UKSC 2015/0138, 2015/0137, 2015/0139

IN THE SUPREME COURT OF THE UNITED KINGDOM

IN THE MATTER OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
AND IN THE MATTER OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)
AND IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (INADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
(2) LEHMAN BROTHERS HOLDINGS INC
(3) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)

APPELLANTS

AND

(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)
(2) CVI GVF (LUX) MASTER SARL

RESPONDENTS

WRITTEN CASE OF THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED ("LBHI2") (IN ADMINISTRATION)

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1. The Appellants have agreed to divide the issues up as follows:

   1.1 LBHI2 will cover the construction of the Sub Debt Agreements (ie declaration (i) of the Order of David Richards J dated 19 May 2014);

   1.2 LBHI2 and LBL will cover Currency Conversion Claims (ie declarations (ii) and (iii));

   1.3 LBL will cover issues relating to post-insolvency interest (ie declarations (iv) and (v));

   1.4 LBHI2 will cover the scope of the s. 74 liability of LBIE's contributories (ie declaration (vi));

   1.5 LBHI will cover the provability of the s. 74 liability by LBIE in the insolvency estates of its contributories whilst LBIE is in administration and issues relating to the Contributory Rule and insolvency set-off (declarations (vii)-(x)).

2. Accordingly, this Written Case contains the case of LBHI2 on (i) its appeal on the construction of the Sub Debt Agreements and LBIE's cross-appeal on the provability of the Sub Debt in LBIE's insolvency, (ii) Currency Conversion Claims and (iii) the scope of the liability imposed on contributories by s. 74.

3. LBHI and LBL support and adopt the position of LBHI2 on Currency Conversion Claims (save that LBL does not in respect of paragraph 134 below) and the scope of the s. 74 liability. LBHI also supports and adopts LBHI2's position on the construction of the Sub Debt Agreements.

4. LBHI2 supports and adopts LBL's position on post-insolvency interest (as does LBHI) and LBHI's position on the provability of the s. 74 liability and the Contributory Rule/insolvency set-off.

5. This Written Case is structured as follows:

   (A) Introduction: non-provable liabilities (paragraphs 6-24)
      (1) The role of proof
      (2) Non-provable liabilities recognised by the courts

(A) Introduction: non-provable liabilities

6. The appeals on the true construction of the Sub Debt Agreement, on CCCs and on the scope of the s. 74 liability, and LBIE's cross-appeal against declaration (v) regarding post-insolvency interest, all raise issues as to the existence, nature and treatment of non-provable liabilities within or without the statutory insolvency scheme.

(1) The role of proof

7. The statutory insolvency scheme is a scheme for the collective enforcement of debts, providing for *pari passu* distribution among those who have participated in the scheme by proving.[1]

8. The proof process is fundamental to the scheme. Proving a debt is the mechanism that a creditor must follow in order to participate in distributions. In respect of companies in administration,[2] IR 2.72 **[Auths/3/38]** provides (emphasis added):

> "(1) A person claiming to be a creditor of the company and wishing to recover his debt in whole or in part must (subject to any order of the court to the contrary) submit his claim in writing to the administrator.
>
> "(2) A creditor who claims is referred to as 'proving' for his debt and a document by which he seeks to establish his claim is his 'proof'."

In other words, it is proof that entitles a creditor to payment by way of distributions.

9. As Patten LJ held in *Danka Business Systems plc* [2013] Ch 506 at [38] **[Auths/1/8/p.522]**, "The liquidator is entitled to proceed to a distribution to members on the basis of the debts admitted to proof". Lewison LJ correctly explained at [100] **[Appx/p.33]** in this case that, in *Danka Business Systems*, the Court of Appeal held that, at least in the case of provable debts, a liquidator is

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1 The *pari passu* principle on distributions is reflected in the statutory regime at ss. 107 **[Auths/2/18]** and 306(1) **[Auths/2/41]** (voluntary winding-up and personal bankruptcy), IR 4.181 **[Auths/3/56]**(winding-up by the court) and IR 2.69 **[Auths/3/36]** (administration).

2 In respect of companies being wound-up by the court, equivalent rules are found at IR 4.73 **[Auths/3/46]**.

entitled to make a distribution to members on the basis of provable debts having been proved in full and valued in accordance with the Rules.[3]

10. Further, as Lord Neuberger recently described in *Re Nortel GmbH* [2014] AC 209 at [92]-[93] **[Auths/1/17/p.241-242]**, there has been a general trend towards the inclusion of as many claims as possible within the proof process so that the statutory insolvency scheme itself can deal comprehensively with all the sums that should be paid when a company has gone into an insolvency process:

> "[92] The *Report of the Review Committee on Insolvency Law and Practice* … ('the Cork Report'), para 1289, described it as a
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> > 'basic principle of the law of insolvency that every debt or liability capable of being expressed in money terms should be eligible for proof … so that the insolvency administration should deal comprehensively with, and in one way or another discharge, all such debts and liabilities.'
>
> [93] The notion that all possible liabilities within reason should be provable helps achieve equal justice to all creditors and potential creditors in any insolvency, and, in bankruptcy proceedings, helps ensure that the former bankrupt can in due course start afresh. Indeed, that seems to have been the approach of the courts in the 19th century …. If that was true in 1871, it is all the more true following the passing of the 1986 and 2002 Acts, and as illustrated by the amendment to rule 13.12(2) effected following the decision in *Re T&N Ltd* [2006] 1 WLR 1728, so as to extend the rights of potential tort claimants to prove."

11. Particularly in the light of this passage, Lord Neuberger's dictum earlier in *Nortel,* at [39] **[Auths/1/17/p.230-231]**, including non-provable liabilities in the list of payments to be made out of the assets of a company in liquidation or administration, cannot and should not be treated as suggesting that non-provable debts form part of the statutory scheme for distribution of a company's assets. As

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3 The scheme requires a liquidator to distribute the company's assets to its creditors in accordance with their proved claims and then "if there is a surplus, to the persons entitled to it" (s. 143(1) IA 1986 **[Auths/2/22]**; see also s. 107 **[Auths/2/18]** in the case of a voluntary liquidation).

set out in more detail below, there are no provisions for quantification or payment of non-provable liabilities in the statutory scheme.

12. Further, contrary to Briggs LJ's description of the effect of the 1986 Act and Rules at [145]-[146] **[Appx/p.43]** in this case, it is clear that the statutory scheme was intended to be comprehensive, as was recognised by Briggs J (as he then was) in *Nortel* **[Auths/4/12]** at first instance[4] and by David Richards J (as he then was) in *T&N Ltd* **[Auths/1/21]**.[5] The 1986 Act was designed to implement the recommendations of the Cork Report, which included the paragraph quoted (as set out above) by Lord Neuberger, reiterating the aim of including as many claims as possible within the proof process so that the statutory insolvency process can deal comprehensively with and discharge all the sums that should be paid when a company has gone into an insolvency process.

13. Finally, the capital structures used by companies are increasingly complicated so that a broad and simple division into debt and equity is no longer accurate. This fact makes it particularly important that any insolvency regime should be cohesive and comprehensive, and so provide the continuity which is valued by those investing in the companies subject to that insolvency regime. The recognition of a broad category of potential non-provable claims, which claims are not expressly provided for in the Act and Rules, cuts entirely across the certainty which is (and should be) one of the main aims of the English insolvency scheme.

(2) Non-provable liabilities recognised by the courts

14. Although the courts have held that particular liabilities are non-provable claims in a number of cases since the introduction of the new statutory scheme created by the 1986 Act and Rules, each of those cases were either ones in which the factual situation arising had been unforeseen by the legislature (in other words, non-provable claims have been recognised where a claim on the company would otherwise have fallen through the cracks) or have been subsequently overruled:

    14.1 In *Re T&N Ltd* **[Auths/1/21]**, the decision that tort claimants who had not sustained damage until after the liquidation commenced could not

4 *Bloom v Pensions Regulator* [2011] Bus LR 766 at [66] **[Auths/4/12/p.786]**

5 [2006] 1 WLR 1728 at [76] and [84] **[Auths/1/21/p.1757; 1759]**

prove, led to the revision of IR 13.12(2) **[Auths/1/6;7]** to make such claims provable.[6]

14.2 The decision of Sir Donald Nicholls V-C in *Re Kentish Homes Ltd* (1993) 91 LGR 592 **[Auths/5/6]** that the company's liability to the community charge arising after the liquidation date was a non-provable claim was (as Lewison LJ explained at [24]) **[Appx/p.12]** overruled by the House of Lords in *In re Toshoku Finance UK plc* [2002] 1 WLR 671 **[Auths/6/18]**.

14.3 In *Nortel* **[Auths/1/17]** the Supreme Court overruled the authorities which had held that the liability to pay costs under an order of the court made after the date of entry into insolvency was a non-provable liability (see [90]-[91] **[Auths/1/17/p.241]** per Lord Neuberger and [136] **[Auths/1/17/p.251-252]** per Lord Sumption).

All the cases referred to by the CA as demonstrating the existence of non-provable claims are cases in which the claims so recognised have subsequently been recognised as provable or other types of claims, whether by legislative reform or by subsequent decisions of the Courts.[7]

15. Although in *Nortel* Lord Neuberger said at [114] **[Auths/1/17/p.246]** that "if the liability in these cases did not rank as a provable debt, it would not count as an expense of the administration", thereby implying that if the liability had not been a provable debt, it would have been a non-provable liability, that statement was obiter (as Lord Neuberger had already held that the liability did rank as a provable debt).

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6 The revised wording of IR 13.12(2) **[Auths/1/7]** means that the claims considered in *In re R-R Realisations Ltd* [1980] 1 WLR 805 **[Auths/6/9]** would now also be provable (as they were in fact at the time of that decision, but would not have been after the introduction of the 1986 legislation and before the amendment to IR 13.12(2), as discussed further below).

7 See further Lightman & Moss, *The Law of Administrators and Receivers of Companies*, 5th Edn at 4-007 **[Auths/8/11/p.120-121]** (pre-dating the Supreme Court decision in *Nortel*): "In *Toshoku*, Lord Hoffmann did not appear to envisage that a company in liquidation could incur a liability to a third party that would neither be provable nor payable as an expense, and hence would fall into a 'black hole'. But it has been pointed out that this was not the ratio of his decision, and subsequent cases have shown that this was a possibility [footnote referring to *T&N*]. It will, however, be a rare case in liquidations, and certainly not a result that a court would readily reach if the legislation made express provision for a liability to be payable by a company in liquidation."

(3) The specific statutory provisions concerning what is, and is not, provable

16. The statutory scheme's basic provision is that all claims are provable: IR 12.3(1) **[Auths/3/72]** states "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."[8]

17. The limited exceptions are set out at IR 12.3(2), IR 12.3(2A) and IR 12.3(3) **[Auths/3/72]**.

17.1 IR 12.3(2)[9] provides for a very limited category of debts to be "not provable", with the consequence that they are not payable in the relevant insolvency process: see eg *Levy v Legal Services Commission* [2001] 1 All ER 895 per Jonathan Parker LJ at [41] **[Auths/5/8/p.904]** and per Peter Gibson LJ at [58] **[Auths/5/8/p.907]**.

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8 The version of IR 13.12 **[Auths/1/6]** that was in force from 1 June 2006 to 5 April 2010 (ie including the date on which LBIE went into administration (15 September 2008) and became a distributing administration (4 December 2009) defined "debt" as follows (with references to winding-up being read as if they were a reference to administration: IR 13.12(5)):

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

9 The wording of IR 12.3(2) **[Auths/3/71]** as applicable to LBIE (ie the version of IR 12.3 that was in force from 1 April 2005 to 18 March 2012; LBIE went into administration on 15 September 2008 and became a distributing administration on 4 December 2009) is:

"The following are not provable –

> (a) in bankruptcy, any fine imposed for an offence, and any obligation (other than an obligation to pay a lump sum or to pay costs) arising under an order made in family proceedings or any obligation arising under a maintenance assessment made under the Child Support Act 1991;
> (b) in administration, winding up or bankruptcy, any obligation arising under a confiscation order made under section 1 of the Drug Trafficking Offences Act 1986 or section 1 of the Criminal Justice (Scotland) Act 1987 or section 71 of the Criminal Justice Act 1988 or under Parts 2, 3 or 4 of the Proceeds of Crime Act 2002."

17.2 IR 12.3(2A) **[Auths/3/71]** as applicable to LBIE provides for postponed debts as follows:

> "The following are not provable except at a time when all other claims of creditors in the insolvency proceedings (other than any of a kind mentioned in this paragraph) have been paid in full with interest under section 189(2), Rule 2.88 or, as the case may be, section 328(4) –
>
> (a) in an administration, a winding up or a bankruptcy, any claim arising by virtue of section 382(1)(a) of the Financial Services and Markets Act 2000, not being a claim also arising by virtue of section 382(1)(b) of that Act; …
>
> (c) in an administration or a winding up, any claim which by virtue of the Act or any other enactment is a claim the payment of which in a bankruptcy, an administration or a winding up is to be postponed."

It is notable that this sub-rule expressly provides for these postponed debts to be paid after all other creditors' claims have been paid.

17.3 IR 12.3(3) **[Auths/3/71]** as applicable to LBIE provides that:

> "Nothing in this Rule prejudices any enactment or rule of law under which a particular kind of debt is not provable, whether on grounds of public policy or otherwise."

The type of claims recognised as falling within this sub-rule are claims which are not only not provable but not payable in the insolvency, or outside it. Such claims include liabilities to pay foreign taxes which are unenforceable under English law (see *Government of India v Taylor* [1955] AC 491 **[Auths/4/33]** and the discussion of foreign revenue claims in the Cork Report at [1300-1302]) **[Auths/8/3/p.296 -297]**.

(4) Impact on these appeals

18. It is not necessary for the purposes of these appeals for LBHI2, LBL and LBHI to go so far as to contend that non-provable liabilities do not exist at all as a category of payments to be made from the estate of a company which has gone into

distributing administration or liquidation. All that LBHI2, LBL and LBHI need to show is that the particular species of non-provable liability asserted by CVI in these proceedings, namely CCCs, does not exist, and (on LBIE's cross-appeal) that the non-provable claims for interest which are the subject of that cross-appeal do not exist.

19. The purpose and structure of the statutory insolvency scheme (set out above and developed further below) point to the conclusion that the category of non-provable liabilities ought to be narrowly confined.

20. Against that background, it is surprising that the CA has held that:

    20.1 the Sub Debt is subordinated to non-provable claims generally;

    20.2 CCCs exist as non-provable claims, resulting from the operation of the statutory insolvency regime itself, despite the fact that the scheme is intended to be comprehensive; and

    20.3 the statutory liability of members to contribute under s. 74 extends to contributing to pay LBIE's non-provable liabilities.

21. There is a fundamental distinction between, on the one hand, CCCs and, on the other hand, the types of claims within the exceptions at IR 12.3(2), (2A) and (3) **[Auths/3/72]** and the claims recognised by the courts as non-provable liabilities to date (see paragraph 14 above). That is, that the debt said to give rise to a CCC (ie the foreign currency debt owed by the company) is itself provable. It would be remarkable if the statutory scheme intended to create a non-provable debt arising from the proof process, with the result that the proof process bifurcated the original underlying obligation to give rise to both a provable and non-provable debt (for reasons set out in more detail below).

22. The non-provable claims which have been asserted and recognised by the courts to date (see paragraph 14 above) arose where the creditor had no provable claim at all because it fell outside the scope of the definition of provable claim; whereas foreign currency creditors do have a provable debt (which is then mandatorily converted into sterling and paid in sterling along with other proved debts) and a CCC is a <u>further</u> claim (outside the proving process) for the "loss" suffered by reason of the mandatory statutory conversion. That is a very different situation

from that of, say, the asbestosis claimants in *Re T&N Ltd* (see paragraph 14.1 above **[Auths/1/21]**).

23. The Court should note that, after David Richards J's decision that CCCs do exist as non-provable liabilities of LBIE, further non-provable liabilities of a similar character to CCCs (ie non-provable liabilities created by the operation of the statutory scheme itself) were asserted in a further application issued by LBIE's Administrators on 25 June 2014 ("*Waterfall II*" **[Core/E/4]**).[10] See:

    23.1 Issue 29 raised in the original Application Notice, which asks whether there is a non-provable claim against LBIE where a creditor receives statutory interest at the Judgments Act rate on a sterling proved debt (converted from a foreign currency) but that statutory interest sum received by the creditor is less than the amount of interest which would have accrued had the Judgments Act rate been applied to the original unconverted foreign currency claim;

    23.2 Issue 30 raised in the original Application Notice, which asks whether there is a non-provable claim against LBIE where a creditor receives statutory interest at a rate other than the Judgments Act rate (where the same is required by the terms of IR 2.88(7)) **[Auths/1/5]** on a sterling proved debt (converted from a foreign currency) but that statutory interest sum received by the creditor is less than the amount of interest which would have accrued had that interest rate been applied to the original unconverted foreign currency claim; and

    23.3 Supplemental Issues 2-5 raised on 9 October 2015 **[Core/E/10]**, which ask questions about the proper calculation of various asserted non-provable liabilities.[11]

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10 A copy of the *Waterfall II* Application Notice **[Core/E/4]** will be included in the papers for the appeal hearing, together with a list of supplemental issues (a copy of which will also be included) that were raised after judgment of David Richards J on 31 July 2015 in the first of three tranches of decisions on the various issues in the original Application Notice.

11 A list of supplemental issues in *Waterfall II* **[Core/E/10]** will be included in the papers for the appeal hearing.

24. The Court is invited to conclude that if non-provable claims exist at all they should be strictly limited and cannot arise directly from the operation of the statutory scheme. As is explained below, CCCs (if they exist) would arise directly from the operation of the statutory scheme.

B. Construction of the Sub Debt Agreements

(1) Natural meaning

(a) Introduction to Clause 5

25. The CA held that the Sub Debt is a provable contingent debt. LBHI2 agrees that the Sub Debt is provable and contingent: this appeal concerns what repayment of the Sub Debt by LBIE to LBHI2 is contingent on, and thus the extent of the subordination of the Sub Debt. The CA held that repayment of the Sub Debt is contingent on the repayment in full of proved debts and statutory interest and other non-provable liabilities of LBIE.[12] The Judge decided the same (albeit on an apparently different analysis).[13] LBHI2 submits that this interpretation is wrong: repayment of the Sub Debt is in fact contingent on payment in full only of the debts provable in a formal insolvency process.

