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Chambers

Notifiable events:

"What are the practical and legal implications of the new notifiable events triggers and "declarations of intent", and which corporate activities will likely be caught?"

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Introduction; and caveats & disclaimers

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- Errr … where are the Regulations ?
- ‘Chatham House Rules’ apply
- Any views expressed are mine alone …
- Nothing I say should be treated as reflecting views of tPR

Agenda

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- The stated purpose of the notifiable events regime changes re: employers
- Which corporate activities will probably be caught
- The draft Regulations, their flaws and the legal implications of those flaws
- The likely practical implications of the notifiable events regime changes
- Questions/discussion

Purpose: origins …

- March 2018 White Paper: "*Protecting Defined Benefit Pension Schemes*"
- June 2018 Consultation: "*Protecting Defined Benefit Pension Schemes – A Stronger Pensions Regulator*" (proposing "*Declarations of Intent*")
- February 2019 Consultation Response
- PSA21 s.109 inserted s.69A PA04 (not yet in force)
  - s.69A requires notice re: prescribed notifiable events with an "*accompanying statement*" explaining any adverse effects on the scheme, steps taken to mitigate those effects and communications with the trustees.

Purpose: so that tPR

- "*is better sighted on relevant business transactions and events which may have a detrimental impact on the pension scheme, thus giving* [tPR] *an earlier warning of potential problems, and should incentivise better employer behaviours by creating greater transparency around the outcomes of transactions.*"
- "*can be more proactive and get involved earlier when employers make changes which could impact the pension scheme*"

[source: June 2018 consultation]

Purpose: how to achieve it?

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A two-stage notification process.

s.69(2)(b):

- bringing forward the timing of the trigger for relinquishing control of an employer to when a "*decision in principle*" to do so or "*an offer to acquire control*" is made.
- Adding two new triggers:
  - a "*decision in principle*" by an employer to sell or transfer a material proportion of its business or assets; and
  - a "*decision in principle*" by an employer to grant or extend relevant security giving a creditor priority above the scheme in the order of priority for debt recovery.

69A: requiring a further notice & accompanying statement "*where the main terms have been proposed*" for relinquishing control, selling a material proportion of its business/assets or granting/ extending such security.

Which corporate activities will be caught?

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Speaking generally [absent the final form of the Regulations] … Except where tPR otherwise directs (*viz.* full s.179 funding and no material failure to pay a scheduled contribution in the last year):

- a controlling company deciding to relinquish control of an employer or receiving an offer to acquire control of an employer;
- an employer deciding to sell or otherwise transfer ownership of a material proportion of its business or assets; and
- an employer granting or extending security over a material proportion of its assets or those of subsidiaries giving a creditor priority above the scheme.

➢ But the devil will be in the detail …

Draft Regulations: context

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- Most of the triggers re: an employer under the existing notifiable events regime are a "*decision*" or similarly clear-cut event; e.g. "*a **decision** by a controlling company to relinquish control of the employer company*"
- It is critically important that the triggers constituting notifiable events are clear-cut, because a failure to notify:
  - exposes the employer or its officers individually to a financial penalty under s.88A;
  - is a potentially relevant factor under s.38(7)(d) informing whether it is reasonable to impose a Contribution Notice; and
  - may trigger a duty under s.70 (including on professional advisers) to report breaches of the law.

Draft Regulations: summary

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- See the APL L&P sub-committee response.
- Use of PA04's defined term 'employer' (without extension) made the regime inapplicable to frozen schemes.
- A number of typos / formatting errors.
- Apparent anomalies in delivery of policy
- Onerous in their application to multi-employer schemes
- Critically, very significant uncertainty as when triggers occur …

Draft Regs: s.69 {stage one} – relinquishing control

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- **Brought forward**: "*(i)* ***a decision in principle*** *by a controlling company to relinquish control of the employer company, or (ii) an offer to acquire control of the employer company where the {employer} controlling company has not made a decision in principle*"
- "*decision in principle*" defined as "*a decision* ***prior to any negotiations*** *or agreements* ***being entered into with another party***"
- Assumes a decision is made to embark on a transaction before negotiating its terms: but that is commonly not the order of events.
- Businesses often first explore what might be negotiated; and there is no "*decision*" to relinquish control until after terms have largely been negotiated. What commonly happens at the earlier stage is a decision simply to explore the potential for a transaction.
- Interpreted literally, the trigger "*decision*" would often be only a few days before transaction completes; cf. the policy intention.

Draft Regs: s.69 {stage one} – relinquishing control (cont.)

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- "… ***or*** *(ii)* ***an offer*** *to acquire control of the employer company where the {employer} controlling company has not made a decision in principle to relinquish such control*"
  - typo: the grey highlighted word "*employer*" should be "*controlling*".
- What constitutes 'an offer' ?
  - Something capable of acceptance to form a binding contract ? = late in the process cf. the apparent policy intention ?
  - If earlier in the process, drafting needs to define the degree of detail & formality which triggers an obligation to notify ?
- In either case, this alternative trigger would require notification to tPR no matter how unlikely it is that the 'offer' would actually be accepted: even a derisory and unsolicited offer would trigger the notification obligation.

Draft Regs: s.69 {stage one} – relinquishing control (cont.)

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- ? A lacuna re: on whom the notification obligation is imposed ?
- s.69(3)(b) provides that the 'appropriate person' who must notify is (i) the employer; and (ii) "*a person of a prescribed description*".
- The 2005 regulations did not prescribe the 'controlling company' as an 'appropriate person' (in addition to the employer).
- In contrast, for the second stage notification, s.69A provided that the 'appropriate person' is not only the employer, but also a person connected or associated with the employer – thereby including the controlling company.
- There thus seems to be a lacuna (and mismatch relative to s.69A) as to who has the notification obligation re: a controlling company relinquishing control.

