IN THE COURT OF APPEAL (CIVIL DIVISION)

Appeal Court Ref. Nos. 2014/1822; 2014/1826; 2014/1839;

ON APPEAL FROM THE HIGH COURT OF JUSTICE, CHANCERY DIVISION, COMPANIES COURT (MR JUSTICE DAVID RICHARDS)

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N :

(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)

(2) THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)

(3) LEHMAN BROTHERS HOLDINGS, INC

Appellants

- and -

(1) ANTHONY VICTOR LOMAS
(2) STEVEN ANTHONY PEARSON
(3) PAUL DAVID COPLEY
(4) RUSSELL DOWNS
(5) JULIAN GUY PARR

(in their capacity of Joint Administrators of Lehman Brothers International (Europe) (in administration))

(6) CVI GVF (LUX) MASTER SARL

Respondents

LBIE'S SKELETON ARGUMENT IN RESPONSE TO THE APPELLANTS' APPEALS

Introduction and background to the appeals

1. This skeleton argument of the Joint Administrators of Lehman Brothers (International) Europe (in administration) ("**LBIE**") (the "**Administrators**") is filed in opposition to the following appeals:

   1.1 The appeal by Lehman Brothers Holdings, Inc ("**LBHI**") against paragraphs (i), (ii), (iii), (v), (vi), (viii), (ix) and (x) of the Order of Mr Justice David Richards dated 19 May 2014 (the "**Order**") **[App/C/6/102-104]**;

   1.2 The appeal by LB Holdings Intermediate 2 Limited ("**LBHI2**") against paragraphs (i), (ii), (iii), (v), (vi), (viii), (ix) and (x) of the Order **[App/C/6/102-104]**; and

   1.3 The appeal by Lehman Brothers Limited ("**LBL**") against paragraphs (ii), (iii) and (vi) of the Order **[App/C/6/103]**.

2. LBIE is an unlimited company. LBL and LBHI2 (together the "**Members**") are its only shareholders. The Members (which are creditors of LBIE) are liable to contribute to LBIE's assets to meet any deficiency in its winding up. Section 74(1) of the Insolvency Act 1986 (the "**1986 Act**") **[Auth/3/20]** 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*".

3. As matters stand, LBIE is not being wound up but is in administration; however, winding up is an "exit route" available to the Administrators. Whether that course is adopted will depend upon what is in the creditors' best

interests as a whole, taking into account, amongst other matters, the outcome of these appeals and LBIE's own appeal[1].

A. Paragraph (i) of the Order

(a) Background and context

4. Paragraph (i) of the Order **[App/C/6/102]** concerns the effect, in the context of LBIE's *"insolvency"* (as defined), of Standard Term 5(1) of the three subordinated loan agreements (the "**SLAs**") entered into on 1 November 2006 (the "**Sub-Debt**") **[App/D1/5/205-206]**. This term provides that LBHI2's rights in respect of the Sub-Debt "*are subordinated to the Senior Liabilities*" and that payment of any amount due to LBHI2 in respect of the Sub-Debt is conditional upon LBIE "*being 'solvent'*" at the relevant time or times. The Judge held (and ordered by paragraph (i) of the Order **[App/C/6/102]**) that the claims of LBHI2 under the SLAs are, pursuant to the terms of the SLAs, subordinated behind provable debts, statutory interest and non-provable liabilities, all of which must be paid in full before LBHI2 is entitled to prove in LBIE's administration in respect of the Sub-Debt and before LBHI2's claims in respect of the Sub-Debt are available for insolvency set-off.

(b) Why paragraph (i) of the Order is correct

5. On the proper construction of the provisions of the SLAs, LBHI2 is prevented from proving in respect of the Sub-Debt unless and until provable debts, statutory interest and non-provable liabilities have been paid in full.

6. Standard Term 5(1)(b) provides (inter alia) that LBHI2's rights in respect of the Sub-Debt "*are subordinated to the Senior Liabilities*" **[App/D1/5/205-**

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[1] See the Fourth Witness Statement of Russell Downs, paragraph 65 **[App/D1/10/298]**.

206]. The Senior Liabilities are "*all Liabilities [of LBIE] except the Subordinated Liabilities and Excluded Liabilities*"[2].

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

> "*all present and future sums, liabilities and obligations payable or owing by [LBIE] (whether actual or contingent, jointly or severally or otherwise howsoever)*". **[App/D1/5/203]**

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

9. It follows, as a matter of plain language, that statutory interest and non-provable liabilities fall within the definition of Liabilities used in Standard Term 5(1)(b) **[App/D1/5/205-206]**.

10. Standard Term 5(2) **[App/D1/5/206]** also provides that payment of any amount due to LBHI2 in respect of the Sub-Debt is (in circumstances where LBIE is in administration or liquidation) conditional upon LBIE:

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

11. Standard Term 5(2) **[App/D1/5/206]** provides that for this purpose, LBIE will be "*solvent*" if it is:

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

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[2] The Administrators are not aware of the existence of any Excluded Liabilities (defined as "*Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of [LBIE]*"). **[App/D1/5/202]**

12. Accordingly, LBIE will not be solvent for the purposes of Standard Term 5(2) **[App/D1/5/206]** and, therefore, the Sub-Debt will not be repayable under Standard Term 5(1)(b) **[App/D1/5/206]**, unless and until LBIE has paid, or is in a position to pay, all of its Liabilities.

13. The reference in Standard Term 5(2)(a) **[App/D1/5/206]** to LBIE being able to pay Liabilities disregarding "*obligations which are not payable or capable of being established or determined in the Insolvency of [LBIE]*" does <u>not</u> require LBIE's obligations in respect of: (a) statutory interest (payable under rule 2.88(7) of the Insolvency Rules 1986 (the "**1986 Rules**") **[Auth/3/21]** or section 189(2) of the 1986 Act **[Auth/3/20]**); or (b) non-provable liabilities, to be disregarded[3].

14. The threshold for disregarding obligations is that they would not be payable or capable of being established or determined in the "*Insolvency*" of LBIE. "*Insolvency*" is defined as various types of insolvency *proceedings*, as opposed to by reference to the financial state of LBIE **[App/D1/5/202]**. Both statutory interest and non-provable liabilities are matters which are capable of being established and determined within a liquidation or administration (i.e. two examples of proceedings falling within the definition of "*Insolvency*") and, where there are sufficient funds available to meet them, payable within such process:

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

    14.2. Non-provable liabilities are also clearly payable within the process of administration or liquidation, both of which involve distributions to all creditors and, thereafter, to members. This necessarily encompasses

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3 Any other construction would be inconsistent with the rights of the Lender being "*subordinated to the Senior Liabilities*" which term plainly includes both statutory interest and non-provable liabilities (Standard Term 5(1) **[App/D1/5/205-206]**).

payment in respect of non-provable liabilities, which must be paid before any return to members.

