

Neutral Citation Number: [2011] EWCA Civ 1124

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT
MR JUSTICE BRIGGS
[2010] EWHC 3010 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 14 October 2011

Before:

LORD JUSTICE LAWS
LORD JUSTICE LLOYD
and
LORD JUSTICE RIMER

Between:

**IN THE MATTER OF NORTEL GMBH (IN
ADMINISTRATION) AND OTHER COMPANIES
(Appeal 2011/0062)**
**IN THE MATTER OF LEHMAN BROTHERS
INTERNATIONAL (EUROPE) (IN
ADMINISTRATION) AND OTHER COMPANIES
(Appeal 2011/0103)**

**Appeal
2011/0062**

**(1) ALAN ROBERT BLOOM (2) ALAN MICHAEL
HUDSON (3) CHRISTOPHER JOHN WILKINSON
HILL (4) STEPHEN JOHN HARRIS (5) DAVID
MARTIN HUGHES**

Appellants

- and -

**(1) THE PENSIONS REGULATOR
(2) BOARD OF THE PENSION PROTECTION FUND
(3) NORTEL NETWORKS UK PENSION TRUST LTD**

Respondents

**Appeal
2011/0103**

**(1) ANTHONY VICTOR LOMAS (2) STEVEN
ANTHONY PEARSON (3) MICHAEL JOHN
ANDREW JERVIS (4) DAN YORAM
SCHWARZMANN (5) DEREK ANTHONY HOWELL**

Appellants

and

**(1) THE PENSIONS REGULATOR
(2) BOARD OF THE PENSION PROTECTION FUND
(3) PETER ANTHONY GAMESTER (4) BRIAN
SEWARD (5) PETER SHERRATT (6) THOMAS PAUL
BOLLAND
(7) LEHMAN BROTHERS HOLDINGS**

**INCORPORATED (8) NEUBERGER BERMAN
EUROPE LIMITED**

Respondents

(Transcript of the Handed Down Judgment of
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Hearing dates: 26 to 29 July 2011

Judgment

Lord Justice Lloyd:

Introduction

1. These appeals raise important and difficult questions posed by the impact of legislation for the protection of pension funds upon companies which are undergoing an insolvency process. The proceedings were issued in September 2010 and came to trial before Briggs J over 5 days at the end of November 2010. He gave judgment, [2010] EWHC 3010 (Ch), on 10 December 2010. The appeals, for which he gave permission, came on before us at the end of July 2011.
2. UK legislation for the protection of the funds of defined benefit occupational pension schemes has developed considerably over recent years, to meet different problems as they have been perceived and experienced. Following the report of the Goode Committee (the Pension Law Review Committee, Cm 2630), the Pensions Act 1995 was passed. Among its provisions was section 75. This created a debt owed by the employer to the trustees of an occupational pension scheme which was not a money purchase scheme, if the value of the assets of the scheme, at a given time, was less than the amount of its liabilities, the debt being of the amount of that difference. The given time was when the scheme was being wound up (before any insolvency event in relation to the employer), unless an insolvency event occurred as regards the employer before the scheme came to be wound up, in which case the given time was immediately before the insolvency event. Since the Pensions Act 2004, an insolvency event includes entering administration. For the purposes of insolvency legislation, the debt was deemed to arise immediately before the insolvency event. This had the effect that it would be a provable debt; it was expressly provided not to be a preferential debt. (Some obligations of an employer to contribute to its pension fund are preferential: see Insolvency Act 1986 Schedule 6 paragraph 8, and Pension Schemes Act 1993 Schedule 4. These are much more limited in scope and amount than the section 75 debt or any amount payable under the liabilities at issue in these appeals.)
3. The legislation with which these appeals are most directly concerned is in the Pensions Act 2004, and is directed at a different but related problem. As an example, a group of companies may be organised in such a way that the employees who are to work on behalf of any company in the group are employed by one particular company, which may have no other significant functions within the group, and in particular may have no particularly valuable assets. As employer of those employees, it would be the employer in relation to the occupational pension scheme. It may, however, depend on transfers of funds, by way of management charges or otherwise, from its parent company or from other companies within the group, to discharge its obligations to the employees, and generally. It will be subject to the section 75 debt, if the pension fund assets are inadequate, as they often are nowadays, but it may well not have assets with which to discharge that debt.
4. In order to alleviate that problem, the Pensions Act 2004 includes provisions by which the Pensions Regulator, the new regulator set up by that Act, can require other companies which are or were associated with the employer to provide financial support for the scheme, issuing a financial support direction for that purpose. An elaborate procedure is laid down for this process, which I will describe later. At the end of the process, if it is not complied with at an earlier stage, the Pensions Regulator

may issue a notice, called a contribution notice, under which the person on whom it is served is liable to pay a specified sum to the trustees of the scheme, which is the whole or part of the shortfall sum, measured by reference to the amount estimated to be due at the time by way of a section 75 debt. The 2004 Act provides for contribution notices in other situations as well, but these appeals are only concerned with contribution notices following non-compliance with a financial support direction.

5. The 2004 Act also introduced the Pension Protection Fund (PPF), which is financed by levies on occupational pension schemes, and which provides protection (albeit limited) for beneficiaries of defined benefit schemes in deficit where the employer has become insolvent. Part of the point of the financial support direction regime is to avoid or reduce the risk of the moral hazard that groups of companies including an employer in such a position would leave the scheme without adequate funds to meet the liabilities of the scheme and leave the employer without assets with which to make good the deficit, thereby passing the risk to the PPF.
6. Unlike section 75, both as originally passed and as modified by the 2004 Act itself, the provisions of the 2004 Act about financial support directions and contribution notices refrain from making any express provision as to how the liability under a contribution notice, or any obligation under a financial support direction, is to be treated for the purposes of any insolvency proceedings. That issue has to be resolved by reference to the general provisions of the insolvency legislation. The sums in question may be large. In relation to the Lehman Brothers insolvency the shortfall under section 75 is estimated to be of the order of £125 million; in the case of Nortel Networks UK Ltd it was put at £2.1 billion when that company went into administration in January 2009. Accordingly, the way in which any liability under a financial support direction or a contribution notice is to be treated in insolvency proceedings may have a major impact on the members of the scheme and on the creditors of relevant companies.
7. The Pensions Regulator has not got to the stage of issuing either a financial support direction or a contribution notice in relation to any company in either the Nortel group or the Lehman Brothers group which is a party to these appeals as yet, but it has started on the way towards such steps being taken. In January 2010 it issued a Warning Notice to a number of Nortel companies to the effect that it was considering exercising its power to issue a financial support direction. After the appropriate statutory process, the Determinations Panel of the Pensions Regulator gave notice that it had concluded that a financial support direction should be issued, as set out in a determination notice dated 25 June 2010. It is open to the recipients of such a notice to refer the matter to the Upper Tribunal (Tax and Chancery Chamber) and that right has been exercised by the companies which are parties to these appeals. (Four Nortel companies did not exercise the right, and financial support directions have been made in relation to them.) In the meantime the question of the issue of a financial support direction remains in suspense. In the case of the Lehman Brothers group, after a Warning Notice dated 24 May 2010, served on various dates between then and early July 2010 on different companies in the Lehman Brothers group, the Determinations Panel determined on 13 September 2010 that a financial support direction should be issued in relation to six companies in the group, though not against others on which the Warning Notice had been served. Again, that process remains in suspense pending a reference to the Upper Tribunal. The judge said at paragraph 6 of his

judgment that a decision on the issues raised by the present proceedings was highly desirable before the regulator and the respective office-holders address in practical terms the questions that would arise as regards the issuing of, and compliance with, a financial support direction or, in turn, a contribution notice. I agree. That lends urgency to the proceedings and to the appeals.

Financial support directions and contribution notices under the Pensions Act 2004

8. The judge provided an admirable description of the relevant legislation in the 2004 Act at paragraphs 15 to 41 of his judgment, to which reference may be made. Given the availability of that description, I can be rather more brief and summary in setting out the provisions that are most pertinent to the appeals.

9. Part I of the 2004 Act relates to the Pensions Regulator. It includes a number of provisions of greater or lesser relevance to the issues arising in these appeals. I will limit my reference, at this stage, to those most relevant, though some others will call for mention later. The sections dealing with financial support directions, and with contribution notices issued on non-compliance with a financial support direction, start at section 43. The judge rightly said of this legislative regime, at paragraph 13:

“It is on any view a novel and unusual regime, giving rise to legal obligations of a type with which (if applicable to targets in an insolvency process) the existing rules as to priority in insolvency have not previously had to contend.”

10. By section 43(3) a financial support direction in relation to a scheme is a direction which requires the person to whom it is issued to secure that financial support for the scheme is put in place within a period specified in the direction, that that or other financial support remains in place while the scheme is in existence and that the Pensions Regulator is notified in writing of prescribed events (which include insolvency events) in respect of the financial support as soon as reasonably practicable after the event occurs. Such a direction may only be issued in respect of a scheme which is an occupational pension scheme and is not a money purchase scheme: section 43(1). It may only be issued if the Pensions Regulator is of the opinion that the employer in relation to the scheme is either a service company or insufficiently resourced, in each case at a time within a prescribed period (currently 2 years) before the time when the regulator determines to exercise the power: section 43(2). That earlier time is defined as the relevant time and is important for several purposes. It was referred to by the judge and in argument as the “look-back” date. A direction may only be issued to a person (conveniently referred to in argument as a target) who at the relevant time was the employer in relation to the scheme or a corporate body connected with, or an associate of, the employer: section 43(6). (If the employer is an individual, the direction may be issued to some associated individuals.) Moreover, the Pensions Regulator may only issue a financial support direction if it is of the opinion that it is reasonable to impose the requirement of the direction on that person: section 43(5)(b). Section 43(7) requires the Pensions Regulator to have regard to such matters as it thinks relevant in deciding whether it is reasonable to impose the requirements of a direction on a person, including (where relevant) some specified matters; these include the financial circumstances of the person.

