IN THE HIGH COURT OF JUSTICE **Nos. 7942 and 7945 of 2008 and No. 429 of 2009**

CHANCERY DIVISION

COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration) AND OTHERS

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN:

THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration) AND OTHERS

Applicants

-and-

LEHMAN BROTHERS HOLDINGS, INC AND ANOTHER

Respondents

LBIE'S WRITTEN OPENING SUBMISSIONS (for hearing on 11-20 November 2013)

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INTRODUCTION

1. These written opening submissions are filed on behalf of the administrators of Lehman Brothers International (Europe) ("LBIE") in advance of the trial of an Application made jointly by the respective administrators of LBIE, Lehman Brothers Limited ("LBL") and LB Holdings Intermediate 2 Limited ("LBHI2") for directions as to a number of issues which impact upon the administrations of those three companies.

2. It is likely that there will be a surplus in LBIE's administration after payment of the principal amounts due to LBIE's ordinary unsecured creditors. In the LBIE administrators' Tenth Progress Report (for the period from 15 March 2013 to 14 September 2013), the "high" projected outcome for unsecured creditors would result in a surplus.

3. The central issue which arises on the Application is whether statutory interest is payable to LBIE's creditors (pursuant to IR 2.88(7)) out of the surplus in the administration in priority to debts owed by LBIE to LBL and LBHI2 (together "the Members") including, in particular, LBHI2's claims against LBIE under one or more of three subordinated loan agreements entered into on 1 November 2006 ("the Subordinated Loan Agreements").

4. LBIE is an unlimited company. The Members are its only shareholders.

   (1) LBL holds only one ordinary share in LBIE.

   (2) LBHI2 holds the entirety of the remainder of LBIE's ordinary shares and the entirety of LBIE's Class A preference shares and Class B preference shares.

5. The Members (which are also creditors of LBIE) are liable to contribute to LBIE's assets to meet any deficiency in its winding up. Section 74(1) of the Insolvency Act 1986 ("the 1986 Act") provides that:

> "*When a company is wound up, every present and past member is liable to contribute to its assets to any amount sufficient for payment of its*

> *debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves*".

6. As matters stand, LBIE is not being wound up but is in administration; however, winding up is an "exit route" available to LBIE's administrators. Whether that course is adopted will depend upon what is in the creditors' best interests as a whole, taking into account, amongst other matters, the outcome of this Application[1].

7. The other key issues raised by the Application go to: (i) the rights LBL and LBHI2 have to prove in LBIE's administration (and any subsequent liquidation); (ii) the rights LBIE has to prove in LBL's and LBHI2's administrations (and any subsequent liquidations) in circumstances in which the Members: (a) have claims against LBIE, in LBHI2's case both pursuant to the Subordinated Loan Agreements and otherwise; and (b) are liable to contribute to LBIE's assets pursuant to section 74 of the 1986 Act; and (iii) whether a claim exists wherever, where a creditor has a contractual right to be paid a debt in a currency other than sterling, the amount paid to the creditor, in sterling, on its proof in LBIE's insolvency is – when converted into the relevant other currency upon the date it is paid – less than 100% of the full amount of the debt expressed in that other currency.

8. The parties have agreed a List of Issues to be determined on the Application [1/3]. The issues are to be determined against the backdrop of the Statement of Agreed Facts at [1/4] ("the SAF").

9. In these written opening submissions, LBIE addresses the issues raised thematically, and not in the order in which they are raised in the List of Issues. However, to assist the Court, set out in the Schedule to these submissions are LBIE's answers to each of the issues in the Application, by reference to the List of Issues. Those answers reflect the position adopted by LBIE in its position paper [2/1].

10. The approach taken in these written opening submissions is to address in turn:

[1] See the Fourth Witness Statement of Russell Downs, paragraph 65 [3/6/22].

(1) the proper construction of the Subordinated Loan Agreements;

(2) the insolvency waterfall;

(3) the scope of the Members' liability to contribute under section 74;

(4) the components of the section 74 claims against the Members, including non-provable liabilities such as claims to interest which are not provable and currency conversion claims;

(5) how the section 74 claim is to be quantified;

(6) the Members' obligation to contribute and their rights *inter se;*

(7) the application of the contributory rule that a person who owes an estate money cannot claim a share in that estate without first making the contribution which completes it;

(8) how the contributory rule affects the Members' claims against LBIE; and

(9) how the contributory rule affects LBIE's claims against the Members.

11. References in these submissions:

(1) to LBIE, LBL or LBHI2 should be read, where the context requires, as including references to the administrators of the relevant company or companies;

(2) to sections are to the sections of the Insolvency Act 1986 (unless specified otherwise); and

(3) to IRs are to the Insolvency Rules 1986.

A BRIEF OVERVIEW OF LBIE'S CASE

12. The liabilities of a company in administration or winding up were exhaustively listed, in their order of priority, by Lord Neuberger P. in *Re the Nortel Companies*[2]. They include, in the order that follows: (i) debts owed to secured creditors (ii) expenses; (iii) preferential liabilities; (iv) unsecured provable debts; (v) statutory interest; and (vi) non-provable liabilities. It is only after payment of those liabilities that a return can be made to the members.

13. This reflects the principle of company law that the members of a company "*must stand in the queue behind its creditors*"[3].

14. Further, a member "*can receive* *nothing* *until he has paid* *everything* *he owes as a contributory*"[4]. He must discharge his obligation to the company before he can participate in any distributions. This rule, which is referred to in these written opening submissions as "the contributory rule", arises out of the rule in *Cherry v Boultbee*, which may be summarised as follows[5]:

> *"A person who owes an estate money, that is to say, who is bound to increase the general mass of the estate by a contribution of his own, cannot claim an aliquot share given to him out of that mass without first making the contribution which completes it. Nothing is in truth retained by the representative of the estate; nothing is in strict language set off; but the contributor is paid by holding in his own hand a part of the mass, which, if the mass were completed, he would receive back. That is expanding what the Lord Chancellor calls in Cherry v Boultbee 'a right to pay out of the fund in hand,' rather than a set-off…".*

15. The contributory rule differs from the rule in *Cherry v Boultbee* in that it precludes any set-off between the member's obligation to contribute and the company's liability to the member.

[2] [2013] 3 WLR 504 at [39]

[3] *Re Kaupthing, Singer and Friedlander Ltd (No. 2)* [2012] 1 AC 804 ("*Kaupthing*") *a*t [53]

[4] *Kaupthing a*t [52]

[5] By Kekewich J in Re Akerman [1891] 3 Ch 212 at 219, cited with approval by Lord Walker in *Kaupthing* at [13].

16. In this case, the Members are entitled to receive nothing from LBIE's administration and any future liquidation unless and until all of LBIE's provable debts (and statutory interest thereon) and non-provable liabilities (including currency conversion claims) have been paid:

(1) as to LBHI2, because its claims are in respect of loans made by it to LBIE on terms which involved its rights being contractually subordinated behind LBIE's other liabilities; and

(2) as to both LBL and LBHI2, because they have a liability, as members in an unlimited company, to contribute to LBIE's assets *"to any amount sufficient for payment of its debts and liabilities, and the expenses of the winding up…"*[6] and, until that liability has been discharged, are by application of the contributory rule shut out from participating in distributions made by LBIE.

17. The contributory rule also dictates that, when LBIE comes to prove in the Members' distributive administrations or liquidations, the Members will not have the benefit of any set-off taking place as between LBIE's claim to a contribution and the Members' claims against LBIE.

18. LBIE contends that the effect of both the subordination provisions contained in the Subordinated Loan Agreements and the contributory rule is that the relevant member may not prove in the insolvency of LBIE until it has contributed all that it owes *qua* member.

19. In the alternative, however, LBIE contends (as developed in more detail below) that priority is nevertheless to be afforded to statutory interest and non-provable liabilities (including currency conversion claims) owed to creditors of LBIE over the debt claims of LBHI2 and LBL even if the effect of the subordination provisions and the contributory rule is only that the relevant member may not receive any amount from LBIE's insolvency until it has contributed all that it owes *qua* member.

[6] Section 74(1).

20. It is clear on the authority of cases such as *Grissell's Case*[7] that the contributory rule is a substantive rule of equity that overrides what would otherwise be a statutory requirement for a *pari passu* distribution to be made in respect of debts owed to the Members alongside the proved debts of other creditors. It similarly overrides what would otherwise be a statutory requirement that "proved" debts are paid before any statutory interest is paid under IR 2.88(7) and section 189(2).

SUBORDINATION – THE CONTRACTUAL ANALYSIS [ISSUES 17 AND 18]

Introduction

21. LBHI2 has contractually subordinated its rights as regards the subordinated debt ("the Subordinated Debt") lent by it to LBIE under the terms of the Subordinated Loan Agreement(s) [4/210-260]. The Subordinated Debt formed part of LBIE's regulatory capital (see paragraph 42 of the SAF [1/4/7]) and the Subordinated Loan Agreements were on the Financial Services Authority's ("FSA") standard terms (see paragraph 41 of the SAF [1/4/7]).

22. In this section of LBIE's written opening submissions, LBIE deals with the effectiveness of subordination agreements and the extent of LBHI2's subordination under the Subordinated Loan Agreement(s).

The effectiveness of subordination agreements

23. It is well established that the *pari passu* principle does not render debt subordination ineffective.

[7] See paragraph 133ff.

24. In *Re Maxwell Communications Corp plc (No. 2)*[8], Vinelott J. held that a simple contractual subordination is effective in a formal insolvency, without there needing to be anything as sophisticated as the creditor agreeing to hold the debt or its proceeds on trust for the other creditors or to assign the benefit of the debt to those creditors.

The extent of the subordination

25. The agreement(s) pursuant to which the LBHI2 Subordinated Debt is owed provide(s), by Standard Term 5(1) [4/253][9], that LBHI2's rights in respect of the Subordinated Debt "*are subordinated to the Senior Liabilities*" (being "*all Liabilities [of LBIE] except the Subordinated Liabilities [i.e. LBIE's liabilities to LBHI2 in respect of the Subordinated Debt] and Excluded Liabilities*"[10] [4/250]) and that payment of any amount due to LBHI2 in respect of the Subordinated Debt is (in circumstances where LBIE is in administration or liquidation) conditional upon LBIE:

> "*being 'solvent' at the time of, and immediately after, the payment by [LBIE] and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that [LBIE] could make such payment and still be 'solvent'*" [4/254].

