Appeal Court Ref Nos 1822, 1826, 1833 and 1839 of 2014

IN THE COURT OF APPEAL (CIVIL DIVISION)

ON APPEAL FROM

THE HIGH COURT OF JUSTICE Nos.7924 & 7945 of 2008 & No.429 of 2009

CHANCERY DIVISION

COMPANIES COURT

Mr Justice David Richards

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION) and others

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN

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

Appellants

and

(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)
(2) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)
(3) LYDIAN OVERSEAS PARTNERS MASTER FUND LIMITED

Respondents

SHORTENED SKELETON ARGUMENT OF THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (“LBHI2”)

Introduction

1. This appeal concerns the priority of payments to be made from the assets of Lehman Brothers International (Europe) ("LBIE") in its current administration or any subsequent liquidation. The background to the appeal is that the assets are expected to be sufficient to enable payment in full of the principal amounts due to LBIE's unsecured, unsubordinated creditors, who it is common ground rank first after the payment of secured debts and expenses. The question is what is to be done with the balance. The administrators of LBIE and the administrators of its two members, LBHI2 and Lehman Brothers Ltd ("LBL"), brought a joint application for directions to resolve the various issues that arise. LBHI2 appeals with the permission of the Judge against eight of the ten declarations which he made.

C/1/1-7

C/6/101-8

2. The key issues are:

   2.1 The true construction of three subordinated debt agreements between LBHI2 as lender and LBIE as borrower worth US$2.25bn ("the Subordinated Debt Agreements") in order to determine the nature and degree of subordination of such debt, and in particular whether such subordinated debt ranks for payment prior to, or after, (i) the payment of statutory interest on the unsubordinated debts, and (ii) if they exist, any non-provable debts.

   2.2 Whether, in principle, a foreign currency creditor who has received full payment and statutory interest on his proved debt under the statutory insolvency scheme can assert a further non-provable and non-statutory claim against LBIE, asserting that because his claim was converted into sterling at the prevailing rate at the commencement of the insolvency pursuant to the currency conversion rules set out in the Insolvency Rules 1986 ("IR 1986"), this meant that he had received less than he would have received had the claim been paid in the foreign currency (a "Currency Conversion Claim" or "CCC").

   2.3 The potential extent of the members' liability to contribute to LBIE's estate on any call that might be made by a subsequently appointed liquidator under s. 74 of the Insolvency Act 1986 ("IA 1986").

2.4 Whether LBIE's administrators would be entitled to lodge a proof in the insolvency of LBL or LBHI2 in respect of the possible future liabilities that those companies might have if LBIE was (a) to go into liquidation and (b) its liquidator was to make a call on LBL or LBHI2 under s. 74 IA 1986.

3. The Judge held that LBHI2 could not be paid, or even prove for, any sum in respect of the subordinated debt until LBIE had paid in full its unsecured unsubordinated creditors, statutory interest on those unsubordinated claims and any non-provable liabilities (including CCCs). LBHI2 says that decision was wrong and that, on the true construction of the Subordinated Debt Agreements, the subordinated debt falls to be paid after the unsecured unsubordinated claims, but before the payment of any statutory interest on proved claims and before payment of any non-provable liabilities of LBIE.

C/4/32-98

4. The Judge held in principle that CCCs exist as non-provable liabilities of LBIE. He also held that they rank for payment after LBIE's administrators have paid statutory interest on other claims, but before the repayment of the subordinated debt to LBHI2 or the return of any funds to LBIE's members. LBHI2 says that such claims do not exist; the position of creditors whose debts are denominated in a foreign currency is dealt with exhaustively in the statutory insolvency scheme in the IA 1986 and the IR 1986 and there is no residual or further claim that such creditors can assert after they have been paid their proved debts in full together with statutory interest in accordance with that scheme. Alternatively, if (contrary to LBHI2's primary case) CCCs exist and are payable before distributions are made to LBIE's members, they nevertheless fall to be paid after payment of all proved debts including the subordinated debt.

5. The Judge held that LBIE's administrators would be entitled to lodge a proof on a contingent basis in any distributing administration or liquidation of LBHI2 or LBL in respect of that member's potential liability for a call under s.74. LBHI2 contends that this is not so: the potential right of a liquidator who might be appointed in the future to make a call under s.74 is not an asset of the company falling under the control of, or capable of being asserted by, the administrators.

6. The Judge held that the potential liability of a member for a call under s.74 IA 1986 extends to provable debts, statutory interest, non-provable liabilities of LBIE and an amount sufficient for the adjustment of rights between members. LBHI2 says that this is wrong: its potential liability to a call under s.74 extends only to the amount sufficient for the payment of provable debts, and the expenses of the winding up, and for the adjustment of rights between members.

Declaration (i): Construction of the Subordinated Debt Agreements

The natural meaning of the wording of the Subordinated Debt Agreements

7. The starting point for any decision on subordination must be the terms of the subordination agreement itself. The subordination provisions are set out in Standard Terms of the Subordinated Debt Agreements cl.5 and were set out in full in the Judgment ¶53. The material parts of cl.5(1) are:

D1/5/205-6; 221-2; 239-41

C/4/43-5

> *"Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon –*
>
> *(a)… (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower …) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower… ; and*
>
> *(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".*

8. Although the opening words of the clause refer to LBHI2's rights as Lender in respect of the Subordinated Liabilities being "*subordinated*" to the Senior Liabilities, that says nothing about how or to what extent the subordination is to take place. The nature and scope of the subordination is given by the remaining parts of the clause. If the subordination was simply as set out in the opening words of cl.5, then (i) the subordinated term loans could not be repaid **at any time** when LBIE had **any** outstanding "Senior Liabilities" (for example, other contractual debts), and (ii) the express ability to make payment conditional upon compliance with the Financial Resources Requirement in cl.5(1)(a) and the "solvency" test under cl.5(1)(b) would be otiose.