11. The phrases “service company” and “insufficiently resourced” are explained by section 44.
 - i) An employer is a service company at the relevant time if it is a company, and a member of a group of companies, and its turnover, as shown in its latest individual statutory accounts, is solely or principally derived from amounts charged for the provision of the services of its employees to other members of the group.
 - ii) An employer is insufficiently resourced at the relevant time if its resources are less than a prescribed proportion of the estimated section 75 debt in relation to the scheme (currently 50%), and if one or more of its associates have resources which (in the case of a single associate, on its own, or if there is more than one, then in aggregate) are not less than the difference between the value of the employer’s resources and 50% of the estimated section 75 debt. The target of a financial support direction does not have to be the associate, or any of the associates, of the employer whose assets at the relevant time enable this test to be satisfied.
12. A financial support direction does not prescribe what financial support is to be given nor how it is to be provided. It is up to the person to whom a financial support direction is issued to decide what arrangements to make for the purpose, but by section 45 financial support for a scheme, such as is required to be provided in order to comply with a financial support direction, must be arrangements within the scope of the section the details of which are approved in a notice issued by the Pensions Regulator. It can only approve such arrangements if it thinks they are reasonable in the circumstances. The possible range of the arrangements mentioned in section 45(2) is very wide. It is therefore for the target company or companies to decide what arrangements it or they wish to put in place in order to comply with the financial support direction, and then to obtain the Pensions Regulator’s approval of the arrangements.
13. If a company to which a financial support direction was issued fails to comply with it, the Pensions Regulator may issue a notice to any one or more persons to whom the financial support direction was addressed, stating that the person is under a liability to pay to the trustees of the scheme the sum specified in the notice: section 47(1), (2). This is called a contribution notice. The regulator may only do this if it considers it reasonable to impose the liability on the person to pay the specified sum; in deciding whether it is, the regulator is to have regard to such matters as it thinks relevant, with some particular matters being identified expressly: section 47(3), (4). The sum specified may be the whole or part of the shortfall sum, which is defined by reference to what is estimated as being the debt due under section 75 or what the regulator estimates would be the amount of that debt if it were already due.
14. Thus a contribution notice defines the relevant obligation in money terms, as a specific obligation to pay a given amount of money to the trustees of the relevant scheme. The obligation created by a financial support direction may be binding on administrators or liquidators (I will address that point later), but it is not one which can itself be the subject of a proof of debt because it does not create an obligation by reference to a specific sum of money; by contrast the debt created by a contribution notice could be the subject of a proof.

15. Those are the two essential stages in the process by which the Pensions Regulator can seek to shore up the adequacy of a deficient scheme in the relevant circumstances. However, the procedure attending these steps is elaborate. One significant aspect is that certain functions, called in section 10 reserved regulatory functions, must be exercised on behalf of the Pensions Regulator by its Determinations Panel, which is an independent committee constituted under section 9. These include the powers to issue a financial support direction or a contribution notice, but not the power to determine whether to approve arrangements pursuant to a financial support direction. Both the Pensions Regulator and the Determinations Panel are to determine the procedure which they will follow in relation to relevant regulatory functions, and this procedure is to be published: section 93(1), (3), section 94.
16. The standard procedure for the relevant regulatory functions must provide for the giving of a warning notice to such persons as it appears to the Pensions Regulator would be directly affected by the regulatory action under consideration, for those persons to have the opportunity to make representations, for the representations to be considered before a final decision whether or not to take the action in question, and for the giving of notice of the determination to persons directly affected by it: section 96(2). If notice is given of a determination to take the action in question, a person on whom the notice is served may refer it to the Upper Tribunal: section 103. No action can be taken on the determination while a reference is possible, or while a reference is pending. On such a reference the Upper Tribunal may consider any evidence relating to the subject-matter of the reference, even if it was not available to the Pensions Regulator at the relevant time, and the Tribunal must determine what (if any) is the appropriate action for the regulator to take in relation to the matter referred. It must remit the matter to the regulator with appropriate directions (if any) for giving effect to its own determination, which may confirm the regulator's determination, vary or revoke it, or substitute a different determination: section 103(4), (5) and (6). Thus, the proceedings before the Upper Tribunal involve a fresh hearing and decision. This may be invoked by a person on whom a determination notice is served stating that it has been decided to issue a financial support direction or a contribution notice.
17. Given that time necessarily elapses before the issue of a warning notice in respect of either a financial support direction or a contribution notice, that further time must elapse after a warning notice, for the making and consideration of representations, before a determination notice is served, and that there may then be a reference to the Upper Tribunal, and given that this may apply both at the financial support direction stage and at the later contribution notice stage after non-compliance with a financial support direction, the process from initial investigation to the issue of a contribution notice may take a good deal of time. The Determinations Panel held a hearing to decide whether to determine that a financial support direction should be issued in each of these cases. The Nortel targets were not represented at the hearing convened in that case, but the Determinations Panel nevertheless required to be satisfied (by those appearing for the Pensions Regulator and for the trustee of the Nortel scheme) that the conditions for issue of a financial support direction were satisfied, including the requirement of reasonableness. At the hearing relating to the Lehman Brothers scheme several targets were represented, and there was substantial argument both on preliminary and on substantive points. That process, including the hearing, was conducted under serious time pressure on the basis that, if there was to be a determination to issue a financial support direction, the provision about looking back

two years from the date of the determination (referred to in paragraph [10] above) meant that it had to be made within the 2 year period from the collapse of the Lehman Brothers group in September 2008.

18. Both of the present cases were initiated after the insolvency process had started. We were told of one other case in which a financial support direction was issued, Sea Containers, described by the judge at paragraphs 43 to 46 of his judgment. In that case the insolvency process ensued within a few months of the Pensions Regulator starting its investigation; the warning notice was issued just after the inception of the insolvency process. Even if the financial support direction process is initiated at a time when no insolvency process is in prospect, there may be significant changes in the financial circumstances of relevant entities in the course of the process under the 2004 Act, including the onset of an insolvency process.
19. There is no statutory procedure for a challenge to a financial support direction once issued, or a contribution notice, though presumably a challenge by way of judicial review is a theoretical possibility, at least if the statutory procedure had not been followed properly. An appeal lies (with permission) from the decision of the Upper Tribunal to the Court of Appeal, on a point of law.

The financial support direction procedure and insolvent companies: general

20. Under English insolvency law two different kinds of insolvency procedure have to be considered: administration and liquidation. When the administration regime was first introduced, in the Insolvency Act 1986, it did not allow for distributions to creditors within the administration. If the administration did not succeed in rescuing the company altogether, it was expected that a winding-up would follow, and the available assets would be distributed to creditors within the liquidation. The clear division between administration and winding-up for this purpose was eroded to some extent as a result of judicial decisions. Under the Enterprise Act 2002, it changed entirely, so that it is possible for assets to be distributed to creditors by administrators, and a winding-up may not be necessary at all. (Conversely, a company which is in liquidation may now come out of it and go into administration.) Of course there may be companies which go into liquidation without having been in administration, but those with which we are concerned (apart from one which is not insolvent) are in administration, and may or may not eventually go into liquidation.
21. This matters because of a particular distinction. In general, the unsecured debts of a company which goes into an insolvency process, identified as at the start of that process, will be payable *pari passu* to the relevant creditors, who claim payment by proving for their debts. There has to be a cut-off date to determine the class of creditors who are to participate in the distribution of the company's available net assets. As the law stood as regards the companies with which these appeals are concerned, the cut-off date for claims in a liquidation is the date on which the company goes into liquidation, whether or not the liquidation was immediately preceded by an administration. The cut-off date for claims in an administration is the date on which the company entered administration. Under this regime, if an administration is followed immediately by a liquidation, the debts provable in the liquidation would include any which arise during the administration, although debts provable in the administration would be limited to those arising before the administration.

22. The position in this respect has changed, as of 5 April 2010, but without retrospective effect. Now, if a liquidation is immediately preceded by an administration, the cut-off date for claims in the liquidation is the date when the administration began. The same issue as arises in these appeals can still arise. The difference is that there will not be an artificial distinction between the position applying if the company proceeds from administration to winding-up and that applying where it does not. The change will tend to increase the importance of the dispute as to the correct treatment for insolvency purposes of the liabilities arising under a financial support direction or a contribution notice.
23. It is therefore accepted, as regards the companies presently concerned, that if a liability of such a company arises during the administration, and if a winding-up follows later, that liability can be the subject of proof in the liquidation. The judge decided that and it is not challenged on the appeals.

Payments to creditors in insolvency processes – general

24. At the risk of stating the obvious, an insolvency process is intended to achieve the collective realisation of the assets of the debtor and their distribution among the relevant creditors, that distribution being *pari passu*, subject to specific exceptions, such as the ranking of some debts as preferential, and leaving aside secured creditors to the extent of their security. In order to determine which creditors are within the relevant class, there has to be a cut-off date, which is normally the inception of the insolvency process. I have already noted the different treatment of liquidations for this purpose at the time relevant to these appeals, on the one hand, and now after the statutory change on the other.
25. In theory the distribution is simultaneous, and the cut-off date applies for the purpose of deciding both which are the relevant debts and also what is the amount of each debt: see *Stein v Blake* [1996] 1 AC 243, at 252C, per Lord Hoffmann. Thus, later changes are ignored, for example by the exclusion of interest on the debt (except as provided for by statute in the insolvency, if the assets suffice) and by ignoring changes in exchange rates if the debt is in a foreign currency: see *Re Dynamics Corporation of America* [1976] 1 W.L.R. 757. The rules as to what debts can be claimed in an insolvency have changed over time, for example as regards tort claimants. There is no general rule that all persons who were creditors at the cut-off date must be able to claim in the insolvency. Instead there are specific rules as to who can prove in the insolvency for what debts. Those rules include provision for debts or liabilities present, future and contingent. I will set the relevant rules out below.
26. In practice, of course, the distribution cannot be simultaneous. The insolvency process takes time, and may take a very great deal of time. This means that there may be changes in the situation as regards a given debt. Some of these are ignored, such as exchange rate differences, as already noted. Others are not ignored, as where a bank was liable on a guarantee at the beginning of an insolvency process in relation to the bank but, after a proof of debt had been lodged, the liability of the bank was transferred to a different entity under relevant statutory provisions, so that the bank was no longer liable and the debt was no longer provable: *Wight v Eckhardt Marine GmbH* [2003] UKPC 37, [2004] 1 AC 147.

