Corporate Insolvency and Governance Act 2020 – the pensions implications

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Introduction

Expedited as a result of the COVID-19 pandemic, the Corporate Insolvency and Governance Act 2020 ("the Act") received Royal Assent on 25 June 2020. The Act is designed to provide businesses in financial difficulties with the flexibility and breathing space they need to continue trading and/or to explore a potential rescue or restructuring.

Key points

- The Act introduces two new options for companies in financial difficulties – a free-standing moratorium (similar to the one afforded employers in administration) and a restructuring plan. Both are intended to enable a corporate rescue (which could, ultimately, benefit a related DB scheme).
- Subject to certain conditions, an employer may be able to obtain a moratorium for up to a year, providing a payment holiday from certain debts. Although there are some payments companies are obliged to continue during a moratorium, in our view, these will not include deficit reduction contributions ("DRCs"), or payments in respect of section 75 debts.
- When a company is subject to a moratorium, trustees cannot (subject to limited exceptions) enforce any contingent assets it has granted to them, or serve it with a winding-up petition.
- Neither the moratorium, nor the proposal of a restructuring plan, is an "insolvency event" for the purposes of the Pensions Act 2004, meaning there is no trigger for a section 75 debt or a PPF assessment period.
- If proceedings for the winding-up of a company are begun, or it enters administration within 12 weeks of the end of the moratorium, certain debts are given super-priority. This could push floating charge holders and unsecured creditors, including a DB scheme, further down the priority list.
- Provided certain conditions are met, even dissenting classes of creditors or members may be bound by a restructuring plan (known as a "cross-class cram down").
- A temporary inability to serve statutory demands or winding-up petitions will decrease trustees' leverage with their sponsor in the short-term. This provision is due to expire on 30 September 2020.

Moratorium

To enter the new moratorium:

- the company must, in the opinion of its directors, be or be likely to become unable to pay its debts, and
- in the proposed "monitor's" view (an insolvency practitioner), it must be likely that a moratorium would result in the rescue of the company as a going concern. (This requirement is temporarily modified to allow the monitor to disregard any worsening of the financial position of the company for reasons relating to COVID-19.)

Initially, the moratorium lasts for 20 business days. It can be extended (without creditor consent) for a further 20 business days. An extension beyond 40 business days requires consent from certain creditors (broadly those who are subject to a payment holiday and whose debts have fallen, or may fall, due before the proposed revised end date), or a court order.

The company's creditors, which will normally include the trustees, and where a DB scheme is involved, TPR and the PPF, must be notified that a moratorium is in force and receive any subsequent notices regarding its status.

Effect

The directors will continue to run the business whilst a moratorium is in force. However, the monitor must monitor the company's affairs in order to establish whether it remains likely that the moratorium will result in the company's rescue.

The company's creditors may not take action against it (eg winding-up petitions may not be served and, subject to limited exceptions, security cannot be enforced) during the moratorium. In addition, subject to certain exclusions, the company obtains a payment holiday for pre-moratorium debts (broadly debts or liabilities that existed before the moratorium began).

The pensions exception

"Wages or salary arising under a contract of employment" are one of the exceptions to the payment holiday rule, and must still be paid during the moratorium. Helpfully, contributions "to an occupational pension scheme" are included within the definition of "wages or salary" for this purpose.

However, whilst far from clear, there are real concerns that certain DB obligations would fall outside of the above pensions exception. These include DRCs, payments in respect of a section 75 debt, and payments to TPR under a contribution notice or financial support direction.

In its recent guidance, TPR states that "all contributions due in respect of the company's *employees who are members* of any occupational pension scheme" must be paid (our emphasis). This seems to favour a narrow interpretation of the pensions exception, with only contributions in respect of active members having to be continued during a moratorium.

A further issue in relation to the pensions exception is the apparent omission of payments to personal pension schemes, placing employers using such schemes for auto-enrolment purposes in danger of breaching their obligations under that legislation. This was raised during debate on the Bill, and we understand further action is being taken in the hope of remedying what would appear to be an oversight.