9. Cl.5(2) defined "solvent" for the purpose of the cl.5(1)(b) "solvency" test:

> *"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…"*

10. The relevant question posed by cl.5(1)(b) and 5(2)(a) is whether liabilities or obligations qualifying as "Liabilities" are nevertheless to be disregarded when determining whether the Borrower would be "solvent" for the purposes of cl.5(1)(b) because they are *"obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower".* On this point, the Judge simply held that statutory interest which the Administrator would be directed to pay if IR2.88(7) applied in an administration was not excluded by cl.5(2)(a) because such amounts would be *"payable … in the administration or liquidation of LBIE"*: see Judgment ¶79. **C/4/51**

11. Contrary to the approach adopted by the Judge, in construing cl.5(2)(a) it is important to have regard to the clause as a whole. Focusing on the word "*payable*" and simply linking it to the words "*in the Insolvency of the Borrower*" distorts the structure of the clause and gives no meaning to the words "*or capable of being established or determined in the Insolvency of the Borrower*". For an obligation to be *"payable"* in an Insolvency, it presupposes that the existence and amount of the obligation has been established or determined by the relevant office-holder.

12. Instead, what the wording of cl.5(2)(a) actually does is to limit the "*Liabilities*" that are to be taken into account for the purposes of ascertaining whether the Borrower is "*solvent*" - and hence whether the subordinated debt should be paid - in a way which reflects the familiar concept of provable debts. A creditor can prove in the insolvency not only for debts which have fallen due for payment at the relevant date, but also for those debts which are not due and payable at the relevant date, but which will or might fall due for payment at a future date and which must be ascribed a fair value by the office-holder in the process of proof, adjudication of debts and payment of dividends.

13. Cl.5(2)(a) is modeled on that statutory scheme. The computation for the purposes of deciding whether the subordinated debt can be paid is required to include all of the Borrower's debts that are currently due and payable, and also those prospective and contingent liabilities that would be admitted to proof in an insolvency. But obligations or liabilities are to be disregarded if they are neither "*payable*" at the time of the determination nor "*capable of being established or determined in an insolvency*" – i.e. if they are not prospective or contingent liabilities that would, in the process of proof of debt, be the subject of an estimation by the relevant office-holder in an insolvency.

14. That is a workable scheme. To the contrary, however, the Judge's interpretation of cl.5(2)(a) would require regard to be had to any and all sums that might be "*payable*" in an Insolvency of the Borrower, whether or not they are provable. The Judge did not address the consequences of adopting that very broad formulation, but they would require a provision to be made for the payment of the costs and expenses of a hypothetical insolvency (including the remuneration of the office-holder), because it would only be after estimating those sums that it could be determined whether proved debts could be paid and whether there could be a surplus so as to trigger payment of statutory interest. A further estimation would then (presumably) also have to be made of the duration of the hypothetical insolvency in order to estimate what statutory interest might be payable. It is unlikely in the extreme that the parties meant such guesswork to be required by the subordination test in cl. 5(2)(a).

15. The Judge also decided (Judgment ¶87) that LBHI2's debt was subordinated to the payment of non-provable liabilities, although the Judge did not begin to explain how such conclusion was consistent with the terms of cl.5(2)(a). Any such non-provable liabilities could not on any view be described as "*payable…in the Insolvency of the Borrower*"; still less are they "*capable of being established or determined in the Insolvency of the Borrower*". By definition, any claim for payment of a non-provable liability is not made "*in the Insolvency*" or under any provision of the statutory insolvency scheme. Indeed, on the basis of the Judge's approach, the essential basis of a CCC is to enforce the "full contractual rights" of the counterparty under a pre-existing contract

C/4/53

with the company, the enforcement of which was prevented by the statutory insolvency scheme[1].

16. The meaning and operation of the subordination provisions, and in particular cl.5(1)(b) and 5(2), cannot be any different after LBIE has entered an insolvency process from that which applied before it did. In that respect it is important to observe that, contrary to the Judge's view, the subordination provisions do not seek to prevent, and contain no restriction on, LBHI2 proving its claims in an insolvency of LBIE. Instead, the subordination is, as before insolvency, structured as a condition imposed on LBIE which is obliged not to make payment to LBHI2 in respect of its debt if the relevant pre-conditions are not satisfied. Contrast the type of language commonly used by draftsmen when it is intended that there should be a restriction on a subordinated creditor proving a debt in competition with other creditors. Such a clause might provide that, until all other creditors have been paid in full, the subordinated creditor *"shall not claim, rank, prove or vote as a creditor …"*: see for example the clause in issue in Re SSSL Realisations (2002) Ltd [2006] Ch 610 at 618D. The distinction between these two forms of contractual subordination is well recognised[2]. **Auths 1C/80**

17. The Judge's view of the subordination mechanism was that, although cl.5 did not itself prevent LBHI2 proving its debt, two other provisions of the Subordinated Debt Agreement, namely cl.7(d) and (e), had that effect (Judgment ¶69). But those clauses do not say anything about LBHI2 not proving its debt and cannot reasonably be understood in that way. Sub-cl.(d) bars LBHI2 attempting to obtain *"repayment"* but does not prevent it proving its debt; and both sub-clauses are expressed merely as reinforcing and giving effect to the subordination provisions contained elsewhere **D1/5/207-8**

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[1] Further, in holding that CCCs can be asserted (Judgment ¶98), the Judge commented: *"..I do not understand why [liquidation] should prevent those creditors who have not received their contractual entitlement from pressing their claims against the company once the statutory regime for pari passu distributions has run its course"* (emphasis added). The Judge thereby recognised that CCCs are not payable as part of that statutory regime. **C/4/58**

[2] See e.g. Goode on Legal Problems of Credit and Security, 4th Edn at p.210 *"Another reasonably straightforward form [of contractual subordination] is where the subordinated debt is expressed as a contingent obligation, so that it is only payable if the senior creditor is paid in full, or if the debtor has sufficient assets to pay the senior creditor in full … The most controversial form is a plain contractual subordination where the subordinated creditor agrees not to claim or prove until the senior creditor has been fully paid, without creating a contingent debt …"*. **Auths 2/4**

in the agreements, rather than as themselves forming an essential part of the subordination mechanism or setting out anything about the extent of the subordination. Further, they are not contained in cl.5 (headed *"Subordination"*) where a provision with substantive effect in relation to subordination might be expected to be found, but are instead to be found in cl.7 headed *"Representations and undertakings of Lender"* which contains ancillary provisions. What sub-clauses 7(d) and (e) <u>do</u> prohibit is, for example, the Lender seeking to attach assets abroad in jurisdictions which do not recognise the English insolvency, thus giving the Borrower contractual rights to prevent such steps being taken (rather than having simply to rely on the equitable doctrine of hotchpot to require the Lender to disgorge his receipts to the office-holder).