27. Also inevitably, time is taken and further liabilities arise in the course of the insolvency process. These may or may not be provable in the insolvency. I will need to examine the true nature of the test, but in general terms (and without prejudice to my later discussion) they are provable if they arise from liabilities which existed at the inception of the process. Some do, for example rent for periods after the inception under a lease entered into beforehand. Some do not, for example liabilities undertaken, or imposed, for the first time during the insolvency process. The latter are not provable. If they are payable in the insolvency it is as an expense of the administration or liquidation, as the case may be.
28. Generally speaking, expenses are not provable and provable debts are not payable as expenses; normally the two classes are entirely distinct. There is, however, an overlap between the two. To take an illustrative example, rent due under a lease entered into before the insolvency and falling due for periods during the insolvency is a provable debt, but it may be payable as an expense if the office-holder retains the relevant property for the purposes of using it in the course of the insolvency, or of disposing of it advantageously, or otherwise for the benefit of the insolvent estate: see *Re Lundy Granite Co, ex parte Heaven* (1871) LR 6 Ch App 462, *Re Toshoku Finance UK plc* [2002] UKHL 6, [2002] 1 W.L.R. 671, (*Toshoku*) per Lord Hoffmann at paragraphs 25 to 29, and for an example close to home, so to speak, *Goldacre (Offices) Ltd v Nortel Networks UK Ltd* [2009] EWHC 3389 (Ch), [2010] Ch 455.
29. The provisions as to what is payable by the office-holder as an expense of the insolvency are found in the relevant legislation; I set them out below. Whether any particular liability is so payable depends on whether it is within the statutory words. It would, however, be surprising to find that a statutory liability, imposed on a company which is undergoing an insolvency process, is not either provable or payable as an expense. As Lord Hoffmann said at paragraph 30 of *Toshoku*:
- “There would be little point in a statute which specifically imposed liabilities upon a company in liquidation if they were payable only in the rare case in which it emerged with all other creditors having been paid.”
30. Given the precedent set in relation to section 75 by the 1995 Act, and given the relationship between the obligation under a financial support direction and the liability under a contribution notice, on the one hand, and the section 75 debt on the other, it might not have been surprising to find that the 2004 Act provided that the liability under a contribution notice was a provable debt in the insolvency of the relevant target company. One looks in vain for any such express provision in the 2004 Act.
31. Accordingly, the liability under a contribution notice is not provable in the insolvency of the relevant target company unless the nature of that obligation satisfies the general test in the insolvency legislation as interpreted in previous cases. As for whether it is payable as an expense, it is not in dispute that a company which is undergoing an insolvency process may be made the subject of a financial support direction and eventually a contribution notice. The question is whether the nature of the obligation imposed is such as to satisfy the test in the legislation as interpreted in *Toshoku* and subsequent cases.

The issues in the appeals and the parties' positions

32. The judge held that if a contribution notice is issued when the relevant target company is in administration, the liability under the contribution notice is not capable of proof in the administration, but that if the company then went into liquidation it could be proved for in the liquidation. (It was not necessary, on the facts, to consider the case of a contribution notice pursuant to a financial support direction issued before the company entered administration.) Moreover, even if the contribution notice was issued while the company was in liquidation, but the prior financial support direction had been issued while it was in administration, the liability would be provable in the liquidation. If, however, the financial support direction was not issued until the company was in liquidation, neither it nor any eventual contribution notice could be the subject of proof, and if the financial support direction or contribution notice was issued when the company was in administration and the company did not later go into winding-up, the liability would not be provable in the administration.
33. There is no appeal against the decision that the liability under a contribution notice issued while the company is in liquidation but pursuant to a financial support direction issued during administration is a provable debt in the liquidation. The issue arises in relation to the other possible cases. What happens if the company does not go into liquidation at all, so that the rights of creditors are to be determined only by reference to the administration regime? What is the position if the company does go into liquidation, but the financial support direction is not issued until after that has happened? There are, essentially, three possibilities: (1) the debt is provable in the administration or the liquidation as the case may be, or (2) it is payable by the administrators as an expense of the administration or, as the case may be, by the liquidators as an expense of the liquidation, or (3) it is not payable at all, except insofar as all other creditors have been paid in full. The third answer was referred to as the black hole since, for practical purposes, it means that the liability will not be met at all.
34. The judge's conclusion was that the liability could not be the subject of proof in these circumstances, but that it is payable as an expense. This is challenged by the appellants, Mr Trower Q.C. arguing (on the part of the Nortel administrators) that the liability creates a provable debt and Mr Dicker Q.C. (for the Lehman administrators) that it is destined for the black hole. By Respondent's Notices some of the respondents argue in favour of provable status for the debts, if the judge's conclusion in favour of an expense of the administration or the liquidation is not accepted. The seventh and eighth respondents in the Lehman appeal, which are solvent, also challenge by a Respondent's Notice the judge's rejection of an application of the principle in *Ex parte James* (1874) LR 9 Ch App 609.
35. The various points arising were allocated by agreement between Counsel for the respondents, so that Miss Agnello Q.C., for the Pensions Regulator, showed us the structure and detail of the legislation in the 2004 Act, Mr Sheldon Q.C. dealt with arguments about whether the liability was an expense in the administration or the liquidation, supported by some submissions from Mr Tennet Q.C. as regards the pensions legislation, Mr Moss Q.C. dealt with the arguments about whether the liability was provable, and Mr Barry Isaacs Q.C. covered *Ex parte James*.

36. The court was much assisted by the careful and clear presentation of the written and oral submissions on the part of all Counsel which, allowing for the complexity and importance of the issues, was commendably well-focussed, covering all aspects while avoiding unnecessary duplication or repetition.
37. As the judge observed, it cannot be said that, just because a debt is not provable, it should be held to be payable as an expense. There is no principle that every debt to which an insolvent company was subject must be payable in the insolvency process in one way or another. Former employees of Turner & Newall to whom the company was under a potential liability in tort but where the prior negligence (as regards exposure to asbestos) had not yet caused actionable damage when the company went into liquidation found this out to their cost: see *Re T & N Ltd* [2005] EWHC 2870 (Ch), [2006] 1 W.L.R. 1728. The law on that particular point has been changed since then. However, it is still the case that whether a liability can be the subject of proof and whether it is payable as an expense are two quite separate questions, to be decided according to the two different sets of relevant statutory provisions. If a liability does not satisfy either, then in the case of a corporate insolvency it will fall down the black hole.
38. For my part, as the judge did, I find it helpful to start with the question whether the debt is provable or not.

Is the liability a provable debt?

39. The applicable statutory provision is rule 13.12 of the Insolvency Rules 1986. It has been amended but, as relevant to these appeals, it was as follows:

“13.12 “Debt”, “liability” (winding up)

- (1) “Debt” in relation to the winding up of a company, means (subject to the next paragraph) any of the following
 - (a) any debt or liability to which the company is subject at the date on which it goes into liquidation;
 - (b) any debt or liability to which the company may become subject after that date by reason of any obligation incurred before that date; and
 - (c) any interest provable as mentioned in Rule 4.93(1).
- (2) For the purposes of any provision of the Act or the Rules about winding up, any liability in tort is a debt provable in the winding up, if either
 - (a) the cause of action has accrued at the date on which the company goes into liquidation; or
 - (b) all the elements necessary to establish the cause of action exist at that date except for actionable damage.

- (3) For the purposes of reference in any provision of the Act or the Rules about winding up to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, or whether its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion; and references in any such provision to owing a debt are to be read accordingly.
- (4) In any provision of the Act or the Rules about winding up, except in so far as the context otherwise requires, “liability” means (subject to paragraph (3) above) a liability to pay money or money’s worth, including any liability under an enactment, any liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution.
- (5) This Rule shall apply where a company is in administration and shall be read as if references to winding-up were a reference to administration.”

40. Rule 13.12(2) was introduced in 2006 to alter the position established in *Re T & N Ltd* to which I have referred already. Before that the company was deemed to become subject to the liability in tort by reason of an obligation incurred when the cause of action accrued, so if the defendant’s negligence only caused actionable damage after the cut-off date, the liability was not provable. Earlier still, before the 1986 legislation, a liability in tort for unliquidated damages could not be the subject of proof at all unless quantified by judgment or agreement.
41. Rule 13.12(5) was introduced in 2003 to extend the definition to administration, as a consequence of the changes to the administration regime by the Enterprise Act 2002.
42. The critical question is whether the liability under a contribution notice is within the terms of rule 13.12(1)(a) or (b) at the date when the company goes into administration, if the contribution notice has not yet been issued and a financial support direction has also not yet been issued. As I have described, there are many steps along the way to a contribution notice. In practice, it would make no difference to examine the position at any earlier stage of the process, as regards the position in an administration, in the present cases, since no step had been taken before the companies went into administration. Nevertheless, in principle the critical stage could possibly be, not the issue of the financial support direction or the contribution notice itself, but the issue of a determination notice by the Determinations Panel announcing the decision to issue a financial support direction or a contribution notice as the case may be; both Mr Trower and Mr Dicker recognised that possibility in the course of their submissions. There could perhaps be a case for taking the service of a warning notice by the Pensions Regulator as the decisive moment. I will ignore those possibilities for the purposes of this judgment since it makes no difference on the present facts. Nothing I say is to be taken as deciding either way as to the possible relevance of any earlier stage in the process than the issue of a financial support direction.

43. Leaving that aside, the regime under the 2004 Act has to be examined as to how the terms of rule 13.12 apply to it.
44. Rule 13.12(1) appears to envisage two different cases: a debt to which the company *is* subject at the relevant time, and a debt to which it *may become* subject after that date by reason of an obligation incurred before the date. That language indicates a comprehensible distinction between a present, accrued debt on the one hand, and a future debt, including one which is contingent, on the other, so long as the latter is attributable to an obligation already incurred. There are several decided cases about what is meant by the latter category. I will turn to them shortly.
45. Mr Trower and Mr Moss each advanced an argument on the terms of rule 13.12(1) to which I must refer first. They pointed to rule 13.12(3), which applies for the purposes of any reference in any provision in the rules about winding-up to a debt or liability. In each of rule 13.12(1)(a) and (b) there is a reference to debt and to liability, which is in a provision of the rules about winding-up. So, they argued, the debt or liability referred to in each of those paragraphs may be present or future, certain or contingent. Thus, it would be wrong to regard subparagraph (a) as concerned only with present and certain debts and liabilities, and subparagraph (b) alone as concerned with future or contingent debts or liabilities. Each subparagraph deals with all kinds of debt and liability.
46. From this they argued that, as subparagraph (a) must be taken to cover contingent liabilities, so subparagraph (b) must be read as having wider scope. They argued that the proper way to interpret subparagraph (b), in the light of this, is to give it a much wider application, and therefore to interpret “by reason of an obligation incurred before that date”, and in particular the word obligation in that phrase, more widely than would otherwise be the case.
47. For myself, and apart from authority, I would reject that submission. Paragraph (3) does of course apply for the proper reading of “debt” and “liability” in the rules about winding-up, but it does not take the form of a conventional definition rule, unlike paragraph (1) or paragraph (4). Paragraph (4) provides a partial definition of “liability”, itself expressly subject to paragraph (3). Paragraph (1) provides a definition of “debt” which is not expressly subject to paragraph (3). It seems to me that paragraph (1) sets out a clear distinction between two kinds of “debt” or “liability” in its two subparagraphs. It does not seem to me to make sense to read the two parts of this cumulative definition as being subject to paragraph (3) so that both subparagraphs apply to contingent liabilities. I would be inclined to regard each element of rule 13.12 as self-sufficient, except insofar as the rule itself says otherwise, as it does in paragraph (4), and as applying to other provisions of the rules, not to other parts of rule 13.12 itself except as so stated. Alternatively, since the point of paragraph (3) is to make sure that “debt” and “liability” are understood as including both present and contingent obligations, and since paragraph (1) makes that clear in itself, paragraph (3) might be regarded as not adding anything to what paragraph (1) already says. I note that David Richards J rejected the same argument as was put to us, when put to him in *Re T & N Ltd*, (referred to above) at paragraphs 114 and 115 of his judgment.

