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

**IN THE SUPREME COURT OF THE UNITED KINGDOM**

**ON APPEAL FROM HER MAJESTY'S COURT OF APPEAL (CIVIL DIVISION) (ENGLAND AND WALES) ([2015] EWCA CIV 485)**

**IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)**

**AND 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 THE INSOLVENCY ACT 1986**

**B E T W E E N :**

**(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**

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# CASE OF THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)

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**Contents** **Page**


| | | Page |
|---|---|---|
| A | INTRODUCTION AND OVERVIEW | 3 |
| B | THE SUBORDINATED DEBT AGREEMENTS | 6 |
| | (1) Introduction | 6 |
| | (2) The extent of the Sub Debt's subordination | 12 |
| | (3) Cross-appeal: Sub Debt not currently capable of being proved | 27 |
| C | CURRENCY CONVERSION CLAIMS | 32 |
| D | POST-ADMINISTRATION INTEREST | 33 |
| | (1) Introduction | 33 |
| | (2) Survival of post-administration statutory interest in liquidations | 35 |
| | (3) Accrued post-administration interest is provable in a liquidation | 41 |
| | (4) Non-provable claim for interest | 43 |
| E | THE EXTENT OF THE LIABILITY UNDER SECTION 74 | 47 |
| | (1) Introduction | 47 |
| | (2) The construction of section 74(1) | 48 |
| | (3) Non-provable liabilities | 52 |
| | (4) Statutory interest | 57 |
| | (5) The "bootstraps" argument | 66 |
| | (6) The position in bankruptcy | 70 |
| | (7) The LBHI2 Administrators' other arguments | 71 |
| F | SET-OFF, PROVABILITY AND THE CONTRIBUTORY RULE | 74 |
| | (1) Introduction | 74 |
| | (2) Background | 74 |
| | (3) Set-off in LBIE's administration | 75 |
| | (4) Provability | 83 |
| | (5) Contributory rule in distributing administrations | 95 |
| G | CONCLUSION: REASONS | 109 |

## A: INTRODUCTION AND OVERVIEW

1. Lehman Brothers International (Europe) (in administration) ("**LBIE**") was incorporated on 10 September 1990 under the Companies Act 1985 as a company limited by shares. On 21 December 1992, it was re-registered as an unlimited company.

2. LBIE was the principal trading company of the Lehman Brothers group in Europe. It went into administration on 15 September 2008.

3. Lehman Brothers Limited ("**LBL**") and LB Holdings Intermediate 2 Limited (in administration) ("**LBHI2**") (together, the "**Members**")) are LBIE's only members.

4. In their capacity as members of LBIE, LBL and LBHI2 are liable to contribute to LBIE's assets to meet any deficiency in its winding up. Section 74(1) of the Insolvency Act 1986 (the "**1986 Act**") **[Auth/1/1]** provides that:

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

5. LBHI2 is a creditor of LBIE including under three subordinated loan agreements entered into on 1 November 2006 (the "**Sub Debt Agreements**") **[Core/D/7] [Core/D/8] [Core/D/9]**. It has lodged unsecured claims in the LBIE administration for: (i) approximately £38 million (in respect of the general intercompany unsecured balance); and (ii) approximately £1.25 billion in respect of its claims under the Sub Debt Agreements. LBL has also lodged an unsecured claim in the LBIE administration although the figure is the subject of discussions between the joint administrators of LBIE (the "**LBIE Administrators**") and the joint administrators of LBL (the "**LBL Administrators**").

6. As matters stand, LBIE is not being wound up but is in administration. However, the LBIE Administrators have the power to cause LBIE to move into liquidation, as that has been approved by LBIE's creditors as a possible "exit route" from the administration.

Whether that course is adopted will depend upon what is in the creditors' best interests as a whole, taking into account, amongst other matters, the outcome of these appeals.[1]

7. As the Supreme Court explained in *In re the Nortel Companies and Ors* [2014] 1 AC 209 **[Auth/1/17]** at [39], in a liquidation or an administration where there is no question of trying to save the company as a going concern, the order of priority for payment out of the company's assets is, in summary terms, as follows (the "**Waterfall**"):

   (1) Fixed charge creditors;
   (2) Expenses of the insolvency proceedings;
   (3) Preferential creditors;
   (4) Floating charge creditors;
   (5) Unsecured provable debts;
   (6) Statutory interest;
   (7) Non-provable liabilities; and
   (8) Shareholders.

8. The administration of LBIE has been a very successful one. LBIE has paid, in full, the debts which have been admitted to proof by the LBIE Administrators, i.e. all of the liabilities up to and including level 5 of the Waterfall have been paid or provided for, and there is a surplus remaining thereafter of some £7 billion.

9. The central issue which arises as between LBIE and LBHI2 is whether statutory interest payable pursuant to rule 2.88(7) of the Insolvency Rules 1986 (the "**1986 Rules**") **[Auth/1/4]** and non-provable claims are payable to LBIE's creditors in priority to LBHI2's claims against LBIE under one or more of the Sub Debt Agreements.

10. The other key issues raised by these appeals concern: (i) whether LBIE's creditors' accrued right to statutory interest payable out of the surplus in the administration would be lost upon LBIE moving from administration into liquidation; (ii) whether "Currency Conversion Claims" exist as a species of non-provable liability; (iii) the extent of the Members' liability to contribute pursuant to section 74 of the 1986 Act **[Auth/1/1]**; (iv) the operation of set-off as between the Members' claims against LBIE and their liability

[1] Fourth Witness Statement of Russell Downs, [65].

to contribute; and (v) the Members' ability to prove in LBIE's administration in light of their obligation to contribute to LBIE's assets pursuant to section 74 of the 1986 Act **[Auth/1/1]**.

11. The LBIE Administrators' case: (i) responds to the cases filed by each of the joint administrators of LBHI2 (the "**LBHI2 Administrators**"), the LBL Administrators and Lehman Brothers Holdings Inc. ("**LBHI**"); and (ii) advances the LBIE Administrators' arguments on their cross-appeals.

## B: THE SUBORDINATED DEBT AGREEMENTS

### (1) Introduction

12. LBHI and the LBHI2 Administrators appeal against the Court of Appeal's Order that the claims of LBHI2 under the Sub Debt Agreements **[Core/D/7] [Core/D/8] [Core/D/9]** (the "**Sub Debt**") are subordinated behind statutory interest and non-provable liabilities and are repayable only on the occurrence of contingencies including payment of all such claims.[2]

13. The LBIE Administrators oppose those appeals. Further, the LBIE Administrators cross-appeal against the Court of Appeal's Order that the claims under the Sub Debt Agreements are provable in the administration or liquidation of LBIE in advance of the payment in full by LBIE of statutory interest and non-provable liabilities.[3] The LBIE Administrators contend that the Supreme Court should restore declaration (i) made by David Richards J (as he then was), which was in the following terms:

> "*The claims of* [LBHI2] *under its subordinated loan agreements with* [LBIE] *are subordinated to provable debts, statutory interest and non-provable liabilities, all of which (other than the claims of LBHI2 under its subordinated loan agreements and statutory interest thereon, if any) must be paid in full 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*".

14. The background to the appeals and the cross-appeal in respect of the Sub Debt is set out in the agreed Statement of Facts and Issues (the "**SFI**") at [19]-[21] and in the Court of Appeal's judgment (the "**CA Judgment**") **[Core/D/3]** at [9]-[14]. In summary:

    14.1. The Sub Debt Agreements **[Core/D/7] [Core/D/8] [Core/D/9]** contain subordination provisions in materially identical form, entered into between LBIE (as borrower) and LBHI2 (as lender) on 1 November 2006.[4]

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[2] Paragraph 2 of the Court of Appeal's Order dated 14 May 2015 (amended on 20 May 2015) **[Core/D/2]**.
[3] Ibid.
[4] SFI, [19].

14.2. Before 2006 LBIE had three subordinated loan facilities with its then immediate parent company as subordinated lender.[5]

14.3. In 2006, LBIE's regulatory capital base was restructured, so as to replace some of its subordinated debt with share capital and to reduce its interest payments. LBHI2 was interposed as the immediate holding company of LBIE and part of the then existing subordinated debt was replaced with preference shares issued to LBHI2.[6]

14.4. The subordinated loan facility agreements then in place were cancelled and replaced with similar facility agreements with LBHI2. Some US$4.7 billion of subordinated debt was drawn down by LBIE.[7]

14.5. The amount outstanding under the Sub Debt Agreements fluctuated but, as at the date of LBIE's entry into administration, it stood at US$2.225 billion.[8]

14.6. LBHI2 has lodged a proof in LBIE's administration for £1,254,165,598.48 (the sterling equivalent of US$2.225 billion, converted in accordance with rule 2.86 of the 1986 Rules), in respect of its claims under the Sub Debt Agreements.[9]

<u>(i) Structure of the Sub Debt Agreements</u>

15. Each of the Sub Debt Agreements **[Core/D/7] [Core/D/8] [Core/D/9]**, including in particular the subordination provisions, was based on templates provided by the Financial Services Authority ("**FSA**") (as it then was). As David Richards J recorded in his judgment (the "**HC Judgment**") **[Core/D/5]** at [48], there is no evidence to suggest that anyone in the Lehman Brothers group gave any consideration to how these provisions would operate in the event of an insolvency of LBIE and indeed the recollection of several witnesses in interviews suggested that it was highly unlikely that any such consideration was given.

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[5] CA Judgment **[Core/D/3]**, [10].
[6] CA Judgment **[Core/D/3]**, [11].
[7] CA Judgment **[Core/D/3]**, [11].
[8] CA Judgment **[Core/D/3]**, [13].
[9] SFI, [21].

16. Each of the Sub Debt Agreements **[Core/D/7] [Core/D/8] [Core/D/9]** contains Schedule 1, setting out the variable terms (the "**Variable Terms**"), and Schedule 2, setting out the standard terms (the "**Standard Terms**").

17. As to the Variable Terms:

    17.1. Paragraph 8 provides for the payment of interest on a monthly basis.

    17.2. Paragraph 9 provides for repayment of the monies extended to LBIE under the facility "*subject always to paragraphs 4(3)… and 5… of the Standard Terms*".

18. Standard Term 5(1) provides (*inter alia*) that LBHI2's rights in respect of the Sub Debt "*are subordinated to the Senior Liabilities*". It is the extent of that subordination which is at the heart of the appeals by LBHI and the LBHI2 Administrators on this issue.

(ii) Purpose of the Sub Debt Agreements and their regulatory context

19. The Sub Debt formed part of LBIE's regulatory capital and the Sub Debt Agreements must therefore be construed in that context.[10] As David Richards J put it in the HC Judgment **[Core/D/5]** at [33]:

> "*The subordinated loans formed part of LBIE's regulatory capital. Under capital adequacy rules made by regulators, banks and other financial institutions are required to hold capital of a certain amount, which depends in broad terms on the extent of their business and their risk exposures. The purpose of capital adequacy rules is so far as possible to ensure that firms provide financial resources to protect their customers and other stakeholders against failure and enable them to withstand some level of loss*".

20. Subordinated loan capital is, in concept and to achieve its purpose, meant to rank "*after the claims of* ***all other creditors*** *and is not to be repaid until* ***all other debts outstanding at the time*** *have been settled*".[11] In this context, it would be wrong to read "*debts*"

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[10] See, in particular, the CA Judgment **[Core/D/3]** per Lewison LJ at [29] to [31] and the HC Judgment **[Core/D/5]** at [60]-[64].

[11] See Article 4(3) of Directive 89/299/EEC **[Auth/7/1]** implementing Basel I referred to in the HC Judgment **[Core/D/5]** at [37] and reiterated in Article 64(3) of Directive 2006/48/EC **[Auth/7/2]** implementing Basel II, referred to in the HC Judgment **[Core/D/5]** at [40]. The same point can be made with reference to Basel II which refers at [49(xii)] to short-term subordinated debt needing to be "*capable of becoming part of a bank's permanent*

where it appears in the relevant EU Directives as having the peculiar and very specific English law meaning of a "*provable debt*" because minimum capital adequacy requirements are set at an EU level, not at a domestic level, and the English insolvency law concept of what qualifies as a provable debt is irrelevant in the EU context.

21. The Sub Debt was advanced on a subordinated basis to help LBIE to meet its capital adequacy requirements, which were in place primarily to protect its clients. The following aspects of the regulatory context are consistent with and support the construction adopted by the Court of Appeal and David Richards J below:

21.1. The Sub Debt Agreements were made on a form approved by the FSA, as it then was, which was printed as part of the *Interim Prudential Sourcebook* ("**INPRU**"). INPRU set out the financial resources requirements applicable to LBIE from 31 December 2006 until it entered administration.[12]

21.2. Capital is repayable only after repayment of all of the debts owed to creditors, whether provable or not. As David Richards J put it in the HC Judgment **[Core/D/5]** at [45]-[46], "*Subordination was a characteristic of all three tiers of [the capital resources a firm is required to hold to meet the requirements of GENPRU]*". GENPRU set out the capital adequacy requirements applicable to LBIE at the time it went into administration, although it was INPRU which applied at the time when the Sub Debt Agreements were entered into.

21.3. The general rule contained in r.10-62(1) of INPRU **[Auth/8/7]** was that "*[a] firm must, at all times, maintain financial resources in excess of its financial resources requirement as detailed in rule 10-70 below*".

21.4. Rule 10-62(2) **[Auth/8/7]** required a firm to calculate its financial resources in accordance with Table 10-62(2)A, subject to certain exceptions. That Table allowed financial resources to include ordinary share capital, reserves excluding

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*capital and thus be* ***available to absorb losses in the event of insolvency***" (see the HC Judgment [**Core/D/5]** at [39]). Losses in the event of insolvency encapsulates not just principal and interest accruing up to the date of the insolvency, but losses arising out of the loss of the use of money for which statutory interest is meant to compensate, as well as other losses under which, in the event of an insolvency, a creditor suffers, whether or not provable.

[12] CA Judgment **[Core/D/3]** per Lewison LJ at [29].

revaluation reserves, externally verified net profits, preference shares and short-term subordinated loans. All these went onto the credit side of the balance. The Table also provided for deductions to go on to the debit side of the balance.

21.5. Rule 10-63(1) **[Auth/8/8]** provided that "*[a] firm may take into account subordinated loan capital in its financial resources in accordance with Tables 10-62(2) A, B and C subject to (2) to (12) below*".

21.6. Rule 10-63(2)(a) **[Auth/8/8]** required a subordinated loan agreement to be drawn up in accordance with the standard forms obtained from the FSA. In the present case, the Standard Terms, as set out in Schedule 2 of the Sub Debt Agreements, reflected this requirement.

22. The terms of the Sub Debt Agreements were intended to subordinate the Sub Debt in such a way as to permit it to be treated as part of LBIE's regulatory capital.

(iii) Terms of the Sub Debt Agreements

23. The relevant terms of the Sub Debt Agreements were identified and summarised in the HC Judgment **[Core/D/5]** at [50]-[54]:

> "*[50] Clause 1(1) of the Standard Terms contains a number of definitions. 'Financial Resources Requirement' is defined as having the meaning given to it in the FSA Handbook. 'Insolvency' is defined to mean and include liquidation, administration and other similar procedures. 'Liabilities' means 'all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever)'. 'Senior Liabilities' means 'all liabilities except the Subordinated Liabilities and Excluded Liabilities'. 'Subordinated Liabilities' is defined to mean 'all Liabilities to the Lender in respect of each Advance made under this Agreement and all interest payable thereon'. 'Excluded Liabilities' is defined to mean 'Liabilities which are expressed to be, and in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower'.*
>
> *[51] Clause 4 provides for repayment, but 'subject in all respects to the provisions of paragraph 5 (subordination)': clause 4(1). Clause 4(3) contains restrictions on the ability of LBIE to effect early repayment of any loan or to pay interest by reference to its Financial Resources Requirement.*
>
> *[52] The effect of clause 4(4)-(7) is that the only remedy available to the lender for repayment of any advances or enforcement of the terms of the loan facility*

*agreements is to institute proceedings for the Insolvency of LBIE. This is a standard term of subordinated loan agreements and precludes the lender from obtaining judgment and executing or otherwise enforcing the judgment, thereby avoiding the subordination provisions.*

*[53] Clause 5 contains the subordination provisions:*
*'(1) 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 and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that–*
>
> > *(i) paragraph 4(3) has been complied with; and*
> >
> > *(ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and*
>
> *(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'.*

*(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, and*
>
> *(b) the Excluded Liabilities.*

*(3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.*

*(4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated as accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency or Insolvency.*

*(5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities –*

> *(a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or*
>
> *(b) where such payment is prohibited under paragraph 4(3).*

*(6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.*

*(7) Any sum so returned shall then be treated for the purposes of the Borrower's obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.*

*(8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.'*

> *[54] Clause 7 contains undertakings by LBHI2 as Lender not to take any of the steps specified in clause 7 without the prior written consent of the FSA. These undertakings are designed to prevent any action which might subvert the subordinated status of the Liabilities. In particular, in sub-clauses (d) and (e), the Lender undertook not without the prior written consent of the FSA to:*
>
> > *'(d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;*
> > *(e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected.'.*"

**<u>(2) The extent of the Sub Debt's subordination</u>**

24. The Court of Appeal held that the Sub Debt is subordinated not only to provable debts, but also to statutory interest and non-provable liabilities and is, accordingly, only repayable following the repayment in full of those liabilities.

25. The starting point is Standard Term 5(1), which subordinates what are described as the Subordinated Liabilities to what are described as the Senior Liabilities.

26. The phrase "*Senior Liabilities*" is defined to mean "*all Liabilities [of LBIE] except the Subordinated Liabilities and Excluded Liabilities*".

27. The word "*Liabilities*" is defined to mean "*all present and future sums, liabilities and obligations payable or owing by [LBIE] (whether actual or contingent, jointly or severally or otherwise howsoever)*".

28. This definition of "*Liabilities*" is framed in very broad terms:

    28.1. The definition uses the phrase "*liabilities and obligations payable or owing*". This is both different in concept from, and wider than, the debts for which a creditor may be able to prove in an administration or liquidation.

    28.2. It extends to future and contingent liabilities and obligations. Accordingly there is no need for the liability or obligation to have accrued due.

29. It follows that statutory interest and non-provable liabilities fall within the definition of Liabilities used in each Sub Debt Agreement. It also follows that they will be Senior Liabilities within Standard Term 5(1) unless:

29.1. they are not Liabilities *of LBIE*; or

29.2. they are excluded by the words of exception ("*except the Subordinated Liabilities and Excluded Liabilities*").

30. As to the former, statutory interest and non-provable liabilities are both Liabilities *of LBIE*. The LBHI2 Administrators' submission that statutory interest is not a liability *of LBIE* is wrong for the reasons explained below at [140ff].

31. As to the latter, statutory interest and non-provable liabilities do not fall within either of the categories of Liability which are excluded from being Senior Liabilities (i.e. Subordinated Liabilities or Excluded Liabilities):

31.1. The phrase "*Subordinated Liabilities*" means "*all Liabilities to the Lender in respect of each Advance made under this Agreement and all interest payable thereon*". The Subordinated Liabilities are thus the Sub Debt itself and interest thereon.

31.2. The phrase "*Excluded Liabilities*" means "*Liabilities which are expressed to be and, in the opinion of the Insolvency Holder of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower*". The Administrators are not aware of the existence of any Excluded Liabilities. Neither of the statutory interest nor non-provable claims are expressed to be junior to the Sub Debt and, insofar as relevant, in the LBIE Administrators' opinion they do not rank junior to the Sub Debt.

32. Accordingly, all of LBIE's Liabilities other than in respect of the Sub Debt fall within its "*Senior Liabilities*". The Sub Debt is, therefore, subordinated behind all of LBIE's other Liabilities.

33. Standard Term 5(1)(b) gives effect to the subordination by providing for the obligation to pay the Subordinated Liabilities to be conditional on LBIE being "*solvent*" within the meaning of Standard Term 5(2) at the time of, and immediately after, the payment. It states that "*no … amount which would otherwise fall due for payment shall be payable except to the extent that [LBIE] could make such payment and still be 'solvent'*".

34. Standard Term 5(2) provides that LBIE will be "*solvent*" if it is:

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

35. In other words, the notion of being "*solvent*" corresponds with the liabilities to which the Sub Debt is subordinated. Those liabilities have to be capable of being paid first. Accordingly, LBIE will not be solvent for the purposes of Standard Term 5(1)(b), and therefore the Sub Debt will not be repayable under Standard Term 5(1), unless and until LBIE has paid, or is in a position to pay, all of its Liabilities, disregarding for this purpose only:

    35.1. the Subordinated Liabilities and any Excluded Liabilities; and

    35.2. any obligation which is not payable or capable of being established or determined in LBIE's administration.

36. The Court of Appeal held unanimously (agreeing with David Richards J) that neither statutory interest nor non-provable liabilities fall within the reference in Standard Term 5(2)(a) to "*obligations which are not payable or capable of being established or determined in the Insolvency of [LBIE]*". This was correct and is consistent with the rights of the Lender being "*subordinated to the Senior Liabilities*" – a term which includes both statutory interest and non-provable liabilities (Standard Term 5(1)). The next two sections of this Case deal separately with statutory interest and non-provable liabilities.

(i) Statutory interest

37. In the event of a surplus after the payment of proved debts in insolvency proceedings in respect of the Borrower, the Borrower's liability to pay statutory interest must be taken into account in the "*solvency*" test in Standard Term 5(2) because it is a liability which is "*payable or capable of being established or determined in the Insolvency of [LBIE]*".

38. The LBHI2 Administrators accept that statutory interest is capable of being established and determined in the Insolvency of LBIE. However, they contend that statutory interest is to be disregarded for the purposes of the "*solvency*" test in Standard Term 5(2) on the basis that it is not a liability of the company but simply a direction to the office-holder to apply the company's assets in a particular way.[13]

39. The LBHI2 Administrators' contention on this point is wrong for the reasons given by Lewison LJ in the CA Judgment **[Core/D/3]** at [45]-[48]. Specifically:

39.1. Neither rule 2.88(7) of the 1986 Rules **[Auth/1/4]** nor section 189(2) of the 1986 Act **[Auth/1/2]** is expressed as a direction to the office-holder. Rather, each constitutes a statutory statement as to how the fund is to be dealt with, creating an obligation to pay.

39.2. Pursuant to paragraph 69 of Schedule B1 to the 1986 Act **[Auth/3/7]**, an administrator acts as the agent of the company and so any payment of interest under rule 2.88(7) **[Auth/1/4]** is a payment procured on behalf of the company by the administrator. The position should be no different as regards a liquidator.[14]

39.3. Legal title to the assets which constitute the surplus remains vested in the company, whether it is in administration or liquidation, and so in either case interest will be paid out of the company's funds. Accordingly, the interest is paid by the company and, therefore, must be payable by the company.

[13] LBHI2 Administrators' Written Case, [43].

[14] See *McPherson's Law of Company Liquidation*, 3rd Ed., [8-028] **[Auth/8/12]**: "*In relation to the company, viewed as a corporate entity, there is little doubt that the liquidator occupies the position of agent*" (*citing Re Anglo-Moravian Ry Co* (1875) 1 Ch D 130; *Knowles v Scott* [1891] 1 Ch 717; and *Butler v Broadhead* [1975] Ch 97 at 108).

39.4. In interpreting an agreement which envisages the borrower entering insolvency proceedings outside of England and Wales and, potentially, in a multitude of jurisdictions, it is not workable to adopt a narrow interpretation of the words based exclusively on a particular provision of English insolvency law.

39.5. The LBHI2 Administrators seek to rely on the decision of Mervyn Davies J in *In re Lines Bros Ltd* [1984] BCLC 215 **[Auth/1/16]** to support their contention that statutory interest is not a liability of the company.[15] This is misplaced for the reasons set out below at [159] to [171].

40. For these reasons, the LBHI2 Administrators are wrong to contend that the Borrower's liability to pay statutory interest is to be disregarded for the purposes of the "*solvency*" test in Standard Term 5(2).

(ii) Non-provable liabilities

41. The LBHI2 Administrators contend that non-provable liabilities are not "*payable or capable of being established or determined in the Insolvency of the Borrower*" because: (i) they are not currently due and payable or otherwise provable; and (ii) they fall outside the scope of the English insolvency regime.[16]

42. The LBHI2 Administrators' contention is wrong. Non-provable liabilities of the Borrower are to be taken into account for the purposes the "*solvency*" test in Standard Term 5(2) because, like statutory interest, they are "*payable or capable of being established or determined in the Insolvency of [LBIE]*". In the LBIE Administrators' submission:

42.1. The majority of the Court of Appeal (Briggs and Moore-Bick LJJ) were correct to hold that non-provable liabilities are both payable and capable of being established or determined in LBIE's administration or liquidation, for the purposes of Standard Term 5(2)(a).

[15] LBHI2 Administrators' Written Case, [43.2].
[16] LBHI2's Grounds of Appeal, [21]; LBHI2 Administrators' Written Case, [53]-[54].