18. The fact that the subordination provision in cl.5 does not prevent proof of LBHI2's debt necessarily defines the relative priority of the payment of that debt and the payment of statutory interest. IR2.88(7) contains a direction to the administrators to make payment of statutory interest which is only triggered and can only operate <u>if</u> there is a surplus after payment of proved debts. IR 2.88(7) provides, **Auths 3/21/p.19**

> *"<u>Any surplus remaining after payment of the debts proved shall</u>, before being applied for any purpose, be applied in paying interest on those debts in respect of the period during which they have been outstanding since the relevant date."*

19. The natural meaning conveyed by cl.5 is therefore that the subordinated debt would rank for payment after other proved debts but before any obligation upon the administrators to apply surplus funds in payment of statutory interest. The position is *a fortiori* in respect of payment of any non-provable debts which rank after payment of statutory interest on proved debts.

20. This construction is also supported by the fact that, once the trigger under IR2.88(7) for the payment of statutory interest on unsecured debts occurs (namely, the existence of a surplus after payment in full of proved debts), then the administrators have to pay statutory interest equally on all unsecured proved debts (regardless of their respective priorities for payment of dividend) because statutory interest under IR2.88(7) *"ranks equally whether or not the debts on which it is payable rank equally"*: IR2.88(8). By contrast, the Judge's decision requires the statutory interest provision

in IR2.88(7) to be triggered twice (once when all the unsecured, unsubordinated proved debts are paid, and then again when all the subordinated debts are paid) with the result that, contrary to IR2.88(8), the statutory interest payable does not rank *"equally whether or not the debts on which it is payable rank equally"*.

The regulatory and statutory background

21. Reference to the regulatory requirements in force at the time the Subordinated Debt Agreements were entered into (and until the time when LBIE went into administration) supports the submission that the Subordinated Debt Agreements were not intended to restrict LBHI2 from proving for the subordinated debt.

22. Each of the Subordinated Debt Agreements recites that LBIE wishes to use the loans *"in accordance with FSA rule IPRU(INV) 10-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan and each Advance"*. By Sched.2, ¶1(2), *"Any reference to any rules of the FSA is a reference to them as in force from time to time"*. At the time LBIE went into administration, IPRU(INV) 10 had been replaced by the FSA's General Prudential Sourcebook (GENPRU) and Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU). The subordinated debt must, for capital resources requirements, have been either lower tier 2 or tier 3 (as recorded in the monthly FSA 003 reports referred to at ¶¶50-53 of the Statement of Agreed Facts). GENPRU 2.2.159R applied to both lower tier 2 capital and also (with certain immaterial adjustments) to tier 3 capital. As at the date LBIE entered administration in 2008 it provided,

D2/2/17

Auths 4/4

> *"A capital instrument must not form part of the tier two capital resources of a firm unless it meets the following conditions: (1) the claims of the creditors must rank behind those of all unsubordinated creditors;(2) …; (3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the capital instrument <u>must</u> (subject to GENPRU 2.2.161 R) <u>be limited to</u> petitioning for the winding-up of the firm or <u>proving for the debt in the liquidation or administration</u>…"*.

23. The regulatory requirements thus require subordination but <u>not</u> by the imposition of any restriction on the lender's ability to <u>prove</u> for the debt: indeed, the regulatory requirements in force at the time LBIE entered administration <u>specifically permit the lender to prove</u> in the insolvency of the borrower.

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

(a) The "*claims*" of unsubordinated creditors referred to here are claims for principal and provable interest (i.e. interest payable in respect of the pre-administration period). A creditor has no "*claim*" within the Rules for statutory interest. IR 12.3(1) provides that, *"Subject as follows, in administration, winding up and bankruptcy, all claims by creditors are provable as debts against the company … whether they are present or future, certain or contingent, ascertained or sounding only in damages"*. But a creditor has no "claim" to statutory interest and, therefore, cannot prove for it: see, for example, the wording of IR 2.88(7) which would be unworkable otherwise. **Auths 3/21/p.83** **Auths 3/21/p.21**

(b) This is also made clear by the wording of IR12.3(2A) because, in order to provide that the category of postponed debts under that Rule is postponed to statutory interest, IR12.3(2A) contains a specific further provision that they are postponed not only to the "*claims of creditors*" but also to statutory interest on those claims. **Auths 3/21/p.83**

Nor does the requirement that the claims of the subordinated creditors must "rank" behind those of all other creditors prevent repayment of the subordinated debt while the company is not in any insolvency process: the word "rank" is applicable only in an insolvency process and this requirement applies only when the company is in an insolvency process.

25. Further, there is no good reason why the definition of "Senior Liabilities" should include statutory interest. The rationale behind the payment of statutory interest is to compensate creditors for the delay in receipt of their money caused by the formal insolvency process. It is not relevant to the capital adequacy requirements; accordingly, there is no reason why payment of tier 2 capital (i.e. the subordinated debt) should rank behind statutory interest.

26. The Judge also expressed the view that it *"is not appropriate to construe the subordination provisions in the agreements strictly by reference to the relevant provisions of the UK insolvency legislation"* (Judgment ¶67). It is, however, plain that the statutory provisions of the IA 1986 and the IR 1986 formed part of the background reasonably available to **C/4/48**

both parties. Moreover, it is striking that, as set out above, GENPRU made specific reference to the concept of "proof" which is a concept found specifically in the UK insolvency legislation.

