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Legal Update
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Court of Appeal Confirms Financial Support Directions Issued in Insolvency have Super Priority

The Court of Appeal has confirmed that the costs of complying with Financial Support Directions ("**FSDs**") proposed to be issued to certain Nortel and Lehman companies by the Pensions Regulator ("**TPR**") qualify as "super priority" administration expenses, payable in priority to unsecured creditors, floating charge holders and the administrators' own fees.

The question

The Court of Appeal considered whether the High Court was correct to hold that the costs of complying with an FSD (or a Contribution Notice ("**CN**")) is an expense of an administration or liquidation and takes priority over the administrator's own fees, floating charge holders and unsecured creditors. TPR has the power to require companies connected to sponsoring employers in relation to defined benefit pension schemes to provide reasonable financial support for such schemes (by issuing an FSD). If a target of an FSD fails to provide support, TPR may then require it to contribute to the pension scheme by making a specified payment to the pension trustees (by issuing a non-compliance CN). TPR had determined that certain of the Nortel and Lehman companies in administration should be the subjects of an FSD. The question then arose as to the ranking of the costs of complying with such FSDs. (For details of the High Court case, see our December 2010 Client Alert: http://www.mayerbrown.com/publications/article.asp?id=10155&nid=6).

The Court of Appeal's ruling

The appeal was unanimously dismissed. Lord Justice Lloyd, with whom Lord Justices Rimer and Laws agreed, concluded (as did Briggs J at first instance) that an FSD cannot be a provable debt because it does not satisfy the statutory requirement that it must arise out of a pre-existing legal obligation. The moral hazard regime involves the exercise of discretion by TPR and is too complex a process for a legal obligation to be said to arise pre-administration if TPR does not take action until after the company in question is in administration. Having agreed with Briggs J that it cannot have been intended that the costs of complying with FSDs or CNs should not be paid unless all other creditors were paid in full first (ie in practice, never), those costs had to be an expense.

The Court of Appeal expressly left open the question of the date at which the liability of an FSD comes into existence. The Court argued that it is possible for the liability of an FSD to be created as early as the TPR's Determination Panel's decision to issue the FSD, rather than at the date that the FSD is actually issued.

Comment

The Court of Appeal's ruling is not surprising, but will disappoint lenders and distressed investors, as well as the insolvency profession. On the other hand, the decision looks, at first sight, like good news for pension scheme trustees. However, trustees may end up losing out if the indirect consequences of the case are that scheme sponsors cannot obtain finance and beneficial restructurings are prevented. A further appeal to the Supreme Court seems likely, given the potentially serious impact on the relevant companies in question, their administrators and other creditors.

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