15. Standard Term 7 **[App/D1/5/207-208]** contains a number of undertakings given to LBIE by LBHI2 in support of the subordination. Among those undertakings, LBHI2 undertook <u>not</u> to take the following steps without the prior written consent of the FSA:

15.1. to "*purport to retain or set-off at any time any amount payable by it to [LBIE] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement…*" (sub-paragraph (b) **[App/D1/5/207]**); and

15.2. to "*attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement*" (sub-paragraph (d) **[App/D1/5/207]**).

16. LBHI2's focus (paragraph [24] of LBHI2's skeleton argument **[App/E/3/44/[17]]**) on the use of the word "*repayment*" in clause 7(d) **[App/D1/5/207]** (contrasting an entitlement to be repaid with an entitlement to prove) is overly linguistic and fails properly to take into account both the terms of the SLAs as a whole and the regulatory context in which the SLAs fall to be construed. The subordination provision imports an agreement by LBHI2 that nothing is to be regarded as due from LBIE to LBHI2 under the SLAs, including by way of dividends, until the debts of the unsubordinated creditors and all non-provable liabilities have been paid in full. The "*Repayment*" provisions of the SLAs (Standard Term 4) **[App/D1/5/204-205]** are expressly "*subject in all respects to the provisions of paragraph 5 (subordination)*" (see Standard Term 4(1) **[App/D1/5/204]**) 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) **[App/D1/5/205-206]** is satisfied, i.e. unless all Liabilities have been paid in full.

17. What flows from this is that LBHI2 is prevented from proving in respect of the Sub-Debt, and is prevented from receiving any dividends on its proof, until such time as LBIE is solvent for the purposes of Standard Term 5(2) **[App/D1/5/206]**. This is because the subordination provisions import an agreement by LBHI2:

    17.1. not to prove for the Sub-Debt in LBIE's administration or liquidation until the debts of the unsubordinated creditors and all non-provable liabilities have been paid in full. To prove for the Sub-Debt in competition with LBIE's other creditors would be a breach of the undertaking given in Standard Term 7(d)[4] **[App/D1/5/207]**; or

    17.2. that nothing is to be regarded as due from LBIE to LBHI2 under the SLAs, including by way of dividends, until the debts of the unsubordinated creditors and all non-provable liabilities have been paid in full. The "*Repayment*" provisions of the SLAs (Standard Term 4) **[App/D1/5/204-205]** are expressly "*subject in all respects to the provisions of paragraph 5 (subordination)*" (see Standard Term 4(1) **[App/D1/5/204]**) 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) **[App/D1/5/205-206]** is satisfied, i.e. unless all Liabilities have been paid in full.

18. LBHI2 submits that statutory interest and non-provable debts are obligations "*not payable or capable of being established or determined in the Insolvency of the Borrower*" (for the purposes of Standard Term 5(2)(a) **[App/D1/5/206]**). LBHI2 criticises the Learned Judge's construction of Standard Term 5(2)(a), in particular for focusing (in LBHI2's view) on the word "*payable*" and its link to the words "*in the Insolvency of the Borrower*", and for failing (in LBHI2's view) to give any meaning to the words "*or capable of being established or determined in the Insolvency of the Borrower*".

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[4] LBHI2 is similarly prevented from attempting to achieve payment through set-off (as a result of the undertaking given by it in Standard Term 7(b) **[App/D1/5/207]**).

19. LBHI2's argument is wrong. As noted above, the language of Standard Terms 5(2)(a) **[App/D1/5/206]** does not require LBIE's obligations in respect of: (a) statutory interest (payable under rule 2.88(7) of the 1986 Rules **[Auth/3/21]** or section 189(2) of the 1986 Act **[Auth/3/20]**); or (b) non-provable liabilities, to be disregarded. Further:

19.1. Statutory interest is both payable, and capable of being established or determined, in the Insolvency of the Borrower through the medium of rule 2.88(3) of the 1986 Rules **[Auth/3/21]** and section 189(2) of the 1986 Act **[Auth/3/20]**.

19.2. Non-provable liabilities are capable of being established and determined in the Insolvency of the Borrower because they ought to be established and paid before a liquidator makes a return to members. See *Re T&N Ltd* [2006] 1 WLR 1728 **[Auth/1C/79]**.

19.3. What Standard Term 5(2)(a) **[App/D1/5/206]** contemplates is obligations such as (but by way of example only) statute-barred debts[5], or non-EC foreign revenue claims[6]. Such obligations satisfy in full the Standard Term 5(2)(a) **[App/D1/5/206]** description of obligations "*not payable or capable of being established or determined in the Insolvency of the Borrower*" on the basis that, though strictly speaking liabilities, they are unenforceable at any stage in the insolvency process before a return to members.

19.4. In any event the word "Insolvency" is defined to mean various types of insolvency proceedings but not necessarily English insolvency proceedings. Accordingly, and given that the SLAs are standard form agreements, it may be that the language used in clause 5(2)(a) **[App/D1/5/206]** in relation to obligations "*not payable or capable of*

[5] See *Re Art Reproduction Co Ltd* [1952] Ch. 89 **[Auth/1A/44]**.

[6] See *Government of India v Taylor* [1955] A.C. 491, at pp. 508-9 **[Auth/1A/45]**.

being established or determined in the Insolvency of the Borrower" is explicable in terms of the insolvency law of other jurisdictions.

19.5. Moreover, the fact that statutory interest would not be taken into account outside of an insolvency situation for the purposes of determining whether the company is unable to pay its debts or should be deemed unable to pay its debts is beside the point. The term "solvent" is a term which bears a particular meaning in the SLAs and LBHI2 cannot draw any support from how the term might be applied outside the very particular circumstances of the SLAs.

19.6. The definition of "solvent" in Standard Term 5(1)(b) **[App/D1/5/205-206]** applies only where LBIE is in an insolvency process and that is why what is disregarded from the calculation of LBIE's insolvency is limited to (i) "*obligations which are not payable or capable of being established or determined* ***in [LBIE's insolvency proceeding]***" (emphasis added); and (ii) "Excluded Liabilities". Therefore, whilst payment of statutory interest is not relevant to the question whether a company should be placed into a formal insolvency process, it is clearly relevant to the question of whether LBIE is solvent for the purposes of Standard Term 5(1)(b) **[App/D1/5/205-206]**.

19.7. Finally, LBHI2 contends, relying (inter alia) on the Court's construction of a clause in *Re SSSL Realisations (2002) Ltd* [2006] Ch. 610 **[Auth/1C/80]**, that, since there is no express provision in Standard Term 5 **[App/D1/5/205-206]** preventing or restricting LBHI2 from proving its claims in an insolvency of LBIE, it follows that LBHI2 is entitled to prove in LBIE's administration. LBHI2's contention is wrong. In fact, as the Learned Judge correctly concluded at paragraph [69] **[App/C/4/48-49]**, the prohibition on proving is contained in Standard Terms 7(d) and (e) **[App/D1/5/207]**, which provide that the Lender undertakes 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."