27. Further, it appears that the origins of the wording used in cl.5(2)(a), *"obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower"*, are in fact specifically English, dating from 1988. Prior to 2001 LBIE was regulated by The Securities Association ("TSA") and then its successor organisation, The Securities and Futures Association ("SFA"). TSA Rule 50.04 permitted subordinated loans to be treated as "Qualifying Capital" provided that the loans were *"drawn up … in accordance with the appropriate standard forms of Subordinated Loan agreement approved by"* the TSA. SFA Rule 10-63 referred to a standard form that could be *"obtained from"* the SFA. LBHI2's advisers have been unable to locate copies of the TSA's or SFA's standard form agreements prior to 2001, but like all self-regulating organisations, the TSA and SFA were supervised by the Securities and Investment Board ("SIB"). The SIB published a standard form subordinated loan agreement in June 1990 which included subordination wording similar to that in cl.5 of LBHI2's Subordinated Debt Agreements with LBIE, including the following definition of "solvency":

Auths 4/5

Auths 4/6/p.6

Auths 4/15/p.4

> *"For the purposes of this sub-paragraph, the Borrower shall be solvent if it is able to pay its debts in full and in determining whether the Borrower is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the insolvency of the Borrower and the Excluded Liabilities."*

28. The earliest form of this wording of which LBHI2's advisers are aware is in a "Short Term Subordinated Loan Facility Agreement" published by the Association of Futures Brokers and Dealers Limited ("AFBD") in March 1988, pursuant to an obligation imposed on such self-regulatory organisations formed under the Financial Services Act 1986 ("FSA 1986") to ensure that their members had adequate capital. The AFBD rules (published in late 1987 with the relevant chapters to come into force in April 1988) required that a firm's "*financial resources*" calculated in accordance with the rules should at all times exceed its "*financial resources requirement*" calculated in accordance with the rules. The rules provided that subordinated loans in the standard form approved by the AFBD were to be excluded from a firm's liabilities in calculating its liquid resources for the purpose of this "*financial resources*" requirement.

Auths 4/14/p.3

Auths 4/13/ rule 8.32.1

Auths 4/13/ rule 8.41.20

Clause 6 of the AFBD's standard form dated 24 March 1988 contained a subordination clause in very similar wording to cl.5(2)(a). **Auths 4/14/p.3**

29. In summary, LBHI2 submits that the Judge erred in giving (1) insufficient weight to the relevant structure of the English insolvency regime in construing the Subordinated Debt Agreements, (2) insufficient weight to the wording of the FSA Rules in force at the time of LBIE's administration; and (3) too much weight to a vague concept of the 'regulatory background'[3].

30. The Judge also erred in his approach to construing the Subordinated Debt Agreements in failing to distinguish sufficiently between LBHI2 as a creditor and as a shareholder: see, for example, Judgment ¶¶60 and 63. The Judge wrongly tended to assimilate the subordinated loans provided by LBHI2 with equity capital rather than recognizing that entities such as LBIE were entitled to meet their regulatory capital requirements by means of subordinated debt from any source on the terms of the agreements used in this case, rather than by requiring equity investment. **C/4/47**

<u>**Declaration (ii): Currency Conversion Claims ("CCCs")**</u>

31. LBHI2 submits that the Judge was wrong to recognise the existence of CCCs as a category of claims which are not provable but nevertheless remain to be calculated and paid after the payment in full of proved debts and statutory interest thereon.

32. By way of preliminary observations:

    (a) There should be no predisposition to assume that CCCs exist. It is quite possible for a creditor to think that it has been prejudiced in an ordinary enforcement process if it converts its foreign currency judgment into sterling immediately before enforcement begins ("Judgments: Foreign Currency" [1976] 1 WLR 83), but there is no mechanism to recover such "loss" from the debtor. It should therefore not come as a surprise that the collective insolvency regime might also result in uncompensated currency conversion losses. **Auths 4/7**

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[3] LBIE expressly disavowed (in oral submissions at the November 2013 hearing) any suggestion that there was anything in the regulatory materials which supported its arguments on construction.

(b) The Court should also be aware that the argument that a creditor is entitled to re-assert his full contractual rights in the event of a surplus (on which the Judge based his decision on CCCs: see Judgment ¶¶110-111) is being used by creditors in a further substantive application before the Judge (part of which was heard between 18 February and 26 February 2015) to advance an esoteric range of claims (such as whether a creditor is entitled to compensation, including by way of damages for loss, restitution or in any other way, for delay in payment of a non-provable claim) which would (if accepted) have to be satisfied from any surplus. **C/4/61**

33. Against that background, whether or not CCCs exist depends upon the meaning and effect of IR2.86. The Judge held that IR2.86 had a purely procedural effect solely for the purposes of valuing claims for the process of proof under the statutory insolvency scheme, without any substantive effect on the foreign currency creditor's underlying right to be paid the sum due in that currency (see Judgment ¶94). **Auths 3/21/p.17** **C/4/57**

34. It is submitted that the Judge was wrong. IR2.86 has a wider effect. It causes the mandatory conversion of the foreign currency debt into sterling and renders the sterling equivalent of the debt provable in the administration of the debtor, such that payment of the proved – sterling - sum together with statutory interest satisfies the creditor's claim.

35. The fact that certain provisions contained in the statutory insolvency scheme operate with substantive effect and can and do create and/or extinguish substantive rights is demonstrated by Lord Hoffmann's judgment in the House of Lords in Stein v Blake [1996] AC 243, in which he considered the effect of statutory insolvency set-off (at pp.251 D-E and 255 B); see also Judgment ¶77 in which the Judge appeared to accept that the provisions for valuation of contingent and future debts have the substantive effect of meaning that payment of the proved debt is to be regarded as payment of the debt in full. **Auths 1B/66** **C/4/51**

36. IR2.86 has just such a substantive effect. This is demonstrated by the example in the Judgment ¶¶96 and 97, in which sterling appreciates against a contractual currency between the date of entry into an insolvency process and the date of a distribution, **Auths 3/21/p.17** **C/4/57-58**

resulting in "overpayment" of the foreign currency creditor by reference to his contractual rights. The basis upon which the Judge accepted that a creditor could not be required to refund any excess that it receives as a result cannot simply depend upon some *laissez faire* or presumed largesse on the part of the insolvent company or other creditors. It must be because the statutory scheme *entitles* the creditor to the payment that he has received. But if IR2.86 can have the effect of increasing the amount which a foreign currency creditor is entitled to be paid out of the debtor's estate (to the extent that sterling appreciates against that currency), it must also be capable of having the effect of decreasing the amount to which a foreign currency creditor is entitled to be paid out of the debtor's estate (to the extent that sterling depreciates against that currency). Otherwise IR2.86 would create substantive entitlements for foreign currency creditors of an insolvent company (to sterling payments) if sterling appreciates, but raise only procedural bars (to foreign currency payments) if sterling depreciates.