26. Standard Term 5(2) [4/254] provides that for this purpose, LBIE will be "*solvent*" if it is:

> "*…able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding – (a) obligations which are not payable or capable of being established or determined in the Insolvency of [LBIE], and (b) the Excluded Liabilities.*"

27. The term "*Liabilities*" is defined as meaning:

[8] [1993] 1 WLR 1402

[9] The numbering of the Standard Terms does not appear on the copy of the November 2006 $8 billion Short Term Subordinated Loan Facility as it appears in the bundle but is clear from the two Long Term Subordinated Loan Facilities which are at [4/210ff] and [4/225ff] respectively.

[10] The LBIE Administrators are not aware of the existence of any Excluded Liabilities (defined as "*Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of [LBIE]*").

> "*all present and future sums, liabilities and obligations payable or owing by [LBIE] (whether actual or contingent, jointly or severally or otherwise howsoever)*" [4/250].

28. It is difficult to conceive of a broader definition. In particular, the definition uses the phrase "*liabilities and obligations*", which is both different in concept and wider than the debts for which a creditor may be able to prove in LBIE's administration or liquidation.

29. Accordingly, LBIE will not be solvent for the purposes of Standard Term 5(2) and, therefore, the Subordinated Debt will not be repayable under Standard Term 5(1)(b), unless and until LBIE has paid, or is in a position to pay all of its Liabilities.

30. The reference in Standard Term 5(2)(a) to disregarding "*obligations which are not payable or capable of being established or determined in the Insolvency of [LBIE]*" does not require LBIE's obligations in respect of: (a) statutory interest (payable under IR 2.88(7) or section 189(2)); or (b) non-provable liabilities, to be disregarded[11]. The threshold for disregarding obligations is that they would not be payable or capable of being established or determined in the "*Insolvency*" of LBIE. "*Insolvency*" is defined as various types of insolvency *proceedings*, as opposed to by reference to the financial state of LBIE [4/249]. Both statutory interest and non-provable liabilities are matters which are capable of being established and determined within a liquidation or administration (i.e. two examples of proceedings falling within the definition of "*Insolvency*") and, where there are sufficient funds available to meet them, payable within that process:

    (1) The payment of statutory interest clearly forms part of the process of administration or liquidation, being specifically catered for within the statutory provisions governing those insolvency proceedings.

    (2) Non-provable liabilities are also clearly payable within the process of administration or liquidation, both of which involve distributions to all

[11] Any other construction would be inconsistent with the rights of the Lender being "*subordinated to the Senior Liabilities*" which term plainly includes both statutory interest and non-provable liabilities (Standard Term 5(1)).

creditors and, thereafter, to members. This necessarily encompasses payment in respect of non-provable liabilities, which rank before any return to members[12].

31. Standard Term 7 [4/256] contains a number of undertakings given to LBIE by LBHI2. Among those undertakings, LBHI2 undertook not to take the following steps without the prior written consent of the FSA:

(1) to "*purport to retain or set-off at any time any amount payable by it to [LBIE] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement…*" (sub-paragraph (b)); and

(2) to "*attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement*" (sub-paragraph (d)).

32. What flows from this is that LBHI2 is prevented from proving in respect of the Subordinated Debt, or is prevented from receiving any dividends on its proof, until such time as LBIE is solvent for the purposes of Standard Term 5(2). This is because the subordination provision imports an agreement by LBHI2:

(1) not to prove for the Subordinated Debt in LBIE's administration or liquidation until the debts of the unsubordinated creditors and all non-provable liabilities have been paid in full. To prove for the Subordinated Debt in competition with LBIE's other creditors would be in breach of the undertaking given in Standard Term 7(d)[13]; or

(2) that nothing is to be regarded as due from LBIE to LBHI2 under the Subordinated Loan Agreements, including by way of dividends, until the debts

[12] See below the section of LBIE's written opening submissions entitled "*The Insolvency Waterfall*" (paragraphs 61 et seq.).

[13] LBHI2 is similarly prevented from attempting to achieve payment through set-off (as a result of the undertaking given by it in Standard Term 7(b)).

of the unsubordinated creditors and all non-provable liabilities have been paid in full. The "*Repayment*" provisions of the Subordinated Loan Agreements (Standard Term 4 [4/251-253]) are expressly "*subject in all respects to the provisions of paragraph 5 (subordination)*" (see Standard Term 4(1) [4/251]) which makes clear that LBHI2 is not entitled to seek any repayment, and no repayment can fall due, unless the condition contained in Standard Term 5(1) is satisfied, i.e. unless all Liabilities have been paid in full.

33. If this contractual analysis is wrong, then (as is explained below at paragraph 133 et seq.), LBHI2 is nevertheless prevented from proving in respect of the Subordinated Debt, or is prevented from receiving any dividends on its proof, by reason of the application of the contributory rule.

Liabilities

34. The "Liabilities" to which LBHI2's rights are subordinated (in addition to provable debts, as to which there is no dispute on this Application) include:

(1) interest payable pursuant to IR 2.88(7) and section 189(2);

(2) non-provable liabilities generally;

(3) currency conversion claims; and

(4) liabilities owed by LBIE to its Members which rank behind the categories of liability listed in sub-paragraphs (1) to (3) above.

35. In the following paragraphs, the nature of these categories of liability (which is relevant to the disposal of the remaining issues raised by the Application) is explained.

(1) Statutory interest [ISSUE 21]

36. Interest payable under IR 2.88(7) of the Rules falls also within the definition of "Liabilities" in the Subordinated Loan Agreements (as does interest payable in a liquidation under section 189(2)).

37. IR 2.88(7) provides as follows:

> "*Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the [date on which the company went into administration].*"

38. It is a liability or obligation of the company which is payable contingently (the contingencies being the payment in full of the debts proved and the existence of a surplus) or "otherwise howsoever"[14].

39. LBHI2 appears to contend that statutory interest is only payable once payment has been made "*of [all] the debts proved*", even if the creditor's rights are subordinated behind the other creditors' right to statutory interest, such that no statutory interest is payable if there is a debt proved which has not been paid, even though that debt may be subordinated by the Subordination Agreement or subject to the contributory rule (as to which see below at paragraph 133 et seq.). This approach is wrong for two separate but interlinked reasons.

40. The first is that, properly construed, the Subordination Agreement varies the effect of IR 2.88(7) to provide that the Liabilities which are subordinated by Standard Term 5 rank behind the other proving creditors' statutory entitlement to interest. That subordination is effective in accordance with the general principle explained in *Re Maxwell Communications Corp plc (No. 2)*[15].

[14] See the definition of "Liabilities" at paragraph 27 above.

[15] [1993] 1 WLR 1402. There is nothing inherently surprising in a creditor (particular one which is also a member of the company) lending on a subordinated basis or subordinating its debt behind statutory interest; see, for example, *Re British & Commonwealth Holdings plc (No. 3)* [1992] BCC 58 at 65B-F.

41. Put another way, even if statutory interest were otherwise only payable once all debts proved were paid, LBHI2 has agreed that it shall not be paid until after statutory interest (and indeed other liabilities, including non-provable liability) has been paid, in precisely the same way as it has agreed not to be paid until after ordinary unsecured creditors' claims for principal. The treatment and permissibility of such a provision is the same no matter where in the "insolvency waterfall" the relevant liability appears.

42. The second is that, in any event, properly construed, the reference in IR 2.88(7) to payment "*of the debts proved*" relates to proofs which rank for dividend ahead of statutory interest. A debt which is proved but not paid, because it is subordinated behind statutory interest or does not rank for payment until the creditor discharges its own liability to the company, does not rank for payment ahead of statutory interest and cannot hold up the application of the surplus to pay statutory interest.

43. The converse result would be absurd because:

(1) in the case of a proof for subordinated debt, this would frustrate the purpose of the subordination. Just as the *pari passu* principle contained in IR 2.69 does not apply so as to render debt subordination ineffective, the non-payment of subordinated debt does not prevent IR 2.88(7) from leading to the payment of statutory interest; and

(2) in the case of debts subject to the application of the contributory rule (as to which see below at paragraph 133 et seq.), it would be contrary to a well-established principle of law.

44. As IR 2.88(9) makes clear, the rate of interest payable under IR 2.88(7) is whichever is the greater of the rate specified in section 17 of the Judgments Act 1838 on the date when the company entered administration or the rate applicable to the debt apart from the administration.

(2) Non-provable liabilities generally

45. Winding up imposes a process of collective enforcement which leaves the underlying liability untouched, save to the extent that it is paid out of dividends[16]. The same principle is applicable in relation to a distributive administration.

46. Consistent with this principle, the mere fact that a liability is not provable does not mean to say that it does not continue as a liability owed by the debtor. The liability continues to subsist, albeit as one in respect of which a creditor has no entitlement to a distribution by way of dividend. Thus, and by way of example, prior to an amendment being made to IR 13.12(2) by the Insolvency (Amendment Rules) 2006, SI 2006/1272, contingent claims in tort were not provable unless the cause of action had accrued before the date on which the company went into administration or liquidation[17]. Nonetheless the liability continued, and it was always open to the Court to permit the creditor to obtain and execute a judgment on its claim before any surplus was distributed to the members[18].

47. It follows that a non-provable liability is one of LBIE's "Liabilities" within the broad meaning of "Liabilities" under the Subordinated Loan Agreements.

48. To the extent that interest is not payable pursuant to IR 2.88(7) or section 189(2), an important category of LBIE's non-provable liabilities would be non-provable interest.

49. A significant proportion of LBIE's creditors have a contractual right to be paid interest on the sums owing to them, for example, on the early termination amount payable by LBIE on the close-out of an ISDA Master Agreement under which LBIE is the paying party. The creditors' right to contractual interest, insofar as it relates to the post-administration period, is not provable (IR 2.88(1)). It is not, however, extinguished.

[16] *Wight v. Eckhardt Marine* [2004] 1 AC 147 at [27]

[17] *Re T&N Ltd* [2006] 1 WLR 1728 at [141]. That remains the case in respect of liabilities in tort where elements necessary to establish the cause of action (other than actionable damage) did not exist at the relevant date (see IR 13.12(2)(b)).

[18] *Re T&N Ltd* [2006] 1 WLR 1728 at [107]

50. Accordingly, where creditors have such rights (which might be contractual or statutory (e.g. judgment interest)), LBIE has a corresponding liability, which, although the relevant creditors cannot prove in respect of it, continues to subsist, and therefore ranks ahead of LBHI2's claim for repayment of the Subordinated Debt.

(3) Currency conversion claims [ISSUE 22]

51. A currency conversion claim is a species of non-provable liability. It arises where a creditor has the contractual right to be paid a debt in a currency other than sterling and exists wherever the amount paid to the creditor, in sterling, on its proof in LBIE's administration or liquidation, although it amounts to payment in full when converted into the relevant other currency upon the date it is paid, is less than the full amount of the debt expressed in that other currency.