26. The starting point for any decision on the extent of subordination must be the terms of the subordination agreement itself. Subordinated debt is provided in many different forms, and therefore on different terms, and by different types of lender. The holders of subordinated debt are often not members of the borrower, although they may well be. The subordination provisions at issue on this appeal are set out in clause 5 of the Standard Terms of the Sub Debt Agreements **[Appx/p.164-165]**.[14] The material parts of clause 5(1) are:

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12 see CA's Judgment at [39] **[Appx/p.17]** (provability), [48] **[Appx/p.19]** and [57]-[59] **[Appx/p.21]** (statutory interest) and [60]-[61] (non-provables) **[Appx/p.22]**, which state that (1) statutory interest falls within the definition of "*Liabilities*" and is not to be disregarded for the purposes of the solvency test because it "is both payable in the Insolvency of [LBIE] and also capable of being established of determined in the Insolvency of [LBIE]" and (2) non-provable liabilities are not to be disregarded either because they "once established or determined outside the Insolvency of [LBIE], are nevertheless payable within it" (emphasis added).

13 see [64] **[Appx/p.22-23]** of the Judgment which states that "*Liabilities*" is not restricted to provable debts, [69] **[Appx/p.24]** which held that clauses 7(d) and (e) of the Sub Debt Agreements mean that the Sub Debt cannot be repaid until after statutory interest and non-provable liabilities, [71] **[Appx/p.25]** which held that statutory interest was a "*debt or liability*" of LBIE for the purposes of the Sub Debt Agreements, [79] **[Appx/p.27-28]** which held that the debts excluded by clause 5(2)(a) were not restricted to provable debts and [87] **[Appx/p.29]** which held that "all or almost all" of the arguments addressed to statutory interest applied also to non-provable liabilities, with the result that they too were payable before the Sub Debt.

14 set out in full in [36] **[Appx/p.15-16]** of the CA's Judgment.

> "Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon –
>
> (a)… (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower …) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower… ; and
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> (b) the Borrower being "solvent" at the time of and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be "solvent".

27. The opening words of clause 5 **[Appx/p.164-165]** refer to LBHI2's rights as Lender in respect of the *"Subordinated Liabilities"* being "*subordinated*" to the "*Senior Liabilities*" but say nothing about how or to what extent the subordination is to take place. The nature and scope of the subordination is given by the remaining parts of the clause.

28. The clause expressly contemplates that repayment of the Sub Debt might be made by LBIE to LBHI2 either when LBIE is in a formal insolvency process or when it is not and is still a going concern.[15] Accordingly, there has to be (and the draftsman must have intended) a unitary understanding of what obligations are captured by clause 5(2) **[Appx/p.165]** because the bespoke "*solvency*" definition in clause 5(2) must be able to operate at any given time, both inside and outside a formal insolvency process.

29. Clause 5(2) defines "*solvent*" for the purpose of the clause 5(1)(b) **[Appx/p.165]** "*solvency*" test as follows :-

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15 In the former case, LBIE may repay the Sub Debt if it fulfils the bespoke solvency test set out at clause 5(2) **[Appx/p.165]**; in the latter case, LBIE may repay the Sub Debt provided that it passes the Financial Resources Requirement test under clause 5(1)(a) **[Appx/p.164 -165]** and the bespoke solvency test at clause 5(2).

> "For the purposes of sub-paragraph (1)(b) above, the Borrower shall 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 the Borrower…"

30. The question that arises from these clauses is whether liabilities or obligations of the Borrower (LBIE) qualifying as "*Liabilities*" within the definition at Schedule 2 to the Standard Terms of the Sub Debt **[Appx/p.162]** are nevertheless to be disregarded when determining whether LBIE would be "*solvent*" for the purposes of clause 5(1)(b) **[Appx/p.165]** because they are "*obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower*". If they do qualify as such, they are to be disregarded on the application of the solvency test. If they do not qualify, they have to be taken into account and capable of being paid in full before repayment of the Sub Debt by LBIE.

31. Clause 5(2)(a) **[Appx/p.165]** expressly envisages that the subordination of the Sub Debt is not absolute; it is expressly envisaged that the Sub Debt can be repaid even though LBIE cannot pay <u>some</u> obligations (ie the obligations disregarded under clause 5(2)(a)[16]). So the Sub Debt can be repaid ahead of certain other obligations of LBIE. The question is what those obligations are.

32. The wording of clause 5(2)(a) answers that question by limiting the "*Liabilities*" which are to be taken into account for the purposes of ascertaining whether LBIE is "*solvent*" under clause 5(1)(b) - and hence whether the Sub Debt should be paid - in a way which captures the concept of provable debts which is familiar from the statutory insolvency scheme.

33. The language of clause 5(2)(a) **[Appx/p.165]** is short-hand for the concept of provable debts. Under the statutory scheme, a creditor can prove not only for debts which have fallen due for payment at the relevant date (the commencement of the insolvency), but also for those debts which are not due and payable at the relevant date, but which will or might fall due for payment at a future date and

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16 and clause 5(2)(b) **[Appx/p.165]**, the "*Excluded Liabilities*" (as to which, see below at paragraph 43).

which must be ascribed a fair value by the office-holder in the process of proof, adjudication of debts and payment of dividends.

34. Clause 5(2)(a) **[Appx/p.165]** is modelled on that statutory scheme. In determining whether the Borrower is "*solvent*" for the purposes of deciding whether the Sub Debt should be paid, the computation is required to include all debts that are currently due and payable, and also those prospective and contingent liabilities that would be admitted to proof in any insolvency process. But obligations or liabilities are to be disregarded if they are neither "*payable*" at the time of the determination nor "*capable of being established or determined in an insolvency*", the latter referring to sums that are not future liabilities or contingent liabilities which would be admitted to proof by the relevant office-holder in an insolvency.

35. That is the natural reading of the words, is a readily workable scheme, and means that the "solvency" test in clause 5(2) **[Appx/p.165]** can apply (as it has to) regardless of whether LBIE is inside or outside a formal insolvency process.

36. If LBIE were outside a formal insolvency process and the CA's/Judge's construction were accepted, there would have to be a complicated process of estimation of matters such as how long and complex the (hypothetical) insolvency process would be, if and when a distribution might be made, whether LBIE would be in a position to pay statutory interest at the end of the process and, if so, how much.

37. That is avoided by LBHI2's construction and accords with what must have been intended by the parties.

38. However, the judgments do not even consider this construction.

39. Instead, the construction advanced by the CA (like that of the Judge) distorts the structure of the clause and, in particular, gives no meaning to the words "*or capable of being established or determined in the Insolvency of the Borrower*". These words cannot properly be ignored in this way. LBHI2's construction, as set out above, gives meaning to those words and provides a straightforward interpretation of the types of obligation which are disregarded under clause 5(2)(a) - and which accordingly rank below the Sub Debt for payment in an insolvency of LBIE.

40. The Judge focused on the word "*payable*" in clause 5(2)(a) **[Appx/p.165]** and linked it to the words "*in the Insolvency of the Borrower*". He held that statutory interest and non-provable claims were "payable … in the Insolvency of the Borrower" and did not make any distinction in his analysis[17] between the reasons for that conclusion in respect of both statutory interest and non-provable liabilities.

41. The CA did consider whether statutory interest and non-provable liabilities fell within clause 5(2)(a) separately.

    41.1 They decided that statutory interest fell within the definition of "*Liabilities*" ([48]) **[Appx/p.19]** and is "both payable in the Insolvency of the Borrower and also capable of being established or determined in the Insolvency of the Borrower" ([57] **[Appx/p.21]**).

    41.2 Lewison LJ decided that non-provable liabilities were established and determined outside the Insolvency of the Borrower but were "payable" within it ([61] **[Appx/p.22]**) while Briggs and Moore-Bick LJJ decided that non-provable liabilities were capable of being "established or determined in the Insolvency" as well as "payable within the Insolvency" ([134] and [246] **[Appx/p.40-41; 66]**).

42. It is convenient to take these points in turn.

(b) Does statutory interest fall within clause 5(2)(a)?

43. First, statutory interest does not fall within the definition of "*Liabilities*" in the Sub Debt Agreements, because it is not a sum "*payable or owing by the Borrower*" (ie LBIE). The CA erred in deciding (see [45] of the CA's Judgment **[Appx/p.18]**) that it is.

    43.1 In a distributing administration, the assets of the company are no longer owned by it beneficially but are under the custody, control and management of the office-holder (see paragraphs 1(1), 67-68 of Schedule B1 to the Act **[Auths/3/5; Auths/3/6]**) who has statutory duties to

[17] see [87] of the Judgment **[Appx/p.29]**.

comply with in his management of the affairs of the company and the assets in the estate in accordance with the legislative regime.[18]

43.2 Both IR 2.88(7) and s. 189(2) of the Act **[Auths/1/5; Auths/1/2]** contain a direction to the relevant office-holder as to how to apply the fund under his control, once all proved debts have been discharged in full. Accordingly, statutory interest is something which the office-holder pays in discharge of his statutory duty to manage the company's assets. It is not an obligation derived from any obligation of the company: statutory interest is payable by the administrator to a creditor who has no contractual right to interest against the company at all and at a rate which has no reference to any contractual obligation of the company. In *Re Lines Bros Ltd* [1984] BCLC 215 Mervyn Davies J held (at 223) **[Auths/1/16/p.223]** that the liquidator's obligation to pay interest under s. 33(8) of the Bankruptcy Act 1914[19] **[Auths/2/4]** is not a debt or liability of the company, but is "pursuant to a statutory direction to him, being an obligation which is part of the statutory scheme for dealing with a company's assets which comes into operation at the outset of the winding up".

43.3 This is supported by the fact that the only way in which payment of statutory interest can be enforced by a creditor is against the office-holder (ie for misapplication of funds; see *Re HIH Casualty & General Insurance Ltd* [2005] EWHC 2125 (Ch) **[Auths/5/2]** per David Richards J[20]), not by suing the company.

44. Secondly and in any event, even if IR 2.88(7)/s. 189(2) **[Auths/1/5; Auths/1/2]** impose an obligation <u>on the Borrower</u> to make a payment, such that it falls within the definition of "*Liabilities*", it will still be disregarded for the purposes of the "solvency" test under clause 5(2)(a) **[Appx/p.165]** if it is "*not payable or capable of being established or determined in the Insolvency*" of LBIE. As that phrase refers to debts

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18 The same is true in a liquidation: see *Ayerst v C & K (Construction) Ltd* [1976] AC 167at pp.176-177 per Lord Diplock **[Auths/4/6/p.176-177]**.

19 s. 33(8) **[Auths/2/4]** provided that: "If there is any surplus after payment of the foregoing debts, it shall be applied in payment of interest from the date of the receiving order at the rate of four pounds per centum per annum on all debts proved in the bankruptcy".

20 Reversed on other grounds by the House of Lords.

which are not provable in an insolvency process of LBIE (for the reasons set out in more detail below), statutory interest (which is not a provable debt) should be disregarded for the "solvency" test, thus ranking for payment in an insolvency process behind the Sub Debt.

45. The construction found by the CA and the Judge (for slightly different reasons) does not give full meaning to the wording of clause 5(2)(a) **[Appx/p.165]** as a whole because, if correct, the clause would then cover all "*Liabilities*" which would fall to be paid by the Borrower in a formal insolvency process (defined as "*Insolvency*" **[Appx/p.161]** in the Sub Debt Agreements). That would mean that there would be no need for, or meaning to be given to, the words "*or capable of being established or determined*" (which is obviously intended to mean something different from "*payable*").

46. On the reasoning of both the Judge and the CA, it is difficult to see what types of obligation would be excluded from the solvency test by clause 5(2)(a). It could not, for example, sensibly be suggested that the clause required subordination of LBHI2's claim not only to those liabilities and obligations which were required to be paid in the insolvency, but also to those which, though in theory "*capable of being established or determined*", would in fact be rejected.[21]

47. The fact that the subordination provision in clause 5 expressly operates on payment of LBHI2's debt rather than on proof, necessarily defines the relative priority of the payment of LBHI2's debt and the payment of statutory interest. That is because IR 2.88(7) **[Auths/1/5]** contains a direction to the administrators as to how to manage the fund under their control, ie to make payment of statutory interest, which is only triggered and can only operate if there is a surplus after payment of proved debts. IR 2.88(7) provides:

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21 The liabilities that are disregarded by clause 5(2)(a) **[Appx/p.165]** must be different from the "*Excluded Liabilities*" **[Appx/p.161]**(see clause 5(2)(b) **[Appx/p.165]**), which are also disregarded for the purposes of the "solvency" test. "*Excluded Liabilities*" is a defined term in the Standard Terms at Schedule 2 of the Sub Debt agreements. That concept refers to "*Liabilities*" which are "expressed to" and do, in the opinion of the Borrower's office-holder, rank below the Sub Debt in a formal insolvency process of LBIE, so that "*Excluded Liabilities*" includes eg further subordinated debt, expressly created to rank lower than the Sub Debt.

> "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 period during which they have been outstanding since the relevant date." (emphasis added)

48. The natural meaning conveyed by clause 5 **[Appx/p.164-165]** is therefore that the Sub Debt would rank for payment after other proved debts but before any obligation upon the administrators to apply surplus funds in payment of statutory interest. (The position is *a fortiori* in respect of payment of any non-provable debts which necessarily rank after payment of statutory interest on proved debts: see further below.)

49. Further or alternatively, the terms of IR 2.88(7) **[Auths/1/5]** mean that if statutory interest is a liability of LBIE (contrary to LBHI2's primary case), then it is within the definition of "Excluded Liabilities" referred to in clause 5(2)(b) **[Appx/p.165]** because IR 2.88(7) expressly provides that statutory interest is to be paid after payment of proved debts.

50. Thirdly, this construction is also supported by the way in which statutory interest is payable under the insolvency regime, ie once the trigger under IR 2.88(7) for the payment of statutory interest on unsecured debts occurs (namely, the existence of a surplus after payment in full of proved debts), the office-holder has to pay statutory interest equally on all unsecured proved debts (regardless of their respective priorities for payment of dividend) because statutory interest under IR 2.88(7) "ranks equally whether or not the debts on which it is payable rank equally": IR 2.88(8) **[Auths/1/5]**.[22] The regime contains a requirement to pay statutory interest once and equally, irrespective of whether some debts are subordinated or not. Thus, interest payable under IR 2.88(7) applies to and ranks equally in respect of different classes of debts.[23]

51. LBHI2's construction of the Sub Debt Agreements accords with this: statutory interest applies equally to all provable debts, despite their ranking in LBIE's

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22 see s. 189(3) **[Auths/1/2]** for liquidations.

23 ie preferential and non-preferential debts, which are, by statute, different classes of debt for the purpose of ranking for dividend payment, with preferential debts ranking above non-preferential debts: s. 386 **[Auths/2/47]** and Schedule 6 to the 1986 Act **[Auths/3/27]**.

administration for dividend payment on the principal sum being (a) preferential debts then (b) non-preferential, non-subordinated debts and then (c) subordinated debts. By contrast, the CA's and the Judge's decisions in relation to the ranking as between the Sub Debt and statutory interest appear to require the statutory interest provision in IR 2.88(7) **[Auths/1/5]** to be triggered twice (once when all the unsecured, unsubordinated proved debts are paid, and then again when all the subordinated debts are paid), with the result that IR 2.88(8) **[Auths/1/5]** is breached because the statutory interest payable does not rank *"*equally whether or not the debts on which it is payable rank equally*"*. That cannot have been intended.

52. Fourthly, there is no commercial reason why a subordinated creditor would intend to subordinate his provable debt to the payment of statutory interest of unsubordinated creditors. The purpose of the payment of statutory interest is to compensate creditors for being kept out of their money during the period of the insolvency. Subordinated creditors are kept out of their money, just as much as unsubordinated creditors and it would be surprising if, bearing in mind the purpose of statutory interest and the express terms of IR 2.88(8) **[Auths/1/5]** in relation to the ranking for statutory interest of creditors *inter se*, one creditor subordinated himself to payment of statutory interest to compensate for the delay in payment without some express acknowledgement of that (which does not appear in the Sub Debt Agreements). There is no reason why the subordination provision should be taken to require one creditor to pay for the delay caused by the collective misfortune suffered by all of them by reason of the company's insolvency.

(c) Do non-provable liabilities fall within clause 5(2)(a)?

53. The Judge (and LBIE) correctly recognised that non-provable liabilities are not payable as part of the statutory regime.[24] However, the CA decided that they were (see, in particular, [61] **[Appx/p.22]**). Further, Briggs and Moore-Bick LJJ held (with Lewison LJ dissenting on this point) that non-provable liabilities are

24 See [98] **[Appx/p.107]** of the Judgment: "I do not understand why [liquidation] should prevent those creditors who have not received their contractual entitlement from pressing their claims against the company once the statutory regime for pari passu distributions has run its course." (emphasis added).

established or determined as part of the statutory insolvency process. Non-provable liabilities are in fact neither established nor determined, or payable, as part of the statutory regime.

54. Non-provable liabilities (if they exist at all) are by definition outside the insolvency regime. In order for creditors to participate in the collective enforcement process of an insolvency process, they must prove. The liquidator or administrator in a distributing administration has no statutory remit to make any payments on debts that have not been proved: *Government of India v Taylor* [1955] AC 491 at 503 **[Auths/4/33/p.503]** and 508-509 **[Auths/4/33/p.508-509]** per Lord Simmonds (and see also *Danka* **[Auths/1/8]** referred to at paragraph 9 above). Questions of liability and quantum of any non-provable claims held to exist would have to be determined in separate proceedings outside the insolvency process and, once the collective enforcement process of insolvency had run its course, there might be further payments in respect of non-provable liabilities if there were sufficient assets.