Wight v Eckhardt

37. LBIE and CVI rely on the Privy Council decision in Wight v Eckhardt [2004] 1 AC 147 in support of their submissions that the effect of IR2.86 is purely procedural. However, Wight v Eckhardt does not provide support for the submission that claims denominated in a foreign currency must continue to exist unaffected by the insolvency scheme for all purposes. It could not do so, for example, if such claims were the subject of mandatory insolvency set-off against debts owed to the company in sterling or some other currency: see Stein v Blake (supra). **Auths 1C/75**

38. The crucial passages on which LBIE and CVI rely are ¶¶26-27 of Lord Hoffmann's opinion. These statements must be read in the context of the question that the Privy Council had to decide. The key question was whether a particular company which was a creditor in respect of a claim governed by a foreign law on the date the winding up order still had a right to participate in the dividend payment process if, after the commencement of the liquidation, but prior to the distribution being made, its debt was discharged in accordance with its governing law, rather than by payment out of the insolvent estate. In order to avoid the consequences of discharge under the governing law, the creditor sought to suggest that the effect of the winding-up order was to replace the underlying claim with a claim under the statutory scheme.

The decision was that the winding-up order did not have that effect and the underlying claim continued to exist and was then discharged in accordance with its governing law. Moreover, there was nothing unfair in preventing someone from participating in a distribution if he had by the time of payment ceased to be a creditor in accordance with the law governing his debt.

39. The nub of ¶¶26-27 of Lord Hoffmann's opinion is that the entry by a company into a formal insolvency process does not in itself alter creditors' substantive rights against that debtor company – for example, the mere making of a winding-up order does not immediately replace a creditor's rights against the debtor which are governed by the law of Bangladesh with new rights governed by the law of the Cayman Islands. The decision certainly had nothing to do with whether particular provisions within the statutory insolvency regime had procedural or substantive effect and it did not decide that no provision of the statutory insolvency regime could have substantive effect. Specifically, there is nothing in Wight v Eckhardt that is inconsistent with a conclusion that a claim denominated in a foreign currency must, so far as English law is concerned, be regarded as converted into a claim denominated in sterling by the substantive operation of IR2.86, albeit that the debt must be regarded as continuing to be governed by its underlying foreign law for the purposes of ascertaining whether it has been discharged by any means other than payment (or set-off) in the insolvency.

para 55 of CVI shortenened skeleton

paras 6(2)&(6) of CVI shortened skeleton

40. Consideration of the wider statutory scheme also undermines the contention made by CVI (¶83 of its skeleton argument) that *"A liquidation is a process of collective enforcement of provable debts"* insofar as that assertion is intended to support a case that the provisions of IA and IR do not have substantive effect (see ¶¶10(2) and (6) of the skeleton argument). The insolvency scheme undoubtedly has substantive effect, for example: (a) as set out above, by several legislative provisions which deal with administrations after issue of an IR2.95 notice (eg IR2.81 on contingent debts, IR2.85 on set off, IR2.86 on foreign currency claims, IR2.88 on post-administration interest and IR2.105 on future debts), (b) where a liquidator disclaims onerous property (which the company would not otherwise be permitted to do) pursuant to s.178 and any person sustaining loss or damage as a consequence is deemed a creditor to the extent of the loss and damage for which he may prove in the winding

E/8/169

E/8/149-50

Auths 3/21/ pp.13-28

up, and (c) where transactions prior to a liquidation or administration are unwound by order of the Court under ss.238 or 239 as transactions at an undervalue or preferences and the Court has wide discretion as to what order to make under s.241.

Auths 3/20/ pp.36A-36H

41. CVI also maintains that a foreign currency creditor will have a CCC based on the difference between his contractual entitlement in the foreign currency and the total payments received by way of dividends in sterling (converted into the relevant foreign currency at the date of receipt – or in the case of set-off, presumably on the date of the IR2.95 notice): see, for example, ¶¶15 and 79(3) of its skeleton. But where there is insolvency set-off, this would involve treating the part of the creditor's claim which was, on true analysis, extinguished by set-off as at the date of the IR2.95 notice as remaining alive (in its original foreign currency) to be included in the computation and to be satisfied by a further payment in the event of a surplus. This is flatly inconsistent with insolvency set-off having the substantive effect it undoubtedly does following Stein v Blake.

paras 10 & 52(3) of CVI shortened skeleton

E/8/150-1; 167

42. CVI relies heavily on the decision in Re Kaupthing [2011] BCC 555 to try to overcome this problem for its arguments. But on proper analysis the case provides no support for CVI's approach. The Court of Appeal accepted that the combined effect of discounting under IR 2.105 and set-off under IR 2.85 would be substantively to reduce the future debt by an amount equivalent to the discounted sum included in the set-off as at the date of the IR 2.95 notice. The worked example given by Etherton LJ at ¶35 of the report makes this clear: the amount of the loan said to be remaining due and payable in July 2018 was the original £1,000 less £147.75 (rather than less the £94.34 which was the discounted value of the £147.75 included in the set-off by reason of IR 2.105). In other words, the combined application of IR 2.105 and 2.85 had the substantive effect of extinguishing £147.75 of the underlying contractual obligation, not just the £94.34 included for the purposes of insolvency set-off.

Auths 1C/85

Auths 3/21/ pp.28 & 14

Re Humber Ironworks

43. CVI's skeleton argument at ¶33 places emphasis on Giffard LJ's statement in Re Humber Ironworks (1869) LR 4 Ch App 643 at 647 that *"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"*.

para 17 of CVI shortened skeleton

E/8/154-5

Auths 1A/12

That statement does not assist CVI in its arguments as to the true effect of IR 2.86. **Auths 3/21/p.17** In Humber Ironworks, the question was whether interest payable after the commencement of the winding up was provable in the liquidation. At first instance it had been held that principal and interest should be calculated up to the time of declaring the dividend, and the dividend treated as applicable in payment of principal and interest pro rata. The Court of Appeal allowed the appeal against that decision, holding that creditors whose debts carried interest were entitled to dividends only upon what was due for principal and interest at the date of the winding up, and that it was only in the event of there being a surplus that such creditors could assert a claim for interest accruing after the date of the winding up. At the time (and as remained the case until 1986), there was no statutory entitlement to interest following the commencement of the winding up.

