24 July 2013

PRESS SUMMARY

In the matter of the Nortel Companies; In the matter of the Lehman Companies; In the matter of the Lehman Companies (No. 2) [2013] UKSC 52

On appeal from [2011] EWCA Civ 1124

JUSTICES: Lord Neuberger (President), Lord Mance, Lord Clarke, Lord Sumption, Lord Toulson

BACKGROUND TO THE APPEALS

These appeals raise questions of some significance arising out of the interrelationship of the statutory schemes relating to the protection of employees' pensions and to corporate insolvency. In order to protect employees from the adverse consequences of an under-funded occupational pension scheme, the Pensions Act 2004 ("the 2004 Act") introduced a financial support direction ("FSD") regime. This enables the Pensions Regulator in specified circumstances (i) to impose, by the issue of an FSD to some or all of the other group companies (known as "targets"), an obligation to provide reasonable financial support to the under-funded scheme of the service company or insufficiently resourced employer, and (ii) to deal with non-compliance with that obligation by imposing, through a Contribution Notice (a "CN"), a specific monetary liability payable by a target to the trustees.

Many UK registered members of the Lehman group of companies and of the Nortel group of companies have gone into insolvent administration. One of those Lehman group companies entered into service contracts with, and ran a pension scheme for the benefit of, employees who worked for other group members. The Nortel group included a company which had a pension scheme, and which was insufficiently resourced to fund that scheme. The pension scheme ("the Scheme") in each case was a final salary scheme, which appears to be, and to have been for some time, in substantial deficit. The Pensions Regulator subsequently initiated machinery under the 2004 Act to require certain other group members – the target companies – to provide financial support for the Scheme. That machinery has been held up so it can be decided how the administrators of a target company should treat that company's potential liability under the FSD regime (in due course the liability under a CN) in a case where the FSD is not served until after the company has gone into administration (or into insolvent liquidation). Specifically, would the liability under such a requirement rank (a) as an expense of the targets' administration, (b) pari passu (i.e. equally) with the target companies' other unsecured creditors, or (c) as neither? Under option (a) the liability would rank ahead of the unsecured creditors, and may well be paid in full; under option (b) it would rank equally with those creditors; under option (c) it would rank behind them, and would probably be worthless. Briggs J and the Court of Appeal concluded that option (b) was not open to them, and preferred option (a) to option (c).

JUDGMENT

The Supreme Court considers option (b) to be correct, and unanimously allows the appeals to the extent of declaring that a target's liability under the FSD regime, arising pursuant to an FSD issued after the company has gone into administration, ranks as a provable debt of the company, and does not rank as an expense of the administration. Lord Neuberger gives the main judgment of the Court, with which Lord Mance, Lord Clarke and Lord Toulson agree. Lord Sumption gives a short concurring judgment, with which Lord Mance and Lord Clarke agree.

REASONS FOR THE JUDGMENT

The potential liability as a result of an FSD issued after the commencement of an administration or an insolvent liquidation ("an insolvent event") can constitute a "provable debt" within rule 13.2 of the Insolvency Rules 1986 (SI 1925/1986) ("the Insolvency Rules"). Whilst the potential FSD regime liabilities in the present cases do not fall within rule 13.12(1)(a) **[68]-[71]**, they fall within rule 13.12(1)(b) **[83]**. It is common ground that if a CN had been issued in respect of a target before an insolvent event, it would give rise to a provable debt. The courts below considered that, if a CN were issued after an insolvent event, it would give rise to a provable debt if it was based on an FSD issued before the insolvent event. It appears somewhat arbitrary that the characterisation and treatment of the liability under the FSD regime should turn on when the FSD or CN happens to have been issued, if it is based on a state of affairs which existed before the insolvent event **[59]**. The courts below felt constrained by a consistent line of authority from reaching the conclusion the Supreme Court has reached, although it appears that they would have so held if they had felt able to do so **[56]**. These earlier authorities can be overruled: the judgments are very short of reasoning, are inconsistent with another line of authority, and were decided at a time when the legislature and the courts were less anxious than currently for an insolvency to clear all the liabilities of a bankrupt (as they were all concerned with individual insolvencies) **[87]-[94]**.

There is no doubt that the liability which is imposed on a target on the issuing of an FSD after an insolvent event is a liability for the purposes of rule 13.12(1)(b), as it is a "liability under an enactment" within rule 13.12(4). The question is, however, whether it can be said to be a liability which arose "by reason of any obligation incurred before" the insolvent event **[72]**. That issue centres on the meaning of the word "obligation" in rule 13.12(1)(b) **[74]**. At least normally, in order for a company to have incurred a relevant "obligation" under rule 13.12(1)(b), it must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship), and which (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred. If these two requirements are satisfied, it is also relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1)(b) **[77]**. In these appeals, all these requirements are satisfied, and accordingly the relevant "obligation" arose before the target companies went into administration.

Given that the potential FSD liability in each of these cases is a provable debt within rule 12.3 of the Insolvency Rules, and therefore it would not be an expense, it is strictly unnecessary to consider whether the liability under an FSA served after an insolvent event would be a liquidation expense, if, as the courts below held, it was not a provable debt **[97]**. However, given that this issue was fully debated before the Court, and is one of some potential importance, the Court concludes that, if the liability did not rank as a provable debt, it would not count as an expense of the administration **[98]-[114]**. The Court also concludes that if it had taken a different view on the provable debt issue, it would not have held that it had a residual discretion to direct the administrator of a target company to accord to the potential liability under the FSD regime a higher ranking than it would be given under the relevant legislation **[115]-[127]**.

Lord Sumption adds some observations about the limitations on what constitutes an "obligation incurred" for the purpose of rule 13.12(1)(b) of the Insolvency Rules **[129]-[136]**.

References in square brackets are to paragraphs in the judgment