

UK Pensions Briefing: Pension Schemes and the Corporate Insolvency and Governance Act 2020

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Background to the Corporate Insolvency and Governance Act 2020

The Corporate Insolvency and Governance Act 2020 (the Act) made lightning quick progress through the Parliamentary process – it was introduced as a Bill in the House of Commons on May 20, 2020, and obtained Royal Assent on June 25, 2020. It contains a number of permanent changes to insolvency and restructuring law and some temporary changes to seek to rescue businesses in the COVID-19 crisis. The permanent changes took effect from June 26, 2020. Most of the temporary measures introduced by the Act are retrospective in the sense that they are effective from dates in either March or April 2020 which dovetail with the dates that the Government announced the proposed changes in the law. The Guidance Notes published by the Government on the new legislation stresses the objective, which is to save as many companies as possible in the aftermath of the COVID-19 crisis. This is the new insolvency legislation to support the significant cash loans, tax and rates deferrals and the Job Retention Scheme introduced to alleviate the financial impact of the lock down on companies in England and Wales.

During the Parliamentary process, the Government was lobbied by a number of pensions industry groups who highlighted significant concerns that the effect of the legislation on the position of defined benefit pension scheme trustees and the Pension Protection Fund (PPF) needed to be considered as regards the new permanent measures being introduced in the Act, otherwise their position would likely be weakened. A number of amendments were then made to the draft legislation in the House of Lords before the Act was passed. Shortly after the Act received Royal Assent, regulations were also passed which provide additional voting powers to the PPF in relation to these new measures. However, questions remain over the potential short and long-term impact of some of the Act's provisions on the position of defined benefit pension schemes whose sponsoring employer is experiencing difficulties, in particular as regards the treatment of the pension scheme as a creditor in the new Restructuring Plan which we comment on below.

In its final form, the Act includes a number of measures aimed at providing flexibility and breathing space to businesses to continue trading during the period of economic uncertainty arising from the COVID-19 pandemic to promote rescue. It includes some of the most radical changes in insolvency law in over 20 years which will change the way restructurings are dealt with in the future, both for English and Welsh companies and foreign companies who have sufficient connection to the English jurisdiction to use the procedures. It is therefore imperative that trustees of defined benefit schemes, who will in most instances be unsecured creditors in insolvency, understand how their scheme will be impacted by these new measures.

This briefing covers the key provisions of the Act which will affect defined benefit pension schemes and we run through some key questions which trustees are likely to have in relation to the consequences of these provisions for their schemes.

Which of the Act's measures are most relevant to pension schemes?

The key measures which are relevant for trustees are outlined below.

Company moratorium

The Act introduces a new standalone moratorium, where the directors will remain in control of the company under the supervision of a monitor (a licensed insolvency practitioner) whilst they seek to rescue the company. The moratorium will last for an initial period of 20 business days but may be extended without creditor consent for a further period of 20 business days. Further extensions for a period of up to a year or more are possible with creditor consent or with court approval. The trustees as creditors of the company would be given notice of the moratorium and any extensions to it, or the termination of it. The Act provides that notice should also be given to the PPF of these events.

The trustees would be consulted as creditors regarding extensions of the moratorium for a period over 40 business days, and would be asked to consent to those extensions – for PPF eligible schemes regulations passed under the Act mean that the PPF will be provided with these voting rights to the exclusion of the trustees, as discussed below. The directors of the sponsoring employer would therefore no doubt outline the plan for the proposed rescue of the company in order to explain the need for an extension to the moratorium period. The trustees would also be able to ask the monitor for their views on the progress of the rescue and the need for an extension.

The intention is that the sponsoring employer will restructure in the moratorium period or use the time to refinance or prepare a proposal for a Company Voluntary Arrangement (CVA) or Restructuring Plan to rescue the company. The focus in the moratorium is on the rescue of the company and not of the business of the company.

Extension of the prohibition on the use of *ipso facto* termination clauses of contracts for the supply of goods and services by reason of insolvency

Prior to the Act, these provisions applied to essential supplies of utilities and IT related supplies. The Act extends this to cover all contracts for the supply of goods and services other than the contracts excluded from the operation of the section, or if the court

considers that the continued supply would cause the supplier hardship. The exclusions are categories of supplier e.g. insurers and banks and categories of excluded contracts, mainly relating to financial services. The provisions should enable more businesses to restructure or survive as going concerns where they rely on contracts for the supply of goods and services to continue to trade, such as outsourcing contracts. This will also hopefully lead to struggling companies that are insolvent or likely to become insolvent and in financial difficulties, to be able to continue to trade so that they are in a position to progress a rescue plan as an alternative to the closure and liquidation of the business.

