



Who is 'connected' or 'associated'?

EMPLOYMENT, PENSIONS AND BENEFITS: BRIEFING 178

This briefing explains why the definitions of 'connected' and 'associated', as contained in the Insolvency Act 1986, are important in pensions law. It then outlines the statutory provisions and highlights some difficult areas of law.

Pensions and insolvency legislation uses the test in the Insolvency Act 1986 for assessing whether a person is 'connected' or 'associated' with another. This test is important because various statutory provisions use it, especially in limiting the persons whom the Pensions Regulator can make responsible for pension scheme deficits under the 'moral hazard' powers in the Pensions Act 2004. This briefing gives an outline of the statutory provisions and points to some difficult areas.

Why is this relevant?

The Insolvency Act 1986 includes a definition of someone who is connected with a company (section 249) or associated with an individual or company (section 435).

The insolvency legislation has special rules dealing with situations involving an insolvent person and someone who is connected or associated with that person. For example, it is easier for an insolvency practitioner to challenge transactions that took place with an associated person before insolvency as transactions at an undervalue or preference etc.

The pensions legislation uses these definitions from the Insolvency Act 1986 in various areas, including the following.

- The Pensions Regulator (TPR) can make a moral hazard order (contribution notice or financial support direction) only against a person who is associated or connected with an employer (see our briefings 132 *The Pensions Act 2004: moral hazard*

provisions, 173 Expansion of the Pensions Regulator's powers to issue contribution notices and 177 Proposed changes to the Pensions Regulator's powers to issue contribution notices and financial support directions, available at www.freshfields.com).

- There are restrictions on employer-related investment by pension schemes. This is defined as investment in an employer or in someone associated or connected with an employer.
- The scheme actuary or auditor must generally not be associated or connected with a trustee.

The concept of associated or connected persons is also used in relation to independent trustees on insolvency, Pension Protection Fund guarantees, lien rules, pensions provision on 'TUPE' transfers (ie on a relevant transfer of all or part of a business in the UK), cross-border schemes and notifiable events.

Some general points

- All wholly owned companies in a group are associated.
- Directors are associated with the company on whose board they sit, but not necessarily with its subsidiaries.
- A company is associated with each of its directors, officers and employers.
- Significant shareholders (over one-third) will have control and so be associated with the company and its subsidiaries.

Overview of sections 249 and 435 of the Insolvency Act 1986

Adapted from the TPR's guidance on clearance (2008)

Associated persons

A person is an associate of an individual if that person is, for example:

- the individual's husband, wife or civil partner;
- a relative of the individual;
- a relative of the individual's husband, wife or civil partner;
- the husband, wife or civil partner of a relative of the individual; or
- the husband, wife or civil partner of a relative of the individual's husband, wife or civil partner.

References to a husband, wife or civil partner include a former husband, wife or civil partner and a 'reputed' husband, wife or civil partner.

A person is an associate of any person with whom he is in partnership and of the husband, wife, civil partner or relative of any individual with whom he is in partnership. A Scottish firm is an associate of any person who is a member of the firm.

A trustee is associated with beneficiaries of the trust (but excluding pension schemes and employees' share schemes).

A person is an associate of any person whom he employs or by whom he is employed. Any director or other officer of a company is to be treated as employed by that company.

If a person is associated with another person then they are associates of each other.

Points to watch

Is there a chain of links?

The 'associate' test does not generally link – ie if A is associated with B and B is associated with C, this does not mean that A is associated with C.

But there are two exceptions to this:

- if A controls B and B controls C, this usually means A controls C (and so A is associated with C); and
- if A is *associated* with B and B is a director (or shadow director) of C, this means A is *connected* with C.

Control = one-third of the voting power

A person has control of a company if he has one-third or more of the voting power in it. Such control may be possible through a voting agreement. It is also possible that separate holdings of separate shareholders can be added together to give joint control.

A company is an associate of another company if:

- the same person has control of both or a person has control of one and persons who are his associates, or he and persons who are his associates, have control of the other; or
- a group of two or more persons has control of each company and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person of whom he is an associate.

A company is an associate of another person if that person has control of it or if that person and persons who are his associates together have control of it.

There are special rules for members of a limited liability partnership.

Control

A person is to be taken as having control of a company if:

- the directors of the company or of another company that has control of it (or any of them) are accustomed to act in accordance with his directions or instructions; or
- he is entitled to exercise, or control the exercise of, one-third or more of the voting power at any general meeting of the company or of another company that has control of it.

If two or more persons together satisfy either of the above conditions, they are to be taken as having control of the company.

Connected persons

A person is connected with a company if that person is:

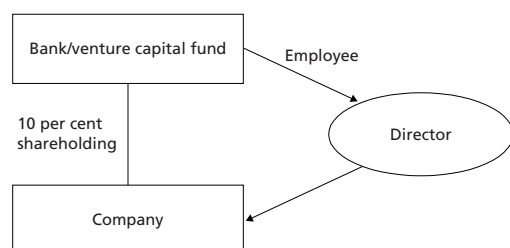
- a director or shadow director of the company;
- an associate of such a director or shadow director; or
- he is an associate of the company.

Common directors

The 'connected' test will mean that person A is *connected* with company B if any of B's directors is *associated* with A (eg if the director is a director or employee of A). But this connection will not on its own mean that A is *associated* with B's subsidiaries (in the absence of some other link). See example below.

Example

A bank or venture capital fund that has nominated one of its employees to be a director of a company (perhaps to protect its interests as minority shareholder) will be connected with that company.



Do nominee directors give control?

If person A appoints a nominee (B) to a company's board of directors, A will be *connected* with the company if A is an associate of B (eg if A employs B or B is a director of A). If B is accustomed to act in accordance with A's directions, this may also give A *control* of the company (it is unclear whether control of the whole or a majority of the board of directors is needed – or if control of just one director is enough). If A has control of the company, it will also be associated with the company's subsidiaries.

Share mortgages

A mortgagee over shares in a company may take control of the voting powers under the mortgaged shares. If the shares represent more than one-third of the voting shares in the company, it is likely that the mortgagee will control the company. It is probable (but not certain) that a mortgagee will avoid this (at least up to a declaration of default by the mortgagee) if the mortgage instrument provides that the mortgagor retains the voting rights (at least up to that event).

Overseas companies

The 'associated' test applies to bodies corporate wherever incorporated.

Some terms defined

'Employer' means 'the employer of pensions in the description of employment to which the scheme relates' and can be extended by regulations (eg to cover some former employers). This can be a difficult test in some cases (eg if there are life members or if a participating company in a scheme has employees, but none is an active member of the scheme).

'Shadow director' means 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act' (but not if the person is a professional advisor) – section 251 of the Insolvency Act 1986. It seems that all the board (or a majority) must so act.

'Director' generally includes 'any person occupying the position of director, by whatever name called'. So it covers a 'de facto' director – section 251 of the Insolvency Act 1986.

'Company' includes a body corporate (whether incorporated in the UK or overseas).

A more detailed technical paper on this topic is available – please email david.pollard@freshfields.com.

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