Nortel & Lehmans – a triumph of common sense?

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A triumph of common sense?

- What was the problem?
  - Insolvency priority order
  - FSDs and 2 previous court decisions
- What options did the Supreme Court have?
- What did they decide?
- Common sense triumph…?

Nortel & Lehmans

- Insolvencies for both groups
- Determinations Panel decided FSDs should be imposed in both cases
- Appeals to Upper Tribunal issued
- But preliminary question as to where FSD would rank in insolvency priority order

What's the problem – insolvency priority order

1 • Fixed charge creditors

2 • Expenses of the insolvency

3 • Preferential creditors

4 • Floating charge holders

5 • Unsecured provable debts

6 • Statutory interest

7 • Non-provable liabilities

8 • Shareholders

Where do pension claims fit in priority order?

- Claims under Schedule of Contributions / s.75 debts?
  – Typically unsecured, so fall within category 5
  – If secured, typically fall within 4 or perhaps 1
- Certain employer contributions for contracted-out schemes
  – Preferential debt so fall under Category 3 (Schedule 4 Pension Schemes Act 1993)

Financial Support Directions…?

- Determinations Panel decides a FSD *should be* imposed
- Terms of financial support negotiated between target and Regulator
- If no agreement, Regulator can seek a Contribution Notice for a specific amount
- CN/FSD doesn't become binding until appeals process exhausted
- In all FSD cases save for ITV & Box Clever, FSD has been imposed on companies already in insolvency proceedings (Sea Containers came out of Chapter 11)

Ranking of FSDs

- FSDs only arose (or were even contemplated) after the insolvency
- Nothing in PA2004 or Insolvency Rules
- 3 possible options:
  - Category 2 – administration expense
  - Category 5 – unsecured provable debts
  - Category 7 – unprovable debts
- Both High Court and Court of Appeal held it fitted into Category 2
  - Criticised by administrators
  - Perverse (why pre/post insolvency difference?)
- Administrators appealed to the Supreme Court

Supreme Court decision

- Upfront comment that "fair answer" was that it be a provable debt (Category 5)
- Problematic definition of "debt":

> "*any debt or liability to which the company* ***may become subject*** *after [the insolvency date] by reason of* ***any obligation incurred before that date***"

- Difficulties were:
  - Target had no contractual/legal "obligation" prior to insolvency to the scheme
  - Discretionary process of Regulator & DP made it too arbitrary to be an obligation under legislation?

Lord Neuberger's analysis

- Where liability could be imposed by statute in future, that could constitute an "obligation" prior to the power being exercised…
- …but only in 3 circumstances – target must have taken or been subjected to steps which:
  - had some legal effect;
  - resulted in it being vulnerable to the specific liability in question
  - would be consistent with the regime to impose liability

All 3 tests met

"Had some legal effect"

Targets had been members of the group for over 2 years (the full look-back period)

Resulted in it being vulnerable to the specific liability

Either service company (Lehmans) or insufficiently resourced employer (Nortel) at the relevant time

Consistent with the regime

FSD regime typically is designed to apply in insolvency situations

- FSD therefore provable debt (Category 5)

Triumph of common sense?

- Could have simply thrown the issue back to Parliament
- Ultimately has reached the "right/fair" answer
- Promotes "rescue culture"
- But…
  – the 3-stage test slightly engineered…?
  – First test – emphasis on the "full 2 years" – but FSD regime doesn't require that
  – Second test – simply begs the question whether FSD jurisdiction tests met
  – If not provable debt will **NOT** be an expense

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