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"Deficit for equity swap": Uniq uses a scheme of arrangement to shed its pension liabilities

In a significant transaction for the pensions' industry, the high court has recently blessed a deal that sees shareholders relinquishing 90% of their shares in exchange for wiping out the company's £473m pension scheme liability. This is the first restructuring where a scheme of arrangement (one of the techniques contained within the Companies Act 2006) has been used to shed this kind of liability. The case may serve as a blueprint for other companies in need of restructuring and weighed down by the enormous liabilities that are derived from participating in defined benefit pension schemes.

David Steinberg, a partner in our restructuring and insolvency group comments:

"This is a great example of the different stakeholders in a restructuring, and in particular, the shareholders, the Pensions Regulator, the PPF and the pension scheme trustees arriving at a commercial solution that ultimately benefits (or has the potential to benefit) all participants. In this case the shareholders, whilst sacrificing a large proportion of their equity, recognised that trying to retain 100% of a company heavily burdened by pension liabilities would risk an eradication of any value in the equity. In agreeing to the restructuring, therefore they retain a hope value that they will ultimately get a return on their investment. Schemes of arrangement have proved to be a very flexible mechanism in recent restructurings, and this latest example illustrates once again how versatile they can be."

Many companies are struggling to support pension schemes which have rapidly growing deficits as a result of factors such as people living longer and depressed investment returns. According to recent estimates from a leading pensions consultancy, the total funding deficit under the standard accounting measure (IAS 19/ FRS 17) in relation to all of the UK's private sector pension schemes was £63bn as at 31 March 2011. In this briefing we are going to look at the technique employed by the former milkmen's conglomerate Uniq plc to free itself from its defined benefit scheme, which had liabilities to over 40,000 members and a funding deficit of £473m. The deal allowed Uniq to leave these liabilities behind and to obtain the court's seal of approval for the deal.

Key Issues

- **Pension scheme deficit swapped for shares**
- **Scheme sanctioned by the court**
- **Commercial approach taken by the Regulatory bodies**
- **A sign of things to come?**

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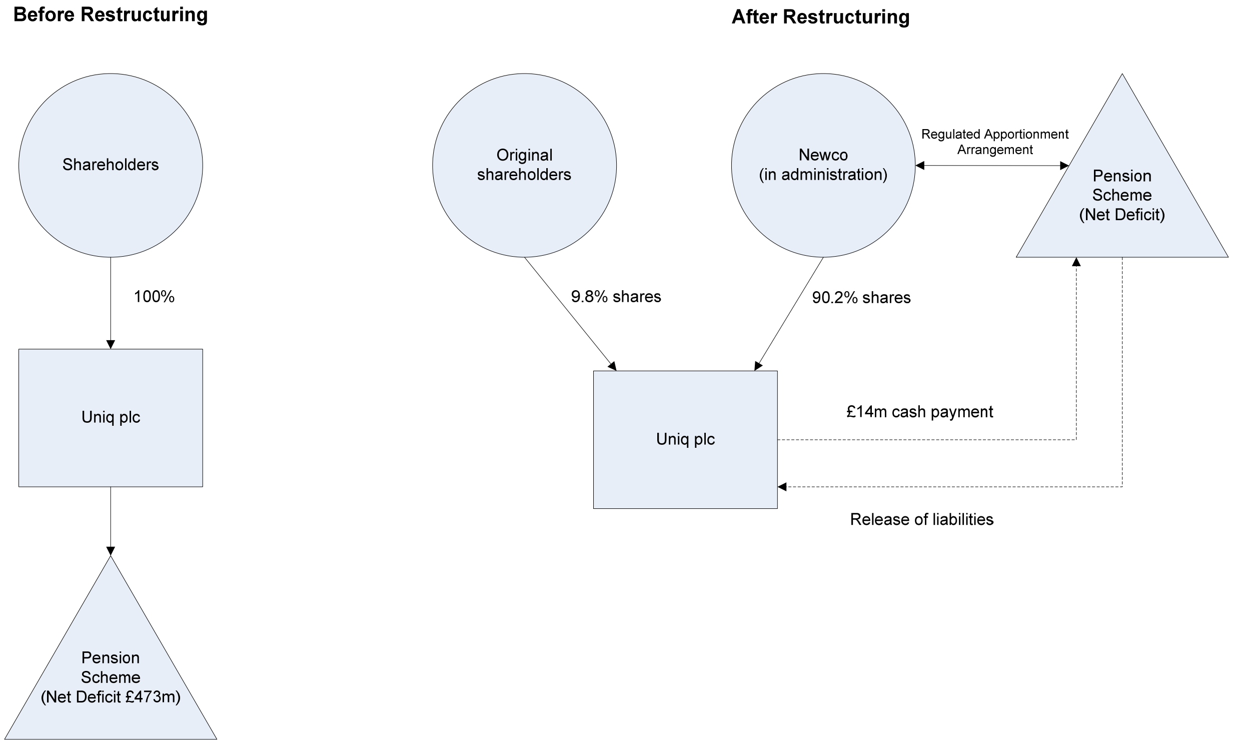
How they did it

The main features of the restructuring were as follows:

- Shareholders gave up 90.2% of their shares and paid a £14m cash payment to the pension scheme in exchange for a release from the company's obligations under the defined benefit scheme. The shares are to be sold for the benefit of the pension scheme which is then likely to go into the Pension Protection Fund (PPF);
- A special purpose vehicle, "Newco", was formed and administered by Capita Trust Company to hold the Uniq shares; and
- Newco assumed the bulk of the pension scheme liabilities under a "regulated apportionment arrangement" (under Regulation 7A Employer Debt Regulations).
- The pension scheme was then terminated, giving rise to a debt on Newco (under s75 Pensions Act 1995), rendering Newco insolvent. This led to the appointment of Grant Thornton as the administrators of Newco which, in turn, triggered a PPF assessment period.

