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HALCROW: LATEST RESTRUCTURING OF A PENSION SCHEME

BACKGROUND

Halcrow Group Limited (HGL) and Halcrow Water Services Limited (together Halcrow), two subsidiaries of Halcrow Holdings Limited (HHL), were the sponsoring employers with legal responsibility for funding the Halcrow Pension Scheme (HPS).

In 2011, HHL was acquired by CH2M Hill (CH2M), a global engineering company based in the US. Halcrow and HHL were loss making entities at that time and the CH2M acquisition was deemed to improve the covenant supporting the HPS, even though HPS had not put in place any legally binding funding commitment such as a parent guarantee.

Following the 2011 acquisition, CH2M provided significant financial support to Halcrow to ensure that contributions were paid to the HPS. The support provided by CH2M continued notwithstanding a deadlock in the 2011 valuation negotiations which meant that the valuation was not agreed by the March 2013 deadline.

THE RESTRUCTURING OPTIONS

While CH2M could have withdrawn the financial backing it provided to Halcrow, it agreed to continue to support Halcrow to allow time to pursue a consensual solvent solution for the HPS. If CH2M had withdrawn its support this would have resulted in Halcrow's insolvency, job losses and the HPS entering the Pension Protection Fund (PPF) with ensuing benefit cut-backs.

An initial restructuring proposal which would have involved transferring all HPS members to a new scheme, providing reduced benefits and without consents from the members was put forward in 2014. This was not pursued as it was found by the court to contravene existing legislative restrictions on transfers without member consent.

A further proposal was then put forward in late 2015 to make benefit reductions subject to individual member consents (2015 Proposal). The 2015 Proposal offered HPS members the option to transfer to a new scheme, the HPS2, which would provide benefits that were above PPF levels but lower than the benefits they were provided under the HPS. It also involved the use of a Regulated Apportionment Arrangement to release Halcrow from its funding liability to the HPS.

REGULATED APPORTIONMENT ARRANGEMENTS (RAAs)

A RAA is a statutory arrangement that allows a sponsoring employer's section 75 debt to be assigned to another sponsoring employer (on a non-crystallised basis). The RAA releases the withdrawing employer from further funding liability to the pension scheme.

RAAs are extremely uncommon and can only be entered into if certain statutory conditions are met. The statutory conditions include the following:

- ◆ The scheme must already be in a PPF assessment period or the trustees must be of the opinion that there is a "reasonable likelihood" that the scheme will enter a PPF assessment period within the following 12 months as a result of the insolvency of the sponsoring employers.
- ◆ Approval from the Pensions Regulator (Regulator) and a confirmation of non-objection from the PPF.

Since their introduction in 2008, the Regulator has only reported on four instances in which RAAs have been used. This includes the 2014 RAA in relation to the Monarch Airlines Pension Scheme (in respect of which Macfarlanes LLP acted for the shareholders of Monarch Airlines).

REGULATORY POLICY

The Regulator expects an application for a RAA to be accompanied by a clearance application and that appropriate mitigation will be offered to the scheme. It works closely with the PPF in considering RAA applications.

The circumstances the Regulator and the PPF will consider include:

- ◆ Whether insolvency of the sponsoring employer would be otherwise inevitable or whether there could be other solutions (including funding options) which would avoid insolvency.
- ◆ Whether the scheme might receive more from an insolvency.
- ◆ Whether a better outcome can be achieved for the scheme by other means (including through the use of the Regulator's anti-avoidance powers where relevant).

- ◆ The position of the rest of the employer group and the outcome of the proposal for other creditors.
- ◆ The advice the trustees have received from independent financial advisers and the appropriateness of the mitigation offered to the scheme and the PPF.

In addition, the PPF usually requires an equity share in the employer that is released from its pension liability of either 10 per cent (where the future shareholders are not currently involved with the employer) or 33 per cent (where they are) on an anti-embarrassment basis.

THE HALCROW CASE

Having considered the 2015 Proposal, the Regulator negotiated additional safeguards as a condition to granting its approval. The key aspects of the final 2015 Proposal were as follows:

- ◆ The HPS2 will be backed by HGL. CH2M will provide a £50m parent guarantee to the HPS2 (CH2M Guarantee).
- ◆ Non-consenting HPS members would remain in the HPS and transfer to the PPF.
- ◆ CH2M will make a cash payment of £80m which will be split between the HPS and the HPS2 depending on the number of members who transfer to the HPS2.
- ◆ An equity stake in HGL of a minimum 25 per cent and maximum 45 per cent to be split between the HPS and the HPS2 depending on the number of members who choose to transfer to the HPS2.
- ◆ HGL's only other creditor was CH2M. In addition to the £80m payment CH2M had agreed to make, CH2M also agreed that HGL can prioritise contributions to the HPS2 over any payments due to it under intercompany loans for a period of eight years.
- ◆ The first recovery plan of the HPS2 to be no longer than eight years.

- ◆ The initial investment and funding strategies of the HPS2 to be dependent on the profile of the HPS members who consent to transfer to the HPS2 with the Regulator negotiating assurances on the principles that will underpin the investment and funding strategies of the HPS2.

The trustees of the HPS (the Trustees) sought independent financial advice which confirmed that Halcrow's insolvency was inevitable and that the proposed £80m cash payment to the HPS / HPS2 was more than what the HPS would receive on Halcrow's insolvency. The final 2015 Proposal was therefore supported by the Trustees as it was deemed to present the best outcome for HPS members.

In 2011, at the time of CH2M's acquisition of HHL, the Regulator had considered but decided against using its anti-avoidance powers. The acquisition was deemed to be part of normal commercial activity that has improved Halcrow's ability to support the HPS. The anti-avoidance powers were again considered as part of the 2015 Proposal but deemed to be unreasonable in all the circumstances having particular regard to the significant financial support CH2M had provided Halcrow since the 2011 acquisition.

COMMENT

Events surrounding the BHS Pension Scheme and the British Steel Pension Scheme (BSPS) have put pension scheme restructuring in the spotlight. We understand that a rescue proposal for the BHS Pension Scheme is being worked on by the parties involved whilst the government is consulting on restructuring options for the BSPS. Suggested solutions in relation to the BSPS include existing restructuring mechanics (such as RAAs) and revisions to current legal provisions which restrict non-consensual benefit changes. Our thoughts on the BHS case can be found [here](#). Our response to the BSPS consultation can be found [here](#).

Under existing law and regulatory practice, RAAs remain the exception rather than the norm. However, the Regulator has shown that it is willing to approve RAAs in appropriate cases where the RAA provides the best outcome to both scheme members and the PPF.

In most cases involving a RAA, the pension scheme does not continue and enters into the PPF or is wound up so that all benefits are secured. Continuation of a scheme in these circumstances is deemed to pose an inappropriate level of risk to the PPF and levy payers. The provision of new financial support from a relatively new owner appears to be the basis for part of the scheme being permitted to continue in this case.

It remains to be seen whether the review carried out by the Parliamentary Select Committee in relation to the BHS Pension Scheme and the consultation in relation to the BSPS results in a wider review of legislation and policy surrounding pensions restructuring. In particular, certain easements from statutory restrictions being proposed in relation to the BSPS could have a significant positive impact on defined benefit schemes in general were they to be rolled out to the wider defined benefit universe subject to appropriate safeguards.

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