NORTEL AND *LEHMAN* – NO SUPER-PRIORITY FOR FINANCIAL SUPPORT DIRECTIONS AND CONTRIBUTION NOTICES IN CORPORATE INSOLVENCY

PENSIONS

THE SUPREME COURT DECISION – 24 JULY 2013

The Supreme Court has issued its eagerly-awaited judgment in *Nortel and Lehman* [2013 UKSC 52] and in doing so has unanimously reversed the decisions of the lower courts. The decision has provided much needed clarification on ambiguous legislative provisions previously interpreted by the lower courts in a manner which was widely seen as having adverse consequences for the "rescue culture". The judgment has wider implications in the field of insolvency generally but these have not been addressed in this briefing.

The case involved the degree of priority to be afforded (if at all) to Financial Support Directions (FSDs) issued by the Pensions Regulator (Regulator) on various Nortel and Lehman companies following the commencement of administration proceedings.

Ambiguity in the insolvency legislation concerning the priority status of FSDs (and any subsequent contribution notices – "CNs") issued after the commencement of administration proceedings led to the parties seeking clarification from the High Court on whether such FSDs or CNs were:

- provable debts within the insolvency legislation (thereby ranking *pari passu* with all other unsecured claims);
- expenses of the administration (giving the pension scheme "super priority" over all other unsecured creditors and floating charge holders); or
- not covered at all and falling into a "black hole" as a claim that need only be met after all creditors are paid out in full.

THE LOWER COURTS' DECISIONS

In December 2010, at the High Court Mr Justice Briggs found himself constrained by the governing legislation and case law to hold, albeit reluctantly, that an FSD or CN issued following the commencement of administration proceedings was an expense of the administration, thereby having "super priority" over all other unsecured creditors and floating charge holder claims. This was despite the fact that an FSD or CN issued prior to the administration proceedings would rank as an ordinary unsecured claim, and produced a result which was contrary to Parliament's own view (reflected in the relevant legislation) that an ordinary section 75 debt on the employer should not be a preferential debt.

In October 2011, the Court of Appeal unanimously upheld the High Court's original decision.

As the law stood before the Supreme Court's decision, the status of an FSD or CN under insolvency laws depended largely on the timing of the insolvency event and the issuing of the FSD or CN.

REGULATORY COMFORT?

In an attempt to alleviate concerns that arose following the decision of the Court of Appeal, the Regulator issued a press statement and a more formal regulatory statement that emphasised:

- the requirements under the Pensions Act 2004 for the Regulator to act "reasonably" before exercising its anti-avoidance powers;
- its intention not to deliberately delay issuing an FSD until after an insolvency event; and
- its intention not to frustrate legitimate insolvency and restructuring practice, nor impact negatively on the lending market.

While the Regulator's statements were helpful to some extent, they could not provide the certainty which providers of debt finance to companies operating defined benefit schemes and insolvency practitioners appointed to groups operating such schemes were entitled to expect.

THE SUPREME COURT'S REASONING

Lord Neuberger, who delivered the main judgment of the Supreme Court, considered that reversing the decisions of the lower courts and treating the liability under an FSD or CN issued after insolvency as a provable debt ranking *pari passu* with all other unsecured creditors was the *"sensible and fair answer"*.

The Supreme Court was unable to see a compelling reason to differentiate the rights of a pension scheme's trustees from that of any other unsecured creditor.

The Court also found it to be arbitrary that the characterisation and treatment of a liability arising under the Regulator's powers should, as the law stood, turn on when the FSD or CN happens to have been issued given that they were based on a state of affairs that existed prior to the insolvency event.

Unlike the lower courts before it, the Supreme Court was not constrained by the previous authorities and these were mainly disregarded on the basis that they were concerned with personal insolvency and *"short of any reasoning"*.

The key legal finding which underpinned this ruling was that the liability arising under an FSD or CN imposed post-insolvency should be considered as a liability which arose *"by reason of an obligation incurred before"* the insolvency event and hence a provable debt under insolvency laws.

The following factors were also seen as relevant:

- the inter-relationship between the Regulator's powers and the employer debt liabilities under section 75 of the Pensions Act 1995 – as the legislation provides that the section 75 debt on the employer would itself be a provable debt, it would be surprising if the more indirect statutory obligation imposed by the Regulator could have a greater priority;

- the unlikelihood of the legislature intending to give the Regulator *"a significantly valuable and somewhat arbitrary power"* to enhance the priority in insolvency afforded to liabilities arising under FSDs or CNs imposed by the Regulator; and

- the unlikelihood of the legislature intending to give liabilities arising under FSDs or CNs imposed by the Regulator a priority ranking behind other provable debts (i.e. black hole status) given that FSDs and CNs are ordinarily issued in respect of insolvent companies.

IMPLICATIONS

Lenders whose security is in the form of a floating charge, and who are lending to companies or groups operating defined benefit pension schemes are likely to welcome the clarity afforded by this ruling. Where there is no security provided lenders will still have to jostle alongside the pension fund creditor in the form of whether the trustees themselves or the Pensions Regulator seeking payment on behalf of the trustees where an FSD is issued after the commencement of the insolvency.

There are sufficient uncertainties in lending without the substantial uncertainty of knowing where your interest ranks in an insolvency. Certainty provides a platform from which to measure other risks and contingencies, and the more accurately these can be calibrated, the better the deal should be for both parties.

From the legal viewpoint, the case can be welcomed as a primary example of the Supreme Court doing exactly what it should be doing in sweeping away previous unsound decisions and cutting a path through the tangle of legislation and case-law to reach a common-sense result.

The less charitably-minded might observe that if the framers of the FSD and CN regime had thought a bit harder about the issue when drafting the Pensions Act 2004, there would have been no need for three successive court cases involving no less than 11 QCs and eight eminent junior Counsel. But it is at least fortuitous that the decision has avoided the need for further statutory intervention, and it has come early enough in the unfolding history of the FSD regime to have filled a black hole created by the legislation itself.

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