48. There appears to be authority in this court that, albeit without argument on the point, treats subparagraph 13.12(1)(a) as extending to contingent liabilities, because of paragraph (3). I will come to this later.
49. Even if this is right, however, it does not follow that subparagraph 13.12(1)(b) is to be read in an unnaturally wide manner, in order to avoid duplication resulting from the impact of paragraph (3) on paragraph (1)(a). Since paragraph (1)(b) defines in clear terms the nature of the obligation which must exist at the cut-off date, namely as one which exists then, by reason of which the liability in question later comes to be imposed on the company, it seems to me that it cannot be right to rewrite that phrase so as to give it an artificially wide reading, merely because of the effect of paragraph (3), which appears to be intended to do no more than to clarify references to debt and to liability, not to change their effect in any other way.
50. Accordingly, it seems to me that, either way, the question is whether the liability under a contribution notice issued after the start of the relevant insolvency process is one to which, as at that start date, the company may become subject *by reason of an obligation incurred before that date*. No relevant step along the way had been taken before any relevant company entered administration, but the circumstances can be taken to have existed in which the statutory regime could be invoked, and the look-back date was before the start of the insolvency process.
51. In order to see what is sufficient or necessary for the purpose of subparagraph 13.12(1)(b), I must refer to several cases cited to us, to which the judge also referred. Some of them concerned bankruptcy, rather than corporate insolvency, as to which there is a practical difference, namely that a company does not survive winding-up, so that a liability which is not an expense and is not provable does indeed disappear down the black hole, whereas a bankrupt will be discharged from bankruptcy, so that a liability which is not an expense and is not provable in the bankruptcy may still be asserted against the bankrupt after his discharge. Despite this important practical difference, the legislation concerning bankruptcy and corporate insolvency is, so far as relevant, in identical terms.
52. Several of the cases were decided at Court of Appeal level, but some of those decided in the High Court are instructive, so I will not limit my reference to those which are binding upon us.
53. The first in time is a decision of the Queen's Bench Divisional Court on appeal from the county court in 1886: *Re Smith; ex parte Edwards* (1886) 3 Morrell 179. The judge summarised the case as follows at his paragraph 82:

“That was a case on the substantially identical language of section 37 of the Bankruptcy Act 1883. The debtor became bankrupt after entering into an arbitration agreement with the creditor which provided that the costs of the arbitration were to be in the discretion of the arbitrator. After the debtor became bankrupt, the arbitrator made an award, including a costs award, in favour of the creditor. The Divisional Court held, reversing the County Court judge, that the costs award was provable in the bankruptcy, identifying the contractual submission of the debtor to the arbitrator's costs discretion as a sufficient pre-cut-off date legal obligation.”

54. The obligation incurred before the bankruptcy was, therefore, the contractual obligation undertaken by the arbitration agreement, by reason of which the debtor was at risk of having a costs order made against him.
55. A costs obligation, but arising in ordinary litigation, not arbitration, featured in the next and more important case, *Glenister v Rowe* [2000] Ch 76. In this case the debtor obtained an order striking out a claim by the creditor. The creditor filed a notice of appeal, but the debtor was then made bankrupt. Shortly after the debtor's discharge, the creditor's appeal was allowed, with costs. The creditor sought to serve a statutory demand on the debtor for the taxed costs. The debtor resisted this on the basis that the debt had been provable in his earlier bankruptcy, so that it was no longer enforceable against him. The registrar held that the debtor was wrong and refused to set the statutory demand aside. The deputy judge allowed the debtor's appeal, by reference to section 382(1)(a), but rejected an argument based on section 382(1)(b). Those two subparagraphs are, in substance, identical to rule 13.12(1)(a) and (b).
56. The appeal to the Court of Appeal was based on section 382(1)(a). The respondent sought at a late stage to resurrect the argument under section 382(1)(b) which had been rejected below. The Court of Appeal refused to allow this argument to be run (see [2000] Ch 85C-D). Despite the case being reported in the Law Reports with Counsel's argument, it is not possible to identify what this argument based on section 382(1)(b) was. Counsel for the appellant had referred to both subparagraphs in his submissions: see [2000] Ch 77E-G.
57. The Court of Appeal allowed the appeal. It is in this context that the court addressed section 382(1)(a) on the footing that, because of section 382(3), it applied to contingent liabilities: see [2000] Ch 80B referring to the deputy judge's decision and the fact that the case was argued in the Court of Appeal and decided only on section 382(1)(a) but on the basis of a contingent liability falling (or not falling, on the facts) within that paragraph. Because the argument turned on section 382(1)(a) there was no specific attention to the question whether the liability arose by reason of an obligation incurred before the cut-off date (though the point is touched on in passing in paragraph (3) in the passage which I quote below). The focus was more simply on whether at the cut-off date there was a contingent liability at all. Mummery LJ said this at [2000] Ch 84 B-F, setting out his reasons for allowing the appeal and holding that there had been no contingent liability at the date of the bankruptcy.

“(1) Costs of legal proceedings are in the discretion of the court. Until an order for payment of costs is made there is no obligation or liability to pay them and there is no right to recover them.

(2) Once legal proceedings have been commenced there is always a possibility or a risk that an order for costs may be made against a party and, in certain circumstances, even against a non-party or the representative of a party. I would accept that an order for costs is a “contingency” which may or may not happen at some stage during or at the conclusion of the proceedings.

(3) The fact that an order for costs (a) creates an obligation to pay money and (b) is a contingency in legal proceedings is not sufficient, however, to make a claim that the court should exercise its discretion

to make such an order a “contingent liability” of the person against whom such an order may ultimately be made. It is accepted that before an order is made there is no present liability to pay. Nor can there be a future liability: there is no certainty that the court will exercise its discretion to make such an order. If, as some of the authorities hold, a contingent liability must arise out of an existing or underlying liability, no such liability can exist simply by reason of a claim for costs made in a writ, summons, application or notice of appeal to the judge or to the Court of Appeal.”

58. He referred to *Re Sutherland deceased* [1963] AC 235, an estate duty case about contingent liabilities under Scots law, which had been relied on for the respondent to show that there can be a contingent liability without an existing or underlying obligation. He held that it was necessary to identify something done by the respondent to give rise to a liability on his part, and said that there had been nothing of that kind, and the discretionary nature of the court’s power to order costs showed that there was no liability, contingent or otherwise, in the absence of a court order. He then said this, at [2000] Ch 85 A-B:

“(5) It is true that the language of the Act of 1986 differs from that of the earlier insolvency legislation, particularly in the definition of “liability” to include a liability to pay money. That is wide enough to include an order for costs when it is made. But it is not wide enough to embrace a possibility that the court may exercise its discretion to make a costs order. Further, the reference to liability “under an enactment” is open to the same comment. The Supreme Court Act 1981 as amended, confers a wide power on the court to make orders as to costs, but the liability to pay costs is created not *under the Act* but under the specific order made by the court in each particular case in the exercise of the general power conferred on the court by the Act.”

59. Thorpe and Butler-Sloss LJ agreed. Thorpe LJ said this at [2000] Ch 85E-F:

“Of course when his client issued his strike-out application he exposed himself to the risk of a liability for costs contingent on the future exercise of the court’s discretion when determining the pending application. The element of contingency is certainly satisfied but, in my judgment, the element of liability is not. The future exercise of the court’s discretion might eliminate that risk of liability. Equally it might elevate the risk of liability into an actual liability, either present, in diem, or subject to taxation. This essential distinction between incurring a liability and exposing oneself to the risk of liability should not be undermined.”

60. Consistently with this decision, the High Court of Australia held in *Foots v Southern Cross Mine Management Pty Ltd* [2007] HCA 56, [2007] BPIR 1498 (on legislation substantially similar to that which we have to consider) that even where the party in question had fought the action to trial and lost before becoming bankrupt, so that a costs order was probably inevitable, the eventual costs order was not a provable debt because it was not a contingent liability at the time of the bankruptcy.

61. We were shown two other cases in the Court of Appeal in which *Glenister v Rowe* was considered. The first, a bankruptcy case, is *R (Steele) v Birmingham City Council* [2005] EWCA Civ 1824, [2006] 1 W.L.R. 2380. The liability under examination in that case was to repay sums overpaid by way of jobseekers' allowance. The sequence of events was that the claimant was awarded jobseekers' allowance as of December 1999, he became bankrupt on his own petition in September 2001, in March 2002 the Secretary of State determined, under the relevant legislation, that he had been overpaid the allowance between December 1999 and March 2001, and the Department started to recover the overpayment by a weekly deduction from the claimant's incapacity benefit. When informed of the bankruptcy, the department suspended the recovery until after his discharge in September 2003, but the recovery was then resumed. He claimed that the liability to repay the allowance was a contingent debt at the date of the bankruptcy, therefore provable, and no longer recoverable. The Court of Appeal's decision was that there was no obligation to repay until the Secretary of State had made a determination under the relevant Act, and that a person who might be made the subject of such a determination, but had not yet been, was not subject to a contingent liability under section 382 of the Insolvency Act 1986.
62. Sir Martin Nourse, who delivered the first judgment, considered *Glenister v Rowe* and cited at paragraph 13 passages from it which I have quoted above. He found that the reasoning in *Glenister v Rowe* was applicable to the case of *Steele*. There was no present liability and, it being uncertain whether a determination would be made, no future liability until the Secretary of State had made the determination. It was not just the extent and method of enforcement that remained to be decided. Arden LJ also considered the point, and referred to *Re Sutherland deceased*. She distinguished that case, holding that its different approach to the nature of a contingent liability was in any event not applicable to the issue arising in insolvency proceedings, and stressed that the court was only considering the extent of section 382 of the Insolvency Act 1986. At paragraph 22 she said this, referring to *Glenister v Rowe*:
- “If a liability may be described as a contingent debt for the purposes of section 382 even though at the date of the bankruptcy order there is no legal obligation, then the range of liabilities which are provable in a bankruptcy is enlarged. Such liabilities would include the case where a party is exposed to a risk of an order for costs because he is involved in litigation but has not yet become subject to a liability to pay costs because the court has not made an order for costs against him. This was the situation in *Glenister v Rowe* ..., where, as Sir Martin Nourse has explained, this court held that the risk of an order for costs did not give rise to a contingent liability for the purposes of section 382, the very provision with which we are concerned on this appeal.”
63. Accordingly, she regarded it as essential that there should be a prior legal obligation in order that, at the commencement of the bankruptcy, a contingent liability could exist. May LJ agreed with both judgments.
64. In *Haine v Day* [2008] EWCA Civ 626, [2008] BCC 845, both these cases were considered in order to decide whether protective awards payable by a company to its employees dismissed before the company went into liquidation without prior consultation were or were not provable debts in the liquidation. It was held that they

were provable, because they stemmed from a breach of obligation before the liquidation, and although there was an element of judicial discretion in the making of the award, the employment tribunal “had no option but to make an award”.