20. Further, LBHI2 is wrong to contend that the consequence of the Learned Judge's conclusion as to the effect of the subordination provisions is that rule 2.88(7) of the 1986 Rules **[Auth/3/21]** will be "*triggered twice*" (paragraph [27] of LBHI2's skeleton argument **[App/E/3/45-46/[20]]**). The surplus to which rule 2.88(7) applies is a surplus of assets over proved debts. It is not, and does not purport to be, a surplus after the discharge of all of the company's liabilities.

21. LBHI2's alternative submission, that if statutory interest fell within the definition of "Liabilities" then it constituted an "Excluded Liability" and therefore was not a Senior Liability with the consequence that it did not rank ahead of subordinated debt, is also wrong. The definition of "Excluded Liabilities" is "*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*" **[App/D1/5/202]**. This does not cover statutory interest. Statutory interest is nowhere expressed to rank junior to the "Subordinated Liabilities" in LBIE's administration, and in the opinion of LBIE's administrators it does not so rank.

22. Contrary to LBHI2's skeleton argument, there is nothing unworkable about the Learned Judge's construction of Standard Term 5(1)(b) and 5(2) **[App/D1/5/205-206]**. In particular, LBHI2 is wrong to say (paragraph [17] of its skeleton argument **[App/E/3/43/[14]]**) that the Learned Judge's construction requires a provision to be made for the payment of the costs and expenses of a hypothetical insolvency. Standard Term 5(1)(b) **[App/D1/5/205-206]** applies whether or not LBIE is subject to formal insolvency proceedings. In either scenario, the correct analysis is to ascertain whether LBIE is able to pay its Liabilities (as defined and with the Standard Term 5(2) exclusions

[App/D1/5/206]). In any event, the Liabilities do not include counterfactual or entirely hypothetical obligations. Accordingly:

22.1. If LBIE is subject to insolvency proceedings, then these Liabilities would include the costs and expenses of those insolvency proceedings. However, if LBIE is not subject to insolvency proceedings, then these Liabilities would not include the costs and expenses of any counterfactual insolvency proceedings.

22.2. Therefore, the Learned Judge's construction of Standard Terms 5(1)(b) and 5(2) **[App/D1/5/205-206]** does not require regard to be had, where the Borrower is not subject to pending insolvency proceedings, to all sums that might (hypothetically) be "*payable*" in (hypothetical) insolvency proceedings of the Borrower.

23. Finally, the SLAs should, as the Learned Judge held (Judgment [60] to [64] **[App/C/4/47]**), be construed in their regulatory context.

24. The Learned Judge's construction of the SLAs is consistent with GENPRU 2.2.159R **[Auth/4/4]** because, although the lender's remedies must be limited to, but *may* include, proving for the subordinated debt, by paragraph (4) of that rule, the remedies are expressly required not to prejudice the subordination in paragraph (1) by which the lender's claims "*must rank behind those of all unsubordinated creditors*". Pursuant to the terms of the SLAs, LBHI2 can prove for the Sub-Debt, but only when it is contractually entitled to do so.

25. Further, the subordinated loans amounted to lower tier 2 or tier 3 regulatory capital for the purposes of the applicable provisions of GENPRU. Accordingly, the Learned Judge's construction is also consistent with the concept that subordinated loan capital qualifies as part of an institution's regulatory capital.

26. Moreover, the language of GENPRU 2.2.159R **[Auth/4/4]** is to be read in light of paragraph 23 of Basel I **[Auth/4/1]** and paragraphs 49(xii) and 49(xiv)

of Basel II **[Auth/4/2]**, which expressly refer to the absorption of losses by subordinated debt in a liquidation. Accordingly, GENPRU 2.2.159R **[Auth/4/4]** cannot mean that subordinated creditors can "*prove*" (in the technical sense) alongside unsubordinated creditors.

27. In any event the language, as used in GENPRU 2.2.159R **[Auth/4/4]**, of a creditor under a relevant "*capital instrument*" "*proving for the debt in the liquidation or administration*", is to be construed purposively to give effect to the relevant provisions of Basel I **[Auth/4/1]** and Basel II **[Auth/4/2]** (as brought into effect by way of the relevant EC Directives).

28. For all these reasons the Appellants' appeals on this point should be dismissed.

B. Paragraphs (ii) and (iii) of the Order

29. LBIE adopts the arguments set out in the skeleton argument of CVI GVF (Lux) Master Sarl **[App/B/7]** in support of paragraphs (ii) and (iii) of the Order **[App/C/6/103]**.

C. Paragraph (v) of the Order

(a) Background and context

30. The rate at which statutory interest is payable in an administration is whichever is the greater of the Judgment Rate and the rate applicable to the debt apart from the administration (rule 2.88(9) of the 1986 Rules) **[Auth/3/21]**. This will usually be a rate payable under a contract.

31. Paragraph (v) of the Order **[App/C/6/103]** concerns the entitlement of a creditor whose debts bear interest whether pursuant to contract, judgment or

otherwise, to claim in a subsequent liquidation of LBIE for such interest as accrued on its debt during the period of the preceding administration.

32. The amount of statutory interest payable on the debts proved in the administration of LBIE is very substantial. LBIE has been in administration since September 2008 and statutory interest has since then been accruing at the rate of 8% or the contractual rate of interest, whichever is the higher. It may be in the interests of LBIE's creditors for the administrators of LBIE to take steps to place LBIE into liquidation.

33. Paragraph (iv) of the Order **[App/C/6/103]** provides that, in an administration of LBIE which is immediately followed by a liquidation, any statutory interest payable in respect of the period of the administration which has not been paid before the commencement of the liquidation will not be provable as a debt in the liquidation, nor will it be payable as statutory interest under either rule 2.88 of the 1986 Rules **[Auth/3/21]** or section 189 of the 1986 Act **[Auth/3/20]**. LBIE is appealing this determination but, if the Judge's decision on paragraph (iv) **[App/C/6/103]** is upheld, then it is of some practical importance to establish whether creditors with a pre-administration right to interest are entitled, in a subsequent liquidation of LBIE, to interest in respect of the period of LBIE's administration on some alternative basis.

34. It is against this background that the Learned Judge ordered (in paragraph (v) of the Order **[App/C/6/103]**) that those creditors of LBIE entitled to interest on their provable debts otherwise than under rule 2.88(7) of the Rules **[Auth/3/21]** 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 liability, payable after the payment in full of all proved debts and statutory interest on such debts.

