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KEY POINTS

- Statutory provisions do not expressly make the transaction unenforceable.
- Illegality and public policy principles will govern the enforceability of the relevant transaction.
- Enforceability will depend upon how the offending act is pleaded by the Regulator and the knowledge of parties to the relevant transaction.

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What is the effect on a transaction if the Pensions Regulator brings successful proceedings under the Pension Schemes Act 2021?

In this article, Raquel Agnello KC considers the enforceability of transactions involved in the act, course of conduct or failure to act which is relied upon by the Pensions Regulator when imposing a criminal sanction or civil penalty under the Pension Schemes Act 2021 (PSA 2021).

The Pension Schemes Act 2021 (PSA 2021) created new criminal sanctions as well as civil penalties for specific conduct which has the effect essentially of prejudicing pension schemes in attempts to recover the s 75 debt due to those schemes which is imposed upon employer companies pursuant to the Pensions Act 1995 (s 75 of the Pensions Act 1995). These much discussed civil and criminal sanctions were part of a series of new measures designed to provide the Regulator with more powers and the ability to act faster in protecting pension schemes as well as acting as a deterrent to those who are contemplating actions detrimental to pension schemes. The new provisions are viewed as improving the existing system, supporting the enforcement role of the Regulator and providing an effective deterrent for reckless behaviour.

In summary, the new criminal sanctions are:

- (i) offence of avoidance of employer debt as a result of an act, course of conduct or failure to act where the person intends the act or course of conduct and the person did not have a reasonable excuse (s 58A Pensions Act 2004 (PA 2004) as amended by the PSA 2021);
- (ii) offence of conduct risking accrued scheme benefits and the person knew or ought to have known that the act/course of conduct would have that

effect without a reasonable excuse for doing the act or engaging in the course of conduct (s 58B as amended by PSA 2021); and

- (iii) failure to comply with a contribution notice (s 42A PA 2004 as amended by PSA 2021).

The new financial civil penalties mirror the criminal sanctions save that there is a more limited intention requirement:

- (i) avoidance of employer debt as a result of an act, course of conduct or failure to act and it was not reasonable for the person to act or fail to act in the way the person did (s 58C PA 2004 amended by PSA 2021);
- (ii) conduct risking accrued scheme benefits and the person knew or ought to have known that the act/course of conduct would have that effect without a reasonable excuse for doing the act or engaging in the course of conduct (s 58D PA 2004 as amended).

The imposition of a contribution notice by the Regulator depends upon the Regulator identifying an act, course of conduct or failure to act. It is therefore wider than the identification of a transaction which is then alleged to provide the necessary purpose or the detrimental effect upon the recovery of the actual or potential s 75 debt by the

pension scheme. The PSA 2021 provides no further guidance on the effect upon transactions in relation to those criminal and civil cases where a particular transaction has been identified and is the act relied upon by the Regulator or forms part of the course of conduct. The new criminal sanction and civil penalties are essentially based on the original and modified contribution notice regime introduced by the Pensions Act 2004 and subsequently amended in the Pensions Act 2008. The original and modified regime did not contain any criminal sanctions or civil penalties in relation to a contribution notice being issued. Imposition of a contribution notice under those early regimes was treated as a monetary judgment as against the relevant defendant (called a target under the legislation). There are very few cases in the public domain relating to earlier contribution notice cases brought by the Regulator under the original or material detriment test and no case to date has been the subject of contested proceedings before the Upper Tribunal. A few examples demonstrate the variety of what has been treated as a successful contribution notice as well as showing that the formulation of the act, series of acts or failure to act is key.

The Desmond Pension Scheme proceedings (2010) culminated in a settlement just before the full hearing before the Upper Tribunal. That case involved a members voluntary liquidation carried out by members of the Desmond group of companies which resulted in the pension scheme being unable to recover the large deficiency despite the companies in the group being solvent and able to pay their debts.