55. None of the cases referred to by Lewison LJ at [24] to [26] **[Appx/p.12-13]**, as recognising non-provable claims, provide any authority for the contention that establishing or paying non-provable claims is part of the purpose of a liquidation or administration under the Act or Rules.

56. In *Re T&N Ltd* (see, in particular, at [106] – [107] **[Auths/1/21/p.1765-1766]**) David Richards J did not suggest that it would be any part of the liquidator's function in the liquidation to establish or determine the amount of any non-provable liabilities or to make any payment to such claimants. He envisaged that, after payment of proved debts, the stay on enforcement would be lifted so that a person with a non-provable claim could bring proceedings and seek to execute a judgment against the assets of the company. He was not contemplating the non-provable claim being established, determined or paid within the liquidation. On the contrary, he envisaged the non-provable claim being adjudicated on by the ordinary processes of issue of a claim form, judgment and execution in spite of (not as part of) the insolvency process.

57. The second case referred to by the CA is *In re R-R Realisations Ltd* [1980] 1 WLR 805 **[Auths/6/9]**. As to that case (which pre-dated the 1986 statutory scheme):

57.1 The question for the Court was whether to give permission to voluntary liquidators to distribute a surplus to members in a situation in which some late claims had been made against the company by writ (there being no automatic stay of claims in a voluntary liquidation) following an air crash which occurred after the commencement of the winding-up. Although Megarry V-C ordered a delay of the distribution, there was no discussion of whether or how the liquidator should deal with the claims made by writ. The only issue was whether the liquidator should pay monies over to members whilst claims were outstanding.

57.2 But in any event, at that time (as was later held by Harman J in *Islington Metal and Plating Works* [1984] 1 WLR 14 at 23-24 **[Auths/5/4/p.23-24]**, and as explained by David Richards J in *Re T&N* at [87]-[90] **[Auths/1/21/p.1760-1761]**), such tortious claims could be admitted to what was then (before the introduction of the 1986 statutory scheme) a secondary process of proof once it transpired that the company was solvent under s. 316 of the Companies Act 1948 **[Auths/2/10]**. Accordingly, at the time of the decision, the claims being asserted were provable claims. (The law was then changed by the 1986 legislation so that there was no longer any mechanism for proving tort claims where the cause of action accrued after the commencement of the winding up, even in a solvent liquidation: see the explanation in *T&N* at [74] and [106] **[Auths/1/21/p.1756; p.1765]** of the wording of IR 13.12 **[Auths/1/7]**; but the amendment made to IR 13.12 shortly after the decision in *T&N* mean that the claims would now once again be provable.)

58. The third case relied on is *Re Nortel* **[Auths/1/17]** where, as mentioned above, Lord Neuberger included non-provable liabilities in the list of payments to be made out of the assets of a company in liquidation or administration which he listed "in summary terms" at [39] **[Appx/p.17]** at the start of the analysis in his judgment. But there is nothing in that judgment to suggest that Lord Neuberger included non-provable liabilities in that list by reason of any of the statutory provisions he referred to, or because he considered that the payment of such liabilities formed part of the liquidation or administration. His list was a very broad summary introducing the judgment. There was in any event nothing in the

judgment stating why or how the payment of non-provable liabilities (let alone their establishment or determination) could be said to fall within the scope of the insolvency legislation, not least because the Supreme Court's decision on the question before them avoided treating the relevant pension liability as a non-provable liability.[25]

59. There is no statutory mechanism empowering or directing the liquidator or administrator to establish, determine or pay non-provable claims. By contrast with an office-holder where the company itself holds funds on trust (for example, the liquidator of *Berkeley Applegate* **[Auths/4/10]**, a company which held money in clients' accounts and the benefit of mortgages on trust for its investors[26]), to the extent that there is a trust of the company's assets to be administered by the relevant office-holder in accordance with the statutory scheme, it is to be administered by him "for the benefit of those persons only who are entitled to share in the proceeds of realisation of the assets under the statutory scheme" (*Ayerst v C & K (Construction) Ltd* [1976] AC 167 at 177C-D **[Auths/4/6/p.177]** per Lord Diplock). That does not include the holders of non-provable claims and there is no basis for a suggestion that the statutory trust exists for their benefit.

60. Insofar as non-provable claims can be discharged at all during a formal insolvency process, they are payable <u>despite</u> or <u>notwithstanding</u> the statutory insolvency scheme, not in it.

61. The effect of the CA's decision appears to be that the only test to be applied under clause 5(2)(a) **[Appx/p.165]** is whether the obligation was "*payable*" by the office-holder <u>whilst</u> the company was in the formal insolvency process, which deprives the remainder of the clause of any meaning. An office-holder will of course not make a payment in respect of an obligation of an amount that has not been established or determined – a process has to be gone through to ensure that an office-holder has a basis for paying out any sums he does. If that process is done <u>in</u>

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25 It is also notable that neither the *Government of India v Taylor* case [1955] AC 491 (House of Lords) **[Auths/4/33]** nor *Re Art Reproduction Co Ltd* [1952] Ch 89 (Ch Div) **[Auths/4/3]**, which made the point that a statute-barred debt cannot be proved and a liquidator cannot pay it from the insolvency estate without the contributories' consent, and which was affirmed in *Government of India* at 509 **[Auths/4/33/p.509]**, were cited to the Supreme Court in *Nortel* **[Auths/1/17]**.

26 *In Re Berkeley Applegate (Investment Consultants) Ltd* [1989] Ch 32 **[Auths/4/10]**

the formal insolvency process (eg the estimation of the value of a contingent debt in accordance with the Rules), then it is caught by the wording of clause 5(2)(a) **[Appx/p.165]** and is not disregarded. But if the process of establishment/determination of the obligation is done outside the process, it properly falls outside the wording of clause 5(2)(a) and cannot be brought back in on some broad and vague interpretation of the word "payable". Such an analysis, which simply poses the question whether a sum would be "payable" during the course of an insolvency process, again renders the remainder of the clause otiose.

62. Given this background, it cannot have been intended by the parties to subordinate the Sub Debt to this category of claims which fall outside the insolvency process and in respect of which there is no mechanism for their "establishment or determination" in the insolvency process. There would have to be a complicated process of estimation of matters such as how long and complex the insolvency process would be, whether LBIE would be in a position to pay statutory interest at the end of the process and, if so, how much and then whether any non-provable liabilities existed and, if so, how would they rank *inter se*. That obviously unintended complication is avoided by LBHI2's construction, which requires the person assessing "solvency" at any given time only to take into account known claims which are quantifiable (ie provable claims).

(d) Further analysis showing that the Sub Debt ranks ahead of statutory interest and non-provable liabilities

63. The construction contended for above is also supported by the following analysis of the provisions of clause 5:

63.1 Clause 5(1)(b) **[Appx/p.165]** makes payment of the Sub Debt conditional on LBIE being "*solvent*" in accordance with the bespoke solvency definition *"at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be 'solvent'";*

63.2 Neither statutory interest nor non-provable liabilities are payable unless there are surplus assets remaining after payment of all proved debts (of which the Sub Debt is, as the CA correctly held, one);

63.3 Since the Sub Debt is provable, it is only possible to work out whether there is a surplus at all (for the payment of statutory interest and non-provable liabilities to be triggered at all) by paying the Sub Debt;

63.4 There is therefore no liability to pay statutory interest or non-provable liabilities in any sum exceeding whatever surplus is left after payment of unsecured unsubordinated creditors who proved and the Sub Debt;

63.5 Accordingly, once the unsecured unsubordinated creditors have been paid and the office-holder is deciding whether he can pay back the Sub Debt consistent with clause 5(2) **[Appx/p.165]**, he can be sure that the payment of the Sub Debt will always leave the company "solvent" because the sum to be applied in payment of statutory interest and non-provable liabilities is only whatever remains once the Sub Debt (a provable debt) has been paid.

(2) The regulatory and statutory background

64. Although the Judge placed substantial emphasis on a vague concept of the "regulatory background" in reaching his conclusions as to the construction of the Sub Debt Agreements (see Judgment [35]-[47] and [60]-[63] **[Appx/p.89-92; 96]**) at the first instance hearing in November 2013, LBIE expressly disavowed any suggestion that there was anything in the regulatory materials which supported its construction of the Sub Debt Agreements. This is because there is indeed nothing which supports the construction for which LBIE was contending.

65. The CA's Judgment mentioned the regulatory precedent on which the Sub Debt Agreements were based and rules pursuant to which the precedent was intended to give effect (see [29]-[31] **[Appx/p.13-14]**) but that background did not form part of the CA's analysis of the proper construction of the subordination provisions.

66. Reference to the regulatory requirements in force at the time the Sub Debt Agreements were entered into in 2006 and subsequently (until the time when LBIE went into administration on 15 September 2008) supports the submission that the terms of the Sub Debt Agreements were not intended to subordinate the Sub Debt below statutory interest or non-provable liabilities in the waterfall. Thus:

66.1 Each of the Sub Debt Agreements recites that, *"the Borrower [LBIE] wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the*

Standard Terms) in accordance with FSA rule IPRU(INV) 10-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan and each Advance" **[Appx/p.156]**.

66.2 By Schedule 2, para 1(2), *"Any reference to any rules of the FSA is a reference to them as in force from time to time"* **[Appx/p.162]**.

66.3 At the time LBIE went into administration, IPRU(INV) 10 had been replaced by GENPRU for LBIE's purposes.

67. GENPRU 2.2.159R(1) **[Auths/8/4]** (which provides that "the claims of the creditors must rank behind those of all unsubordinated creditors") does not require subordination to statutory interest and non-provable claims.

67.1 The "claims" of unsubordinated creditors referred to here are claims for principal and provable interest (ie interest payable in respect of the pre-administration period). IR 12.3(1) **[Auths/3/72]** provides that "Subject as follows, in administration, winding up and bankruptcy, all claims by creditors are provable, as debts against the company … whether they are present or future, certain or contingent, ascertained or sounding only in damages". But a creditor has no "claim" to statutory interest under the Rules and, therefore, cannot prove for it. If there were any question of a creditor being able to prove for a "claim" to statutory interest, the wording of IR 2.88(7) **[Auths/1/5]** would be unworkable; IR 2.88 **[Auths/1/5]** specifically makes a distinction between pre-insolvency interest as a provable debt and post-insolvency interest, which is a different creature.

67.2 This is also made clear by the wording of IR 12.3(2A) **[Auths/3/72]** because, in order to provide that the category of postponed debts under that Rule is postponed to statutory interest, IR 12.3(2A) contains a specific further provision that they are postponed not only to the "claims of creditors" but also to statutory interest on those claims: the draftsman clearly uses "all other claims of creditors in the insolvency proceedings (other than any of a kind mentioned in this paragraph)" to mean claims for which a creditor can prove (pursuant to IR 12.3(1) **[Auths/3/72]**) and as not including statutory interest. Consistent with this legislative background,

the reference to the "claims of the creditors" in GENPRU 2.2.159R(1) **[Auths/8/4]** does not include a reference to statutory interest.

67.3 Nor does the requirement that the claims of the subordinated creditors must rank behind those of all other creditors mean that repayment of the Sub Debt cannot properly be made while the company is not in any insolvency process: the word "rank" is applicable only in an insolvency process and so this requirement applies only when the company is in an insolvency process. While the company is not in an insolvency process, the claims of its creditors are simply paid as they fall due: there is no question of "ranking" those claims. But when the company is insolvent, requiring creditors to lodge a proof of debt and then "ranking" the proved claims is an inherent part of the process (and see also the definition of "*Excluded Liabilities*" **[Appx/p.161]** in the Standard Terms of the Sub Debt Agreements, which refers to *"Liabilities which are expressed to be and … do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower"*, (emphasis added)).

67.4 Further, it is clear that, given that the Sub Debt was intended to be used for capital adequacy purposes (which have the twin aims of (a) enabling the institution's solvency to be estimated and (b) the absorption of losses and continued survival of the regulated institution), there is no good reason why the definition of "*Senior Liabilities*" **[Appx/p.162]** should include statutory interest. The payment of statutory interest is only triggered if there is a surplus when the institution has been formally placed into an insolvency process and payment of all debts proved in that insolvency process has been made in full. The rationale behind the payment of statutory interest is to compensate creditors for the delay in receipt of their money caused by the formal insolvency process. It is not relevant to the twin aims of the capital adequacy requirements set out above; accordingly, there is no reason why payment of tier 2 or tier 3 capital (such as the Sub Debt) should rank behind statutory interest.

68. It is plain that the statutory provisions of the UK insolvency legislation formed part of the background reasonably available to both LBHI2 and LBIE when they entered into the Sub Debt Agreements.

68.1 It is striking that GENPRU (the relevant regulations at the time of LBIE's entry into administration) made specific reference to the concept of "proof" which is a concept found specifically in the UK insolvency legislation[27].

68.2 The Sub Debt Agreements are documents which were intended to apply to entities regulated within the UK. Therefore, questions relating to when the Sub Debt could and could not be repaid by LBIE (an English company) would have to be decided under English insolvency law and, accordingly, that is the relevant background.

68.3 Further, it appears that the origins of the wording used in clause 5(2)(a) **[Appx/p.165]**, "*obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower*", are English, dating from 1988 (ie shortly after the enactment of the IA 1986). Given the recent enactment of that legislation, which included at s. 123 IA 1986 **[Auths/2/20]** a definition of "solvency"[28], that was an obvious place for the draftsman of the precedents to look when defining the concept of "solvency" and that is reflected in the precedent wording.

68.4 In summary, the origins are as follows:

68.4.1 LBIE was regulated (during the period up to 2001 when the FSA became sole regulator of the financial services industry) by the Securities Association ("TSA") and then its successor organisation, the Securities and Futures Association ("SFA"). The TSA Rules in respect of regulatory capital permitted subordinated loans to be treated as "Qualifying Capital"

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27 GENPRU 2.2.159R **[Auths/8/4]** provided (as at 15 September 2008) that the conditions for tier two capital included that "the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the capital instrument must … be limited to petitioning for the winding-up of the firm or proving for the debt in the liquidation or administration …" (emphasis added). That condition was applied to tier three capital also by GENPRU 2.2.245R **[Auths/8/5]**.

28 Section 123(1)(e) **[Auths/2/20]** provides that a company is deemed unable to pay its debts "if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due", and s. 123(2) **[Auths/2/20]** provides that "A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities".

provided that the loans were "drawn up … in accordance with the appropriate standard forms of Subordinated Loan agreement approved by" the TSA (TSA Rule 50.04) **[Auths/8/20/p.2-3]**. The SFA Rules referred to a standard form that could be "obtained from" the SFA (SFA Rule 10-63) **[Auths/8/18/p.6-8]**.

68.4.2 LBHI2's advisers have been unable to locate copies of the standard form agreements promulgated pursuant to these rules by the TSA or SFA before 2001. However, like all self-regulating organisations, the TSA and SFA were supervised by the Securities and Investment Board ("SIB"). The SIB published a standard form subordinated loan agreement in June 1990 which included subordination wording similar to that in clause 5 of the Standard Terms in LBHI2's Subordinated Debt Agreements with LBIE, including the following definition of "solvency" **[Auths/8/19/p.4]**: "For the purposes of this sub-paragraph, the Borrower shall be solvent if it is able to pay its debts in full and in determining whether the Borrower is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the insolvency of the Borrower and the Excluded Liabilities."

68.4.3 The earliest form of this wording of which LBHI2's advisers are aware is in a "Short Term Subordinated Loan Facility Agreement" published by the Association of Futures Brokers and Dealers Limited ("AFBD") **[Auths/8/2/p.3]** in March 1988, pursuant to an obligation imposed on such self-regulatory organisations formed under the Financial Services Act 1986 ("FSA 1986") to ensure that their members had adequate capital.

68.4.4 By paragraph 3(1) of Schedule 2 to the FSA 1986 **[Auths/2/15]**, the AFBD was obliged to make provisions in its rules equivalent to the safeguards set out in s. 49 **[Auths/2/14]** concerning capital adequacy:

68.4.4.1 The AFBD rules **[Auths/8/1]** (published in late 1987 with the relevant chapters to come into force in April 1988) required that a firm's "financial resources" calculated in accordance with the rules should at all times exceed its "financial resources requirement" calculated in accordance with the rules. The rules provided that subordinated loans in the standard form approved by the AFBD were to be excluded from a firm's liabilities in calculating its liquid resources for the purpose of this "financial resources" requirement.

68.4.4.2 The AFBD's standard form Short Term Subordinated Loan Facility Agreement dated 24 March 1988 **[Auths/8/2]** contained a subordination clause as follows at clause 6 (emphasis added):

> "Notwithstanding the provisions of paragraph 5 hereof, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal interest or otherwise) of the Subordinated Liabilities is conditional upon:-
>
> > (a) (if an order has not been made or an effective resolution passed for the insolvency of the Borrower) the Borrower being in compliance with its Net Worth Requirement prevailing at the time of payment by the Borrower; and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that, subject to sub-paragraph (2) below, the Borrower

could make such payment and still be in compliance with such Net Worth Requirement immediately thereafter;

(b) (if an order has been made or effective resolution passed for the insolvency of the Borrower) [or if the Borrower shall be dissolved**] the Borrower being solvent at the time of payment by the Borrower; and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Borrower shall be solvent if it is able to pay its debts in full as and when they become due and in determining whether the Borrower is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the insolvency of the Borrower and the Excluded Liabilities."

69. In summary, the regulatory background to the Sub Debt Agreements in fact supports LBHI2's construction of clause 5 of the Sub Debt Agreements **[Appx/p.164-165]** (both in relation to the provability of the Sub Debt and the extent of the subordination intended) and neither David Richards J nor the CA took that properly into account in deciding the extent of the Sub Debt's subordination.