42.2. Alternatively, Lewison LJ (who was in the minority on this point) was correct to hold that non-provable liabilities are payable in LBIE's administration or liquidation.

43. As to why non-provable liabilities are *payable*:

43.1. It is not necessarily the case that non-provable liabilities are not currently due and payable. Currency conversion claims, for example, are currently due and payable insofar as they represent the residual part of a currently due and payable foreign currency debt which remains in existence after the proof process in a liquidation or administration. Whilst non-provable liabilities at level 7 in the Waterfall fall to be paid only after levels 1 to 6, they comprise part of a debt which may well be currently due and payable.

43.2. In any event, to the extent that non-provable liabilities are not currently due and payable, this cannot be the test for whether a given type of Liability is to be regarded as "*payable*" for the purposes of Standard Term 5(2)(a). Contingent and prospective liabilities may be provable. Such liabilities are not currently due and payable, and yet it could not be contended (and is not contended by the LBHI2 Administrators) that they should be disregarded as not "*payable*" for the purposes of Standard Term 5(2)(a).

44. As to why non-provable liabilities are *capable of being established and determined in the Insolvency of the Borrower:*

44.1. The class of non-provable liabilities has at various times included claims for post-liquidation contractual interest, unliquidated tort claims and claims for post-liquidation rent under pre-liquidation leases. The Courts have always made clear that such liabilities, whilst not provable debts, must be paid from the assets of the company before any surplus can be returned to the shareholders: see *Re T & N Ltd* [2006] 1 WLR 1728 **[Auth/1/21]** at [107]; and see below at [135].

44.2. Non-provable liabilities are capable of being established and determined in the administration or liquidation of the Borrower, because that is what the office-

holder is required to do in order to ensure that they are paid before any return to members.[17]

44.3. Since the adjustment of the members' rights *inter se* and the return of the surplus to the members are integral to the powers and duties of the liquidator or administrator, it would be wrong to suggest that non-provable liabilities, the level immediately prior to the members, are not payable within the insolvency process. The payment of non-provable liabilities is a necessary step to the conclusion of a liquidation in which a return to the members is capable of being made pursuant to either section 107 **[Auth/2/18]** or 154 **[Auth/2/26]** of the 1986 Act. If not capable of being established and/or determined (or indeed paid) in the liquidation or administration, how are payments to members to be made? Nothing can be paid to the members unless and until the non-provable liabilities have been paid.

44.4. Further, as noted above, the word "*Insolvency*" is defined to mean various types of insolvency proceedings (and not necessarily English insolvency proceedings). Given that the solvency test provided by Standard Term 5(2) of the Sub Debt Agreements is intended to be capable of applying to formal insolvency processes in other jurisdictions, it would be arbitrary and illogical for the formal requirements of provability, as understood specifically by English law, to apply for the purpose of determining whether or not a liability is to be disregarded.[18]

(iii) Responses to the LBHI2 Administrators' arguments

45. The LBHI2 Administrators contend that there is no mechanism empowering or directing the liquidator or administrator to establish or determine non-provable claims[19] and that questions of liability and quantum in respect of non-provable liabilities could only be determined in litigation outside of the insolvency process.[20] This is wrong. It is part of the duty of a liquidator or an administrator to pay non-provable claims, as explained

[17] This is the combined effect of sections 107 **[Auth/2/18]**, 148 **[Auth/2/23]** and 154 **[Auth/2/26]** of the 1986 Act.
[18] HC Judgment **[Core/D/5]**, [67].
[19] LBHI2 Administrators' Written Case, [59].
[20] LBHI2 Administrators' Written Case, [54]. The submission ignores the fact that these very proceedings – an application for directions in the administration – have been taken by the LBIE Administrators to determine, amongst other things, whether LBIE is liable in respect of Currency Conversion Claims.

below at [136]. To the extent that there was no dispute, such claims would simply be paid. Litigation outside the insolvency process would not be required unless there was a dispute.[21] Even if such litigation were necessary to resolve a dispute, the payment of the non-provable liability would take place as part of the insolvency proceedings, since the liquidator or administrator would (and would be required to) pay it.

46. The LBHI2 Administrators seek to rely on the Court of Appeal's comment in *Re Danka Business Systems Plc* [2013] EWCA Civ 92 **[Auth/1/8]** at [38] to the effect that a liquidator or administrator is entitled to proceed to a distribution to members on the basis of the debts admitted to proof. [22] This is misplaced. The Court of Appeal's comment in *Danka* must be read in the context in which it was made. The payment of non-provable debts and statutory interest was not in issue in that case and it is obvious that the comment in *Danka* cannot be read as dealing with the point at all, since it is clear that post-liquidation interest payable by virtue of section 189 of the 1986 Act **[Auth/1/2]** must be paid before any distribution to members is made (even though it is not a provable debt).[23]

47. The LBHI2 Administrators also seek to rely on the decision of David Richards J in *Re T & N Ltd* [2006] 1 WLR 1728 **[Auth/1/21]**,[24] which concerned the process by which non-provable asbestosis claims were to be treated in the company's liquidation. David Richards J said at [106]-[107] that, in the event of a surplus, the Court would not restrain the asbestosis claimant from obtaining and then executing a judgment. David Richards J left open the question how a surplus insufficient to meet all such claims would fairly be distributed. He did not hold that dealing with non-provable claims fell outside the scope of the liquidator's duties nor that litigation was the only means by which they could be recognised.[25] David Richards J was not addressing that point.

48. The LBHI2 Administrators also seek to rely on *In re R-R Realisations Ltd* [1980] 1 WLR 805[26] **[Auth/6/9]** and *In re the Nortel Companies and Ors* [2014] 1 AC 209[27] **[Auth/1/17]** to contend that the payment of non-provable claims falls outside the scope

[21] CA Judgment per Briggs LJ at [134] and [187]-[189] and per Moore-Bick LJ at [246] **[Core/D/3]**.
[22] LBHI2 Administrators' Written Case, [54].
[23] CA Judgment per Lewison LJ at [56] **[Core/D/3]**.
[24] LBHI2 Administrators' Written Case, [56].
[25] CA Judgment per Briggs LJ at [188] **[Core/D/3]**.
[26] LBHI2 Administrators' Written Case, [57].
[27] LBHI2 Administrators' Written Case, [58].

of the liquidator's duties. However, these cases to not support the LBHI2 Administrators' contention. As explained below at [136], the payment of non-provable liabilities is part of the duty of the liquidator. Further, if a liquidator concluded that there was no answer to a non-provable claim, the liquidator would not require the claimant to issue proceedings. Rather, the liquidator would simply cause the company to pay the liability. The position would be the same in an administration such as that of LBIE.

49. The LBHI2 Administrators contend that the construction of Standard Term 5 by the Court of Appeal and David Richards J (and contended for by LBIE) is unworkable where the Borrower is not subject to any insolvency proceeding. In particular the LBHI2 Administrators suggest that, if statutory interest and non-provable liabilities constitute Liabilities for the purposes of the "*solvency*" test in Standard Term 5(2),[28] and if the construction of Standard Term 5 by David Richards J and the Court of Appeal is accepted, then, where the Borrower is ***not*** subject to any insolvency proceeding, there would have to be a complicated process of estimation of matters such as how long and complex a hypothetical insolvency process might be, if and when a distribution might be made, and so on.[29] This is wrong:

49.1. It is right to say that the "*solvency*" test in Standard Term 5(2) must have a unitary meaning both where the Borrower is in a formal insolvency proceeding and where the Borrower is solvent.[30]

49.2. It is also correct that, even where the Borrower is solvent, the "*solvency*" test requires consideration of whether obligations would be payable or capable of being established in the formal insolvency proceedings of the Borrower, if (hypothetically) it were to enter such formal insolvency proceedings.

49.3. Thus, in referring to Liabilities which are not "*capable of being established or determined in the Insolvency of the Borrower*", what Standard Term 5(2)(a)

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[28] Standard Term 5(2) provides as follows:"*(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, and (b) the Excluded Liabilities*".

[29] LBHI2 Administrators' Written Case, [36].

[30] LBHI2 Administrators' Written Case, [28].

contemplates are liabilities such as (in an English context) statute-barred debts[31] or non-EU foreign revenue claims[32]. Such liabilities are disregarded for the purposes of the "*solvency*" test in Standard Term 5(2) whether the Borrower is solvent or is in a formal insolvency proceeding. By contrast, non-provable liabilities are not disregarded for the purposes of the "*solvency*" test in Standard Term 5(2) because they are "*payable*" and "*capable of being established or determined in the Insolvency of the Borrower*".

49.4. However, contrary to the LBHI2 Administrators' case, the "*solvency*" test in Standard Term 5(2) does ***not*** demand that, where the Borrower is solvent (and has not entered formal insolvency proceedings), a hypothetical exercise has to be carried out to ascertain what liabilities the Borrower might accrue if but only if (counterfactually) the Borrower were to enter formal insolvency proceedings.

49.5. Thus the Borrower will only accrue a liability to pay statutory interest in circumstances where it has actually entered into formal insolvency proceedings. Statutory interest is payable by a company in formal insolvency proceedings so as to compensate its creditors for being kept out of their money for the period of time between the insolvent company's entry into insolvency proceedings and the payment of proved debts in full.

49.6. A solvent Borrower will not be subject to the liability to pay statutory interest, since it is not in fact and will not be subject to a formal insolvency proceeding. A solvent Borrower is, by definition, able to pay its liabilities as they fall due and so there is no basis on which its creditors would need to be compensated for being kept out of their money.

49.7. Also, outside a formal insolvency proceeding, there is (as a matter of English law) no distinction between provable and non-provable liabilities; they are both simply liabilities of the company and both therefore fall within the assessment of "solvency".

[31] See *Re Art Reproduction Co Ltd* [1952] Ch. 89 **[Auth/4/3]**.
[32] See *Government of India v Taylor* [1955] A.C. 491, at pp. 508-9 **[Auth/4/33]**.

49.8. Therefore, the "*solvency*" test in Standard Term 5(2) does not require hypothetical or counterfactual liabilities to be taken into account at all. Accordingly, contrary to the LBHI2 Administrators' case, there is no requirement to assume a hypothetical formal insolvency proceeding and then to carry out the wholly artificial exercise of estimating matters such as how long and complex that hypothetical insolvency proceeding would be, if and when a distribution might be made, and so on.

50. The LBHI2 Administrators contend that, on their true construction, Standard Terms 5(1)(b) and 5(2)(a) limit the "*Liabilities*" which are to be taken into account in ascertaining whether the Borrower is "*solvent*" to the debts which are ***provable*** in a formal insolvency process.[33] Indeed, the LBHI2 Administrators contend that the language of Standard Term 5(2)(a) is "*short-hand*" for the concept of provable claims as this concept is understood specifically from the perspective of English law.[34] This is wrong. The LBHI2 Administrators' contention rewrites the language of the clause and imports the domestic English law concept of provability into a clause intended to have application in insolvencies in other jurisdictions.

51. If the draftsman had had the notion of provable debts in mind and had wanted to limit the subordination only to provable debts, rather than those which became payable, he could easily have used the language of provability. It is not surprising that he did not do so given the background to, and purpose of, the Sub Debt Agreements.

52. As to the fact that this clause was intended to have application in foreign insolvencies:

52.1. Standard Terms 5(1)(b) and 5(2)(a) are intended to apply so that the Borrower's solvency may be ascertained with reference to what would be "*payable or capable of being established or determined in the Insolvency of the Borrower*". The concept of "*Insolvency*"[35] is not limited to an English liquidation or administration with their specific rules regarding provability.

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[33] LBHI2's Grounds of Appeal, [19].
[34] LBHI2 Administrators' Written Case, [33].
[35] The definition of "Insolvency" given in the Standard Terms is as follows: "*'Insolvency' means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject*".

52.2. The Sub Debt was intended to form part of the Borrower's regulatory capital for the purposes of INPRU. As noted above at [20], minimum capital adequacy requirements are set at an EU level, not at a domestic level, and different jurisdictions adopt different rules as to what debts are provable.[36]

52.3. The LBHI2 Administrators are wrong to contend that Standard Term 5(2)(a) is modelled on the English statutory scheme.[37] This contention ignores the regulatory and commercial context in which the Standard Terms fall to be construed. It is irrelevant whether the English statutory material would have been, as the LBHI2 Administrators contend[38], reasonably available to both LBHI2 and LBIE when they entered into the Sub Debt Agreements. Further, the LBHI2 Administrators are wrong to contend that there is anything in the language of Standard Term 5(2) which demands, contrary to the regulatory and commercial context of the agreement, that it be construed narrowly with reference to the English insolvency regime only.[39]

52.4. Accordingly, as a matter of construction, it cannot be correct that Standard Terms 5(1)(b) and 5(2)(a) limit the "*Liabilities*" (which are to be taken into account in ascertaining whether the Borrower is "*solvent*") to the debts which are provable in the English liquidation or administration of LBIE.

53. The LBHI2 Administrators seek to suggest that the reference in the Sub Debt Agreement to Liabilities which are not "*capable of being established or determined in the Insolvency of the Borrower*" is intended to ensure that future and contingent liabilities are considered for the purposes of the "*solvency*" test in Standard Term 5(2).[40] However, whilst the concept of liabilities which are "*capable of being established or determined in the Insolvency of the Borrower*" would include future and contingent liabilities, there is no warrant for construing these words to be limited to future and contingent liabilities, to the exclusion of anything else. Further, the LBHI2 Administrators' argument that the phrase is a reference to the treatment of future and contingent liabilities in English insolvency law wrongly approaches the "*solvency*" test

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[36] HC Judgment, [67] **[Core/D/5]**. Indeed, foreign insolvency regimes may have no notion of "provability" at all.
[37] LBHI2 Administrators' Written Case, [34].
[38] LBHI2 Administrators' Written Case, [68].
[39] LBHI2 Administrators' Written Case, [68.3]-[68.4].
[40] LBHI2 Administrators' Written Case, [34]-[35].

in Standard Term 5(2) in light of the English insolvency regime, whereas, for the reasons set out above, that cannot be the correct approach.

54. The LBHI2 Administrators contend that the construction by the Court of Appeal (and David Richards J below) renders otiose the words "*or capable of being established or determined in the Insolvency of the Borrower*" and that the draftsman meant those words to mean something different from "*payable*".[41] This is wrong. Liabilities which are not "*capable of being established or determined in the Insolvency of the Borrower*" include liabilities such as (in the context of English law) statute-barred debts[42] or non-EU foreign revenue claims[43] but they do not include Liabilities which are payable at levels 6 or 7 of the Waterfall which *are* capable of being established or determined in the Insolvency of the Borrower.

55. The LBHI2 Administrators seek to rely on Standard Term 5(1)(b), which provides that the payment of the Sub Debt is conditional on LBIE being "*solvent*" (as defined in Standard Term 5(2)) "*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*".[44] In particular, the LBHI2 Administrators contend that:

55.1. Neither statutory interest nor non-provable liabilities are payable unless there are surplus assets remaining after payment of all proved debts.

55.2. The Sub Debt is itself a provable debt and, 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 by paying the Sub Debt.

55.3. There is therefore (and can be) no liability to pay statutory interest or non-provable liabilities in any sum exceeding whatever surplus is left after payment of the Sub Debt (because it is a provable debt).

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[41] LBHI2's Grounds of Appeal, [19]; LBHI2 Administrators' Written Case, [39], [45] and [61].
[42] See *Re Art Reproduction Co Ltd* [1952] Ch 89 **[Auth/4/3]**.
[43] See *Government of India v Taylor* [1955] AC 491 at 508-9 **[Auth/4/33]**.
[44] LBHI2 Administrators' Written Case, [63].

55.4. Accordingly, once the unsecured unsubordinated debts have been paid and the LBIE Administrators are deciding whether they can pay the Sub Debt consistent with the requirements of Standard Term 5(2), they can be confident that payment of the Sub Debt will always leave the company "*solvent*" because the sum to be applied in payment of statutory interest (and in payment of non-provable liabilities, if and so far as that is required) is only whatever remains once the Sub Debt is paid (because the Sub Debt is a provable debt).

56. The LBHI2 Administrators' contentions are wrong:

56.1. For the reasons set out in detail below at [61] to [70], the Court of Appeal was wrong to hold that the Sub Debt is provable in LBIE's administration.[45] If the LBIE Administrators succeed in appealing this decision then the LBHI2 Administrators' contentions in their Grounds of Appeal at [23] will proceed on a false premise and will be wrong for that reason alone.

56.2. In any event, the LBHI2 Administrators' argument that the Sub Debt must be paid in order to ascertain the surplus is circular. The Sub Debt would have been payable with the provable debts were it not for its subordination. But that fact cannot of itself define the extent of its subordination. The LBHI2 Administrators' argument on this point is therefore a "boot straps" argument which begs the question in dispute.

56.3. Alternatively, if the Sub Debt is provable prior to the Senior Liabilities being paid, then: (i) it is a ***contingent*** provable debt because the Sub Debt Agreement itself provides that repayment is not due until certain contingencies have occurred; and (ii) when the proof is lodged the office-holder would be expected to value the contingency at nil and then to revalue it once (and only once) it becomes clear that the conditions have been satisfied.[46]

[45] CA Judgment per Lewison LJ at [39] **[Core/D/3]**.
[46] CA Judgment per Lewison LJ at [41] **[Core/D/3]**.

56.4. The Court of Appeal was correct to hold (unanimously) that the preconditions for the repayment of the Sub Debt include the payment in full of statutory interest and non-provable liabilities.

56.5. Accordingly, unless and until both statutory interest and non-provable debts are paid or provided for in full, the Sub Debt will be valued at nil; and it will ***only*** be revalued once statutory interest and non-provable debts have both been paid or provided for in full.

56.6. Further and in any event, the LBHI2 Administrators' contentions in their Grounds of Appeal at [23] as to how Standard Term 5 is intended to operate cut across the regulatory context and purpose of the Sub Debt Agreements.[47]

57. For all these reasons, the LBHI2 Administrators' contention that there is (and can be) no liability to pay statutory interest or non-provable liabilities in any sum exceeding whatever surplus is left after payment of the Sub Debt, is wrong. The consequence of the Sub Debt being a contingent provable debt (if, as the Court of Appeal held, that is what it is) is precisely that statutory interest and non-provable liabilities must be paid in full before: (i) it is revalued at any amount greater than nil; and therefore (ii) it is to be repaid in any amount.

58. For the avoidance of doubt, if and to the extent that the LBHI2 Administrators contend that the LBIE Administrators are required to make a reserve to provide for payment of the Sub Debt in full (or in any amount) prior to being able properly to pay statutory interest or non-provable liabilities, then this is incorrect. See the Court of Appeal decision in *Re Danka Business Systems Plc* [2013] EWCA Civ 92 at [37] **[Auth/1/8]**.[48]

59. Finally, the LBHI2 Administrators contend that the Court of Appeal erred in failing to declare expressly that the Sub Debt is available for set-off as well as being provable.[49] The LBIE Administrators agree that, if the Sub Debt is provable, it would have gone

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[47] See above at [19] to [21].

[48] In particular (per Patten LJ): "*But there are, I think, real difficulties in seeing how a liquidator who has already valued the contingent claims and so admitted them to proof in the amount of the valuation comes under a legal duty to provide for the contingency in full by making a reserve against any distribution to Members. The reference to the company's liabilities in s.107 must be to the liabilities as determined in accordance with the 1986 Rules. Otherwise they serve no useful purpose*".

[49] LBHI2's Grounds of Appeal, [25].

into the account for set-off purposes once the LBIE Administrators gave notice of their intention to make distributions to LBIE's general body of unsecured creditors.[50] However, for the reasons set out below at [61] to [70], the LBIE Administrators contend that the Court of Appeal erred in concluding that the Sub Debt is a provable debt.

60. Accordingly, the LBHI2 Administrators' appeal should be dismissed.

**(3) Cross-appeal: The Sub Debt is not currently capable of being proved**

61. For the reasons set out below, the LBIE Administrators contend that the Court of Appeal was wrong to conclude that the Sub Debt Agreements permit the lodging of a proof of debt in respect of the Sub Debt prior to the payment in full of the Senior Liabilities.[51] David Richards J was correct to hold that:

> "*the lodging of a proof in respect of the subordinated loan debts coupled with an attempt to require the administrator to admit the proof would be both an attempt to obtain repayment of subordinated liabilities otherwise than in accordance with the terms of the agreement, within the meaning of clause 7(d), and the taking of action whereby the subordination of those liabilities to the Senior Liabilities might be impaired or adversely affected, within the meaning of clause 7(e). In my view, an attempt to rely on provisions of the applicable insolvency law to advance the subordinated liabilities above Senior Liabilities is well within the intended scope of paragraphs (d) and (e) of clause 7*".[52]

62. Further, and in particular, David Richards J was correct to declare that provable debts, statutory interest and non-provable liabilities must be paid in full before: (i) LBHI2 is entitled to prove and require the LBIE Administrators to admit such proof in respect of its claims under the Sub Debt Agreements; and (ii) such claims are available for insolvency set-off.

63. On their true construction, the Sub Debt Agreements provide that creditors under the Sub Debt Agreements (e.g. LBHI2) would not be entitled to prove unless and until the relevant contingencies have occurred.

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[50] Insolvency set-off is automatic and self-executing: see *Stein v Blake* [1996] AC 243 **[Auth/1/20]**. See also rules 2.85(3) **[Auth/3/41]** and 2.95 **[Auth/3/42]** of the 1986 Rules.
[51] Judgment per Lewison LJ at [39]-[41] **[Core/D/3]**.
[52] HC Judgment, [69] **[Core/D/5]**.

64. Standard Term 7 contains a number of undertakings given to LBIE by LBHI2 in support of the subordination. Among those undertakings:

64.1. LBHI2 undertook not to "*purport to retain or set-off at any time any amount payable by it to [LBIE] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement…*" (sub-paragraph (b));

64.2. LBHI2 undertook not to "*attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement*" (paragraph (d)); and

64.3. LBHI2 undertook not to take or omit to take "*any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected*" (paragraph (e)).

65. Construing these undertakings in the context of the Sub Debt Agreements as a whole (and their regulatory context), the correct analysis is that they prohibit LBHI2 from taking any steps to prove in respect of the Sub Debt or to attempt to require the administrator to admit the proof until the relevant contingencies have occurred.

66. The act of proving is an inherent and necessary part of the process of attempting to obtain payment in the context of a distributing administration or liquidation. Indeed, as Lewison LJ held, proving is the only way of attempting to obtain repayment of the Sub Debt in an English insolvency.[53] Accordingly, proving for the Sub Debt before statutory interest and non-provable claims have been paid in full would constitute an act by which the subordination of the Sub Debt "*might be… impaired or adversely affected*" within the meaning of Standard Term 7(e).

67. Further, Standard Term 4, which deals with repayment, is clear that LBHI2's remedies are ***limited*** to those permitted by that provision. These remedies do not include the ability to prove for the Sub Debt unless and until statutory interest and non-provable claims have been paid in full. In particular:

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[53] CA Judgment per Lewison LJ at [39] **[Core/D/3]**.

67.1. Standard Term 4(1) provides that the "*Repayment*" provisions of the Sub Debt Agreement (i.e. Standard Term 4) are expressly "*subject in all respects to the provisions of paragraph 5 (subordination)*," which makes clear that LBHI2 is not entitled to seek any repayment, and no repayment can fall due, unless the condition contained in Standard Term 5(1) is satisfied, i.e. unless all Liabilities have been paid in full.

67.2. Standard Term 4(4) provides that, in the event of certain defaults in repayment, the Lender might "*enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Days' prior written notice to the FSA ...*"

67.3. Standard Term 4(5) also gives the Lender the right to institute proceedings for the insolvency of the Borrower in certain events.

67.4. Standard Term 4(7) provides: "***No remedy** against the Borrower **other than as specifically provided by this paragraph 4** shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement*" (emphasis added).

68. Accordingly, Lewison LJ's reliance on the absence of any express provision in Standard Term 5 prohibiting the subordinated creditor from lodging a proof in the insolvency of the Borrower is misplaced.[54] In particular:

68.1. It is Standard Term 4 and not Standard Term 5 that sets out the Lender's remedies.

68.2. Standard Term 4(7) provides that the remedies provided by Standard Term 4 are exhaustive. The Lender has no remedies other than those provided by Standard Term 4.

[54] CA Judgment per Lewison LJ at [39] **[Core/D/3]**.

68.3. Standard Term 4 does not permit the Lender to prove in the Borrower's insolvency before statutory interest and non-provable claims have been paid in full. It permits very limited steps, which do not include proving.

68.4. It follows that the Lender is not entitled to prove in the Borrower's insolvency before statutory interest and non-provable claims have been paid in full. If the Lender seeks to do so then, for the reasons set out above, it will be in breach of Standard Terms 7(b) and 7(d), as well as Standard Term 7(e).

