

Review

Pensions



The Pensions Regulator's Moral Hazard Powers may enjoy Super-Priority in Insolvency

The much awaited court decision on the status of Financial Support Directions ("FSDs") and Contribution Notices ("CNs") * issued by the Pensions Regulator against target companies after the commencement of English insolvency processes in respect of such targets was handed down by the court on Friday 10 December 2010. The reluctant decision of Mr Justice Briggs that FSDs and CNs in these circumstances were not provable debts but ranked as expenses of the insolvency process, taking precedence ahead of unsecured creditors, has caused dismay in the restructuring community. The decision is subject to appeal to the Court of Appeal and is likely ultimately to reach the Supreme Court unless a legislative solution intervenes.

Lehman and Nortel insolvencies

The issue was considered in the context of the Lehman and Nortel insolvencies which involved huge defined benefit pension scheme deficits under Section 75 of the Pensions Act 1995. The Pensions Regulator had commenced FSD proceedings against a number of companies in each group which were in administration/liquidation. The central issue in each case was the effect of the FSD regime upon companies in an insolvency process where the target went into administration or liquidation prior to the issue of an FSD. Was the cost of complying with a FSD or a CN a provable debt in or an expense of the administration or liquidation? This question was not answered by the Pensions Act 2004 which created the FSD and CN jurisdiction and therefore fell to be determined by the construction of relevant insolvency legislation, the Insolvency Act 1986 and the Insolvency Rules 1986 (the "Rules").

The decision

The judge decided that Rule 13-12 of the Rules, which set out what was a provable debt, did not cover a FSD/CN issued to a target after the commencement of its insolvency process. Unless the FSD or CN was to be deprived of practical financial effect the only alternative available was to find that the FSD/CN was an expense of the insolvency process, which meant, amongst various unfortunate consequences, that it will be paid out of floating charge realisations in priority to the administrators' costs and preferential and unsecured creditors. The rights of fixed charge secured creditors will be unaffected by this decision although the value of floating charges would clearly be adversely affected. A financier who operates a Debt Purchase Agreement (DPA) with a client will also be unaffected by the decision, as the debts subject to the DPA are vested in the financier and thus will not form part of the administration estate.

* Financial Support Directions and Contribution Notices have specific meaning under the Pensions Act 2004 and can be issued to a scheme's sponsoring employer (or persons "connected" or "associated" with that employer). Broadly, an FSD requires financial support to be put in place for a defined benefit scheme within a specified period. A CN requires payment to be made to the pension scheme. The only other case where a financial support directive was issued was in the Sea Containers case in 2008.

Administrator difficulties

The administrators of Lehman and Nortel pointed out the difficulties they would face in trying to achieve their statutory objectives if faced with contingent FSD liabilities with priority of an indeterminate but potentially crippling amount; that this would in practice impede any informed judgment as to the administrators' choice between the alternative statutory objectives of administration; and would disable them from the beneficial management of the company's business and affairs. While sympathetic to the administrators' position, Mr Justice Briggs thought that these difficulties could be substantially overcome by certain practical steps in the course of the administration. A view which insolvency practitioners may not share and is likely to make them hesitate over accepting appointments in any case where service of an FSD/CN is a risk.

More to come?

The judge concluded that he hoped a higher court would be able to find a way through the existing authorities to enable a FSD/CN in these circumstances to be a provable debt rather than an expense. He ended with an observation that the Insolvency Service or Parliament might wish to consider a suitable amendment, either to the Rules or to the Pensions Act 2004, if persuaded, as he was, that the conferring of super-priority as expenses upon the financial liabilities arising from the FSD regime was both potentially unfair to the target's creditors and inconsistent with a decision taken in 2004 not generally to elevate employees' pension claims above the claims of those creditors. We now wait to see whether the Insolvency Service or Parliament will take action.

FURTHER INFORMATION

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