65. The case had a special feature, unlike all others we have seen, in that if and insofar as the protective award was not paid by the company, it was payable by the Secretary of State. There was, therefore, no risk that the employees would not get paid the compensation awarded. The question was whether the award was payable in the liquidation, either as an expense or as a provable debt; if it was, then the Secretary of State’s liability would be the less.

66. The legislation providing for protective awards was enacted in order to give effect to an EU Directive, and the court accepted that the UK’s obligation in that respect was to ensure that breaches of the relevant law were penalised under conditions which make the penalty effective, proportionate and dissuasive. In the judgment of the court, at paragraph 56, this point was made:

“Of major importance to both reasons is the underlying basis of a protective award – that it is to be a measure that enforces the obligation placed on the employer and the failure to comply with that obligation is backed by a penalty which is to be ‘effective, proportionate and dissuasive’. That can only be so if it is visited on the employer. It is to our mind unrealistic to say it is not imposed ‘by reason of an obligation incurred’ before the liquidation.”

67. On that basis the court held that the liability under a protective award was at least a contingent liability within the meaning of rule 13.12(1)(b) and (3).

68. Examining authority on the provisions as to protective awards, the court concluded that although in general terms there was a discretion not to make an award, so that the liability could not be said to be certain, rather than contingent, nevertheless on the facts of the given case (see paragraph 67):

“In these circumstances, and against this background, it seems to us unreal to describe the protective award as depending upon the exercise of a judicial discretion. The employment tribunal had no option but to make an award. If it had failed to do so its ruling would have been open to challenge as perverse. In our judgment, therefore, it is in no sense stretching the language of rule 13.12(1)(b) to describe the protective award as being ‘a liability to which the company may become subject after it went into liquidation by reason of an obligation incurred before that date.’ Indeed, we think that is precisely what it is.”

69. On that basis they felt able to distinguish both *Glenister* and *Steele*. As regards *Glenister* they said this at paragraph 75:

“... we are of the view that there is a plain distinction between a prospective and discretionary award of costs (which is not only dependent upon outcome but upon a host of case specific factors and is wholly uncertain) and a liability for a protective award which has

arisen directly from the breach of the duty to consult and which, based on the legislative scheme we have described, will be for the maximum period and will only be reduced if there are mitigating circumstances justifying a reduction.”

70. They distinguished *Steele* on a somewhat similar basis, at paragraph 85:

“In *Steele*, the Secretary of State plainly had a discretion whether or not to make the determination referred to, and until he did so, no liability arose. However, and for the reasons we have already given, this is, in our judgment in no sense analogous to the ‘discretion’ which arises in the employment tribunal following a breach by employers of their duty to consult under section 188. Under the latter it is the employer’s breach which triggers the procedure under sections 189 and 190, and rendered them liable both to the declaration and the protective award under section 189(2).”

71. Thus, a costs order in ordinary civil proceedings made after the onset of insolvency proceedings in relation to the paying party under the order is not provable in those proceedings, because it is not a contingent liability within section 382(1)(b) or rule 13.12(1)(b). The fact that the person in question is a party to proceedings and may, therefore, come to be ordered to pay costs is not sufficient to establish that the liability under the eventual order arises because of a legal obligation incurred before the insolvency. The party is in a situation in which an adverse order for costs may be made, which may or may not be of his own choosing. But the making of such an order is a matter depending not only on future events but also on the exercise of a judicial discretion. That is not enough. By contrast, to have accepted the risk of such an award in an arbitration, by signing the arbitration agreement, is sufficient for a post-insolvency award of costs by the arbitrator to be provable as a contingent debt: see *Re Smith ex parte Edwards* referred to above. Equally, the need for the Secretary of State to make a determination as to overpaid jobseekers’ allowance, and to decide how and to what extent to recover the overpayment is too uncertain for the possibility of having to make such repayments, having received overpayments, to be a contingent liability. In *Haine v Day*, by contrast, the circumstances giving rise to the prospect of being subjected to a protective award had occurred before the insolvency, and there was no such uncertainty as to the making of a protective award as would show that the prospect of liability for such an award was not a contingent liability.

72. Briggs J also referred to a decision of Norris J in the Nortel administration, *Unite (the Union) v Nortel Networks UK Ltd* [2010] EWHC 826 (Ch), [2010] BCC 706. The proceedings arose from the administrators having terminated the employment of a number of the employees of NNUK some six weeks after the administration began. The employees wished to claim compensation for unfair dismissal, breach of contract and discrimination, as well as protective awards. The question was whether they should be able to start proceedings despite the statutory moratorium during the administration. For this purpose it was relevant to decide whether the claims constituted provable debts in the administration. Norris J decided that they did. This is what Briggs J said about that at paragraph 95, including a quotation from Norris J’s own judgment:

“The breach of contract claim arose out of the obligation in each contract of employment, even though the breach occurred after the cut-off date. The claims for unfair dismissal and discrimination were analysed as claims based on statutory obligations imposed on NNUK in favour of each employee from the moment of the commencement of his or her employment, it being, again, irrelevant that the breaches of those statutory obligations all occurred after the cut-off date: see paragraph 25(b) to (d) inclusive. After a concise review of *Glenister, Steele, Haine v. Day* and [*Casson v Law Society* [2009] EWHC 1943 (Admin)], the judge continued, at paragraph 33 as follows:

“I am not in any doubt about the matter: but if I were, I think the court should incline towards restricting the category of claims which are not provable. The consequence of the claims not being provable in bankruptcy in *Glenister ... Steele ...* and *Casson ...* was that the claims could still be pursued against the discharged bankrupt. But a company does not survive its liquidation: so if a claim is not provable in the liquidation it is completely irrecoverable. It does not seem to me desirable (especially in relation to employees) to create a category of claim which cannot be dealt with in the insolvency process and is otherwise irrecoverable.””

73. Briggs J held that the effect of the Court of Appeal decisions was that, without a pre-existing legal obligation such as is referred to in rule 13.12(1)(b) or section 382(1)(b), a liability cannot qualify as a contingent liability so as to be provable under those provisions. I agree with him as to that.

74. I also agree with him that, even on the basis that the circumstances which may give rise to the use of the financial support direction regime by the Pensions Regulator will exist at a date before the inception of any relevant insolvency proceedings, and that the look-back date for the purposes of these provisions will be before that inception, nevertheless there is at that stage no more than the possibility that the regime will be invoked at all or, if it is, then in relation to what particular target company or companies. No company other than the employer is under any relevant legal obligation before the financial support direction regime is invoked. The use of the regime involves the use of many discretions, on the part of the Pensions Regulator, the Determinations Panel and potentially the Upper Tribunal. Even as regards the Pensions Regulator alone I agree with the judge’s observation at paragraph 101:

“by no stretch of the imagination can the complex and sophisticated discretionary process created by the FSD regime be described as one in which the Regulator has no real discretion not to issue an FSD or a CN against a target.”

75. It is not sufficient to say that, if you look at the circumstances on the basis of which the discretion under section 43 was exercised to issue a financial support direction, as they were at the time of its exercise, and if you can say that it could have been exercised (had the facts been known and the process already invoked) immediately before the start of the insolvency, that shows that the obligation arose before the outset of the insolvency process. There was no obligation as at that date, and there

were far too many contingencies and variables, including decisions to be made, above all by the Pensions Regulator, on a discretionary basis, for it to be possible to say that the existence of the situation as a result of which the obligation might be imposed of itself amounts to the existence of the obligation, even on a contingent basis.

76. I agree, too, with the judge's telling comments at his paragraph 103 on the unsatisfactory nature of some of the distinctions that have been drawn in the cases. However it seems to me that he was right to decide that he was bound by decisions of the Court of Appeal to the effect that a prior legal obligation is essential to establish that a liability which has matured after the commencement of an insolvency process was, at the outset of that process, already a contingent liability, so that it is provable in the relevant process, whether bankruptcy, administration or liquidation. We too are so bound. The existence, before the onset of the insolvency, of the financial support direction regime and of the facts on which it could be invoked does not show that any company which might be made the subject of an eventual financial support direction or contribution notice is then under a legal obligation for the purposes of rule 13.12(1)(b).
77. Nor does the argument presented by Mr Trower and Mr Moss, already noted, based on rule 13.12(3), allow a different conclusion. The extent to which *Glenister v Rowe* is an authority about section 382(1)(b) is unclear, but *Steele* was concerned with that subparagraph, and *Haine v Day* was concerned with rule 13.12(1)(b). In those circumstances it seems to me that, even though previous courts may not have had the advantage of this ingenious submission, the decision that there must be a prior legal obligation for a liability to be provable as a contingent liability under rule 13.12(1)(b) or section 382(1)(b) is incompatible with this argument. We cannot decide that point in their favour, even if we were inclined to do so which, for my part, I would not be.
78. We were shown a decision of Lord Drummond Young in the Outer House of the Court of Session, *Liquidator of the Ben Line Steamers Ltd* [2010] CSOH 174, in which he had to consider whether a particular liability of a by then insolvent company was a contingent liability at the inception of the insolvency. He considered Scots writers and *Re Sutherland*, as well as English cases which had been cited to him, including *Steele* and *Haine v Day*. For my part I do not find the case helpful on the issues which we have to decide, for at least two reasons. First, the legislation is different for insolvencies in Scotland. Secondly, the law as to contingent obligations appears to be different in Scotland, and was certainly treated distinctly in that case.
79. *Re Sutherland* itself was also relied on before us, but it seems to me that it is not open to us to follow that case, if and insofar as it would lead to a result different from that which follows from *Glenister v Rowe* and from *Steele*, because in *Steele* (by Arden LJ, with whom May LJ agreed) *Re Sutherland* was held not to be relevant to the issue before the Court of Appeal. It seems to me that we are bound by that decision.
80. We were also shown *Secretary of State for Trade and Industry v Frid* [2004] UKHL 24, [2004] 2 AC 506. The Secretary of State had paid sums to employees of a company in an insolvent liquidation by way of redundancy and other payments, which the company ought to have paid but which the Secretary of State was liable to pay if the company did not. Under the relevant statute the Secretary of State had a subrogated claim in the company's insolvency for the amounts so paid. The issue was whether that claim could be set-off against sums due from the Crown to the company

by way of repayment of VAT, the argument to the contrary being that, in order to be set-off, the amount had to be due, not merely contingently due, at the beginning of the insolvency. The House of Lords held that the rule allowed set-off where at the date of the insolvency there were obligations arising out of a contract or a statute by which a debt sounding in money would become payable on the occurrence of a future event. Since the Secretary of State's payments, after the beginning of the insolvency, arose from a statutory obligation which existed before the insolvency date, they could be set-off, just as if they had been made under a contractual guarantee pre-dating the insolvency. Given the closeness of the analogy with a contractual guarantee, which can clearly create a contingent liability for the purposes of rule 13.12(1)(b), it does not seem to me that reference to this case takes the matter any further, or begins to show that it is not necessary to show some existing obligation, as at the date of the insolvency, if a liability is to be admitted to proof as a contingent liability.