The reasoning behind the appointment of administrators to Newco was so that the pension scheme liabilities assumed by Newco would be eligible for compensation under the PPF. The appointment of administrators constitutes an "Insolvency Event" for the purposes of s121 Pensions Act 2004, which triggers the start of the PPF assessment period. The PPF pays compensation to members of eligible defined benefit schemes whose employer has become insolvent where the pension scheme is unable to provide benefits at the PPF minimum. In this case, the beneficiaries of the pension scheme may benefit from the immediate cash payment and the funds raised from the sale of the shares in Uniq if they provide enough to exceed the PPF minimum level of benefits. If not, they will fall into the safety net of the PPF.

See below a simplified diagram of the restructuring, designed for illustrative purposes only:



Listing formalities

Prior to the scheme of arrangement, Uniq's shares had been listed on the Official List of the London Stock Exchange. The listing was however cancelled to accommodate the restructuring and in particular to permit the proportion of shares held in public hands to fall below the 25% threshold required for a full listing. Post the restructuring, the shares are being traded on the Alternative Investment Market (AIM). Grant Thornton have already appointed Spayne Lindsay, corporate financiers, to sell the shares with the proceeds going to the pension scheme as Newco's only creditor. The sale of the shares may, depending on the nature of the offers, bring about the operation of the Mandatory Bid process under the City Code on Takeovers and Mergers. This could mean that the shareholders are also obliged to sell their remaining 9.8% stake on a compulsory basis.

The scheme of arrangement: its participants and voting thresholds

Whilst the scheme of arrangement was a vital part of the restructuring, and necessary to achieve the release from the pension scheme deficit, the scheme itself was between the company and its shareholders. None of the company's creditors were parties to the scheme. Under Part 26 of the Companies Act 2006, there are certain formalities that the scheme must adhere to before seeking the court's approval to the scheme itself. In particular, in order to benefit from the provisions of the Companies Act 2006, the Uniq scheme had to constitute a compromise or arrangement between the company and its members or creditors, or classes of members of creditors. Where members or creditors give up rights, but do not receive a benefit, the scheme would not be classified as a compromise or arrangement (see the decision in NFU Developments Trust Ltd [1972] 1 WLR 1548). In this case, whilst the scheme itself would not result in a direct benefit to the members, it was recognised that as part of the overall restructuring they would retain an interest in a viable company. In considering the scheme as part of a restructuring as a whole, the judge in this case adopted the same approach as that taken in the IMO Car Wash case (Re Bluebrook Ltd [2010] 1 BCLC 338.)

In addition to the scheme falling within the definition of a compromise or arrangement, the company must also satisfy certain other criteria including seeking the court's permission to convene meetings of shareholders and creditors (if affected by the terms of the scheme) to consider the proposals under the scheme. There are also voting thresholds that must be met. In particular those affected by the scheme must vote in classes formed according to their interests, and each class must achieve a majority in number of those present and voting and also 75% in value. In the case of Uniq, whilst the statutory thresholds were achieved, the court's attention on the sanction hearing did involve a consideration of the fact that there had been a low turnout at the meeting of members, in fact only 14% of the shareholders, which meant that 9,773 shareholders did not vote. The court, was not however concerned by these statistics as it was recognised that the constituency of the shareholders had always been numerous, but was limited to small stakes.

The court gave its seal of approval to the arrangement recognising that it was part and parcel of the restructuring plan and whilst it had the effect of diluting the shareholders' interest, the shareholders did at least retain an interest in a company that was able to continue in business. In his concluding remarks the judge recognised that the scheme of arrangement passed the "fair and reasonable" test used by the court in that the restructuring was something that an honest and intelligent member might reasonably approve, and represented "the only viable means of enabling the group to continue, free of the deficit and thereby permitting the existing members to retain some value in the shares".

Win/win?

The scheme of arrangement is the first of its kind although the model of a "deficit for equity swap" involving the PPF has been used successfully a number of times before. It required the "buy in" not just of the shareholders, who were sacrificing a significant part of their equity holding, but also the pension scheme trustees, the Pensions Regulator and the PPF. It is a good example of those participants taking a pragmatic and commercial view, not just by accepting the equity stake and facilitating a structure which would mean the scheme remains eligible for entry into the PPF, but also a recognition that the restructuring offered a better solution than the alternative. Clare Hoxey, partner in our pensions group notes: "Eligibility for entry into the PPF was vital in this case for the members of the pension scheme since the sale of the 90.2% shareholding may not raise enough cash for the pension scheme to provide benefits exceeding PPF compensation levels. The alternative facing Uniq was an inevitable decline into insolvency, zero returns for the shareholders and the pension scheme would still have fallen into the PPF."

Philip Hertz, a partner in our restructuring and insolvency group concludes: *"Following this restructuring, Uniq and the PPF will share the potential upside in the restructured business. Using a scheme of arrangement to deal with such exposures, will not be an appropriate way of dealing with every case where a significant deficit has arisen, but in this case it offered the stakeholders an option, where otherwise there would have been no real alternative other than a liquidation of the company. It also offered the PPF the possibility of a better return than it would have received as a creditor of the insolvent Uniq."*