(b) Why paragraph (v) of the Order is correct

35. There is no reason why creditors whose debts carried interest prior to the administration, whether by way of contract, judgment interest or otherwise,

should not be entitled, in the liquidation, to claim such interest at such rate for the period of the administration as a non-provable liability. As the Learned Judge held (at paragraph [127] of the Judgment **[App/C/4/65]**), the reasoning in *In re Humber Ironworks and Shipbuilding Co* (1869) L.R. 4 Ch.App. 643, at p.647 (*per* Giffard LJ) **[Auth/1A/12]** applies in these circumstances, and "*the creditor whose debt carries interest is remitted to his rights under the contract*", or to any other rights to interest which he may enjoy.

36. Contrary to LBHI's submission (at paragraph [4] of its skeleton argument **[App/A/12/141]**), the premise of the Learned Judge's reasoning on this point is correct. Plainly, the legislative developments in the years since *In re Humber Ironworks and Shipbuilding Co* **[Auth/1A/12]** was decided mean that parts of that case are no longer good law. For example, as LBHI notes, it is no longer good law that "*where the estate is solvent [...] a creditor who has not stipulated for interest does not get it*" (at p.647, *per* Giffard LJ **[Auth/1A/12]**). However, the statement of principle made by Giffard LJ in *In re Humber Ironworks and Shipbuilding Co*, upon which the Learned Judge relied (at p.647, *per* Giffard LJ **[Auth/1A/12]**), remains good law.

37. Giffard LJ's principle in *In re Humber Ironworks and Shipbuilding Co* **[Auth/1A/12]** has found favour with the Court of Appeal and the Privy Council in more recent years in different contexts.

    37.1. "*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* " (Brightman LJ in *In re Lines Bros. Ltd.* [1983] Ch 1, at p.21E-F **[Auth/1B/57]**).

    37.2. "*... [a winding up order] leaves the debts of the creditors untouched. It only affects the way in which they can be enforced. [It] does not either create new substantive rights or destroy the old ones*" (Lord Hoffmann's opinion in the Privy Council decision in *Wight v Eckhardt Marine GmbH* [2004] 1 A.C. 147, at paragraph [27] **[Auth/1C/75]**).

38. LBHI2 contends (at paragraphs [69] and [70] of LBHI2's skeleton argument **[App/E/3/59/[58-59]]**) that, because it is an aim of English insolvency law that each liability which the insolvent person was subject to should be comprehensively dealt with as part of the insolvency process (see *In re T&N Ltd* [2006] 1 WLR 1728, at [76] to [83] **[Auth/1C/79]**), it therefore necessarily follows that the Learned Judge was wrong to reach the conclusion that a creditor can fall back on his contractual or other rights to interest and claim in respect of the non-provable liability owed to it.

39. This is given some support by Lord Neuberger noted in *In re Nortel GmbH* [2013] 3 WLR 504, at [90] **[Auth/1C/96]**, but the limitations of this support are significant. While it may be the case that the legislature has progressively widened the definition of provable debts and (as a result) narrowed the class of non-provable liabilities, it is plain from *Nortel* itself that non-provable liabilities continue to exist[7]. A failure to recognise the existence of non-provable liabilities would lead to the debtor company's members receiving a windfall at the expense of the creditor whose contractual rights have not been fully met.

40. Where there is a lacuna in the legislative regime in relation to interest, it must follow that the creditor's contractual or other right to interest remains intact and is recoverable as a non-provable liability of the debtor company.

41. Finally, LBHI's submission (at paragraphs [8] to [11] of its skeleton argument **[App/A/12/142-143]**) in relation to the supposed consequences of the Learned Judge's conclusion in the context of bankruptcy is misconceived. In particular, LBHI is wrong to contend that an unpaid contractual liability to pay interest would "*survive the insolvency process*" such that the bankrupt would not be discharged from such a liability upon his discharge.

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[7] See *In re Nortel GmbH* [2013] 3 WLR 504, at paragraph [93] **[Auth/1C/96]**. See also paragraph [23] of the Judgment of David Richards J in the decision subject to appeal **[App/C/4/38-39]**.

42. Rather, the Learned Judge's reasoning, relying on Giffard LJ's statement of principle 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*" (*In re Humber Ironworks and Shipbuilding Co*, p.647 **[Auth/1A/12]**), was that where there is a surplus otherwise available to the members, and <u>the creditor has not recovered statutory interest</u>, the creditor will be entitled to fall back on his contractual (or other) right to interest and be able to make a non-provable claim on the basis of such right. Thus:

42.1. It is in the absence of an applicable statutory provision for payment of post-insolvency interest that Giffard LJ's statement of principle applies, i.e., (assuming that LBIE does not succeed on its appeal against the declaration made in paragraph (iv) of the Order **[App/C/6/103]**) in the context of a liquidation immediately following an administration.

42.2. By contrast, in the context of personal insolvency, the statutory insolvency regime does provide for interest accruing since the commencement of bankruptcy (see section 328(4) of the 1986 Act **[Auth/3/20]**; compare rule 2.88(7) of the 1986 Rules **[Auth/3/21]**).

42.3. It is not the case, contrary to LBHI's submission, that a consequence of the Judge's conclusion on this point is that, in the bankruptcy context, an unpaid contractual liability to pay interest would "*survive the insolvency process*" such that the bankrupt would not be discharged from such a liability upon his discharge. The obligation to pay interest under arising out of the creditor's pre-bankruptcy contractual or other right would amount to a "*bankruptcy debt*" for the purposes of section 382(1)(b) **[Auth/3/20]** (such that the bankrupt would be discharged from it under section 281(1) **[Auth/3/20]**), since this obligation would amount to a "*debt or liability to which he may become subject <u>after</u> the commencement of the bankruptcy (including after his discharge from bankruptcy) by reason of any obligation incurred <u>before</u> the commencement of the bankruptcy*".

43. For all these reasons the Appellants' appeals on this point should be dismissed.

D. Paragraph (vi) of the Order

(a) Background and context

44. The issue here is whether the liability to contribute to the assets of a company in liquidation under section 74(1) of the 1986 Act **[Auth/3/20]** extends to providing the funds needed to pay statutory interest and any non-provable liabilities or whether, as the Appellants submit, it is limited to the funds required to pay the debts proved in the liquidation. On either basis, the liability also extends to the provision of funds for the payment of the expenses of the winding up and for the adjustment of the rights of contributories among themselves.

45. A *"contributory"* is a member or past member of the company who is liable to contribute to the assets of the company in a winding up (section 79 of the 1986 Act **[Auth/3/20]**).

46. In Lord Neuberger P.'s judgment in *Re the Nortel Companies*[8] **[Auth/1C/96]**, he explained that:

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

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8 [2013] 3 WLR 504 at [39] **[Auth/1C/96]**.

(5) Unsecured provable debts;
(6) Statutory interest;
(7) Non-provable liabilities; and
(8) Shareholders."