52. The basis for the claim is as follows:

(1) Prior to the company going into an insolvency process, the creditor has a contractual entitlement: (i) to be paid in a foreign currency; and (ii) to obtain a judgment for that foreign currency debt and to obtain execution against assets in England in an amount equal to its sterling equivalent calculated as at the exchange rate on the date of execution[19].

(2) In an administration or liquidation, so as to pay dividends on provable debts rateably, it is necessary to convert all foreign currency debts into sterling[20].

(3) However, the payment of dividends in sterling might, at the relevant exchange rate on the date of payment, amount to less than the amount of the debt expressed in that other currency.

[19] *Miliangos v George Frank (Textiles) Ltd* [1976] AC 443

[20] In a liquidation, IR 4.91(1) states that a foreign currency debt is to be converted into sterling "for the purpose of proving…" and the same expression appears in IR 2.86(1).

(4) Where it does so, a shortfall will exist (as compared to that which the creditor is contractually entitled to) and that shortfall constitutes a non-provable liability of the company.

53. The proving process in an administration or liquidation does not involve the release of the company from its liabilities or the extinction of those liabilities[21]. As Buckley J. put it in *Re West Coast Gold Fields Ltd*[22]:

> "*The argument is that proof is equivalent to payment. To my mind that is an axiomatic or epigrammatic way of stating something which, in the circumstances, is quite untrue for the material purposes of this case. Of course, proof is equivalent to payment in this sense, that the debtor can be pressed no further than for that amount; he is discharged, but his estate is not discharged. The proof is the record of the fact that his estate is liable, and that from his estate you are entitled to receive, rateably with the other creditors, dividends until the whole amount has been paid. That is not payment at all for any purpose which is material here.*"

54. The general principle, therefore, is that, where a liability of a company gives rise to a provable debt, the fact that the creditor can and does prove in respect of it, whether or not it receives a dividend, does not extinguish the liability. The liability is merely reduced by the amount of dividends paid to the creditor in respect of the liability.

55. IR 2.86 and IR 4.91(1) require the conversion into sterling of debts incurred or payable in a foreign currency at the official exchange rate prevailing on the date when the company entered administration only "*[f]or the purpose of proving [that] debt*". They do not purport to affect the fact that, when a creditor receives from the administrators dividends which, when converted into the foreign currency on the dates they are received, are less than the amount of the debt, the creditor remains unpaid, and the company remains liable, for the balance.

56. In *Re Lines Bros*[23], Brightman LJ raised the possibility that in a liquidation, where all of the debts of the company have been paid in full, it may be possible for a creditor

[21] See the submission at paragraph 45 et seq. above based on *Wight v. Eckhardt Marine* [2004] 1 AC 147 at [27] and *Re T&N Ltd* [2006] 1 WLR 1728 at [107].

[22] [1905] 1 Ch. 597 at 601

who has suffered a loss as a result of being paid out in a currency other than its contractual currency, to claim in respect of that loss against the company, prior to any surplus being returned to shareholders. Brightman LJ stated as follows (at 21F-G[24]):

> "*It may well be the duty of the liquidator, in the case of a wholly solvent liquidation, if a foreign currency creditor has been paid less than his full contractual foreign currency debt, to make good the shortfall before he pays anything to the shareholders. I do not say that this is necessarily the solution to the problem posed, but I have not heard any convincing objection to that solution.*"

57. The solution proposed by Brightman LJ is consistent with principle and correct.

58. For convenience, this specie of non-provable claim is referred to in these written opening submissions as the "currency conversion claim".

(4) The non-subordinated claims of Members

59. As is explained below (at paragraph 133 et seq.), a person liable as contributory must discharge himself in that character before he can receive anything in his capacity as a creditor. The Members are in the position of being at the back of the creditor queue.

60. The liabilities owed to them are, however, "Liabilities" within the meaning of the Subordinated Loan Agreements and the Members (i.e. LBL and, as regards its non-subordinated claim, LBHI2) rank in front of LBHI2 as regards its claim for repayment of the Subordinated Debt.

[23] [1983] 1 Ch. 1

[24] See also at 22A-C.

THE INSOLVENCY WATERFALL [ISSUES 19 AND 20]

61. Quite apart from the effectiveness of the Subordinated Loan Agreements and the extent of LBHI2's subordination under them, the Application raises issues as to the priority of various categories of liabilities owed by LBIE.

62. LBIE contends that, once the provable debts have been paid or secured for, the surplus assets must be applied in the following order:

(1) Statutory interest;

(2) Non-provable liabilities;

(3) The debts owed to Members which are not subordinated;

(4) The Subordinated Debt.

63. A helpful starting point is Lord Neuberger P.'s judgment in *Re the Nortel Companies*[25]. In that case, he explained that:

> "*In a liquidation of a company and in an administration (where there is no question of trying to save the company or its business), the effect of insolvency legislation (currently the 1986 Act and the Insolvency Rules, and, in particular, sections 107, 115, 143, 175, 176ZA, and 189 of, and paras 65 and 99 of Schedule B1 to, the 1986 Act, and rules 2.67, 2.88, 4.181 and 4.218 of the Insolvency Rules), as interpreted and extended by the courts, is that the order of priority for payment out of the company's assets is, in summary terms, as follows:*
>
> *(1) Fixed charge creditors;*
>
> *(2) Expenses of the insolvency proceedings;*
>
> *(3) Preferential creditors;*
>
> *(4) Floating charge creditors;*
>
> *(5) Unsecured provable debts;*
>
> *(6) Statutory interest;*
>
> *(7) Non-provable liabilities; and*

[25] [2013] 3 WLR 504 at [39]

> *(8) Shareholders.*"

64. As is explicit in this explanation, the waterfall is the same in a "liquidating" or "distributive" administration as it is in a liquidation. The submissions which follow apply to both types of insolvency procedure.

65. This Application concerns only the 5th to 8th items in the waterfall.

66. As set out above (at paragraph 37), IR 2.88(7) provides:

> "*Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the [date on which the company went into administration].*"

67. The *Nortel* case establishes at Supreme Court level that the effect of this rule is that statutory interest is payable in priority to non-provable liabilities. The higher ranking of statutory interest flows from the requirement in IR 2.88(7)[26] that interest is required to be paid out of the surplus remaining after payment of "the debts proved" but before being applied for any other purpose. The non-provable liabilities identified by Lord Neuberger in *Nortel* include debts owed to the Members which are not provable or proved, or on which no dividend is payable.

68. As the LBIE Administrators will explain below, the application of the contributory rule is such that the Members are not entitled to prove in LBIE's administration or to receive any dividends from LBIE's administrators unless and until they have contributed what is due from them to LBIE in their capacity as contributories. The liabilities owed to them will rank behind LBIE's other non-provable liabilities.

69. By virtue of the contractual subordination of LBHI2's claim to repayment of the Subordinated Debt, that claim (in any event) ranks behind the claims of LBIE's other creditors, whether or not those claims are provable.

[26] See, for the liquidation equivalent, section 189(2).

THE SCOPE OF, AND ENFORCEMENT OF THE CONTRIBUTORIES' LIABILITY UNDER, SECTION 74

70. Before turning to the application of the contributory rule, it is necessary to establish the scope of the Members' liability under section 74.

71. Section 74(1) of the Act provides that:

> "*When a company is wound up, every present and past member is liable to contribute to its assets to any amount sufficient for payment of its debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves.*"

72. A "*contributory*" is a member or past member of the company who is liable to contribute to the assets of the company in a winding up (section 79).

73. The nature of the contributory's liability is spelt out in section 80. It provides that:

> "*The liability of a contributory creates a debt (in England and Wales in the nature of an ordinary contract debt) accruing due from him at the time when his liability commenced, but payable at the time when calls are made for enforcing the liability.*"

74. The liability of a contributory commences at the time the contributory first became a shareholder[27], so it follows that from that time the debt is due, although it does not become payable until a call is made.

75. The making of calls against contributories, and thereby recovering contributions from the members is a task that is in the ordinary course carried out by the liquidator. The liquidator's first duty is to ascertain or identify those who are liable to contribute. This is done by settling the list of contributories. The duty is technically that of the Court, under section 148, but IR 4.196 provides that the liquidator is to discharge the

[27] *Ex parte William Canwell* (1864) 4 De Gex, Jones & Smith 539; *Thomas George Williams v Robert Palmer Harding* (1866) L.R. 1 H.L. 9.

duty as its delegate. The next step (which affects only the members) is to make and enforce calls against those on the list and to adjust the rights of contributories so as to ensure that losses are evenly distributed amongst all the members. In order to avoid the expense of proceeding against each contributory individually, the liquidator may obtain what is known as a balance order, which is a summary order made by the Court under section 150 directing all of those settled on the list of contributories to pay to the liquidator the amounts due from each of them by way of a contribution to the assets of the company.

76. The terms "*debts*" and "*liabilities*" which appear in section 74 are defined in IR 13.12. IR 13.12(1) contains the definition of "debts". Debts can be proved in an administration or liquidation. The definition of "liabilities" is broader (IR.13.12(4)). Liabilities extend beyond what is provable and encompass non-provable liabilities.

77. The applicable version of IR 13.12 is (materially) in the following terms:

> "*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).*
>
> ...
>
> *(3) For the purposes of references 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.*"

78. The scope of the contributory's liability to contribute is, therefore, broad and (subject to the exceptions of which the two most important are listed below at paragraph 79) unlimited. The contributory is liable to contribute to the company's assets an amount sufficient for payment of the provable debts of the company, statutory interest, its non-provable liabilities and the expenses of the winding up.

79. In many cases, however, the exposure of the contributory is capped.

    (1) The liability of a contributory in a company limited by shares cannot exceed the amount (if any) unpaid in respect of his shares (section 74(2)(d)).

    (2) If the company is limited by guarantee, the contributory's liability is limited to the amount which he has undertaken to contribute in its Memorandum of Association (section 74(3)).

80. LBIE is, of course, an unlimited company. Accordingly, the Members do not have the advantage of such a cap. Their exposure is unlimited and capped only by reference to the aggregate amount of LBIE's debts and liabilities and the expenses of its winding up.

THE COMPONENTS OF THE SECTION 74 CLAIMS AGAINST THE MEMBERS

Debts and liabilities

81. As explained, the Members are liable to contribute to LBIE's assets to any amount sufficient for payment of its debts and liabilities, and the expenses of the winding up.

82. The term "*debt*" in relation to the winding up of a company is defined in IR 13.12(1)[28].

83. The Supreme Court has recently considered the scope of provable debts in the context of the potential statutory liabilities faced by LBIE and others arising out of the deficiency in the Lehman Brothers pension scheme. In its judgment[29], the Supreme Court gave guidance as to the scope of IR 13.12(1)(a) (at [68] to [71]) and IR 13.12(1)(b) (at [72]-[86]).

