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PENSIONS, INSOLVENCY AND THE LEHMAN LEGACY: SUPER PRIORITY (0) SUPER DEBTS (1) – SOME POST-MATCH ANALYSIS

PENSIONS

NEW PENSIONS HEADACHE FOR INSOLVENCY PRACTITIONERS AND LENDERS

It was just six months ago that the Supreme Court ruled that liabilities under financial support directions (FSDs) issued by the Pensions Regulator after the start of an insolvent administration do not have "super-priority" status. So the pension scheme isn't promoted ahead of other unsecured creditors. The same goes for contribution notices (CNs)[1].

In further litigation arising from the Lehman administration, the High Court has now ruled that any CNs issued for non-compliance with "post-administration" FSDs may require the targeted entities to pay amounts which in aggregate are greater than the actual s.75 deficit at the date on which the administration started (the official s.75 calculation date)[2].

The decision potentially enables the pension scheme to obtain a different form of preferred status through the back door. In this note we consider some of the implications.

BACKGROUND

If a "target" fails to comply with an FSD requiring them to provide financial support to a pension scheme, the Regulator can issue a CN against the target.

The legislation provides that the sum specified in such a CN may be the whole or part of the "shortfall sum" in relation to the relevant scheme. If, at the time of non-compliance with the FSD, a debt was due from an employer to the scheme under s.75 of the Pensions Act 1995 (e.g. because the employer had suffered an insolvency event, as was the case with the relevant Lehman employers) the shortfall sum will be the figure which the Regulator estimates to be the amount of the debt at that time.

The administrators of 14 Lehman group companies supported by the ultimate parent company applied to the High Court for directions in relation to whether, if two or more CNs were issued for non-compliance with the FSDs, the aggregate amount that could be specified or recovered under them was limited to the shortfall sum.

This was of particular concern to the Lehman administrators. The official s.75 debt which was triggered on the appointment of its administrators in September 2008 was £119m. The actual buyout shortfall subsequently soared to an estimated range of £214m - £275m as a result of the subsequent financial conditions which now appear to be one unfortunate aspect of the "new normal". It is perhaps ironic that if one marks the collapse of Lehman as the real beginning of the financial crisis, these financial conditions might themselves be seen by some as part of the wider Lehman fall-out.

THE PARTIES' POSITIONS

The administrators and the Lehman targets argued that the aggregate amount specified in all CNs relating to the same non-compliance could not exceed the shortfall sum (i.e. £119m). Whilst they accepted that no express limitations appeared in the legislation, they argued that such limitations should be implied.

The trustees and the Regulator submitted that there was no justification for "reading in" such a cap. If a cap had been intended, the legislation would have said so.

DECISION

Richards J ruled in favour of the Pensions Regulator.

He noted that the Regulator had to act reasonably in imposing liability under CNs, and held that this, and the construction of the relevant FSD legislation, tended against the imposition of further implied limitations. He also expressed the view that the purpose of FSDs was to secure financial support for a scheme which may be different from, and larger than, any s.75 debt. He therefore considered that there was therefore little logic in linking the aggregate amounts which may be specified in the CNs to the "historic" s.75 debt.

He observed (somewhat wryly perhaps) that even if the "aggregate cap" argument were to apply, there would still be some uncertainty regarding the actual amount of the s.75 deficit, which could only be resolved after detailed actuarial investigation.

SOME IMPLICATIONS

- The absence of an aggregate cap on liability is likely to make it harder for target companies to agree between themselves the amount to reserve against their contingent liabilities to contribute to a pension scheme where an FSD has been imposed.
- The amount of a scheme's recovery may now be dependent on the number of targets. If there is only one potential target, the recovery cannot exceed the shortfall sum, but if there are other possible targets, and the actual scheme deficit subsequently exceeds the value of the historic s.75 debt, a greater recovery might be possible.

[1] re Nortel & Lehman Companies [2013] UKSC 52
[2] re Storm Funding Limited (in administration) [2013] EWHC 4019

- The judgment highlights the fact that FSDs which are issued even in non-administration situations are not subject to a shortfall cap - although again the Regulator must act “reasonably”. Lenders (particularly where there is no further available security) and borrowers may be surprised to hear that the extent of a borrowing group’s aggregate liability to its pension scheme is technically limited only by the degree of restraint exercised by the Regulator, rather than solely by the actuary’s calculations.

- In the same vein, it may not be easy to explain to clients why the legislation imposes a specific s.75 calculation date in insolvency situations if in practice the Regulator is entitled to act as if the deficit were an amount which can float upwards to match subsequent market conditions.

It remains to be seen whether the Regulator will issue a self-denying ordinance against being over-enthusiastic in flexing its powers of recovery, as it did at the earlier stages of the Lehman litigation when it seemed as if FSDs might have super-priority over unsecured creditors and even over holders of floating charges. An appeal against the judgment remains a possibility.

Lehman’s contribution to the scrutiny of the “moral hazard” regime introduced by the Pensions Act 2004 continues. Sadly we are unlikely ever to know whether those responsible for drafting the legislation foresaw all of the issues which have emerged to date. It would be remarkable if they had done so.

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