47. Accordingly, the issue is whether the Learned Judge was right to find that the members' obligation to contribute under section 74(1) of the Act **[Auth/3/20]** extends to provide for all of the company's liabilities at items (1) to (7) of Lord Neuberger's list, or whether the obligation extends only to items (1) to (5) **[Auth/1C/96]**.

(b) Why paragraph (vi) of the Order is correct

(i) The nature of the obligation to contribute under section 74(1) of the 1986 Act

48. The liability of a contributory commences at the time the contributory first became a shareholder[9], so it follows that from that time the debt is due, although it does not become payable until a call is made.

49. The making of calls against contributories, and thereby recovering contributions from the members, is a task that is carried out by the liquidator. The liquidator's first duty is to ascertain or identify those who are liable to contribute. This is done by settling the list of contributories. The duty is technically that of the Court, under section 148 of the 1986 Act **[Auth/3/20]**, but rule 4.196 of the 1986 Rules **[Auth/3/21]** provides that the liquidator is to discharge the duty as its delegate.

50. The next step (which affects only the members) is to make and enforce calls against those on the list and to adjust the rights of contributories among themselves. In order to avoid the expense of proceeding against each contributory individually, the liquidator may obtain what is known as a balance order, which is a summary order made by the Court under section 150 of the 1986 Act **[Auth/3/20]** directing all of those settled on the list of

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[9] *Ex parte William Canwell* (1864) 4 De Gex, Jones & Smith 539 **[Auth/1A/3]**; *Thomas George Williams v Robert Palmer Harding* (1866) L.R. 1 H.L. 9 **[Auth/1A/4]**.

contributories to pay to the liquidator the amounts due from each of them by way of a contribution to the assets of the company.

51. For the purposes of winding up and administration, the terms "*debts*" and "*liabilities*" which appear in section 74 **[Auth/3/20]** are defined in IR 13.12 **[Auth/3/21]**. IR 13.12(1) contains the definition of "debts" **[Auth/3/21]**. Debts can be proved in an administration or liquidation. The definition of "liabilities" is broader (rule 13.12(4) of the 1986 Rules **[Auth/3/21]**). Liabilities extend beyond what is provable and encompass non-provable liabilities.

52. The scope of the contributory's liability to contribute is, therefore, broad and (subject to the exceptions of which the two most important are listed below at paragraph 85) unlimited. The contributory is liable to contribute to the company's assets an amount sufficient for payment of the provable debts of the company, statutory interest, its non-provable liabilities and the expenses of the winding up.

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

    53.1. The liability of a contributory in a company limited by shares cannot exceed the amount (if any) unpaid in respect of his shares (section 74(2)(d) of the 1986 Act **[Auth/3/20]**).

    53.2. If the company is limited by guarantee, the contributory's liability is limited to the amount which he has undertaken to contribute in its Memorandum of Association (section 74(3) of the 1986 Act **[Auth/3/20]**).

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

(ii) The components of the section 74 claims against the Members

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

56. The term "*debt*" in relation to the winding up of a company is defined in rule 13.12(1) of the 1986 Rules[10] **[Auth/3/21]**. Its meaning is limited by reference to its status and characterisation at the time the company entered administration. The Supreme Court has recently considered the status and characterisation of a debt in the context of determining whether the potential statutory liabilities faced by LBIE and others arising out of the deficiency in the Lehman Brothers pension scheme were provable. In its judgment[11], the Supreme Court gave guidance as to the scope of rule 13.12(1)(a) of the 1986 Rules **[Auth/3/21]** (at [68] to [71]) and IR 13.12(1)(b) **[Auth/3/21]** (at [72]-[86]).

57. Rule 13.12(1)(a) of the 1986 Rules **[Auth/3/21]** is concerned with liabilities to which the company "is subject" at the date of the insolvency event, whereas rule 13.12(1)(b) **[Auth/3/21]** is directed to those liabilities to which it "may become subject", subsequent to that date, and there is no overlap between these two categories[12].

58. Turning to rule 13.12(1)(b) of the 1986 Rules **[Auth/3/21]**, as Lord Neuberger P. said at [75] **[Auth/1C/96]**:

> *"Where a liability arises after the insolvency event as a result of a contract entered into by a company, there is no real problem. The contract, in so far as it imposes any actual or contingent liabilities on the company, can fairly be said to impose the*

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[10] See rule 12.3(1) of the 1986 Rules and *Re the Nortel Companies* **[Auth/3/21]**; *Re the Lehman Companies* [2013] 3 WLR 504 at [66] **[Auth/1C/96]**.

[11] *Re the Nortel Companies; Re the Lehman Companies* [2013] 3 WLR 504 **[Auth/1C/96]**.

[12] *Re the Nortel Companies; Re the Lehman Companies* [2013] 3 WLR 504 at [70] **[Auth/1C/96]**.

> *incurred obligation. Accordingly, in such a case the question whether the liability falls within para (b) will depend on whether the contract was entered into before or after the insolvency event."*

59. As noted above, the term "*liability*" is broader than the term "*debt*" and because it is not restricted by its status and characterisation at a particular moment in time encompasses non-provable liabilities. The term is defined in rule 13.12(4) of the 1986 Rules **[Auth/3/21]** as follows:

> "*…'liability' means…* a *liability to pay money or money's worth, including any liability under an enactment, any liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution*".

60. That definition is subject to rule 13.12(3) **[Auth/3/21]** which provides that:

> "*For the purposes of references in any provision of the Act or the Rules about winding up to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, or whether its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion; and references in any such provision to owing a debt are to be read accordingly.*"

61. Reading rules 13.12(3) and 13.12(4) **[Auth/3/21]**, it is hard to conceive of any valid claim against the company that would not give rise to a "liability". Accordingly, the Members' liability under section 74 **[Auth/3/20]** relates both to provable debts and all other liabilities, including statutory interest and non-provable liabilities.

62. LBHI contends that the phrase "debts and liabilities" which appears in section 74 **[Auth/3/20]** and which defines the scope of the liability to contribute in fact refers only to provable debts. In support of that construction of the section, LBHI relies in particular upon section 107 **[Auth/3/20]**, where it is said that the word "liabilities" simply means "provable debts" because those are the liabilities that are paid *pari passu*.

63. This submission cannot be correct in the terms in which it is made because section 189 **[Auth/3/20]** provides for non-provable statutory interest to be paid before any distribution to members, which cannot stand with LBHI's construction of section 107 **[Auth/3/20]**. It follows that the only way of reading section 107 in a manner which is consistent with section 189 **[Auth/3/20]** is by construing the word "liabilities" in section 107 **[Auth/3/20]** as meaning all liabilities whether or not provable, but the obligation to pay *pari passu* does not apply across the entirety of the liabilities. As Lord Neuberger's "insolvency waterfall"[13] makes clear, statutory interest and non-provable liabilities rank higher than the members' rights.