(3) Provability of the Sub Debt

69A. LBIE has cross-appealed to contend that the Sub Debt is not provable until the relevant contingencies upon which repayment of the Sub Debt is contingent have been fulfilled[29] and that, accordingly, until statutory interest and non-provables have been paid in full, LBHI2 cannot either (1) submit a proof for the Sub Debt and require LBIE's administrators to admit the proof or (2) use the Sub Debt in insolvency set-off against claims by LBIE against LBHI2.[30]

69B. LBIE argues at [59] of its Written Case that the CA was wrong to conclude that the Sub Debt is provable and was provable (as a contingent debt) from the outset of the administration. LBIE asks the Court (at [62] of its Written Case) to revert to the position as declared by David Richards J: ie the Sub Debt is "*subordinated to provable debts, statutory interest and non provable liabilities, all of which must be paid before (a) LBHI2 is entitled to prove and require the LBIE Administrators to admit such proof in respect of its claims under its subordinated loan agreements with LBIE and (b) such claims are available for insolvency set-off resulting from the giving of notice by the LBIE Administrators, on 4 December 2009, that they proposed to make a distribution to LBIE's unsecured creditors.*"

69C. LBIE's submission is wrong and the CA correctly held at [39-41] **[Appx/p.17-18]** that LBHI2 could prove for the Sub Debt in LBIE's insolvency process. LBHI2 submits that the CA's approach was correct in summary because:

69C.1 The debt created by the Sub Debt Agreements fall within the definition of "debt" within IR 13.12 **[Auths/1/7]** and "provable debt" within IR 12.3 **[Auths/3/72]**.

69C.2 Neither the terms of the Sub Debt Agreements nor the relevant regulatory background against which the Sub Debt Agreements are to be construed (as set out at paragraphs 66-68 above and paragraphs 77-78 below) seek to prevent LBHI2 from proving, or restrict the circumstances in which LBHI2 can prove, its claims in an insolvency process of LBIE; by proving as a subordinated creditor LBHI2 is doing nothing to circumvent or undermine that subordination;

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29 LBIE's Written Case at [63]

30 LBIE's Written Case [62]

69C.3 The provisions of the Sub Debt Agreements specifically provide that LBHI2 is permitted to institute insolvency proceedings against LBIE in certain defined circumstances and it is implausible to suppose that insolvency proceedings could be instituted by LBHI2 but LBHI2 could not seek to obtain repayment of its Sub Debt by submitting a proof in those insolvency proceedings;

69C.4 Similarly, the relevant regulatory provisions (GENPRU r. 2.2.159) **[Auths/8/4]** permitted the subordinated creditor to petition for winding up or prove in a liquidation or administration for the subordinated debt;

69C.5 A claim by LBHI2 for the Sub Debt is for a contingent debt, repayment of which is contingent upon the prior-ranking liabilities of LBIE being paid in full; contingent debts are provable in accordance with the Rules and there is nothing in the Sub Debt Agreements which suggests that the Sub Debt should be treated in an insolvency any differently from any other contingent debt.

69D. As with any other contingent debt, the appropriate step for a contingent creditor to take is to prove at the outset of the relevant insolvency process for his (contingent) debt, at which point it will be valued by the administrator/liquidator of the company (and, in future, revalued, if appropriate) prior to any dividend being paid out on it. In this case, as LBHI2 submitted and as the CA accepted, the proof of the Sub Debt is to be valued at nil unless and until LBIE has sufficient assets to pay prior-ranking claims in full, and at that point the Sub Debt is revalued to its full value and paid on that basis.[31] There will only be payment (whether by dividend or by set-off) once the contingencies have fallen in. Given that analysis, there is no proper basis for LBIE's contention that a proof of debt cannot be submitted by LBHI2 prior to the contingencies having been fulfilled.

69E. LBIE is wrong to suggest that the Standard Terms of the Sub Debt Agreements prevent a proof of debt. The above analysis is entirely consistent with all the Standard Terms on which LBIE relies in its Written Case.

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31 CA Judgment [41] *per* Lewison LJ **[Appx/p.17-18]**

69E.1 LBIE's argument (in part in reliance on David Richards J's Judgment at [69]) **[Appx/p.97-98]** that the lodging of a proof by LBHI2 constitutes an attempt to advance the Sub Debt ahead of liabilities that rank prior to it, such that Standard Terms 7(b), (d) and (e) **[Appx/p.166-167]** are breached[32] is wrong. It ignores the fact that repayment of the Sub Debt (by dividend or by its use in insolvency set-off) will occur, even if a proof has been submitted, only when the contingencies are fulfilled;

69E.2 LBIE's interpretation of Standard Term 4 **[App/p.163]** does not make sense. It is correct that the repayment provisions are subject to the subordination provisions.[33] However, the above analysis is entirely consistent with that. The subordination provisions (properly construed) determine what contingencies have to be fulfilled before the Sub Debt can be repaid (ie what claims rank prior to the Sub Debt) and LBHI2 only seeks to obtain repayment of the Sub Debt in such a way that protects the prior ranking of those claims. But Standard Terms 4(4), (5) and (7) **[Appx/p.163-164]** specifically give LBHI2 the right (as part of an exhaustive list of remedies) to institute proceedings for the insolvency of LBIE to "*enforce payment*" when payment is to be made, as LBIE accepts.[34] Since the institution of insolvency proceedings is one of the specific remedies granted to the Borrower there can be no conceivable reason why LBHI2 should be prevented from proving in such an insolvency. As proof is a prerequisite for payment, there is no need for there to be further language in Standard Term 4 expressly permitting the submission of a proof of debt and/or the admission of the same to proof.[35] It goes without saying.

69E.3 David Richards J's view of the subordination mechanism was that Standard Terms 7(d) and (e) **[Appx/p.166]** prevented LBHI2 proving for the Sub Debt.[36] But those Standard Terms do not say anything about LBHI2 not

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32 LBIE Written Case at [64-66]

33 LBIE Written Case [67.1]; Standard Term 4(1) of the Sub Debt Agreements **[Appx/p.163]**.

34 LBIE Written Case [66]

35 See, to the same effect, Lewison LJ at [39] of the CA Judgment **[Appx/p.17]**.

36 Judgment [69] **[Appx/97-98]**

proving its debt and cannot reasonably be understood in that way. Both are expressed merely as reinforcing and giving effect to the subordination provisions contained elsewhere in the agreements, rather than as themselves forming an essential part of the subordination mechanism or setting out anything about the extent of the subordination. They are non-circumvention provisions. They are not contained in clause 5 (headed *"Subordination"*) **[Appx/p.164-165]** where a provision with substantive effect in relation to subordination might be expected to be found, but are instead to be found in clause 7 headed *"Representations and undertakings of Lender"* **[Appx/p.166-167]** which contains ancillary provisions. What these sub-clauses do prohibit is, eg, LBHI2 seeking to attach assets abroad in jurisdictions which do not recognise the English insolvency, thus giving LBIE contractual rights to prevent such steps being taken (rather than having simply to rely on the equitable doctrine of hotchpot to require the Lender to disgorge his receipts to the office-holder).

69F. Further, the type of subordination language in the Sub Debt Agreements can be contrasted with the type of language used by draftsmen when it is intended that subordination should be achieved by the placing of a restriction on a subordinated creditor proving a debt in competition with other creditors. See eg:

69F.1 The clause in issue in Re SSSL Realisations (2002) Ltd [2006] Ch 610 at 618D **[Auths/6/13/p.618]**, providing that the subordinated creditor *"shall not claim, rank, prove or vote as a creditor …*" until payment of other liabilities. The distinction between these two forms of contractual subordination is well-recognised.[37]

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37 See, e.g., Goode on Legal Problems of Credit and Security, 4th Edn (2008) at p.210 **[Auths/8/6]** (the text having already referred to turnover subordination): *"Another reasonably straightforward form [of contractual subordination] is where the subordinated debt is expressed as a contingent obligation, so that it is only payable if the senior creditor is paid in full, or if the debtor has sufficient assets to pay the senior creditor in full. This does not infringe the pari passu rule, since if the contingency is not satisfied, the subordinated debt is valued at nil by the liquidator, and if the contingency is satisfied the subordinated creditor is paid pari passu with the other creditors. The most controversial form is a plain contractual subordination, where the subordinated creditor agrees not to claim or prove until the senior creditor has been fully paid, without creating a contingent debt … If anything, the result of the agreement is that the subordinated creditor is worse off, rather than the senior creditor being better off, and the subordinated creditor is free to bargain for this position, for which he will*

69F.2 Another instructive comparison is to "postponed debts" which are defined in the statutory insolvency regime by IR12.3(2A) **[Auths/3/72/p.2]** and are,

> *"…not provable except at a time when all other claims of creditors in the insolvency proceedings (other than any of a kind mentioned in this paragraph) have been paid in full with interest under section 189(2), Rule 2.88 or, as the case may be, section 328(4)."* (emphasis added)
>
> This provision expressly states (a) that postponed debts are "not provable" (rather than "not payable") and (b) that they are not provable until after payment of statutory interest (as well as after payment of other creditors' claims). The draftsman considered express wording necessary (a) to exclude them from the process of proof until a particular point in time and (b) to postpone these debts to statutory interest as well as to *"all other claims of creditors in the insolvency proceedings"*.

69G. Finally, reference to the regulatory requirements in force at the time when LBIE went into administration on 15 September 2008 supports the submission that the terms of the Sub Debt Agreements (including clauses 7(d) and (e) **[Appx/p.166]**) were not intended to restrict LBHI2 from proving for the Sub Debt. Thus:

69G.1 As set out above:

69G.1.1 Each of the Sub Debt Agreements recites that, *"the Borrower [LBIE] wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) in accordance with FSA rule IPRU(INV) 10-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan and each Advance"* **[Appx/p.156]**;

69G.1.2 By Schedule 2, para 1(2) **[Appx/p.162]**, *"Any reference to any rules of the FSA is a reference to them as in force from time to time"*.

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usually receive an enhanced return. This form of subordination has, accordingly, been held to be valid in a number of cases." (emphasis added)

69G.1.3 At the time LBIE went into administration, IPRU(INV) 10 had been replaced by GENPRU for LBIE's purposes.

69G.2 The Sub Debt must, for capital resources requirements, have been either lower tier 2 or tier 3. GENPRU 2.2.159R **[Auths/8/4]** applied to both lower tier 2 capital and also (with certain immaterial adjustments) to tier 3 capital. It provided (as at 15 September 2008) as follows (emphasis added):

> *"A capital instrument must not form part of the tier two capital resources of a firm unless it meets the following conditions:*
>
> *(1) the claims of the creditors must rank behind those of all unsubordinated creditors;*
>
> *(2) the only events of default must be non-payment of any amount falling due under the terms of the capital instrument or the winding-up of the firm and any such event of default must not prejudice the subordination in (1);*
>
> *(3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the capital instrument must (subject to GENPRU 2.2.161 R) be limited to petitioning for the winding-up of the firm or proving for the debt in the liquidation or administration;*
>
> *(4) any (a) remedy permitted by (3) … must not prejudice the matters in (1) and (2) …".*
>
> (emphasis added)

69H. The regulatory requirements thus require subordination but the extent of the required subordination is not such as to impose any restriction on the lender's ability to prove for the debt: indeed, the regulatory requirements in force at the time LBIE entered administration specifically permit the Lender to prove in the liquidation or administration of the Borrower (and, as set out above, there would be no point in such a right being available unless the Lender could seek to participate in the statutory process for collective enforcement of debts and distribution on the basis of proof). They do not, as any part of the subordination mechanism, contain a restriction on proving in order to effect the subordination of payment of the debt to payment of statutory interest on other proved debts. It cannot sensibly be suggested that GENPRU intended to impose such a restriction but did not expressly provide one. LBIE is, accordingly, also wrong to

suggest[38] that the terms of the Sub Debt Agreements would not accomplish their regulatory purposes if they permitted the submission of a proof prior to the contingencies having occurred. GENPRU indicates the opposite and the regulatory purposes of the Sub Debt are protected by the fact that the proof will be valued at nil prior to the contingencies occurring.

38 LBIE Written Case [69.2]

C. Currency Conversion Claims

(1) Introduction

70. The majority of the CA (Moore-Bick and Briggs LJJ) were wrong to recognise the existence of CCCs as a category of claims which are not provable but nevertheless remain to be calculated and paid after the payment in full of proved debts and statutory interest thereon. Lewison LJ dissented on each of what he identified as the three strands of the argument in favour of the existence of CCCs, namely –

70.1 reversion to contract, at [91-96] **[Appx/p.30-32]**;

70.2 winding up as a collective enforcement process, at [97-98] **[Appx/p.32]**; and

70.3 payment of debts and liabilities as a two stage process involving not only the payment of provable debts at stage 1 but also the payment of non-provable claims at stage 2, at [99-100] **[Appx/p.32-34]**, on which last strand Lewison LJ gave ten specific reasons in support of his conclusions.

71. The starting point is IR 2.86 **[Auths/1/3]**, which reads (insofar as relevant):

> "For the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company entered administration or, if the administration was immediately preceded by a winding up, on the date that the company went into liquidation."

72. Briggs LJ (with whom Moore-Bick LJ agreed) agreed with the decision of David Richards J that IR 2.86 had a limited effect, ie notionally to convert a foreign currency debt for the purposes of valuing claims for the proof process, without any substantive effect on the foreign currency creditor's underlying right to be paid the sum due in that foreign currency.[39] Briggs LJ said at [148]-[152] **[Appx/p.43-44]** that this limited effect was made clear by the words, "For the purpose of

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39 Briggs LJ at [166]; Moore-Bick LJ at [257]-[259] **[Appx/p.47; 69-70]**.

proving …" at the beginning of IR 2.86. The majority then held that creditors could advance CCCs as non-provable claims.

73. It is submitted that this is wrong and that, as Lewison LJ held **[Appx/p.33-34]**, IR 2.86 **[Auths/1/3]** causes the mandatory conversion of the foreign currency debt into sterling[40] and renders the sterling equivalent of the debt provable in the administration of the debtor, such that payment of the proved – sterling – sum, together with statutory interest, satisfies the creditor's claim.

74. The result of the CA's decision is particularly arresting because the creditor may have benefited from other aspects of the statutory insolvency regime, such as: (i) the statutory 5% discount rate on future debts (which may be more advantageous than the real market discount rate calculated by reference to the contractual interest rate); and (ii) the statutory interest from which foreign currency creditors have benefited during the administration, which is paid (a) on the basis that the creditors' proved claims are sterling debts and (b) at a sterling rate. Further, statutory interest at that sterling-based rate of 8% p.a. (accrued since LBIE went into administration and until payment of the proved debt in full) has been extremely favourable to creditors holding LBIE debt (many of whom purchased that debt, which has been actively traded since the administration began, at a substantial discount).

75. Although David Richards J's decision (at [99] **[Appx/p.107]**) left open the possibility that a foreign currency creditor seeking to assert a CCC would have to give credit for benefits received under the statutory scheme (such as statutory interest), in his decision on the subsequent application[41] made by LBIE's Administrators [2015] EWHC 2269 (Ch), [2016] Bus LR 17 ("*Waterfall IIA*")

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40 Rule 14.21(1) **[Auths/8/15]** of the proposed new Insolvency Rules 2016 provides: "For the purpose of proving for any debts incurred or payable in a foreign currency, the amount of those debts must be converted into sterling at a single rate for that currency determined by the office-holder with reference to the exchange rates prevailing on the relevant date." P1 of the Explanatory Notes to the Rules says: "References to "shall" in the current Rules have been replaced by "must" in the new rules in accordance with modern drafting practice which uses "must" to indicate an obligation." (emphasis added)

41 The *Waterfall II* application demonstrates some of the complicated questions to which the decision that CCCs exist gives rise. The *Waterfall II* application notice **[Core/E/4]** and a list of the supplemental issues **[Core/E/10]** raised on that application will be in the papers for the appeal hearing. The CA is due to hear the appeal from David Richards J's decision in *Waterfall IIA* in April 2017.

[Auths/1/14] David Richards J held at [226]-[231] **[Auths/1/14/p.68-69]** that credit would not have to be given for statutory interest in calculating CCCs. The CA's decision (see per Briggs LJ at [137] **[Appx/p.41]**) appears to proceed on the basis that no such credit would have to be given. This is a particularly surprising result when compared with what would have happened outside insolvency, where, if a creditor obtained judgment in a foreign currency, the Court would apply a rate of interest appropriate to that foreign currency,[42] rather than the 8% per annum rate applicable under the Judgments Act to sterling judgments.

76. If CCCs were to exist, they would work only to the advantage of the creditor. They would provide the foreign currency creditor with a one-way bet or upside-only option. This would operate against the members (and, where the members are insolvent, the members' creditors), as it would diminish their right to a surplus in the company. In addition, as Lewison LJ explained at [100] **[Appx/p.33-34]**: "The problem becomes all the more acute if one postulates a creditor who has claims in more than one currency (say dollars, euros and roubles) which have moved in different directions against sterling. It is not suggested that such a creditor should give credit for his currency gains against his currency losses." Briggs LJ's observations on this point, at [160] **[Appx/p.46]**, do not identify an answer to this problem.

77. Further, foreign currency creditors should not be able to assert competing non-provable CCCs which would reduce the assets available to meet any sterling non-provable claims, whether those of (to take the CA's example) a pedestrian injured by the negligent driving of an employee of a company trading while in administration, or (as discussed in *Nortel* **[Auths/1/17]**) any liabilities imposed by statute which are neither provable debts nor administration expenses. As the statutory scheme is silent on the existence (let alone the ranking) of non-provable claims to be paid by the relevant office-holder, there is no principled basis on which it could be said that CCCs should rank behind other non-provable claimants who might be considered more "deserving" (and whose claims exist because the statutory insolvency scheme has, apparently accidentally, failed to cover their

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42 To be decided by the Court in its discretion under s. 44A of the Administration of Justice Act 1970 **[Auths/2/1]** on the compensatory principle summarised in *Novoship (UK) Ltd v Nikitin* [2015] QB 499 at [125]-[141] **[Auths/5/19/p.537-542]** per Longmore LJ (as set out further below).

claims), or why those other non-provable claimants should bear exchange rate risk for the benefit of foreign currency creditors. That sterling creditors should not bear exchange rate risk for the benefit of foreign currency creditors is the premise of the decision of the Court of Appeal in *Re Lines Bros Ltd (in liquidation)* [1983] Ch 1 **[Auth/1/15]**, and Lewison LJ's analysis of the reasoning of the judgments in that decision (at [70]-[81]) **[Appx/p.24-28]** was entirely correct (contrary to the observations of Briggs LJ at [157]-[158]) **[Appx/p.45-46]**. Furthermore, it is not in accordance with the legislative and judicial policy to widen the class of creditors with non-provable claims.