69. Finally, Lewison LJ's reliance[55] on the comment in *Goode on Legal Problems of Credit and Security*, 4th Ed. (2008, Sweet & Maxwell) at 210 **[Auth/8/6]** (describing a contractual provision precluding the subordinated creditor from proving in the insolvency of the debtor until all other creditors have been paid as the "*most controversial form*" of subordination agreement) is misplaced. In particular:

69.1. As Lewison LJ recognised,[56] a contractual subordination provision of this kind preventing a creditor from proving in the borrower's insolvency has been held to be legally valid: see the Court of Appeal's decision in *Re SSSL Realisations Ltd (in liquidation)* [2006] Ch 610 **[Auth/6/13]**.

69.2. Contrary to Lewison LJ's suggestion,[57] it is not difficult to suppose that in its standard form the regulator chose to adopt this form of subordination. Rather, given the provisions of INPRU with which the Standard Terms were intended to comply (in particular r.10-62) **[Auth/8/7]**,[58] it is difficult to see how the Standard Terms would be capable of accomplishing their regulatory purpose if they permitted the Lender to prove in the Borrower's insolvency before statutory interest and non-provable claims have been paid in full.

69.3. In any event, the comment in *Goode on Legal Problems of Credit and Security*, 4th Ed. (2008, Sweet & Maxwell) **[Auth/8/6]**, at 210, did not refer to (or have in

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[55] CA Judgment per Lewison LJ at [38] and [40] **[Core/D/3]**.
[56] CA Judgment per Lewison LJ at [38] **[Core/D/3]**.
[57] CA Judgment per Lewison LJ at [40] **[Core/D/3]**.
[58] See above at [21].

its contemplation) the regulatory context and exigencies with which the present case is concerned.

69.4. Accordingly, in these circumstances, the comment in *Goode on Legal Problems of Credit and Security*, 4th Ed. (2008, Sweet & Maxwell) **[Auth/8/6]**, at 210, is irrelevant.

70. For these reasons, on their true construction, the Sub Debt Agreements prohibit subordinated creditors from proving for the Sub Debt or requiring an administrator to admit that proof until the relevant contingencies have occurred.

## C: CURRENCY CONVERSION CLAIMS

71. CVI GVF (Lux) Master Sarl ("**CVI**"), an unsecured creditor of LBIE, took on the burden of the argument in favour of the existence of Currency Conversion Claims before the Court of Appeal and will again do so before the Supreme Court.

72. The LBIE Administrators have had the opportunity of considering CVI's written case in draft. They are content to adopt CVI's written case and do not intend to make oral submissions as to the existence of Currency Conversion Claims.

## D: POST-ADMINISTRATION INTEREST

### (1) Introduction

74. The issue is whether the right to statutory interest which has arisen during the administration as a result of the existence of a surplus will be lost if the company goes into liquidation without such statutory interest having been paid.

75. This turns on the interpretation of rule 2.88(7) of the 1986 Rules **[Auth/1/4]** and section 189(2) of the 1986 Act **[Auth/1/2]**.[59] These provisions are (as in force at the relevant time):

75.1. Rule 2.88(7):

> "*Any surplus remaining after the payment of the debts proved in a winding up shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company entered administration*".

75.2. Section 189(2):

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

76. The factual premise of the issue which arises in the present case is that there is, in the hands of the LBIE Administrators, a substantial surplus out of which statutory interest is payable under rule 2.88(7) **[Auth/1/4]** on debts proved in LBIE's administration.

77. The Court of Appeal held that, if a surplus is passed to the liquidator in a subsequent liquidation, it will arrive burdened by an obligation to pay interest to creditors who proved in the administration; and that so much of the fund as must be applied for that purpose will not count in the liquidation as making up part of any future surplus.[60]

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[59] References to rules and sections are, unless otherwise stated, to the 1986 Rules and the 1986 Act, respectively.

[60] See the CA Judgment per Lewison LJ at [107], per Briggs LJ at [135] and per Moore-Bick LJ at [246] **[Core/D/3]**.

78. Briggs LJ held in the CA Judgment **[Core/D/3]** at [135] that a *Quistclose*-type trust analysis of the effect of rule 2.88(7) was the best way, in legal terms, of giving effect to the clear legislative intent embodied in that provision; whereas Lewison LJ considered at [107] that he considered it inappropriate to become "*bogged down*" in selecting a suitable private law label to describe the statutory instruction.

79. The LBL Administrators, supported by the LBHI2 Administrators and LBHI, contend that the Court of Appeal erred in law and that the provisions of the statutory scheme are inconsistent with the survival of rule 2.88(7) **[Auth/1/4]** in a liquidation for statutory interest.[61] It is anticipated that they will also contend (in their case in reply to the LBIE Administrators' case) that: (i) statutory interest which was not paid in the administration would not be provable in a subsequent liquidation; and (ii) interest to which a creditor has a contractual or other right apart from the administration cannot be claimed as a non-provable liability of the company in liquidation.

80. The LBIE Administrators contend that the Court of Appeal was correct for the reasons given in the CA Judgment. The LBIE Administrators submit that:

80.1. The surplus in the hands of the administrator will, when passed on to the liquidator in LBIE's subsequent liquidation, be required to be applied in paying the statutory interest which was payable (but remained unpaid) in the administration before it can be used by the liquidator for any other purpose.

80.2. If that is wrong, the creditors who proved in the administration and who were entitled to receive statutory interest out of the surplus will be entitled to prove in the liquidation in respect of the statutory interest that was, immediately prior to the administration coming to an end, due to be paid to them out of the surplus pursuant to Rule 2.88(7) **[Auth/1/4]**.

80.3. If that too is wrong, those of the creditors who had a contractual or other right to interest apart from the administration are entitled to receive the amount of that

[61] LBHI2's Grounds of Appeal, [27].

interest which remains unpaid as a non-provable liability of the company in liquidation. (This point forms the LBIE Administrators' cross-appeal.)

## (2) Survival of post-administration statutory interest in liquidations

81. The LBIE Administrators maintain that the provisions of the statutory scheme are consistent with the survival of the creditors' right to unpaid post-administration statutory interest in a subsequent liquidation. It is also clear that there are sound policy reasons for such a conclusion:

81.1. There is no policy reason that would justify the conclusion reached by David Richards J in the HC Judgment **[Core/D/5]** at [118] that:

> "*where an administration is followed by a liquidation, interest on interest-bearing debts is provable in respect of the period down to the commencement of the administration, but statutory interest is payable out of a surplus only from the date of the liquidation. On this basis, if LBIE were to go into liquidation, creditors would not receive interest in respect of the period from September 2008 when it went into administration until the date it goes into liquidation*".[62]

81.2. David Richards J himself acknowledged in the HC Judgment **[Core/D/5]** at [119] that:

> "*There would seem to be no purpose served in a denial of any interest during the period of an immediately preceding administration or liquidation. That there was no policy justifying such denial would appear to be demonstrated by the amendments made to rule 2.88 with effect from 6 April 2010 which ensure that in an administration which has been immediately preceded by a liquidation, statutory interest is payable in respect of the period since the commencement of the earlier liquidation*".

81.3. By contrast there is an obvious policy reason that would justify the unanimous conclusion reached by the Court of Appeal that the obligation impressed upon the surplus by rule 2.88(7) **[Auth/1/4]** to pay post-administration interest remains notwithstanding the company's entry into liquidation, namely the policy that creditors should not be deprived of accrued rights by an office-holder moving a

[62] See the CA Judgment per Lewison LJ at [106] **[Core/D/3]**.

company from one kind of insolvency proceeding into another. Indeed, substantial injustice would be caused if the conclusion of David Richards J were correct. As Lewison LJ put it in the CA Judgment **[Core/D/3]** at [108], rule 2.88(7) **[Auth/1/4]** gives rise to "*an accrued statutory right which should not be allowed to disappear into a black hole*".[63]

82. Quite apart from questions of policy, both the structure of rule 2.88(7) **[Auth/1/4]** itself and the natural meaning of its language are consistent with the conclusions reached by the Court of Appeal:

82.1. While rule 2.88(7) **[Auth/1/4]** applies only to a surplus which arises, or which can retrospectively be shown to have arisen, in the course of the administration, the requirement to pay interest is not limited to a direction to the administrator. Rather, it represents both: (i) a liability of the company;[64] and (ii) a statutory instruction that the surplus cannot be applied for any purpose other than paying statutory interest until statutory interest has been paid in full.

82.2. On its proper construction, rule 2.88(7) **[Auth/1/4]** entitles all creditors who have proved in the administration to post-administration interest on their proved debts, without specific regard to the question of whether or not the administration is subsisting or the company has been moved into liquidation.[65]

83. The LBL Administrators contend that the conclusion fashioned by the Court of Appeal is unwarranted judicial legislation. This is wrong:

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[63] As David Richards J explained in *Re Lehman Brothers International (Europe) (In Administration)* [2016] Bus LR 17 **[Auth/1/14]** at [149]: "*The right to interest out of a surplus under rule 2.88 is not a right to the payment of interest accruing due from time to time during the period between the commencement of the administration and the payment of the dividend or dividends on the proved debts. The dividends cannot be appropriated between the proved debts and interest accruing due under rule 2.88, because at the date of the dividends no interest was payable at that time pursuant to rule 2.88.* ***The entitlement under rule 2.88 to interest is a purely statutory entitlement, arising once there is a surplus and payable only out of that surplus***" (emphasis added). Once there is a surplus, the creditors with proved debts have a right to have that surplus administered in accordance with rule 2.88(7) of the 1986 Rules **[Auth/1/4]**. It is in that sense that Lewison LJ refers to the right to statutory interest as being "*an accrued statutory right*".

[64] See below at [140ff] in relation to the scope of contributories' liability to contribute to a company in liquidation under section 74 of the 1986 Act **[Auth/1/1]**.

[65] See the CA Judgment per Lewison LJ at [108] **[Core/D/3]**.

83.1. The conclusion reached accords with the natural meaning of the words used in rule 2.88(7) **[Auth/1/4]** and is consistent with fairness and what the draftsman must have intended. The result for which the LBL Administrators contends is one which can only be reached by adding a gloss to the terms of rule 2.88(7) **[Auth/1/4]** to the effect that the surplus shall not be applied in accordance with the statutory requirement if, before the surplus has been distributed to creditors, the company moves into liquidation.

83.2. It was not necessary for the Court of Appeal to decide which type of private law trust or charge is most closely analogous to the effect of rule 2.88(7) **[Auth/1/4]**. In this respect, Lewison LJ was correct to consider it unnecessary to become "*bogged down*" in selecting a suitable private law label for describing the mechanism by which the rule 2.88(7) **[Auth/1/4]** obligation attaches to the relevant fund and survives the end of the administration. The trust or statutory charge to which rule 2.88(7) **[Auth/1/4]** gives rise is ***not*** a private law trust or charge and it would be wrong to find that it cannot exist simply because it does not comply with all of the formal requirements of a particular type of private law trust or charge.

83.3. In any event, as submitted above, the conclusion reached by the Court of Appeal does no more than give full and proper effect to the meaning and intention of rule 2.88(7) **[Auth/1/4]**. In reaching its conclusion, the Court of Appeal did not stray into the realm of judicial legislation, unwarranted or otherwise. Accordingly, the submissions made in the LBL Administrators' Written Case at [36]-[38], as regards the limits of judicial corrections of statutory drafting mistakes, are misplaced.

84. The LBL Administrators' suggestion that the "*identical lacuna in the obverse situation*" (i.e. the status of unpaid post-liquidation statutory interest in a subsequent administration) "*could only be filled by legislative amendment*" is misconceived.[66]

84.1. Prior to the amendment to rule 2.88(1) of the 1986 Rules **[Auth/1/4]** to which LBL refers, any unpaid post-liquidation statutory interest would have only been

[66] LBL Administrators' Written Case, [23].

payable in a subsequent administration out of any surplus which had arisen in the liquidator's hands under section 189(2) **[Auth/1/2]** and which subsequently came into the hands of the administrator.

84.2. The amendment to rule 2.88(1) **[Auth/1/5]** has improved upon this situation by, in effect, entitling creditors in a subsequent administration to statutory interest in respect of the post-liquidation period ***regardless*** of whether there had been a section 189(2) surplus in the preceding liquidation, whereas prior to the amendment their entitlement to post-liquidation interest would have depended on the existence of a section 189(2) surplus in the previous liquidation.

84.3. Accordingly, the LBL Administrators are wrong to contend that the amendment to rule 2.88(1) **[Auth/1/5]** had the same effect on the "*identical lacuna in the obverse situation*" (i.e. the status of unpaid post-liquidation statutory interest in a subsequent administration) as the Court of Appeal's conclusion regarding the status of unpaid post-administration statutory interest in a subsequent liquidation.

85. It is right to say that the Court of Appeal's approach regarding the continued application of rule 2.88(7) **[Auth/1/4]** in a winding up immediately following an administration means, given the comparable language found in section 189(2) **[Auth/1/2]**, that an analogous analysis applies in the context of an administration that immediately follows a liquidation[67]. However:

85.1. If a section 189(2) surplus arises in the liquidation then a creditor's right in a subsequent administration to post-liquidation interest will be payable in the first instance out of any surplus which had arisen in the liquidator's hands under section 189(2) **[Auth/1/2]** and, to the extent that the section 189(2) surplus does not exhaust this entitlement to post-liquidation interest, then it will be 'topped up' pursuant to the amendment to Rule 2.88(1) **[Auth/1/5]**.

85.2. For the avoidance of doubt, there is nothing in rule 2.88(7) **[Auth/1/4]** which requires the company to pay interest twice if and to the extent that a creditor has

[67] LBL Administrators' Written Case, [35].

already had his right to post-liquidation interest satisfied out of the section 189(2) surplus.

86. The LBL Administrators contend that there is no basis for requiring the liquidator to follow rule 2.88(7) **[Auth/1/4]** since, pursuant to rule 2.1(1) **[Auth/3/32]**, it applies only in an administration.[68] This is wrong. Whilst it is clear that rule 2.88(7) **[Auth/1/4]** is engaged in an administration (see rules 2.1.1(d) **[Auth/3/32]** and 2.68(1) **[Auth/3/34]**), there is nothing in the Rules or the Act which provides that a creditor's accrued statutory right to post-administration interest disappears down a black hole upon the company moving into liquidation.[69] The fact that, upon the company's entry into a subsequent liquidation, the administrator relinquishes control over the assets he was administering, which the LBL Administrators pray in aid of their construction of rule 2.88(7) **[Auth/1/4]**,[70] does not affect this analysis. It would be surprising if the change in identity of the officeholder, or the change in insolvency process, caused creditors to lose their accrued rights to statutory interest.

87. The LBL Administrators are also wrong to contend that the Court of Appeal's construction of rule 2.88(7) **[Auth/1/4]** breaches the Waterfall in a liquidation.[71] Rule 2.88(7) **[Auth/1/4]** imposes a liability on the company to pay post-administration interest. That liability of the company is impressed on such amount of the post-administration surplus as is required to pay post-administration interest (the "**Rule 2.88(7) Fund**"). That liability in respect of the Rule 2.88(7) Fund persists in the company's subsequent liquidation. In any event, rule 2.88(7) **[Auth/1/4]** does not interfere with the statutory regime for the distribution of the company's liquidation estate since the Rule 2.88(7) Fund does not form part of the liquidation estate. There is no question of rule 2.88(7) **[Auth/1/4]** taking precedence over or contravening the express provisions of the Act[72] any more than paragraph 99 of Schedule B1 to the 1986 Act **[Auth/3/21]** does.

88. The LBL Administrators contend that rule 2.88(7) **[Auth/1/4]** has no application once the company is no longer in administration and is to be contrasted with paragraph 99 of

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[68] LBL Administrators' Written Case, [30].
[69] See above at [81] to [82].
[70] LBL Administrators' Written Case, [31].
[71] LBL Administrators' Written Case, [32].
[72] LBL Administrators' Written Case, [32(5)].

Schedule B1 of the 1986 Act **[Auth/3/21]**, which, it is said, shows that where the draftsman intended to create an obligation binding on the assets after they passed from the hands of the administrator into the hands of the liquidator, specific provision is made for such a continuing obligation by way of statutory charge.[73] This is wrong:

88.1. The fact that the statutory regime is capable of creating expressly an obligation binding on the assets after they passed from the hands of the administrators into the hands of the liquidator (as is the case pursuant to paragraph 99(3)(a) of Schedule B1 of the 1986 Act **[Auth/3/21]**) does not of itself preclude the statutory regime from creating such an obligation by necessary implication. Indeed, there is nothing in the statutory regime that prevents such an obligation arising by necessary implication.

88.2. The correct question is what, on the correct construction of rule 2.88(7) **[Auth/1/4]**, is to happen to a "*surplus*" of the relevant kind once it comes into the hands of the liquidator. For the reasons set out above, the correct conclusion is that, on the proper construction of rule 2.88(7) **[Auth/1/4]**, such a surplus is to remain impressed with the obligation provided by that statutory provision.

88.3. It is correct to say that, pursuant to rule 2.1(1) **[Auth/3/32]**, rule 2.88(7) **[Auth/1/4]** applies in administration. However, the effect of rule 2.88(7) **[Auth/1/4]** in administration is to impress the "*surplus*" arising in the administrators' hands with an enduring obligation that it be applied to a particular purpose. The fact that rule 2.88(7) **[Auth/1/4]** cannot be newly engaged upon a company moving from administration into liquidation does not mean that the effect that this statutory provision already has is cancelled or reversed in any way.

89. Finally, the LBL Administrators' criticisms of the Court of Appeal's approach to rule 2.88(7), as set out in their Written Case at [41]-[44], are misplaced.

89.1. In essence the LBL Administrators complain that the Court of Appeal's conclusion does not completely solve the problem, in that it does not come to the

[73] LBL Administrators' Written Case, [33].

assistance of creditors in certain other situations (such as where a creditor has not proved in an administration).[74]

89.2. This is the wrong approach. If the Court of Appeal's conclusion does not solve the problem in all situations (and it does not), then this is because an amendment is required to be made to section 189(2) **[Auth/1/2]** to solve the problem in other situations. It is a non-sequitur to say that the conclusion reached by the Court of Appeal as to the effect of rule 2.88(7) **[Auth/1/4]**, and the manner in which it has avoided the problem and ensured the correct outcome in the situation which arises in this case, is flawed.

89.3. The Court of Appeal approached the construction of rule 2.88(7) **[Auth/1/4]** correctly, with reference to the language used in that statutory provision and the statutory context in which it is to be found.

90. Accordingly, the appeals against the Court of Appeal's conclusion on this issue should be dismissed. On the proper construction of rule 2.88 **[Auth/1/4]**, the surplus is burdened in the hands of a liquidator by an obligation to pay statutory interest to creditors who proved in the administration.

## (3) Accrued post-administration interest is provable in a liquidation

91. Permission has been granted for the LBIE Administrators to advance a fallback argument that, if the Court of Appeal was wrong to hold that the surplus is burdened in the hands of a liquidator by an obligation to pay statutory interest to creditors who proved in the administration, any right to statutory interest which had arisen pursuant to rule 2.88(7) **[Auth/1/4]** in the course of LBIE's administration will be provable in a subsequent liquidation of LBIE (to the extent that such right has not been satisfied in the preceding administration).

[74] It is in any event not clear that there is a lacuna to be closed, or assistance justified, for a creditor who has not proved in the administration. If, notwithstanding the opportunity to do so (in LBIE's administration, an opportunity available for several years), a creditor does not prove, it also has not taken the step required to become entitled to statutory interest, such that there is no accrued right to statutory interest to be lost when moving into liquidation.

92. This argument was raised by the LBIE Administrators before the Court of Appeal,[75] although it was not dealt with by the Court of Appeal.

93. The version of rule 13.12(1) **[Auth/1/6]** applicable to the subsequent liquidation of LBIE provides that the following will be provable in that liquidation:

> "*(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)*".

94. In *In re the Nortel Companies and Ors* [2011] Bus LR 766 **[Auth/4/12]** at [104] and [111]-[123], Briggs J (as he then was) held that, on the proper construction of this version of rule 13.12(1) **[Auth/1/6]**, the cut-off date for the provability of a relevant debt or liability in such a liquidation will be the date of the commencement of the subsequent liquidation (rather than the date of the commencement of the preceding administration). (The validity of this part of Briggs J's decision was not affected by the subsequent decision of the Supreme Court in that case.)

95. Any right of an unsecured creditor of LBIE to statutory interest that has arisen under rule 2.88(7) **[Auth/1/4]** prior to LBIE's entry into liquidation will amount to a debt or liability for the purposes of rule 13.12(1) **[Auth/1/6]**, specifically rule 13.12(1)(a) **[Auth/1/6]**, on the basis that it will be a "*debt or liability to which the company is subject at the date on which it goes into liquidation*". The LBIE Administrators' submissions in respect of statutory interest being a liability of LBIE have been explained above at [39] and are developed further below at [140ff].

96. It follows that, if LBIE moves from administration into liquidation, then those creditors who prior to LBIE's entry into liquidation have a right to statutory interest under rule 2.88(7) **[Auth/1/4]** will be entitled to prove in respect of that right (to the extent that it has not been satisfied in the preceding administration).

[75] Court of Appeal transcript, Day 4, page 30, line 2 to Day 4, page 47, line 14.

## **(4) Non-provable claim for interest**

97. In the event that the Supreme Court holds:

    97.1. that the Court of Appeal erred in holding that the rule 2.88(7) **[Auth/1/4]** "surplus" comes into the hands of the liquidator in a subsequent liquidation already burdened by an obligation to pay interest to creditors who proved in the administration (granting the LBHI2 Administrators' appeal); and

    97.2. that accrued but unpaid rights to statutory interest under rule 2.88(7) **[Auth/1/4]** are not provable in a subsequent liquidation (rejecting the LBIE Administrators' argument set out above at [91] to [96]),

then the LBIE Administrators will contend that David Richards J's declaration (v) should be restored.

98. David Richards J's declaration (v) was as follows:

> "*Those creditors of LBIE entitled to interest on their provable debts otherwise than under r.2.88(7) of the Rules or s.189 of the Act will be entitled to claim in a liquidation of LBIE, which immediately follows the administration, for interest which accrued due during the period of the administration, as a non-provable claim against LBIE, payable after the payment in full of all proved debts and statutory interest on such debts*".

99. The Court of Appeal held, in allowing LBIE's appeal against David Richards J's related decision in declaration (iv), that if the administration of LBIE is immediately followed by a liquidation, any statutory interest in respect of the period of the administration which was payable under rule 2.88(7) **[Auth/1/4]** but was not paid before the commencement of the liquidation will be payable in the liquidation under rule 2.88(7) **[Auth/1/4]** from any part of the fund which constituted the "surplus" in the administration (as defined in rule 2.88(7) **[Auth/1/4]**) and which subsequently comes into the hands of the liquidator(s). The effect of the Court of Appeal allowing LBIE's appeal against David Richards J's declaration (iv) was to preserve in any subsequent liquidation all creditors' accrued post-administration interest rights, regardless of whether a given creditor had a pre-existing right to such interest.

100. Accordingly, by allowing LBIE's appeal against David Richards J's declaration (iv), the Court of Appeal provided a much more complete solution than the one provided by David Richards J's solution to what would otherwise be a possible "lacuna" in the 1986 Act and the 1986 Rules for the preservation in a subsequent liquidation of accrued post-administration interest rights.

101. This is because David Richards J's solution, embodied in declaration (v), only had the effect of preserving the rights to post-administration interest of those who would have been entitled to such interest but for LBIE's insolvency proceedings (for example by way of a pre-administration contractual right).

102. Indeed, the reason why the Court of Appeal allowed the appeal against declaration (v) was because the issue underlying declaration (v) no longer arose as a result of the Court of Appeal granting the appeal against declaration (iv).[76]

103. If the Supreme Court were to reverse the Court of Appeal's determination of the appeal against declaration (iv) and to reject the fallback argument that any interest entitlement would be provable, then declaration (v) should be restored so that creditors' pre-existing contractual or other rights to interest in respect of the period of the administration will be preserved in a subsequent liquidation. In particular:

  103.1. As a matter of principle, it is right, where there is no statutory provision for post-administration interest in a liquidation that follows an administration in respect of the period of the preceding administration, that the surplus in a company's insolvency should not be returned to the company's shareholders until the rights of the company's creditors have been vindicated in full.

  103.2. In these circumstances, where the statutory regime has made no provision for such post-administration interest, it is just that the creditor should be remitted to its pre-administration rights.

[76] See the CA Judgment per Lewison LJ at [112] **[Core/D/3]**.

103.3. In this regard, David Richards J was correct to conclude in the HC Judgment **[Core/D/5]** at [126]-[127] that Giffard LJ's reasoning in *In re Humber Ironworks and Shipbuilding Co* LR 4 Ch App 643 **[Auth/1/11]** ("*the creditor whose debt carries interest is remitted to his rights under his contract*") is applicable.

103.4. Since the statutory regime is silent as regards what entitlement to interest a creditor has in respect of the relevant period, the correct analysis is that a creditor's pre-administration right to interest in respect of that period has not been discharged by (or otherwise lost under) the statutory regime.

