Briefing

BURGES SALMON

Insolvency

July 2013

Financial Support Directions downgraded in insolvency

Summary

Liabilities to pension scheme trustees that derive from a financial support direction (FSD) issued after a company has gone into administration rank alongside the claims of other unsecured creditors.

The Supreme Court's decision today in relation to the Lehman and Nortel schemes overturns the view of the Court of Appeal and the High Court that these liabilities enjoy "super priority" status as expenses of the administration. If the Court of Appeal's decision had been upheld, the effect would have been to rank FSDs above the claims even of floating charge holders and to elevate the status of such claims after a liquidation or administration occurs.

Winners and losers

Today's decision will be welcomed by lenders, licensed insolvency practitioners and corporate borrowers in particular. Pension scheme members, the Pensions Regulator (TPR) and Pension Protection Fund (PPF) would no doubt have preferred super priority to be upheld, due to the consequent deterrent effect FSDs would have held. But the outcome is better for them than if the Court had found a post-insolvency FSD to have no effect at all.

Had the court decided the FSD was without effect, new legislation would have been needed to settle the pecking order - and that would have taken some time. The case is not about liabilities that derive from an FSD issued before insolvency: it is accepted that these rank with the claims of unsecured creditors.

Why has the issue arisen?

The question the Supreme Court has answered arose because steps were not taken to reconcile pensions and insolvency legislation in 2004 when TPR was given power to issue FSDs (and contribution notices). This was at odds with the Section 75 regime, which includes provision deeming the Section 75 debt to have arisen immediately before insolvency, precisely to ensure that the liability would rank as a provable debt. The failure to do the same with FSDs and contribution notices represented an oversight by the draftsmen, and the current appeals were concerned with trying to address that oversight by shoehorning FSDs within a category of admissible claim under the insolvency legislation. The Supreme Court was no doubt aware of the incongruous nature of according a FSD the status of an expense, as it observed (paragraph 108 of the judgment) that it would be an unusual result if a FSD, which is a mere unsecured obligation before insolvency, gets elevated to the rank of an expense after insolvency, especially if it failed to be recognised as a provable debt.

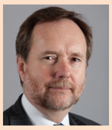
The distinction made by the Supreme Court appears to be that a FSD is capable of being a provable debt within the meaning of Insolvency Rule 13.12(1)(b), because the companies in question fit the profile of the type of companies intended to be liable to FSDs. However the court ruled that FSDs cannot rank as an expense of the administration, since liabilities arising out of statutory obligations can only qualify as "expenses" under the insolvency legislation where they result from some act or decision taken or made by the administrator. This is not the case with a FSD, which is issued at The Pensions Regulator's discretion. On this last point, the ruling is to be welcomed as it puts paid to the suggestion that Insolvency Rule 2.67(1)(f) (which concerns expenses) might be interpreted such that all liabilities arising under statute as expenses of administrations and/or liquidations.

The full judgment is now live.

Contact

If there is anything here you would like to discuss further please contact your usual Burges Salmon contact or one of our specialists:

Michael Hayles
Partner
+44(0)117 939 2248
michael.hayles@burges-salmon.com



Patrick Cook
Partner
+44(0)117 307 6807
patrick.cook@burges-salmon.com

Burges Salmon LLP, One Glass Wharf, Bristol BS2 0ZX Tel: +44 (0) 117 939 2000 Fax: +44 (0) 117 902 4400
6 New Street Square, London EC4A 3BF Tel: +44 (0) 20 7685 1200 Fax: +44 (0) 20 7980 4966
www.burges-salmon.com

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