



PENSIONS AS A DEAL BREAKER

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Pensions in the news



Agenda

- Current problems for buyers and sellers: deficits, statutory debts, moral hazard, scheme trustees
- Share sales v. asset transfers
- Due diligence: what to look for and why
- Pensions in the sale agreement: warranties; indemnities; bulk transfers; interim participation periods

What are some of the current problems?



- ▶ Underfunded final salary scheme
 - ▶ section 75 of the Pensions Act 1995 (as amended)
 - ▶ FRS 17 impact
- ▶ Risk of buy-out debt
 - ▶ full cost of purchasing annuities with an insurer
- ▶ Moral hazard provisions of the Pensions Act 2004
 - ▶ financial support directions
 - ▶ contribution notices
 - ▶ clearance procedure (NB. voluntary)
- ▶ Relationship with scheme trustees
 - ▶ co-operation not guaranteed (WH Smith; M&S; Big Food Group)
 - ▶ balance of powers

Transaction structures



- A. Sale of entire group
- B. Sale of shares in a subsidiary company ("the target")
- C. Transfer of some or all of the assets of a business (possibly involving a TUPE transfer)

A. Sale of entire group



- ▶ Acquire pension scheme (and any deficit) "lock stock & barrel"
- ▶ Issues:
 - ▶ ongoing funding liability
 - ▶ contingent winding-up debt liability
- ▶ Options:
 - ▶ reduction in purchase price?
 - ▶ funding injection prior to completion?
 - ▶ walk away from the deal?

B. Sale of subsidiary's shares



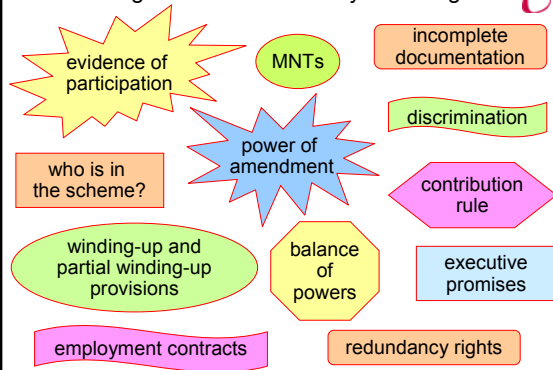
- Employer and employees cease to participate in the scheme
- Issues:
 - liability for proportion of buy-out deficit
- Options:
 - indemnity or discharge by trustees if no debt?
 - escrow account?
 - apportionment of liability by amendment to the scheme?
 - compromise agreement?
 - withdrawal arrangement?

C. Asset sale / TUPE transfer



- TUPE occupational pensions exclusion
 - impact of the Pensions Act 2004
- Issues:
 - scope of ECJ's Beckmann decision (eg early retirement benefits/ enhanced redundancy benefits?)
 - liability passes to buyer
 - claims by employees / former employees
- Options:
 - replicate final salary benefits
 - negotiate indemnity
 - warranty that no previous TUPE transfers

Due diligence: what is the buyer looking for?



And, evidence of:



- ⊗ Financial obligations: past, present and future
- ⊗ Funding holes / deficits
- ⊗ Statutory compliance
- ⊗ Litigation liability



Pension terms in the sale agreement



- ⌚ Warranties
 - eg no other pension arrangements; disclosure of documents; compliance; funding; discretionary practices; identity of members and employers; contracting-out; TUPE transfers; no litigation
 - "so far as the seller is aware"
- ⌚ Indemnities
 - eg Section 75 debt; sex equality; part-timers' claims; Beckmann; age
 - check limitation periods and caps
- ⌚ Obligations on buyer for future service benefits
 - imposed by law; and/or
 - negotiated with the seller

Pensions Schedule



- ⊗ Is a temporary (interim) participation period needed?
 - no automatic right to this (check permitted by scheme rules; likely to need agreement of the trustees)
 - length?
 - risk of continued participation / later exit debt
 - terms of participation (employer contributions; funding life cover; scheme expenses; no admission of new employees; restrictions on pay rises; redundancy controls)
- ⊗ Bulk transfers / transfer payments
 - why agree to one?
 - how much? (share of fund, past service reserve, cash equivalent)
 - areas of risk (date of calculation of transfer payment; actuarial assumptions; role of trustees; shortfall clause)



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ANY QUESTIONS?

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