Lehman Brothers – A lesson on Financial Support Directions

Elmer Doonan, Partner, Dentons
Jay Doraisamy, Partner, Dentons

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Agenda

- Part I: The pitfalls of the FSD process
- Part II: Impact of the Court proceedings in relation to the Lehman Brothers Pension Scheme

Part I: The pitfalls of the FSD process

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The pitfalls of the FSD Process

- Preliminary enquiries by the Regulator
- Time limits for issuing FSDs
- Potential Targets
- Warning Notice and its contents
- Representations
- Determinations Panel (**DP**) procedure
- Determinations
- References to the Upper Tribunal (**UT**)
- Strike-out
- Liability of Targets and effect of non-compliance

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Preliminary enquiries by the Regulator

- Exact process is unclear
- Case Team investigates the facts of the case
- s72 PA 04 (Provision of Information)
- S73 PA 04 (Inspection of Premises)
- Case Team may discuss concerns with ‘directly affected parties’
- Problems may arise with complex group structures and or large volumes of information
- Regulator decides whether it is appropriate to use anti avoidance powers

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Time limits for issuing FSDs

- Regulator may issue a FSD if the employer was a ‘service company’ or ‘insufficiently resourced’ at the ‘relevant time’ and the target was the employer, or associated with the employer at that time
- From 3 January 2012, the look back period ends when a Warning Notice is issued (previously ended when a Determination was made)
- Amendment extends the amount of time for the Regulator to obtain FSD

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Potential Targets

- If the employer in relation to a DB scheme is a 'service company' or 'insufficiently resourced', the Regulator may issue a FSD to any person, who was at the relevant time:
  - The employer in relation to the scheme
  - An individual associated with the employer (unless the only association arose from employment)
  - A company that was connected with or associated with the employer
- Connected or associated defined in sections 249 and 435 IA 1986 and very complex

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Warning Notice and its contents

- Who may be served with a Warning Notice?
  - Regulator will decide which persons appear to be directly affected parties and serve the Warning Notice upon them.
- Warning Notice will contain:
  - the circumstances of the case, the action or decision under consideration and the grounds and evidence on which the case is based
  - details of the specific powers under consideration
  - material(s) received/obtained by the Regulator that support/undermine the case for the use of the powers
  - length of time Parties have to make representations

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Representations

- Case Team will give a timeframe that it considers is ‘reasonable’ for making representations.
  - What is reasonable?
    - Not normally less than 14 days
    - Parties can request an extension
- Case Team will consider representations and decide whether:
  - to refer the matter to the DP
  - to provide a ‘Response’ to representations received
  - not to refer the matter to the DP
- Case Team will communicate its decision to each directly affected party

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DP Procedure

- DP will set a timetable for progress of the matter
- DP will decide whether or not there should be an oral hearing
- DP will not have taken part in the investigations by the Case Team and may:
  - consider additional evidence supplied by the Parties so long as it is submitted within a time period that means it can be properly considered by all Parties
  - request the production of apparently existing information or material
  - decide to consider any additional information from non directly affected parties
- Before making a determination, DP will review and decide which Parties are ‘directly affected’ by the Determination.

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Determination

- Standard of proof is the 'balance of probabilities'
- The burden of proof is on the Case Team
- DP will issue a Determination Notice when it reaches a decision
- Reasons will accompany the Determination Notice
- Determination Notice must contain information about the right of a directly affected party to refer matter to the Upper Tribunal

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Reference to the UT

- Time to refer – 28 days from the date of the Determination Notice
- The right of reference is either automatic or with permission
  - permission may be granted to a party that persuades the Upper Tribunal that it is directly affected by the Determination.
  - no formal procedure for granting permission
  - Upper Tribunal has adopted a wide view regarding the meaning of 'directly affected'
- The Regulator cannot make a reference
  - 'second bite of the cherry' argument
  - confirmed by Warren J in Bonas Group Pension Scheme [2011]
- The reference is by way of re-hearing and is not based on points of law or facts

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Liability and effect of non-compliance

- The FSD must identify all persons to whom it is issued and require the Targets to secure that:
  - financial support for the scheme is put in place within a specified period
  - the financial support remains in place while the scheme is in existence
  - TPR is notified of certain events
- TPR can issue a Non Compliance Contribution Notice if Targets fail to comply with FSD.
  - Non compliance contribution notices can require the payment of some or all of the employer debt due at the date of non-compliance.
  - TPR can only issue a non compliance contribution notice if it is reasonable to do so
  - Non compliance contribution notice cannot be issued if the PPF has assumed responsibility for the scheme

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Part II: Impact of the Court Proceedings in relation to the Lehman Brothers Pension Scheme

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Background to the Court Proceedings

- Two legal actions have arisen out of the Lehman FSD case
- The first legal action is about the time limits on TPR for issuing a FSD and whether trustees can appeal a DP's decision (the **FSD Issue**)
- The second legal action is about where a FSD ranks in the statutory order of priority for meeting creditors' claims in company insolvency (the **Priority Issue**)

The Lehman Administration

- On 15 September 2008 many Lehman Brothers UK companies enter administration in the UK after the US parent, Lehman Brothers Holdings Incorporated, entered Chapter 11.
- Lehman Brothers had a UK DB pension scheme with had an estimated section 75 deficit of £148m in 2007 – now certified under section 75 as £121m.
- Sole employer in the DB pension scheme was Lehman Brothers Limited (**LBL**) which employed all UK staff in Lehman UK companies and was a service company for FSD purposes.

