication of the Regulator's draft criminal offences policy, we (along with many other practitioners) expressed concern that significant uncertainty remained regarding the application of the new pensions offences.[16] The draft policy itself created further uncertainty by failing to provide assurances that the offences would not be engaged in common scenarios that to most observers fall well inside the bounds of 'ordinary commercial activity' and by failing to provide commercially realistic and robust examples.

The final policy goes some way to addressing this. However, perhaps unsurprisingly, given the simple and somewhat contrived scenarios set out in the policy, uncertainty remains.

This means directors of companies and groups with DB schemes, along with lenders, suppliers, investors, advisers and insolvency practitioners are now operating in new and unfamiliar territory with somewhat rudimentary navigational tools for guidance. Probably the greatest reassurance can be taken from the fact that attacks by the *'beast of pensions moor'* tend to be rare. But that doesn't mean wanderers won't hear its growl or that it doesn't lie in wait for the unwary.

Notes

16 Samantha Brown and John Whiteoak, 'Pensions Regulator Outlines Scope of New Pensions Criminal Offences but Uncertainty Remains', (2021) 18 *International Corporate Rescue* 206.

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International Corporate Rescue

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