December 2005

FINANCIAL MARKETS LAW COMMITTEE

ISSUE 104 – PENSIONS ACT: ASSOCIATED AND CONNECTED PERSONS

Insolvency Practitioners – Receivers and the Pensions Act 2004

c/o Bank of England
Threadneedle Street
London EC2R 8AH
www.fmlc.org

FINANCIAL MARKETS LAW COMMITTEE

ISSUE 104 WORKING GROUP

Adrian Cohen – Clifford Chance

Ian Gault – Herbert Smith

Kate Gibbons – Clifford Chance

Louise Hourigan – Barclays Capital

Chris Mullen – Pinsent Masons

Deborah Neale – Clifford Chance

Mark Sterling – Allen & Overy

Mike Wollard – SJ Berwin

Joanna Perkins – FMLC Secretary

Stephen Parker – FMLC Legal Assistant

Insolvency Practitioners – Receivers and the Pensions Act 2004

Introduction

1. The role of the Financial Markets Law Committee ("FMLC") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

2. In the course of 2005, the FMLC raised a number of legal certainty issues arising out of the moral hazard provisions of the Pensions Act 2004 with the Pensions Regulator. Several of the issues raised by the FMLC were addressed in the responses from the Pensions Regulator. However, some issues remained outstanding and it became clear that they would need to be resolved, if at all, by legislation. This purpose of this paper is to examine one such issue and to address the possibility of a solution.

3. The particular issue under consideration is whether receivers should be included in the definition of "insolvency practitioner" for the purposes of the Pensions Act 2004 and why this would be of benefit to, and promote certainty in, the wholesale financial markets.

Background

4. The moral hazard provisions of the Pensions Act 2004[1] came into force on 6 April 2005. The stated aim of the moral hazard provisions is to mitigate against the risk of employers deliberately shifting the responsibility for the deficits in their pension schemes onto the newly formed Pension Protection Fund.

5. In particular, section 38 of the Pensions Act 2004 empowers the Pensions Regulator to require any person (which includes an individual) who is "connected" with or an "associate"[2] of the sponsoring employer of a defined benefit pension scheme which is in deficit to make a contribution equal to the whole or a specified part of the shortfall sum if:

   (a) the person was a party to an act or failure to act which took place after 27 April 2004 (being the date the moral hazard provisions were first published) and ultimately within a six year period and which had as a main purpose the avoidance of pension liabilities; and

   (b) it would be reasonable to impose liability on that person. In deciding whether it is reasonable to impose liability, the Pensions Regulator is required to consider various matters, including the degree of involvement

---

1 Sections 38-51

2 These terms are defined by sections 435 and 249 of the Insolvency Act 1986.

> of the person in the act or failure to act, whether the person had 'control' of the employer and the purpose of the act or failure to act.

6. The FMLC has raised a number of issues arising out of the moral hazard provisions of the Pensions Act 2004 with the Pensions Regulator. The first of these concerned whether a lender who took security over shares in a company was subject to those moral hazard provisions. Such a lender would normally have a right under the security instrument to exercise voting rights in relation to the shares on an event of default in relation to the loan. The FMLC sought clarification from the Pensions Regulator as to whether it considered that the lender could be subject to a contribution notice or financial support direction in the following situations:

   (a) where an event of default has not occurred and so no right to vote the shares has accrued, but a contingent right to exercise voting rights exists under the terms of the security instrument; or

   (b) where the right to vote the shares had accrued following a default, but no control over the shares or direction to vote had been exercised by the lender.

7. The Pensions Regulator provided clarification on this issue. The correspondence has been published on the FMLC's website at www.fmlc.org.

8. The second issue the FMLC raised with the Pensions Regulator related to whether receivers should be included in the definition of insolvency practitioner for the purposes of the Pensions Act 2004. Insolvency practitioners are not subject to the moral hazard provisions of the Pensions Act 2004 if they act in accordance with their functions as an insolvency practitioner. The FMLC has been given to understand the Pensions Regulator regards this as an issue that would be better raised with the Insolvency Service.

The position of insolvency practitioners

9. In the context of insolvency practitioners, section 38(3)(c) of the Pensions Act 2004 provides that the Pensions Regulator may issue a contribution notice to a person only if,

> the Regulator is of the opinion that the person in being a party to the act or failure, was not acting in accordance with his functions as an insolvency practitioner in relation to another person …

For the purposes of section 38 of the Pensions Act 2004, insolvency practitioner is defined as a person acting as an insolvency practitioner in accordance with section 388 of the Insolvency Act 1986 or within the meaning of section 121(9)(b) of the Pensions Act 2004.

10. Section 388 of the Insolvency Act 1986 provides that a person acts as an insolvency practitioner in relation to a company by acting as its liquidator, provisional liquidator, administrator, administrative receiver or in relation to a scheme of arrangement, a nominee or supervisor. In addition, section 121(9)(b) of the Pensions Act 2004 provides that an insolvency practitioner, in relation to a person, means in such circumstances as may be prescribed, a person of a prescribed description.[3]

11. It is clear from the Report for Grand Committee dated October 2004 entitled "Consultation on the Moral Hazard Clauses in the Pensions Bill" that the inclusion of a statutory exemption from the contribution notice regime for insolvency practitioners came about as a result of the consultation process and is an acknowledgement that it would not be fair and reasonable to impose liability for pension scheme deficits on insolvency practitioners to the extent they are acting in accordance with their functions.

The current position in relation to receivers

12. It is not evident from either the consultation documentation referred to in paragraph 11 above or from Hansard as to how the definition of "insolvency practitioner" was arrived at in the context of the Pensions Act 2004.