84. IR 13.12(1)(a) is concerned with liabilities to which the company "is subject" at the date of the insolvency event, whereas IR 13.12(1)(b) is directed to those liabilities to which it "may become subject", subsequent to that date, and there is no overlap between these two categories[30].

85. Turning to IR 13.12(1)(b), as Lord Neuberger P. said at [75]

> *"Where a liability arises after the insolvency event as a result of a contract entered into by a company, there is no real problem. The contract, in so far as it imposes any actual or contingent liabilities on the company, can fairly be said to impose the incurred obligation. Accordingly, in such a case the question whether the liability falls within para (b) will depend on whether the contract was entered into before or after the insolvency event."*

[28] See IR 12.3(1) and *Re the Nortel Companies; Re the Lehman Companies* [2013] 3 WLR 504 at [66].

[29] *Re the Nortel Companies; Re the Lehman Companies* [2013] 3 WLR 504.

[30] *Re the Nortel Companies; Re the Lehman Companies* [2013] 3 WLR 504 at [70]

86. Lord Neuberger P. went on to consider statutory liabilities. At [77], he explained that:

> *"…the mere fact that a company could become under a liability pursuant to a provision in a statute which was in force before the insolvency event, cannot mean that, where the liability arises after the insolvency event, it falls within rule 13.12(1)(b). It would be dangerous to try and suggest a universally applicable formula, given the many different statutory and other liabilities and obligations which could exist. However, I would suggest that, at least normally, in order for a company to have incurred a relevant "obligation" under rule 13.12(1)(b), it must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship), and which (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred. If these two requirements are satisfied, it is also, I think, relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1)(b)."*

87. This guidance clearly covers an acquisition or issuance of shares which expose the shareholder to the statutory liability to respond to a call.

88. As submitted above, the term "*liability*" is broader than the term "*debt*" and encompasses non-provable liabilities. The term is defined in IR 13.12(4) as follows:

> "*…'liability' means…* 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*".

89. That definition is subject to IR 13.12(3) which provides that:

> "*For the purposes of references 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.*"

90. Accordingly, the Members' liability under section 74 relates both to provable debts and all other liabilities, including statutory interest and non-provable liabilities.

91. Section 74 expressly includes, in framing the scope of the contributory's liability to contribute, any amount sufficient "*for the adjustment of the rights of the contributories among themselves*", i.e. payments to shareholders[31], which rank last of all. If the members' obligation extends to enabling the company to make payments to shareholders *qua* shareholders, then it must follow that their obligation extends to any and all liabilities which rank for payment ahead of such payments to shareholders, including therefore statutory interest and any non-provable liabilities.

92. There are further textual indicators that statutory interest falls within the "debts and liabilities" referred to in section 74:

(1) Section 89(1) provides that a statutory declaration of solvency for the purpose of a members' voluntary winding up must address the company's ability to pay "*its debts in full, together with interest at the official rate*"; and

(2) Section 149(3) provides that it is only when "*all the creditors are paid in full (together with interest at the official rate)*" that a contributory is able to exercise a right of set-off in respect of any subsequent call.

93. The official rate as referred to in section 89(1) and section 149(3) is defined by section 251 to mean the rate payable under section 189(4)[32].

94. These provisions make clear that statutory interest is to be paid in full: (i) if a voluntary liquidation is not to become a creditors' voluntary liquidation with the consequential loss of member influence over the liquidation process (including as to the identity of the liquidator); and (ii) before a contributory is able to exercise a right of set-off in respect of any subsequent call in circumstances in which calls are made in the context of the adjustment of the rights of the contributories among themselves.

[31] *Re West Coast Gold Fields Ltd* [1905] 1 Ch 597 is an example of a case where the member's obligation to contribute related to payments that were to be made to shareholders, there being a surplus in the winding up.

[32] Which is itself the same rate as that provided for by IR 2.88(9).

95. This approach is also consistent with the judgment in *Re Overnight Ltd*[33], where Roth J. proceeded on the assumption that a liability to contribute to the assets of the company in the context of a fraudulent trading claim (under section 213) includes the liability of the company in respect of statutory interest. It would be surprising if the extent of the liability of a member to contribute to the assets of the company was to be construed in a narrower way.

96. The following paragraphs address the components of the "debts and liabilities" which are part of the subject matter of the liability to contribute.

Provable debts

97. It is the responsibility of the administrators of LBIE to establish what are the debts provable against LBIE in its administration. Those debts, potentially together with other debts[34], would equally be provable in a subsequent liquidation.

98. The Members' liability to contribute in respect of LBIE's debts should prove straightforward to calculate because it is simply the aggregate value of the proofs admitted to the extent that they are unpaid. As matters stand, there should be no deficiency as regards the provable debts and so the Members' liability to contribute will not include an amount in respect of LBIE's debts.

Statutory interest

99. It is necessary to consider separately post-liquidation interest, under section 189, and post-administration interest, under IR 2.88(7).

100. In a winding-up, the liability of the company to pay interest accruing since the date of the winding-up, pursuant to section 189, is clearly encompassed within "debts and liabilities" of the company within section 74. There is no warrant for limiting section

[33] [2010] BCC 803

[34] Applying the analysis of Briggs J. in *Bloom v The Pensions Regulator; Lomas v The Pensions Regulator* [2011] BCC 277 at [113]-[123].

74 to provable liabilities, particularly when it expressly includes amounts due to shareholders in order to adjust the rights among them, which amounts rank for payment only after payment of statutory interest: see paragraph 63 above.

101. The fact that interest under section 189 is payable only out of any surplus after paying proved debts in full is irrelevant. The members' obligation is to contribute to the assets so that there is an amount sufficient to pay liabilities. In the context of the company's liabilities under section 189, that means simply that members must contribute an amount sufficient to ensure there is a surplus out of which post-administration interest can be paid.

102. Under the insolvency rules in force at the time of LBIE's administration, in the event of a subsequent liquidation of LBIE, a creditor could prove for interest due on its debt in respect of any period up to the date on which LBIE went into administration: IR 4.93(1). Under section 189(2), however, statutory interest in the liquidation would be payable only for the period in which the debts had been outstanding since the company went into liquidation.

103. On one reading of these provisions, interest accruing on debts during the period of administration is neither provable, nor included within the scope of statutory interest. In other words, on that reading, interest accruing during the period of administration followed by a winding-up is simply lost.

104. That reading, however, cannot properly reflect the Legislature's intention. Parliament clearly intended that: (i) creditors should be entitled to interest accruing during an administration before any return was made to members; and (ii) creditors should be entitled to interest accruing during a winding-up before any return was made to members. There is no logical or policy reason to permit assets of the insolvent company to be returned to members in priority to creditors' rights to interest

accruing during the period of administration, simply because the administration is converted into winding-up before distribution is made[35].

105. It is true that, to the extent that creditors have a *contractual* entitlement to interest, then they would not lose completely the right to recover interest accruing during the period of administration, where distribution occurs in a liquidation. That is because the contractual liability, even though not provable, remains a liability of the company and must be paid once all proved debts and statutory interest have been paid. This was undoubtedly the position before post-liquidation interest became the subject of a statutory rule[36], and the same conclusion must apply if a contractual entitlement to interest is not otherwise satisfied via the rules applicable in the winding-up.

106. This is, however, only a partial answer, and provides no answer at all where a creditor has no contractual right to interest, but accrues a right to interest during an administration by virtue of IR 2.88(7).

107. To avoid an obvious lacuna if the above reading of the provisions relating to statutory interest is adopted, it is submitted that the correct interpretation of those provisions is as follows:

(1) Section 189 addresses only what occurs in a winding up. It does not contemplate a prior administration. It is thus limited to interest accruing on debts since the company went into liquidation;

(2) IR 2.88(7) applies once the administration has become a distributive administration because notice has been given under IR 2.95(1)[37]. It addresses interest on debts proved thereafter, and provides for the payment of interest accruing since the commencement of the administration;

[35] Note that in the reverse situation, where an administration follows immediately upon a winding-up, then statutory interest runs from the date of the commencement of the earlier winding-up: see the definition of "relevant date" in IR 2.88(1).

[36] See, for example, *Re Humber Ironworks & Shipbuilding Co* (1869) LR 4 Ch. App. 643.

[37] See IR 2.68(1).

(3) IR 2.88(7) does not *cease* to apply merely because the distributing administration is succeeded by a winding-up, before creditors' proofs of debt are paid in full. There is nothing in the wording of s.2.88(7) which requires it to cease to apply upon the conversion of the administration into a winding-up, or which limits the "*surplus remaining*" to a surplus remaining in the hands of the administrators;

(4) It is true that IR 4.73(8) provides that where a winding-up is immediately preceded by an administration, a creditor who has proved in the administration is deemed to have submitted a proof in the winding up, so that section 189(2), by its terms, can be taken to apply to such a creditor. It would be wrong, however, to apply this deeming provision so as to deprive a creditor who had *actually* proved in the administration (and so fell within IR 2. 88(7)) from the benefit of receiving interest on any surplus arising before any return was made to members;

(5) Accordingly, if an administrator has given notice of an intention to make a distribution to creditors, and the company subsequently goes into liquidation before all proofs of debt have been paid, but there is then a surplus (in the hands of the liquidator) after payment of all the debts proved, then either:

(a) IR 2.88(7) applies to all creditors who actually prove thereafter (whether during the administration or after, there being no temporal limit as regards proving within the sub-rule) and section 189 is simply unnecessary; or

(b) IR 2.88(7) applies to creditors who actually proved during the administration, while section 189(2) applies to those creditors who actually proved during the winding-up.

Non-provable liabilities

108. The Members' liability under section 74 includes liability to make a contribution to the assets to an amount sufficient for payment of the non-provable liabilities.

109. The nature of non-provable liabilities has been dealt with above (at paragraph 45 et seq.) and LBIE has explained that the fact that a liability is not provable does not mean that it is extinguished by an insolvency process, or that it is no longer a liability within the meaning of section 74(1). If there is a surplus after the payment in full of the provable debts and statutory interest, the creditor to whom a non-provable liability is owed is entitled to be paid ahead of any distribution being made to the members. That is why non-provable liabilities appear as the penultimate category of liabilities in the insolvency "waterfall" set out in paragraph 63 above.

110. LBIE's non-provable liabilities include:

(1) to the extent, if any, that it is not payable as statutory interest, interest which provable debts bear but which, because it relates to the period after the commencement of the administration, is not provable (as to which see paragraphs 48 to 50 above); and

(2) currency conversion claims (as to which see paragraphs 51 to 58 above).