Super-priority

In any winding-up or administration that occurs within 12 weeks of a moratorium, any prescribed fees or expenses of the official receiver (acting in any capacity in relation to the company) and any moratorium debts (a debt arising or liability incurred during the moratorium) and priority pre-moratorium debts (broadly, pre-moratorium debts which are not subject to the payment holiday, bar any accelerated financial indebtedness) are to be paid in preference to all other claims, including any DB scheme's section 75 debt.

Although the aim of the moratorium is to rescue the company, should this fail, the above provisions could result in the worsening of a DB scheme's position.

Restructuring plan

Sitting alongside schemes of arrangement and a company voluntary arrangement (CVA), the new restructuring plan provides struggling companies with a third statutory mechanism for reaching a compromise or arrangement with their creditors. To be eligible, the company must have encountered, or be likely to encounter, financial difficulties that are affecting (or will / may affect) its ability to carry on business as a going concern. The purpose of the restructuring plan is to eliminate, reduce, prevent, or mitigate the effect of some or all of these financial difficulties.

Bar the introduction of the cross-class cram down (see below), the process for agreeing a restructuring plan is the same as that for a scheme of arrangement. In brief, it involves:

- an application to the court for an order to summon a creditors' meeting
- provision of prescribed information on the proposal to creditors or members (including TPR and the PPF where a DB scheme is involved)
- a vote on the proposal by the creditors or members
- sanction (or not) by the court, which has absolute discretion.

Cross-class cram down

Imported from the US Chapter 11 process, this allows the court to sanction a proposal where the requisite 75% in value of creditors or members (or classes thereof) do not agree to it, provided that:

- none of the members of the dissenting class would be any worse off under the plan than they would be in the event of "the relevant alternative" (being whatever the court considers would be most likely to occur in relation to the company if the restructuring plan were not sanctioned), and
- at least one class who would receive a payment, or have a genuine economic interest in the company in the event of the relevant alternative, voted in favour of the plan.

Whilst this feature could potentially limit the options available to DB trustees, and their influence over any restructuring of the scheme sponsor, there may be circumstances where a DB sponsor might shape its proposal in a way that gets the trustees' support in order to help "cram down" potential dissent by other creditors. In addition, as the court's job is to ensure that any dissenting class is not worse off, it seems that it must at least take into account the effect a restructuring package would have on a DB scheme.

PPF entry

Subject to certain exceptions, schemes which compromise their section 75 debt cease to be eligible for the PPF. There is a specific exclusion here for compromises under a scheme of arrangement. Similarly, this is not an issue for a CVA, as PPF assessment is triggered by the proposal.

While it seems unlikely to be the intention, if a restructuring plan were to include a compromise of the scheme's section 75 debt this could prevent PPF entry.

Anti-avoidance

The provisions of the Act do not sit comfortably with those in the Pension Schemes Bill (see our Alert). On a literal reading, directors and trustees entering a restructuring plan could potentially fall foul of the criminal sanctions relating to avoidance of an employer debt and/or conduct risking accrued DB benefits. This may yet be addressed by amendments to the Pension Schemes Bill during its progress through Parliament.

Creditors can challenge the monitor's or the directors' actions on grounds that an act or failure to act has unfairly harmed the interests of the creditor, and we think there may be scope to argue that where there is material detriment to the scheme it was "unfairly harmed".

The PPF's role

Under powers provided by the Act, where the company in question is or has been an employer of a DB scheme, the Pension Protection Fund (Moratorium and Arrangements and Reconstructions for Companies in Financial Difficulty) Regulations 2020 (which came into force on 7 July 2020) provide, in certain circumstances, for the PPF to:

- take over the exercise of the creditors' rights of the pension scheme trustees in relation to a moratorium
- have the same creditor rights as the trustees in respect of a proposal for a restructuring plan
- exercise, to the exclusion of the trustees, certain voting rights in relation to a proposal for a restructuring plan.

The PPF is required to consult with the trustees before exercising any rights in their place. Given the PPF often takes an active role in CVAs, we would expect to see it involved in negotiations under moratoria and restructuring plans too.

Action

DB trustees must ensure they understand the potential ramifications of these changes for their scheme. Please speak to your usual Sackers contact for further information and advice.

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