

# Steps in the wrong direction

The complexity of the government's latest proposals to reform the employer debt regime may create yet further problems for businesses looking to restructure, says **James Clifford**

**IN SEPTEMBER 2009** the Department of Work and Pensions published a consultation paper on its latest proposals to change the employer debt regime. The consultation sought responses to the DWP's proposal to introduce a change to the employer debt regime to cater for what is described as "corporate restructuring". There is also a proposal to introduce a 'de minimis' exception, where the debt is less than £100,000.

It is well arguable that the employer's balance of cost covenant in traditional occupational pension schemes has always given rise to a debt on the employer. However, this covenant, or promise, was apparently considered insufficient, so section 75 of the Pensions Act 1995 was enacted to create a statutory, unsecured, non-preferential debt in two specific circumstances: when the scheme was wound up or when an employer became insolvent.

Initially, the debt was calculated on the minimum funding requirement (MFR) basis. But in 2003 this was changed to the buyout basis. This was a shock to many employers, some of whom found that they could no longer afford to wind up their schemes (which was no doubt the government's intention).

But more was to follow. In 2004, section 75A of the Pensions Act 1995 was introduced which extended the employer debt regime to the situation where a single employer left a multi-employer pension scheme. However, the fundamental problem with the employer debt regime, in the multi-employer scheme context, is that a wide variety of ordinary corporate activity is liable to give rise to an "employment-cessation event", thereby triggering a section 75 debt. Indeed, the threat of such a debt has sometimes brought otherwise desirable corporate activity to a grinding halt almost before it has begun. The pension industry developed some practical workarounds to enable the debt to be avoided in certain circumstances. But regulatory clearance was not always forthcoming, was subject to unacceptable conditions, and there was always the threat of contribution notices and financial support directions if things went wrong. So many corporate transactions were still halted for no other reason



than that the parties were unable to resolve the difficulties arising from the triggering of the employer debt.

Some of these difficulties were sought to be removed in 2008 by the introduction of scheme apportionment arrangements, withdrawal arrangements, approved withdrawal arrangements and grace periods. But the problem persists that a regime which was designed to protect members' pensions has had the consequence of undermining desirable corporate activity; a problem which has been exacerbated by the regulator's tendency to use its powers to control what it considers to be undesirable corporate activity (or so it must sometimes seem to beleaguered employers).

The 2009 consultation can also be seen as part of a continuing effort by the government to try to strike the right balance between the twin aims of ensuring member protection while not inhibiting corporate activity. The argument that such aims can be better achieved by less, rather than more, regulation has been well and truly lost. As a result, we can look forward to more regulations (and more fine-tuning of existing regulations), of which the proposed Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2010 are the most recent, although they are unlikely to be the last.

The draft 2010 regulations provide for "general easements" and "de minimis easements", in what appears to be another example in this area of regulation of legal terms being given a wholly new, and private, meaning. The "general easements" refer to eight steps, all of which must be taken in order avoid a corporate restructuring being

treated as an "employment-cessation event". Thus the latest approach is not to provide ways of mitigating the debt (as in the past), but rather to provide ways of preventing the debt arising in the first place.

The eight steps (in somewhat simplified form) comprise the following:

- Step one:** the exiting employer must write to the trustees;
- Step two:** the trustees must consult the exiting and receiving employer;
- Step three:** the trustees must decide whether the receiving employer will be at least as likely as the exiting employer to meet the liabilities of the exiting and the receiving employer after the receiving employer has taken over responsibility for the exiting employer's liabilities;
- Step four:** the trustees must send their decision to the exiting employer;
- Step five:** the exiting and receiving employers must "decide whether they are satisfied" that they aren't insolvent and won't become insolvent within 12 months;
- Step six:** the receiving employer and the exiting employer must tell the trustees whether they are so satisfied;
- Step seven:** the receiving employer then takes over responsibility for the exiting employer's liabilities;
- Step eight:** the receiving employer and the exiting employer must then tell the trustees that step seven has been carried out.

In what may prove to be a sting in the tail, (i.e. inhibiting the very restructuring the regulations are said to want to encourage), the debt can still be triggered if, in the words of the consultation document, "decisions made by the receiving and existing employers about the likelihood of insolvency were unrealistically optimistic".

That this reserve power is contained in a regulation which glorifies in the designation "6ZA(3)", and the fact that it exists at all, speaks eloquently to the complexity, and uncertainty, which will continue to exist in this area of the law.

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