111. Accordingly, the Members are liable to contribute in respect of LBIE's liability to creditors: (i) entitled to be paid non-provable interest (which might be contractual or statutory (e.g. Judgments Act interest)), to the extent, if any, that it is not payable as statutory interest; and those (ii) which have currency conversion claims.

112. The Members' liability to contribute will extend to any other non-provable liabilities of LBIE.

Subordinated liabilities

113. Liabilities of LBIE which have been subordinated fall within the broad definition of liabilities contained in IR 13.12(4).

114. They too fall within the scope of section 74 and the Members are liable to contribute in respect of the Subordinated Debt owed by LBIE to LBHI2.

QUANTIFYING THE SECTION 74 CLAIM [ISSUES 13 AND 14 (AND 21 AND 22)]

(1) In administration

Contingencies

115. LBIE's contribution claim under section 74 is for a provable debt in the administrations / liquidations of each of the Members. It is a contingent liability within the meaning of IR 13.12(1)(b), the contingencies being the winding up of LBIE and the making of a call by its liquidator. In the context of proving in an administration, the Insolvency Rules 1986 make provision for the estimation of contingent debts.

116. IR 2.81(1) provides that:

> *"The administrator shall estimate the value of any debt which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value; and he may revise any estimate previously made, if he thinks fit by reference to any change of circumstances or to information becoming available to him. He shall inform the creditor as to his estimate and any revision of it."*

117. IR 2.81(2) adds that:

> *"Where the value of a debt is estimated under this Rule, the amount provable in the administration in the case of that debt is that of the estimate for the time being."*

118. IR 2.85(5) makes clear that, in the context of administration set-off:

> *"Rule 2.81 shall apply for the purposes of this Rule to any obligation to or from the company which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value."*

119. Accordingly, in a distributive administration of one of the Members, LBIE would be entitled to prove in respect of the contingent claim under section 74 and the administrators of the Member would be required to estimate its value.

120. Equally, if contrary to the arguments set out in these written opening submissions, the Members were entitled to prove in LBIE's administration and receive distributions, the value of LBIE's contingent claim would be estimated for the purposes of calculating the net debt due to or from LBIE under IR 2.85(8).

121. In estimating the value of the contingent claim, the relevant administrators would (at the relevant time) have to take into account the likelihood of LBIE going into liquidation and estimate the extent of LBIE's deficiency as regards the debts and liabilities owed by it to its creditors and the likely expenses of the liquidation process. Their assessment would not be undertaken in a vacuum. The LBIE administrators would provide information and documentation in support of LBIE's proof.

IR 2.105

122. IR 2.105 is a provision which, like IR 11.13, applies a discounting formula to the amount to be paid in respect of debts admitted to proof debts which are certain (as opposed to contingent) but payable only in the future.

123. The rule is designed to deprive the creditor of a windfall he would otherwise obtain from receiving a dividend on his debt before it falls due.

124. IR 2.105, like IR 11.13, does not apply to contingent debts[38] and is, therefore, not relevant to the issues raised on this Application.

125. The non-application of IR 2.105 to contingent debts (which are required to be valued pursuant to IR 2.81) can be demonstrated as follows:

(1) In the case of many contingent debts, it will not be known when the contingent liability will fall due. For example, assume the company guarantees a principal liability of £100 owed by a third party to the creditor. Whilst the

[38] *Re Park Air Services plc* [2000] 2 AC 172.

administrator might be able to estimate the prospects of that contingency occurring, he cannot know when the debt would otherwise be due.

(2) The formula contained in IR 2.105 requires "n" to be inputted. IR 2.105(2)(b) provides that: *"'n' is the period beginning with the relevant date and ending with the date on which the payment of the creditor's debt would otherwise be due expressed in years and months in a decimalised form"*. Where "n" is not known, the formula is incapable of application.

(2) In liquidation

126. If the Members, or either of them, were to go into liquidation, LBIE's claim would be treated in materially the same way. IR 4.86 is in materially the same terms as IR 2.81.

127. If LBIE were to go into liquidation, its claims against the Members under section 74 would remain provable in the Members' administrations / liquidations but, as from the time calls are made on the Members, those claims would no longer be contingent.

128. In such a scenario, the value of the debt in the Members' insolvency proceedings might still require some estimation and, if so, IR 2.81 (if the Members remained in administration) or IR 4.86 (if the Members were, by then, in liquidation) would apply.

129. IR 11.13 would not apply, for the same reason as IR 2.105 does not apply.

THE MEMBERS' OBLIGATION TO CONTRIBUTE AND THEIR RIGHTS INTER SE [ISSUES 15 AND 16]

130. The Members' liability under section 74 is unlimited, because LBIE is an unlimited company. It is a joint and several liability in the sense that the Members are each liable for the full amount of LBIE's debts and liabilities and the expenses of its liquidation. Accordingly, each is liable to contribute to LBIE's assets "*to any amount sufficient for payment of its debts and liabilities, and the expenses of the winding up*",

leaving aside what (if any) rights they might then have against each other for contribution, indemnity or adjustment.

131. In the event of LBIE going into liquidation, the Members' liability might be enforced by way of a balance order made pursuant to section 150 (as to which see paragraph 75 above), directing the Members to pay to the liquidator the amounts due from each of them by way of a contribution to the assets of the company.

132. LBIE does not advance a positive case on the further issues contained within Issue 15. LBIE does contend, however, in answer to Issue 16, that the value of LBIE's proof in the administrations or subsequent liquidations of the Members is the aggregate of LBIE's deficiency as regards its creditors' provable debts, statutory interest, LBIE's non-provable liabilities and the expenses of LBIE's winding up.

THE CONTRIBUTORY RULE

133. Having established that the Members are subject to a liability to contribute to LBIE's assets in the event of its liquidation, and it appearing that the Members have claims against LBIE, the remaining issues raised by the Application relate to the way in which those respective claims would be dealt with in LBIE's and/or in the Members' respective administrations and subsequent liquidations.

134. LBIE contends that the contributory rule is critical to the disposal of the remaining issues. For that reason, its scope and import are considered first.

135. It is firmly established that a person liable as contributory must discharge himself in that character before he is entitled to receive anything in his capacity as a creditor[39].

136. This rule, which has been applied on numerous occasions since the seminal[40] decision of Lord Chelmsford LC and the Lords Justices in *Re Overend, Gurney, and Co;*

[39] *Re West Coast Gold Fields Ltd; Rowe's Trustee's Claim* [1905] 1 Ch 597 at 602 (per Buckley J).

Grissell's Case[41], was recently described by the Supreme Court (Lord Walker) as being a "*cogent principle of law [which] requires one claim to be given strict priority to another*"[42].

137. In *Grissell's Case*, Lord Chelmsford LC considered that the question raised in that case, namely, whether a shareholder, who was also a creditor of a limited liability company, was entitled either to set-off, or to have credit for, so much of his debt as was equal to the amount of calls which had been made upon, but not paid by, him, and to receive a dividend for the balance[43], depended entirely upon the construction of the Companies Act 1862[44]. He said that the primary intention of the Legislature, as expressed in section 133 of that Act, must be regarded.

138. Section 133 of the Companies Act 1862 contained what is commonly referred to as the *pari passu* principle. It provided that: *"the property of the company shall be applied in satisfaction of its liabilities* pari passu*, and subject thereto shall, unless it be otherwise provided by the regulations of the company, be distributed amongst the members according to their rights and interests in the company".*

139. In that light, Lord Chelmsford LC held (at 536) that:

> *"Taking the Act as a whole, the call is to come into the assets of the company, to be applied with the other assets in payment of debts. To allow a set-off against the call would be contrary to the whole scope of the Act. In support of this view it will be sufficient to refer again to the 133rd section as to the satisfaction of the liabilities of the company pari passu. And the argument against the allowance of a set-off, addressed to the Court on behalf of the official liquidators, is extremely strong — that if a debt due from the company to one of its members should happen to be exactly equal to the call made upon him, he would in this way be paid*

[40] As it is described by Lord Walker in *Kaupthing, Singer and Friedlander Ltd* [2012] 1 AC 804 at [20].

[41] (1866) LR 1 Ch App 528

[42] *Re Kaupthing, Singer and Friedlander Ltd* [2012] 1 AC 804 at [53].

[43] (1866) LR 1 Ch App 528 at 534

[44] At 534

> *twenty shillings in the pound upon his debt, while the other creditors might, perhaps, receive a small dividend, or even nothing at all."*

140. Lord Chelmsford LC added (also at 536):

> *"…with respect to a member of a company with limited liability, if a set-off were allowed against a call, it would have the effect of withdrawing altogether from the creditors part of the funds applicable to the payment of their debts."*

141. The rationale for the contributory rule has been explained in similar terms in a number of cases. For example, in *Re Auriferous Properties Ltd (No. 1)*[45], Wright J explained that:

> *"The ground of the rule is that all contributions from shareholders enforceable in the liquidation are by the Companies Acts made applicable for the payment of the company's creditors pari passu (ss. 38, 101, 133 of the Companies Act, 1862), and that a person who is a creditor and also a contributory cannot be allowed to do what might amount to paying his own claim in full out of a fund which ought to be distributed rateably (see Black & Co.'s Case and In re Pyle Works, where the decision in In re Whitehouse & Co. is approved, though some of the reasons given by Jessel M.R. in that case are questioned)."*

142. Notwithstanding the many changes to the insolvency legislation which have taken place since the 1862 Act, the *pari passu* principle has remained at the heart of English insolvency law, and nothing has affected the basic principle that shareholder contributions are to be applied towards the *pari passu* payment of creditor claims. Today, the *pari passu* principle is contained in section 107 (voluntary winding-up), IR 4.181 (winding-up by the Court) and IR 2.69 (administration)[46].