It was not part of the Regulator's case that the members voluntary liquidation itself and the distributions made to shareholders thereunder, were to be set aside in the event that a contribution notice was imposed. The contribution notice proceedings asserted that the act or series of acts of planning and placing the company into a member's voluntary liquidation had as its main purpose to prevent the recovery of the employer debt which would fall due. The case relied upon the act of placing the company into members voluntary liquidation and the earlier steps taken to execute this. The Regulator's proceedings sought a specific sum from the targets which effectively represented the s 75 deficiency of the pension scheme.

A later case, *Carrington Wire* (2015), was brought pursuant to both the original contribution notice provisions (to prevent the recovery of) and the new material detriment provisions. This case related to a share sale agreement which was carried out "in secret" without notification to the trustees of the pension scheme and which released the guarantee provided by the Russian parent of the employer company guaranteeing payment of the pension scheme deficiency. The guarantee only applied as long as the employer company remained part of the parent group of companies. The act and series of acts relied upon concentrated on the planning and implementation of the share sale agreement which was planned and executed without notification to the trustees of the pension scheme or to the Regulator. This was part of the act to ensure that the parent company's guarantee fell away. The case settled as between the Russian parent company and the Regulator but proceeded to a hearing before the Determinations Panel in relation to Richard Williams, the person who had acquired the shares through Gillico Limited, an SPV set up for this purpose. Mr Williams had also received a sum of just under £400,000 from the transaction. An order was made by the Determinations Panel against Mr Williams. In this case, the share sale agreement was the transaction under attack but the Regulator relied on the way that it was being executed because that effectively is what caused the material

detriment as well as meeting the avoidance of employer debt original purpose.

Other cases, such as *BHS Pension Scheme* (2017), *Meghraj Pension Scheme* (2020) and *Dosco Overseas Engineering Limited* (2021), contain agreements and/or transactions but the acts identified combine the relevant share sale agreements etc as well as the planning and execution of the relevant transaction. In *Dosco*, the Regulator attacked the payments made to the parent company repaying loans made which placed the parent company as a creditor in a better position than the pension scheme. In *Meghraj*, currently subject to a referral to the Upper Tribunal, the Regulator attacked payments made by the subsidiary to other parties rather than being retained by the subsidiary and thereafter being moved up the corporate tree by way of a dividend to the employer company. As contribution notices produce monetary judgments, it is unsurprising that there is no real consideration upon the effect of the contribution notice upon the relevant transaction. The Regulator does not need to set aside any transaction in order to obtain a contribution notice. The PSA 2021 has also created a modified contribution notice cause of action. The new contribution notice does not create criminal sanctions or civil penalties save in the event of a failure to comply with the same. There are a variety of acts or courses of action relied upon in historical cases relating to the original and modified contribution notices provisions.

So, the question therefore arises as to what is the effect on the relevant transaction of the imposition of either a criminal sanction or a civil penalty. As already stated above, the words of the relevant provisions provide no direct assistance in this respect. The provisions are focussed on providing the criminal sanctions or civil penalties which can be enforced against the relevant party by the Regulator, including setting out the requirements, the reasonable defence and the procedure which needs to be followed under the statute. There are two issues to consider here:

- the concepts and principles relating to illegality as a defence or creating an

unenforceable contract and the effect on the cause of action; and

- what immoral or illegal acts are capable of triggering the illegality defence.

The issue of illegality and contracts has been before the Supreme Court in a series of recent cases. The principle appears, as recognised by many of the cases, easier to state than apply. Simply put, an English court will not enforce a cause of action which arises as a consequence of illegality or *ex turpi causa* – that is where the claim arises from illegal or immoral conduct. The favourite dictum is that a person should not benefit from his own wrongdoing. Again, this is easier to state than to apply when third parties are involved.

There are two distinct bases on which a claim under the transaction, as a contract, may be defeated on the ground of illegality:

- "Statutory illegality" applies when the legislative provisions prohibit the making of the contract so that it is unenforceable by either party or provides that it, or some particular term, is unenforceable, in full or in the relevant respect; the court is then bound to respect that provision.
- "Common law illegality" arises where the formation, purpose or performance of the contract involves conduct that is illegal and where to deny enforcement to one or other party is an appropriate response to that conduct. This useful summary is taken from *Okedina v Chikale* (CA) [2019] ICR 1635.