64. Further, section 74 **[Auth/3/20]** expressly includes, in framing the scope of the contributory's liability to contribute, any amount sufficient "*for the adjustment of the rights of the contributories among themselves*", i.e. payments to shareholders[14], which rank last of all. If the members' obligation extends to enabling the company to make payments to shareholders *qua* shareholders, then it must follow that their obligation extends to any and all liabilities which rank for payment ahead of such payments to shareholders, including therefore statutory interest and any non-provable liabilities.

65. In this connection LBHI2 is wrong to contend (at paragraph [89] of its skeleton argument **[App/E/3/63/[71]]**) that a call under section 74 **[Auth/3/20]** to make such an adjustment is different in kind from a call under section 74 **[Auth/3/20]** to fund a shortfall in assets to pay proved debts. A call under section 74 **[Auth/3/20]** to make such an adjustment could be a part of a general call to produce funds which flow all the way down through the waterfall to include adjustment as between contributories. Therefore it is wrong to say that the distribution of surplus assets can be separated, for the purposes of section 74 **[Auth/3/20]**, from adjustment as between contributories.

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13 *Re the Nortel Companies* [2013] 3 WLR 504 at [39] **[Auth/1C/96]**.

14 *Re West Coast Gold Fields Ltd* [1905] 1 Ch 597 is an example of a case where the member's obligation to contribute related to payments that were to be made to shareholders, there being a surplus in the winding up **[Auth/1A/33]**.

66. Moreover, LBL is wrong to submit (at [3(3)(a)] of its grounds of appeal **[App/A/6/48-49]**) that rule 2.88(7) of the 1986 Rules **[Auth/3/20]** does not create a liability of the company (on the basis that it simply creates a direction to the administrator as to how apply surplus in his hands).

67. This submission is wrong for the various reasons given by the Learned Judge at [163] to [164] of the Judgment **[App/C/4/74-75]**. In particular, there is no 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. LBL's reliance in this context on the decision of Mervyn Davies J in *In re Lines Bros Ltd* [1984] BCLC 215 **[Auth/1B/59]** (relating to the meaning of the phrase "*debts and liabilities*" in the legislation going back to section 10 of the Supreme Court of Judicature Act 1875 **[Auth/3/11]**) is misplaced. First, the question in that case was whether the company was insolvent in circumstances where there was a surplus of assets over all proved debts, rather than the nature of the contributory's liability to contribute to the assets of the company. Secondly, the view expressed by Mervyn Davies J that statutory interest be regarded as a debt or liability of the company is not one which featured in the various earlier cases on which his decision was purportedly based, for example the judgment of Pennycuick V-C in *In re Rolls-Royce Co Ltd* [1974] 1 WLR 1584 **[Auth/1B/52]**.

68. There are further textual indicators that statutory interest falls within the "debts and liabilities" referred to in section 74 **[Auth/3/20]**:

    68.1. Section 89(1) **[Auth/3/20]** provides that a statutory declaration of solvency for the purpose of a members' voluntary winding up must address the company's ability to pay "*its debts in full, together with interest at the official rate*"; and

    68.2. Section 149(3) **[Auth/3/20]** provides that it is only when "*all the creditors are paid in full (together with interest at the official rate)*"

that a contributory is able to exercise a right of set-off in respect of any subsequent call.

69. The official rate as referred to in section 89(1) **[Auth/3/20]** and section 149(3) **[Auth/3/20]** is defined by section 251 **[Auth/3/20]** to mean the rate payable under section 189(4)[15] **[Auth/3/20]**.

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

71. This approach is also consistent with the judgment in *Re Overnight Ltd*[16] **[Auth/1C/86]**, where Roth J. proceeded on the assumption that a liability to contribute to the assets of the company in the context of a fraudulent trading claim (under section 213 **[Auth/3/20]**) includes the liability of the company in respect of statutory interest. It would be surprising if the extent of the liability of a member to contribute to the assets of the company was to be construed in a narrower way.

72. Contrary to LBHI2's submission, the Learned Judge was correct to proceed on the basis that "*It is the purpose of a liquidation to pay all liabilities of the company, including those which are not capable of proof*" (at [152] of the Judgment **[App/C/4/71-72]**). The liquidation regime is not limited to the provisions of the 1986 Act and the 1986 Rules but also includes a variety of common law and equitable principles. This may be seen in Lord Neuberger's statement of the ranking of claims in insolvency proceedings in the recent Supreme Court decision in *In re Nortel GmbH* [2013] Bus LR 1056, where, at

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15 Which is itself the same rate as that provided for by rule 2.88(9) **[Auth/3/21]**.

16 [2010] BCC 803 **[Auth/1C/86]**.

[39] **[App/1C/96]**, he stated (emphasis added): "*In a liquidation of a company and in an administration (where there is no question of trying to save the company or its business), the effect of insolvency legislation…, as interpreted and extended by the courts, is that the order of priority for payment out of the company's assets is, in summary, as follows: (1)… (6) Statutory interest; (7) Non-provable liabilities; and (8) Shareholders.*"

73. The use of the word "*surplus*" in section 189(2) **[Auth/3/20]** does not mean that a contributory is not liable, under a section 74(1) call **[Auth/3/20]**, to contribute towards the satisfaction of a company's statutory interest liabilities. The suggestion is that the Learned Judge's conclusion is circular because, unless and until there is a surplus after payment of the debts proved, there is no liability to pay statutory interest or non-provable liabilities. This submission is wrong because the premise on which it is based is flawed:

    73.1. LBHI2's premise is that the word "surplus" as used in section 189(2) **[Auth/3/20]** refers to the fund which is left after all of the company's liabilities have been satisfied.

    73.2. However, it is clear from the way in which the word "surplus" is used in section 189(2) **[Auth/3/20]** that it is only describing what remains after provable debts have been paid in full.

74. Furthermore, if there is a right to make a call in respect of any liability ranking below statutory interest in Lord Neuberger's waterfall *(Re the Nortel Companies*[17] **[Auth/1C/96]***)*, including making a call to adjust the rights of contributories, receipt of the proceeds of that call will inevitably comprise the surplus and therefore have to be applied in payment of interest before being applied for any other purpose (section 189(2) **[Auth/3/20]**), i.e. towards the amount in respect of which the call was made.

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[17] [2013] 3 WLR 504 at [39] **[Auth/1C/96]**.

75. Finally, there is no force in LBHI's submission (paragraph [19] of its skeleton argument **[App/A/12/145]**) that, if a liability of a Company to pay statutory interest is imposed by section 189(2) "*independently of the Surplus*" **[Auth/3/20]**, then a bankrupt (who would be subject to a like obligation under section 328(4) **[Auth/3/20]**) would not be released from this liability upon his discharge. LBIE does not say that the obligation to pay statutory interest arises independently of the surplus. The obligation is one to pay statutory interest to the extent of the surplus. In the context of a liquidation the surplus includes the proceeds of calls. That is obviously inapplicable in the context of a bankruptcy where calls cannot be made.