103.5. It follows that these rights remain in existence notwithstanding the operation of the insolvency regime and are capable of being asserted as non-provable claims after statutory interest has been paid in full (and *pari passu* with other non-provable claims).

104. The LBL Administrators are wrong to contend that there can be no such non-provable claim on the basis that "*the statutory code for the payment of interest in an insolvency was intended to be a complete code and to replace any pre-existing rights to interest*".[77] In particular:

104.1. The statutory codes for post-insolvency interest (section 189 **[Auth/1/2]** and rule 4.93 **[Auth/3/53]** in liquidation and rule 2.88 **[Auth/1/4]** in administration) are intended to be complete codes and to replace any pre-existing rights in respect of post-liquidation and post-administration interest respectively, not for all interest.

104.2. In this regard, the LBL Administrators' contention represents a misunderstanding of David Richards J's decision on this point in *Waterfall IIA*. See, in particular, *Re Lehman Brothers International (Europe) (In Administration)* [2015] EWHC 2269 (Ch), [2016] Bus LR 17 at [164] **[Auth/1/14]**:

> "*In my judgment, Wentworth and the administrators are right in their submission that rule 2.88 represents a complete code for the payment of post-administration interest. The new approach introduced by the 1986*

[77] LBL Administrators' Written Case, [7].

*legislation for post-liquidation interest was intended to replace the previous law, as stated in Re Humber Ironworks & Shipbuilding Co. Rule 2.88 is not a partial measure for dealing with post-insolvency interest. If it was only a partial measure, why provide that interest is payable at the rate applicable apart from the administration, if higher than judgment rate? If the SCG and York were right, the effect of the legislation is to prescribe one regime for the payment of interest as a first charge out of the surplus remaining after the payment of proved debts in full, leaving without any explicit recognition the possibility of the payment of further post-insolvency interest as a non-provable debt out of the surplus remaining after the satisfaction of creditors' rights to statutory interest. I do not think that rule 2.88 can be read in this way*".

105. The present case concerns the creditors' entitlement in a subsequent liquidation to interest that would have accrued prior to the liquidation (i.e. from the date of administration up to the date the company entered liquidation). The present case therefore falls outside the statutory code for post-liquidation interest as set out in section 189 **[Auth/1/2]** (*post-liquidation* interest on debts proved in the winding up which is payable out of any surplus) and rule 4.93 **[Auth/3/53]** (interest which is provable in the winding up as part of the provable debt for the *pre-administration* period (where the liquidation was immediately preceded by an administration)). The statutory code does not make provision for, and therefore cannot be taken as extinguishing, a contractual or other right to interest which accrues during the post-administration, pre-liquidation period.

106. The present case also falls outside the statutory code for post-administration interest since, in the premises on which this cross-appeal must proceed (set out above at [97]), rule 2.88 **[Auth/1/4]** ceases to have any effect whatsoever (whether as a statutory code for post-administration interest or otherwise) once the company ceases to be in administration.

107. Accordingly, and in the circumstances adumbrated above, the Supreme Court should restore David Richards J's declaration (v).

## E: THE EXTENT OF THE LIABILITY UNDER SECTION 74

### (1) Introduction

109. The issue on this point is whether the liability of members under section 74(1) **[Auth/1/1]** of the 1986 Act to contribute to the assets of a company in liquidation "*to any amount sufficient for payment of its debts and liabilities*" is restricted to the funds required to pay the provable debts in the liquidation or whether it also extends to the funds required for the payment of statutory interest and any non-provable liabilities of the company.

110. Section 74(1) of the 1986 Act **[Auth/1/1]** provides that:

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

111. Section 150(1) **[Auth/2/25]**, which is ancillary to section 74(1) **[Auth/1/1]**, provides further that:

> "*The court may, at any time after making a winding up order, and either before or after it has ascertained the sufficiency of the company's assets, make calls on all or any of the contributories for the time being settled on the list 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*".

112. David Richards J and the Court of Appeal (unanimously) held that the liability of members under section 74(1) of the 1986 Act **[Auth/1/1]** to contribute to the assets of a company in liquidation "*to any amount sufficient for payment of its debts and liabilities*" is not restricted to the funds required to pay the provable debts in the liquidation but also extends to the funds required for the payment of statutory interest and any non-provable liabilities of the company. Declaration (vi) of David Richards J's Order **[Core/D/4]** dated 19 May 2014 provided:

> "*The obligation of members to contribute under section 74(1) of the Act extends to provide for proved debts, such statutory interest on those debts as is payable under section 189 of the Act, and non-provable liabilities*".

113. By its Order dated 14 May 2015 **[Core/D/2]**, the Court of Appeal dismissed the appeals of the LBL Administrators, the LBHI2 Administrators and LBHI against this declaration.

114. The LBL Administrators, the LBHI2 Administrators and LBHI now appeal and invite the Supreme Court to overturn declaration (vi) of David Richards J's Order **[Core/D/4]** and to hold instead that the obligation of the Members to contribute under section 74(1) **[Auth/1/1]** is limited to provable debts and does not extend to statutory interest or non-provable liabilities.

115. The LBIE Administrators oppose the appeals of the LBL Administrators, the LBHI2 Administrators and LBHI on this point and submit that the conclusion reached both by David Richards J and the Court of Appeal was correct. The obligation of the Members under section 74(1) **[Auth/1/1]** does extend to statutory interest and non-provable liabilities, because they form part of the debts and liabilities to which section 74(1) **[Auth/1/1]** refers; and the obligation of the Members to contribute forms part of the assets which must be applied in satisfaction of those debts and liabilities. The answer reached by David Richards J and the Court of Appeal is consistent with the statutory scheme as a whole and the position of statutory interest and non-provable liabilities in the Waterfall.[78]

## (2) The construction of section 74(1)

### (i) Debts

116. The word "*debt*" is defined by rule 13.12(1) of the 1986 Rules **[Auth/1/6]**:

> "*'Debt', in relation to the winding up of a company, means (subject to the next paragraph) any of the following—*
> *(a) any debt or liability to which the company is subject at the date on which it goes into liquidation;*

[78] As set out by Lord Neuberger in *In re the Nortel Companies and Ors* [2014] AC 209 **[Auth/1/17]** at [39].

> *(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)*".[79]

117. Limbs (a) and (b) of this rule were considered in *In re the Nortel Companies and Ors* [2014] 1 AC 209 **[Auth/1/17]** at [68]-[86]. Limb (c) relates to pre-liquidation interest, which is provable within rule 4.93(1) **[Auth/3/53]**.[80]

(ii) Liabilities

118. The LBIE Administrators submit that the word "*liabilities*" goes beyond, and is broader than, the definition of debts.

119. Rule 13.12(4) **[Auth/1/6]** defines "*liability*" in the following terms:

> "*In any provision of the Act or the Rules about winding up, except in so far as the context otherwise requires, 'liability' means (subject to paragraph (3) above) a liability to pay money or money's worth, including any liability under an enactment, any liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution*".

120. Rule 13.12(4) **[Auth/1/6]** applies "*in any provision of the Act or the Rules about winding up*".

121. The reference in rule 13.12(4) **[Auth/1/6]** to "*paragraph (3) above*" is a reference to the immediately preceding provision, rule 13.12(3) **[Auth/1/6]**, which provides:

> "*For the purposes of references in any provision of the Act or the Rules about winding up to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, or whether its amount is*

[79] This is the form of rule 13.12(1) that applies in LBIE's administration: rule 13.12(5) **[Auth/1/6]** provides that rule 13.12(1) shall apply "*where a company is in administration and shall be read as if references to winding-up were a reference to administration*". This form of rule 13.12(1) **[Auth/1/6]** will also apply to LBIE's liquidation: the transitional provisions in Schedule 4 to the Insolvency (Amendment) Rules 2010 (SI 2010/686) provide at [1(7)] that the amendments introduced by the Insolvency (Amendment) Rules 2010 (SI 2010/686) do not apply to a liquidation occurring on or after 6 April 2010, if it is immediately preceded by an administration taking effect prior to that date. See *In re the Nortel Companies and Ors* [2011] Bus LR 766 **[Auth/4/12]** per Briggs J at [104] and [111]-[123].

[80] Rule 4.93(1) **[Auth/3/53]** (in the form applicable in LBIE's administration and any future liquidation) provides: "*Where a debt proved in the liquidation bears interest, that interest is provable as part of the debt except in so far as it is payable in respect of any period after the company went into liquidation or, if the liquidation was immediately preceded by an administration, any period after the date that the company entered administration*".

*fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion; and references in any such provision to owing a debt are to be read accordingly*".

122. Since it does not contain any of the qualifications found in the definition of "*debt*" in rule 13.12(1) **[Auth/1/6]**, the class of "*liabilities*" within rule 13.12(4) **[Auth/1/6]** is wider than the class of provable debts within rule 13.12(1) **[Auth/1/6]**. Rule 13.12(4) **[Auth/1/6]** defines the term "*liability*" very widely and in terms which make it clear that its scope extends beyond provable debts.

123. This is supported by the use of the composite phrase "*debts and liabilities*" in section 74(1) **[Auth/1/1]**. In this context, the term "*liabilities*" must mean something other than "*debts*". According to the LBL Administrators, the LBHI2 Administrators and LBHI, however, the phrase should be interpreted to mean "*debts and debts*" – a superfluous repetition which ignores the wider definition of "*liability*".

124. With reference to section 38 of the Companies Act 1862 **[Auth/2/6]**, a statutory predecessor to section 74 of the 1986 Act **[Auth/1/1]**, Lord Hatherley LC, in *Webb v Whiffin* (1872) LR 5 HL 711 **[Auth/1/22]** at 718, stressed the breadth of the obligation to contribute in the following terms:

> "*There are directions, in the first instance, that all the shareholders shall contribute to the assets of the company for the payment of the costs and of the debts of the company.* ***These directions are in the largest and most general terms***" (emphasis added).

125. Lord Chelmsford said at 724:

> "***Nothing can be more general than these words****, embracing, as they do, all present and past members, and rendering them all liable to contribute to the assets of the company ... [for]* ***the payment generally of the debts and liabilities of the company***" (emphasis added).

(iii) The statutory scheme as a whole

126. The conclusion that the "*debts and liabilities*" within section 74(1) **[Auth/1/1]** include statutory interest and non-provable liabilities is consistent with the wider statutory scheme.

127. As Lord Neuberger explained in *In re the Nortel Companies and Ors* [2014] 1 AC 209 **[Auth/1/17]** at [39], liabilities in corporate insolvency proceedings must be discharged in a particular order of priority, in accordance with the Waterfall. Before there is a return to shareholders, statutory interest and non-provable liabilities must be paid in full.

128. In the LBIE Administrators' submission, David Richards J and the Court of Appeal were right to hold that the liability of the contributories under section 74(1) **[Auth/1/1]** extends to all levels of the Waterfall.

129. The starting point in the analysis is that the liability of the contributories extends to level 8, which is the final level of the Waterfall. Section 74(1) **[Auth/1/1]** itself provides for the amount payable by the contributories to be sufficient to deal with "*the adjustment of the rights of the contributories among themselves*". Given that the liability under section 74(1) **[Auth/1/1]** extends to the final level of the Waterfall, it would be illogical for it not to extend to every level above.[81] As Lewison LJ observed in the CA Judgment **[Core/D/3]** at [121]:

> "*If (as section 74 expressly provides) that liability extends to adjusting the rights of contributories, which are at the bottom of the waterfall, the logic is inescapable that the contributory's liability encompasses liabilities that are higher up the waterfall. It must necessarily follow that the liability encompasses the creation of a surplus out of which to pay statutory interest since that ranks higher than both non-provable claims and also the rights of contributories as between themselves*".

130. The fact that section 74(1) **[Auth/1/1]** requires members to contribute sums sufficient not only for the payment of the debts and liabilities of the company but also "*for the*

[81] It is not suggested by any party that it does not extend to level 5 and it expressly includes level 8. The Appellants' case therefore requires an officeholder to "leapfrog" steps 6 and 7.

*adjustment of the rights of the contributories among themselves*" therefore supports the conclusion that the phrase "*debts and liabilities*" within section 74(1) **[Auth/1/1]** is to be given a broad meaning, encompassing all the liabilities of the company, whether provable or not. As the adjustment of the rights of the contributories among themselves lies at the bottom of the Waterfall, the contributions required from contributories are to be applied in discharge of the liabilities which rank below provable debts but above the adjustment of rights among contributories. Those liabilities include statutory interest and non-provable liabilities.

131. There is symmetry between the Waterfall and the extent of the members' obligation to contribute to the company's deficiency. Before there can be a return to members, all higher ranking debts and liabilities of the company must be discharged. Before the rights of the contributories among themselves can be adjusted under section 74 **[Auth/1/1]**, they must contribute to the company's assets sufficient for payment of all of its debts and liabilities which are payable in the Waterfall ahead of any return to the members. The scope of the obligation to contribute therefore extends to all of the debts and liabilities of the company which appear in the Waterfall and which rank ahead of a return to the members.

**<u>(3) Non-provable liabilities</u>**

132. For the reasons set out above, the Court of Appeal was right to hold that the Members' obligation to contribute towards the debts and liabilities extends to the non-provable liabilities within level 7 of the Waterfall. Such liabilities, whilst not provable, continue to exist as liabilities of the company and must be paid before anything can be received by a shareholder.

133. The LBHI2 Administrators contend that non-provable liabilities "*are by definition outside the insolvency regime*".[82] They contend that paying non-provable claims is not part of the purpose of a liquidation or administration.[83] They also argue that a liquidator has no statutory mandate to make a payment in respect of a non-provable claim.[84] These contentions are misplaced.

[82] LBHI2 Administrators' Written Case, [54].
[83] LBHI2 Administrators' Written Case, [55].
[84] LBHI2 Administrators' Written Case, [141].

134. First, the fact that a liability is not provable within rule 13.12(1) **[Auth/1/6]** does not mean that it ceases to exist as a liability of the company. There is no concept of discharge in corporate insolvency proceedings. As the Privy Council held in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 **[Auth/1/23]** at [27]: "*Their debts ... are discharged by the winding-up only to the extent that they are paid out of dividends ... There is no equivalent of the discharge of a personal bankrupt which extinguishes his debts*". Consequently, the fact that a non-provable liability falls outside rule 13.12(1) **[Auth/1/6]** means only that it does not rank for a dividend at level 5 of the Waterfall. However, it continues to exist as a liability of the company and is payable at level 7 of the Waterfall.

135. Secondly, the authorities show that non-provable liabilities must be paid from the assets of the company before any surplus can be returned to the shareholders. For example:

135.1. *In re Fine Industrial Commodities Ltd* [1956] Ch 256 **[Auth/4/28]**, the liquidator realised sufficient money to pay the company's provable debts in full and was left holding a large surplus. At the request of the shareholders, the liquidator applied to the Court for directions as to how to distribute the surplus. Vaisey J held that a non-provable claim for post-liquidation interest (which arose under the Judgments Act 1838 on a pre-liquidation judgment against the company) was payable from the surplus remaining after the payment of the provable debts and that they had to be paid before anything could be returned to the shareholders.

135.2. In *In re Islington Metal & Plating Works Ltd* [1984] 1 WLR 14 **[Auth/5/4]**, there was a contest between the non-provable tort claimants[85] and the company's shareholders.[86] Harman J concluded that the assets had to be applied in discharge of the non-provable liabilities before anything could be returned to the shareholders saying, at 24:

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[85] Unliquidated tort claims were non-provable until the 1986 reforms to insolvency law. Even after 1986, claims in tort could not be proved unless the cause of action had accrued by the commencement of the administration or liquidation, until rule 13.12 **[Auth/1/6]** was amended to reverse the effect of the decision in *In re T & N Ltd* [2006] 1 WLR 1728 **[Auth/1/21]**.

[86] Harman J explained at 22: "*The contest on this occasion was whether once all the company's undoubted unsecured creditors and the costs of liquidation had been paid or secured, any surplus moneys then in the hands of the liquidators should go to the tort claimants or to the contributories*".

"*I therefore hold that in this liquidation if all the undoubted creditors are satisfied and provision has been made for the costs and there is then a surplus, the tort claimants are entitled to claim in that surplus notwithstanding that their claims exceed, or may exceed, the amount available*".[87]

136. Thirdly, in the event of a surplus, the payment of the non-provable liabilities at level 7 of the Waterfall is part of the duty of the liquidator. Indeed, it is as much a part of his duty as the payment of provable debts at level 5 or statutory interest at level 6, or any other item in the Waterfall. The liquidator is the agent of the company[88] and is charged with distributing its assets to those entitled to them. It would be anomalous and illogical if he had no obligation to deal with the non-provable liabilities. The authorities make clear that the liquidator's duty extends to the payment of non-provable liabilities:

136.1. Brightman LJ held in *In Re Lines Bros Ltd (In Liquidation)* [1983] Ch 1 **[Auth/1/15]** at 21 that, in the event of a surplus of assets after the payment in full of the provable debts, it was the duty of the liquidator to pay non-provable claims for post-liquidation interest:

"*the view has been repeatedly expressed in relation to interest that, once the provable debts have been satisfied in full, so that the company has in that sense a surplus of assets,* ***<u>the duty of the liquidator</u> is to discharge the contractual indebtedness of the company in respect of such debts to the extent that the contractual indebtedness exceeds the provable indebtedness****. '[A]s soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract; ...' per Giffard LJ in In re Humber Ironworks and Shipbuilding Co (1869) LR 4 Ch App 643, 647; and Selwyn LJ to the same effect at 645.* ***It is on that principle that a creditor may claim post-liquidation interest. He does this on the basis that obligations under the contract are not necessarily discharged despite the fact that all provable debts have been paid at 100 pence in the pound***" (emphasis added).[89]

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[87] David Richards J reached the same conclusion in *In re T & N Ltd* [2006] 1 WLR 1728 **[Auth/1/21]** at [107]. The LBHI2 Administrators seek to suggest that David Richards J was envisaging that the proceedings should take place outside the insolvency proceedings (LBHI2 Administrators' Written Case, [56]). However, this would be the case only in the event of a dispute (in precisely the same way that the moratorium might be lifted to enable a provable claim to be determined in ordinary civil proceedings under Part 7 of the CPR in appropriate circumstances). (The LBIE Administrators' submissions on *In re T & N Ltd* [2006] 1 WLR 1728 **[Auth/1/21]** have been developed already above at [44] and [47].)

[88] See *McPherson's Law of Company Liquidation*, 3rd Ed., [8-028] **[Auth/8/12]**: "*In relation to the company, viewed as a corporate entity, there is little doubt that the liquidator occupies the position of agent*".

[89] At the time of this decision, post-liquidation contractual interest was not provable in an insolvent liquidation, but it was payable when a surplus emerged after payment of the provable debts; and it had to be paid before anything could be returned to the shareholders. See *In re Humber Ironworks & Shipbuilding Co* (1869) LR 4 Ch

136.2. In *Gooch v London Banking Association* (1886) 32 Ch D 41 **[Auth/4/32]**, Pearson J held that, in the event of a surplus of assets after the payment in full of the provable debts, it would be a breach of duty for a liquidator to distribute assets to shareholders without first providing for a landlord's non-provable claim for future rent.[90] Pearson J held at 48:

> "*I have come to the conclusion that* ***the liquidators would be guilty of a dereliction of duty if they were to distribute the assets without providing for this liability****, and that the landlord therefore in the present case, who has a claim, as it is admitted, against the company for the future rent which may become due, is interested in seeing that the liquidators discharge their duty properly, and is entitled to come to this Court and ask to restrain them, when upon the face of their affidavit it appears, and it is admitted by their counsel, that they claim as a matter of right, not with the intention of course of doing anything that is improper or dishonest, but as a matter of right, to distribute these assets without providing for this liability*" (emphasis added).

136.3. The House of Lords reached the same conclusion in respect of a non-provable claim by a landlord in *Lord Elphinstone v Monkland Iron & Coal Co Ltd* (1886) 11 App Cas 332 **[Auth/5/11]**.[91] The wording of the House of Lords' order (reported only at (1886) 13 R (HL) 98 **[Auth/5/12]**) confirms that the liquidators were under a duty to pay the non-provable liability:

> "*Declared that ... Monkland Iron and Coal Company, Limited, were, at the time of their going into voluntary liquidation, and still are, bound to implement and fulfil to the appellant the whole obligations and liabilities undertaken by the lessees in the lease ... and also that* ***the respondents William Mackinnon and Nathaniel Spens, as liquidators of the said Monkland Iron and Coal Company, Limited, are bound to make due provision for implementing and fulfilling the foresaid obligations and liabilities****, and for that purpose to set aside the surplus assets of the*

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App 643 **[Auth/1/11]** per Giffard LJ at 647 ("*as soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract*"). See also *Re Spedley Securities Ltd (in liq)* [2000] NSWSC 593 **[Auth/7/7]** per Windeyer J at 596and *Re Emilco Pty Ltd (in liquidation)* [2002] NSWSC 1124 **[Auth/7/3]** per Barrett J at 1128.

[90] Landlords' claims for future rent were non-provable until 1888. The non-provability of future rent was established in *In re London and Colonial Company, Horsey's Claim* (1868) LR 5 Eq 561 **[Auth/5/10]**, which, as explained in *In Re Midland Coal, Coke, and Iron Company, Craig's Claim* [1895] 1 Ch. 267 **[Auth/5/17]** per Lindley LJ at 275, was not overturned until future rent was held to be provable by the House of Lords in *Hardy v Fothergill* (1888) 13 App Cas 351 **[Auth/5/1]**.

[91] Lord Herschell LC held at 344: "*If any liability to the appellant existed on the part of the respondent company, he was entitled to have provision made for it by the liquidators before the assets of the company were distributed among the shareholders*".

*company remaining in their hands at the time when this action was raised, or so much thereof as may be necessary for implementing and fulfilling said obligations and liabilities*" (emphasis added).[92]

137. Under the 1986 Act:

137.1. there remain certain categories of liability which are not provable in a liquidation; and

137.2. it remains the case that non-provable liabilities must be paid before anything can be returned to the shareholders, as the Waterfall in *In re the Nortel Companies and Ors* [2014] 1 AC 209 **[Auth/1/17]** at [39] makes clear.

138. It also remains the case that, to the extent that there are any non-provable liabilities, it is the duty of the liquidator to pay them. The position is the same in a distributing administration. Briggs LJ was therefore correct to say in the CA Judgment **[Core/D/3]** at [184]:

> "*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 after payment of provable debts*".[93]

139. The assets of the insolvent company must therefore be applied in discharge of the provable debts and, to the extent that anything remains thereafter, to pay statutory interest and, once statutory interest has been paid in full, to discharge the non-provable

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[92] Whilst this was a Scottish case, the law of England is the same. See *In Re Midland Coal, Coke, and Iron Company, Craig's Claim* [1895] 1 Ch 267 **[Auth/5/17]** per Lindley LJ at 276: "*The last of these cases was in the House of Lords, and the House made an order in favour of the lessor of a limited company which was being wound up voluntarily, and declared that the lessee company was bound to fulfil its future obligations under its lease, and that the liquidators were bound to make due provision for fulfilling such obligations and to set aside assets of the company in their hands for that purpose. It is true that this was a Scottish case, and a case between lessor and lessee; but we see no reason to suppose that there is any difference between English and Scottish law in this respect*".

[93] In a voluntary liquidation, this duty arises under section 107 of the 1986 Act **[Auth/2/18]**, which provides: "*Subject to the provisions of this Act as to preferential payments, the company's property in a voluntary winding up shall on the winding up be applied in satisfaction of the company's liabilities pari passu and, subject to that application, shall (unless the articles otherwise provide) be distributed among the members according to their rights and interests in the company*". It is submitted that Briggs LJ was correct when he said in CA Judgment **[Core/D/3]** at [185]: "*Since it is plainly not the case (and never has been) that the liquidator may distribute to members without regard to non-provable liabilities, it is clear that the word 'liabilities' in section 107 must include them*". In the case of a compulsory liquidation, section 143(1) **[Auth/2/22]** provides: "*The functions of the liquidator of a company which is being wound up by the court are to secure that the assets of the company are got in, realised and distributed to the company's creditors and, if there is a surplus, to the persons entitled to it*".

liabilities. This is part of the statutory scheme and a "*duty of the liquidator*" (as Brightman LJ held in *In Re Lines Bros Ltd (In Liquidation)* [1983] Ch 1 **[Auth/1/15]** at 21).

## (4) Statutory interest

140. David Richards J and the Court of Appeal held unanimously that statutory interest payable pursuant to rule 2.88(7) **[Auth/1/4]** and section 189(2) **[Auth/1/2]** is a "*liability*" for the purposes of section 74(1) **[Auth/1/1]** such that the members' obligation to contribute under section 74(1) **[Auth/1/1]** extends to the company's liability to pay statutory interest. Briggs LJ said in the CA Judgment **[Core/D/3]** at [195]:

> "*I can see no good reason why a statutory requirement for payment of a sum out of the assets of a company to persons entitled to it should not be regarded as a liability of the company, at least for the purposes of section 74*".