44. This situation was entirely changed by the IA and IR 1986, which (for reasons explained below) provide expressly and exhaustively for the payment of interest in respect of the period after the commencement of liquidation (or administration) by way of statutory interest. There is simply no room under the statutory scheme contained in the IA and IR for the concept of a creditor being *"remitted to his rights under his contract"* in the event of a surplus arising.

45. Indeed, the current statutory scheme produces a different and inconsistent result than that which would be produced by applying the reasoning in Humber Ironworks. For example, assume two creditors, each of whom is owed a debt of £100 at the date of winding up. One of the creditors has a contractual entitlement to interest at 5% per annum and the other creditor has no contractual entitlement to interest. The company has assets of £205 after the liquidation has been going on for 1 year. On the approach set out in Humber Ironworks, the creditor entitled to contractual interest would receive £105 while the other received £100. On the application of the current statutory scheme, each creditor would receive £102.50. In other words, under the current statutory scheme, creditors are not remitted to their contractual rights as to interest in the event of a surplus. It follows that the approach in Humber Ironworks cannot be applied to determine how any part of the current insolvency regime should operate.

46. The improbability that IR2.86 was intended to permit CCCs to exist based upon the continued existence of an underlying contractual claim in the foreign currency is further demonstrated by three considerations: (a) the insolvency regime under the IA and IR 1986 was intended to be comprehensive and was formulated with foreign currency creditors squarely in mind; (b) if CCCs do exist, they would give rise to inconsistent results as between creditors with set-off and those without, and (c) the narrow construction placed by the Judge upon the words *"for the purpose of proving"* leads to absurdity when applied to other provisions of the insolvency code.

(a) The 1986 legislation is a comprehensive code formulated with foreign currency creditors in mind

47. As set out in re T&N [2006] 1 WLR 1728 at ¶¶76-83, it has long been a goal of English insolvency law (and a principle of construction of insolvency legislation) that each liability to which the insolvent person was subject should be comprehensively dealt with as part of the insolvency process. The Cork Report, the recommendations of which the 1986 Act was designed to implement, re-stated that aim (¶1284).

Auths 1C/79

Auths 4/9/ para 1289

48. It is, moreover, the case that creditors can be required to prove their debts in order to participate in the distribution of a company's assets and, once those debts have been proved and paid in accordance with the statutory scheme, they cannot seek to prevent a distribution of surplus to contributories by reference to their contractual rights. So, for example, a creditor with a contingent claim will be entitled to participate on the basis of a valuation of that contingent claim in a distribution in an administration or liquidation (and may be entitled to revise that proof or have it determined with the benefit of hindsight if the contingency occurs during the insolvency), but he cannot prevent a distribution being made of the resultant surplus to contributories on the basis of his original contractual rights by requiring that a fund be set aside against the possibility that the contractual contingency may actually happen: see Stanhope v Registrar of Companies [1994] 1 BCLC 628 at 633 and Danka Business Systems plc [2013] Ch 506 at ¶¶36–38. As Patten LJ held in Danka at ¶38, *"The liquidator is entitled to proceed to a distribution to members on the basis of the debts admitted to proof"*.

Auths 1B/65

Auths 1C/91

49. Accordingly, the introductory words of IR2.86 *("For the purpose of proving a debt …")* do not limit that rule to having only a procedural effect: the statutory insolvency

Auths 3/21/p.17

scheme requires a liquidator to distribute the company's assets to its creditors, in accordance with their proved claims, and then, *"if there is a surplus, to the persons entitled to it"* (s.143(1) IA 1986; see also s.107 in the case of a voluntary liquidation). Further, those introductory words in IR2.86(1) do not say that IR2.86 applies for the purpose of proving a debt and no other purpose – compare IR11.13(2) (IR2.105(2) in administration). IR2.86 explains how to calculate the amount of a proof in respect of a debt incurred or payable in a currency other than sterling, and the rule would make little sense without the introductory words.

Auths 3/20/ pp.17 & 13

Auths 3/21/ pp.81 & 28

50. Against that background, it is significant that the Cork Committee expressly turned their minds to the position of foreign currency claimants in ¶1309 and stated that they agreed with the Law Commission (Working Paper No.80) that conversion at the date of commencement of the relevant insolvency proceedings should continue to apply. The reference to the Law Commission Working Paper is instructive: in ¶¶3.39-3.47 the Law Commission had expressly considered the problem that has now arisen and concluded:

Auths 4/9

Auths 4/8

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

51. Although the judgment of the Court of Appeal in Re Lines Brothers was not commented upon by the Cork Committee, it was considered in the Law Commission's final report in October 1983. In the Judgment ¶109, the Judge described the Law Commission's Final Report as endorsing the conversion of foreign currency debts into sterling as at the date of liquidation, but he remarked that it *"left open"* the question of whether CCCs could be advanced in the event of a surplus of assets. That is a mischaracterisation of the Final Report. The Law Commission Working Paper had expressly considered the suggestion that if a company proved to be solvent, foreign currency creditors should be *"compensated from*

C/4/61

the assets of the company or the bankrupt for adverse exchange rate fluctuations between the date of the relevant order and the date of actual payment", and plainly rejected it in favour of a *"once-for-all"* date for conversion of every foreign currency debt into sterling as at the commencement of the liquidation. The Final Report then expressly adhered to that view after having considered the Court of Appeal's judgment in Re Lines Brothers: see ¶3.36. The effect of the Judge's ruling is to permit precisely the *"compensation from the assets of the company"* that the Law Commission rejected.

Auths 4/11/p.38

52. Moreover, it is quite clear is that the question of whether foreign currency creditors should receive additional payments to compensate them for foreign currency fluctuations after the commencement of insolvency proceedings cannot be regarded as having been overlooked or "fallen through the cracks" in the same manner as the incomplete tort claims considered In re T&N Ltd. If the legislative intention had been that the question posed by the Law Commission concerning the payment of compensation to foreign currency creditors should be answered in the affirmative, it is inconceivable that it would not have been expressly dealt with – not least because the legislative changes in 1986 also specifically addressed the use of surplus assets to pay statutory interest by the introduction of s.189.