76. For all these reasons the Appellants' appeals on this point should be dismissed.

E. Paragraph (viii) of the Order

(a) Background and context

77. The issue in dispute is whether a proof may be lodged by an administrator of a company in the insolvency of a member in respect of a contingent liability under section 74(1) of the 1986 Act **[Auth/3/20]**, which is contingent on the company going into liquidation and on calls being made by the liquidator.

78. The administrators of LBL have, since the Judge's decision was handed down, now given notice of an intention to declare dividends, and so the issue in dispute is now a live one, having been a hypothetical (or contingent) one at first instance.

79. The Learned Judge held correctly that LBIE, acting by its Administrators, will be entitled to lodge a proof in a distributing administration or a liquidation of LBL or LBHI2 in respect of those companies' contingent liability to contribute under section 74(1) of the 1986 Act **[Auth/3/20]**. LBHI and LBHI2 challenge this finding on the basis that section 74(1) of the 1986 Act **[Auth/3/20]** is only applicable once a company is wound up and not before,

and that the Learned Judge's decision would serve to deprive contributories of certain statutory protections.

80. For the avoidance of doubt, it is not in dispute that, if a liquidator has made calls in respect of the liability under section 74(1) **[Auth/3/20]**, he may prove for the amount of such calls in the liquidation, administration or bankruptcy of the contributory. The call creates a presently payable debt and there is no reason why it should not form the subject of a proof[18].

(b) Why paragraph (viii) of the Order is correct

81. The correct approach to this issue, consistent with the Learned Judge's reasoning, is to ascertain whether LBIE has a claim which will be provable in the administrations (or any subsequent liquidations) of LBHI2 and LBL within the meaning of rule 13.12(1)(b) of the 1986 Rules **[Auth/3/21]**.

82. Rule 12.3(1) of the 1986 Rules **[Auth/3/21]** provides that:

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

83. It is not possible to read Rule 12.3(1) **[Auth/3/21]** on its own. The broad range of claims to which it refers, are provable "as debts". That necessarily brings in the provisions that define "debt". Rule 13.12 **[Auth/3/21]** defines "debt" for the purposes of winding up (and, now, administration). It is only if a claim falls within the definition of "debt" in IR 13.12 **[Auth/3/21]** that it is provable[19].

84. The statutory regimes for distributing the assets of an insolvent estate amongst those entitled to prove involve a cut-off date by which any actual or contingent

[18] Paragraph 8 of schedule 4 to the 1986 Act expressly gives power to a liquidator to prove in the bankruptcy or insolvency of any contributory for any balance against his estate **[Auth/3/20]**.

[19] *Re T&N Limited* [2006] 1 WLR 1728 at [112] **[Auth/1C/79]**.

liability has to have been incurred by the debtor. It is rule 13.12(1) **[Auth/3/21]** which provides the requisite cut-off date. By rule 13.12(1) **[Auth/3/21]**, a "*debt*" is defined as being limited to a debt or liability to which the company either:

> "*is subject at the date on which it goes into liquidation*" (rule 13.12(1)(a)); or
>
> "*may become subject after that date by reason of any obligation incurred before that date*" (rule 13.12(1)(b)).

85. For the purposes of an administration, Rule 13.12(5) provides that the 1986 Rules "*shall be read as if references to winding up were references to administration*" **[Auth/3/21]**. So, for an administration, the relevant cut-off date is the date on which the company went into administration.

86. The wording of rule 13.12(1) **[Auth/3/21]**, including in particular the words "*by reason of any obligation incurred before that date*" in rule 13.12(1)(b) **[Auth/3/21]** can be traced back as far as section 31 of the Bankruptcy Act 1869 **[Auth/3/10]**. That section permitted, for the first time, proof in respect of contingent debts and liabilities, and claims to unliquidated damages, but only subject to an identical cut-off date[20].

87. LBIE's claim against its Members is a contingent claim falling within the scope of rule 13.12(1)(b) **[Auth/3/21]** and is therefore provable.

88. In *Re the Nortel Companies*[21] **[Auth/1C/96]**, the Supreme Court considered the scope of rule 13.12(1)(b) **[Auth/3/21]** in the context of statutory liabilities. At [77], Lord Neuberger P. held that:

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20 Section 31 of the Bankruptcy Act 1869 provided that: "*all debts and liabilities, present and future, certain or contingent, to which the bankrupt is subject at the date of the order of adjudication, or to which he may become subject during the continuance of the bankruptcy by reason of any obligation incurred previously to the date of the order of adjudication, shall be deemed to be debts provable in bankruptcy*" **[Auth/3/10]**.

21 [2013] 3 WLR 504 at [76]-[77] **[Auth/1/96]**.

88.1 the mere fact that a company could come under a liability pursuant to a provision in a statute which was in force before the insolvency event, cannot mean that, where the liability arises after the insolvency event, it falls within rule 13.12(1)(b) **[Auth/3/21]**; but

88.2 at least normally, in order for a company to have incurred a relevant "obligation" under rule 13.12(1)(b) **[Auth/3/21]**, it must have taken, or been subjected to, some step or combination of steps:

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

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

88.2.3. 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) **[Auth/3/21]**.

89. These requirements are satisfied from the moment in time at which a person acquires or is issued with shares in an unlimited company because, from that time, a debt accrues due from him to the company under section 80 of the 1986 Act **[Auth/3/20]**.

90. LBHI is wrong to submit (paragraph [36] of its skeleton argument **[App/A/12/150-151]**) that the Learned Judge was wrong to rely on *Ex parte Canwell* (1864) 4 De G, J & S 539 **[Auth/1A/3]**, and *Williams v Harding* (1866) LR 1 HL 9 **[Auth/1A/4]**, in support of the proposition that the liability of a member as a contributory commences for the purposes of this section when he becomes a member. LBHI is right to note that these decisions do not decide that a contingent liability under section 74(1) **[Auth/3/20]** is provable in a contributory's bankruptcy. However they are consistent with and support

the proposition that the liability of a member as a contributory commences for the purposes of this section when he becomes a member.

91. Even if it were not the case that a debt accrues due from the contributory to the company under section 80 **[Auth/3/20]** from the moment in time at which a person acquires or is issued with shares in an unlimited company, the liability is still provable within the *Nortel* test **[App/1C/96]**. The result of his becoming a shareholder: (a) is that a legal relationship between him and the company arises; (b) which renders him vulnerable to a liability to contribute under section 74 **[Auth/3/20]**, such that there is a real prospect of that liability being incurred; and (c) it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1)(b) **[Auth/3/21]**.