141. The LBIE Administrators submit that David Richards J and the Court of Appeal were right. For the reasons mentioned above in the context of the Sub Debt and developed further below, the liability to pay statutory interest is a liability of the company and for the reasons set out below the liability of contributories under section 74(1) **[Auth/1/1]** extends to the payment of statutory interest.

### (i) The position of statutory interest in the Waterfall

142. As stated above, the Members are liable to contribute to all levels of the Waterfall, including the final level. There is no basis in logic or law for thinking that they have no liability in respect of statutory interest, which ranks above the final level (and, indeed, above the non-provable liabilities to which the Members must also contribute). As David Richards J held in the HC Judgment **[Core/D/5]** at [164]:

> "*Further, the non-provable liabilities which rank behind statutory interest are, on any footing, liabilities of the company, although not provable debts. If section 74(1) extends to making calls for the payment of non-provable liabilities, ranking behind statutory interest, it makes no sense at all that calls cannot be made in order to fund the payment of statutory interest*".

143. Statutory interest is payable from the assets of the company. In a voluntary liquidation, the obligation to pay statutory interest is a liability for the purposes of section 107 **[Auth/2/18]**. As Briggs LJ held in the CA Judgment **[Core/D/3]** at [186]:

> "*...statutory interest payable under section 189 in relation to the period after the commencement of the winding up is not a provable debt, but must be paid in priority to shareholders. Statutory interest must therefore fall within the word 'liabilities' as it is used in that section*".

144. The position is the same in a compulsory liquidation, pursuant to section 143 **[Auth/2/22]**.

145. This is confirmed by section 149(3) **[Auth/9/17]**, which is closely linked to the liability under section 74(1) **[Auth/1/1]**. Section 149(3) **[Auth/9/17]** provides:

> "*In the case of any company, whether limited or unlimited, **when all the creditors are paid in full (together with interest at the official rate)**, any money due on any account whatever to a contributory from the company may be allowed to him by way of set-off against any subsequent call*" (emphasis added).

146. This provision is consistent with the liability under section 74(1) **[Auth/1/1]** extending to statutory interest, rather than excluding it.

(ii) The pre-1986 position in respect of post-liquidation interest

147. The conclusion of David Richards J and the Court of Appeal is also supported by analysis of the pre-1986 position.

148. Prior to the 1986 reforms to insolvency law, there was no free-standing right to statutory interest for the post-liquidation period. A creditor with no existing right to interest did not receive any and a creditor with a contractual right to interest had a non-provable claim for his post-liquidation non-provable interest, which was payable in priority to the shareholders. As Giffard LJ explained in *In re Humber Ironworks & Shipbuilding Co* (1869) LR 4 Ch App 643 **[Auth/1/11]** at 647, "*as soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his*

*contract; and, on the other hand, a creditor who has not stipulated for interest does not get it*".[94]

149. Since post-liquidation contractual interest was a non-provable liability payable in priority to shareholders, it was a liability to which the shareholders could be required to contribute, under the predecessor to section 74(1) **[Auth/1/1]**, on the basis explained above.

150. There is no reason for thinking that the legislature's decision to put post-liquidation interest on a statutory footing in 1986 was intended to alter the liability of contributories to pay it.

151. Indeed, one of the rates available in the case of statutory interest is "*the rate applicable to [the] debt apart from the winding up*": see section 189(4)(b) **[Auth/1/2]**.[95] Where this applies, the creditor continues to be entitled to interest at the contractual rate. Statutory interest does no more than to put his existing contractual right to interest on a statutory footing. Interest for the post-liquidation period continues to accrue at the contractual rate. There is no basis for thinking that the legislature's decision to put the interest on a statutory footing has eliminated the liability of members to pay for it. As David Richards J held in the HC Judgment **[Core/D/5]** at [164]:

> "*There is, moreover, the point ... that until the introduction of section 189(2) contractual interest was payable in a liquidation but was not provable in competition with other debts. I do not find it plausible that the use of language in section 189(2) was intended to have the effect that what was previously clearly a liability of the company should cease to be so for the purposes of section 74(1)*".

152. Further, as David Richards J said at [153]:

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[94] Brightman LJ held in *In Re Lines Bros Ltd (In Liquidation)* [1983] Ch 1 **[Auth/1/15]** at 21: "*the view has been repeatedly expressed in relation to interest that, once the provable debts have been satisfied in full, so that the company has in that sense a surplus of assets,* ***the duty of the liquidator is to discharge the contractual indebtedness of the company in respect of such debts to the extent that the contractual indebtedness exceeds the provable indebtedness****. '[A]s soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract; ...' per Giffard LJ in In re Humber Ironworks and Shipbuilding Co (1869) LR 4 Ch App 643, 647; and Selwyn LJ to the same effect at 645.* ***It is on that principle that a creditor may claim post-liquidation interest. He does this on the basis that obligations under the contract are not necessarily discharged despite the fact that all provable debts have been paid at 100 pence in the pound*****"** (emphasis added).

[95] This rate is payable where it is higher than the rate applicable under the Judgments Act 1838 (currently 8% per annum).

> "*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*".

153. The LBHI2 Administrators suggest that it would be more surprising if the legislature had sought to increase the liability of members.[96] However, there is nothing surprising in the decision of David Richards J or the Court of Appeal. It is plainly foreseeable (and unsurprising) that the imposition of a new liability to pay interest in liquidations would increase the burden on the members on whom the liquidator is entitled to call for contributions to meet the debts and liabilities of the company.

(iii) Logic and consistency

154. Considerations of logic and consistency show that the obligation to pay statutory interest from the assets is a liability for the purposes of section 74(1) of the 1986 Act **[Auth/1/1]**.

155. Where a company's debts bear interest, the *pre-liquidation* interest is provable under rule 4.93(1) of the 1986 Rules **[Auth/3/53]**, which provides (in the form applicable in any future liquidation of LBIE) that:

> "*Where a debt proved in the liquidation bears interest, that interest is provable as part of the debt except in so far as it is payable in respect of any period after the company went into liquidation or, if the liquidation was immediately preceded by an administration, any period after the date that the company entered administration*".

156. It is common ground that the liability of members under section 74(1) **[Auth/1/1]** extends to the payment of the provable debts, which include the *pre-liquidation* contractual interest. There is no basis for concluding that the liability of members under section 74(1) **[Auth/1/1]** does not extend to *post-liquidation* interest, which, whilst not provable, continues to be payable on a statutory footing, as explained above. As David Richards J held in the HC Judgment **[Core/D/5]** at [154]:

[96] LBHI2 Administrators' Written Case, [146]-[152].

"*It is worth bearing in mind the position which exists prior to the liquidation. The company, particularly for example a bank, may have many liabilities which carry interest… It is difficult to see the policy which would make members of an unlimited company liable to contribute for the purposes of paying the principal amount of such contractual debts but not require them also to provide funds for the payment of contractual interest, all the more so when on any basis they had to do so for contractual interest accruing due before the commencement of the liquidation*".

157. The position is the same in respect of a judgment creditor who obtained his judgment against the company prior to the commencement of its winding-up:

157.1. Such a creditor is entitled to interest on his judgment at the rate of 8% per annum, pursuant to section 17 of the Judgments Act 1838 **[Auth/3/73]**. His pre-liquidation interest is provable under rule 4.93(1) **[Auth/3/53]**, as set out above.

157.2. His post-liquidation interest is payable only in the event of the payment in full of the provable debts. In that event, it is payable at the same rate of 8% per annum. Section 189(4) **[Auth/1/2]** provides:

> "*The rate of interest payable under this section in respect of any debt ('the official rate' for the purposes of any provision of this Act in which that expression is used) is whichever is the greater of— (a) the rate specified in section 17 of the Judgments Act 1838 on the day on which the company went into liquidation, and (b) the rate applicable to that debt apart from the winding up*".

157.3. His pre-liquidation interest is therefore payable at 8% per annum, pursuant to section 17 of the Judgments Act 1838 **[Auth/3/73]**. His post-liquidation interest is also payable at 8% per annum, pursuant to section 17 of the Judgments Act 1838 **[Auth/3/73]**, which is applied by section 189(4)(a) **[Auth/1/2]**.

157.4. In both cases, it is payable on the basis of a statute: the Judgments Act 1838 for the pre-liquidation period; and the Insolvency Act 1986 (cross-referring to the Judgments Act 1838) for the post-liquidation period.

157.5. It would make no sense to say that the members are liable to contribute only in respect of interest which accrued during the pre-liquidation period, on the basis

that the interest accrued during that period under one statute rather than another. To so hold would be to say that the liability of the members in respect of interest payable by the company is critically dependent on the happenstance of its accrual under one statute, rather than another. This would be illogical and produce an unprincipled outcome. Interest payable under one statute is as much a liability of the company as interest payable under the other.

158. As David Richards J concluded in the HC Judgment **[Core/D/5]** at [163]:

> "*I find it impossible to discern the policy reason for saying that members are liable to contribute assets for the payment of the principal amount of provable debts, but are not liable for the interest on those debts which is payable to compensate the creditors for being kept out of their money until a distribution is made in the liquidation. The justification for statutory interest, even in those cases where the debts do not already carry a right to interest, is that the creditors are prevented by the liquidation regime from obtaining judgment against the company which would then carry interest at judgment rate.* ***If a judgment were obtained before the commencement of the liquidation, interest at the judgment rate is provable down to the commencement of the liquidation. Members are liable to contribute in respect of such interest. There is no plausible policy reason why they should cease to be so liable in respect of interest accruing due after the commencement of the liquidation. The fact that such interest, at the same rate, becomes payable under section 189(2) rather than under the Judgments Act provides no sound reason for distinguishing between them***" (emphasis added).

(iv) *In re Lines Bros Ltd* [1984] BCLC 215

159. In support of their argument that their liability under section 74 **[Auth/1/1]** does not extend to statutory interest, the Members of LBIE have relied on *In re Lines Bros Ltd* [1984] BCLC 215 **[Auth/1/16]**, in which the issue was whether the proving creditors of a company in creditors' voluntary winding up were entitled to statutory interest, in circumstances where the winding up had produced a surplus after payment of provable debts and expenses.[97]

160. In that context, Mervyn Davies J had to decide (*inter alia*) whether interest falling due after the commencement of the winding up formed part of the debts and liabilities of the company for the purposes of section 317 of the Companies Act 1948 **[Auth/2/11]** (the

[97] See, for example, the LBHI2 Administrators' Written Case at [145.2].

"**1948 Act**") (the successor to section 10 of the Supreme Court of Judicature Act 1875 (the "**1875 Act**")), in order to determine whether the company was insolvent within the meaning of section 317 of the 1948 Act **[Auth/2/11]**. He said in relation to statutory interest, at 223:

> "*This is not a debt or liability within section 10 for two reasons: (1) the section speaks of 'its' debts and liabilities. At no stage can statutory interest be regarded as a debt or liability of the company. The liquidator's obligation under section 33(8) to pay interest out of the surplus 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*".

161. LBIE's Members rely on the linguistic similarity between:

 161.1. the phrase "*the payment of its debts and liabilities and the cost of winding up*" in section 317 of the 1948 Act **[Auth/2/11]** (and its predecessor, section 10 of the 1875 Act); and

 161.2. the phrase "*its debts and liabilities and the expenses of the winding up*" in section 74(1) of the 1986 Act **[Auth/1/1]**.

162. They say that, if (as Mervyn Davies J held in *In re Lines Bros Ltd* [1984] BCLC 215 **[Auth/1/16]**) statutory interest is not a debt or liability of the company for the purposes of section 317 of the 1948 Act **[Auth/2/11]** (or its predecessor, section 10 of the 1875 Act), then it cannot be part of the "*debts and liabilities and the expenses of the winding up*" in section 74(1) of the 1986 Act **[Auth/1/1]**.

163. However, this argument ignores the fact that section 74(1) of the 1986 Act **[Auth/1/1]** is not comparable to section 317 of the 1948 Act **[Auth/2/11]** or to section 10 of the 1875 Act. The decision of Mervyn Davies J is readily distinguishable.

164. This is because section 317 of the 1948 Act **[Auth/2/11]** contained a solvency test, which was applicable at the commencement of the winding-up to determine whether the bankruptcy regime (including the payment of statutory interest under section 33(8) of the Bankruptcy Act 1914 **[Auth/2/4]**) would be applicable to the liquidation.

165. Statutory interest under section 33(8) **[Auth/2/4]** could not be a debt or liability for the purposes of section 317 of the 1948 Act **[Auth/2/11]**, because section 317 of the 1948 Act **[Auth/2/11]** was designed to identify whether section 33(8) **[Auth/2/4]** was engaged. Interest under section 33(8) **[Auth/2/4]**, which would arise only if section 317 **[Auth/2/11]** was engaged, could not be taken into account in deciding whether section 317 **[Auth/2/11]** was or was not engaged. To include statutory interest under section 33(8) **[Auth/2/4]** as a debt or liability within section 317 **[Auth/2/11]** would be to pre-judge the result of the test in section 317 **[Auth/2/11]** and cause a circularity in the analysis of a company's solvency. Further, it would have been impossible in practice to calculate statutory interest ahead of time, since the total quantum of such interest as a percentage of the debt per annum over a period of time could be calculated only at the end of the process when the length of the relevant period of time was known.

166. By contrast, section 74(1) **[Auth/1/1]** is concerned to identify the items for which contributories are liable to contribute to payment, when the company is in liquidation.

167. The context with which he was concerned explains Mervyn Davies J's choice of language. Mervyn Davies J did not hold that the liability to pay statutory interest under section 33(8) **[Auth/2/4]** would never be a debt or liability; rather, he held that it is "*not a debt or liability **within section 10***" (emphasis added). Further, when he said "*At no stage*," he was referring to the stage before the conclusion that section 317 **[Auth/2/11]** was applicable. The obligation under section 33(8) **[Auth/2/4]** does not arise at all unless and until it was applied by section 317 **[Auth/2/11]**. As Mervyn Davies J held, the obligation under section 33(8) **[Auth/2/4]** "*is part of the statutory scheme for dealing with a company's assets which comes into operation at the outset of the winding up*". A debt or liability could not exist under section 33(8) **[Auth/2/4]** in the period before section 33(8) had become applicable.

168. David Richards J held in the HC Judgment **[Core/D/5]** at [73] that the decision of Mervyn Davies J was irrelevant, saying that "*the context of the decision in In re Lines Bros Ltd [1984] BCLC 215 is so different from the present context that it is not in my judgment of assistance*". He was correct to do so.

169. In the CA Judgment **[Core/D/3]** at [194]-[195], Briggs LJ agreed that the decision of Mervyn Davies J was distinguishable and was correct to do so:

> "*[194] There is an obvious linguistic similarity between the phrase 'the payment of its debts and liabilities and the cost of winding up' in section 10 of the 1875 Act and 'its debts and liabilities, and the expenses of the winding up' in section 74(1) of the 1986 Act. But* ***the purposes of the two provisions are entirely different. Section 10 was designed to serve as a solvency test, so as to identify the circumstances when the bankruptcy regime (including the payment of statutory interest) would be applicable to a company in winding up. By contrast, section 74(1) is concerned to identify the items for which contributories are liable to contribute to payment, when the company is in liquidation****. By 1986, the entitlement to statutory interest no longer depended on whether the company was solvent or not: see section 189(2) and (for administration) rule 2.88.*
>
> *…* ***I can see no good reason why a statutory requirement for payment of a sum out of the assets of a company to persons entitled to it should not be regarded as a liability of the company, at least for the purposes of section 74****. The contrary view would give rise directly to the anomaly of an apparent gap in the middle of the waterfall to which the fruits of a call on contributories could be applied, which I have already described*" (emphasis added).

170. The LBHI2 Administrators seek to bolster their reliance on *In re Lines Bros Ltd* [1984] BCLC 215 **[Auth/1/16]** by contending that "*the only way in which payment of statutory interest can be enforced by a creditor is against the office-holder (i.e. for misapplication of funds; see Re HIH Casualty & General Insurance Ltd [2005] EWHC 2125 (Ch) per David Richards J), not by suing the company*".[98] However, this is misplaced. The fact that a creditor may sue a liquidator personally for misapplication of funds in the event of non-payment does not prove that the liability in question is not a liability of the company. This is clear from the case of provable debts. If (in breach of the *pari passu* rule) a liquidator fails to pay a valid proof of debt which has been lodged by a creditor, the creditor's remedy is to sue the liquidator personally. That is the very point which David Richards J made in *Re HIH Casualty & General Insurance Ltd* [2005] EWHC 2125 (Ch) **[Auth/5/2]** at [116]:

> "*If a liquidator causes loss to a creditor by disregarding his personal rights, for example by distributing assets without regard to a claim for which the creditor has proved in time and which has not been rejected, the creditor has a personal cause of action. He has a personal claim for damages against the liquidator for breach of statutory duty … These principles were established in Pulsford v*

[98] LBHI2 Administrators' Written Case, [43.3].

*Devenish [1903] 2 Ch 624 and James Smith & Sons (Norwood) Ltd v Goodman [1936] Ch 216 (CA)*".

171. According to the logic of the LBHI2 Administrators' argument, the fact that the creditor has a remedy against the office-holder personally in the event of non-payment of a provable debt is sufficient to show that the provable debt itself is not a liability of the company. This is, of course, wrong. The fact that the person responsible for distributing the company's assets may be liable by reason of his own negligence does not establish that the liability in respect of which a distribution should have been made was not a liability of the company. To the contrary, the fact that it is the company's assets (rather than the office-holder's personal assets) which should have been applied in making a distribution in respect of that liability shows that the liability in question is to be regarded as a liability of the company.

**(5) The "bootstraps" argument**

172. The Members of LBIE rely on what the Court of Appeal described as the "bootstraps" argument.[99] The Members say that statutory interest is payable only if there is a surplus (see rule 2.88(7) **[Auth/1/4]** and section 189(2) **[Auth/1/2]**) and that, if there is no surplus, it is not payable at all. The Members say that, if there is no surplus and statutory interest is not payable at all, the Members cannot be called on to pay any contributions, because there is no liability in respect of which to contribute.[100]

173. The bootstraps argument was rejected by David Richards J and the Court of Appeal, essentially on the basis that the argument is back-to-front. The assets of the company from which statutory interest is payable include the pre-existing rights of the company against its members to make contributions without limit. This is apparent from section 74(1) **[Auth/1/1]** itself, which makes clear that the members are "*liable to contribute to its assets*". The liability to contribute is part of the assets.

174. As David Richards J explained in the HC Judgment **[Core/D/5]** at [165]:

[99] CA Judgment **[Core/D/3]**, [196]-[198].
[100] See, for example, the LBHI2 Administrators' Written Case, [145.1].

> "*In my judgment, this submission is misconceived. The assets available to a liquidator to meet the claims of creditors, including statutory interest and non-provable debts, includes the right to make calls. Clearly no distribution can in fact be made except to the extent that, so far as calls are concerned, payments are made in response to those calls. If, on its proper construction, the liability of contributories under section 74 extends to providing funds for the payment of statutory interest and non-provable debts, the liquidator by making calls for that purpose is not creating a surplus, and so causing the obligation to pay statutory interest to arise, but is making calls in response to the requirement to pay statutory interest*".

175. In the CA Judgment **[Core/D/3]** at [197], Briggs LJ agreed with David Richards J, adding at [198]:

> "*In my view, the use in section 189, rule 2.88 and elsewhere in the statutory code of the concept of payment out of a surplus is merely a convenient way of identifying liabilities which fall lower than other liabilities in the priorities encapsulated in the waterfall. No class within the waterfall receives anything unless there is a surplus after payment in full of the prior class or classes. No-one doubts that provable debts are liabilities of the company, but they are payable only if there is a surplus after payment of floating charge creditors. Statutory interest is by the same token a liability of the company, payable only if there is a surplus after payment of provable debts*".

176. The LBIE Administrators submit that David Richards J and the Court of Appeal were right on this point. The assets available for distribution include the contributions which may be demanded from the Members.

177. The correctness of this conclusion is confirmed by the authorities. In *In re Oriental Commercial Bank; Morris' Case* (1871) LR 7 Ch App 200 **[Auth/6/1]**, for example, James LJ held at 204:

> "*The company's assets include, of course, all the unpaid capital that is recoverable from the existing shareholders; and, according to the 133rd section, which is a direction given in cases of voluntary winding-up, the whole assets of the company, which, of course, include the unpaid capital, are to be applied pari passu in payment of all the creditors*".

178. See also *Webb v Whiffin* (1872) LR 5 HL 711 **[Auth/1/22]** per Lord Hatherley LC at 720-721:

> "*The assets of the company of course include all contributions which you are entitled to raise from the members ... When that is done, a common fund is formed, and you find no direction in the Act whatever, except for the distribution of the common fund so formed*".

179. And see Lord Chelmsford at 725:

> "*all the contributions of both the present and past members are to be carried to a common fund called the assets of the company, and to be applied in satisfaction of the debts and liabilities, not of the members, but of the company*".

180. Lord Chelmsford observed that the members are:

> "*made liable by the Act to contribute, not specifically to the payment of those debts and liabilities, but to the assets of the company, to be applied generally in payment of its debts and liabilities*".

181. And see Lord Cairns at 735:

> "*Now, I ask the question, are the contributions to be made by the ex-members the property of the company or are they not? Can it be contended for a moment that they are not? Whose property are they, if they are not the property of the company? Is there anything in this Act of Parliament which makes them the property of any other person but the company? It appears to me, my Lords, beyond all doubt, that all unpaid calls, whether from members or from ex-members, are part of the property and the assets of the company*".

182. Similarly, in *In re General Works Company, Gill's Case* (1879) 12 Ch D 755 **[Auth/4/29]**, Bacon V-C held at 757:

> "*The law vests in the liquidator the control of all the assets of the company, and the assets of the company in this case consist of, amongst others, a sum which Mr Gill undertook to contribute to the assets of the company, whatever might happen*".

183. The LBHI2 Administrators' suggestion that the liability of the contributories is not an asset of the company[101] is therefore wrong.

[101] LBHI2 Administrators' Written Case, [145.5].

184. Further, the suggestion that the liability of members of an unlimited company does not constitute the "*capital*" of the company (see *In re Pyle Works* (1890) 44 Ch D 534 **[Auth/1/19]** per Cotton LJ at 574-5) is irrelevant: whether or not it forms part of the capital, it is undoubtedly an asset of the company, and part of the property of the company, for the purposes of the insolvency legislation. Importantly, whilst the principle of limited liability gives rise to "*capital*" by defining a fixed amount of contributions to which the company is entitled, it does not alter the nature of the members' liability. See *Oakes v Turquand* (1867) LR 2 HL 325 **[Auth/5/20]** per Lord Cranworth, holding at 364 that:

> "*…the introduction of the principle of limited liability… plainly left every shareholder subject to all previous liabilities, except only that a line or boundary was fixed, beyond which his obligations could not be extended*".

185. Therefore, whether it is capped by the principle of limited liability in the case of a limited company or uncapped in the case of an unlimited company, the liability of the members to pay contributions is an asset of the company.

186. Since the liabilities which are payable include the non-provable liabilities of the company, and the assets which are to be applied in paying them include the company's rights of contribution against its members, it necessarily follows that the members' liability to make those contributions to the company includes a liability to contribute to the payment of the company's non-provable liabilities.

187. It is therefore the fact that the members are already liable, without any limit to their liability, which creates a surplus, causing statutory interest to become payable.

188. The LBHI2 Administrators' argument gains no support from the fact that the power to make a call is a power of the court which is delegated to the liquidator.[102] The provisions in respect of the enforcement of the liability to contribute[103] say nothing about the ownership of the chose in action comprised of the liability to contribute. It is plain that this liability does not belong to the court or to the liquidator. The LBHI2

[102] Rule 4.202 **[Auth/3/64]** delegates the court's power to make calls to the liquidator "*as an officer of the court subject to the court's control*".
[103] Rule 4.205(2) **[Auth/3/67]** provides: "*Payment of the amount due from any contributory may be enforced by order of the court*".

Administrators' argument confuses the concept of ownership of a chose in action with the concept of power to enforce it. The liability of the contributories is owed to the company and, as such, is an asset of the company, which is enforceable by the court in its conduct of the winding-up, as delegated to the court's own officer, the liquidator. However, it remains an asset of the company throughout.

189. For the reasons set out above, David Richards J and the Court of Appeal were right to hold that the liability of members under section 74(1) of the 1986 Act **[Auth/1/1]** to contribute to the assets of a company in liquidation "*to any amount sufficient for payment of its debts and liabilities*" is not restricted to the funds required to pay the provable debts in the liquidation but also includes the funds required for the payment of statutory interest and any non-provable liabilities of the company.