Restructuring Plan

Currently there are two procedures under English law for compromise with creditors; the CVA (which cannot compromise the claims of secured creditors), and the scheme of arrangement under Part 26 of the Companies Act 2006 (Arrangement Scheme). In an Arrangement Scheme the company looks to compromise different classes of creditors and members with each class having similar rights. Each class votes on the Arrangement Scheme and the approval of 75% in value and a majority by number is required. The court then decides whether to sanction the Arrangement Scheme.

The Act includes a new restructuring process as Part 26A of the Companies Act 2006 which will enable directors to propose a Restructuring Plan to compromise the claims of creditors and/or members. A key feature of the new provisions is the new "cross-class cram down" feature, which is not possible in an Arrangement Scheme. This allows the court to sanction the approval of a compromise or arrangement, where dissenting classes of creditors or members are also bound, on certain conditions. The trustees will be included in a class of creditors asked to consider the proposed Restructuring Plan, and will need to review the proposals and consider the fairness of the proposals in the context of the proposals to other classes of creditors and shareholders. However, as discussed below, for PPF eligible schemes regulations passed under the Act mean that the PPF will be provided with the voting rights of the trustees on the Restructuring Plan to the exclusion of the trustees.

Temporary measures: Prohibition on the service of statutory demands or the issue of Winding-up petitions or the making of Winding up orders until October 1, 2020, and the "suspension" of wrongful trading in that period

These provisions will have a draconian effect on the ability of landlords and suppliers to put pressure on tenants and counterparties to pay outstanding rent and invoices, or indeed trustees to press for payment of unpaid contributions. This is a very "debtor friendly" provision which is intended to give a

number of companies breathing space to start to make profits after lockdown without the fear of facing a winding up petition. However for all creditors of companies, including trustees of a defined benefit pension scheme, this represents a challenge as it removes any pressure on their counterparty to pay until October 2020.

What are the potential positives of these measures for scheme trustees?

The provisions are designed to promote the rescue of companies and businesses and ensure that viable businesses are able to survive the effects of the coronavirus pandemic and beyond. If a viable sponsoring employer is able to remain in business, the members of your scheme are likely to benefit from the survival of the sponsoring employer in the long-term.

What are the risks?

As the Act is designed to provide protection and support to struggling businesses, the downside for trustees of defined benefit pension schemes is that as unsecured creditors you will find your negotiating position weakened and the options for taking action against your scheme's sponsoring employer when it is in distress more limited.

The key risk which trustees should watch out for is that the position of the sponsoring employer deteriorates further during the moratorium period, and during that period you will have limited options for recourse against the sponsoring employer in order to protect the interests of your scheme members. In order to ensure that the risk is limited as far as possible you should engage with the directors and the monitor to discuss the proposed rescue of the company and ensure that the interests of the pension scheme are considered in the rescue plans. You may need to seek advice on the effect of the proposed rescue on the pension scheme, and negotiate improved terms if possible.

Will our defined benefit scheme receive any contributions during the moratorium?

The moratorium provides for a stay on any debts due at the date of the moratorium commencing. These debts are called pre-moratorium debts with a payment holiday provided. These would include arrears of contributions.

However, during the moratorium various categories of pre-

moratorium debts without a payment holiday in the moratorium for amounts that fall due during the moratorium are payable. These categories include *'wages or salary arising under a contract of employment'*, and this is expressed as including occupational pension scheme contributions.

However, there are a number of questions about whether or not this covers the employer (as opposed to employee) contributions, and whether that extends to those in respect of auto-enrolment. It is even less clear whether it is broad enough to cover deficit recovery contributions (DRCs) and scheme expenses – the emerging consensus seems to be that these will not be covered and that employers will get payment holidays from DRCs during any moratorium period. The definition in the Act also does not cover contributions to group personal pension plans.

The guidance from the Insolvency Service on the Act suggests that liabilities such as contribution notices and financial support directions under the Pensions Act 2004 should be considered to be pre-moratorium debts with a payment holiday even if the request to pay arises after the moratorium. So they will not be paid during the moratorium.

Trustees may therefore wish to consider whether the potential consequences of the moratorium affects the view of any request which you may have received from your sponsoring employer to defer DRCs. When considering any requests for back-end loading of contributions under recovery plans you should also consider how this might be impacted by any potential moratorium.

Can we issue a winding-up petition during a moratorium period?

Although often a remedy of last resort the threat of issuing a winding-up petition will not be an option open to trustees if a moratorium is in place where creditors of the company are not allowed to issue insolvency proceedings against the company. Creditors are also not able to enforce security during the moratorium other than certain specific share charges.