Auths 1C/79

Auths 3/20/p.34

(b) Inconsistent results

53. The decision that CCCs exist as non-provable liabilities also causes unexplained and inconsistent results in the context of insolvency set-off. Take the following illustration: on 1 January, insolvent company A enters administration. On that date, A had foreign currency dealings with two creditors. A owes creditor B a single debt of $100 million. A, however, owes C $110 million on one trade, but C owes A $10 million on a related trade. The net position of the two creditors is therefore identical. In accordance with Rule 2.86(1), the debts owing each way are converted to sterling as at the official exchange rate on 1 January. For simplicity, assume that on 1 January, sterling and dollars are at parity. On 1 May, the administrator gives notice that he intends to make a distribution. On that date, exchange rates have moved so that $1 = £1.50. Pursuant to Rule 2.85(3), an account is taken of A and C's mutual dealings. Pursuant to Rules 2.85(6) and 2.86(1), the amounts owing are each converted to sterling at the prevailing rate at the date of commencement of the liquidation and set-off, leaving a net balance of £100 million owing by A to C which

is provable in the administration. On 1 August, the distribution occurs. By that date, sterling has fallen to £2 to the dollar. Both B and C receive a distribution of £100 million in respect of their proved debts (the equivalent of $50 million).

54. According to the Judgment, B has a CCC for $50 million, namely $100 million less the dollar equivalent on 1 August of the £100 million received on that day, i.e. $50 million. The position of C is, however, different. It is plain that the conversion and set-off required by the IR2.85 and 2.86 takes place in sterling and results in a net balance in sterling: given the possibility of multi-currency claims, there could be no other feasible alternative. But on the authority of Stein v Blake it is also quite clear that this net sterling balance is the resultant substantive debt that is owed, and the two dollar cross-claims no longer exist. On this basis, there is no continuing foreign currency debt, and C simply has no CCC at all[4].

Auths 3/21/ pp.14-17

Auths 1B/66

(c) Absurd results

55. If one reads for the "*purpose of proving*" in IR2.86 as making IR2.86 incapable of affecting the creditor's substantive rights, there would appear to be no principled reason not to apply the same approach elsewhere in the Rules. For example, IR2.105(2) provides that, "*for the purpose of dividend (and no other purpose)*" one applies a discount rate of 5 per cent to future debts. Applying the approach taken by the Judge to CCCs: (i) the debt is discounted for the purposes of dividend (and no other); (ii) the insolvency process does not affect the future creditor's underlying rights; therefore (iii) to the extent that the creditor's investment returns are, in fact, lower than 5 per cent, that creditor has not received satisfaction of its full contractual rights; and (iv) that creditor is entitled to claim for the difference as an unprovable liability upon the due date of its debt. It is submitted that that simply cannot be the result intended by Parliament when it used the words "*for the purpose of dividend*". The commercial effect is that a debtor company, on paying the last of its provable debts

Auths 3/21/p.17

Auths 3/21p.28

4 It might be argued that on one view of the Judgment, C has a CCC for $53.33 million (namely $110 million less the equivalent (at the date of set-off) of the £10 million notionally received on that date as a result of the set-off, i.e. $6.67m, less the distribution received on 1 August converted into dollars on that date, i.e. $50 million. But that takes no account of Stein v Blake, and produces a different result in any event from the claim of creditor B with an equivalent single claim and no set-off. Such anomalies cannot have been intended by the legislature.

and statutory interest, would find that it had guaranteed its prospective creditors investment returns of 5 per cent.

56. If (as the Judge considered "may well" be necessary) the foreign currency creditor would have to give credit for the extent to which the statutory insolvency scheme has benefited him, the CCC effectively becomes a claim for damages caused by operation of the statutory regime. This would be novel and entirely contrary to the legislative intention that the 1986 Act and Rules would provide a comprehensive code. **C/4/58**

57. Further or alternatively, the purpose of the Act is to ascertain the liabilities of the company as at the date of the winding up and to secure the division of its property among creditors pro rata according to the value of their claims at that date. CCCs allow recovery on the basis of the value of the claim at the date of payment rather than the date of the winding up, and thereby introduce what the Act impliedly prohibits, namely a distribution of the company's property which is not pari passu (cf Re Dynamics Corporation [1976] 1 WLR 757, 761G-H, 764F-765A, 768D-F). **Auths 1B/55**

Declaration (v): Whether interest accrued during LBIE's administration is a non-provable claim in LBIE's subsequent liquidation

58. For similar reasons as set out above in support of the contention that the provisions of the 1986 Act and Rules provide a comprehensive code, LBHI2 submits that the Judge was wrong to hold that creditors whose debts carried interest prior to the administration and which accrued statutory interest due but unpaid during LBIE's administration could claim interest (by way of contract, judgment interest or otherwise) in respect of the period of the administration as a non-provable liability in a subsequent liquidation of LBIE.

59. It is clear that the legislature intended the statutory code to provide a comprehensive code for the payment of interest once a company entered administration or liquidation. If that code did not provide for payment of interest in a particular circumstance, then the Court cannot fill what it perceives as a gap in the legislation and impose a further liability on the company (or its contributories): see In re Nortel [2014] AC at ¶¶125-127 and Re Portsmouth City FC [2013] Bus LR 1152 at ¶35. **Auths 1C/95 & 96**

60. LBHI2 adopts the further submissions on this issue made by LBHI.

Declaration (vi): the extent of the s.74 liability

61. The liability provided by s.74 is triggered only upon winding-up. The s.74 liability is part of the statutory scheme under which creditors receive pari passu distributions in payment of their proved debts: see, for example, Re Lines Bros (No.1) [1983] Ch 1 at 20E-F per Brightman LJ. Although the Judge asserted (Judgment ¶152) that *"It is the purpose of a liquidation to pay all liabilities of the company, including those which are not capable of proof"*, that is incorrect.

Auths 3/20/p.2

Auths 1B/57

C/4/71-2

62. Liquidation is a process of collective enforcement which (by statute) operates by pari passu distribution of the assets to creditors who have proved in the liquidation. While cases such as Re T&N and the waterfall set out by Lord Neuberger in Re Nortel make it clear that (if they exist) non-provable liabilities are to be paid from surplus assets before any such assets are returned to members, of itself the statutory insolvency scheme simply makes no provision for the determination, still less payment, of non-provable debts by the liquidator.

