



August 2011



## The Great Lakes great escape?

**The Pensions Regulator has managed to successfully use the threat of its powers to enforce a funding arrangement for a pension scheme, this time in the case of the Great Lakes UK Limited Pension Plan (“the Plan”). The Pensions Regulator has had reasonable success with this approach in recent years, though not always in such a transparent manner.**

### Background

The Pensions Regulator announced on 13<sup>th</sup> July 2011 that it has decided not to pursue moral hazard proceedings against Chemtura Manufacturing UK Limited (“CMUK”) and its US parent Chemtura Corporation in relation to the Plan. CMUK is the sponsoring employer of the Plan and the main UK subsidiary of Chemtura Corporation, the US headquartered global speciality chemical business.

The Pensions Regulator’s decision was the result of the agreement reached by the relevant parties regarding the funding of the Plan which included:

- a £30 million up front cash contribution to the Plan;
- further payments of £30 million to the Plan over the next three years; and
- a guarantee and further security arrangements provided by Chemtura Corporation in relation to the Plan’s liabilities.

We have outlined below the timeline of relevant events.

### March 2009

#### Chemtura Corporation files for Chapter 11 protection

The US parent (along with 26 of its US affiliates) filed for Chapter 11 bankruptcy protection in the US in March 2009. Interestingly, CMUK remained solvent and carried on trading on a going concern basis, and therefore was not subject to the requirements of any insolvency proceedings and was not included in the financial restructuring of its US parent. Despite this, the trustees of the Plan and the Pensions Regulator were concerned about the financial position of the Plan and the covenant support available to it.

### June 2009

#### Trustees approach the Pensions Regulator

CMUK’s turnover declined by 25% in 2009 compared to the year before, however it remained profitable and had a positive balance sheet position with around £60 million worth of net assets (excluding the pension deficit), exceeding the £48 million accounting shortfall of the Plan. While on first sight this may seem acceptable, given the ongoing trading of CMUK, there were two factors that would have caused concerns for trustees and the Pensions Regulator.

Firstly, the Plan’s deficit on the solvency or buy-out basis, which estimates the additional funding needed to transfer the Plan’s liabilities to an insurance company, was much higher, around £95 million as at 30<sup>th</sup> June 2009 (more than 1.5 times higher than the net asset value of CMUK). If CMUK had also become insolvent, this would have been the relevant measure of the pension debt. Based on the latest accounts, the value of CMUK’s assets would not have been sufficient to cover this shortfall.

### In brief:

- **The Pensions Regulator has successfully used the threat of its powers to enforce a funding settlement in the case of the Great Lakes UK Limited Pension Plan.**
- **The Pensions Regulator has not proceeded with moral hazard proceedings as the trustees reached an agreement with Chemtura UK and Chemtura Corporation.**
- **The case gives some useful pointers regarding the actions which the Pensions Regulator is likely to take in particular circumstances.**
- **There are some interesting parallels (and differences) between this case and the recent high profile cases involving Nortel and Lehman.**

Secondly, there were material intercompany balances of CMUK which – due to the Chapter 11 proceedings in the US – had the potential to materially change and affect the strength of the employer covenant and the trustees' security position. CMUK owed some £110 million to fellow group companies, but it was also owed a broadly similar amount by other group entities. The net impact of these inter-company balances was therefore roughly neutral regarding the net asset position of CMUK, but the company was clearly at risk of these positions being potentially negatively impacted by the US insolvency process.

## October 2009

### Trustees file claims in bankruptcy

Against this financial backdrop, it could be argued that CMUK was insufficiently resourced (defined as the net assets being worth less than half of the buy-out deficit) while its parent had sufficient resources to provide financial support to the Plan. This 'insufficiently resourced test' is one of the key tests that must be met for the Pensions Regulator to be able to issue a financial support direction (FSD). The trustees filed claims against each of the insolvent entities in the US in October 2009.

## November 2010

### Chemtura Corporation exits Chapter 11

Following its successful financial restructuring, Chemtura Corporation emerged from the Chapter 11 protection in November 2010. The parties agreed that the UK pension claims and corresponding objections would be withdrawn, and any claims from the trustees would be dealt with via the relevant UK regulatory process after the Chapter 11 restructuring had finished.

## December 2010

### Pensions Regulator issues warning notice

The Pensions Regulator issued a warning notice for an FSD to a number of entities within the Chemtura Group, including Chemtura Corporation and CMUK, indicating that the Regulator's Determinations Panel would hear the case and may issue a formal FSD to these companies.

## June 2011

### Pensions Regulator announces settlement

The case was settled prior to the formal hearing. The Pensions Regulator announced on 13<sup>th</sup> July that it had decided not to pursue moral hazard proceedings against CMUK and Chemtura Corporation in relation to the Plan due to the agreement reached with the trustees regarding the funding package.

## General comments

Clearly there are some striking similarities between this case and the recent Nortel and Lehman FSDs. Common features include:

- insolvent North American group companies under Chapter 11 bankruptcy protection;
- UK pension schemes with some material shortfalls;
- historical financial links between the UK employer and the insolvent overseas group entities; and
- the UK Pensions Regulator seeking financial support from the overseas parent companies.

However, a key difference in this case was that there was a solvent UK employer and its US parent was emerging from Chapter 11 as a going concern. As such, finding a solution for the ongoing funding of the Plan was feasible.

Some were surprised that the Pensions Regulator issued the warning notice in December 2010, rather than earlier while Chemtura Corporation was in Chapter 11 proceedings. However, this step by the Regulator is explained by the agreement that was reached by the relevant parties about a month before.

A key point to note from this case was that from December 2010 onwards, the trustees were able to negotiate with the company from a position of strength, with the imminent threat of regulatory action against the companies. This situation has been rare in the past and we suspect that it was only achieved because of the Chapter 11 proceedings.

It was also interesting to see that the Pensions Regulator decided to communicate the news via a section 89 report, only the third time that the Pensions Regulator has adopted this form of communication. The last instance was just over a month ago regarding the Bonas Contribution Notice, where the outcome for the Pensions Regulator had been less favourable. It may be that the Pensions Regulator wishes to demonstrate publicly that its strategy can be successful.

### Where can I get further information?

For specific advice, please get in touch with **Lorant Porkolab** on 020 7004 0074 or by email on [Lorant.Porkolab@pstransactions.co.uk](mailto:Lorant.Porkolab@pstransactions.co.uk), or **James Saunders** on 020 7533 6980 or by email on [James.Saunders@pstransactions.co.uk](mailto:James.Saunders@pstransactions.co.uk).

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