FYI® Alert
For Your Information®

Volume 2020

Issue 31

13 July 2020

Authors
Paul Moore
Matt Goodchild
Gary Crockford

Protection from creditors for employers in financial difficulty

On 25 June 2020 the Corporate Insolvency and Governance Act 2020 came into force. The Act is aimed at eligible companies in financial difficulty and gives them the opportunity to obtain various protections from creditors.

This FYI Alert summarises the key considerations for UK pension schemes.

Background

The Corporate Insolvency and Governance Act 2020 (the Act) enables eligible companies in financial difficulty to obtain a moratorium, which gives the company various protections from creditors, or to enter a restructuring plan. Neither the moratorium nor the restructuring plan are "insolvency events", and they, therefore, do not trigger a section 75 debt or a Pension Protection Fund (PPF) assessment period.

To obtain a moratorium, the directors of the company must submit a statement that, in their view, the company is, or is likely to become, unable to pay its debts. Furthermore, the proposed monitor of the company (a licensed insolvency practitioner) must submit a statement that a moratorium is likely to rescue the company as a going concern.

The moratorium will initially last for 20 days. Companies can extend the moratorium for a further 20 days without creditor consent, or extend it for up to a year, from the start of the moratorium, with creditor consent. The moratorium will generally give payment holidays for any debts which became due before, or during, the moratorium period.

Once a moratorium comes into force, the monitor must notify the Pensions Regulator and the Board of the PPF. The Regulator has published some short guidance on the Act. This guidance notes that the Regulator will "*take a risk-based approach, reviewing and assessing the information we receive against a range of risk indicators*". Also, the guidance notes that contributions due to a pension scheme in respect of current employees of the company are still payable during the moratorium.

Restructuring plans sit alongside existing schemes of arrangement and company voluntary arrangements. The process for entering into a restructuring plan, but for one exception (see below), is the same as that for a scheme of arrangement.

Moratoriums - Considerations for pension schemes

Trustees and their advisors should be made aware, by a sponsoring or participating employer of a pension scheme, if the employer has obtained a moratorium. Every business document issued by, or on behalf of, the company must state that there is a moratorium in force for the company.

If the trustees or their advisors become aware of a moratorium, they should consider the impact this will have on the pension scheme. For example, this could signify a dramatic weakening in the covenant of the sponsoring employer compared with that assumed in the previous triennial actuarial valuation. Therefore, the pension scheme's investment strategy, and the agreed recovery plan, may no longer be supportable in light of the significant change in the covenant provided by the company. While companies are obliged to pay pension contributions during a moratorium, it is not clear that deficit reduction contributions (DRCs), or payments in respect of a section 75 debt, are required to be paid. Guidance from the Regulator, that all payments in respect of a company's employees who are scheme members must be paid, adds weight to the argument that DRCs are not covered. Careful consideration will need to be given as to whether the next actuarial valuation should be brought forward.

The Act states that no steps can be taken during the moratorium to enforce any security over the company's property, unless this relates to a collateral security charge. Furthermore, the company may only grant security over its property if the monitor deems this likely to support the rescue of the company as a going concern. Therefore, trustees and their advisors should be aware of any contingent security that the pension scheme has been provided with from the company, and whether this in enforceable during the moratorium. They should also ensure that they have a good understanding of where the pension scheme sits in the priority order of creditors upon wind-up of the company.

Moreover, the company is only able to make a payment in respect of a pre-moratorium debt to an unsecured creditor if the monitor deems this payment is likely to support the rescue of the company as a going concern. Therefore, trustees and their advisors should be mindful of the difficulty in accessing further cash from the company once it has entered into a moratorium.

A creditor, such as the pension scheme, may apply to the court if they believe that their interests have been unfairly harmed as a result of the actions of the company, or the monitor, during the moratorium. Trustees and their advisors should therefore be aware of the actions taken by a sponsoring employer during a moratorium in case any action has a detrimental effect on the pension scheme as a creditor.

The Act also allows the Board of the PPF to make an application to the court on behalf of the trustees and/or managers of a pension scheme as a creditor of the company.

Where a company enters administration or proceedings for a wind-up are commenced within 12 weeks of the end of the moratorium, certain debts are given super priority status. They include the fees and expenses of the official receiver and any debts or liabilities incurred during the moratorium, as well as priority pre-moratorium debts. This could have an adverse effect on a defined benefit pension scheme's section 75 debt.

Restructuring plans

Whilst the process for agreeing a restructuring plan is similar to that for a scheme of arrangement, the Act introduces the concept of a cross-class cram down. This allows the court to sanction a proposal where 75% (in value) of creditors or members do not agree to it provided two conditions are met.

- Condition A - none of the dissenting creditors, or members, would be worse off under the plan than they would have been under, what the court considers, would be the most likely alternative to the plan (the relevant alternative).
- Condition B – at least one of the classes of creditors, or members, who would receive a payment, or have a genuine interest in the company in the event of the relevant alternative, voted in favour of the plan.

Summary

The Act gives companies in financial difficulty short-term protection from creditors. This could be a crucial lifeline for some companies which have suffered due to the COVID-19 pandemic. Alternatively, it could simply prolong the inevitable insolvency of a company. Trustees and their advisors should ensure that they have a good understanding of the covenant of any sponsoring or participating employer and how this has been affected as a result of COVID-19.

Furthermore, they should also be vigilant as to whether a sponsoring or participating employer has entered into a moratorium and, if so, what actions the company takes during this period, and the effect of such actions on the pension scheme. Trustees and their advisors should be aware of the challenges of enforcing any contingent security in place, or accessing further security/cash from the company, whilst a moratorium is in place.

The provisions of this Act might not stop directors and trustees being caught by the criminal sanctions, which are being brought in under the Pension Schemes Bill relating to avoidance of an employer debt and conduct risking accrued DB benefits.