As the pension provisions contain no express prohibition, this is not a case of statutory prohibition. Additionally, this is also, in my opinion, not a case of such a prohibition being implied. *Okedina* states that a court should only find that Parliament has intended to prohibit a contract of a particular kind, or particular circumstances, where the implication is clear, referring to *St John. Shipping Corp'n* [1957] 1 QB 267. In my opinion, such implication is simply not clear in relation to these pension provisions. This is especially the case where the act/course of conduct or failure to act

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may include conduct or acts beyond the transaction itself identified.

Carrington Wire provides a good example of this. The Regulator was not attacking the sale of the shares, but the way it was carried out and the price paid. The Regulator's case was that the parent company agreed with Mr Williams to sell the shares to a special purchase vehicle owned by Mr Williams with the intention of releasing the guarantee. This needed to be carried out without alerting either the trustees of the pension scheme or the Regulator. The unenforceability of the share sale agreement does not follow as a necessary implication.

Common law illegality has been considered in the recent Supreme Court case of *Patel v Mirza* [2016] UKSC 42 which related to a claim for restitution of money paid over for an illegal purpose, namely placing bets based on insider information. At para 120, Lord Toulson stated:

"It is necessary (a) to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim, (b) to consider any other relevant public policy on which the denial of the claim may have an impact and (c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts."

As set out in that case in the judgments, the majority of the Supreme Court identified the key question, when a claim is tainted by illegality, to be whether granting the claim would produce inconsistency and disharmony in the law, essentially harming the integrity of the legal system. The focus should be on the need for the civil courts to uphold public policy rather than on whether a particular litigant will profit from doing wrong.

The purpose underlying the pension provisions has been summarised above. It relates to providing sanctions in relation to acts which avoid the pension debt or are materially detrimental to the recovery of the

pension debt. It relates to providing a deterrent as well as protecting the pension schemes. Allowing enforcement of the underlying transaction will not necessarily undermine the purpose underlying the law, but much depends upon the transaction identified and its role in the offending conduct. Each particular case will be, in my opinion, fact specific. That is not to say that the purpose underlying the law which has been breached changes, but in this case, the act, course of conduct or failure to act changes in relation to each case. In some cases, the transaction itself may be the act. In others, such as *Carrington Wire*, it is how the transaction was carried out which provided the offending conduct.

The facts in *Okeidina* provide a good example of the analysis which is carried out by the court. In that case the claimant brought proceedings for breach of her contract of employment. Her employer, the defendant asserted that the claimant was precluded from pursuing her contractual claims by reason of ss 15 and 21 of the Immigration, Asylum and Nationality Act 2006 because those claims had arisen at a time when the employee's leave to remain had expired. The Court of Appeal dismissed the appeal by the employer. The Court of Appeal considered that the relevant provisions did not state in terms that no person shall be a party to a contract of employment where the employee does not have the appropriate immigration status such that the contract should be unenforceable by either party. The penalty is only on the employer. The Court of Appeal considered the terms of the provisions and the mischief and stated that (para 49) public policy did not require a construction of the sections which would have the effect of depriving the innocent employee of all contractual remedies against an employer in circumstances where there is no culpability on the part of the employee.

It seems that similar points can be made in relation to the pension provisions. The provisions seek to provide a speedy and effective sanction in relation to those who engage in conduct that either prevents the recovery of the pension debt or creates a material detriment as to its recovery. It also provides a deterrent. In my opinion,

those who engage in such conduct and are found guilty of the criminal offence or have a civil penalty imposed are not entitled to rely and/or seek to enforce a transaction which formed part of the act, course of conduct or failure to act which was relied upon by the Regulator.