**(6) The position in bankruptcy**

190. The LBHI2 Administrators argue that, if section 189 **[Auth/1/2]** "*imposed a liability on a company to pay statutory interest independently of a surplus arising in a liquidation, the equivalent provision in bankruptcy ... would impose a like liability on a bankrupt*".[104] The LBHI2 Administrators say that the bankrupt would not be released from this liability (since he is only released from "*bankruptcy debts*") and that a bankrupt would therefore be at risk of successive bankruptcies based on the non-payment of statutory interest, thus undermining the legislative aim of providing bankrupts with a 'fresh start'.[105]

191. This argument is wrong for two reasons:

191.1. The liability to pay statutory interest is never a liability of the bankrupt. This is because the liability to pay statutory interest, which arises only if and to the extent that there is a surplus available to pay it, is a liability of the person with legal title to the surplus from which such interest is payable. In corporate insolvency proceedings (whether administration or liquidation), legal title to those assets remains vested in the company; and the liability to pay statutory

[104] LBHI2 Administrators' Written Case, [145.3].
[105] LBHI2 Administrators' Written Case, [145.3].

interest is accordingly a liability of the company. The administrator or liquidator acts as the agent of the company in making payment of statutory interest. In personal insolvency proceedings, by contrast, the assets vest in the trustee in bankruptcy (see section 306 of the 1986 Act **[Auth/2/41]**); and the liability to pay statutory interest (which arises only to the extent that there is a surplus available to pay it) is a liability of the trustee in bankruptcy. It is not a liability of the bankrupt. Further, a trustee in bankruptcy acts in his own right and is not an agent of the bankrupt. Lewison LJ was therefore correct to say in the CA Judgment at [47] that "*in a bankruptcy, unlike a corporate insolvency, the bankrupt's property vests in the trustee. So the only person liable to pay the statutory interest is the trustee*".

191.2. In any event, the premise of the LBHI2 Administrators' argument is flawed. It is not the case that section 189 **[Auth/1/2]** "*impose[s] a liability on a company to pay statutory interest independently of a surplus arising in a liquidation*". The LBIE Administrators do not so contend; and neither David Richards J nor the Court of Appeal so held. Rather, as explained above, the assets available for distribution in a liquidation include the liability of the members as contributories. There is no equivalent in bankruptcy: the assets of the bankrupt which vest in the trustee do not include any liability of the bankrupt to pay contributions. A bankrupt is not a shareholder in himself. There is therefore no analogy and the decision of David Richards J and the Court of Appeal does not have the knock-on consequences for bankruptcy law which the LBHI2 Administrators seek to suggest.

## (7) The LBHI2 Administrators' other arguments

192. The LBHI2 Administrators seek to rely on the fact that section 74 **[Auth/1/1]** refers separately to the expenses of the winding-up. According to the LBHI2 Administrators, this shows that "*liabilities*" in section 74 **[Auth/1/1]** cannot include liabilities to which the company became liable in the winding-up. Since statutory interest is a liability to which the company became liable in the winding-up but is not mentioned separately (like the expenses of the winding-up), it cannot (according to the LBHI2 Administrators' argument) fall within the concept of "*liabilities*". This is wrong. The

term "*liabilities*" is very broad and will include every liability, including liabilities to which the company became liable in the winding-up. The expenses of the winding-up are mentioned separately because often these are not liabilities incurred by the company at all; rather, they are incurred by the office-holder in a personal capacity (e.g. a costs order against the liquidator personally in litigation commenced by him by way of an application in his own name under section 238 or section 239 of the 1986 Act). The expenses are mentioned separately in section 74 **[Auth/1/1]** to ensure that liabilities which are properly to be regarded as expenses of the winding-up, but which are neither debts nor liabilities of the company, are brought within the scope of the section.

193. The LBHI2 Administrators rely on the fact that only pre-liquidation interest is provable.[106] That is correct, but it leads only to the conclusion that post-liquidation interest is not a "*debt*". It does not lead to the conclusion that post-liquidation interest is not a "*liability*". Section 74 **[Auth/1/1]** refers to "*debts and liabilities*"; and the definition of liabilities is broad and extends to post-liquidation interest for the reasons explained above.

194. Finally, the LBHI2 Administrators seek to suggest that funds resulting from a call on contributories should be ring-fenced for the payment of provable debts and non-provable liabilities, and not applied in payment of statutory interest.[107] This argument is unsustainable for two reasons:

194.1. It depends on the LBHI2 Administrators' contention that the liabilities in section 74 do not include the liability to pay statutory interest, which is wrong for the reasons explained above.

194.2. The idea of ring-fencing the proceeds of a call for the payment of particular liabilities was rejected in *Webb v Whiffin* (1872) LR 5 HL 711 **[Auth/1/22]**, in which Lord Hatherley LC held that the proceeds of calls are to be distributed in accordance with the statutory order of priority (see at 721):

> "*The assets of the company of course include all contributions which you are entitled to raise from the members ... When that is done, a*

[106] LBHI2 Administrators' Written Case, [145.4].
[107] LBHI2 Administrators' Written Case, [154].

> *common fund is formed, and you find no direction in the Act whatever, except for the distribution of the common fund so formed*".

195. Accordingly, the Members' appeals should be dismissed.

## F: SET-OFF, PROVABILITY AND THE CONTRIBUTORY RULE

### (1) Introduction

197. The issues of set-off, provability and the contributory rule are related; and they arise from the claims and cross-claims between LBIE and its Members.

198. In summary, it is the LBIE Administrators' case that:

198.1. **The set-off issue:** Insolvency set-off occurred in LBIE's administration whether or not LBIE's contingent claims against the Members are provable in the Members' administrations or liquidations.

198.2. **Provability:** If relevant, LBIE's contingent claims against the Members are in any event provable in the Members' administrations or liquidations.

198.3. **Contributory rule:** If there was no insolvency set-off, the contributory rule should be extended to permit the LBIE Administrators to retain, on account of the contingent liabilities of LBL and LBHI2, the distributions that would otherwise be payable to LBL and LBHI2.

### (2) Background

199. These issues arise out of the fact that LBL and LBHI2 have two separate relationships with LBIE:

199.1. LBL and LBHI2 are (or claim to be) creditors of LBIE.

199.2. LBL and LBHI2 are also members of LBIE. In that capacity, they are contingently liable to LBIE as contributories.[108]

[108] The liability of LBL and LBHI2 is contingent, because it depends on LBIE going into liquidation in the future. A liquidator has the ability to make calls but an administrator has no such ability. As a result, there can be no calls at present by the LBIE Administrators. There is simply the prospect of calls in the future by a subsequently appointed liquidator of LBIE.

200. If LBL and LBHI2 were both solvent, the dual capacities of LBL and LBHI2 as both creditors and contributories would not cause any difficulties. The LBIE Administrators would be able to make substantial distributions to LBL and LBHI2 in their capacity as creditors, safe in the knowledge that, if later called on to contribute, LBL and LBHI2 would be able to discharge their obligations as contributories. However, LBL and LBHI2 are both insolvent. Consequently, if the LBIE Administrators were to make substantial distributions to LBL and LBHI2 now, a substantial proportion of that money would never come back; and any calls that are made by a future liquidator of LBIE would go largely unsatisfied.

**(3) Set-off in LBIE's administration**

201. The LBIE Administrators submit that, whether or not it would be provable in the Members' administrations or liquidations, the Members' liability to contribute to LBIE's deficiency under section 74 of the 1986 Act **[Auth/1/1]** went into the set-off account in LBIE's administration when set-off took effect on 4 December 2009.[109]

(i) Insolvency set-off

202. Rule 2.85 of the 1986 Rules **[Auth/3/41]** provides as follows:

> "*(1) This Rule applies where the administrator, being authorised to make the distribution in question, has, pursuant to Rule 2.95 given notice that he proposes to make it.*
> *(2) In this Rule 'mutual dealings' means mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company proving or claiming to prove for a debt in the administration ...*
> *(3) An account shall be taken as at the date of the notice referred to in paragraph (1) of what is due from each party to the other in respect of the mutual dealings and the sums due from one party shall be set off against the sums due from the other.*
> *(4) A sum shall be regarded as being due to or from the company for the purposes of paragraph (3) whether–*
> *(a) it is payable at present or in the future;*
> *(b) the obligation by virtue of which it is payable is certain or contingent; or*
> *(c) its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion.*

[109] This was the date on which the LBIE Administrators gave notice of their intention to make distributions in LBIE's administration.

*(5) Rule 2.81 shall apply for the purposes of this Rule to any obligation to or from the company which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value.*
*...*
*(7) Rule 2.105 shall apply for the purposes of this Rule to any sum due to or from the company which is payable in the future.*
*(8) Only the balance (if any) of the account owed to the creditor is provable in the administration. Alternatively the balance (if any) owed to the company shall be paid to the administrator as part of the assets except where all or part of the balance results from a contingent or prospective debt owed by the creditor and in such a case the balance (or that part of it which results from the contingent or prospective debt) shall be paid if and when that debt becomes due and payable*".

203. This provision is modelled on liquidation set-off in rule 4.90 **[Auth/3/49]**, which in turn derives from the provisions for bankruptcy set-off which stretch back many centuries.

(ii) The features of insolvency set-off

204. The authorities establish the following propositions:

204.1. Insolvency set-off is automatic and self-executing. See *Stein v Blake* [1996] AC 243 **[Auth/1/20]** per Lord Hoffmann at 255.[110]

204.2. The set-off provision is wide-ranging in scope. See, for example, *Peat v Jones & Co* (1881) 8 QBD 147 **[Auth/6/3]** at 149: "*Now the enactment as to 'mutual credits' is a very old one, first appearing in 5 Geo. 2, c. 30, but the whole tendency of the subsequent legislation, as of the legislation respecting provable debts, has been to extend the principle on which it is founded*".[111]

[110] See also *Re Deveze Ex parte Barnett* (1874) LR 9 Ch App 293 **[Auth/4/25]** per Lord Selborne LC at 295 ("*there is to be a rule of set-off, not, as I understand it, at the option of either party, but an absolute statutory rule*"); *Mersey Steel & Iron Co Ltd v Naylor Benzon & Co* (1882) 9 QBD 648 **[Auth/5/16]** per Jessel MR at 664 ("*True, the Act of Parliament only says that when the claimant comes to prove in bankruptcy, an account is to be taken. But the Courts take the meaning of the Act to be that when one of the parties is a bankrupt an account shall be taken between the parties, and that, whether the other party brings his claim into the Court of Bankruptcy or not, there shall be no claim except for the balance*"); *Watkins v Lindsay & Co* (1898) 5 Mans 25 **[Auth/6/20]** per Wright J at 29 ("*set-off ... in bankruptcy is automatic and not dependent on the option of the party*"); and *Re City Life Assurance Co Ltd* [1926] Ch 191 **[Auth/4/22]** per Pollock MR at 203 ("*It is to be observed that s. 31 is definite in its terms that where there is a mutual credit, mutual debt or other mutual dealings, the sums are to be set-off and the balance of the account and no more shall be claimed or paid on either side respectively. It is not merely permissive, but it is a direct statutory enactment that the balance only is to be claimed in bankruptcy*").

[111] And see *Eberle's Hotels and Restaurant Co v Jonas* (1887) 18 QBD 459 **[Auth/4/26]** per Lord Esher MR at 465: "*I should, speaking for myself, desire to give the widest possible scope to the section, and, in my opinion, wherever in the result the dealings on each side would end in a money claim, its provisions would be applicable*".

204.3. In particular, contingent liabilities are included in the set-off account. See *Stein v Blake* [1996] AC 243 **[Auth/1/20]** per Lord Hoffmann at 252:

> "***Bankruptcy set-off therefore requires an account to be taken of liabilities which, at the time of bankruptcy, may be due but not yet payable or may be unascertained in amount or subject to contingency*** *... The claims may have been contingent at the bankruptcy date and the creditor's claim against the bankrupt may remain contingent at the time of the calculation, but they are nevertheless included in the account*" (emphasis added).[112]

204.4. Since 2005,[113] such contingent liabilities must be brought into the account whether they are owed to or by the company in administration: see Rule 2.85(4) **[Auth/3/41]**. A contingent liability owed to a company in administration is therefore just as much a part of the set-off account as a contingent liability owed by the company in administration.[114]

205. The Members' liability to contribute to LBIE's deficiency in the event of its liquidation is "*regarded as being a sum due to ... the company*" (i.e. LBIE) as contemplated by rule 2.85(4) at the time the set off account was taken in its administration.

206. First, the Members' payment obligation is a contingent payment obligation within rule 2.85(4)(b) **[Auth/3/41]**. It arises by reason of the contract of membership between the Members and LBIE, which has the statutory effect of causing the Members to be liable for LBIE's debts and liabilities and the expenses of its winding-up in the event of its liquidation:

206.1. The Members' obligation to contribute is a statutory obligation which springs from the contract to take shares. See *In Re General Works Company, Gill's Case* (1879) 12 Ch. D. 755 **[Auth/4/29]** per Bacon V-C at 757: "*I do not hesitate to say that I do not consider that there is.* ***Mr Gill's debt is a statutory obligation***

[112] See also *Gye v McIntyre* (1991) 171 CLR 609 **[Auth/1/10]** per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ at 618.

[113] Insolvency (Amendment) Rules 2005 (SI 2005/527).

[114] A similar change was made to rule 4.90 **[Auth/3/49]**, the liquidation set off rule, and reverses the principle described by Lord Hoffmann in *Stein v Blake* [1996] AC 243 **[Auth/1/20]** in the following terms (at 253): "*There is no similar machinery for quantifying contingent or unascertained claims against the creditor, because it would be unfair upon him to have his liability to pay advanced merely because the trustee wants to wind up the bankrupt's estate*".

***springing from the contract to take shares***" (emphasis added). The position of LBL and LBHI2 was that, by applying for and accepting shares in LBIE, they became bound by the statute to pay contributions in LBIE's liquidation, if the moneys which it received from its other assets were insufficient to discharge in full its debts and liabilities and the expenses of its winding-up.

206.2. The Members' obligation to contribute is a contingent obligation within rule 2.85(4)(b) **[Auth/3/41]**, because it is contingent on LBIE's liquidation. In *In re Sutherland, dec'd* [1963] AC 235 **[Auth/6/16]**, Lord Reid held at 249 that a contingent liability is "*a liability which,* ***by reason of something done by the person bound****, will necessarily arise or come into being if one or more of certain events occur or do not occur*" (emphasis added). In the present case, the liability of the Members is one which, by reason of their contract of membership with LBIE, will necessarily come into being if LBIE goes into liquidation with an insufficiency of assets to pay its debts and liabilities and the expenses of its winding-up.

207. Secondly, the amount for which the Members are contingently liable is capable of being ascertained as a matter of opinion (see rule 2.85(4)(c) **[Auth/3/41]**). It may be estimated by the LBIE Administrators under rule 2.81 **[Auth/3/40]**, in accordance with rule 2.85(5) **[Auth/3/41]**.

208. The Members' liability to contribute to LBIE's deficiency in the event of its liquidation therefore satisfies the requirements for a contingent outward claim to be included in the set off account in LBIE's administration.

(iii) The requirement for the inward claim to be provable

209. To these principles of insolvency set-off may be added the proposition that the inward claim (i.e. the claim against the company in administration) must be provable in the administration in order for insolvency set-off to apply to it: see rule 2.85(2) **[Auth/3/41]**.

210. The reference to "*any creditor of the company proving or claiming to prove for a debt in the administration*" does not limit the set-off provision to those creditors who actually lodge proofs of debt in the administration. Rather, it is a reference to those creditors who, apart from insolvency set-off, would have been entitled to prove. To qualify for insolvency set-off, the creditor's claim against the insolvent company must be one which otherwise satisfies the test for provability in rule 13.12(1) **[Auth/1/6]**. See *Stein v Blake* **[Auth/1/20]** per Lord Hoffmann at 253.[115]

(iv) No requirement for the outward claim to be provable

211. It is only the creditor's claim against the company in administration (the inward claim) that has to satisfy the test for provability in order to qualify for insolvency set-off in the company's administration. In the LBIE Administrators' submission, the company's claim against the creditor (the outward claim) does not have to satisfy the test for provability.

211.1. There is no warrant in the wording of rule 2.85 **[Auth/3/41]** for any such conclusion.

211.2. Indeed, in most cases, the creditor will not be insolvent; whether the company's claim is provable is academic and the test for provability will not apply, or be capable of applying, at all to the company's claim against the creditor. In such a case, there is no basis for thinking that the company's claim against the creditor will be excluded from the insolvency set-off account in the company's administration unless it would be provable in a hypothetical administration or liquidation of the creditor.

211.3. Further, even if the creditor were to become insolvent, the creditor would not necessarily go into insolvency proceedings in England. The creditor might go into insolvency proceedings in a different jurisdiction, in which rule 13.12(1) **[Auth/1/6]** would be inapplicable and a different provability test altogether might apply.

[115] See also *Gye v McIntyre* (1991) 171 CLR 609 **[Auth/1/10]** per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ at 621-622.

212. This conclusion is supported by *Gye v McIntyre* (1991) 171 CLR 609 **[Auth/1/10]**, which was decided at a time when unliquidated tort claims were not provable. Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ held at 628:

> "***There is nothing at all in the Act which requires that a claim of a person who has become bankrupt which vests in his trustee should, for the purposes of s 86 (or, for that matter, any other section), be subjected to the additional test of whether, if the debtor of the bankrupt had himself become bankrupt, the claim would have been a provable debt in the debtor's bankruptcy. Nor is there any reason in fairness or common sense why such an additional test should be imposed***" (emphasis added).[116]

213. It is submitted that the Court should hold this reasoning to be equally applicable to insolvency set-off under rule 2.85 **[Auth/3/41]** in LBIE's administration. Whilst the creditor's claim against LBIE must (as with all other creditors' claims) satisfy the test for provability in LBIE's administration, LBIE's cross-claim does not need to satisfy the test for provability in the administration or liquidation of the creditor in order to go into the set-off account in LBIE's administration.

(v) The requirement for mutuality

214. In the LBIE Administrators' submission, the reference to "*mutual*" dealings does not mean that the test for provability applies to the company's claim against the creditor, as well as to the creditor's claim against the company.

215. The reference to mutuality was explained in *Secretary of State for Trade and Industry v Frid* [2004] 2 AC 506 **[Auth/6/10]** per Lord Hoffmann at [26]:

> "*Mutuality requires that each party should be debtor and creditor in the same capacity. A claim by a trustee on behalf of a beneficiary cannot be set off against*

[116] See also Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ at 629: "*there is no reason why the words of the section should be further confined by the introduction of an additional requirement to the effect that the countervailing claim of the trustee in bankruptcy must be of a kind which would be provable in the bankruptcy of the person who has had mutual dealings with the bankrupt if that person were to become a bankrupt. The only further control of the type of claim which can be set off under s 86 is that specified by the section itself, namely, that the countervailing claims be in respect of mutual credits, mutual debts or other mutual dealings which existed or had occurred at the time of the sequestration order*".

*a debt owing to the trustee personally. The law is concerned with beneficial ownership and not mere legal title*".[117]

216. In the present case, LBIE does not hold its contingent claims against the Members on trust; and the Members do not hold their claims against LBIE on trust. Thus, the requirement for mutuality provides no bar to the application of insolvency set-off.

(vi) The requirement for commensurability

217. In the LBIE Administrators' submission, the reference in the case law to the need for commensurability does not mean that the company's claim against the creditor must, like the creditor's claim against the company, satisfy the test for provability. All that this means is that both claims have to sound in money. See *Eberle's Hotels and Restaurant Co Ltd v Jonas* (1887) 18 QBD 459 **[Auth/4/26]** per Bowen LJ at 468:

> "*How can an account be taken where the claim on one side is to a return of goods in specie, and the claim on the other side is a money claim? The two things are incommensurable*".[118]

218. In the present case, LBIE's contingent claims against its Members and the Members' claims against LBIE both sound in money. The requirement of commensurability therefore creates no obstacle to the application of insolvency set-off under rule 2.85 **[Auth/3/41]**.

(vii) *In re Bank of Credit and Commerce International SA (No 8)* [1996] Ch 245

219. The only obstacle to the conclusion that insolvency set-off would apply under rule 2.85 in LBIE's administration, even if LBIE's contingent claims against its Members were not provable in the Members' administrations, is *In re Bank of Credit and Commerce International S.A. (No. 8)* [1996] Ch 245 **[Auth/4/7]** in which Rose LJ held at 256:

> "*It has been said many times that the right of set-off in bankruptcy is a rule as to debts and liabilities provable ... [Any] claim which is admissible to proof is*

[117] See also *Re City Life Assurance Co Ltd* [1926] Ch 191 **[Auth/4/22]** per Pollock MR at 216 and *Gye v McIntyre* (1991) 171 CLR 609 **[Auth/1/10]** per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ at 619.
[118] See also Fry LJ at 469 and Lord Esher MR at 465.

> *capable of set-off if the other requirements of set-off are satisfied. The converse is equally true: a claim is not capable of set-off unless it is admissible to proof ... To qualify for set-off, therefore, the creditor's claim must be capable of proof ...* ***This is true of both sides of the account. The right to set off a particular claim depends on the nature and character of the claim itself and not upon the side of the account on which it is to be placed****: Graham v. Russell (1816) 5 M & S 498, 501*" (emphasis added).

220. According to Rose LJ, therefore, the company's claim against the creditor must satisfy the test for provability, as well as the creditor's claim against the company, in order to qualify for insolvency set-off in the company's insolvency proceedings.

221. When the case reached the House of Lords, Lord Hoffmann did not think that this was right. He said in *In re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214 **[Auth/4/8]** at 228:

> "*It is clear that ... the claim by the creditor against the insolvent company must be a provable debt ... The Court of Appeal held that the same was true of the claim by the company against the creditor ...* ***I am not sure that this is right*** *and ... the contrary was decided by the High Court of Australia in Gye v McIntyre (1991) 171 CLR 609, a case which does not appear to have been cited to the Court of Appeal*" (emphasis added).

222. However, whilst doubting Rose LJ's view in *In re Bank of Credit and Commerce International SA (No 8)* [1996] Ch 245 **[Auth/4/7]**, Lord Hoffmann did not expressly hold it to be incorrect; the point did not arise for consideration before the House of Lords. The LBIE Administrators invite the Supreme Court to hold Rose LJ's view to be incorrect. Whilst rule 2.85 **[Auth/3/41]** clearly does import the requirements of rule 13.12(1) in respect of the creditor's claim against the company in administration (as shown by the reference to "*proving or claiming to prove*" in rule 2.85(2)) **[Auth/3/41]**, it does not import the requirements of rule 13.12(1) **[Auth/1/6]** in respect of the company's claim against the creditor; rather, the company's claim against the creditor in the set-off account in the company's administration is required only to satisfy the requirements of rule 2.85(4) **[Auth/3/41]**.

223. Further, rule 2.85(4) **[Auth/3/41]**, which did not exist in its current form at the time of *In re Bank of Credit and Commerce International SA (No 8)* [1996] Ch 245 **[Auth/4/7]**,

makes no reference to any requirement for the outward claim to be provable and is therefore inconsistent with Rose LJ's conclusion.

224. Further, *Graham v Russell* (1816) 5 M & S 498 **[Auth/4/34]**, on which Rose LJ relied, is not an authority on rule 4.90 **[Auth/3/49]** or rule 2.85 **[Auth/3/41]** of the 1986 Rules. Lord Ellenborough CJ's conclusion at 502 that "*the question, whether any particular item shall be introduced into it, must depend upon the nature and character of the item itself, and not upon the side of the account at which it is to be placed*" was not a conclusion on any point of construction arising on rule 4.90 **[Auth/3/49]** or rule 2.85 **[Auth/3/41]**.

225. For these reasons, the LBIE Administrators submit that LBIE's contingent claims against its Members went into the insolvency set-off account against the Members' claims in LBIE's administration as at 4 December 2009. They were, at that date, contingent claims within rule 2.85(4)(b) **[Auth/3/41]**, which must be valued in accordance with rule 2.85(5) **[Auth/3/41]**. The taking of the account will have produced a net sum owing to LBIE which would not have been payable immediately, but deferred by rule 2.85(8) **[Auth/3/41]** until a call is actually made by LBIE's liquidator. Nevertheless, that net sum is provable as a contingent debt in the Members' distributing administrations or liquidations.

**(4) Provability**

226. Even if this Court holds that Rose LJ was correct in *In re Bank of Credit and Commerce International S.A. (No. 8)* [1996] Ch 245 **[Auth/4/7]** at 256 to conclude that set-off only takes place as between debts which are provable against the company and which would be provable in the creditor's insolvency, the contingent liability of a Member under section 74(1) **[Auth/1/1]** is a provable debt in the Member's distributing administration or liquidation within the meaning of rule 13.12(1)(b) of the 1986 Rules **[Auth/1/6]**.

(i) Test for provability

227. Rule 12.3(1) **[Auth/3/71]** provides:

"*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*".