81. I would therefore reject the arguments advanced both by Mr Trower on behalf of the Nortel administrators and by Mr Moss on behalf of the various respondents to the effect that the judge was wrong to hold that a liability under a contribution notice would not be a provable debt in the administration of any of the companies with which we are concerned, since no relevant event had occurred before the company entered administration. I consider that he was right to hold that he could not decide otherwise, and nor can we. The same applies to a liability under a contribution notice served during a liquidation unless (in the present cases) the relevant financial support direction is issued before the commencement of the liquidation (leaving aside as possible but undecided the potential relevance of the occurrence of some other earlier stage in the process before that date).

An expense in the administration?

82. Paragraph 99 of Schedule B1 to the Insolvency Act 1986 provides for payment of an administrator's remuneration and expenses out of property of which he has custody or control. Rule 12.2(1) of the Insolvency Rules 1986 defines in general terms what is payable as an expense in an administration or other insolvency process:

“All fees, costs, charges and other expenses incurred in the course of winding up, administration or bankruptcy proceedings are to be regarded as expenses of the winding up or the administration or, as the case may be, of the bankruptcy.”

83. In relation to liquidation, this repeats Rule 4.218(1) of the Insolvency Rules 1986 which deals with the expenses of a liquidation, and goes on to provide at rule 4.218(3) in more detail for the order of priority, thereby identifying a number of specific examples within the general class of expenses. Thus, while the general question is whether a particular liability is or would be within the class of fees, costs, charges or other expenses incurred in the course of the liquidation, that is assisted by considering whether it falls within any of the subparagraphs of paragraph (3). The particular example is that in subparagraph (m): “any necessary disbursement by the liquidator in the course of his administration”. Since the relevant companies are in administration and might not go into liquidation, I will at this stage consider the position by reference only to an administration.

84. As regards administration expenses, the equivalent to rule 4.218(3) is rule 2.67(1), and paragraph (f) of that rule is in terms corresponding to those of 4.218(3)(m). It is worth noting also that paragraph (a) gives the highest priority to “expenses properly incurred by the administrator in performing his functions in the administration of the company”. Paragraph (f) therefore contemplates the possibility of something which is a “necessary disbursement” but not an “expense properly incurred”. Rule 2.67(3) gives the court power to alter the priorities laid down by paragraph (1) of the rule, in the event of the assets being insufficient to satisfy the liabilities. (The equivalent power in a liquidation arises under Insolvency Act 1986 section 156 and rule 4.220.)
85. In order to decide whether payment of the liability under a contribution notice issued during the administration would be an expense of the administration it is necessary to consider both the terms of the Pensions Act 2004 and the decision of the House of Lords in *Toshoku* to which I have already referred. I will start with the latter.
86. The issue in *Toshoku* was whether the liquidators of the company were liable to pay a sum by way of corporation tax on an amount of interest deemed to have been paid to it by an associated company in respect of a period during the liquidation, which had not been and would not be paid in fact. The House of Lords, affirming the Court of Appeal, held that because the tax legislation expressly imposed the liability on a company in liquidation in respect of a period after the commencement of the liquidation, the tax liability was one which the liquidator was obliged to pay, and it was therefore a necessary disbursement within rule 4.218 and was payable accordingly with the priority afforded by rule 4.218. In coming to that conclusion the House of Lords accepted the submission of Counsel for the Crown, Mr Michael Briggs Q.C. as he then was.
87. The argument to the contrary was that the list of items in rule 4.218(3) was not a complete definition of what liabilities were properly to be regarded as expenses of the liquidation, and that there was an additional test which all had to satisfy, namely that the liability is payable as an expense only if it arose as a result of a step taken with a view to, or for the purposes of, obtaining a benefit for the estate in liquidation, by way of what was referred to as the liquidation expenses principle.
88. In his speech Lord Hoffmann set out the main cases decided in relation to this principle. He referred to the undoubted proposition that, in certain circumstances, a debt which is provable in the liquidation may be treated as an expense of the liquidation, so as to be payable with a higher priority. The best-known example is rent under a lease pre-dating the liquidation, where the liquidator decides to retain the property for the benefit of the insolvent estate. The point was stated, though not for the first time, by the Court of Appeal in *Re Lundy Granite Co* (1871) LR 6 Ch App 462. Later Lindley LJ said this in *Re Oak Pits Colliery Co* (1882) 21 Ch D 322 at 330:

“When the liquidator retains property for the purpose of advantageously disposing of it, or when he continues to use it, the rent of it ought to be regarded as a debt contracted for the purposes of winding up the company, and ought to be paid in full like any other debt or expense properly incurred by the liquidator for the same purpose.”

89. Commenting on this, Lord Hoffmann said at paragraph 27:

“My Lords, it is important to notice Lindley LJ was not saying that the liability to pay rent had been incurred as an expense of the winding up. It plainly had not. The liability had been incurred by the company before the winding up for the whole term of the lease. Lindley LJ was saying that it would be just and equitable, in the circumstances to which he refers, to treat the rent liability as if it were an expense of the winding up and to accord it the same priority. The conditions under which a pre-liquidation creditor would be allowed to be paid in full were cautiously stated. Lindley LJ said (at page 329) that the landlord “must shew why he should have such an advantage over the other creditors”. It was not sufficient that the liquidator retained possession for the benefit of the estate if it was also for the benefit of the landlord. Not offering to surrender or simply doing nothing was not regarded as retaining possession for the benefit of the estate.”

90. Lord Hoffmann said that the *Lundy Granite* principle was settled by the end of the 19th century. He went on to say this at paragraph 30:

“It was not, however, a general test for deciding what counted as an expense of the liquidation. Expenses incurred after the liquidation date need no further equitable reason why they should be paid. Of course it will generally be true that such expenses will have been incurred by the liquidator for the purposes of the liquidation. It is not the business of the liquidator to incur expenses for any other purpose. But this is not at all the same thing as saying that the expenses will necessarily be for the benefit of the estate. They may simply be liabilities which, as liquidator, he has to pay. For example, there will be the fees payable to fund the Insolvency Service, ranking as paragraph (c) in rule 4.218(1), where the benefit to the estate may seem somewhat remote.”

91. Immediately after that passage he made the point which I have already quoted at paragraph [29] above.

92. Further, he drew a telling distinction between the position as regards rent under a lease held by the company and rates payable in respect of the relevant property. The rent might be only a provable debt for some period during the liquidation, even if for a later period it was to be treated as an expense and so paid in full. But rates for the period after the beginning of the liquidation were payable in full as an expense regardless of whether, and if so how, the liquidator had decided to make use of the property. Rates accrue due from day to day merely as a result of rateable occupation (or ownership), so the rates for the period before the liquidation are a provable debt but rates thereafter are the liability of the liquidator, whether or not there is any benefit to the estate from the use or occupation of the property, and they are therefore payable as an expense. This was held to be the position in relation to administration by David Richards J in *Exeter City Council v Bairstow* [2007] EWHC 400 (Ch), [2007] BCC 236. (The legislation already relieved a liquidator of liability for unoccupied rates, and has now been changed to extend that position to administrators as well: Non-Domestic Rating (Unoccupied Property) (England) Regulations 2008, SI 2008/386, regulation 4.)

93. The *Lundy Granite* principle had led Nicholls LJ in *Re Atlantic Computer Systems plc* [1992] Ch 505 to hold that the court had a discretion to hold that a liability arising during the liquidation should or should not be paid. In *Re Kentish Homes Ltd* [1993] BCLC 1375, as Sir Donald Nicholls V-C, he applied that decision so as to hold that a liquidator should not pay community charge referable to the period during the liquidation on empty flats. Lord Hoffmann, affirming the Court of Appeal, held that this decision was wrong, and that there was no relevant discretion in the court. To summarise his conclusion, I quote his paragraphs 41, 42 and 46:

“41. The Court of Appeal said that they were driven to the conclusion that this case was wrongly decided. I respectfully agree. In the first place, the question of whether the community charge should count as an expense of the liquidation was not a matter for the judge’s discretion. It depended upon whether it came within one of the paragraphs of rule 4.218. In my opinion if, as was common ground, the company was the chargeable person, it was a necessary expense which came within paragraph (m). If, therefore, the liquidator had sufficient assets after satisfying the liabilities coming within paragraphs (a) to (l), he was obliged to pay it. Secondly, the *Lundy Granite Co* principle had no relevance. The liability did not arise out of a pre-liquidation obligation. If it came within the language of paragraph (m), it was a liquidation expense.

42. I therefore respectfully adopt the simple approach of Brightman J in *Re Mesco Properties Ltd* [1979] 1 WLR 558 at 561. The statute expressly enacts that a company is chargeable to corporation tax on profits or gains arising in the winding up. It follows that the tax is a post-liquidation liability which the liquidator is bound to discharge and it is therefore a ‘necessary disbursement’ within the meaning of the Insolvency Rules.”

“46. In my opinion, the question of whether such liabilities should be imposed upon companies in liquidation is a legislative decision which will depend upon the particular liability in question. It should not be ruled out by an illegitimate extension of the liquidation expenses principle, which was devised more than a century ago for an altogether different purpose.”