However, the mischief which these provisions seek to deal with does not appear to require innocent parties of being deprived of their entitlement to seek to enforce the transaction itself. Much will depend, in my opinion, on the role played in the offending conduct. There may well be cases where the transaction is itself the entire "act" relied upon by the Regulator. In those cases, it is difficult to imagine that a court would not seek to hold that transaction as unenforceable. Equally, the other parties to that particular transaction would potentially be parties to the act and potentially liable. Regardless if those who are parties have a reasonable defence or not, a court may well judge those cases differently from cases where the innocent party is seeking to enforce a transaction which is not the sole constituent element of the act or course of conduct identified by the Regulator.

Courts seem quite prepared to allow parties to enforce actions based on contract or tort rather than refuse to enforce such actions. In the more recent case of *Stoffel v Grondona* [2020] UKSC 42, the Supreme Court considered a claim for negligent breach by solicitors in relation to their retainer. The Supreme Court held that the solicitors could not escape liability for their negligence in failing to register documents to complete a property transfer on the basis that the transfer was part of an illegal mortgage fraud. In affirming the Court of Appeal judgment, Lord Lloyd Jones (delivering the sole judgment) clarified the application of the "trio of necessary considerations" as established in *Patel* as being:

- Identifying the underlying purpose of the illegality and whether that purpose would be enhanced by denying the claim.
- Whether there are other public policies on which denying the claim might have an impact.

Biog box

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- Whether denying the claim would be proportionate in response to the illegality.

Accordingly, as explained by the judge, a court should first identify the policy considerations for the first two points at a general level (but not evaluate them) and determine whether enforcing a claim tainted by illegality would be inconsistent with those policies or, where the policies compete, where the overall balance lies. If it concludes that the claim should not be barred by illegality, there is no need to consider proportionality; proportionality should only be considered if the balancing of policies suggests a denial of the claim. The Supreme Court held that the claim should not be barred by the solicitor's illegality defence. This meant that there was no need to consider the issue of proportionality, but the court considered the issue anyway and found that it would have been disproportionate to deny the claim against the solicitors for negligence as it was an entirely separate concept from the mortgage fraud. This approach as developed by the Supreme Court increases the tendency in my opinion to restrict unenforceability to cases where public policy concerns really require that to be the outcome.

In my opinion, the court would consider there to be no material distinction as between a criminal sanction case and a civil penalty case. In *Les Laboratoires Servier v Apotex Inc* [2014] UKSC 55, the Supreme Court stated that only criminal or quasi criminal acts engage the rule against illegality. A quasi-criminal act is one which engages the public interest in the same way as a crime and includes:

- Dishonesty and corruption: for example, the tort of fraud.
- Prostitution, which is not itself an offence but involves criminal liability for secondary parties.
- Infringements of statutory rules enacted to protect the public interest, which carry only civil or regulatory sanctions, without creating a criminal offence.

The example given by the Supreme Court is the prohibition on anti-competitive behaviour in s 2 of the Competition Act 1998, as discussed by Flaux J in *Safeway Stores Ltd v Twigger* [2010] EWHC 11 (Comm) (a decision reversed on appeal on other grounds).

Although the majority of the Supreme Court in *Patel v Mirza* rejected the formulation of the rule against illegality

set out in *Servier v Apotex*, no criticism was made of the decision relating to what triggers the rule against illegality. It is difficult therefore to consider that a court would regard the two types of sanctions as being different.

Those involved and effectively parties to a transaction which forms the basis of the act relied upon by the Regulator may have some difficulty in seeking to enforce the underlying transaction. Those who are innocent parties may well find a court more sympathetic. Ultimately the effect upon a transaction will depend on what is the offending behaviour relied upon by the Regulator. Those who have concerns relating to the transactions and its effect on pension liabilities would be wise to obtain advice before proceeding. ■

Further Reading:

- UK Pension Schemes Act 2021: new criminal offence in force: lenders take note (2022) 1 JIBFL 48.
- Legal Ease with LexisPSL: (2022) 4 JIBFL 290.
- LexisPSL: Corporate Crime: Practice Note: Powers of the Pensions Regulator (TPR) to enforce pensions offences.