(2) The history of the rules relating to currency conversion

78. Before considering the operation of the currency conversion rules, it is necessary to look at the background relating to their introduction into the statutory insolvency scheme and how the CA considered that background in their judgment when deciding that CCCs existed.

79. The inherent improbability that IR 2.86 **[Auths/1/3]** was intended to permit CCCs to exist based upon the continued existence of an underlying contractual claim in the foreign currency is demonstrated by the fact that the insolvency regime under the 1986 Act and Rules was not only intended to be comprehensive but was also formulated with foreign currency creditors squarely in mind (and yet makes no provision for CCCs).

80. The Cork Committee considered the position of foreign currency claimants. In para 1309, the Cork Report **[Auths/8/3/p.298-299]** stated (emphasis added):

> "We strongly recommend that any future Insolvency Act should expressly provide that the conversion of debts in foreign currencies should be effected as at the date of commencement of the relevant insolvency proceedings. Furthermore, we take the same view as the Law Commission (Working Paper No. 80) that conversion as at that date should continue to apply, even if the debtor is subsequently found to be solvent. To apply a later conversion date only in the case where the exchange rate has moved to the advantage of the creditor but

(necessarily) not where it had moved against him, would, in our view, be discriminatory and unacceptable."[43]

81. The reference to the Law Commission Working Paper No. 80 **[Auths/8/9/p.89-94]** is instructive: in paragraphs 3.39 to 3.47, the Law Commission had specifically considered a number of issues arising from the need to convert foreign currency claims in an insolvency. The Law Commission had considered precisely the problem that arises in this case and concluded **[Auths/8/9/p.93-94]**:

> "3.46 It may turn out in a small minority of cases that, conversion of foreign currency debts having been duly made as at the date of the winding-up order, the company is found to be solvent. This raises a third question – namely, whether in such cases foreign currency creditors should be compensated from the assets of the company or the bankrupt for adverse exchange rate fluctuations between the date of the relevant order and the date of actual payment …
>
> "3.47 To summarise: we support the view of Oliver J in the *Dynamics Corporation* case that the date of the winding-up order is the appropriate, once-for-all, date for the conversion of every foreign currency debt on the winding up of both solvent and insolvent companies: and we believe that similar rules should apply to bankruptcy, whether or not it transpires that the debtor is solvent …"

82. Lewison LJ quoted at [68] **[Appx/p.24]** the following passage from Oliver J's judgment in the case to which the Law Commission had made reference, *Re Dynamics Corporation of America (in liquidation)* [1976] 1 WLR 757 at 768D-F **[Auths/1/9/p.768]**:[44]

> "There is, as I see it, no doubt about what the obligation of the company is at the date of the winding up order: it is not an obligation to pay to the dollar creditor whatever may be the sterling equivalent of his debt at some time, possibly a year or more hence, when the liquidator has time to consider and adjudicate the proof of debt. It is an obligation to pay

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43 The reference to the Law Commission Working Paper (No.80) is to paragraphs 3.39-3.47 **[Auths/8/9/p.89-94]**.

44 Judgment of Oliver J in the *Dynamics* **[Auths/1/9]** case is dated 18 December 1975.

> whatever is the sterling equivalent at that date; and to adjust it subsequently to reflect an altered rate of exchange, whether up or down at the time when the proof falls to be adjudicated is not simply the ascertainment of what was the debt at the date of the winding up order but the substitution for the ascertained (or at least readily ascertainable) value at that date of a new and quite different value ascertained at a different date."

As Lewison LJ stated (at [69]) **[Appx/p.24]**, this seems "a very clear statement that the company's obligation to pay in foreign currency is substantively replaced by an obligation to pay the sterling equivalent at the date of the winding up. In other words, the conversion into sterling is not merely procedural: it affects substantive rights."

83. In the Law Commission's *Final Report on Private International Law Foreign Money Liabilities* (Law Com No.124) **[Auths/8/10/p.13]**, the Law Commission referred at para 2.23 to Brightman LJ's obiter comments in *Re Lines Bros* **[Auths/1/16]** that where the debtor was solvent, the foreign currency creditor "might well" be entitled to be paid his full contractual debt before the shareholders received anything, referred at para 3.34 **[Auths/8/10/p.37]** to the view expressed by the Cork Committee and stated at para 3.36 **[Auths/8/10/p.38]** that they remained "of the view which we expressed in the working paper".

84. As Lewison LJ concluded at [85] **[Appx/p.29]**, it is clear that the Law Commission's view, with which the Cork Committee agreed, was that conversion should remain fixed even if the debtor turned out to be solvent. And Briggs LJ accepted at [156] **[Appx/p.45]** that, "I would agree with Lewison LJ that if this question of construction turned purely on the written recommendations and commentary of the Cork Committee and the Law Commission then there would be grounds, on balance, for favouring LBHI2, LBHI and LBL's construction of the conversion rules".

85. The decision of the majority of the CA is to permit precisely the "compensation from the assets of the company" that the Law Commission rejected. Had it been

intended by the Cork Committee[45] or by Parliament that creditors should be able to obtain such compensation – exactly what the Law Commission had rejected – then that would have been expressly commented on and expressly provided for as part of the statutory scheme that was being put in place. The existence of CCCs would entail the rejection of the advice of the Cork Committee and the conclusion of the Law Commission, and it would also contradict the Government's stated aim of simplifying insolvency procedures (see para 4 of the Government's White Paper on Insolvency Law published in February 1984) **[Auths/8/21/p.5-6]**.

86. One example of a place in the legislative scheme which indicates that CCCs were never intended to exist is provided by the rules for a members' (solvent) voluntary winding up. The requirement that foreign currency debts be converted into sterling applies in a members' (solvent) voluntary winding up just as it does in a creditors' (insolvent) voluntary winding up because IR 4.91 **[Auths/3/50]** (proof of foreign currency claims) applies in a members' voluntary winding up[46]. If the Cork Committee or Parliament had intended that CCCs should be available if all proved debts were paid in full, then provision would have been made for such claims in a members' voluntary liquidation, given that that process requires solvency.[47]

87. This is the first relevant aspect of the legislative history: the very question of how to treat currency changes after the date of proving was considered and the legislation made no provision for CCCs.

88. There are, secondly, more general aspects of the legislative history which are relevant to this question. The change in the rules governing currency conversion

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45 The weight to be given to the Cork Report in interpreting the 1986 legislation has repeatedly been recognised, for example, by Lord Neuberger in the passage quoted above from *Nortel* at [92] **[Auths/1/17/p.241-242]**.

46 By operation of IR 4.1(1) and IR 4.1(2) **[Auths/3/44]** (unless specific provision is made to the contrary, Chapter 9 of part 4 of the IR, containing IR 4.91 **[Auths/3/50]**, applies in a creditors' (insolvent) voluntary liquidation as in compulsory liquidation, and applies in the same way to a members' voluntary winding up as in a creditors' voluntary winding up).

47 It is also noted that the new draft Insolvency Rules 2016 (at r.14.21) **[Auths/8/15]** provide that "(1) For the purpose of proving for any debts incurred or payable in a foreign currency, the amount of those debts must be converted into sterling at a single rate for that currency determined by the office-holder with reference to the exchange rates prevailing on the relevant date" and gives a creditor, who considers that the rate determined by the office-holder by reference to the exchange rates prevailing on the relevant date is unreasonable (for the relevant date), the ability to apply to the Court in that regard (r.14.21(2)) **[Auths/8/15]**. The fact that such an application is now expressly provided for suggests that CCCs do not exist.

was, of course, only one of the changes effected by the 1986 Act and Rules. Another change was the new statutory scheme providing for post-insolvency interest, intended to bring the position of company liquidations into line with bankruptcy. Bankruptcy law already had statutory provision for post-insolvency interest in s. 33(8) of the Bankruptcy Act 1914 **[Auths/2/4/p.2]**. That provided that, if there was a surplus, interest should be paid at a flat rate of 4% to all creditors in respect of the post-bankruptcy period, matching the then judgment rate of 4% (which applied from 1838 to 1971, when the rate was first changed, at that point to 7.5%) and there was no reversion to contractual rights.

89. The decision of the majority of the CA in this case relies heavily on the comments by Brightman LJ in *Re Lines Bros Ltd (in liquidation)* [1983] Ch 1 **[Auths/1/15]** (a decision which pre-dated the 1986 legislation[48]) adopting the "remission to contract" analysis, which was developed in *Re Humber Ironworks & Shipbuilding Co* (1869) LR 4 Ch App 643 **[Auths/1/11]** in relation to contractual interest, namely that, in the event of a surplus after payment of proved debts, creditors are remitted to their rights as they existed apart from the insolvency. But the interest provisions introduced by the 1986 Act and Rules (like the rules which had previously applied only in bankruptcy) were not consistent with a "remission to contract" approach.

90. The statutory scheme introduced for companies by the 1986 legislation produces a different and inconsistent result to that which would be produced by applying the reasoning in *Humber Ironworks* (which did not in any event consider the position of foreign currency creditors).

91. For example, assume two creditors, each of whom is owed a debt of £100 at the date of winding up. One of the creditors has a contractual entitlement to interest at 5% per annum and the other creditor has no contractual entitlement to interest. The company has assets of £205 after the winding up has been going on for 1 year. On the approach set out in *Humber Ironworks*, the creditor entitled to contractual interest would receive £105 while the other received £100. On the application of the statutory scheme introduced in 1986, each creditor would receive £102.50. In other words, under the current statutory scheme (which has replaced the approach

48 The date of the CA's judgment (Lawton, Brightman and Oliver LJJ) is 11 February 1982.

in *Humber Ironworks*) **[Auths/1/11]**, creditors are not remitted to their contractual rights as to interest in the event of a surplus.

92. Further, any argument based on remitting creditors to their contractual rights would have to compare the position that each creditor found itself in to the position that creditor would have been in but for the insolvency process. Thus, a creditor asserting a CCC would have to give credit for the benefits received from the statutory insolvency scheme, which in the circumstances of this particular case have been substantial because of the minimum 8% rate of interest payable to unsecured creditors. But the CCCs for which CVI and LBIE contend do not involve such credit being given and are, therefore, on analysis not an example of creditors being remitted to their contractual rights.

93. It is striking that, though the legislation introduced in 1986 put statutory (post-insolvency) interest in place for the first time, there was no commentary in the Cork Report on the *Humber Ironworks* "remission to contract" approach. Had the Cork Committee considered there was any prospect of non-provable claims being generated outside the new statutory scheme for payment of post-liquidation interest, that is something that would undoubtedly have been discussed in their Report.

94. In fact, the changes made by the 1986 statutory scheme are inconsistent in fundamental respects with "remission to contract". Previously, pursuant to ss. 316 and 317 Companies Act 1948 **[Auths/2/10; 11]**, the bankruptcy rules restricting the claims which could be proved applied only when a company was insolvent so that if the company was solvent, or became solvent during the course of the winding up, "all debts payable on a contingency, and all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company."[49] The 1986 Act and Rules removed that distinction between the claims which could be proved when a company was insolvent and those which could be proved when it was or became solvent. Making that change while making no provision for (or even reference to) any "remission to contract" in the event of the company being or becoming solvent cannot be reconciled with the contention that the Cork Committee or the

[49] As explained by David Richards J in *Re T&N* at [87] **[Auths/1/21/p.1760-1761]**.

legislature intended the *Humber Ironworks* **[Auths/1/11]** "remission to contract" approach to survive.

95. Thus, as Lewison LJ accepted at [92] **[Appx/p.30]** and Briggs LJ apparently accepted at [139] **[Appx/p.42]**, the *Humber Ironworks* analysis is no longer of any relevance to post-insolvency interest. David Richards J accepted this point in *Waterfall IIA* **[Auths/1/14/p.54-55]** where he stated that IR 2.88 "represents a complete code for the payment of post-administration interest. The new approach introduced by the 1986 legislation for post-liquidation interest was intended to replace the previous law, as stated in [Humber Ironworks]".[50]

96. It follows that there is no principled basis for the contention that the approach in *Humber Ironworks*, of remission to contractual rights, should be applied to permit creditors to assert further claims in respect of, but going beyond, their provable debts. Lewison LJ was right to conclude at [95] **[Appx/p.31]** that the "reversion to contract" theory simply does not apply to provable debts.

97. Thus, as a matter of legislative history, the provision for currency conversion in IR 2.86 **[Auths/1/3]** cannot be read as creating a bifurcated regime; the rule creates a complete code for the payment of foreign currency creditors as part of the proof process and there is no provision for foreign currency creditors to be paid further sums as non-provable debts out of any surplus remaining after the satisfaction of their proved debt (ie the converted sum) and any interest thereon.

98. What is particularly unlikely is that the statutory scheme - which was intended to be exhaustive - should (a) itself permit non-provable claims arising as a direct result of the operation of the statutory scheme for proof of debts (particularly where the provable debt has been paid in full), where (b) the statutory scheme provides no regime for recognising and quantifying the liabilities or indicates who should be responsible for doing so. As Lewison LJ said at [100] **[Appx/p.33-34]**:

> "I agree with Mr Snowden that it is impossible to suppose that when rule 2.86(1) and rule 4.91(1) were introduced Parliament intended to split a unitary obligation to pay a sum in a foreign currency into two claims, one

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50 At [164] of the *Waterfall IIA* judgment (*Re Lehman Brothers (International) Europe (in administration)* [2015] EWHC 2269 (Ch) **[Auths/1/14/p.54-55]**

of which was provable and the other of which was not. That conclusion would run counter to the whole history of the gradual expansion of the range of claims that fall within the insolvency code. It would also involve the proposition that Parliament had positively created a non-provable claim when, again, the history of the legislation shows that Parliament has done its best to eliminate non-provable claims."

99. The CCCs recognised by David Richards J and by a majority of the CA in this case are in this way very different from the non-provable claims which have been recognised by the courts since the introduction of the 1986 Act and Rules. So, for example, in *Re T&N Ltd* **[Auths/1/21]**, the Court recognised as non-provable claims tort claims which had genuinely not been foreseen by the legislature. Following that decision, Parliament swiftly enacted legislation to make the (unforeseen) non-provable claim provable (see the Insolvency (Amendment) Rules 2006, SI2006/1272 **[Auths/3/31]**, which amended IR 13.12), so continuing the process of bringing as many claims into the proof process as possible.

100. By contrast, the question whether foreign currency creditors should receive additional payments to make up or compensate them for any shortfall resulting from foreign currency fluctuations after the commencement of insolvency proceedings cannot be regarded as having been overlooked or "fallen through the cracks" in the same manner as the incomplete tortious claims considered in *Re T&N Ltd*. Rather, IR 2.86 **[Auths/1/3]** represents Parliament's considered view that foreign currency liabilities should be converted into sterling liabilities as at the date of entry into insolvency proceedings, and Parliament made no provision for any additional payments to foreign currency creditors from the assets of the company. Had the legislative intention been that the question posed by the Law Commission concerning the payment of compensation to foreign currency creditors should be answered in the affirmative, it would have been expressly dealt with – not least because the legislative changes in 1986 also specifically addressed the use of surplus assets to pay statutory interest by the introduction of IR 2.88(7) **[Auths/1/5]**. All the more so as the Rules themselves expressly provide that IR 4.91 **[Auths/3/50]** (providing for currency conversion in the case of winding up, in the same terms as IR 2.86 for administration) applies whether the liquidation is solvent or insolvent: Chapter 9 of Part 4 of the Rules, including IR 4.91, applies in

a members' solvent voluntary winding up as well as in a creditors' voluntary winding up.

(3) The position in personal insolvency

101. It is instructive also to consider the regime applicable to personal insolvency. CCCs cannot and do not exist for payment in a bankruptcy context and the legislature cannot sensibly have intended there to be differences between the corporate and personal insolvency regimes. IR 6.111 **[Auths/3/69]** (providing for the mandatory conversion into sterling of foreign currency claims in bankruptcy) is in the same terms as IR 2.86 **[Auths/1/3]**.[51]

102. There is no concept in bankruptcy of a second round of non-provable claims against the insolvent estate after payment in full of all provable debts and statutory interest. That is because those debts which are excluded from proof in bankruptcy (by IR 12.3 **[Auths/3/72]**) are excluded from the release upon discharge from bankruptcy under s. 281 **[Auths/2/40]**. In other words, the general scheme is that, to the extent that there are non-provable claims, they are not recovered from the insolvency estate at some second stage of claims after proved debts and interest have been paid in full, but are recoverable from the bankrupt himself, post-discharge.

103. The trustee has the power to pay dividends only in respect of bankruptcy debts for which creditors have proved: s. 324(1) **[Auths/2/43]**. Once the bankruptcy debts have been proved and those proved debts paid in full, together with interest under s. 328(4) **[Auths/2/44]**, the surplus (if there is one) is returned to the bankrupt by s. 330(5) **[Auths/2/45]**. There is no provision for payment of a CCC arising from the original provable debt from the assets in the insolvency estate before they are returned to the bankrupt[52].

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51 IR 6.111(1) **[Auths/3/69]** has at all times since 29 December 1986 read "(1) For the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date of the bankruptcy order." The definition of "the official exchange rate" (in IR 6.111(2)) has changed since. The same is true of the wording of IR 2.86(1) **[Auths/1/3]** since its introduction on 15 September 2003. As in bankruptcy, the definition of "the official exchange rate" (in IR 2.86(2) **[Auths/1/3]**) has changed since.

52 This analysis is in line with David Richards J's analysis in *Waterfall IIA* at [53 to 56], [91] and [139 to 140] **[Auths/1/14/p.30-31; 37-38; 48-49]** where the Judge rejected the

104. On discharge, the bankrupt is released from the proved foreign currency debt (mandatorily converted into sterling by IR 6.111) **[Auths/3/69]**: by s. 281(1) **[Auths/2/40]**, the bankrupt is released from all the bankruptcy debts, which are defined by s. 382 **[Auths/2/46]** as "(a) any debt or liability to which [the bankrupt] is subject at the commencement of the bankruptcy; (b) any debt or liability to which he may become subject after the commencement of the bankruptcy (including after his discharge from bankruptcy) by reason of any obligation incurred before the commencement of the bankruptcy." This is consistent with the policy that releasing the debtor from bankruptcy constitutes a 'fresh start' for the former bankrupt, such that the class of claim that is excluded from the release is narrowly prescribed (fraud, fines or similar claims arising out of criminal proceedings and certain matrimonial debts: s. 281).