The FSD Issue – Determinations Panel

- On 24 May 2010 TPR issued a Warning Notice against 73 Lehman companies.
- Time limit for obtaining FSD was 2 years, ending on the date FSD issued. TPR elected for time to run from 15 September 2008 so FSDs must be issued by 15 September 2010.
- DP oral hearing on 8/9 September 2010. At that point TPR had decided not to proceed against 29 Targets, so 44 Targets remained.

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The FSD Issue – the DP

- Only two Targets represented at the DP oral hearing, the other 42 refused because of lack of time to prepare case and reserved their right to refer matter to the Upper Tribunal.
- On 13 September 2010 DP issued Determination Notice that an FSD should be imposed on 6 Targets.
- DP decided no FSD should be issued against 38 Targets and accepted written submissions that TPR had not set out a case in the Warning Notice against them.

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The FSD Issue – Reference to Upper Tribunal (UT)

- In October 2010 the Trustees referred DP determination not to issue a FSD against 38 Targets to the UT and 6 Targets also referred the determination that a FSD be issued against them to the UT.
- The references stayed by the UT on14 November 2010, pending the outcome of the Court application on the Priority Issue.
- On 8 July 2011 the 38 Targets applied for the stay to be lifted for the purpose of making an application to strike-out the Trustees' reference.

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The FSD Issue – The Strike-out Application before the Upper Tribunal

- Two legal grounds
  - DP had to determine to issue FSD within two years i.e. by 15 September 2010, under the Pensions Act 2004, so out of time.
  - Only a 'directly affected' person entitled to refer DP determination to the UT. The Trustees not 'directly affected' persons – only Targets fall into this category.
  - Trustees argue Art. 6 of Human Rights Convention breached if they have no right of appeal to an independent tribunal.
  - UT decided still possible to determine to issue a FSD against 38 Targets and that Trustees are 'directly affected' persons so strike-out failed.

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The FSD Issue – Appeal to Court of Appeal

- 38 Targets appeal UT decision to Court of Appeal in July 2012 and Trustees cross-appeal on Art. 6 issue
- Appeals heard by Court of Appeal in April 2013.
- Judgment reserved and expected July 2013.
- Similar issues heard by NI Court of Appeal in Desmond in December 2012 and judgment awaited
- Possible appeal to Supreme Court?
- If strike-out fails the case will return to UT for re-hearing on whether FSDs should be imposed on the 38 Targets

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Part II: The Priority Issue

- DP determined to issue FSDs against 20 companies in Lehman and Nortel administrations.
- PA 2004 silent on where FSD (or CN) liability ranks in order of priority of creditors in insolvency so unclear how administrators should deal with cost of complying with a FSD or a CN.
- Applications made to Court by the administrators for directions on status of FSD liability in administration or liquidation.

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The Priority Issue - Bloom v Pensions Regulator – High Court

- High Court judgment in December 2010
- Issue whether FSD or CN liability was (a) an administration expense; (b) a provable debt (i.e., unsecured debt claim) or neither and only payable if funds left after settling all other claims.
- If FSD/CN liability an administration expense would rank ahead of costs of administrators and all creditors other than fixed charge holders.
- If FSD/CN liability neither an administration expense or a provable debt it would fall into “black hole” and not be paid.
- Briggs J decided an administration expense.

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The Priority Issue - Bloom v Pensions Regulator – Court of Appeal

- Administrators appealed decision to Court of Appeal and judgment in October 2011.
- Court of Appeal upheld High Court decision.
- Both High Court and Court of Appeal decision reached reluctantly and result from failure of PA 2004 to address this issue.
- Both bound to reach conclusion by binding effect of a House of Lords decision that absence of provision for a liability in the insolvency regime makes it an administration expense.
- Many illogical results of decision were noted.

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The Priority Issue - Bloom v Pensions Regulator – The Supreme Court

- Appeal to the Supreme Court heard in May 2013
- Decision unlikely to be published until autumn 2013.
- Supreme Court may determine that FSD/CN liability is not an administration expense but only a provable debt.
- Unlikely to decide that FSD/CN liability is neither as would render them ineffective in insolvencies.
- Implications if FSD/CN is an administration expense.
- Implications if FSD/CN is a provable debt.

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The Priority Issue - Regulatory Guidance on FSDs

- TPR issued statement in July 2012 dismissing concerns following High Court/ CoA decisions it would delay FSD proceedings.
- Administrators can approach TPR before administration commences.
- TPR has stated that it will act ‘reasonably’
- Administrators may apply to court for prospective order varying ‘order of priority’ and TPR has stated in ‘most’ circumstances it will not object to re-ordering
- TPR does not believe High Court or Court of Appeal decisions have hampered insolvency and restructuring process
- TPR has confirmed it does not intend to frustrate insolvency and restructuring process

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Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.