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NORTEL AND LEHMAN FINANCIAL SUPPORT DIRECTIONS – AN UPDATE

PENSIONS

BACKGROUND

The High Court decision in Nortel and Lehman [2010] EWHC 3010 (Ch) in December 2010 was widely seen by insolvency and restructuring practitioners as having far reaching consequences for the "rescue culture". The now familiar facts involved the issue of a Financial Support Direction (FSD) by the Pensions Regulator (Regulator) on numerous Nortel and Lehman companies following the commencement of administration proceedings. Ambiguity in the insolvency legislation on the priority that should be provided to FSDs issued in such circumstances (and subsequent contribution notices (CNs) issued for failing to provide financial support under an FSD) led to the parties involved seeking clarification from the High Court on whether such an FSD or CN was a provable debt within the insolvency legislation (ranking *pari passu* with all other unsecured claims), an expense 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.

Mr Justice Briggs found himself constrained by the governing legislation and case law to hold reluctantly that an FSD or CN issued following the commencement of administration proceedings was an expense of the administration having "super priority" over all other unsecured creditors and floating charge holder claims.

Further details in relation to the High Court's decision can be found **here**.

AT THE COURT OF APPEAL

An appeal from the High Court's decision was heard by the Court of Appeal in October 2011. The Court of Appeal unanimously upheld the High Court's original decision. Following the clarification provided by the Court of Appeal, it was clear that 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.

- An FSD and subsequent CN issued prior to administration would give rise to a provable debt ranking *pari passu* with all other unsecured claims.

- A CN issued after the commencement of administration but which is based on non-compliance of an FSD issued prior to the administration would amount to a provable debt ranking *pari passu* with all other unsecured claims.

- Where the FSD and subsequent CN were both issued following administration, however, the claim under the CN would effectively become an expense of the administration ranking above all other unsecured creditors and floating charge holders.

Following the decision of the Court of Appeal, the Regulator issued a press statement saying that fears expressed about the impact the judgment could have on the rescue culture were "unlikely to be realised". The statement emphasised the requirements under the Pensions Act 2004 for the Regulator to act "reasonably" before exercising its anti-avoidance powers. While the Regulator's statement was well intentioned, it did not appear to provide any certainty or comfort to companies or those dealing with them about the likely categorisation of the pension scheme creditor for insolvency priority purposes. This uncertainty continues to have a detrimental effect on sponsoring companies with many lenders unwilling to make new loans or refinance existing arrangements. Where lenders are willing to lend to such employers, they are likely to seek a form of fixed security to protect their own interests in the event of a future insolvency.

REGULATOR STATEMENT

Given the continued concern on the part of commercial parties that the Regulator might use its powers to issue FSDs and CNs opportunistically in order to maximise the recovery for a pension scheme creditor, a further statement was issued by the Regulator on 26 July 2012 with the aim of providing additional clarity and comfort.

The Regulator's Statement, a seven page document, is littered with statements intended to reassure commercial parties including: "we have no intention of deliberately delaying its [an FSD] issue until after an insolvency event"; "our intention is to ensure that these powers do not frustrate legitimate insolvency and restructuring practice, nor impact negatively on the lending market"; "we will continue to act proportionately and to take seriously our statutory duty to act reasonably"; "where the FSD recipient is insolvent we will have regard to its financial circumstances"; and we are "acutely aware of the importance of an effective restructuring and rescue culture" and do not "intend to frustrate its proper workings…".

The Statement seeks to provide particular comfort to administrators. The Statement provides that in most circumstances, in order to further the purpose of an administration, the Regulator would not seek to object to a subordination of the FSD liabilities behind the administrator's reasonable remuneration. It also observes that many of the other expenses which an administrator would wish to know in advance that they could meet, will rank in priority to a post-insolvency FSD,

and indicates that the Regulator would "consider" proposals to re-order other categories of administration expenses above FSD liabilities.

There is also an interesting statement on how the Regulator might approach the question of what should be regarded as reasonable financial support where an FSD is issued post-insolvency. The Regulator says that in determining this question a "key consideration" would be the amount that may have been recoverable by the pension scheme as an unsecured creditor. While we are yet to see how this regulatory statement may work in practice, it appears that where the recovery amount for the pension scheme as an unsecured creditor would have been limited to say 10p in £1, it would be unreasonable for the Regulator to seek a greater amount as financial support from the target of an FSD. Similarly, it would follow that where financial support is not forthcoming, it would be unreasonable for the Regulator to seek more than that amount by way of a subsequent CN.

The Regulator goes on to say that "it is highly unlikely to be reasonable for us to insist upon a level of support which would leave administrators out of pocket and unsecured creditors without any return as a result of an FSD. The FSD is unlikely to result in contributions amounting to the scheme's entire section 75 debt unless the recipient agrees to this."

COMMENT

Whilst the Statement seeks to provide reassurance, it falls short of providing the certainty that commercial parties may seek in order to determine the risk involved when transacting with a sponsoring employer of a defined benefit pension scheme.

The Statement makes reference to the interests of unsecured creditors. However, it offers no express guidance as to how the Regulator would take account of the interests of lenders who hold, or might take, floating change security. It merely suggests that they make an application for clearance, or otherwise engage with the Regulator either before or early in the insolvency process to discuss any likely action against the insolvent company.

In addition, any comfort that the Statement may offer is somewhat tempered by the disclaimer at the end of the Statement which provides that the Statement is not a definitive interpretation of the legislation, and that *"it should not be read as limiting the Regulator's discretion in any particular case to take such action as is appropriate…".*

The Regulator's statement that it will have regard to what may have been recoverable by a pension scheme had the FSD been issued pre-insolvency is therefore welcome, but limited. It also stands to be seen how this particular statement is implemented in practice and whether the fact that this will be a "key consideration" would limit the amounts recoverable through an FSD or CN to what would have been available to the pension scheme as an unsecured creditor.

Our view continues to be that commercial parties should approach such statements from the Regulator with caution. Whilst it may be obliged to take account of the interests of directly-affected parties, which may include other creditors, it owes no duties to protect their interests. Its express statutory remit is to protect member benefits and minimise calls on the Pension Protection Fund (PPF). This is a remit which it has reiterated that it takes seriously.

An appeal from the decision of the Court of Appeal is set to be heard by the Supreme Court on 14 May 2013. Sponsoring employers, those dealing with them as creditors and insolvency and restructuring practitioners will be hoping that that the Supreme Court will find a way to reverse the original decisions and hold that a CN imposed following the non-compliance of an FSD issued post-insolvency only gives rise to a provable debt. Failing this, legislative amendments would be required to clarify the true intentions of the original draftsman.

In the meantime, notwithstanding its encouraging words, no lender can regard the Statement as an unequivocal, still less binding, indication of what the Regulator will and will not seek to do. Continuing uncertainty as to the security position is likely to deter lenders from lending to and refinancing current arrangements with sponsoring employers of defined benefit pension schemes. This is in turn likely to accelerate the insolvency of sponsoring employers and increase the level of claims on the PPF – an unwelcome consequence of the High Court and Court of Appeal decisions.

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