143. The introduction of insolvency set-off into corporate insolvency did not affect the application of the principle of law established in *Grissell's Case*. Such a contention

[45] [1898] 1 Ch 691 at 696

[46] See *HMRC v The Football League Ltd* [2012] Bus LR 1539 at [63].

was rejected by the Court of Appeal in *Re White Star Line Ltd*[47]. In that case, Clauson LJ said:

> *"It is suggested that the position was varied by s.10 of the Judicature Act, 1875, now represented by s.262 of the Companies Act, 1929. This Court could not so decide without overruling the decision of Bacon V.-C. in In re General Works Co.; Gill's Case, the decision of Fry J. in In re West of England Bank, and the decision of Wright J. in In re Auriferous Properties, Ld. (No. 2). We see no flaw in the reasoning in those judgments, and we are not prepared to overrule them."*

144. Certain of the cases cited above were referred to in *Re Kaupthing, Singer and Friedlander Ltd (No. 2) ("Kaupthing")*[48]. Lord Walker, with reference to the decision of Sargant J in *In re Peruvian Railway Construction Co Ltd*[49], said:

> *"Sargant J's judgment contains a full review of the authorities. These included In re Auriferous Properties Ltd (No 2) [1898] 2 Ch 428 and In re West Coast Gold Fields Ltd [1905] 1 Ch 597. These cases concerned claims made in liquidations by creditors who were also holders of shares which were not fully paid up. In each case it was held, following the seminal decision of Lord Chelmsford LC and the Lord Justices in In re Overend Gurney & Co (Grissell's case) (1866) LR 1 Ch App 528, that the claimant could recover nothing as a creditor until all his liability as a contributory had been discharged. Buckley J said in In re West Coast Gold Fields Ltd [1905] 1 Ch 597, 602 (where the shareholder was bankrupt but the company solvent and in voluntary liquidation):*
>
> > *"The right view is that the person liable as contributory must discharge himself in that character before he can set up that, as a creditor, he is entitled to receive anything, and a fortiori, as it seems to me, before he can set up that, as a contributory, he is entitled to receive anything."*
>
> *That decision was upheld by the Court of Appeal in a brief judgment of the court [1906] 1 Ch 1. The payment-up of the shares in full was a condition precedent to any participation in the distribution of surplus assets."*

[47] [1938] 1 Ch. 458 at 480

[48] [2012] 1 AC 804 at [20]

[49] [1915] 2 Ch 144

145. At [52], Lord Walker referred back to those cases saying:

> *"The situation in this line of authority is that a shareholder is a creditor of an insolvent company, but his shares are not fully paid up, so that he is liable as a contributory. Suppose he has 10,000 £1 shares, 10p paid, and is owed £15,000, but the dividend prospectively payable is only 30p in the pound. If the liquidator calls on him for £9,000 to make his shares fully paid up, he has no right of set-off, and to that extent he is disadvantaged (that is* *In re Auriferous Properties Ltd (No 1) [1898] 1 Ch 691). If he seeks to prove in the liquidation, the liquidator can rely on the equitable rule as it applies in a case of this sort – that is, that he can receive nothing until he has paid everything that he owes as a contributory. That is In re Auriferous Properties Ltd (No 2) [1898] 2 Ch 428. The rule is also very clearly stated by Buckley J in In re West Coast Gold Fields Ltd [1905] 1 Ch 597, 602 (affirmed [1906] 1 Ch 1, and cited in para 20 above). Payment of the call is a condition precedent to the shareholder's participation in any distribution, and again the shareholder is to that extent disadvantaged."*

146. In *Re White Star Line Ltd*, Clauson LJ described the decision in *Grissell's Case* as being "*not only unimpeachable as a matter of reasoning, but… binding on [the Court of Appeal]*"[50].

147. In *Grissell's Case*, at 536, the Lord Chancellor stated that the case of a member of a limited company is different from that of a member of an unlimited company as to set-off. The Lord Chancellor said:

> *"This is exemplified in the 101st section, where a set-off upon an independent contract is allowed to the member of an unlimited company against a call, although the creditors have not been paid — evidently because he is liable to contribute to any amount until all the liabilities of the company are satisfied, and, therefore, it signifies nothing to the creditors whether a set-off is allowed or not. But with respect to a member of a company with limited liability, if a set-off were allowed against a call, it would have the effect of withdrawing altogether from the creditors part of the funds applicable to the payment of their debts."*

148. In fact, the set-off permitted by section 101 of the Companies Act 1862 in the context of unlimited companies was restrictive. Although not spelt out by the Lord Chancellor in *Grissell's Case*, it is clear from the terms of that section that the

[50] [1938] 1 Ch. 458 at 479-480

statutory right of set-off allowed to members of an unlimited company was limited to set-offs against calls made prior to the liquidation. Section 101 of the Companies Act 1862, which is largely replicated in section 149 of the Insolvency Act 1986, read as follows:

> *"The Court may, at any time after making an order for winding up the company, make an order on any contributory for the time being settled on the list of contributories, directing payment to be made, in manner in the said order mentioned, of any moneys due from him or from the estate of the person whom he represents to the company, exclusive of any moneys which he or the estate of the person whom he represents may be liable to contribute* ***by virtue of any call made or to be made by the Court in pursuance of this part of this Act****; and it may, in making such order, when the company is not limited, allow to such contributory by way of set-off any moneys due to him or the estate which he represents from the company on any independent dealing or contract with the company, but not any moneys due to him as a member of the company in respect of any dividend or profit: Provided that when all the creditors of any company, whether limited or unlimited, are paid in full, any moneys due on any account whatever to any contributory from the company may be allowed to him by way of set-off against any subsequent call or calls."* (Emphasis added.)

149. The section did not, however, extend to money owed pursuant to a call made or to be made by the Court under the 1862 Act (i.e. post liquidation), neither did it permit a statutory set-off against those calls[51]. Those calls, i.e. calls made pursuant to what is now section 74, were the subject matter of section 102 of the 1862 Act (a predecessor of section 150 of the 1986 Act).

150. For present purposes, the relevance of section 101 of the 1862 Act is twofold:

(1) The change to the legislation which occurred in 1862 meant that the right of set-off that was formerly available to a contributory against a call was confined to unlimited companies where the call had been made before the winding up.

[51] The finding to the contrary by Sir R. Malins V-C in *Re International Life Assurance Society; Gibbs and West's Case* Law Rep. 10 Eq. 312 at 328 (where he rejected the argument made by counsel, as recorded at 325-6, that section 101 did not apply to calls made under the winding up) was plainly wrong. It appears that Jessel MR considered Malins V-C to have gone wrong on that point in *Re Whitehouse & Co* (1878) 9 Ch. D. 595 at 601 and 606 and Fry J. refused to follow the decision in *Re West of England and South Wales District Bank, ex parte Branwhite* [1879] WN 86. See further Buckley on the Companies Acts (14th edition, 1981) at volume 1, page 627.

(2) The terms of section 101 gave rise to an implication that, in the case of a limited company, *or an unlimited company in relation to which a call is made on the contributory by the Court after the commencement of the winding up*, Parliament intended that the call should be paid without set-off, and this principle has since become entrenched.

151. In *Re Breech-Loading Armoury Company; Calisher's Case ("Calisher's Case")*[52], Lord Romilly MR expressed the position in the following terms:

> *"The 101st section of the Act, upon which this question mainly depends, is very imperfectly framed; indeed it contains one clause, the last (which, however, does not affect this case), upon which it is difficult to put an intelligible construction consistently with the decision of the Court of Appeal that the word "creditors" includes creditors who are also contributories. It is clear that the section applies to the present case; an order has been made for winding up the company, Calisher is a contributory, the call is money due from him to the company,* ***and it is not money which he is liable to contribute by virtue of any call made by the Court in the winding-up.*** *The Court may, therefore, under the first part of the section make the order now asked, directing him to pay the call. The section then proceeds to empower the Court in making such an order, when the company is not limited, to allow the contributory, by way of set-off, any moneys due to him from the company on any independent dealing or contract with the company, but not any moneys due to him as a member of the company in respect of any dividend or profit. The Legislature, therefore, has given the express power to allow a set-off in the case of an unlimited company, and by so doing it must be taken to have implied that without such express provision there would be no right of set-off, and upon the principle of the maxim expressio unius exclusio alterius, to have excluded, for the reason stated by the Lord Chancellor in Grissell's Case, that right in the case of the contributories of a limited company. The case of the Garnett and Moseley Gold Mining Company v. Sutton, in which a contributory of a joint stock company registered under the Act of 1856 was allowed to plead a debt from the company as a set-off against a call, solely on the ground of the express statutory right created by the 17th section of the 21 & 22 Vict. c. 60, which section was repealed and not renewed by the Companies Act, 1862, raises a strong inference that under the latter Act the right does not exist, and it is clear from Grissell's Case that in the opinion of the Lord Chancellor and Lord Justice Knight Bruce, and probably of Lord Justice Turner also, the 101st section of the Act of 1862 excludes the right of set-off, except in the*

[52] (1867-68) L.R. 5 Eq. 214 at 217 to 218

> *case of unlimited companies. Upon the ground, therefore, of the general law I am of opinion that the Respondent is not entitled to the right which he claims."* (Emphasis added.)

152. The above analysis focuses on the position of a contributory seeking to assert a right of set-off in the liquidation of the company entitled to a contribution from him. It is also necessary to analyse the position where that company seeks to prove in the administration or liquidation of the insolvent contributory.

153. In *Re Auriferous Properties Ltd (No. 1)*[53], Wright J. held that there is no set-off in such a situation and that *Grissell's Case* continues to apply so that the contributory company is required to discharge its obligation to the company in full before it can obtain any benefit from its claim against the company. Whilst this is different from the position which (as the law stands) applies as regards bankrupt contributories[54], it is plainly correct as confirmed by the Court of Appeal in *Re White Star Line Ltd*[55].

154. If there is no set-off between the contributory's claim against the company and its liability to contribute in the liquidation of the company, because such a set-off would have the effect of withdrawing from the creditors part of the funds applicable to the payment of their debts, the cogent principle of law which prevents such an outcome must equally prevent the same outcome in the insolvency of the contributory.

155. Therefore, in a situation where both the company and the (corporate) contributory are insolvent, there will be no set-off of the contributory's claims against the company when the company comes to prove in its liquidation (*Re Auriferous Properties Ltd (No. 1)*) and the contributory will be prevented from proving in the company's liquidation until it has discharged its liability to contribute in full (*Re Auriferous Properties Ltd (No. 2)*[56]).

[53] [1898] 1 Ch. 691

[54] See, for example, *Re Duckworth* (1867) LR 2 Ch. App. 578.

[55] [1938] 1 Ch. 458 at 480

[56] [1898] 2 Ch. 428 and *Re White Star Line Ltd* [1938] 1 Ch. 458 at 480

THE MEMBERS' CLAIMS AGAINST LBIE [ISSUES 1 TO 8]

Entitlement to prove

156. As a result of the application of the contributory rule, the Members "*must stand in the queue behind its creditors*"[57]. The Members are not entitled to prove, or are not entitled to receive any dividends, until they have discharged their liability to contribute. The liability to contribute has not yet crystallised but the application of the contributory rule does not depend upon that.

157. As mentioned above (at paragraphs 73 and 74):

(1) Section 80 provides that:

> *"The liability of a contributory creates a debt... accruing due from him at the time when his liability commenced, but payable at the times when calls are made for enforcing the liability."*

(2) The liability of a contributory commences at the time the contributory first became a shareholder[58].

158. It is only where it is clear that all expenses, provable debts, statutory interest and non-provable liabilities will be paid in full that a distribution can be made to a contributory-creditor.

159. Secondly, there is a general principle that: (i) where an estate is being administered by the Court, a party cannot take anything out of the fund until he has made good what he owes to the fund; and (ii) it is immaterial that what he owes to the fund is not ascertained[59].