Auths 1C/79 & 96

63. In that regard, the Judge was wrong to hold, as he did at ¶175, that "liabilities" in s.74 is wider than "debts". The overriding direction to a liquidator in s.107 of the 1986 Act is to apply the company's assets *"in satisfaction of the company's liabilities pari passu"* and, as Patten LJ held in Danka Business Systems at ¶37, *"The reference to the company's liabilities in section 107 must be to the liabilities as determined in accordance with the 1986 Rules"*. Accordingly, the liability to contribute an amount sufficient for payment of "debts and liabilities" is limited to a contribution to pay proved debts and liabilities.

Auths 3/20/p.13

Auths 1C/91

64. Further and in any event, under s.189(2) IA or IR 2.88(7) the existence and extent of any "liability" to pay statutory interest would have to be determined by whether there were any surplus assets remaining "after payment of the debts proved": if there is no surplus, there is no "liability" to pay statutory interest. But an obligation to contribute to pay "debts and liabilities" is not an obligation to create the very surplus without which no statutory interest is payable. The reference to "debts and

liabilities" of the company in s.74 is to be contrasted with the statutory direction as to how to deal with a surplus (if any)[5].

65. There was also no suggestion in the Cork Report or the White Paper (Cmnd 9175) which led to the introduction of statutory interest as part of the IA 1986 that the introduction of this provision involved the imposition of a further potential burden on contributories.

66. The Cork Report at ¶1385 referred to the decision of Pennycuick V-C in Re Rolls-Royce [1974] 1 WLR 1584, in which he said that he reached the conclusion that interest was not payable in the event that the winding-up threw up a surplus, **Auths 1B/52**

> *"with some regret … because as I have already said, it seems fair that a creditor should be compensated for being kept out of his money during the period of administration if there turns out to be a surplus, and again because the difference in this respect between the winding up provisions and the bankruptcy provisions appears to be without logical foundation."*

and continued (at ¶1386): **Auths 4/9**

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

67. There would, of course, be a significant distinction between corporate insolvency and bankruptcy if statutory interest was intended to amount to a new "liability" of a company which could increase the scope of the liability of the contributories under s.74. However, there was no discussion in the Cork Report or in the relevant section of the White Paper (or during the relevant debates in Parliament) which led to the 1986 Act of any potential effect on the liability of a contributory to calls, or whether the new statutory interest entitlement would form part of the s.74 liability to which a contributory is subject. The fact that there was no such discussion in the legislative

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5 And see also the submissions made by LBHI as to the treatment in the bankruptcy legislation of the equivalent provision in bankruptcy, s.328(4) IA 1986. **Auths 3/20/p.48**

history strongly suggests that there was no intention that the new statutory interest regime would increase the statutory liability of contributories.

68. Moreover, given the peculiar nature of statutory interest, it would be surprising if the legislative creation of statutory interest in 1986 imposed, without specific discussion in the Cork Report or legislative materials, an unheralded obligation on contributories to contribute to pay for it. This understanding of the legislature's intention chimes with the fact that when s.74 of the IA 1986 was enacted there was no relevant amendment to the wording of the statutory predecessor to s.74 so as to indicate any intention to impose a new liability to contribute to statutory interest. The predecessor section, s.212 of the 1948 Act, provided for contributories to be liable to contribute to the same three categories of payment as are found in s.74, namely (as put in the 1948 Act) *"[1] its debts and liabilities, and [2] the costs, charges and expenses of the winding up, and [3] for the adjustment of the rights of the contributories among themselves …"*. Further. given the way in which the obligation to pay statutory interest is expressed, i.e. as a direction to the relevant office-holder, if the legislature intended the s.74 liability to extend to provide funds to be dealt with in this way , it would be most surprising for that not to be spelt out in the new s.74.

Auths 3/20/p.2

Auths 3/17

69. Even if the submissions above are not accepted in relation to statutory interest, the Judge was wrong to conclude that payment of CCCs or any other non-provable liabilities is part of the statutory scheme provided by the 1986 Act and Rules. The Judge erred in characterising a "liability" to pay non-provable debts as somehow within the scheme of the 1986 Act and thus within the scope of s.74. The obligation to pay such liabilities (if any such obligation exists) would be an obligation imposed as a matter of common law principles in spite of, rather than under, the statutory insolvency scheme. There is therefore no basis for extending the scope of a contributory's s.74 liability to include the company's non-provable liabilities.

70. The Judge also erred in accepting the argument based upon the fact that s.74 can be used to require members to contribute sums not only for the payment of the debts and liabilities of the company but also *"for the adjustment of the rights of the contributories among themselves"*. The argument was that because this represents a liability almost at the bottom of the waterfall set out in Re Nortel [2014] AC 209, it is implicit that

Auths 1C/96

contributions can be required not only for this purpose but also for payment of the categories above this one (i.e. statutory interest and non-provable liabilities).

71. This argument is wrong because a call under s.74 to make such an adjustment is a call for that specific purpose and need not form part of a general call producing funds which flow all the way down through the waterfall to include distributions to contributories. Roxburgh J held in Phoenix Oil [1958] Ch 560 that the provision now found in s.154 IA 1986 (then s.265 of the 1948 Act) does not indicate that the distribution of the surplus assets of itself involves an adjustment of the rights of contributories: they are two processes and not one. Thus, for example, if a call to fund a shortfall in assets to pay proved debts of £100 was to be made, it could be made entirely on the holders of partly paid shares so as to adjust the rights of contributories, without involving a distribution of surplus assets.

Auths 1A/48

Auths 3/17 & 3/20/p.23

72. Secondly, this analysis confuses the assets of the company with the (different) assets available to a liquidator. A call under s.74 can be made only by a liquidator (not an administrator) and the resulting assets are not assets of the company (see LBHI's skeleton). Accordingly, there is no difficulty with holding that they are to be used for the specific purposes identified in s.74 (just as the proceeds of a statutory claim made by a liquidator are used in making distributions to unsecured creditors rather than being handed over to secured creditors (who form a category above unsecured creditors): Re Yagerphone Ltd [1935] Ch 392).

Auths 1A/41

73. LBHI2 adopts the further submissions on this issue made by LBHI.

Declarations (viii) (and (ix) and (x))

74. LBHI2 adopts the submissions of LBHI on these issues.

9 June 2014

Amended and shortened 16 March 2015

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