228. Rule 13.12 **[Auth/1/6]**, as it stood at the relevant time, provided:

> "*(1) 'Debt', in relation to the winding up of a company, means (subject to the next paragraph) any of the following—*
> *(a) any debt or liability to which the company is subject at the date on which it goes into liquidation;*
> *(b) any debt or liability to which the company may become subject after that date by reason of any obligation incurred before that date; and*
> *(c) any interest provable as mentioned in rule 4.93(1).*
> *…*
> *(3) For the purposes of references in any provision of the Act or the Rules about winding up to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, or whether its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion; and references in any such provision to owing a debt are to be read accordingly.*
> *(4) In any provision of the Act or the Rules about winding up, except in so far as the context otherwise requires, 'liability' means (subject to paragraph (3) above) a liability to pay money or money's worth, including any liability under an enactment, any liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution.*
> *(5) This rule shall apply where a company is in administration and shall be read as if references to winding up were a reference to administration*".

229. The two rules, when read together, are "*strikingly wide*": see in *In re the Nortel Companies and Ors* [2014] 1 AC 209 **[Auth/1/17]** per Lord Neuberger at [66]. This is consistent with the general principle of insolvency law that every debt or liability capable of being expressed in money terms should be eligible for proof so as to achieve equal justice for all creditors in an insolvency: see *Nortel* **[Auth/1/17]** at [92]-[93].[119]

[119] Whilst the LBHI2 Administrators are correct to say (as they do in their Written Case at [12]) that the definition of provable debts seeks to include as many claims as possible in the proof process, LBHI2 is wrong to say that this policy is intended to "***discharge** all the sums that should be paid*" (emphasis in original). As noted above, in contrast to the position in the bankruptcy of individuals (see section 281 of the 1986 Act **[Auth/2/40]**), there is no concept of discharge in corporate insolvency proceedings. As the Privy Council held in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 **[Auth/1/23]** at [27]: "*Their debts ... are discharged by the winding-up only to the extent that they are paid out of dividends ... There is no equivalent of the discharge of a personal bankrupt which extinguishes his debts*".

(ii) Rule 13.12(1)(b) – obligation incurred

230. In the LBIE Administrators' submission, LBIE's contingent claims against each of its Members is a debt or liability to which the Member may become subject after the commencement of the Member's administration by reason of an obligation incurred by it before that date. The obligation that the Members incurred before the commencement of its administration is the obligation that each incurred when it became a Member of LBIE, an unlimited company. By becoming a member of LBIE, an unlimited company, LBL and LBHI2 subjected themselves to obligations to pay LBIE's debts and liabilities (and the costs of its winding-up) without limitation.

231. The obligation was incurred as a result of the contract of membership, which had the statutory effect of requiring the Members to pay LBIE's debts and liabilities (and the costs of its winding-up) without limitation in the event of its liquidation. It was, in that sense, a "*statutory obligation springing from the contract to take shares*" (*In Re General Works Company, Gill's Case* (1879) 12 Ch D 755 **[Auth/4/29]** per Bacon V-C at 757).[120]

232. It makes no sense to say that LBL and LBHI2 do not have (and have never had) any obligations as members of an unlimited company, merely because LBIE is not yet in liquidation. They are already members of LBIE. The obligation of the Members does not arise from nowhere at the commencement of the company's liquidation, but relates back to the date on which they became members of the company. See, for example, *Ex parte Canwell* (1864) 4 De GJ&S 539, 46 ER 1028 **[Auth/4/17]**, in which Lord Westbury LC held (to quote the headnote):

> "*The liability of a contributory under the Companies Act, 1862, s. 75, commences at the date when he enters into the contract under which he becomes a member of the company which is being wound up*".

233. See also *Williams v Harding* (1866) LR 1 HL 9 **[Auth/1/24]**, in which a person became a member of a company before the coming into force of the Bankruptcy Act 1861, but no call was made until after the coming into force of the Bankruptcy Act 1861. The

[120] The fact that the contingent liability to contribute is provable in the member's administration or liquidation is clear from the decision of Stirling J in *In re McMahon* [1900] 1 Ch 173 **[Auth/5/15]**.

House of Lords held that this liability was contracted before coming into force of the Bankruptcy Act 1861, because it related back to the date of the contract of membership. Lord Cranworth LC said at 22:

> "*it is plain that the calls made on the Appellant, and ordered to be paid by him to the official manager, cannot be treated as a debt contracted by him after the passing of the Act of 1861. They constitute an obligation cast on him by law, after the passing of the Act, in consequence of engagements which he had entered into long previously.* ***This obligation must, I think, in construing the 90th section, be referred back to the year 1849, when he became a shareholder and executed the deed. By what he then did, he knew that he might become liable to pay such calls as are now imposed upon him***" (emphasis added).

234. Lord Kingsdown said at 27-28:

> "*At the time when the winding-up order was pronounced, the Appellant, as regarding the creditors of the concern, was liable to the whole amount of all the debts. ... The amount which he might have to pay under either of these liabilities was necessarily uncertain until the accounts were settled, but the liability to pay already existed.* ***The whole purpose of calls to be made under the statute is to give effect to the liability so existing.*** *... The payment of the amount of the calls is to be made to the official manager, not because he is by the Act constituted a creditor of the persons by whom the payments are to be made, but because he is constituted a trustee, to whom debts already due by other persons are to be paid, in order that by his means those other persons may receive, in a more convenient form, what is due to them.* ***The call does not, in my opinion, constitute a new debt, but ascertains the amount and provides for the payment of a debt already due. The debt, therefore, in this case was not, I think, a debt contracted after the Bankruptcy Act of 1861 was passed***" (emphasis added).

235. See also *In re China Steamship Company* (1869) LR 7 Eq 240 **[Auth/4/20]** per Lord Romilly MR at 244, referring to section 75 of the Companies Act 1862 **[Auth/2/7]**: "*The question is, whether that enactment does not create a debt which is debitum in presenti, solvendum in futuro; and I am of opinion that it does*".

236. The Members' obligation is not ***purely*** contractual or ***purely*** statutory. Rather, as explained above, it arises from the contract of membership, which has the statutory effect of imposing an obligation. However, the fact that a statute is involved in the genesis of the obligation makes no difference to the analysis. The term "*liability*" in rule 13.12(1)(b) of the 1986 Rules **[Auth/1/6]** expressly includes "*any liability under an enactment*": see rule 13.12(4) **[Auth/1/6]**. There is therefore no distinction to be drawn

for these purposes between liability under a contract and liability under a statute. As Lord Sumption held in *Nortel* **[Auth/1/17]** at [132]:

> "***Contract is not the only legal basis on which a contingent obligation of this kind may arise. A statute may also give rise to one*** *... If the mandatory provisions of a statute may create a legal relationship between the company and a creditor (or potential creditor) giving rise to a provable debt, then there is no reason why it should not do so contingently on some future event*" (emphasis added).[121]

237. See, for example, the contingent liability to pay costs, which may be awarded by the Court in the exercise of a statutory discretion after the commencement of insolvency proceedings. In overruling the previous authorities in which such a contingent liability had been held not to be provable,[122] Lord Sumption said at [137]:

> "*In the costs cases, I consider that* ***those who engage in litigation whether as claimant or defendant, submit themselves to a statutory scheme which gives rise to a relationship between them governed by rules of court. They are liable under those rules to be made to pay costs contingently on the outcome and on the exercise of the court's discretion. An order for costs made in proceedings which were begun before the judgment debtor went into liquidation is in my view provable as a contingent liability, as indeed it has been held to be in the case of arbitration proceedings****: In re Smith; Ex p Edwards (1886) 3 Morr 179. In both cases,* ***the order for costs is made against someone who is subject to a scheme of rules under which that is a contingent outcome****.* ***The fact that in one case the submission is contractual while in the other it is not, cannot make any difference under the modern scheme of insolvency law under which all liabilities arising from the state of affairs which obtains at the time when the company went into liquidation are in principle provable****.*" (emphasis added).

(iii) The impact of *Nortel*

238. For the reasons set out above, the contingent statutory liability of a member to contribute in the event of the company's liquidation, arising by reason of the contract of membership, would have been a provable liability in the member's administration or liquidation under rule 13.12(1)(b) **[Auth/1/6]**, even before the decision of the Supreme

[121] See *In re Sutherland, dec'd* [1963] AC 235 **[Auth/6/16]** (to which Lord Neuberger referred in *Nortel* **[Auth/1/17]** at [78]-[80]; *Secretary of State for Trade and Industry v Frid* [2004] 2 AC 506 **[Auth/6/10]** (as mentioned by Lord Sumption in *Nortel* **[Auth/1/17]** at [134]); and *Lofthouse v Commissioner of Taxation* [2001] vsc 326 **[Auth/7/4]** (as mentioned by Lord Sumption in *Nortel* **[Auth/1/17]** at [135]).

[122] *In re Bluck; Ex parte Bluck* (1887) 57 LT 419 **[Auth/4/13]**, *In re British Gold Fields of West Africa* [1899] 2 Ch 7 **[Auth/4/15]**, *In re A Debtor (No 68 of 1911)* [1911] 2 KB 652 **[Auth/4/24]**, *In re Pitchford* [1924] 2 Ch 260 **[Auth/6/4]** and *Glenister v Rowe* [2000] Ch 76 **[Auth/4/31]**.

Court in *In re the Nortel Companies and Ors* [2014] 1 AC 209 **[Auth/1/17]**, which widened the concept of contingent liabilities by overruling the anomalous costs cases.

239. Further, given that the decision of the Supreme Court in *Nortel* **[Auth/1/17]** widened the concept of contingent liabilities, the LBIE Administrators submit that it cannot have altered the result in the present case. If (as explained above) a contingent statutory liability would have been provable even before *Nortel* **[Auth/1/17]**, it cannot have become non-provable as a result of *Nortel* **[Auth/1/17]**. The decision in *Nortel* **[Auth/1/17]** was bringing additional contingent statutory liabilities into the fold, not excluding those that were already within it.

240. David Richards J agreed with this analysis in the HC Judgment **[Core/D/5]** at [196]:

> "*It is, in my judgment, clear that the contingent liability of a member to pay calls which may be made in a future winding up of the company satisfies the general characteristics necessary for a provable debt in the insolvency of the member. I have earlier referred to the authorities which establish that such liability commences with the contract by which he became a member. In the case of a corporate member, there is no difficulty in applying the definition of 'debts' in rule 13.12(1) to this liability. It is a 'debt or liability to which the company may become subject after [the date on which the company went into liquidation or prior administration] by reason of any obligation incurred before that date': rule 13.12(1)(b).* ***In view of the contractual basis of the obligation, giving rise to the statutory liability, this would be the case even before the decision of the Supreme Court in In re Nortel [2014] AC 209. There can be no room for doubt on this conclusion, given the very broad meaning given to that provision by the Supreme Court***" (emphasis added).

241. It is submitted that David Richards J was correct.

242. Further and in any event, for the reasons set out below, the LBIE Administrators submit that LBIE's contingent claims against the Members are provable in the Members' administrations, applying Lord Neuberger's analysis in *Nortel* **[Auth/1/17]** at [77]:

> "*However, the mere fact that a company could become under a liability pursuant to a provision in a statute which was in force before the insolvency event, cannot mean that, where the liability arises after the insolvency event, it falls within rule 13.12(1)(b). It would be dangerous to try and suggest a universally applicable formula, given the many different statutory and other liabilities and obligations which could exist. However, I would suggest that, at least normally, in order for a company to have incurred a relevant 'obligation' under rule 13.12(1)(b), it*

*must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship), and which (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred. If these two requirements are satisfied, it is also, I think, relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1)(b)*".

243. In the present case, there is no doubt that limbs (a) and (b) of Lord Neuberger's test are satisfied.

243.1. As to limb (a), LBL and LBHI2 have taken steps which have legal effect by entry into a legal relationship. They became shareholders in an unlimited liability company. The obligation to contribute under section 74(1) **[Auth/1/1]** arises because the member enters into a legal relationship with the company, namely the relationship constituted by membership of an unlimited company.

243.2. As to limb (b), LBL and LBHI2 are vulnerable to the specific liability in question. This has been the case from the outset, because the legal relationship of membership made the Members vulnerable to the liability to contribute. In any event, it cannot be said that there was not a real prospect of that liability being incurred, viewed immediately prior to LBIE's entry into administration.

244. LBHI suggests that "*[the] only step to which the member has become subject which results in it being vulnerable to the section 74 liability ... is the winding-up of the company*".[123] However, this is wrong, as it ignores the fact that the Members took the step of subscribing for shares in LBIE, which is an unlimited company. The legal relationship of membership – which commenced with the taking up of the shares in LBIE by the Members – is what made the Members vulnerable to the liability to contribute in the event of LBIE's winding-up. In the LBIE Administrators' submission, limb (b) is plainly satisfied.

245. It is therefore necessary to consider limb (c) of Lord Neuberger's test, i.e. whether it would be consistent with the regime under which the liability is imposed to conclude

[123] LBHI's Written Case, [60].

that the steps taken by the company, or to which it was subjected, give rise to an obligation under that rule.

246. The LBIE Administrators submit that one would expect the answer to that question to be in the affirmative (taking a common sense approach of the type taken by Lord Neuberger at [58] and [59]):

246.1. First, the sensible and fair answer is plainly for the contingent liability to contribute under section 74(1) **[Auth/1/1]** to be a provable debt in the Members' administrations. It would make no sense to permit a corporate member of an unlimited liability company to escape from the liability to contribute by the simple expedient of going into administration or liquidation.

246.2. Secondly, if there had been a call by a liquidator of LBIE before the commencement of the contributories' administrations, it would have given rise to a provable debt in the contributories' administrations. The fact that a call has not yet been made should not make any difference to the analysis. To paraphrase Lord Neuberger (see *Nortel* **[Auth/1/17]** at [59]), it would be somewhat arbitrary if the characterisation and treatment of the liability under the call regime should turn on when the call happens to have been made, if it is based on the membership of an unlimited liability company which existed before the insolvency event.

247. In challenging the conclusion that the contingent liability is a provable debt, LBHI nevertheless contends that the provability of the contingent liability would be inconsistent with the statutory scheme. LBHI contends that moneys paid in respect of the contributory's liability: (i) are payable only on a winding up of the company; (ii) are never under the control of the directors of the company and cannot be charged, disposed of or in any way dealt with by them; (iii) are not part of the capital of the company; (iv) form a statutory fund which only comes into existence when the company is wound up; and (v) may be called for only by the liquidator to meet the special demands of the fund.[124] LBHI says that if the liability is provable in advance of liquidation under rule 13.12(1)(b) **[Auth/1/6]**, what was an asset ordinarily realisable only by a liquidation

[124] LBHI's Written Case, [13].

could be turned into money by the company's directors, once a member went into an insolvency process, and used impermissibly to further the trading activities of the company.

248. However, there is nothing unexpected or contrary to the legislature's intention for the liability of a contributory in respect of future calls to be provable in the contributory's insolvency. Where the contributory is an individual, there has never been any objection to the prospective liability of the contributory being provable in the contributory's bankruptcy. Section 75 of the Companies Act 1862 **[Auth/2/7]** provided that "*[it] shall be lawful in the case of the bankruptcy of any contributory to prove against his estate the estimated value of his liability to future calls, as well as calls already made*". This provision still exists in the form of section 82(4) of the 1986 Act **[Auth/2/17]**, which states: "*There may be proved against the bankrupt's estate the estimated value of his liability to future calls as well as calls already made*". There is therefore nothing intrinsically wrong or contrary to the intention of the legislature to prove in the bankruptcy of a contributory for the estimated value of his liability for future calls.

249. The fact that this provision applies only to individual contributories who become bankrupt, and not also to corporate contributories who go into administration or liquidation, does not go anywhere. The reason why it is necessary to deal expressly with bankrupt contributories is because, in bankruptcy, the bankrupt's property – including any shares owned by him – vests in the trustee under section 306 of the 1986 Act **[Auth/2/41]**. In section 82 **[Auth/2/17]**, subsection (2) recognises that the trustee in bankruptcy is therefore the contributory in respect of the shares registered in the name of the bankrupt. Without further provision any claim in respect of calls would therefore lie against the trustee in bankruptcy. Subsections (3) and (4) therefore go on to provide that claims in respect of future calls are not to be made against the trustee personally but are to be admitted to proof in the bankrupt's estate. There is no equivalent of section 82 **[Auth/2/17]** in respect of a corporate contributory that enters administration or liquidation because there is no equivalent of the vesting under section 306 **[Auth/2/41]**.

250. David Richards J dealt with this point in the HC Judgment **[Core/D/5]** at [145]:

> "*It was submitted by Mr Wolfson that the presence of the provisions permitting proof in subsections (3) and (4), without any corresponding provisions relating*

*to proof in the administration or liquidation of a corporate contributory, demonstrated that there could be no proof in the latter case in respect of a liability as a contributory. This submission misunderstands the purpose of those subsections. Subsection (2) makes the trustee in bankruptcy the contributory in respect of the shares registered in the name of the bankrupt. Without further provision any claim in respect of calls would therefore lie against the trustee in bankruptcy. Subsections (3) and (4) provide that claims in respect of future calls are not to be made against the trustee personally but are to be admitted to proof in the bankrupt's estate. Without those provisions, the bankrupt's estate would have no liability in respect of future calls and therefore no proof in respect of them could be made. In the case of an administration or liquidation of a corporate contributory, the shares remain registered in the name of the company and there is therefore no need for any provision to the effect that proofs in respect of future calls may be made in the administration or liquidation*".

251. None of the points identified by LBHI provides any basis for concluding that the contingent liability is not provable. As Briggs LJ held in the CA Judgment **[Core/D/3]** at [226]:

"*Turning to Mr Isaacs's suggested consequences, I am not myself persuaded by those which amount to little more than saying that proof of a contributory's future liability enables it to be realised earlier than as provided for in section 74, namely on liquidation of the unlimited company and the making of a call. Proof for a future or contingent debt in a liquidation or administration always realises the relevant asset earlier than it would otherwise be realisable and, to that extent, may be said to cause an injustice as between the creditor and the debtor. But that injustice is outweighed by the policy that all debts and liabilities should, as far as possible, be dealt with in any process for the winding up or distributing administration of the debtor*".

252. Further, LBHI's suggestion that the Court of Appeal's conclusion would enable the directors of a going concern to prove in a member's liquidation[125] should be uncontroversial and is not a basis for concluding that the contingent liability is not provable. If the member's assets are being finally distributed in the member's liquidation, so that there will be nothing remaining in the event of a call being made in the future, it would be preferable for the company to receive a dividend based on the estimated likelihood of its own future liquidation (which, unlike in this case, may in practice be a very low risk) than to receive nothing at all.

[125] LBHI's Written Case, [18].

253. LBHI also says that there could be difficulties in estimating the likelihood of the contingency occurring.[126] But that is often the case with contingent liabilities, which are nevertheless provable. In practice the office-holder has to do his best to estimate a percentage chance of the contingency happening and use that assessment to form a fair estimate of the value of the contingent liability. That is precisely what rule 2.81(1) **[Auth/3/40]** requires: "*The administrator shall estimate the value of any debt which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value*". There is nothing surprising or anomalous in the estimation of the value of contingent debts.

254. LBHI seeks to suggest that the Court of Appeal's conclusion could result in the total amount of the liability under section 74 **[Auth/1/1]** being greater than that specified in section 74 **[Auth/1/1]**.[127] LBHI provides a worked example which purports to prove this point.[128] However, this is a bad point, because it seems to be premised on the suggestion that the Members' liability has been limited in some way. This ignores the fact that LBIE is an unlimited company: the Members are liable without limitation. The Members remain liable until all of the items in section 74(1) **[Auth/1/1]** have been paid: if those items have not been paid at the time of the winding-up, the Members remain liable to pay them.

255. LBHI suggests that, if the Court of Appeal were right, a company could enter into a binding compromise with a contributory, which would be inconsistent with section 74 **[Auth/1/1]**.[129] This is wrong. The Court of Appeal did not reach this conclusion; and, in the LBIE Administrators' submission, the Court of Appeal's reasoning in respect of the provability of the contingent debt does not lead to this conclusion. There is therefore nothing in this point.

256. LBHI seeks to suggest that, if the Court of Appeal were right, a company could sell the right to future calls[130] or charge it.[131] Again, there is nothing in these points. The Court of Appeal's reasoning does not lead to these conclusions.

[126] LBHI's Written Case, [23], [24] and [51].
[127] LBHI's Written Case, [25].
[128] LBHI's Written Case, [26].
[129] LBHI's Written Case, [29].
[130] LBHI's Written Case, [34].
[131] LBHI's Written Case, [35].

257. LBHI says that the mechanism for making calls cannot apply before the making of a winding-up order and that it would be unfair if the various protections for contributories within that mechanism were lost.[132] However, where a contingent debt is proved, the proof process replaces any other process that would have been applied in the ordinary course. This is simply part and parcel of the concept of proving for contingent debts before the occurrence of the relevant contingency. The provisions in the 1986 Rules in respect of estimation and appeals replace any other procedures which would have applied if the debtor had not gone into administration or liquidation and, together with the supervision of the Court, provide adequate protection to members.

258. LBHI seeks to suggest that the Court of Appeal's conclusion could result in the proof of a debt which had been contingent at the commencement of the Member's winding-up, even if it had subsequently become clear that the contingency could never occur.[133] This is wrong. If it becomes clear before the making of any distributions that the relevant contingency will never occur, the provable debt will be re-valued at nil in accordance with the hindsight principle and nothing will be payable in respect of it. Rule 2.81 **[Auth/3/40]** (which relates to the estimation of contingent debts) states that the administrator "*may revise any estimate previously made, if he thinks fit by reference to any change of circumstances or to information becoming available to him*". The operation of the hindsight principle in corporate insolvency proceedings was explained by the Privy Council in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 **[Auth/1/23]** at [29] to [33]. Lord Hoffmann said at [32]-[33]:

> "*[32] ... Hindsight is used because it is not considered fair to a creditor to value a contingent debt at what it might have been worth at the date of the winding-up order when one now knows that prescience would have shown it to be worth more. The same must be true of a contingent debt which prescience would have shown to be worth less.*
>
> *[33] It therefore seems to their Lordships that the principle of pari passu distribution according to the values of the debts at the date of the winding-up does not necessarily lead to the conclusion that someone who was a creditor at that date must be allowed to participate in the distribution even when he is no longer a creditor at all. There is nothing unfair, or contrary to principle, in a rule which requires that anyone who claims to participate in a distribution should have the status of a creditor at the time when he makes that claim. It*

[132] LBHI's Written Case, [42]-[44].
[133] LBHI's Written Case, [45]-[48].

> *would be strange if the court can have regard to subsequent events in valuing a creditor's contingent claim at much less than it would have been thought to be worth at the date of the order but not to the fact that someone has ceased to be a creditor at all*".

259. In LBHI's example in its Written Case at [47] (and adopting the defined terms used by LBHI), if the Member had ceased to be a member of the Company in 2012 and more than two years had elapsed thereafter before the payment of any dividend to the Member's creditor, the hindsight principle would have resulted in the re-valuation of the Company's proof of debt at nil, since it would have become clear at that time that the relevant contingency (namely, the commencement of the Company's winding-up within two years of the Member's cessation of membership) was no longer capable of occurring, and no dividend would have been payable to the Company by the Member's liquidator. LBHI's example is therefore unhelpful, as it does not lead to the conclusion for which LBHI contends.

**(5) Contributory rule in distributing administrations**

260. If (contrary to the LBIE Administrators' submissions) there is no prospect of any set-off (whether in LBIE's administration or in the distributing administrations or subsequent liquidations of the Members), the LBIE Administrators submit that the contributory rule should be extended to distributing administrations, so as to permit the LBIE Administrators to retain, on account of the contingent liabilities of LBL and LBHI2 to pay contributions in LBIE's liquidation, the distributions that would otherwise be payable to LBL and LBHI2 in LBIE's administration on their provable debts.

(i) The terms of the contributory rule

261. A series of cases in the nineteenth century, beginning with *In re Overend Gurney & Co; Grissell's Case* (1866) LR 1 Ch App 528 **[Auth/1/18]**, established the principle that a person could recover nothing as a creditor of a company until he had discharged all his liability as a contributory. A classic statement of this principle was given by Buckley J in *In re West Coast Gold Fields Ltd; Rowe's Trustees' Claim* [1905] Ch 597 **[Auth/6/21]** at 602:

> "*The right view is that the person liable as contributory must discharge himself in that character before he can set up that, as a creditor, he is entitled to receive anything and a fortiori, as it seems to me, before he can set up that, as a contributory, he is entitled to receive anything*".

262. Buckley J also said at 600:

> "*Where a person is both a creditor of and a shareholder in a company ... he must satisfy all his obligations as a shareholder and contributory, by paying into the common fund all sums due from him in respect of calls, before he can say, 'As a creditor I am entitled to take something out of the common fund*'".[134]

263. The passage from the judgment of Buckley J in *In re West Coast Gold Fields Ltd; Rowe's Trustees' Claim* [1905] Ch 597 **[Auth/6/21]** at 602 was cited by Lord Walker in *In re Kaupthing Singer & Friedlander Ltd (in administration) (No 2)* [2011] UKSC 48, [2012] 1 AC 804 **[Auth/1/13]** at [20] in his discussion of this principle by way of analogy with the issue arising for decision in that case. Referring further to this principle, Lord Walker said at [52]:

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

264. As Wright J explained in *In re Auriferous Properties, Limited (No 2)* [1898] 2 Ch 428 **[Auth/4/4]** at 431 (to which Lord Walker referred in this passage from *Kaupthing*):

> "*If the creditor-contributory were allowed to take the dividend without paying the call, he would be receiving payment of a part of the debt which the company owes to him without making his contribution to the fund out of which that debt, with the other debts of the company, was to be paid*".