[57] *Kaupthing* at [53]

[58] *Ex parte William Canwell* (1864) 4 De Gex, Jones & Smith 539; *Thomas George Williams v Robert Palmer Harding* (1866) L.R. 1 H.L. 9.

[59] *Re Rhodesia Goldfields Ltd* [1910] 1 Ch. 239 at 247.

160. Thirdly, the *pari passu* principle applies in administration as it does in liquidation. IR 2.69 would be subverted if the Members were entitled to prove and receive dividends in LBIE’s administration in circumstances in which they have a substantial contingent liability under section 74.

161. Fourthly, the contributory rule is that a person liable as contributory must discharge himself in that character before he can set up that, as a creditor, he is entitled to receive anything[60]. The rule is not limited to circumstances in which a call has already been made. The Members are under an existing liability, albeit one which is contingent and not yet payable.

162. Fifthly, any other result would conflict with the fact that LBIE’s contingent claim under section 74 will be provable in the Members’ distributive administrations / liquidations. That the liability is provable is clear from *Re McMahon*[61] and the approach of the Supreme Court to contingent statutory liabilities under IR 13.12(1)(b) in *Re the Nortel Companies*[62].

Section 149

163. Section 149 has no bearing on the analysis – because LBIE’s contingent claim against its Members falls within the exclusion in section 149(1) (“*exclusive of any money payable by [the contributory]… by virtue of any call in pursuance of… this Act*”) – save that, as Lord Romilly MR held in *Calisher’s Case*, the Legislature is to be taken to have implied that there would be no right to set-off beyond that allowed by section 149(2)(a).

[60] *Re West Coast Gold Fields Ltd; Rowe’s Trustee’s Claim* [1905] 1 Ch 597 at 602 (per Buckley J).

[61] [1900] 1 Ch. 173. See also, in the context of bankrupt contributories, section 82(4).

[62] [2013] 3 WLR 504 at [76]-[77]

Section 74(2)(f)

164. Section 74(2)(f) is not relevant because LBIE accepts that the Members' claims against LBIE are not claims held by them in their character of a member within the meaning of that sub-section.

A subsequent liquidation of LBIE

165. The above analysis will apply equally if and when LBIE goes into liquidation.

LBIE'S CLAIMS AGAINST THE MEMBERS [ISSUES 9 TO 12]

LBIE's entitlement to prove

166. LBIE is entitled to prove in the Members' distributive administrations and/or liquidations in respect of the contingent claim under section 74.

167. IR 12.3(1) provides that:

> *"Subject as follows, in administration, winding up and bankruptcy, all claims by creditors are provable as debts against the company or, as the case may be, the bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages."*

168. It is not possible to read IR 12.3(1) on its own. The broad range of claims to which it refers, are provable "as debts". That necessarily brings in the provisions that define "debt".

169. IR 13.12 defines "debt" for the purposes of winding up (and, now, administration). It is only if a claim falls within the definition of "debt" in IR 13.12 that it is provable[63].

[63] *Re T&N Limited* [2006] 1 WLR 1728 at [112].

170. The statutory regimes for distributing the assets of an insolvent estate amongst those entitled to prove involve a cut-off date by which any actual or contingent liability has to have been incurred by the debtor. It is IR 13.12(1) which provides the requisite cut-off date.

171. By IR 13.12(1), a "debt" is defined as being limited to a debt or liability to which the company either:

(1) "*is subject at the date on which it goes into liquidation*" (IR 13.12(1)(a)); or

(2) "*may become subject after that date by reason of any obligation incurred before that date*" (IR 13.12(1)(b)).

172. For the purposes of an administration, IR 13.12(5) provides that the Rules "*shall be read as if references to winding up were references to administration*". So, for an administration, the relevant cut-off date is the date on which the company went into administration.

173. The wording of IR 13.12(1), including in particular the words "*by reason of any obligation incurred before that date*" in IR 13.12(1)(b) can be traced back as far as section 31 of the Bankruptcy Act 1869. That section permitted, for the first time, proof in respect of contingent debts and liabilities, and claims to unliquidated damages, but only subject to an identical cut-off date[64].

174. LBIE's claim against its Members is a contingent claim falling within the scope of IR 13.12(1)(b) and is therefore provable.

[64] Section 31 of the Bankruptcy Act 1869 provided that: "*all debts and liabilities, present and future, certain or contingent, to which the bankrupt is subject at the date of the order of adjudication, or to which he may become subject during the continuance of the bankruptcy by reason of any obligation incurred previously to the date of the order of adjudication, shall be deemed to be debts provable in bankruptcy*".

175. In *Re the Nortel Companies*[65], the Supreme Court considered the scope of IR 13.12(1)(b) in the context of statutory liabilities. At [77], set out above at paragraph 86, Lord Neuberger P. held that:

(1) the mere fact that a company could come under a liability pursuant to a provision in a statute which was in force before the insolvency event, cannot mean that, where the liability arises after the insolvency event, it falls within IR 13.12(1)(b); but

(2) at least normally, in order for a company to have incurred a relevant "obligation" under IR 13.12(1)(b), it must have taken, or been subjected to, some step or combination of steps:

(a) which had some legal effect (such as putting it under some legal duty or into some legal relationship); and

(b) which resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred; so long as

(c) it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under IR 13.12(1)(b).

176. These requirements are satisfied from the moment in time at which a person acquires or is issued with shares in an unlimited company because, from that time, a debt accrues due from him to the company under section 80. Even if that were not the case, the result of his becoming a shareholder: (a) is that a legal relationship between him and the company arises; (b) which renders him vulnerable to a liability to contribute under section 74, such that there is a real prospect of that liability being incurred; and (c) it would be consistent with the regime under which the liability is

[65] [2013] 3 WLR 504 at [76]-[77]

imposed to conclude that the step or combination of steps gave rise to an obligation under IR 13.12(1)(b).

177. This analysis is consistent with the approach taken by Stirling J. in *Re McMahon*[66] that a company may prove, in the administration of the estate of a deceased shareholder whose estate is insolvent, for the estimated value of the liability to future calls in respect of shares standing in his name.

The application of the contributory rule

178. As explained above (at paragraph 133 et seq.), the application of the contributory rule is that there will be no set-off between LBIE's contingent claim under section 74 and the Members' claims against LBIE.

179. Sections 149 and 74(2)(f) are, again, not relevant (save that the Legislature is to be taken to have implied that there would be no right to set-off beyond that allowed by section 149(2)(a), which set-off has no application on the facts of this case).

CONCLUSION

180. For the reasons set out in these written opening submissions, the LBIE administrators invite the Court to determine the issues raised in the List of Issues in accordance with the answers given by them in their Position Paper and the Schedule attached to these written opening submissions.

William Trower QC
Daniel Bayfield

South Square 24 October 2013

[66] [1900] 1 Ch. 173

SCHEDULE: LBIE'S ANSWERS TO THE QUESTIONS SET OUT IN THE LIST OF ISSUES

LBL's and LBHI2's ability to prove in any liquidation of LBIE

1. Where a company is in liquidation, is it the case that either:

   a. a contributory is not entitled to prove in the company's liquidation until he has contributed everything that he is liable to contribute as a contributory pursuant to section 74 of the Insolvency Act 1986 (the "Act"); or

   b. a contributory who seeks to prove in the company's liquidation can receive nothing until he has contributed everything that he is liable to contribute as a contributory pursuant to section 74 of the Act,

   on the basis of an equitable rule that a person who owes money to an estate cannot claim a share in that estate without first making the contribution which completes it (the "**Alleged Equitable Rule**")?

   Yes. A contributory is not entitled to prove, and/or is not entitled to receive any dividends, until it has discharged its liability to contribute to the estate.

2. What, if any, is the effect on the answers to Issues 1(a) and (b) above of the fact that a call has not been made on the contributory by the company's liquidator(s)?

   This has no effect on the answer to Issues 1(a) and (b). The fact that the liability to contribute has not yet crystallised does not affect the application of the rule that a contributory is not entitled to prove, and/or is not entitled to receive any dividends, until it has discharged its liability to contribute to the estate.

3. If the answer to Issues 1(a) and (b) is no, and the contributory is entitled to prove and (*prima facie*) to receive distributions in the company's liquidation, is credit required to be

given in respect of the contributory's liability to contribute pursuant to section 74 of the Act, either (i) by way of insolvency set-off; and/or (ii) pursuant to the rule in *Cherry v Boultbee* 41 ER 171; and/or (iii) otherwise? If so, in what circumstances is credit required to be given and how? In particular:

a. Is credit only required to be given if a call is made on the contributory by the company's liquidator(s)?

b. How should the potential liability of the contributory be valued for the purposes of giving credit by the company's liquidator(s)?

c. What, if any, is the effect of the proving contributory itself being in administration or liquidation?

In light of the answers to Issues 1(a) and (b), this question does not arise.

LBL's and LBHI2's ability to prove in LBIE's administration

4. Is a contributory *contingently* liable to contribute to the company's assets to an amount sufficient for payment of its debts and liabilities, and the expenses of the winding-up, where the company: (i) is in administration; but (ii) might subsequently move into liquidation; and (iii) might have a shortfall in respect of which the members might be liable to contribute under section 74 of the Act?

    Yes. The contributory has a contingent liability to contribute, the contingencies being the winding up of the company and the making of a call by its liquidator. IR 2.81 makes provision for the estimation of contingent debts.

5. If the answer to Issue 4 is yes, is it the case that either:

a. a contributory is not entitled to prove in the company’s administration until he has contributed everything that he is contingently liable to contribute as a contributory pursuant to section 74 of the Act; or

b. a contributory who seeks to prove in the company’s administration can receive nothing until he has contributed everything that he is contingently liable to contribute as a contributory pursuant to section 74 of the Act

on the basis of the Alleged Equitable Rule?

Yes. The contributory is not entitled to prove, and/or is not entitled to receive any dividends, until they have discharged their liability to contribute. The fact that the liability to contribute has not yet crystallised does not change the position.

6. If the answer to Issue 5 is no, and the contributory is entitled to prove and (*prima facie*) to receive distributions in the administration, is credit required to be given in respect of the contributory’s contingent liability to contribute pursuant to section 74 of the Act, either (i) by way of insolvency set-off; and/or (ii) pursuant to the rule in *Cherry v Boultbee* 41 ER 171; and/or (iii) otherwise? If so, in what circumstances is credit required to be given or is any deduction to be made and how? In particular:

   a. What, if any, is the effect of the proving contributory itself being in administration or liquidation?

   b. Should credit only be given if the company submits a proof of debt in respect of the contributory’s potential liability to the company under section 74 of the Act?

   c. Should credit only be given once the contributory’s administrator(s) or liquidator(s) have placed a value upon the potential liability to the company under section 74 of the Act?

