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Financial Support Directions and Insolvency Part 2 - The Court of Appeal

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As you may recall, the High Court ruled in December 2010, in a case brought by the administrators of 20 insolvent companies in the Lehman and Nortel groups, that the cost of complying with a financial support direction ("FSD"), issued by the Pensions Regulator after the date of the commencement of a company's administration or liquidation, would rank as an expense of the administration or liquidation. Please see the attached link to an *Alert* we prepared on the potential impact of this decision.

As expected, the High Court decision was appealed to the Court of Appeal ("CA"). Last week, the CA upheld the decision, dismissing the appeal. The CA largely accepted the High Court's reasoning, on a detailed analysis of the pensions and insolvency legislative regimes, that the FSD ranks as an expense of the administration or liquidation. This means that FSDs (and by analogy, contribution notices ("CNs")) issued by the Pensions Regulator against insolvent companies have retained their 'super-priority' status as against the claims of any unsecured creditors, floating charge holders, and even against the remuneration of insolvency practitioners. However, Lord Justice Lloyd accepted that this outcome does give rise to "oddities, anomalies and inconveniences".

This issue clearly has arisen because of the lack of any statutory reference to the effect of an FSD (or CN) when made against an insolvent company. Lord Justice Lloyd commented that "one looks in vain for any such express provision in the [Pensions Act 2004]".

Lord Justice Lloyd also noted that it is odd that a "section 75" debt (the statutory debt that arises, in this context, on the insolvency of a participating company in an occupational pension scheme) is provable in the company's insolvency, yet an FSD or CN liability, as things currently stand, has 'super-priority' as an expense of the insolvency, despite the close relationship between the two provisions. In theory, the Pensions Regulator can therefore create a situation under which a debt is enhanced from being provable to being payable as an expense through the back door, simply by issuing an FSD or a CN. Many commentators have argued that this outcome provides a real threat to the rescue culture of the administration process and, as a result, companies in financial difficulty may now find themselves subject to fire-sales of assets.

Commentators and practitioners alike are not surprised by the decision of the CA, given the apparent lacuna in the legislation. This case was always expected to go all the way to the

Supreme Court, which may have the necessary authority to distinguish (or overrule) previous appellate court judgments to determine that an FSD or a CN issued against insolvent companies ranks as a provable debt, rather than as an expense of the insolvency. The administrators have already sought leave to appeal to the Supreme Court and are expected to receive such leave shortly.

Pension scheme trustees and insolvency practitioners alike will await with interest the decision of any appeal to the Supreme Court.

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