94. We were shown several cases decided since *Toshoku*, all of them at first instance, in particular *Re Allders Department Stores Ltd* [2005] EWHC 172 (Ch), [2005] 2 All ER 122, and *Exeter City Council v Bairstow* [2007] EWHC 400 (Ch), [2007] BCC 236. In *Allders* Lawrence Collins J held that statutory redundancy payments which would be due if administrators terminated the contracts of employees of the Claimant in administration were not payable as expenses under rule 2.67(1)(f). In *Exeter v Bairstow* David Richards J held that non-domestic rates payable in respect of property of a company in administration were payable as necessary disbursements of the administration under rule 2.67(1)(f), though not as expenses under rule 2.67(1)(a), whether the property was occupied or not.
95. The judge set out his understanding of the decision in *Toshoku* at his paragraph 135, as follows:

“... my reading of Lord Hoffmann’s speech is that, although on the particular facts in *Toshoku* the statutory liability was imposed expressly on a company in liquidation, he regarded the “necessary disbursements” category of liquidation expense as including all statutory liabilities imposed on a company in liquidation whether expressly, or by a criterion for liability (such as rateable occupation or property ownership) which made no distinction between companies which were, and were not, in liquidation.”

96. He considered *Allders* and *Exeter v Bairstow* and held that neither of them suggested that a different view should be taken of the decision in *Toshoku*. His conclusion on the point is at paragraph 146:

“I therefore conclude that the *Toshoku* principle does indeed establish as a general rule that where by statute Parliament imposes a financial liability which is not a provable debt on a company in an insolvency process then, unless it constitutes an expense under any other subparagraph in the twin expenses regimes for liquidation and administration, it will constitute a necessary disbursement of the liquidator or administrator. That is the general rule, whether the statute expressly refers to companies in an insolvency process as being subject to the liability, or whether the statute achieves the same result by using a criterion for liability which is insolvency neutral. Any other conclusion would in my judgment attribute an excessive weight to the linguistic method by which different legislation achieved the same result, namely that the statutory obligation in question is a liability of a company in an insolvency process.”

97. It had been argued before the judge that *Toshoku* only showed a liability to be an expense (as a necessary disbursement) if it was not merely a liability of the relevant company, but was also one as to which it can be seen that the intention of the relevant legislation was that the relevant office-holder was bound to discharge it. The argument was renewed before us. In the passage from *Toshoku* cited at paragraph [29] above Lord Hoffmann referred to “a statute which specifically imposed liabilities upon a company in liquidation”. The tax legislation under consideration in *Toshoku* did just that. But the non-domestic rates legislation does not. It was described in argument before us as insolvency neutral; the judge used that phrase in the passage which I have just quoted. The phrase may be open to misunderstanding. It seems to me that the judge used it in the sense that the legislation applies to companies generally, making no distinction according to whether the company is or is not in an insolvency process at a relevant time. It is shorthand for his phrase (in paragraph 135): “by a criterion for liability ... which made no distinction between companies which were, and were not, in liquidation”.
98. In *Toshoku* the fiscal legislation at issue related expressly to a company in liquidation. The tax liability related to a period which started with the commencement of the liquidation, and the liquidator was expressly made the person accountable for the tax. The legislation about non-domestic rates is silent as to rateable occupiers or owners who are undergoing an insolvency process, so it is insolvency neutral. Since liability for rates relates to periods of occupation, it can clearly apply to periods after the beginning of an insolvency process. Moreover, whether the liability is incurred, or

continues to be incurred, is (or may be) within the control of the office-holder because the liability might be avoided by ceasing to occupy, or by disposing of, the property. By contrast, it was pointed out, here the liability does not in any way relate to anything done by the company, or otherwise happening, after the commencement of the insolvency, and the legislation does not suggest that anyone other than the company is liable either to comply with a financial support direction or to pay the amount specified in a contribution notice. On that basis, it was argued, this case does not fall within the principle enunciated in *Toshoku*. Mr Trower submitted that in no case other than the present has an amount been held to be payable as an expense unless either the statute referred expressly to it being a liability of a company in an insolvency process, or the liability arose out of something either done by the office-holder or the company after the start of the insolvency, or to a state of affairs attributable to the company after that date, and he argued that one or other of those features was indispensable.

99. The judge rejected the argument put to him. In my view he was right to do so. The effect of *Toshoku* is, in my judgment, correctly set out by him in the passages which I have just quoted, and it is not consistent with the submission made to him or to us in this respect. The sentence at the end of Lord Hoffmann's paragraph 30 is a passing comment, not a formulation of the ratio of the decision, so as to limit the decision to legislation which does make it clear, expressly or by necessary implication, that it applies to a company in an insolvency process.
100. It was submitted to us that the judge was wrong to proceed from the premise that a debt is not provable to the conclusion that it is an expense. I do not accept that this was the judge's reasoning. He recognised that there may be liabilities which are neither provable nor payable as an expense, so that to show that a liability is not provable does not demonstrate that it is payable as an expense. On the other hand, in general (i.e. subject to the *Lundy Granite* principle), if in fact a liability is provable then it will not be an expense because it will arise from a pre-insolvency obligation. It is therefore proper to ask first whether the liability is provable as a debt and only if it is not provable (leaving aside *Lundy Granite*-type cases) to ask whether it is payable as an expense according to the statutory test relevant to that issue.
101. I also agree with the judge that it is not necessary to find a positive indication of statutory intention that the liability is one with which a company in an insolvency process is bound to perform. Of course, the nature and incidence of the liability must be determined by reference to the relevant legislation, which may show, expressly or by implication, that it is not imposed on a company undergoing an insolvency process or, if it is so imposed, how it is to be treated in that process as regards other competing claims on the assets. But absent any such indication, it seems to me that a statutory liability which is imposed for the first time (thus with no issue of provability arising) on a company which is undergoing an insolvency process is at any rate likely to be found to be one which is binding on the company and with which, for that reason, it is the obligation of the relevant office-holder to comply, to the extent that the assets and other claims with prior or equal ranking on those assets allow, or to procure that the company complies.
102. It was also argued that on this principle, *Steele* would have been decided differently, the obligation to repay being found to be an expense of the bankruptcy. Since it was not argued in that case that the liability was payable as an expense, the case is not

authority that it was not so payable, and does not conclude the point in this court. That being so, it seems to me right to proceed from the principles set down by Lord Hoffmann in *Toshoku*, without speculating as to how another, very different case might have been decided if it had been differently argued.

103. It follows from this proposition that one must examine the relevant legislation in order to see what obligation it imposes, in what circumstances. The corporation tax legislation at issue in *Toshoku* was clear and specific. By contrast the Pensions Act 2004 says nothing about the application of the financial support direction regime in insolvency as such. One may wish that it had done so, as section 75 of the 1995 Act did, and as that section, re-enacted in partly different terms by the 2004 Act, still did. It is curious that the repetition in the 2004 Act of the express provision about the section 75 debt came after express consultation on the point, as to whether the priority of that debt should be raised by it being made preferential, whereas no attention seems to have been given to the issue of the priority of the liability under a contribution notice. But we have to ascertain the position as best we can from what the Act does say.
104. I will therefore proceed to address the 2004 Act in the light of the question whether the liability under a contribution notice is a necessary disbursement of the administrator, where the contribution notice is served on the relevant company following a financial support direction itself served since the beginning of the administration (and ignoring the case where a liquidation follows in which it is agreed that the liability would be a provable debt).
105. It is common ground that the 2004 Act does apply to target companies which are in an insolvency process. There is nothing to exclude such companies from the class of potential target companies on which a contribution notice or, for that matter, a financial support direction, may be served.
106. There are some references to insolvency here and there in the parts of the 2004 Act dealing with financial support directions, and elsewhere. One is that a contribution notice may be served in the event of non-compliance with a financial support direction, consisting of failure to notify the Pensions Regulator of prescribed events in respect of financial support once given: see sections 43(3)(c) and 48(3)(c). Prescribed events include insolvency events in relation to any person named in a financial support direction: see the Pensions Regulator (Financial Support Directions Etc) Regulations 2005, SI 2005/2188, regulation 4(b). Thus the Act and the regulations contemplate that a contribution notice may be issued when a relevant company has experienced an insolvency event, so that an insolvency process will have commenced in relation to it. (Insolvency events are defined by reference to section 121 of the 2004 Act.) We were shown some other passing references which show that some thought was given to the application of some of these provisions in relation to insolvency situations. I do not find them of great assistance. The fact is that the financial support direction regime does apply to target companies which are undergoing an insolvency process, and if action is taken under that regime in relation to such a company, it cannot be said that the company is free to ignore the imposition of the relevant obligation.
107. There was some debate before us about the impact of a financial support direction on a company in insolvency. The judge declared, in paragraphs 2 and 3 of his order, that

if a financial support direction were served on a relevant company in administration, or in an eventual liquidation, then it would be the obligation of the company, to be performed at the direction of the office-holder, to comply with the financial support direction. These parts of the order were challenged on the appeals. The administrators sought to show that the office-holder would only be obliged to procure the relevant company to comply with the financial support direction if that would be in furtherance of the statutory objectives of the administration or liquidation as the case may be, and in the interests of the general body of the relevant company's creditors.

108. It seems to me that, as I have just indicated, if a financial support direction is served on such a company, the company comes under an obligation to comply with the direction, notwithstanding the insolvency process, and the relevant office-holder is under an obligation to procure that the company so complies, subject to the availability of assets and the rules as to priority of liabilities. This is not, in those circumstances, a qualified obligation which is in some way subordinated to the interests of the company's creditors as a whole or to the office-holder's view of the best way to perform his statutory functions as such. That seems to me to be an impossible reading of the 2004 Act. Of course, if and to the extent that the office-holder did procure that the company complied with the obligation, the expenditure involved would undoubtedly be payable as an expense of the insolvency. Moreover, the judge's conclusion that a financial support direction issued during administration, followed by a liquidation and a contribution notice issued after the winding-up, gives rise to a debt provable in the liquidation, proceeds on the basis that the financial support direction issued in these circumstances does create an obligation, which is an obligation existing at the date of the liquidation, for the purposes of rule 13.12(1)(b). That is not consistent with treating the financial support direction as anything other than binding on the company in administration.
109. On the other hand, the sanction for non-compliance is the contribution notice procedure. Neither the Pensions Regulator nor the trustees can make the company comply with its obligation, any more than they can (except by persuasion) if the company is not in an insolvency process. If no proposals are made as to suitable financial support within the specified time, or only proposals which the regulator thinks inadequate, then the procedure towards service of a contribution notice can be initiated.
110. In either case, the obligation imposed by a financial support direction and, if it is not complied with, the liability created by a contribution notice is created by statute and is not a provable debt, nor is it an expense under any other sub-paragraph in the expenses regimes for liquidation and administration. It seems to me, therefore, that Parliament thereby imposed a financial liability on a company in an insolvency process which constitutes a necessary disbursement of the liquidator or administrator, within the *Toshoku* principle as enunciated by the judge.
111. This conclusion does lead to some curious consequences. Given the close relationship between the section 75 debt and the liability under a contribution notice, it is odd to find that while the section 75 debt is provable in the insolvency of the employer, the contribution notice liability is payable with much higher priority as an expense in the insolvency of the target. It is the more odd that, as is not disputed, the employer can itself be a target, so that, by service of a contribution notice, it appears

that the Pensions Regulator can produce a situation under which the priority of the relevant part of the debt is enhanced (to the extent of the amount payable under the contribution notice) from being merely provable (and expressly not preferential) to being payable as an expense. (The point of allowing for service of a financial support direction on the employer is said to be that, in particular circumstances, there may not be a section 75 debt, for example if there is no question of insolvency, but this argument from anomaly can be made, even if less strikingly, by reference to how the liability would rank if there were such a debt.)