[134] Buckley J's decision was upheld by the Court of Appeal [1906] 1 Ch 1.

265. See also the explanation of the contributory rule in *In re General Works Company, Gill's Case* (1879) 12 Ch D 755 **[Auth/4/29]** per Bacon V-C at 757:

> "*The law vests in the liquidator the control of all the assets of the company, and the assets of the company in this case consist of, amongst others, a sum which Mr Gill undertook to contribute to the assets of the company, whatever might happen. Though he has become a creditor, he must permit the assets to be realized, including the calls on him. Even if he has obtained a judgment against the company, he cannot levy any execution under it so as to get at assets in the hands of the official liquidator*".

(ii) The basis of the contributory rule

266. There are three reasons for the contributory rule's existence:

266.1. First, it protects the *pari passu* principle;

266.2. Secondly, it fills the gap left by the unavailability of set-off; and

266.3. Thirdly, it ensures that the statutory mechanism for making calls in a liquidation is not defeated.

*(a) Protection of the pari passu principle*

267. The role of the contributory rule in protecting the *pari passu* principle is clear from the first case on the contributory rule, *In re Overend Gurney & Co; Grissell's Case* (1866) LR 1 Ch App 528 **[Auth/1/18]**. Lord Chelmsford described the *pari passu* principle, as "*the primary intention of the Legislature in the provisions relating to the winding-up of companies*":

> "*In considering the questions involved in these applications, the primary intention of the Legislature in the provisions relating to the winding-up of companies must be regarded. That intention is expressed in the 133rd section of the Act, being that 'the property of the company shall be applied in satisfaction of its liabilities pari passu, and subject thereto shall, unless it be otherwise provided by the regulations of the company, be distributed amongst the members according to their rights and interests in the company'*".

268. The relevance of the *pari passu* principle in this context is that the contributory holds in his own hands a part of the estate, which he is liable to contribute to the estate. If he were to pay that amount into the estate, so as to complete the estate, he would then receive back his share of the estate *pari passu* with the other ordinary unsecured creditors. However, if the contributory were to retain part of the estate in his hands, whilst also receiving a dividend, he would receive more than his fair share, in contravention of the *pari passu* principle.

269. This was also explained by Kekewich J in *In re Akerman* [1891] 3 Ch 212 **[Auth/4/1]** at 219, in a passage quoted by Lord Walker in *In re Kaupthing Singer & Friedlander Ltd (in administration) (No 2)* [2011] UKSC 48, [2012] 1 AC 804 **[Auth/1/13]** at 815:

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

270. As Lord Walker observed, Kekewich J was dealing in *In re Akerman* [1891] 3 Ch 212 **[Auth/4/1]** with the equitable rule in *Cherry v Boultbee* (1839) 4 My & Cr 442 **[Auth/4/19]**, rather than the contributory rule in corporate insolvency proceedings, but the two principles are analogous and the position in this regard is the same. If there is no set-off and the contributory rule does not apply, the insolvent contributory would receive more than his fair share, because he would retain in his hands the contribution that he is required to pay into the estate whilst additionally receiving a further part of the estate by way of dividend. This explains why Lord Chelmsford's reasoning in *In re Overend Gurney & Co; Grissell's Case* (1866) LR 1 Ch App 528 **[Auth/1/18]** begins with the *pari passu* principle.

*(b) Filling the gap left by the unavailability of set-off*

271. A further point to emerge from *In re Overend Gurney & Co; Grissell's Case* (1866) LR 1 Ch App 528 **[Auth/1/18]** is that the contributory rule fills the gap left by the unavailability of set-off. Lord Chelmsford held at 536-537 that insolvency set-off was

unavailable in the liquidation of a limited company, as a result of section 101 of the 1862 Act **[Auth/2/8]**.[135] Having reached this conclusion, Lord Chelmsford held at 536-537 that the contributory rule was necessary to plug the gap left by the unavailability of set-off:

> "*But if the amount of an unpaid call cannot be satisfied by a set-off of an equivalent portion of a debt due to the member of a company upon whom it is made,* ***it necessarily follows*** *in the last place, that the amount of such call must be paid before there can be any right to receive a dividend with the other creditors*" (emphasis added).

272. Lord Walker put the point in the same terms in *Kaupthing* **[Auth/1/13]**. At [51] and [52] Lord Walker referred to the authorities on the contributory rule and described it as "*the equitable rule as it applies in a case of this sort*". Then he said at [53]:

> "*So the equitable rule may be said to* ***fill the gap left by disapplication of set-off****, but it does not work in opposition to set-off. It produces a similar netting-off effect except where some cogent principle of law requires one claim to be given strict priority to another.* ***The principle that a company's contributories must stand in the queue behind its creditors is one such principle.*** *The rule against double proof is another. I would accept Mr Moss's submission that it would be technical, artificial and wrong to treat the rule against double proof as trumping*

[135] Section 101 **[Auth/2/8]** provided: "*The court may, at any time after making an order for winding-up the company, make an order on any contributory for the time being settled on the list of contributories, directing payment to be made ... of any monies due from him ... to the company, exclusive of any monies which he ... may be liable to contribute by virtue of any call made or to be made by the court in pursuance of this Part of the Act;* ***and it may, in making such order, when the company is not limited, allow to such contributory by way of set-off any monies due to him … from the company on any independent dealing or contract with the company***" (emphasis added). The express statutory permission for set-off in the liquidation of an unlimited company was taken to impliedly prohibit set-off in the liquidation of a limited company. Mellish LJ explained the implication of section 101 in *In re Paraguassu Steam Tramroad Company, Black & Co's Case* (1872) LR 8 Ch App 254 **[Auth/6/2]** at 265: "*Although that section does not in terms say that there is to be no set-off, yet it shews that the Legislature, in framing that section, thought it had already been enacted that there should be no set-off, because in the 101st section they proceed to say that where there is unlimited liability, then, in the case of any independent contract, there may be a set-off. The reasonable distinction between a company with unlimited and limited liability is obvious. In the case of unlimited liability the reason of allowing the set-off in respect of one particular call is, that it does not at all prejudice the rights of the other creditors, because all the shareholders are liable to the fullest amount of everything they possess, and therefore if that call does not pay the creditors all their debts in the case of an unlimited company, then another call may be made on the shareholders, including this particular shareholder, and so on, until the shareholders have been made to pay everything they can pay and the debts are satisfied. Therefore it appears to me to be plainly enacted that the assets are to be so dealt with, and it is quite clear that the company cannot, by making an agreement with a particular shareholder, save him from that liability which the Act of Parliament has imposed upon him*". See also *In re Breech-Loading Armoury Company, Calisher's Case* (1868) LR 5 Eq 214 **[Auth/4/14]** per Lord Romilly MR at 217: "*The Legislature, therefore, has given the express power to allow a set-off in the case of an unlimited company, and by so doing it must be taken to have implied that without such express provision there would be no right of set-off, and upon the principle of the maxim expressio unius exclusio alterius, to have excluded ... that right in the case of the contributories of a limited company*".

*set-off (as it undoubtedly does) but as not trumping the equitable rule*" (emphasis added).

273. The contributory rule thus fills the gap left by the unavailability of set off; and it does so in order to protect the *pari passu* principle and to ensure that the contributory does not get more than his fair share.

*(c) Ensuring that the statutory machinery for making calls is not defeated*

274. The contributory rule is also necessary to ensure that the statutory mechanism for making calls in liquidations is not defeated. The legislature has created a detailed statutory mechanism for the making of calls by liquidators. In the LBIE Administrators' submission, what the courts have strived to do in *Grissell's Case* **[Auth/1/18]** and subsequent cases is to protect and give effect to this statutory machinery and to make sure that it is not defeated.

275. Indeed, the protection of the mechanism by which calls can be made and the protection of the *pari passu* principle are essentially two different ways of putting the same point, because the mechanism for making calls has itself been seen as part and parcel of the machinery for collecting in and distributing the company's assets *pari passu*, as shown by *In re Paraguassu Steam Tramroad Company, Black & Co's Case* (1872-73) LR 8 Ch App 254 **[Auth/6/2]** per Lord Selborne LC at 262:

> "*The moment that the winding-up takes place, the whole administration is carried on with a view to the payment of the debts of the creditors, and in the first instance to payment pari passu.* ***The different sections of the Act—those which define the liability of limited companies, the 7th, 8th, 23rd, and 38th—those which deal with the administration of assets, the 98th, 101st, and 133rd—those which give the power to make calls, not in the ordinary way, but specially for the purposes of this Act, the 102nd and 133rd—all have in view the payment, pari passu and equally, of the debts due to the creditors; and the hand which receives the calls necessarily receives them as a statutory trustee for the equal and rateable payment of all the creditors****. The result of this contention, that one particular creditor may pay himself in full by retaining his own calls and not paying them, would, in effect, be to give him a preference, and to exonerate him from his obligation as a shareholder to contribute towards the payment of the debts of the other creditors. That appears to me to be utterly opposed to the whole principle of the law of set-off, and to all the provisions of the Act which bear on the subject*" (emphasis added).

276. The fact that the courts have strained to protect the ability of a liquidator to make effective calls in a liquidation is also clear from *In re Pyle Works* (1890) 44 Ch D 534 **[Auth/1/19]** per Lindley LJ at 584:

> "*Those moneys which are payable only on a winding-up, and which by the Act are excluded from the capital of the company, are never under the control of the directors, and cannot, I apprehend, be dealt with in any way by them. Those moneys form a statutory fund which only comes into existence when the company is in liquidation—that is to say, when the powers of the directors have ceased*".

277. What the courts have therefore sought to do is to protect the ability of a liquidator to make a statutory call in a liquidation and to ensure that the special fund is capable of being properly and effectively constituted in that eventuality.

(iii) The role of judge-made rules in corporate insolvency proceedings

278. The contributory rule as it applies in liquidations is not spelt out expressly anywhere in the 1986 Act or the 1986 Rules. However, as explained above, it has been held to exist in order to give effect to the true intention of the legislature in devising the statutory scheme for corporate insolvency. The contributory rule is not unique in this regard. As is well-known, the insolvency code is not a complete code, but is subject to many judge-made rules, which seek to ensure the smooth working of the insolvency code and to ensure that the statutory scheme is not defeated or undermined. For example:

278.1. The anti-deprivation principle was developed at common law to enable the Court to protect the *pari passu* distribution of the estate and to strike down improper attempts to evade it.[136]

278.2. The rule against double proof is a judge-made rule which has been devised by the courts to implement the statutory scheme and to prevent it from producing an outcome which would be contrary to the intention of the legislature. [137]

[136] *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383 **[Auth/4/9]** per Lord Collins at [2], [59], [75], [76] and [78]. At [88], Lord Collins recognised the anti-deprivation principle as a "*common law rule*" applicable to the statutory scheme. See also *Ex parte Mackay, In re Jeavons* (1872-73) LR 7 Ch App 643 **[Auth/5/13]** at 647-648.

[137] *In re Kaupthing Singer & Friedlander Ltd (in administration) (No 2)* [2011] UKSC 48, [2012] 1 AC 804 **[Auth/1/13]**, per Lord Walker at [1]

278.3. The body of judge-made insolvency rules includes the rule in *Ex parte James; In re Condon* (1874) LR 9 Ch App 609 **[Auth/5/5]**.[138]

279. It would therefore be wrong to suggest that there is no scope for supplemental judge-made rules devised to give effect to the statutory scheme and to avoid thwarting or undermining its operation. As Briggs LJ held in the CA Judgment **[Core/D/3]** at [141]-[144]:

> "*[141] Notwithstanding the statutory code set out in the succession of Bankruptcy Acts, judge-made rules continued to form an important part of bankruptcy law and, more importantly for present purposes, the law of corporate insolvency. Examples are set-off, the anti-deprivation rule, the rule against double proof and the contributory rule. Bankruptcy law was therefore a mix of statutory and judge-made provisions, not a self-contained statutory code.*
> …
> *[144] The 1986 insolvency legislation made fundamental changes to the structure… But, despite its greater detail, it was still not a complete statutory code. Important judge-made principles continued to be applicable, such as the rule against double proof, the contributory rule and the anti-deprivation principle*".[139]

(iv) The contributory rule in distributing administrations

280. Distributing administrations are a relatively new procedure, introduced by the Enterprise Act 2002 from 1 September 2003. The introduction of this new procedure has given rise to another area in which a judge-made rule (or, more accurately, the natural extension or development of an existing, judge-made rule) is required to protect the *pari passu* principle. In the LBIE Administrators' submission, the contributory rule must evolve in tandem with developments in the 1986 Act so as to meet the changes in insolvency procedures and, in particular, the power to wind up the affairs of the

[138] See *Nortel* **[Auth/1/17]** at [211] per Lord Neuberger: "***As to the common law**, there are a number of cases, starting with Ex parte James; In re Condon (1874) LR 9 Ch App 609, in which a principle has been developed and applied to the effect that 'where it would be unfair' for a trustee in bankruptcy 'to take full advantage of his legal rights as such, the court will order him not to do so,' to quote Walton J in In re Clark (a bankrupt), Ex parte The Trustee v Texaco Ltd [1975] 1 WLR 559, 563*" (emphasis added).

[139] As Jordan CJ noted in *Page v Commonwealth Life Assurance Society Ltd* (1935) 36 SR (NSW) 85 **[Auth/7/6]** at 89: "*The law of bankruptcy is the creature of statute; but, nevertheless, the policy of the bankruptcy law has always been regarded as a useful guide in determining the operation and limitations of the letter of the law. There are proceedings which, although not within the letter of the statutes, have been regarded as obnoxious to the policy of the bankruptcy law and, therefore, avoided by that law … And there are certain limitations upon the application of the letter of the law which have been extracted from general policy*".

company and to distribute the realised proceeds of a company's assets among creditors in an administration.

281. Without an extension of the contributory rule to meet the particular difficulties of distributing administrations, the result (if there is no set-off) could be unjust: LBL and LBHI2 would receive substantial distributions in LBIE's administration, despite the fact that, due to their own insolvent states, they would be unable to make any contributions were they required to do so by a liquidator of LBIE.

282. The particular features which would require the contributory rule to apply in the present case (if set-off is not applicable) are:

282.1. First, the administration of LBIE is a distributing administration – the assets are being distributed once and for all with irreversible consequences.

282.2. Secondly, the *pari passu* principle is applicable in LBIE's distributing administration. Rule 2.69 **[Auth/3/36]** provides:

> "*Debts other than preferential debts rank equally between themselves in the administration and, after the preferential debts, shall be paid in full unless and assets are insufficient for meeting them, in which case they abate in equal proportions between themselves*".

282.3. Thirdly, liquidation has been selected as a possible exit route in the proposals pursuant to which the LBIE Administrators must manage LBIE's affairs (see paragraph 68 of Schedule B1 to the 1986 Act **[Auth/3/6]**).

282.4. Fourthly, if and when LBIE goes into liquidation, the statutory mechanism in respect of calls will come into effect and it will be possible for calls to be made without limit.

283. In the LBIE Administrators' submission, the Court must consider the operation of the 1986 Act (as it now stands, in its amended form) as a whole. Construing that statute as a whole, the contributory rule should be held to apply in a distributing administration, at least in a case where the proposals approved by the creditors include liquidation as an

exit route and the future applicability of the statutory regime in respect of calls is therefore in prospect.

284. In the present case, if there is no set-off, the contributory rule should be extended to LBIE's distributing administration in order to prevent LBL and LBHI2 from getting more than their fair shares. It would also be necessary to protect the ability of the future liquidator of LBIE to make effective calls on LBL and LBHI2: having retained their share of the distributions within LBIE's estate, the sum retained would be available to discharge the liability of LBL and LBHI2 to pay the calls when made.

285. If the Court were to reject this submission, the entire statutory machinery for making calls in the future liquidation of LBIE would be rendered ineffective. LBL and LHBI2 would have managed to take out before they had paid in: they would have received 100% of their claims whilst leaving unpaid the debts and liabilities of LBIE falling within section 74 **[Auth/1/1]**. In the LBIE Administrators' submission, that would be a wholly unprincipled result, particularly when it is remembered that:

285.1. There is little difference in practice between a distributing administration and a liquidation. It would be anomalous and unprincipled for there to be a stark difference in the legal position applicable in these two cases.

285.2. The administration of LBIE is governed by the 1986 Act – the very statute which itself gives rise to the contributory rule. It would make no sense for the contributory rule, which is spelt out of that very Act (as it was spelt out of the predecessor Acts), to be inapplicable in the present case to proceedings governed by that same Act.

285.3. The LBIE Administrators are bound by paragraph 64 of Schedule B1 to the 1986 Act **[Auth/3/3]** to manage LBIE's affairs in accordance with proposals approved by creditors which include liquidation as an exit route. It would make no sense to conclude that the rules governing such a liquidation, when it commences, will have been defeated already by the fact of LBIE's prior distributing administration.

286. In the LBIE Administrators' submission, the Court should not permit the legislation to produce such a result. If there is no set-off, the statutory scheme as a whole must therefore be interpreted to mean that the contributory rule applies in a distributing administration such as the administration of LBIE – even though calls have not been, and cannot yet be, made. The scope of the contributory rule would otherwise be inadequate fully to address the mischief it is required to meet. The fact that it is only the liquidator who can make calls on the contributories is nothing to the point.

*(a) David Richards J's reasoning*

287. David Richards J's reason for holding (*obiter*) that the contributory rule could not apply in an administration was essentially that an administrator has no power to make calls. David Richards J said in the HC Judgment **[Core/D/5]** at [188]:

> "*The fundamental difficulty in applying the contributory rule in an administration is precisely because there is no statutory mechanism for making calls on contributories in an administration. While LBIE remains in administration, there can be no calls and therefore nothing that LBHI2 and LBL as members could do to put themselves in a position where they could prove as creditors in respect of their subordinated and unsubordinated claims. Yet this would be the result of applying the contributory rule to a company in administration*".

288. However, in the LBIE Administrators' submission, the fact that an administrator has no power to make calls is not a basis for saying that the contributory rule is incapable of applying in an administration. On the contrary, that is a very strong reason for concluding that it should apply. If the contributory rule applies in a liquidation, where the liquidator does have the power to make calls and there is less prospect in practice of the statutory mechanism for calls being defeated, *a fortiori* it must apply in a distributing administration where the administrator has no power to make calls.

*(b) The decision of the Court of Appeal*

289. The Court of Appeal held (*obiter*) that the contributory rule should not be extended to cover distributing administrations. In the CA Judgment **[Core/D/3]** at [239], Briggs LJ identified two perceived injustices which would arise from its extension:

"*It would in my view (and that of the judge) be a serious injustice to a solvent contributory to be disabled from ever proving in a distributing administration because, in the absence of a call, there was nothing which he could pay to free himself from the shackles of the rule. The company might (and usually would) distribute all its assets to its creditors without ever going into liquidation, leaving the contributory high and dry, even though its liability as a contributory might be very small, and its claim as a creditor very large*".

290. However, in the LBIE Administrators' submission, there is nothing in these points.

291. First, Briggs LJ was wrong to suggest that LBHI2 and LBL could do nothing to free themselves from the shackles of the contributory rule.

291.1. The contingent liability under section 74(1) **[Auth/1/1]** exists only for as long as the debts, liabilities and expenses within section 74(1) **[Auth/1/1]** remain outstanding.

291.2. A member of an unlimited liability company in administration, whose liability in respect of those debts, liabilities and expenses is already unlimited as a result of its membership of the company, may always decide to pay them, in advance of any formal call, in order to free itself from the shackles of the contributory rule and thereby qualify for a distribution in the company's distributing administration.

291.3. The fact that LBL and LBHI2 are unable to do this results only from their own insolvent state; it is not an injustice which arises from the 1986 Act or the 1986 Rules or from the application of the contributory rule to distributing administrations.

292. Secondly, Briggs LJ was wrong to suggest that the contributory would be left high and dry. In reality, it would be necessary for the LBIE Administrators to maintain a reserve for the potential benefit of LBL and LBHI2 until it became clear whether or not LBIE would move to liquidation. The maintenance of reserves against potential claims is a well-known technique in insolvency proceedings for ensuring that assets will be available for distribution if and when it becomes appropriate to make such distributions.

293. One of Briggs LJ's main grounds for rejecting LBIE's submissions in respect of the extension of the contributory rule was his observation that it was open to LBIE to resolve the difficulty by moving into liquidation now. Briggs LJ held at [243]:

> "*If the inapplicability of the contributory rule to a distributing administration really meant that an inroad into the pari passu principle would thereby go unchecked, I would have found Mr Trower's submission compelling. But there is, as it seems to me, a readily available means whereby a distributing administrator can fend off any such inroad at the outset. All that needs to be done is to put the company into liquidation, and thereby enable the liquidator to make a call on the insolvent contributory. The contributory rule would then disable the insolvent contributory from receiving anything in that liquidation until the call had been fully paid, while the solvent contributory would suffer no injustice, being able first to meet the call in full, and then prove as a creditor*".

294. However the Court of Appeal's proposal that LBIE should move to liquidation depends, amongst other things, on (and may be viable only as a result of) the Court of Appeal's conclusion in respect of statutory interest (see the CA Judgment **[Core/D/3]** per Lewison LJ at [102]-[111] and per Briggs LJ at [135]). If the Court of Appeal's conclusion in respect of statutory interest were held by the Supreme Court to be wrong, it might not be appropriate for LBIE to move to liquidation at this time, as such a step would be highly prejudicial to LBIE's creditors, at least as regards their entitlement to statutory interest worth many billions of pounds. In any event, there may be other reasons why it is advantageous to remain in administration for an extended period before moving into liquidation.

(v) Conclusion

295. In the LBIE Administrators' submission, therefore, if LBIE's contingent claims against LBL and LBHI2 are not available for set-off under rule 2.85 **[Auth/3/41]**, it will be necessary for the Court to apply the contributory rule in LBIE's distributing administration so as to permit the LBIE Administrators to retain the dividend otherwise payable to LBL and LBHI2 on account of their contingent liability under section 74 **[Auth/1/1]**.

296. As Lewison LJ recognised in the CA Judgment **[Core/D/3]** at [129], it would be a "*defect in the insolvency code if members of a contributory were entitled to be paid out before a claim under section 74 could be made*".

## G: CONCLUSION: REASONS

297. The LBIE Administrators therefore submit that the appeals should be dismissed and/or that the LBIE Administrators' cross-appeals should be allowed, for the following reasons:

297.1. The Sub Debt is subordinated not only to provable debts but also to statutory interest and non-provable liabilities and is accordingly repayable only following the payment in full of all such claims. On their true construction, the Sub Debt Agreements prohibit subordinated creditors from proving for the Sub Debt or requiring an administrator to admit that proof until the relevant contingencies have occurred.

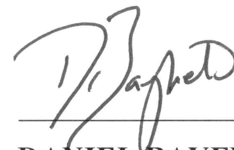
297.2. Currency Conversion Claims exist as a species of non-provable liability.

297.3. The right to statutory interest which has arisen during the administration as a result of the existence of a surplus will not be lost if LBIE goes into liquidation without such statutory interest having been paid, because: (i) the surplus in the hands of the LBIE Administrators will, when passed on to the liquidator in LBIE's subsequent liquidation, be required to be applied in paying the statutory interest which was payable (but remained unpaid) in the administration before it can be used by the liquidator for any other purpose; alternatively (ii) the creditors who proved in the administration and who were entitled to receive statutory interest out of the surplus will be entitled to prove in the liquidation in respect of the statutory interest that was, immediately prior to the administration coming to an end, due to be paid to them out of the surplus pursuant to rule 2.88(7) **[Auth/1/4]**; alternatively, (iii) those of the creditors who had a contractual or other right to interest apart from the administration are entitled to receive the amount of that interest which remains unpaid as a non-provable liability of LBIE in liquidation.

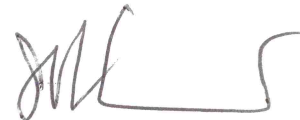
297.4. The obligation of the Members under section 74(1) **[Auth/1/1]** extends to statutory interest and non-provable liabilities.

297.5. Insolvency set-off occurred in LBIE's administration whether or not LBIE's contingent claims against the Members are provable in the Members' administrations or liquidations. LBIE's contingent claims against the Members are in any event provable in the Members' administrations or liquidations. Alternatively, if there was no insolvency set-off, the contributory rule should be extended to permit the LBIE Administrators to retain, on account of the contingent liabilities of LBL and LBHI2, the distributions that would otherwise be payable to LBL and LBHI2.

**WILLIAM TROWER QC**



**DANIEL BAYFIELD QC**



**STEPHEN ROBINS**