105. There is, accordingly, no scope for CCCs to exist in bankruptcy. The provisions requiring the conversion of foreign currency claims into sterling are identical in personal and company insolvency (as set out above) and there is no basis for reading the existence of CCCs into the provisions for currency conversion in company insolvency.

(4) The substantive effect of provisions of the statutory insolvency scheme

106. The natural reading of IR 2.86 **[Auths/1/3]** is that foreign currency debts are converted into sterling and then dealt with as a provable debt of that amount for the purposes of the administration, such that payment in full of the proved debt discharges the debt to the creditor in full.

107. Provisions of the statutory insolvency scheme are capable of creating and/or extinguishing substantive rights. This is demonstrated by, eg, the provisions for statutory interest introduced by the 1986 Act and Rules (which provide for interest to be paid whether or not the relevant creditor was contractually entitled to interest). As explained above, there is no room for the idea of "remission to rights" in relation to interest.

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submission that there is space in the bankruptcy waterfall to make additional payments relating to interest to creditors on top of statutory interest.

108. Another example is insolvency set-off. As Lord Hoffmann explained in the House of Lords in *Stein v Blake (No.1)* [1996] AC 243, (at pp.251 D-E and 255 B) **[Auths/1/20]**:

> "Bankruptcy set-off … affects the substantive rights of the parties … In my judgment the conclusion must be that the original chose in action ceases to exist and is replaced by a claim to a net balance. If the set-off is mandatory and self-executing and results, as of the bankruptcy date, in only a net balance being owing, I find it impossible to understand how the cross-claims can, as choses in action, each continue to exist."

Stein v Blake applies to corporate insolvency as well as to bankruptcy: see *Re BCCI (No.8)* [1998] AC 214 at 222-223 **[Auths/4/8/p.222-223]** per Lord Hoffmann.

109. Briggs LJ expressly recognised the permanent effect of currency conversion for the purpose of insolvency set-off at [152] **[Appx/p.44]**.

110. IR 2.86 **[Auths/1/3]**, like the Rule governing set-off (IR 2.85) **[Auths/3/41]**, the rules on interest (see IR 2.88 **[Auths/1/5]**), the Rule providing for the discounting of future debts for the calculation of dividends (IR 2.105 **[Auth/3/43]**)[53] and the rules on disclaimer (ss. 178 – 182 **[Auths/2/34-38]**) has a substantive (and not just procedural) effect. It provides for the treatment of foreign currency claims in an administration by effecting a mandatory conversion of those claims. The creditor has no choice in the matter, and once the conversion has occurred it has effect for the purposes of the administration of the estate and with substantive effect on the underlying liability.

111. This appears to be so even on the reasoning of the majority, who recognised that, "if the foreign currency has depreciated against sterling the creditor is not expected to refund the balance and that as a consequence in such a case (no doubt relatively unusual) he will recover more than the true value of his debt" (per Moore-Bick LJ at [258] **[Appx/p.70]**; see also per Briggs LJ at [159] **[Appx/p.46]**: the rules "give a non-contractual benefit to such a creditor …"). In other words, on that reasoning, even if currency movements mean that the sterling payment a foreign currency creditor receives is greater than his contractual entitlement, he is entitled

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53 As stated by David Richards J at [77] **[Appx/p.100]** and Lewison LJ at [94] **[Appx/p.31]**.

to that payment. But if IR 2.86 **[Auths/1/3]** thus increases the amount which a foreign currency creditor is entitled to be paid out of the insolvency estate (to the extent that sterling appreciates against that currency), it must also be capable of having the effect of decreasing the amount to which a foreign currency creditor is entitled to be paid out of the insolvency estate (to the extent that sterling depreciates against that currency). To hold otherwise would mean that IR 2.86 would create new substantive entitlements for foreign currency creditors of an insolvent company (to sterling payments) when sterling appreciates, but raise only procedural bars (to foreign currency payments) when sterling depreciates. There is nothing in the wording of the Rule or, indeed, as a matter of principle, to suggest such markedly divergent effects depending on market movements.

112. The operation of the provisions for statutory interest and set-off demonstrate that the statutory scheme has substantive effects (as set out above in relation to certain other insolvency rules) which leave some creditors better off as a result of the insolvency process, and some creditors worse off. They are subject to a common misfortune, namely, the insolvency of their debtor, and the statutory scheme produces a collectively fair outcome, even if for some creditors the position is improved and for others it is worsened. There is therefore nothing intrinsically surprising about the currency conversion provisions of the statutory scheme leaving some foreign currency creditors worse off than if the principal of the debt due to them had not been converted into sterling.

113. It is no answer to say (as Briggs LJ did at [137] **[Appx/p.41]**) that the creditor bargained to receive payment in a foreign currency and, accordingly, should not bear the foreign currency risk where the date of conversion and the date of payment are different. The creditor contracted with an English company which is subject to English insolvency law (if insolvency occurs), one of the provisions of which is that the proof process (which is the necessary first step to receiving payment out of an insolvent estate) requires conversion into sterling at the date of liquidation/the date of administration, even though payment may take place sometime afterwards.

114. The creditor may well (as in this case) benefit substantially from the English statutory scheme, for example by reason of currency movements in its favour after the date of proof or by receiving post-insolvency statutory interest at a rate much

higher than it would have received if it had obtained judgment in the relevant foreign currency in the usual way against a solvent company or through the 5% statutory discount rate for future debts. Taking the position of the US$ creditors who form the vast bulk of LBIE's creditors, if they had obtained judgment in US$ against LBIE before it entered administration, a rate of interest appropriate to that foreign currency would have been applied (to be decided by the Court in its discretion under s. 44A of the Administration of Justice Act 1970 **[Auths/2/1]** on the compensatory principle summarised in *Novoship (UK) Ltd v Nikitin* [2015] QB 499 at [125]-[141] **[Auths/5/19/p.537-542]** per Longmore LJ in a judgment to which all members of the Court had contributed). In *Novoship* the rate awarded was 2.5% over 3 month US$ LIBOR while in *Standard Chartered Bank v Ceylon Petroleum Corpn* [2011] EWHC 2094 (Comm) **[Auths/6/14]**, Hamblen J gave judgment in US$ and awarded interest at the US prime rate (then 3.25%).

115. It is clear from the estimated figures provided by the LBIE Administrators that the US$ creditors will have done better as a result of conversion to sterling with the sterling 8% interest rate than if their claims had remained denominated in US$. The LBIE Administrators estimate that there are £1.6 billion of CCCs (p.14 of their 15th Progress Report). Even if all of those CCCs related to dollar claims (rather than CCCs resulting from movement in other currencies):

    115.1 The LBIE Administrators' base case for statutory interest payable at 8% is £5 billion (p.14 of the 15th Progress Report **[Core/E/14]**).

    115.2 The values of the US prime rate (used in *Standard Chartered*) and 2.5% over 3 month US$ LIBOR (used in *Novoship*) have both averaged less than 4% over the relevant period of LBIE's administration.

    115.3 Approximately 80% of admitted claims against LBIE are dollar denominated, with most of the rest being Euro denominated (see p.25 of the LBIE Surplus Entitlement Proposal dated 10 March 2014 **[Core/E/3]**).

    115.4 It follows that the US$ creditors will receive approximately 80% of the £5 billion of statutory interest at 8%, ie £4 billion.

115.5 But if their claims had remained denominated in US$ with interest at a US$ rate averaging less than 4%, they would have received less than £2 billion (because 80% x £2.5 billion of interest payable at 4% = £2 billion).

Accordingly, the interest benefits (totaling over £2 billion) significantly exceed the CCCs estimated at £1.6 billion by the LBIE Administrators.

116. The operation of the rules on post-insolvency statutory interest in relation to foreign currency claims further demonstrate the substantive effect of currency conversion.

116.1 The purpose of post-insolvency statutory interest (which is by IR 2.88(9) **[Auths/1/5]** payable either at the judgment rate or, if greater, the contractual rate if the creditor had a contractual right to interest) is to compensate creditors for being prevented by the statutory moratorium from obtaining judgment against the company for failure to pay, which would then carry the judgment rate of interest.[54]

116.2 As David Richards J recognised in his judgment in *Waterfall IIA* at [162] **[Auths/1/14/p.53-54]**, if a foreign currency creditor were (outside an insolvency process) seeking judgment against a debtor, the creditor would either obtain judgment in sterling such that the judgment interest rate (set at 8% p.a. in respect of judgments entered after 1 April 1993 by s. 17 of the Judgments Act 1838 **[Auths/3/73]**) would then apply to that judgment debt until satisfaction or (as set out above) obtain judgment in the foreign currency such that a rate of interest appropriate to that foreign currency would apply.

116.3 Those two different routes to post-judgment interest might create inconsistent results between creditors with claims denominated in different currencies in the insolvency scheme. But as IR 2.86 **[Auths/1/3]** makes it mandatory for conversion of the foreign currency claim to take place on the relevant date in order for the claim to be proved, the IR 2.88(9) **[Auths/1/5]** statutory interest rate, which is a rate applicable to proved debts (ie sterling sums), applies across all

54 As recognised by David Richards J at first instance, [163] **[Appx/p.123-124]**.

proved debts equally (regardless of which currency the claims were denominated in prior to the entry into an insolvency process).

116.4 If the conversion under IR 2.86 **[Auths/1/3]** did not have a substantive effect, there would be an unprincipled anomaly in the treatment of foreign currency creditors in the event of a surplus: they would be paid interest at a (beneficial 8%) rate referable to sterling debts but they would receive payment of the principal of their claim effectively on the basis it remained in foreign currency (on the decision of the CA and David Richards J in this case). That cannot have been an intended consequence of the statutory scheme.

117. Given that the statutory scheme provides a complete and stand-alone provision for interest payable by a company in liquidation or administration, it is to be expected that the statutory scheme should provide a similarly complete and substantive rule for foreign currency claims. Currency is, like interest, one of the fundamental terms of any contractual or other payment obligation, and it would be strange if currency were not the subject of substantive provision in the statutory scheme, given that interest is so provided for by the statutory scheme.

118. Briggs and Moore-Bick LJJ relied on the Privy Council decision in *Wight v Eckhardt Marine GmbH* [2003] UKPC 37, [2004] 1 AC 147 **[Auths/1/23]** in support of their decision that the effect of IR 2.86 **[Auths/1/3]** was procedural rather than substantive. They saw this decision as showing that the underlying contractual rights continued to exist notwithstanding the administration and could found the basis for a CCC in respect of any shortfall between the creditor's contractual entitlement and the sterling receipts from the distributions in the insolvency (see per Briggs LJ at [139] **[Appx/p.42]** – "the insolvency code did not affect the underlying debt" – and per Moore-Bick LJ at [249]) **[Appx/p.67]**.

119. However, the general statements made in *Wight v Eckhardt* do not support an argument that claims denominated in a foreign currency must continue to exist unaffected by the insolvency scheme for all purposes. It could not do so, for example, if such claims were the subject of mandatory insolvency set-off against debts owed to the company in sterling or some other currency: see *Stein v Blake* **[Auths/1/20]** (above).

120. The crucial passages on which Briggs LJ and Moore-Bick LJ relied are paragraphs 26 and 27 of Lord Hoffmann's opinion **[Auths/1/23/p.155]**, quoted by Moore-Bick LJ at [249] **[Appx/p.67]** as follows:

> "26. … It is first necessary to remember that a winding up order is not the equivalent of a judgment against the company which converts the creditor's claim into something juridically different, like a judgment debt. Winding up is, as Brightman LJ said in *Re Lines Bros Ltd (in liquidation)* [1983] Ch 1, 20, 'a process of collective enforcement of debts' …
>
> "27. The winding up leaves the debts of the creditors untouched. It only affects the way in which they can be enforced. When the order is made, ordinary proceedings against the company are stayed (although the stay can be enforced only against creditors subject to the personal jurisdiction of the court). The creditors are confined to a collective enforcement procedure that results in pari passu distribution of the company's assets. The winding up does not either create new substantive rights in the creditors or destroy the old ones. Their debts, if they are owing, remain debts throughout. They are discharged by the winding up only to the extent that they are paid out of dividends. But when the process of distribution is complete, there are no further assets against which they can be enforced."

121. These statements must be read in the context of the question which the Privy Council had to decide in *Wight v Eckhardt* **[Auths/1/23]**. The key question requiring determination was whether a particular company which was a creditor in respect of a claim governed by foreign law on the date the winding up order was made still had a right to participate in the dividend process if, after the commencement of the liquidation, but prior to the distribution being made, its debt was discharged in accordance with its governing law, rather than by payment out of the insolvent estate. In order to avoid the consequences of discharge under the governing law, the creditor argued that the effect of the winding-up order was to replace the underlying claim with a claim under the statutory scheme. The decision was that the winding-up order did not have that effect and that underlying claim was discharged in accordance with its governing law. Moreover, there was nothing unfair in preventing someone from participating in a distribution if he had

by the time of payment ceased to be a creditor in accordance with the law governing his debt.

122. The nub of these passages is that the entry by a company into a formal insolvency process does not in itself and without more alter creditors' substantive rights against that debtor company – so, eg, the mere making of a winding-up order does not immediately replace a creditor's rights against the debtor which are governed by the law of Bangladesh with new rights governed by the law of the Cayman Islands. The decision had nothing to do with whether particular provisions within the statutory insolvency regime had procedural or substantive effect (and there is nothing in the decision to suggest that Lord Hoffmann considered he was saying anything inconsistent with his earlier decision in *Stein v Blake* **[Auths/1/20]** on the substantive effect of insolvency set-off).

123. Specifically, there is nothing in *Wight v Eckhardt* **[Auths/1/23]** inconsistent with the proposition that the conversion into sterling pursuant to IR 2.86 **[Auths/1/3]** of a claim denominated in a foreign currency is substantive to the extent of proof and payment (payment being what follows from proof), albeit that the debt must be regarded as continuing to be governed by its underlying foreign law for the purposes of ascertaining whether it has been discharged by any means other than payment (or set-off) in the insolvency. As LBIE and CVI accept, CCCs (if they exist at all) can only be available in circumstances where proved debts have been paid in full (ie at 100p in the £). Therefore it is enough for this appeal to succeed that conversion is substantive to the extent that payment of the proved debt has been made.

124. Conversion being substantive to the extent of proof and payment is consistent with Lord Hoffmann's statement in *Wight v Eckhardt* (at [27] **[Auths/1/23/p.156]**) that the debts "are discharged by the winding up only to the extent that they are paid out of dividends". Accordingly, the contention that proof (in a sterling sum) and payment of that proved debt is substantive is, on a proper analysis, supported by *Wight v Eckhardt* **[Auths/1/23]**, as well as being in accordance with a natural reading of the statutory provisions.

125. In addition, as Lewison LJ noted at [94] **[Appx/p.31]**, Lord Hoffmann in *Wight v Eckhardt* twice referred to *Dynamics* with approval (see [24] and [28])

[Auths/1/23/p.155; 156] and Lewison LJ was correct to conclude at [68]-[69] and [94] **[Appx/p.24; 31]** that Oliver J held in terms in *Dynamics* that the effect of currency conversion was to substitute one obligation for another.

126. In short the statutory scheme requires proof as a necessary first step to payment. As part of the proving process, debts are automatically converted into sterling. Payment of all proved debts is to be made in sterling. Given this it would be very surprising if payment in sterling of such proved debts did not satisfy the creditor's rights in full. The statutory provisions, properly read, do not support such a surprising outcome.

(5) "For the purpose of proving …" (IR 2.86)

127. Contrary to the decision of the majority of the CA, the language used by the statutory draftsman confirms the view that the conversion to sterling required by IR 2.86 **[Auths/1/3]** (or IR 4.91 for winding up **[Auths/3/50]**) is substantive and designed to put in place the recommendations of the Law Commission and the Cork Committee. There is nothing in the Rules or the Act which suggests there exists any residual claim by the foreign currency creditor for any loss suffered by reason of the conversion to sterling. The decision of the majority of the CA that the words "For the purpose of proving …" involve a limitation on the purpose and effect of the mandatory currency conversion required by IR 2.86 is to misunderstand and understate the role of proof in the statutory scheme and the legislative draftsman's use of the concept.

128. For the reasons set out at paragraphs 12 - 13 above, and contrary to the decision of the majority of the CA (see per Briggs LJ at [136], [147]-[151], [154], [156], [157], [163] and [166]) **[Appx/p.41; 43-45; 47]**, the introductory words of IR 2.86 ("For the purposes of proving a debt …") do not limit that rule to having only a procedural effect.

129. By contrast with a number of the other rules applying in relation to a particular step (eg for payment of a dividend in IR 2.105) **[Auths/3/43]** which have a more limited effect than proof, proving is not only necessary to enter the collective process, but it also defines the creditor's claim (and therefore his rights) in that process.

130. It is for this reason, and not the reason Briggs LJ suggested at [149] **[Appx/p.44]** that, whereas IR 2.105 **[Auths/3/43]** says "For the purpose of dividend (and no other purpose) …", IR 2.86 **[Auths/1/3]** does not contain the words "(and no other purpose)": given the fundamental role of proof, such words would make no sense. By contrast, discounting for the payment of dividends on future debts (ie dividends that are declared before the date on which the debt becomes due) pursuant to IR 2.105 is only for that limited purpose (and Briggs LJ was therefore wrong to consider IR 2.105 at [151] **[Appx/p.44]** as an example of a rule "facilitating the process of proof": it has nothing to do with proof but only with discounting for dividends on future debts).

