EUGENE F COLLINS

Employment & Employee Benefits Group

Waterford Crystal Case

Date: 21 June 2013

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"Serious breach" of Ireland's pension obligations to Waterford Crystal employees could lead to a serious bill for the state

Thomas Hogan and others v Minister for Social and Family Affairs, Ireland and the Attorney General. Court of Justice of the European Union, C-398/11 (the "Waterford Crystal case")

The Court of Justice of the European Union (the "CJEU") delivered its preliminary ruling on 25 April 2013 on the questions referred to it by the Irish High Court in the Waterford Crystal case. The CJEU judgment found that the State had not adequately protected the pension rights of members facing double insolvency of both their employer and their pension schemes. This judgment impacts the regulation of defined benefit pension schemes in Ireland.

The case concerned the interpretation of Articles 1 and 8 of Directive 2008/94/EC on the protection of employees in the event of the insolvency of their employer.

In January 2009, Waterford Wedgwood plc. appointed a receiver over their Irish operations. In March 2009, the Company's two defined benefit schemes wound up with a significant deficit (around €110 million). With the support of their trade union, ten former employees of the Company commenced litigation in the Irish High Court on behalf of the members of the Waterford Crystal Pension Schemes against the State. The Plaintiffs claimed that the State failed in their duty to provide adequate pension protection for employees of bankrupt companies.

In the High Court hearing, the actuary retained by the plaintiffs considered that they would receive between 18% and 28% of the amounts to which they would have been entitled if they had received the present value of their accrued old-age pension rights. The actuary retained by the State was critical of that calculation and considered the percentage to be between 16 and 41%. Neither estimate approached the 49% referred to by the Court in a previous case where the CJEU held that provisions of domestic law which lead to a guarantee of less than half of an employee's pension benefits will not be considered as sufficient protection. (Case C-278/05 Robins and Others [2007] ECR I-1053)

In the UK, following the *Robins* ruling, a Pension Protection Fund ("PPF") was introduced which provides 90% "core" pension rights to employees' in the case of a double insolvency, subject to a cap. The PPF provides compensation to members of eligible defined benefit pension schemes when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover the PPF level of benefits. The PPF is funded by way of compulsory annual levies charged on eligible UK schemes.

The Irish High Court referred a series of questions to the CJEU for preliminary ruling. All of the State's arguments were rejected.

The State maintained that, both before and after the judgment in *Robins,* it had in place significant measures designed to protect the interests of beneficiaries of supplemental pension schemes. The State argued that the level of benefits taken into account should include the State pension as the schemes were integrated. The State also submitted that it could not afford to bring in a pension guarantee scheme as it was constrained by the financial crisis.

The CJEU found that the measures adopted by Ireland failed to fulfil the obligations of the 2008 Directive. The Court determined that the economic situation in Ireland did not constitute an exception situation capable of justifying a lower level of protection.

Comment

The extent of the protection to be provided by the State will be determined by the High Court when the case resumes before it, but there is as yet no indication when this will be. While the consequences of the CJEU ruling remain uncertain, the potential exists for members of other schemes, which have since 2007 been wound up in circumstances of double insolvency, to be considered entitled to compensation. Once the extent of the cover the State is required to provide is determined, the Government will need to determine how this protection is to be provided (for both past and potential future cases) and how it will be funded. It is possible that the State could seek to recover part or all of the cost by imposing a further levy on other pension schemes.

The High Court may give consideration to the fact that the Waterford Crystal Pension Schemes were admitted to the Pensions Insolvency Payments Scheme (PIPS) subsequent to the CJEU reference. PIPS allows the trustees of a defined benefit scheme to pay a sum to the Exchequer to cover the cost of paying pensioner benefits instead of purchasing costly annuities which allows for a greater amount remaining to be applied for members. The State has now taken responsibility for making future pension payments to pensioner members, with the result active and deferred members will receive a greater proportion of their expected pension benefits than that initially estimated.

In April, 2013, the OECD reported on long term pension policy in Ireland and was critical of the weak legislative protections for members of defined benefit scheme members. It stated that the 1984 Act and PIPS provide incomplete protection to defined benefit scheme members in the case of employer insolvency.

It is likely, in response that the Government will attempt to reduce its exposure to future claims by requiring employers to strengthen the funding of their pension obligations. The Government may decide to implement a similar system to the PPF in the UK or it may implement what is known in the UK as the 'debt on the employer regime', also known as Section 75 debt. The OECD report criticised existing Irish pensions' legislation which allows sponsoring employers to walk away from insolvent defined benefit schemes without creating any debt on the employer. In the UK, the debt on the employer regime creates a statutory debt calculated on a buy-out basis which is recoverable from any solvent company within the corporate group structure.

The Government could introduce a statutory requirement on employers to fund any deficit on scheme wind-up (the OECD review suggested that this could be subject to a cap) if they were capable of doing so, with the deficit becoming a preferential debt in any insolvency proceedings. Alternatively the current funding standard could be revised.

Employers are already concerned about the cost of maintaining their DB schemes. Whilst the potential changes outlined above aim to improve the security of members' benefits, the reality is that if such changes are implemented, employers will either need to significantly increase contributions to defined benefit schemes or apply for reductions to benefits by way of a Section 50 Order to maintain current contribution levels.

As a consequence, scheme wind-up may now become a more attractive alternative, from a financial and risk management perspective, for some employers.

For members in a situation where a scheme is poorly funded and the sponsoring employer is financially weak, winding-up could arguably be in their best interests if this led to the employer being declared insolvent. Following on from the ruling in the Waterford Crystal case, the State would be required to supplement the wind-up benefits to the level required under the 2008 Directive to ensure that members facing a double insolvency situation are adequately protected. This may be the preferred route for members of an underfunded pension scheme, who otherwise might face a reduction of benefits following a trustee application for a Section 50 Order.

The greater implications of the Waterford Crystal decision for the State, sponsoring employers and members of defined benefit schemes, remain to be seen. Employees can hope for improved pension protection in future whether it comes from the State fulfilling its pensions obligations or heavier responsibilities imposed on the sponsoring employers. The unintended consequence of increasing the funding obligations on sponsoring employers may unfortunately be to accelerate the demise of many defined benefit schemes in Ireland.

For further information on this topic please contact: Garrett Miller, Partner, Employment & Employee Benefits Group, E: gmiller@efc.ie