Separately, to the moratorium procedure, the effect of the Act's temporary measures is also that no winding up petition can be presented against any debtor company at the current time, unless the petitioning creditor can certify that the company has not suffered a financial effect as a result of coronavirus. This prohibition will remain in force until October 1, 2020, and that time period can be extended. The company can grant security as that is not prohibited.

You should check that any security which you have been promised by the sponsoring employer is granted and

perfected now before the company considers entering into a moratorium or any other insolvency or restructuring procedure. Your scheme may have security to support your sponsoring employer's covenant. You should carefully review any events which trigger the ability to enforce this security as it is unlikely that the triggers will cover a moratorium or Restructuring Plan as these are new procedures, so you may need to look to amend the provisions of those documents.

You should also be mindful that your security will not be enforceable in the moratorium without the permission of the court, which is unlikely to be granted.

During the moratorium the sponsoring employer must not grant any further security over its property unless the monitor consents and that the security is granted to support the rescue of the company.

What is the status of Contribution Notices and Financial Support Directions in favour of our Scheme?

As indicated above, the Act defines *'pre-moratorium debt'* as *'any debt or other liability to which the company becomes subject before the moratorium comes into force'*, or *'any debt or other liability to which the company has become or may become subject during the moratorium by reason of any obligation incurred before the moratorium comes into force'*.

This definition alongside the explanatory notes which accompanied the Act's passage through Parliament suggests that Financial Support Directions and Contribution Notices would be regarded as pre-moratorium debts with a payment holiday during the moratorium even if the request to pay them arises after the start of the moratorium.

Contribution Notices and Financial Support Directions will not be able to be enforced during the moratorium and the sponsoring employer will receive a payment holiday from making any such payments during the period of the moratorium.

Will we be behind financial institutions such as bank lenders in the priority order of payments in a subsequent insolvency if the rescue fails?

There was much discussion following the publication of the draft legislation on whether lenders would be able to use contractual rights to accelerate debt during the moratorium period. This would be likely to lead to the termination of the

moratorium by the monitor as the company would be unable to pay the accelerated debt which would then fall due. Any unpaid amounts would then acquire super priority in a subsequent insolvency or restructuring procedure.

The relevant provisions were debated at length in the House of Lords and some amendments made. As a result it is now clear that lenders can accelerate debt in the moratorium if they have the contractual right to do so, but the drafting of the relevant provisions in the Act means that *'relevant accelerated debt'* will not be a *'priority pre-moratorium debt'* for the purposes of super priority in a subsequent insolvency or restructuring procedure. The changes do not resolve all of the potential issues with the operation of this section. For example, amounts falling due under a revolving credit facility in the period do not fall due by reason of acceleration, so those amounts arguably do qualify as *'priority pre-moratorium debts'*. It is important to note also that as currently drafted these provisions include loans from connected parties such as intercompany debt and director's loans. It is expected that these provisions will require amendment if the procedure is to work as intended to support the rescue of businesses in the moratorium.

The amendments reduce the concerns that unsecured lending resulting from the acceleration of a loan will be given super-priority status over unsecured liabilities such as defined benefit pension schemes, but there are still problems with the drafting of the provisions as they potentially allow a revolving credit facility to fall due in the moratorium period and then attract super priority in the subsequent insolvency as it would not be *'relevant accelerated debt'*.

In practice the company is likely to need to agree a standstill with its lenders and a contractual variation of the loan documentation to provide that no amounts fall due to lenders during the moratorium that the company will be unable to pay, and seek the support of the lenders (including the debt lent by connected parties such as intercompany debt and directors' loans) to the use of the moratorium and to the rescue proposed.

What if the company enters administration after the moratorium?

If the company enters administration within 12 weeks of the moratorium ending, any moratorium debts and certain pre-moratorium debts will be priority pre-moratorium debts, payable by the subsequent office holder prior to the payment of the expenses and remuneration of the subsequent office holder. The priority pre-moratorium debts include *'wages or salary arising under a contract of employment so far as relating to a*

period of employment before or during the moratorium'. This also includes *'a contribution to an occupational pension scheme'*, as described above.

Priority pre-moratorium debts do not cover any other amounts which may be owed to the pension scheme such as DRCs or expenses which will be unsecured claims in the subsequent insolvency, save to the extent that security has been granted in favour of the trustees and the scheme.

How would a Restructuring Plan affect the pension scheme?

The key element of the restructuring procedure for trustees to be aware of is the "cross-class cram down procedure." Essentially, this procedure allows the court to sanction a proposed Restructuring Plan (which will be binding on all creditors) in the face of dissent by one or more parties, on certain conditions. They are that the dissenting creditors are no worse off in the Restructuring Plan than they would be in a *'relevant alternative'* (which is likely to be liquidation). The second condition is that one or more classes of creditors who have an economic interest in the relevant alternative (for example, they will receive a payment), have approved the Restructuring Plan.