131. Briggs LJ was also wrong to refer to IR 4.90 **[Auths/3/49]** as an example of a rule having a substantive effect and therefore not expressed as "limited" to the purpose of proof. On the contrary, the draftsman of the statutory scheme reflects the substantive effect of set-off (ie that, as Lord Hoffmann described in *Stein v Blake* at 255B **[Auths/1/20/p.255]**, "the original chose in action ceases to exist and is replaced by a claim to a net balance") by providing, in s. 323 **[Auths/2/42]** (in relation to bankruptcy) and in the equivalent provisions concerning companies (ie IR 4.90(8) and IR 2.85(8) **[Auths/3/49; 41]**) that "Only the balance (if any) of the account owed to the creditor <u>is provable</u> …" (emphasis added). Briggs LJ was wrong to say that "the regime for insolvency set-off in rule 4.90 provides by way of contrast a useful example of a rule which does have substantive permanent effect, and it is couched in terms which make no mention of any limited purpose …". The draftsman in fact used the language of provability in both IR 4.90 /IR 2.85 **[Auths/3/41]** (each providing for insolvency set-off) and IR 2.86 (dealing with foreign currency claims) - for set-off, the provability of the balance resulting from set-off and, for currency conversion, the provability of the sterling equivalent of the foreign currency claim - to show that both rules have substantive effect.

132. Similarly in the case of contingent debts, IR 2.81(2) **[Auths/3/40]** provides, "Where the value of a debt is estimated under this Rule, <u>the amount provable</u> in the administration in the case of that debt is that of <u>the estimate for the time being</u>" (emphasis added). Thus, although as CVI argued in the CA, a contingent creditor can come back for more if the contingency eventuated, as Lewison LJ explained at [95] **[Appx/p.31]**, he does so by reason of the hindsight principle

(explained in *Wight v Eckhardt* **[Auths/1/23]**) and, if necessary, by lodging an additional proof (as Patten LJ explained in *Danka Business Systems* **[Auths/1/8]**). The relevant rules (IR 2.79 and 4.84 **[Auths/3/39; 47]**) make express provision for this. As Lewison LJ said, "What the contingent creditor does not do is pursue a non-provable claim."

(6) Practical problems and anomalous results arising from the recognition of CCCs

133. The CA's decision to recognise CCCs also gives rise to a number of practical problems, such that any perceived "unfairness" suffered by foreign currency creditors by reason of mandatory currency conversion is unlikely to be satisfactorily and fairly resolved by that decision.

133.1 LBHI2 has already referred above to the question of competition arising between Currency Conversion Claimants and any other non-provable claimants who are likely to be thought more "deserving", for example those with non-provable claims arising out of circumstances unforeseen by the legislature such as those in *Re T&N* **[Auths/1/21]**.

133.2 The CA canvassed with CVI's leading counsel during the hearing (see the transcript of [Day 4/pp.146-149] **[Core/E/8]**) the difficulties of (a) identifying a date on which payment of CCCs would be made (different currency creditors having competing interests depending on relevant exchange rates on the particular date chosen) and (b) how a *pari passu* calculation can be carried out by reference to that date of payment before that date is reached (and therefore before the relevant exchange rates are known). This is to be contrasted with the detailed statutory machinery for addressing proved claims. No satisfactory answer was given at the time to those questions and nor was one identified by the CA in its judgment (the issue being addressed by Briggs LJ at [165] **[Appx/p.47]**, who concluded only that, "This is par excellence an area where the judges will have to cope …", and suggested that there should be a further process of *pari passu* distribution between non-provable claims, which may require the imposition by the administrator or liquidator, at the direction of the court,

of a further cut-off date including a date for currency conversion). This is no answer.

133.3 In *Re T&N Limited* [2006] 1 WLR 1728, David Richards J (speaking of asbestosis claims which were – at that time – not provable) said at [106]-[107] **[Auths/1/21/p.1765-1766]** that in the event of a surplus otherwise available to shareholders, the court would not restrain the asbestosis claimant from obtaining and then executing a judgment. In this case, although Lewison LJ said at [60] **[Appx/p.22]** that the injured pedestrian would apply for permission to issue a claim form, on which the Court would adjudicate, leading to a judgment debt, Briggs LJ said at [188] **[Appx/p.52]** that it would not be necessary for a non-provable claimant to obtain a judgment against the company. But if that is correct, it is even more difficult to see how the administrator or liquidator could ensure equality between the holders of non-provable claims, who may not assert their claims at the same time. Given the absence of a process of collective enforcement of non-provable claims, there is a real risk of an "unholy rush to judgment" (Briggs LJ at [188]) and a race between currency conversion claimants (and the holders of such other non-provable claims as may exist).

133.4 As David Richards J noted in *Re T&N Ltd* at [107] **[Auths/1/21/p.1765-1766]**, "in a case where there was a surplus but it was insufficient to pay all tort claims [such tort claims being at that time non-provable claims] in full, the court would face a major issue as to how best to deal with this situation in a fair and sensible manner". This "major issue" is not answered by the majority, and thus a critical lack of certainty arises as to how non-provable claims are to be dealt with by judges and insolvency practitioners.

133.5 There is no obvious date for the conversion of any foreign currency losses (and none was suggested by the majority), and no machinery for choosing an appropriate date. In order to achieve equality between different kinds of non-provable creditors (which may include creditors with multiple claims in different foreign currencies) it would be necessary to value their claims in a common currency on a single date, and thus a second conversion of foreign currency claims would be required in order to calculate the value of

CCCs. No such date is provided for in the Rules (as Lewison LJ pointed out at [96] **[Appx/p.32]**). Moreover, if there were a second conversion date, it could be said that that could give rise to further currency conversion losses, giving rise to the potential for CCCs *ad infinitum*.

133.6 These practical issues of fairness are substantial problems with the decision on CCCs given that the decision appears to be intended to be the answer to a situation which is otherwise perceived to be unfair.[55] If an answer to a problem of perceived unfairness is not clear and fair in its operation, then it is in fact no answer at all.

133.7 The absence of any rules governing any second conversion process, and particularly the absence of a date on which such a second conversion is to be carried out, means that the office-holder is likely to be exposed to claims in relation to his choice of conversion date, criticising him for failing to obtain the greatest possible benefit from exchange rate fluctuations for any one or more particular creditor.

133.8 These practical difficulties will also undoubtedly cause delay and increase the costs of distributing surplus assets. The principle of once-for-all conversion espoused by the Cork Committee and the Law Commission is the only way to ensure equality, certainty and finality.

134. It may also be the case that the existence of CCCs gives rise to anomalous results in the context of set-off. The position is not currently clear because it is unclear from the submissions filed in these proceedings or the *Waterfall II* application **[Core/E/4]**,[56] how CVI contends a CCC should be calculated where the creditor's claim is paid, in part or in full, by insolvency set-off, and the different parties to the Waterfall II application[57] are taking different positions. CVI's position appears to have changed over time as follows:

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55 See [110] of David Richards J's judgment **[Appx/p.110]**; see [137], [153], [166] *per* Briggs LJ in the CA **[Appx/p.41; 44; 47]**.

56 The interrelationship between set-off and CCCs is supplemental issue 2 to the *Waterfall II* application **[Core/E/10]**.

57 Namely, LBIE and other creditor groups.

134.1 CVI's Notice of Objection **[Appx/p.413]** on this appeal, served on 23 June 2015, states (at paragraph 5(3)(a) and (b)) that "(a) Set-off does have a substantive effect on the underlying debts, but only because (and to the extent that) it leads to payment in fact of the debt … (b) Set-off (and the conversion necessary for the purpose of set-off) only affects the underlying debt owed by the company to the extent necessary to enable set-off against any claim that the company has against the creditor …". Taken alone that would appear to suggest that CVI does not contend that payment by set-off can give rise to a CCC. But it is not clear that that is CVI's current position.

134.2 In its Court of Appeal skeleton in this application dated 24 October 2014 **[Core/E/5]**, CVI contended (at paragraph 15(3)) that a foreign currency creditor "is treated as having been paid to the extent of any sums that he receives, for this purpose converting any sterling dividends that he receives into the relevant foreign currency as at the date of payment".

134.3 In its skeleton for the first instance hearing in Waterfall IIA, dated 2 February 2015 **[Core/E/6]**, CVI contended that that method of calculating a CCC applied equally in the case of set-off as to payment by dividends, saying (at paragraph 442(4) and (5)) that "(4) Where the set-off is applied against a sum owed to a creditor in foreign currency, the creditor's foreign currency claim is converted to sterling at the exchange rate prevailing on the date when the company entered administration and is paid (to the extent of the applicable set-off) as at the date of the notice of proposed distribution … (5) Such a creditor's Currency Conversion Claim is calculated by reference to the foreign currency amount of the sums received by way of set-off at the exchange rate prevailing at the date of the notice of proposed distribution."

134.4 Applying this method to calculate a CCC where payment is made by way of set-off (in the same way as for payment by way of dividends) would give rise to a CCC even where the set-off was between mutual claims in the same foreign currency. That is because in administration, the set-off account is (pursuant to IR 2.85(3) **[Auths/3/41]**) taken as at the date of the IR 2.95 **[Auths/3/42]** notice of intention to distribute rather than as at

the date of administration (which is, pursuant to IR 2.86(1) **[Auths/1/3]**, the date as at which the claims on both sides of the set-off account are converted into sterling).

134.5 For example:

(a) Company owes Creditor A $100 and Creditor A owes the Company $100. As at the Company's 1 January administration date, £1 = $1.67, so both the $100 claims convert to £60.

(b) On the 1 May notice of intention to distribute date, the mutual claims between the Company and Creditor A are set-off, discharging both claims in full (per *Stein v Blake*) **[Auths/1/20]**. However, the exchange rate has moved so that, as at 1 May, £1 = $1.25. Accordingly, the £60 Creditor A receives by way of set-off is, at 1 May, worth only $75, leaving Creditor A with a shortfall (using this method of calculation) of $25 because he has received sterling worth only $75 in respect of his $100 claim against the Company.

134.6 CVI has since accepted (in its Supplemental Submissions in *Waterfall IIA* of 20 January 2016 **[Core/E/11]**) that this particular situation does not in fact give rise to a CCC (saying that such a result would be "surprising and … incorrect as it cannot sensibly reflect the intended legal effect of insolvency set-off pursuant to the Rules where there are equal and opposite claims existing in the same currency").

134.7 But it is not clear from those Supplemental Submissions (or otherwise) what CVI contends the position would be if the creditor's claim were in a foreign currency and the company's claim was in sterling (or in a different foreign currency). If the method originally espoused by CVI in its Waterfall I CA skeleton **[Core/E/5]** and its Waterfall II first instance skeleton **[Core/E/6]** is applied to calculating a CCC (regardless of the decision in *Stein v Blake* **[Auths/1/20]**) in such a situation - on the basis that payment by set-off should be treated the same as payment by dividend - then it would give rise to a CCC as follows:

(a) Company owes Creditor B $100 and Creditor B owes the Company £60. As at the Company's 1 January administration date, £1 = $1.67, so Creditor B's $100 claim converts to £60.

(b) On the 1 May notice of intention to distribute date, the mutual claims between the Company and Creditor B are set-off, discharging both claims in full (per *Stein v Blake*). However, the exchange rate has moved so that as at 1 May, £1 = $1.25. Accordingly the £60 Creditor B receives by way of set-off is, as at 1 May, worth only $75, leaving Creditor B with a shortfall (using this method of calculation) of $25, because he has received sterling worth only $75 in respect of his $100 claim against the Company.

134.8 If this is how CVI maintain that a CCC should be calculated in these circumstances, there is an anomaly because Creditor B has a CCC but Creditor A has none, even though the set-off by which each was paid is in substance the same in each example.

134.9 And if this is not how CVI contends that a CCC should be calculated in the context of set-off, then it is not clear why the CCCs for which CVI contend require a different calculation method to be applied where payment is made by set-off rather than by payment of dividends.

134.10 Any decision that CCCs exist as a matter of principle must address these questions. Answers to them are required not just for this case (leaving these questions unanswered will inevitably lead to further uncertainty in the other Waterfall proceedings, and thus possibly a further appeal in due course) but more generally. The method by which a CCC falls to be calculated, and the way in which such a claim relates to insolvency set-off, are key issues going to the nature of CCCs and therefore to the question of whether they exist.

134.11 The existence of an anomaly such as that set out above, relating to the calculation of CCCs in the context of set-off or the treatment of payment by set-off as different to payment by dividend for the purpose of calculating a CCC, demonstrates that the statutory scheme was not intended to, and in fact did not, leave room for the existence of such claims.

(7) Conclusion on the existence of CCCs

135. For all these reasons, there is no proper basis for the decision of the majority of the CA that CCCs exist.

(D) The scope of the s. 74 liability

136. The question is whether the obligation of the members to contribute to the assets of LBIE in a liquidation extends to cover statutory interest and any non-provable liabilities which may be held to exist, or whether it is limited to the debts provable in LBIE's liquidation.

137. S. 74 provides **[Auths/1/1]**:

> "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."

138. The Act uses the term "contributory" to describe the members on whom a liability is imposed by s. 74 (see s. 79 **[Auths/2/16]** for the definition of "contributory"). S. 148 **[Auths/2/24]** provides that the Court shall, after the making of a winding up order, settle a list of contributories, unless it appears that it will not be necessary to make calls on or adjust the rights of contributories. By s. 150 **[Auths/2/25]**, the Court may, either before or after it has ascertained the sufficiency of the company's assets, make calls on all or any of the contributories to the extent of their liability "for payment of any money which the court considers necessary to satisfy the company's debts and liabilities, and the expenses of winding up, and for the adjustment of the rights of the contributories among themselves, and make an order for payment of any calls so made." S. 154 **[Auths/2/26]** provides that the Court shall adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled to it. By s. 160 **[Auths/2/27]**, provision may be made by rules for enabling or requiring the powers and duties of the Court in respect of settling the list of contributories and the making of calls to be exercised or performed by the liquidator as an officer of the court and subject to the court's control. That delegation to the liquidator occurs under IR 4.195-4.205 **[Auths/3/57-67]**.

139. The CA and the Judge held[58] that the s. 74 **[Auths/1/1]** liability included statutory interest and non-provable liabilities, such that the members would be required in LBIE's winding-up to contribute to LBIE's assets if there were any shortfall in the payment of statutory interest and non-provable liabilities. LBHI2 submits that the liability to contribute is only to make good a shortfall in the payment by LBIE of provable debts.

140. First, as is clear from the opening words of s. 74, the liability it imposes is triggered only after winding-up. The s. 74 liability is accordingly part of the statutory scheme under which creditors receive *pari passu* distributions in payment of their proved debts (and the proof process is the means by which creditors become entitled to participate in the collective enforcement process that is a liquidation). Both the CA and the Judge considered that it was part of the statutory scheme for a liquidator to pay provable and non-provable liabilities of the company in liquidation.[59] That is incorrect: see above and, eg, *Re Lines Bros Ltd (in liquidation)* [1983] Ch 1 **[Auths/1/15/p.20]** at 20E-F per Brightman LJ (emphasis added):

> "The liquidation of an insolvent company is a process of collective enforcement of debts for the benefit of the general body of creditors. Although it is not a process of execution, because it is not for the benefit of a particular creditor, it is nevertheless akin to execution because its purpose is to enforce, on a pari passu basis, the payment of the admitted or proved debts of the company."

141. The statutory scheme makes no provision for the determination, still less payment, of non-provable liabilities by the liquidator (as set out in more detail above). Any

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58 See CA Judgment at [181], [203] and [204] per Briggs LJ **[Appx/p.50; 55]** and [121] per Lewison LJ **[Appx/p.38]**; see first instance Judgment at [178] **[App/p.127]**. The basis upon which LBL is a registered shareholder of a $1 share in LBIE and the relationship as between LBL and LBHI2 as shareholders are issues, amongst others, raised in the *Waterfall III* proceedings **[Core/E/12]** (issued on 25 April 2016 and currently due for hearing in early 2017). A copy of the *Waterfall III* application notice will be included in the papers for the appeal hearing.

59 See CA Judgment at [184] and [185] **[App/p.51]** per Briggs LJ where he assets that "It has in my view always been part of the duties of a liquidator to pay the company's non-provable liabilities, to the extent that there are assets available for that purpose" and "…the general scheme of the 1986 Act nonetheless includes dealing with non-provable liabilities as part of the liquidator's duties". The Judge asserted at [152] **[App/p.120]** of the first instance Judgment that "It is the purpose of a liquidation to pay all liabilities of the company, including those which are not capable of proof".

such determination occurs outside the scheme. It is therefore not correct to suggest that a liquidator can include non-provable liabilities in a call: he has no basis in the legislative scheme for determining a non-provable claim and no statutory mandate to make a payment in respect of such a claim.

142. In those circumstances, and contrary to the assumption made by the Judge at [155] **[Appx/p.121]** of the first instance Judgment and the reasoning of Briggs LJ at [184] **[Appx/p.51]** of the CA Judgment, there is nothing in the nature of s. 74 **[Auths/1/1]** to suggest that it is intended that the s. 74 liability should extend to cover anything beyond that which is provided for by the statutory insolvency scheme, ie the payment of proved debts and liabilities.

143. The CA's favoured answer leads to odd results. For a real life example consider the submission made by LBIE in the *Waterfall III* proceedings[60] that, when ascertaining the correct value of the Sub Debt element of the s. 74 liability for the purposes of proving for it and/or making a call, the value could be the full value of the Sub Debt, rather than its value for the purposes of proof (which would need to take into account the relevant contingencies).[61]

144. Secondly, the Judge and the CA were wrong to decide that the reference to the company's "liabilities" in s. 74 includes anything other than provable debts. Briggs LJ accepted at [189] **[Appx/p.52]** that the purposes of voluntary and compulsory winding-up are not intended to be any different and, accordingly, s. 107 **[Auths/2/18]** sheds light on what is intended to be covered by the statutory scheme once a company has gone into any sort of liquidation. The overriding direction to a liquidator in s. 107 is to apply "the company's property … in satisfaction of the company's liabilities pari passu" and, as Patten LJ held in Danka at [37] **[Auths/1/8/p.522]**, "The reference to the company's liabilities in section 107 must be to the liabilities as determined in accordance with the 1986 Rules", ie provable debts.

