

Pensions, jobs and public takeovers: the consequences of regulatory failure

Pension scheme trustees should not be happy with the recent Takeover Panel rule changes confirmed in July 2011 and effective from September 19th 2011.

The changes are the Panel's response to the much needed takeover regulation reform called for in the wake of the takeover of Cadbury plc. They recognise the interests of current employees and their jobs but fail to recognise pension scheme members, pensioners or the pensions on which they depend. The changes reflect the desire to prevent future furores about job losses which arose from Kraft's takeover by Cadbury (and where the pension issues were relatively benign) but this would seem prima facie unfair to pensioners and a serious failure of regulatory reform to recalibrate to meet new developments and identified weaknesses. Do we have to wait for a public takeover with disastrous consequences for pensioners before reform of the Takeover Code is extended to cover these important stakeholders?

The Takeover Code is shareholder centric and adequate protection of all other key stakeholders is both desirable and should now be expected of any comprehensive set of rules governing public takeovers. What pension fund trustees and pensioners really need is not a set of imprecise words comprising a statement of good intention or such like, but clear unequivocal confirmation that a bidder in a public takeover, and as such the prospective new employer, can fund the pension liabilities it will be assuming the legal obligation for on completion of the takeover. After all, a lynchpin of the Takeover Code which is drummed in to all practitioners and advisers from an early age is the requirement for confirmation that the bidder has the cash to fund the purchase price offered.

We believe there is one very simple common sense but fundamental way to address pension issues in public takeovers. This is to require offerors to confirm that they can meet any outstanding pension deficit and therefore fund the outstanding pension liabilities without delay if required to do so. The only definition of pension deficit which could give pensioners the absolute comfort they might wish for is the Section 75 pension debt. However even defining the pension debt as the ongoing deficit would give pensioners more comfort than they are currently afforded. If offerors can't or won't confirm this, then they should be required to reach an agreement with the pension trustees. This does give pension trustees a seat at the negotiating table and some additional leverage, but only in those situations lacking a funding confirmation which are precisely those situations where they need it. It seems unlikely that investment banks would agree to stand behind pension funding confirmations as they currently do cash confirmations. The Pensions Regulator already has the ability to secure funding contributions from transgressors and it would therefore seem logical to extend this automatically to offerors who make pension funding confirmations they later renege on. This would have the considerable advantage of placing offerors firmly and publicly "on the hook" for the pension liabilities they are taking on.

There is a lot of common sense in this proposal and in most cases it would not create even a “speed bump” in offer processes let alone a spanner in the works. It could save a huge waste of professional and corporate time and effort as well as pension regulatory resource and seems quite appropriate to include in a Takeover Code designed to promote an efficient, fair and transparent public takeover process. It would particularly assist the currently very difficult situations generated by hostile or contested offers where confirmation from the bidder that it can meet the pension debt would neatly take pensions out of the equation.

However in cases where there are material deficits relative to employers’ funding capacity, and therefore where takeovers may seriously impact future pension funding, it offers two clear alternative routes forward - but also a potential roadblock for those very offerors who might one day produce a debacle for pensioners. In such instance The Takeover Panel can’t just expect The Pensions Regulator or Pensions Protection Fund to pick up the pieces without attracting criticism itself. This is certainly the case if there was a relatively straightforward amendment to the Takeover Code it could have easily introduced as a result of consultation but chose not to. Should bidders who can’t confirm that they can fund the pension liabilities involved really be allowed to take them on?

The Pensions Act 2004 and subsequent guidance from The Pensions Regulator encourages pension scheme trustees to work out the financial consequences for their schemes of corporate events such as public takeovers, and to seek mitigation if they are shown to cause detriment to scheme funding. The Takeover Code currently contains no reflection of this important area of regulation, nor does it ensure that any agreed set of public takeover terms is based on a true reflection of the overall financial consequences including pension scheme funding. It is an important area in which the pensions regulatory framework does not fit or dovetail with other existing regulatory frameworks designed by other regulatory bodies. It is not the only instance where different regulatory silos don’t seem to join up properly, but it is perhaps one of the more important ones to urgently tackle.

So what are the alternatives to introducing this type of change to the Takeover Code? If trustees are in a position to introduce or negotiate specific protections, one might expect the increasing introduction of change of control clauses into agreements with employers and deficit recovery plans. One suspects that the terms of such change in control clauses may turn out to be entirely arbitrary reflecting the pressures and relative negotiating leverage of each individual situation. As such these clauses could turn out to be distorting as well as defeating the purpose of the Takeover Code in facilitating an orderly market in public company takeovers.

Under the current Takeover Code there is arguably too much incentive for defending company boards to restrict full disclosure of pension information and deflect attention from the pension schemes they are passing on in order to maximise the offer value received by shareholders, who have historically been deemed their prime axis of responsibility. This has the natural consequence of parking the pension issue until after agreement on price and a board recommendation has been reached, perhaps effectively until the next Triennial Valuation and pension scheme recovery plan negotiations. This to a large extent neuters pension scheme trustees unless they are willing to engage in a press campaign to generate additional leverage through adverse publicity.

Press relations were indeed used in some large cases in 2007, notably the takeover of Alliance Boots by KKR and the takeover of Corus by Tata. Whether this has proved good for long term relations between trustees and new owners is not known, but it is understood that the Pensions Regulator has quietly discouraged trustees in other subsequent cases from going public.

If the uncertainty about future funding is material then one can expect more acrimonious cases with trustees airing grievances and demands in the press simply because no other conduit is available for doing so. In the worst instances this can be tremendously damaging for the long-term funding relationship between employer and pension trust board even if publicity does force compensation.

In conclusion, without requisite change in the Takeover Code, we would expect that those public takeovers which involve material pension issues will increasingly involve arbitrary change in control clauses in which a degree of mitigation has been pre-ordained without detailed knowledge of the actual financial consequences, or alternatively we will see more acrimonious and potentially damaging press campaigns as the only route to getting pension issues recognised in takeover agreements. Neither alternative is attractive for employers or pension trustees.

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