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Restructuring & Insolvency Alert

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Financial Support Directions and Insolvency – Possible Leverage for Pension Scheme Trustees?

In a recent high profile case brought by the administrators of 20 insolvent companies in the Lehman and Nortel groups, the High Court ruled that the cost of complying with a financial support direction ("FSD") issued after the date of the commencement of a company's administration or liquidation by the Pensions Regulator would rank 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, in effect, been given a 'super-priority' as against the claims of any unsecured creditors, floating charge holders and even against the remuneration of insolvency practitioners.

Mr Justice Briggs reached this conclusion after an analysis of the relevant provisions of the separate pensions and insolvency legislative regimes and the expenses principles established by a previous House of Lords case.

The Lehman and Nortel administrators will undoubtedly appeal the decision, first in the Court of Appeal and perhaps ultimately to the Supreme Court. Mr Justice Briggs notes at paragraph 150 of his judgment that "the FSD regime was almost certainly drafted by pensions experts rather than insolvency experts, and the complete failure of the [Pensions Act 2004] to make any reference to the effect of the regime upon insolvent companies suggests that issues as to priority of consequential financial obligations of a target company in an insolvency process may never have crossed the draftsman's mind." He even encouraged an appeal to his judgment commenting, at paragraph 199, that a higher court may be able to find a way through or around the "legislative mess", or that the Insolvency Service or Parliament may wish to consider suitable amendment to the relevant legislation.

In the meantime, however, the decision has profound implications for the insolvency/pensions landscape. Commentators are discussing the following potential consequences:

- Mr Justice Briggs himself noted the apparent inconsistency in the fact that liability arising under an FSD (or by implication also a CN) made after commencement of administration will rank as an expense, whereas if the FSD (or CN) had been made even a day earlier, it would rank as an unsecured creditor.
- Section 75 debts (the statutory debt that arises, in this context, on the insolvency of a participating company in an occupational pension scheme) are clearly intended to be a provable (but non-preferential) debt in any insolvency process applied to the employer. However, the Pensions Regulator can (in theory) now impose an FSD or CN to effectively obtain a higher priority ranking through the back door.
- Potential floating charge holders, such as banks, may become more reluctant to take on the now increased risk associated with lending to companies with large pension deficits.
- In a similar vein, it is difficult to see how an insolvency practitioner would agree to take on an appointment of an insolvent company with a defined benefit scheme, particularly if the pension scheme is under-funded and no indemnity is available to ensure the payment of the insolvency practitioner's fees.
- The rescue culture enshrined in the Enterprise Act 2002, which sought to deal with the criticism of the administrative receivership regime that was said to benefit secured creditors to the detriment of all others, may be threatened. This is because the decision would, in effect, create a similar result if the Pensions Regulator chooses to issue an FSD or CN against the insolvent company. As a result of this, companies in financial difficulty which might otherwise have benefited from the administration process may now instead find themselves subject to fire-sales of assets.

From a pension scheme trustee perspective, the decision could be exploited as a negotiating tool against participating companies in the scheme that are in financial difficulty. In the current climate of uncertainty trustees may be able to exert additional influence over secured creditors to seek a consensual financial restructuring. However, as many commentators expect the

decision to be overturned on appeal, we suspect that there will only be a limited time window for any such increased influence to be exercised.

If you are interested in discussing this further, please do not hesitate to contact us.

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