92. This analysis is consistent with the approach taken by Stirling J. in *Re McMahon*[22] **[Auth/1A/30]** that a company may prove in the administration of the estate of a deceased shareholder whose estate is insolvent for the estimated value of the liability to future calls in respect of shares standing in his name.

93. The analysis above is not affected by the contention made by LBHI (paragraph [26] of its skeleton argument **[App/A/12/147-148]**) that the administrator of a company has no greater power to deal with the moneys paid in respect of a call made under section 74(1) **[Auth/3/20]** than its directors. Essentially, LBHI contends that the Judge's decision is wrong because section 74(1) **[Auth/3/20]** does not itself confer express power on an administrator to make a call on contributories.

94. LBHI's contention is misconceived since it equates the power to make a call under section 74(1) **[Auth/3/20]** with the power to deal with sums received by a company from a proof of the contingent liability under section 74(1) **[Auth/3/20]** in a contributory's insolvency:

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22 [1900] 1 Ch. 173 **[Auth/1A/30]**

94.1. If LBHI's contention is right then it follows that, in an administration immediately following a liquidation where the liquidator has made a call under section 74(1) **[Auth/3/20]** and the company has received sums from contributories, the administrator would have no power to deal with the moneys that the company has received. This cannot be correct.

94.2. It is true that it is only the liquidator who has the power to make a call under section 74(1) **[Auth/3/20]**. However, the sums which are owing under such a call (or contingently owing prior to that call being made) are a debt owing not to the liquidator but to the company.

94.3. LBHI does not appear to pursue the submission which it made at first instance, and which the Learned Judge correctly rejected (see Judgment, paragraphs [207] to [212] **[App/C/4/86-88]**), that the liability was owed to the liquidator and not to the company. Among other objections to this submission is that, if the company is not a creditor in respect of such a liability then, before liquidation, there is a contingent liability to contribute but no contingent creditor.

94.4. It follows that the sums received by the company following an administrator's proof in a contributory's insolvency would be properly owing to the company, and so there is no question of the administrator lacking the power to deal with the moneys received by the company.

95. Further, it is nothing to the point for LBHI to point out that a liquidator has powers in respect of a section 74(1) call **[Auth/3/20]** which an administrator or a director of the company lacks, such as the power to compromise the section 74(1) liability **[Auth/3/20]** or to take security for the discharge of such a call (as provided by paragraph 3 of Schedule 4 to the 1986 Act **[Auth/3/20]**). Again, a distinction is to be drawn between the liability which is owing to the company and the powers which the liquidator has in respect of it. The existence of such powers on the part of the liquidator does not affect the

analysis that the company is owed a contingent liability prior to a call being made.

96. LBHI is wrong to suggest (paragraph [27] of its skeleton argument **[App/A/12/148]**) that, because a liquidator could not assign the right to make a call under section 74(1) **[Auth/3/20]**, it follows that the administrator of the company could not prove in respect of the section 74(1) liability **[Auth/3/20]** prior to the liquidation. Again, this submission fails to distinguish between the right to make the call (which is the liquidator's) and the liability owed by the contributory (which is owed to the company). Therefore this submission does not take LBHI's argument any further.

97. Further, the reason why moneys paid in respect of a call under section 74(1) **[Auth/3/20]** cannot be charged by the company is because a call will only be made where the company has yet to satisfy in full all of its debts and liabilities in a winding up.

98. LBHI is not assisted by its submission (paragraph [34] of its skeleton argument **[App/A/12/149-150]**) that, if monies owing under section 74(1) **[Auth/3/20]** were payable prior to the company being wound up, a company (acting by its directors) could dispose of these monies without restriction. It is accepted that there is a risk that a company could use the monies raised in this way in the business, such that if the company later goes into liquidation the liquidator could make a call and the liability to contribute will not have been reduced by the original dividends paid. However, that risk is largely a hypothetical one because distributing administrations and liquidations tend to result in the dissolution of the company. Indeed, the greater risk would be if the company were unable to prove in respect of the section 74(1) liability **[Auth/3/20]** and were then to go into liquidation at a time when the member had been dissolved or no longer had any assets.

99. LBHI's contentions in respect of the alleged loss of certain statutory protections and qualifications which apply only in the context of the company's liquidation are wrong. Those contentions are predicated on the

rules relating to the liquidator's settling of the list of contributories (rules 4.196, 4.198, 4.199, 4.202, 4.203 **[Auth/3/21]**) and the power of the Court and the liquidator to adjust the rights of the contributories (sections 154 and 165(5) **[Auth/3/20]**). However, as the Learned Judge noted in rejecting LBHI's submissions at first instance (Judgment, paragraphs [218] and [223] **[App/C/4/89-90]**), there is no reason why these points could not be taken by the contributory's liquidator or administrator in considering the company's proof of debt. For example, insofar as the member would be entitled to look to other members to share in the liability in the event of calls made in a liquidation, this can be factored into the estimate of the member's contingent liability for the purposes of proof.

100. LBHI submits (at paragraphs [43] to [47] of its skeleton argument **[App/A/12/152-153]**) in relation to section 74(2)(a) **[Auth/3/20]**, which provides that a past member is not liable to contribute if he ceased to be a member for one year or more before the commencement of the winding up, that there are possible factual scenarios in which the contributory will cease to be contingently liable under a section 74(1) call **[Auth/3/20]** in circumstances where the contributory ceases to be a member for the requisite period of time. Again, this submission is misconceived since there is no reason in principle why this point could not be taken into consideration by the contributory's liquidator or administrator. The liquidator or administrator, if it was considered likely that the contributory would avoid liability by virtue of section 74(2)(a) **[Auth/3/20]**, would value the contingency accordingly.

101. For all these reasons the Appellants' appeals on this point should be dismissed.

F. Paragraphs (ix) and (x) of the Order

102. These issues proceed on the basis of the Learned Judge's finding that LBIE is entitled to prove in the administration or subsequent liquidation of LBL or LBHI2 in respect of those companies' contingent liabilities under section 74(1) **[Auth/3/20]**.

103. If, as submitted above, the Learned Judge was right on this point, then it follows that he was also right in respect of paragraphs (ix) and (x) of the Order **[App/C/6/104]**.

104. In particular, if the Judge was correct that LBIE will be entitled to lodge a proof in a distributing administration or a liquidation of LBL or LBHI2 in respect of those companies' contingent liabilities under section 74(1) of the Act **[Auth/3/20]**, then (subject to the Administrators' appeal in respect of paragraph (vii) of the Order **[App/C/6/104]**) it must follow that mandatory insolvency set-off will apply in this connection in the manner set out in paragraphs (ix) and (x) of the Order **[App/C/6/104]**.

Conclusion

105. For these reasons it is submitted that the Appellants' various appeals against the paragraphs (i), (ii), (iii), (v), (vi), (viii), (ix) and (x) of the Order should be dismissed **[App/C/6/102-104]**.

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