The debt due to the pension scheme could therefore be crammed down under this process, but if the Restructuring Plan was approved this would result in the survival of the sponsoring employer as a going concern which should be a positive outcome for the scheme.

It would be important for the trustees to engage with the sponsoring employer on the treatment of the pension scheme in the Restructuring Plan, to ensure that it is treated fairly.

The Act also provides that regulations can be introduced to deal with the treatment of pension scheme creditors.

Who votes on the Restructuring Plan – the trustees or the PPF?

The Pension Protection Fund (Moratorium and Arrangements and Reconstructions for Companies in Financial Difficulty) Regulations 2020 made under the Act and which came into force on July 7, 2020 allow the PPF to exercise the voting rights of the trustees in relation to both a Restructuring Plan and a moratorium. Where a Restructuring Plan is proposed in respect of a sponsoring employer of a

PPF eligible scheme and the trustees are a creditor to whom the Restructuring Plan is proposed, the PPF may exercise any rights exercisable by the trustees as a creditor under the new Part 26A of the Companies Act 2006 in addition to the exercise of those rights by the trustees. Under the Regulations, the right to vote on the Restructuring Plan will be exercised by the PPF to the exclusion of the trustees. The PPF must however consult with the trustees before exercising such voting rights. The PPF is therefore likely to want to be involved in the discussions with the sponsoring employer about the treatment of the pension scheme as a creditor in the Restructuring Plan and to hold discussions with you at an early stage.

Would a PPF assessment period be triggered as a result of a moratorium or Restructuring Plan?

Neither of the new measures would be an 'insolvency event' for the purposes of the pensions legislation, and thus would not trigger a section 75 employer debt, or a PPF assessment period.

However, trustees should separately consider whether these events would fall within the drafting for triggering any security arrangements with your sponsoring employer or for triggering or having the potential to trigger the winding-up of the scheme under your scheme rules.

Has the PPF/TPR been provided with any role or powers?

Following the amendments in the House of Lords, the Act does provide the Pensions Regulator and the PPF with the right to receive the same information and notifications which are provided to the trustees and other creditors in circumstances where the scheme is an eligible scheme for PPF purposes.

The PPF will also have the same rights as the trustees and other creditors to challenge the monitor who is appointed and the same rights to challenge the directors of the sponsoring employer. Both the PPF and the Pensions Regulator are also entitled to make representations at any court hearings.

As set out above, the Pension Protection Fund (Moratorium and Arrangements and Reconstructions for Companies in Financial Difficulty) Regulations 2020 made under the Act and which came into force on July 7, 2020 gives the PPF the powers held by the trustees in any Restructuring Plan situation. Additionally, under these Regulations, if a moratorium comes into force in relation to the sponsoring employer of a PPF eligible

scheme, the rights which are exercisable by the trustees of the scheme as a creditor of the company to vote on extending the moratorium and to apply for a court order challenging the actions of the directors, are instead to be exercised by the PPF to the exclusion of the trustees. The PPF must though consult the trustees before exercising these rights and you should expect close discussions with the PPF from an early stage.

How does the new insolvency regime interact with the Pension Schemes Bill?

Many of the provisions in the Act appear to be in direct conflict with some of those in the Pension Schemes Bill, which is due to enter its report stage in the House of Lords on June 30, 2020. The Pension Schemes Bill seeks to enhance the Pensions Regulator's powers and ensure greater protection for pension schemes. As things stand, the new criminal offences introduced under the Pension Schemes Bill – such as the offence of avoidance of employer debt and the offence of conduct risking accrued scheme benefits - do not sit well with the new insolvency protection provisions outlined above. It remains to be seen if further amendments may be tabled in relation to the Bill's new criminal sanctions.

It therefore remains a case of watch this space to see whether the interaction between the new insolvency regime and the strengthening of the Pensions Regulator's powers and oversight is clarified as the Pension Schemes Bill progresses through Parliament.

What should trustees do now?

As well as bearing the above potential consequences in mind when negotiating future recovery plans and when considering any requests by your sponsoring employer to suspend deficit recovery contributions, you should also ensure that you remain in close contact with your sponsoring employer in order to understand their ongoing financial position. This will allow you to be in the best position to receive early information about any potential moratorium or Restructuring Plan.

Additionally, trustees should keep an eye on the outcome of any insolvencies or restructuring processes which make use of these procedures and the impacts on the position of the pension scheme.

We will also keep you informed of relevant developments.

If you require any further information or assistance with any of the above, your Norton Rose Fulbright pensions adviser is always happy to help.

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