In light of the answer to Issue 5, this question does not arise.

7. Does section 149 of the Act have any bearing on the answers to Issues 1 to 6? If so, in what respects is it relevant on the basis of the facts as set out in the Statement of Agreed Facts?

   No. Section 149 has no bearing on Issues 1 to 6. LBIE's contingent claim falls within the exclusion in section 149(1) ("exclusive of any money payable by [the contributory]… by virtue of any call in pursuance of… this Act").

8. Does section 74(2)(f) of the Act have any bearing on Issues 1 to 6 above? If so, in what respects is it relevant in light of the fact that it is common ground that no sums are due to LBL or LBHI2 in their capacity as Members?

   No. Section 74(2)(f) is not relevant because LBIE accepts that the claims of LBL and LBHI2 against LBIE are not claims held by them in their character as members of LBIE within the meaning of that sub-section.

LBIE's entitlement to prove in the insolvencies of its Members (i.e. LBL and LBHI2)

9. Is a company, acting by its administrator or liquidator, entitled to prove in the administration (or any subsequent liquidation) of a contributory in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act? In this regard:

   a. For the purposes of rule 13.12(1)(b) of the Rules, did the contributory incur an obligation to contribute to the company's assets to an amount sufficient for payment of its debts and liabilities, and the expenses of the winding-up, at a time when it became a member of the company (or at any later time prior to the contributory going into administration)?

   b. Is the quantum of the contributory's contingent liability to contribute to be calculated in the same way as it is under Issue 13 below? If not, how is it to be calculated?

Yes. A company's claim against its contributories is a contingent claim falling within the scope of IR 13.12(1)(b) and is therefore provable. A contributory of an unlimited company incurs an obligation to contribute to the company's assets to an amount sufficient for payment of its debts and liabilities, and the expenses of the winding up, at the time when it becomes a member of the company. The quantum of the contributory's contingent liability to contribute is to be calculated in the same way as it is under Issue 13 below.

10. If the company, acting by its administrator or liquidator, is entitled to prove in the administration (or any subsequent liquidation) of its contributory, is its claim liable to be reduced by insolvency set-off, or by the rule in *Cherry v Boultbee* (or otherwise) in circumstances where:

    a. the contributory's cross-claim is contractually subordinated on the terms of the Sub-Debt Agreements; and/or

    b. the company's claim is in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act; and/or

    c. no call has been made by the company's liquidator(s) in respect of the contributory's liability to contribute

    and, if so, how?

    No. There will be no set-off between the company's contingent claim under section 74 and the contributories' claims against the company as a result of the equitable rule.

11. Does section 149 of the Act have any bearing on the answers to Issues 9 and 10? If so, in what respects is it relevant on the basis of the facts as set out in the Statement of Agreed Facts?

    No. Section 149 of the Act has no bearing on the answers to Issues 9 and 10.

12. Does section 74(2)(f) of the Act have any bearing on Issues 9 and 10 above? If so, in what respects is it relevant in light of the fact that it is common ground that no sums are due to LBL or LBHI2 in their capacity as Members?

    No. Section 74(2)(f) has no bearing on the answers to Issues 9 and 10.

Calculating LBL's and LBHI2's liability to contribute

13. How is the quantum of the contributory's contingent liability to contribute calculated? In this regard:

    a. What are the contingencies which have to be taken into account (e.g. LBIE going into liquidation, there being a shortfall for which the Members may be liable to contribute under section 74(1), a call being made on the Members and/or any others) and how are the prospects of those contingencies occurring to be estimated?

       The quantum of the contributory's contingent liability to contribute is calculated in accordance with IR 2.81(1). The contingencies to be taken in account are LBIE going into liquidation and the making of a call. LBIE's administrators will provide information in support of its proof in the normal way to assist in the assessment of its quantification.

    b. Is rule 2.105 of the Rules relevant to the calculation of the quantum of the contributory's contingent liability and, if so, how can the formula in this rule for accelerated receipt in respect of future debts be applied, given that it is not known when, and if at all, LBIE will be wound up?

       Rule 2.105 does not apply to contingent debts and is therefore not relevant to the issues in this Application.

    c. Does the contributory's contingent liability extend to any interest accruing during the period of the administration under rule 2.88(7) of the Rules or otherwise?

Yes. See paragraphs 99-107 above.

d. Does the contributory's contingent liability extend to the Currency Conversion Claim (if Issue 22 below is answered in the affirmative)?

Yes. The Currency Conversion Claim is a non-provable liability and therefore falls within the scope of section 74.

e. Does the contributory's contingent liability extend to liabilities of the company which have been contractually subordinated on the terms of the Sub-Debt Agreements?

Yes. Liabilities that have been subordinated fall within the scope of section 74.

f. Does the contributory's contingent liability extend to interest payable in the liquidation under section 189(2) of the Act or otherwise? In this regard, if the administrator is in the process of making distributions to the company's general, unsecured creditors and it appears that he will be able to pay the company's provable debts in full, what, if any, interest will be payable under section 189(2) of the Act if the company subsequently moves from administration into liquidation and does any such interest form part of the contributory's contingent liability to the company?

If an administrator has given notice of an intention to make a distribution to creditors, and the company subsequently goes into liquidation before all proofs of debt have been paid and there is then a surplus in the hands of the liquidator after payment of all the debts proved, section 189(2) applies to those creditors who actually proved during the winding-up and the contributory's contingent liability extends to interest payable to those creditors.

14. How would the quantum of the contributory's liability to contribute be calculated if LBIE were placed into liquidation?

If LBIE were placed into liquidation, the quantum of the contributory's liability to contribute would be calculated in the same way as it currently is, save that the liability would then be contingent only on the making of the call.

The Members' obligation to contribute and their rights inter se

15. In the event that the Members are obliged to contribute to the assets of LBIE pursuant to Section 74 of the Act, and in light of the Members' respective shareholdings:

    a. are their obligations joint, several or otherwise as against LBIE;

    b. are they entitled to seek a contribution or indemnity from one another in respect of any payments made pursuant to any such obligation and, if so, what is the nature and extent of such right of contribution or indemnity; and

    c. to what extent is any right to contribution or indemnity as referred to in sub-paragraph (b) above affected by any other claims which LBHI2 and LBL have against one another?

    The obligation under section 74 is a joint and several liability. LBIE does not advance a positive case on the further issues contained within Issue 15.

16. What effect do the answers to Issue 15 above have upon the value of LBIE's proof in the administrations (or subsequent liquidations) of the Members, if any, (if the answer to Issue 9 above is yes)?

    The value of LBIE's proof in the administrations or subsequent liquidations of each of the Members is the aggregate of LBIE's deficiency as regards its creditors' provable debts, statutory interest payable thereon, LBIE's non-provable liabilities and the expenses of LBIE's winding up.

Construction of the Sub-Debt Agreements

17. Is the effect of the contractual subordination of LBIE's liability to LBHI2 under paragraph 5 of the Standard Terms of the Sub-Debt Agreements:

    a. such that LBHI2 is entitled to: (i) prove; but (ii) not receive any dividends payable, in LBIE's administration (or a subsequent liquidation) in respect of the Sub-Debt until LBIE's creditors with provable claims which do not arise out of contracts containing subordination provisions have received full payment of the principal amounts of those provable claims, but then receive dividends payable before:

        i. interest payable under rule 2.88(7) of the Rules (and, in a subsequent liquidation, any interest payable under section 189(2) of the Act) has been paid in full;

        ii. Currency Conversion Claims (to the extent that Issue 22 below is answered in the affirmative) have been paid in full; and

        iii. debts owed to members (potentially including itself) which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule referred to in Issue 1 above have been paid in full?

    or

    b. such that LBHI2 is not entitled to: (i) prove; or (ii) receive any dividends payable, in LBIE's administration (or a subsequent liquidation) in respect of the Sub-Debt until:

        i. LBIE's creditors with provable claims have received full payment of the principal amounts of those provable claims;

        ii. interest payable under rule 2.88(7) of the Rules (and, in a subsequent liquidation, any interest payable under section 189(2) of the Act) has been paid in full;

iii. Currency Conversion Claims (to the extent that Issue 22 below is answered in the affirmative) have been paid in full; and

iv. debts owed to members (potentially including itself) which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule have been paid in full?

The answer is (b).

18. If the constructions of the Sub-Debt Agreements set out at Issue 17 above are not correct, what is the extent of the contractual subordination contained in the Sub-Debt Agreements?

In light of LBIE's answer to Issue 17, this issue doesn't arise.

The waterfall

19. In the event of a surplus having discharged or reserved for the provable debts, in what order of priority are the following payable by an administrator:

    a. post-administration interest payable under rule 2.88(7) of the Rules or otherwise;

    b. the Currency Conversion Claim (if Issue 22 below is answered in the affirmative);

    c. any debts owed to members which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule; and

    d. to the extent that it is not provable, the contractually subordinated debt (on the terms of the Sub-Debt Agreements) (as to which see Issues 17 and 18 above)?

In the event of a surplus having discharged or reserved for the provable debts, these liabilities are payable in the order set out in this question.

20. Is the order of priority for payment by a liquidator the same as for an administrator (as to which see Issue 19 above)?

    Yes. The order of priority is the same whether the company is in administration or liquidation.

Statutory interest

21. Might interest be payable under rule 2.88(7) of the Rules and/or section 189(2) of the Act notwithstanding that, as a result of the application of the Alleged Equitable rule and/or contractual subordination, not all debts proved in the administration or liquidation have been paid in full or at all?

    Yes, see paragraphs 39 to 43 above.

Currency conversion claims

22. Is an unsecured creditor, with a contractual entitlement to payment in a currency other than sterling (the "Contractual Currency"), entitled, following payment in full of:

    a. all provable debts; and

    b. interest payable pursuant to rule 2.88(7) of the Rules,

    to payment in a sum equal to the difference between: (i) the amount of its contractual entitlement to payment in the Contractual Currency; and (ii) the amount received by it in respect of its proved debt, converted into the Contractual Currency as at the date(s) of payment (such claim being referred to as a "Currency Conversion Claim")?

Yes. The Currency Conversion Claim is a species of non-provable liability.

Nos. 7942 and 7945 of 2008 and No. 429 of 2009

IN THE HIGH COURT OF JUSTICE

COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration) AND OTHERS

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN:

THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration) AND OTHERS

Applicants

-and-

LEHMAN BROTHERS HOLDINGS, INC AND ANOTHER

Respondents

LBIE'S WRITTEN OPENING SUBMISSIONS (for hearing on 11-20 November 2013)

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