Draft Regs: s.69 {stage one} – sale of business or assets

- **New:** "*a decision in principle by the employer to sell a material proportion of its business or assets*"
- Same problem that often (contrary to the definition) no "*decision in principle*" is made "*prior to any negotiations … being entered into with another party*".
- " *'Sale' includes the transfer of legal or beneficial ownership*"
- material proportion of the employer's business = one that produces 25% of annual revenue (on its own or cumulatively with other such sales within prior 12 months) as recorded in most recent annual accounts;
- material proportion of the employer's assets = 25% of gross value of assets (on its own or cumulatively with other such sales within prior 12 months) as recorded in most recent annual accounts.

Draft Regs: s.69 {stage one} – sale of business or assets (cont.)

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- NB "*assets*" of an employer "*do not include money*": unclear why …
- And need to cater for wholesalers or retailers of perishable goods (e.g. many foods) who in a 12-month period may turn over more than 25% of their total asset value in sales of stock
- ? a need to provide different definitions of employer assets in the context of 'sales' of employer assets, as opposed to grants of 'relevant security' over employer assets.
- Further or alternatively, ? make asset 'sales' only notifiable when part of the sale of the employer's business, since if an asset is merely converted to cash (at market value), the aggregate pool of assets available to the scheme is not reduced in absolute terms …

Draft Regs: s.69 {stage one} – 'relevant security'

- **New:** "*a decision in principle by the employer to grant or extend a relevant security over its assets, where the grant or extension would result in the secured creditor being ranked above the scheme in the order of priority for debt recovery*".
- Same problem that often (cf. definition) no "*decision in principle*" is made "*prior to any negotiations … being entered into …*"
- 'relevant security' is one granted or extended by the employer or its subsidiaries, seemingly over more than 25% of the employer's consolidated revenue or gross assets …
  - although the formatting went awry, so that (as drafted) this materiality threshold wouldn't apply to security granted by the employer itself.
- Includes fixed and floating charges.
- Excludes "*refinancing of an existing debt, except where this entails the granting of* [fixed/floating charges]", security for specific chattels or financing for company vehicles.

Draft Regs: s.69 {stage one} – security: what's included?

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Seems inconsistent with legal principle to require notification about security over assets of subsidiaries, since obligations of both secured and unsecured creditors of the subsidiary will have priority over any obligation of the parent employer to the scheme.

- The scheme will be structurally subordinated, as a creditor only of the employer, and thus only entitled to share indirectly in any value re: the subsidiary.
- And a grant of security over the subsidiary would not "*result in the secured creditor being ranked above the scheme*" in priority, because the scheme would not rank directly against the subsidiary at all.

Draft Regs: s.69 {stage one} – security: what's excluded?

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Unclear:

- why the "*assets*" of an employer "*do not include money*";
- how exclusion of "*refinancing of existing debt*" operates:
  - exception "*where this entails the granting of* [fixed or floating charges]", which most refinancing will do in practice (even if replicating existing security in all material respects).
  - where "*refinancing of an existing debt*" is so excluded, does that reset a new floor from which the 25% materiality threshold is measured or not ? E.g. if existing debt is 25% of employer's consolidated revenue/gross assets, but refinancing is for 26% ?
- rationale for and extent of exclusion of "*security for specific chattels*" ? e.g. oil rig ?
- rationale for and extent of exclusion of "*financing for company vehicles*" ? e.g. all rolling stock of a train company, entire fleet of an airline or haulier, or all cars of a rental company like Hertz or Avis ?

Draft Regs: s.69A {stage two} – "*main terms have been proposed*"

The second stage obligations under s.69A are triggered by:

- "*(i) the intended relinquishing of control by a controlling company of the employer company*, ***in respect of which the main terms have been proposed***, *or (ii) where the controlling company relinquishes such control without a decision to do so having been taken, the relinquishment of control of the employer company by the controlling company*";
- "*the intended sale by the employer of a material proportion of its business or assets*, ***in respect of which the main terms have been proposed***"; and
- "*the intended granting or extending of a relevant security by the employer over its assets* [in priority ahead of the scheme] ***in respect of which the main terms have been proposed***".

Draft Regs: s.69A {stage two} – "*main terms have been proposed*"

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Yet:

- There would often be scope for dispute about what are "*the main terms*" and thus about when they had all been proposed, so as to trigger the notice & accompanying statement obligations under s.69A.
- Moreover, "*main terms*" might be proposed at an early stage for a transaction which has only a low chance of proceeding.
- Further, this leaves it unclear by whom the "*main terms*" have to have been proposed in order to trigger obligations under s.69A

Practical implications:

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- The practical implications can only be assessed in the light of the final form of the Regulations (and any directions and guidance issued by tPR).
- However, it seems highly likely that:
  - by notice under s.69, employers will have to notify tPR of these 3 forms of corporate activity at a much earlier stage; and
  - by accompanying statement under s.69A, employers and those connected or associated with employers will have to set out their 'case' as to whether such intended future transactions have adverse effects on the scheme and what (if any) mitigation is appropriate.
- In effect, the accompanying statement appears calculated to make employers and those connected or associated with employers start negotiating with tPR and the Trustee in advance of such transactions.

Practical implications (cont.)

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- There will probably be a material extra cost in time and money (and professional advice) in undertaking such transactions.
- The more uncertain questions are:
  - whether employers will make more clearance applications; and
  - what tPR will actually do in practice with all of these notices and accompanying statements: will tPR actually have the resource to engage proactively in advance with many more transactions than it already does ?