145. Further and even if the above submission is not accepted in relation to non-provable liabilities, statutory interest cannot be included as a "liability" at all

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60 A copy of the *Waterfall III* application will be in the papers for the appeal hearing. **[Core/E/12]**

61 Ninth witness statement of Russell Downs **[Core/E/13]**, para 6 of Appendix I; *Waterfall III* application notice at Issue 3.

and/or, if it is a "liability", it is not a liability "of the company" (as required by s. 74) for the following reasons:

145.1 The existence and extent of statutory interest as a "liability" is already determined by whether there are any assets remaining after payment of the proved debts: there is otherwise no "liability" to pay statutory interest. This is consistent with the use of the word "surplus" in s. 189(2) **[Auths/1/2]** to identify the moneys from which the statutory interest is to be paid, because as a matter of ordinary language, a contributory is liable to contribute to a fund to make that fund "sufficient for" payment of debts and liabilities (s. 74) **[Auths/1/1]** but is not liable to contribute to constitute a "surplus": a surplus is something that is left over, not something that is brought in. An obligation to contribute to pay "debts and liabilities" is not an obligation to create the very surplus without which no statutory interest is payable. As David Richards J held in his judgment in *Waterfall IIA* at [149] **[Auths/1/14/p.51]**: "The entitlement under r.2.88 to interest is a purely statutory entitlement, arising once there is a surplus and payable only out of that surplus". Accordingly, LBHI2 submits that the Judge and the CA were wrong to hold that the direction contained in s. 189(2) to the liquidator to apply a surplus first in payment of statutory interest creates a "liability" of the company within the meaning of s. 74.

145.2 Statutory interest is not, even if a "liability", a liability <u>of the company</u>. In *Re Lines Bros Ltd* [1984] BCLC 215 at 223 **[Auths/1/16/p.223]**, Mervyn Davies J held that statutory interest was "not a debt or liability" <u>of the company</u> and was, instead, a "statutory direction to [the liquidator], being an obligation which is part of the statutory scheme for dealing with a company's assets which comes into operation at the outset of the winding up".[62]

145.3 Further, if s. 189(2) imposed a liability on a company to pay statutory interest independently of a surplus arising in liquidation, the equivalent provision in bankruptcy (s. 328(4)) **[Auths/2/44]** would impose a like liability on a bankrupt (given that s. 189 and s. 328 are in the same terms).

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62 See also LBL's Written Case in relation to David Richards J's declaration (iv).

This would result in the bankrupt not being released from his liability to pay statutory interest upon his discharge, because he is only released from "bankruptcy debts" under s. 281(1) **[Auths/2/40]**, and statutory interest is not a "bankruptcy debt" (defined by s 382) **[Auths/2/46]**. If the bankrupt is not released from the liability to pay statutory interest, he would be liable to be adjudged bankrupt again on the petition of any creditor in the first bankruptcy, save where statutory interest had been paid in full. This would undermine one of the main aims of the bankruptcy regime, ie that the former bankrupt should effectively have a 'fresh start'.

145.4 If "debts and liabilities" in s. 74 **[Auths/1/1]** included those to which the company became liable in the winding up, there would be no need to refer in s. 74(1) to the expenses of the winding up. "Debts" are defined in IR 13.12(1) **[Auths/1/7]** and liability is defined in IR 13.12(4) **[Auths/1/7]**; interest is treated separately in IR 13.12(1)(c) **[Auths/1/7]** and is limited to pre-liquidation interest; accordingly, the only interest included within the meaning of "debts and liabilities" in s. 74 is pre-liquidation interest.

145.5 Further, for the reasons set out above, the right to make a call on contributories is not an asset of the company, but a power of the Court delegated to the liquidator. Accordingly, the point made by David Richards J at [165] **[Appx/p.124]** (with which Briggs LJ agreed, at [197] and [201 – 202 **[Appx/p.54-55]**) does not answer the argument set out in the preceding sub-paragraph above. Lewison LJ was right to hold (at [113 – 120]) **[Appx/p.36-38]** that the court's power to call on contributories to contribute to the assets of the company is not the property of the company, as held by the CA in *In re Pyle Works* (1890) 44 Ch D 534 **[Auths/1/19]**, considering *Webb v Whiffin* (1872) LR 5 HL 711 **[Auths/1/22]**.

146. Thirdly, there was no suggestion in the Cork Report **[Auths/8/3]** or the White Paper (Cmnd 9175) **[Auths/8/21]** which led to the introduction of statutory interest as part of the IA 1986 that the introduction of this provision involved the imposition of a further "liability" on the company which might increase the burden on contributories.

147. In fact, the authors of the Cork Report referred to and relied on the decision of Pennycuick V-C in *Re Rolls-Royce Ltd* [1974] 1 WLR 1584 **[Auths/6/8]**, in which he said that he reached his conclusion (that interest was not payable in the event that the winding-up threw up a surplus) "with some regret … because as I have already said, it seems fair that a creditor should be compensated for being kept out of his money during the period of administration if there turns out to be a surplus, and again because the difference in this respect between the winding up provisions and the bankruptcy provisions appears to be without logical foundation."

148. Thus, at para 1385 of the Cork Report **[Auths/8/3/p.314]** the Committee quoted from the passage set out above and continued (at para 1386):

> "Our attention has been drawn to this anomaly between the two insolvency codes by a number of bodies, including the Association of British Chambers of Commerce, who suggest that there should be a common code of rules for situations which occur both in personal insolvency and in winding up proceedings and that, in particular, interest should be payable on debts in the same way in both administrations. We agree."

149. However, there is no discussion in the Cork Report **[Auths/8/3]** or in the relevant section of the White Paper **[Auths/8/21]** (nor during the relevant debates in Parliament) which led to the 1986 Act of the potential effect on the liability of a contributory to calls, and whether the new statutory interest entitlement would form part of the s. 74 liability to which a contributory is subject.

150. The fact that there was no such discussion in the Cork Report or the White Paper and that Pennycuick VC identified no relevant distinction between personal and corporate insolvency in this regard suggests that neither the Cork Committee nor the legislature intended the new statutory interest regime to increase the statutory liability of contributories.

151. It would be surprising if the legislative creation of statutory interest in 1986 imposed, without specific discussion in the Cork Report or legislative materials, an obligation on contributories to contribute to pay for it, particularly given that it would create a distinction between winding-up and bankruptcy, which cannot have been intended in light of the comments made above by the Cork Committee. The

fact that statutory interest is a peculiar creature of statute means that there is no sound basis for the opinions expressed by the Judge at [154] **[Appx/p.121]** of the first instance Judgment and by Briggs LJ at [199]-[200] of the CA Judgment **[Appx/p.55]** that, "It might be thought surprising if the substitution under the insolvency legislation of statutory interest for non-provable contractual interest reduced the liability of members": statutory interest is *sui generis* and cannot be equated with a contractual entitlement to interest pre-liquidation (see also above in relation to *Humber Ironworks*) **[Auths/1/11]**.

152. This understanding of the legislature's intention chimes with the fact that there was no relevant amendment of the wording used in the statutory predecessor to s. 74 **[Auths/1/1]** when s. 74 of the IA 1986 was enacted to impose a new liability to contribute to statutory interest. The predecessor section, s. 212 of the 1948 Act **[Auths/2/9]**, provided for contributories to be liable to contribute to the same three categories of payment as are found in s. 74, namely (as put in the 1948 Act) "[1] its debts and liabilities, and [2] the costs, charges and expenses of the winding up, and [3] for the adjustment of the rights of the contributories among themselves …". Given the way in which the obligation to pay statutory interest is expressed, ie as a direction to the relevant office-holder, it would be surprising if the legislature intended the s. 74 liability to extend to statutory interest for that not to be spelt out in this new s. 74.

153. Fourthly, the CA and the Judge also erred in accepting the argument advanced by LBIE which placed reliance on the fact that s. 74 can be used to require members to contribute sums not only for the payment of the debts and liabilities of the company but also "for the adjustment of the rights of the contributories among themselves".[63] The argument was that because this represents a category of liability almost at the bottom of the order of priority of payments set out by Lord Neuberger in *Re Nortel* **[Auths/1/17]**, it is implicit that contributions can be required not only for this purpose but also for payment of the categories above this one (ie statutory interest and non-provable liabilities).

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63 CA Judgment [202] per Briggs LJ and [121] per Lewison LJ; first instance Judgment at [158]-[159] **[Appx/p.55; 38; 122]**.

154. This argument is wrong. Even if LBHI2 is wrong on the points made above, there is no reason why the funds resulting from a call on contributories under s. 74 **[Auths/1/1]** (on any view, not what Lord Neuberger had in mind in setting out his summary of the usual insolvency waterfall in *Nortel* **[Auths/1/17]**) should not be used solely for payment of the particular items identified in s. 74. The relevant part of s. 74 is addressing the power of the liquidator to call on contributories to make payments for the adjustment of their rights *inter se*: it does not imply that the liquidator has a power to call for funds measured by non-provable liabilities to flow down a notional waterfall including (presumably) those to whom statutory interest and non-provable liabilities are payable. The argument assumes what it seeks to prove: namely that such claims fall within the scope of the debts and liabilities referred to in s. 74.

155. Further, this analysis confuses the assets of the company with the (different) assets available to a liquidator. As set out above, a call under s. 74 can be made only by a liquidator and the resulting assets are not assets of the company[64] (see also LBHI's Written Case in relation to declaration (viii)). Accordingly, there is no difficulty with holding that they are to be used for the specific purposes identified in s. 74 (just as the proceeds of a statutory claim made by a liquidator are used in making distributions to unsecured creditors rather than being handed over to secured creditors (who form a category above unsecured creditors): *Re Yagerphone Ltd* [1935] Ch 392) **[Auths/6/26]**.

64 The right to make calls and the members' liability to contribute "is an asset of the company" ([197] **[Appx/p.54]** per Briggs LJ) and the proceeds of a call "become part of the assets of the company" ([202] **[Appx/p.55]** per Briggs LJ); however, Lewison LJ did not consider the Court's power to call on contributories (which is delegated to the liquidator under the legislative scheme) to be an asset of the company – [113] **[Appx/p.36]**.

(E) Conclusion

156. The Court is asked to allow the appeals addressed in this written case for the reasons set out above. Those reasons can be summarised as follows.

157. **Construction of the Sub Debt Agreements.** The Sub Debt is a provable contingent debt, payable to LBHI2 by LBIE on payment in full by LBIE of proved debts (and before the payment of statutory interest and any other non-provable liabilities of LBIE, to the extent that the latter exist at all) because:

157.1 On a proper construction of the Sub Debt Agreements:

157.1.1 Clause 5(2) limits the "*Liabilities*" **[Appx/p.165]** which are to be taken into account for the purposes of ascertaining whether LBIE is "*solvent*" under clause 5(1)(b) **[Appx/p.165]** – and hence whether the Sub Debt should be paid – to those claims which are provable debts in accordance with the statutory insolvency scheme;

157.1.2 The language of clause 5(2)(a) **[Appx/p.165]** captures the concept of provable debts, which includes not only (i) debts which have fallen due for payment at the commencement of the insolvency (ie obligations which are "*payable*" in the words of clause 5(2)(a)) but also (ii) debts which are not payable at the relevant date but will or might fall due for payment at a future date and must be ascribed a fair value by the office-holder in the process of proof, adjudication of debts and payment of dividends (ie future and contingent obligations which are capable of proof under the scheme – "*capable of being established or determined in the Insolvency*" in the words of clause 5(2)(a));

157.1.3 The CA's construction distorts the structure of the clause and gives no meaning to the words "*or capable of being established or determined in the Insolvency of the Borrower*".

157.2 Statutory interest is excluded from 5(2)(a) because:

157.2.1 It is not a "*Liability*" as defined because it is not a debt or liability of the company, it is instead a direction to the officer-holder as to how he is meant to discharge his payment obligations;

157.2.2 Even if it is a "*Liability*", it is "*not payable or capable of being established or determined in the Insolvency*" of LBIE because it is not a provable debt;

157.2.3 Further or alternatively, even if it is a "*Liability*", it is an "*Excluded Liability*" because the Rules expressly provide for statutory interest to come after proved debts;

157.2.4 This construction is supported by IR2.88(8) **[Auths/1/5]** which requires statutory interest to be paid equally on all unsecured proved debts, regardless of their ranking *inter se*.

157.3 Non-provable liabilities of LBIE are excluded from 5(2)(a) **[Appx/p.165]** because:

157.3.1 They are not part of the statutory insolvency regime and so are not "*payable*" or "*capable of being established or determined*" in a formal insolvency process. They are instead (if they exist at all) payable despite the Insolvency, not in the Insolvency;

157.3.2 There is no statutory mechanism for an office-holder to determine or pay non-provable claims.

157.4 Alternative analysis: The construction contended for above is also supported by the following analysis of the provisions of clause 5:

157.4.1 Clause 5(1)(b) **[Appx/p.165]** makes payment of the Sub Debt conditional on LBIE being "*solvent*" in accordance with the bespoke solvency definition *"at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be 'solvent'";*

157.4.2 There is no liability to pay statutory interest or non-provables in any sum exceeding whatever surplus is left after payment of provable debts. Accordingly, once the unsecured unsubordinated creditors have been paid and the office-holder is deciding whether he can pay back the Sub Debt consistent with clause 5(2) **[Appx/p.165]**, he can be sure that the payment of the Sub Debt will always leave the company "*solvent*" because the sum to be applied in payment of statutory interest and non-provables is only whatever remains once the Sub Debt (a provable debt) has been paid.

157.5 The Sub Debt is provable. There is no restriction (as a matter of construction of the Sub Debt Agreements, including against the relevant regulatory background) on LBHI2 submitting a proof in LBIE's insolvency for the Sub Debt as a contingent debt.

158. **Currency Conversion Claims.** CCCs do not exist because:

158.1 IR 2.86 **[Auths/1/3]** causes the mandatory conversion of the foreign currency debt into sterling and renders the sterling equivalent of the debt provable in the administration of the debtor, such that payment of the proved – sterling – sum, together with statutory interest, satisfies the creditor's claim;

158.2 It would be very surprising – and cannot have been intended by the legislature in enacting the 1986 scheme – for the statutory insolvency scheme to split a unitary obligation to pay a sum in a foreign currency into two claims, one of which is provable and the other of which is not;

158.3 CCCs are fundamentally different from the types of non-provable liabilities which have been recognised by the Courts to date (eg the asbestosis claimants in *Re T&N Ltd*) **[Auths/1/21]** because the underlying foreign currency claim is itself provable;

158.4 Provisions of the statutory insolvency scheme are capable of creating or extinguishing substantive rights, eg the provisions for statutory interest and insolvency set-off. Further, there is no dispute that a foreign currency

creditor who benefits from the currency conversion provisions has a substantive entitlement to the benefits he receives by operation of the statutory scheme;

158.5 Statutory interest is paid pursuant to IR 2.88 **[Auths/1/5]** at a (very favourable) sterling rate, based on creditors' claims being denominated in sterling, not by reference to any foreign currency in which the debt was originally denominated;

158.6 It would be a particularly surprising result if foreign currency creditors were entitled to assert competing non-provable claims which would reduce the assets available to meet any sterling non-provable claims (eg any liabilities imposed by statute which are neither provable debts nor administration expenses);

158.7 The history of the rules relating to currency conversion in an insolvency (including the Cork Report) **[Auths/8/3]** demonstrates that there was no intention that a residual CCC would exist;

158.8 The currency conversion provisions of the corporate and personal insolvency regimes are the same and an analysis of the bankruptcy rules on currency conversion demonstrate that CCCs do not exist;

158.9 The language used by the statutory draftsman (in particular, the use of the concept of "provability") confirms the view that the conversion to sterling required by IR 2.86 **[Auths/1/3]** (or IR 4.91 for winding up **[Auths/3/50]**) is substantive, such that payment of the proved debt in full satisfies the creditor's claim;

158.10 Recognising CCCs gives rise to a number of practical problems which demonstrates that it cannot have been intended that CCCs exist post-1986 (eg recognising CCCs provides the foreign currency creditor with a "one-way bet" against the company or its members).

159. **The scope of the s. 74 liability.** The s. 74 liability (which is triggered only in a winding-up of the company) extends only to provable debts of the company:

159.1 It is the purpose of a liquidation to pay the provable debts of the company;

159.2 Non-provable liabilities are excluded from the scope of s. 74 **[Auths/1/1]** because:

159.2.1 They are not part of the statutory insolvency regime of which s. 74 is part;

159.2.2 There is no statutory mechanism for an office-holder to determine or pay non-provable claims;

159.3 Statutory interest is excluded from s. 74 because:

159.3.1 It is not a "liability" and, even if a "liability", it is not a liability "of the company"; it is instead a direction to the officer-holder as to how he is meant to discharge his payment obligations;

159.3.2 The right to make a call under s. 74 is not an asset of the company but a power of the Court (as delegated to the liquidator);

159.3.3 If "debts and liabilities" in s. 74 included those to which the company became liable in the winding up, there would be no need to refer in s. 74(1) to the expenses of the winding up. "Debts" are defined in IR 13.12(1) **[Auths/1/7]** and liability is defined in IR 13.12(4) **[Auths/1/7]**; interest is treated separately in IR 13.12(1)(c) and is limited to pre-liquidation interest; accordingly, the only interest included within the meaning of "debts and liabilities" in s. 74 is pre-liquidation interest;

159.3.4 There is nothing in the Cork Report or the White Paper **[Auths/8/3; Auths/8/21]** which led to statutory interest being introduced to suggest that any further "liability" was to be imposed on contributories under s. 74. In fact, the Cork Report suggests the opposite;

159.3.5 The fact that a contributory has to contribute under s. 74 for the adjustment of the rights of the contributories *inter se* does not mean the contributory has to contribute to everything else further up the waterfall.

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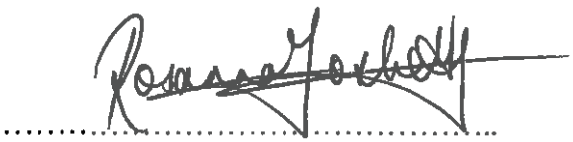

ROSANNA FOSKETT

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