112. On the other hand it might be said to be at least as odd, and a good deal more so, if the liability under a contribution notice had a lower priority than that of the section 75 debt, being relegated to the black hole, and if a potential target company could avoid the effect of the financial support direction regime by putting itself, or being put, into administration before any decisive step could be taken by the Pensions Regulator to impose any liability under this regime. Even if the issue of the Warning Notice is the critical stage, the possible target company (or at least the group) would be likely to have plenty of notice before that stage that the Pensions Regulator was interested in it, not least because it will have been the subject of requests for information under section 72 of the Act.
113. There is force in the argument that the potentially very large liability under an eventual contribution notice, and the open-ended nature of the obligation under a financial support direction, could be a serious impediment to the rescue culture which underlies the administration regime. The judge referred to evidence before him about this effect at paragraphs 160 to 162.
114. He noted two possible ways of alleviating the problems created in any given case. One is the use of the court's power to vary the order of priority, under rule 2.67(3). The other is the application of the reasonableness test as regards the imposition of a financial support direction or a contribution notice. In this respect there was some argument about the relevance of the interests of the creditors of the target. Fairly, it was submitted that the interests which the Pensions Regulator is concerned to protect, namely those of members of the employer's pension fund, are at variance with those of the general body of creditors of the target company. How, then, could the Pensions Regulator be expected to take into account the interests and concerns of the creditors of the target in deciding what obligation to impose on the target, and what to regard as reasonable financial support?
115. There was also some debate as to whether the target's creditors were persons directly affected by the Pensions Regulator's proposed action, so as to be among those persons to whom the Pensions Regulator must have express regard when exercising its regulatory functions: see section 100(2). I agree with the judge in concluding that the target's creditors cannot be regarded as in that category, since otherwise each of them would have to be given a warning notice under section 96(2)(a), which cannot have been intended: see his paragraphs 183 and 184. There is a specific reference to creditors of the employer in section 38(7)(eb), taken with section 38(7A), but this does not include creditors of the target (save where the target is the employer itself), so it does not seem to me that this affects the point.
116. The judge identified several anomalies which he described as "powerful considerations pointing to a conclusion that Parliament did not intend that the

financial consequences of the FSD regime should be to afford the pension trustees super-priority in the administration or liquidation of a target” (paragraph 173). These include the points to which I have referred in paragraph [111] above. He also made another fair point, that the level of priority of the liability under a contribution notice would depend on what might be a matter of chance as to timing as between the commencement of the insolvency process and whatever is the critical point in the financial support direction process – whether service of the financial support direction, or of the Determinations Panel’s determination or of the earlier warning notice – which gives rise to the “obligation incurred before that date” for the purposes of rule 13.12(1)(b).

117. The judge went on from making these points to say this at paragraph 177:

“The force of this point is, if anything, strengthened by the fact that the general description of the invariable requirements imposed by the issue of an FSD under section 44(3) are more readily applicable to a target which is a going concern, with a business future, than to a target which is in the death throes normally associated with being in an insolvency process. It is in that context no answer for the Regulator to point to the fact that, thus far, all cases of the implementation of the FSD regime have occurred after the collapse into insolvency of the target group. My reading of the FSD regime, taken as a whole, is that Parliament expected it to be applied, if possible, to targets which, because they were still trading, had some prospect of being able to provide ongoing support to the relevant pension scheme during the rest of the scheme’s natural life. The fact that the Regulator’s resources and access to relevant information may make that a difficult task in practice, does not significantly impinge upon the perception to be derived from section 43(3).”

118. Having decided that the Pensions Regulator had to consider the interests of creditors of the target company, not as such or as being directly affected, but because when the target is in an insolvency process the interests of its creditors, collectively, are to be taken as the interests of the company (paragraph 185), the judge nevertheless considered that there remained a conflict between the policy of pension scheme protection on the one hand and *pari passu* distribution to creditors (and to some extent also the rescue culture which is the purpose of administration) on the other, and that for the liability under a contribution notice to have super-priority as an expense was a less satisfactory way of resolving that conflict than for the contribution notice liability to be a provable debt (paragraphs 186 and 188). However he was unable to hold that this factor allowed him to decide in favour of the liability being a provable debt where the process started after the inception of the insolvency process. As he said at paragraph 191:

“Notwithstanding that a provable debt solution is, to my mind, obviously fairer as between scheme members and unsecured creditors and preferable as a means of resolving the underlying policy clash, I find myself driven with reluctance to the conclusion that, when formulating the 2004 Act, Parliament did in fact choose to leave the priority questions which would inevitably flow from the application of

the FSD regime to companies in an insolvency process to be resolved purely by the insolvency legislation. ”

119. He concluded that the presence in the 2004 Act of the express provision about priority as regards the section 75 debt and its silence as to the priority of the contribution notice liability may be difficult to account for, but it does not help towards a finding that, by implication, the contribution notice liability is also provable. He considered that the absence of any reference to insolvency in the 2004 Act led inexorably to the conclusion that the treatment of the liability under a contribution notice in an insolvency is left to the application of insolvency law generally, however haphazard, inexplicable, inconvenient and potentially unfair the result of that might be.
120. As against the anomalies relied on to show that it would be wrong to treat the liability under a financial support direction or a contribution notice as an expense, which, like the judge, I would accept as being real, there is the equal or greater anomaly of treating these liabilities as not payable as an expense in cases where they are not provable debts, so that they disappear into the black hole. That would render this particular regime entirely futile in relation to an insolvent target. It must be relatively likely that the regime has to be used in relation to an insolvent employer. It may not follow that all or many of the potential targets are also insolvent, but given the propensity of groups to operate on business lines rather than by reference to separate corporate entities (a feature of both the Nortel and the Lehman Brothers group arrangements) there must be a risk that all or many of the companies within a group will go down at the same time, so that the employer and all or many of the likely targets may well be in the same boat as regards solvency or insolvency.
121. For these reasons, the judge concluded that the liability under a contribution notice served in the circumstances under examination is one which is payable as an expense of the administration or the liquidation, as the case may be.
122. This produces an anomalous distinction (in cases such as the present appeals) between the case where the liability arises (on the issue of a financial support direction, if not before) for the first time during an administration and the company then goes into liquidation, in which the liability would be a provable debt, and one where the company does not go into liquidation, so that the liability is payable as an expense, but that is a feature of the particular legislation then in force which has now been amended.
123. For my part, I consider that the judge was right in this conclusion, despite the oddities, anomalies and inconveniences to which this gives rise. A reading of the Act which makes the contribution notice liability a provable debt in all circumstances is not possible. Therefore the only alternative to treating it as payable as an expense (in these circumstances) is that it would go into the black hole. That cannot have been the intention of Parliament. It leaves only the expenses solution.
124. I am not sure that I agree with everything the judge said in his paragraph 177 as to what Parliament is likely to have had in mind. It seems to me that, if the likely circumstances and nature of the operation of the financial support direction and contribution notice regime were envisaged on a realistic basis, it would be apparent that it might well be used, and properly so, in a situation in which some or all of the targets either were already in insolvency or came to be so during the substantial time

that might be required for the procedure to be invoked and carried through. In a situation in which the regime applies, because the employer was either a service company or insufficiently resourced, then even if the targets are themselves insolvent, they may still have more assets available than the employer does, despite the insolvency. We were told that this is the case in the Nortel insolvency, where, apart from the effect of an eventual financial support direction and contribution notice, creditors of the targets would be expected to receive a significantly higher level of dividend than those of the employer. The legislation has a valuable and realistic purpose if it enables some redistribution of assets in such a situation, where otherwise the creditors of the targets would be able to share in a greater volume of assets, partly as a result of having had the benefit of services (including employees) provided by the employer, but without having to pay in full for the provision of those services, in particular without having to contribute appropriately to the pension liabilities in respect of its employees. The value of the legislation is therefore not confined to a position in which all the relevant companies are solvent going concerns. This seems to me a positive point in favour of the reading of the legislation as applying to insolvent targets. In addition, there is the point already noted that it would be extraordinary if the onset of insolvency were to thwart a process already under way, or even only contemplated, on the part of the Pensions Regulator, towards invoking this regime.

Conclusion and disposition

125. For the same reasons as those expressed by the judge, I would therefore also hold that the liability ranks as an expense of the administration (or, as the case may be, the liquidation if all the relevant events take place during a liquidation). It follows that the appeal is to be dismissed. Except insofar as we have had to consider arguments not addressed to the judge (which seems to be true of the argument set out at paragraphs [45] to [47] above, and rejected at paragraphs [49] and [77] above), this is essentially for the reasons given by the judge.
126. Just as before the judge, the dismissal of the appeals means that the arguments based on *Ex parte James* do not arise.
127. The judge considered some consequential points at paragraphs 200 to 208. We had some submissions on some of these points, but none of them touches on the issues on the appeals. What the judge said about them is unaffected by the dismissal of the appeals.
128. The appeals were brought only against subparagraphs (1) and (3) of paragraph 1 of the judge's order. Those subparagraphs will stand as a result of the dismissal of the appeals. The only further comment I would make is that subparagraph (3) relates to the case where a contribution notice is issued after a relevant company has gone into liquidation, in respect of a financial support direction issued after the commencement of the liquidation. As I have mentioned, there may be room for argument that the stage at which the obligation first arises, for the purposes of rule 13.12(1)(b), is not the issue of the financial support direction but some earlier date, whether the Determinations Panel's determination to issue the financial support direction or even the Pensions Regulator's relevant warning notice. That question has been left entirely open on the argument of these appeals, as it was before the judge. The precise

formulation of subparagraph 1(3) of the order should not be taken to do other than leave that point open for later argument, if it becomes relevant.

Lord Justice Rimer

129. I agree.

Lord Justice Laws

130. I also agree.