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Pensions

Lehman Companies and Nortel Companies – Supreme Court decision

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The Supreme Court has today delivered an important judgment in the *Nortel/Lehmans* case on the interplay of the powers of the Pensions Regulator and insolvency law. This will be of interest to insolvency practitioners and pension scheme trustees, as well as creditors (or potential creditors) of companies which could be subject to the exercise of the Pension Regulator's anti-avoidance powers. The Court has confirmed that if the Pensions Regulator issues a financial support direction (FSD) against an insolvent company based on circumstances that pre-dated the insolvency, the pension scheme trustees and/or Pension Protection Fund (PPF) may enforce claims for liabilities arising from the FSD as unsecured creditors. Such liabilities will be treated for the purposes of insolvency law as provable debts.

The issue

The issue before the Court was what priority should attach to liabilities that arise from an FSD imposed on a company in administration or liquidation, or from any Contribution Notice (CN) subsequently imposed for failure to comply with that FSD. The facts are similar in the *Lehmans* and *Nortel* cases. The employers are insolvent and unable to meet the full deficits in their pension scheme. The Pensions Regulator has decided to impose FSDs on companies within each group; if an FSD is issued and sufficient financial support is not put in place, the Pensions Regulator may issue CNs against the target companies requiring cash payments to be made to the pension scheme. The Lehmans and Nortel administrators had argued that because any debt resulting from a FSD/CN would have arisen after the target companies had gone into administration, the debts would be irrecoverable (except in the very unusual circumstances where the insolvent company turns out to have sufficient assets to meet all its liabilities in full). So in practice FSDs would be unenforceable if issued against companies in administration.

The High Court and the Court of Appeal

The High Court and the Court of Appeal had held that FSD liabilities would constitute expenses of a company in administration and would therefore be payable before the claims of other creditors (other than those holding fixed charges). The same priority would also attach to any CN subsequently imposed on that company for failure to comply with the FSD. Both Courts had commented that this outcome was in some senses anomalous, as the debt imposed on an employer itself under section 75 of the Pensions Act 1995 when the employer becomes insolvent is treated as a provable debt. When enforcing an employer debt, therefore, pension scheme trustees and/or the Pension Protection Fund have the same priority as other unsecured creditors. The Courts had heard arguments put on behalf of the pension scheme trustees that FSD liabilities should also be treated as provable debts and given the same priority as other unsecured debts of the insolvent companies. It was clear that the judges in the High Court and the Court of Appeal were attracted by these arguments, but felt constrained by previous case law to reject them.

If their decisions had been upheld by the Supreme Court, it would have meant that liabilities resulting from FSDs had to be discharged by administrators and liquidators before meeting any liabilities to other creditors (other than fixed charge holders).

Supreme Court judgment

The Supreme Court has upheld the decisions of the High Court and Court of Appeal in rejecting the arguments put by the administrators of the companies in those Courts below that FSD liabilities were not enforceable at all and so fall into a "black hole". The Supreme Court agreed with the lower courts that FSDs should be enforceable, even if issued after a target company has become insolvent. But the Supreme Court has held that FSD liabilities are enforceable as provable debts when a UK company is insolvent, rather than being treated as expenses of administration or liquidation.

The key points from the Supreme Court judgment are:

1. FSD liabilities have the same priority as unsecured, provable debts when FSDs are issued to insolvent UK companies by reference to circumstances that existed before the insolvencies started. This includes the liability under any CN issued against the insolvent company by the Pensions Regulator following failure to comply with the FSD.
2. The High Court and Court of Appeal decisions that FSD liabilities are expenses of administration or liquidation are therefore overturned.
3. The arguments put by the administrators of the companies that FSD liabilities are neither expenses of the administration or liquidation nor provable debts, and therefore fall into a "black hole", are rejected. If FSD liabilities had fallen into a black hole, the companies would not have had to discharge the liabilities unless they had sufficient assets to discharge all their liabilities (including to all unsecured creditors) fully. This would be an extremely unusual state of affairs for a company in administration or liquidation.
4. Some of the cases which constrained the High Court and Court of Appeal were themselves wrongly decided and should not be followed in future. This includes cases going back to the 19th century concerning the liability of bankrupt individuals to meet costs in litigation where the relevant proceedings began before the date of the bankruptcy.

5. There is no general rule that if statute imposes a liability on a company, the company is in an insolvency process and the liability is not a provable debt, it must therefore be a necessary disbursement of the administrator or liquidator. Briggs J in the High Court had suggested that there is such a general rule, based on the House of Lords judgment in *Re Toshoku*, but Lord Neuberger in the Supreme Court held that the position depends on the interpretation of the specific statutory obligation.
6. If a company is in a group including an employer with a defined benefit pension scheme and the conditions for issuing an FSD are met, the company has incurred a sufficient obligation to provide financial support for the purposes of the insolvency legislation. This is why, if the company subsequently becomes insolvent and an FSD is issued by reference to circumstances that pre-date the insolvency, any liabilities flowing from the FSD are provable debts.

On the last point, it should be noted that in both the Nortel and Lehmans cases, FSDs were issued by reference to circumstances existing before the insolvencies began, under the so-called "look-back" provisions of the FSD legislation. The Supreme Court did not therefore need to address the situation in which an FSD might be issued against a company in insolvency proceedings by reference to circumstances or facts that post-date the insolvency.

This judgment will be of comfort to pension scheme trustees, the Pensions Regulator, the Pension Protection Fund and insolvency practitioners alike. It will also be welcomed by banks and other creditors holding floating charges, which (subject to a limited carve-out in the insolvency legislation) rank ahead of provable ordinary unsecured debts in insolvencies. If the Supreme Court had upheld the decisions of the lower courts, treating liabilities under FSDs and CNs as necessary expenses of administration or liquidation, those liabilities would have ranked ahead of floating charges. The outcome of this judgment is one which was widely (though not universally) accepted as the sensible result, although one which (unfortunately) appeared to be ruled out by previous decisions of the Court of Appeal in unrelated cases.

Pension scheme trustees, the Pensions Regulator and the PPF will be relieved that the arguments put by the administrators that FSD liabilities fall into a black hole have been rejected. Equally, insolvency practitioners will be relieved that FSD liabilities are not treated as expenses of administration or liquidation. The threat of FSD proceedings need not, therefore, impair the ability of insolvency practitioners to meet necessary expenses.

Travers Smith LLP advised the Trustees of the Lehman Brothers Pension Scheme.

If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Paul Stannard, Peter Esam, Philip Stear, Susie Daykin and Daniel Gerring.

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