13. It is, however, clear from the definition of "insolvency practitioners" that a receiver, other than an administrative receiver, would not be able to benefit from the statutory exemption for insolvency practitioners contained in section 38(3)(c) of the Pensions Act 2004. This is the case even if such receiver is an insolvency practitioner regulated by the Insolvency Service.

14. Receivers who would not therefore benefit from the exception include receivers appointed to fixed charges only (so called "LPA Receivers") and receivers or managers appointed to companies not incorporated under the Companies Act 1985 or under former Companies Acts, e.g. foreign incorporated companies and statutory companies.[4]

15. In the context of the Pensions Act 2004, it is unclear why receivers are treated differently from administrative receivers, liquidators, provisional liquidators and administrators. We are not aware of any reason why receivers should be treated

---

[3] Prescribed by the Secretary of State by way of regulation (section 318).

[4] Section 251 of the Insolvency Act 1986 requires the term "company" to be construed in accordance with Section 735 of the Companies Act 1985 which defines a company as a "company" formed and registered under the Companies Act 1985, or an existing company (i.e. a company registered under former Companies Acts). This definition is stated to apply "unless the contrary intention appears". Although the first instance case of *Re International Bulk Commodities Ltd* [1992] BCC 463 held that administrative receivership of a foreign company was possible, the reasoning in this case has been criticised in the case of *Devon & Somerset Farmers Ltd* [1994] Ch. 57. Indeed, the widely held view is that *Re International Bulk Commodities Ltd* was wrongly decided.

differently, given their function. Receivers fulfil the same function as administrative receivers and are appointed in the same way. This distinction has potential negative consequences for insolvency practitioners and for secured financing arrangements generally.

The impact of receivers not being included in the definition of insolvency practitioner

16. The potential negative consequences can be demonstrated by looking at the typical secured financing arrangement. When security is taken in the context of a financing arrangement, the security documentation will generally allow the beneficiaries of the security to appoint a receiver upon the occurrence of any breach of the underlying financing arrangements. A receiver appointed over the whole or substantially the whole of a company's property pursuant to a debenture containing a floating charge is an administrative receiver.[5] Any such administrative receiver would be entitled to the statutory exemption in the Pensions Act for insolvency practitioners referred to above if, as a result of the appointment, the administrative receiver becomes "connected" with or an "associate" of the employer company or any holding or intermediate holding company of the employer.

17. In all other cases, the receiver appointed pursuant to the security instrument will not be an "administrative receiver" and will instead be a receiver or a receiver and manager. Therefore, the receiver would not be able to benefit from the statutory exemption in the Pensions Act, even though such receiver could also find himself "connected" or "associated" with the employer company (or its holding company or intermediate holding company) through the powers conferred on him by the security instrument. This places receivers at risk of being made responsible for pension scheme shortfalls through the Contribution Notice regime.

18. A receiver could become "connected" through a security arrangement where the security instrument contains a fixed charge over more than one third of the shares of the employer company (or its holding company or intermediate holding company). On enforcement, the receiver would take on all the rights of a legal owner of the shares including, for example, the right to vote the shares at a general meeting. Similarly, a receiver appointed pursuant to a security agreement could become "connected" if, as a result of his actions he is deemed to be a "shadow director".[6] A receiver could also become an "associate" of the employer (or its holding company or intermediate holding company) in his capacity as officer/employee of any of those companies.[7] Once connected in this way, the

---

5 The ability to appoint an administrative receiver is of course dependent upon the transaction being one that falls within one of the exemptions in the Enterprise Act 2002.

6 Section 435(10)(a) Insolvency Act 1986

7 Section 435(4) Insolvency Act 1986

receiver is then exposed to the risk of being made responsible for pension scheme shortfalls.[8]

19. The risk that receivers may be caught by the provisions of the Pensions Act, when they are simply acting in accordance with their appointment under a security instrument, creates a disincentive for receivers to take appointments, unless they are adequately indemnified for possible pension scheme deficits. There appears to be no underlying reason for receivers (who are commonly regulated insolvency practitioners) to be put in this position. The situation created may seriously impede the ability of creditors to enforce security and therefore undermines the ability of a company to obtain finance.

Conclusion

20. As stated in paragraph 10 above, section 121(9)(b) of the Pensions Act 2004 empowers the secretary of state to prescribe by regulation other persons who may benefit from the exemption. The FMLC considers that there is a strong argument in favour of the Secretary of State exercising those powers to expand the category of insolvency practitioners to include receivers for the purposes of the Pensions Act 2004.

---

[8] These examples could become more acute where the receiver acts as principal, e.g. after the company to which he has been appointed has gone into liquidation, terminating his agency.

FINANCIAL MARKETS LAW COMMITTEE MEMBERS

Lord Browne-Wilkinson, Chairman

Bill Tudor John, Lehman Brothers

Peter Beales, LIBA

Dr Joanna Benjamin, London School of Economics & Political Science

Michael Brindle QC

Lachlan Burn, Linklaters

Keith Clark, Morgan Stanley International

Clifford Dammers, ICMA

Sally Dewar, Financial Services Authority

Mark Harding, Barclays

Therese Miller, Goldman Sachs International

Guy Morton, Freshfields Bruckhaus Deringer

Habib Motani, Clifford Chance

Ed Murray, Allen & Overy

Clive Maxwell, HM Treasury

Steve Smart, AIG

Sir Roger Toulson, Law Commission

Paul Tucker, Bank of England

Secretary: Joanna Perkins, Bank of England