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

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)
IN THE MATTER OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)
IN THE MATTER OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986
BETWEEN:

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

Applicants

-and-

(1) LEHMAN BROTHERS HOLDINGS, INC (a company incorporated in the State of Delaware, USA)
(2) LYDIAN OVERSEAS PARTNERS MASTER FUND LIMITED

Respondents

SUPPLEMENTAL WRITTEN OPENING SUBMISSIONS OF THE JOINT ADMINISTRATORS OF LBL FOR THE TRIAL COMMENCING 11 NOVEMBER 2013

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Introduction

1. These are the supplemental written opening submissions of the LBL Joint Administrators for the trial of the Joint Application. They respond only to points arising from the written opening submissions of the other parties in relation to which the position of the LBL Joint Administrators is not already clear from their previously filed written opening submissions ("**LBL's Written Opening**").

Questions 1 and 2: LBL proving in LBIE's administration (or a subsequent liquidation)

2. The position of the LBIE Joint Administrators and Lydian, as set out in their written openings, is essentially that, in circumstances where there is any theoretical possibility that a call might one day be made on a member, and even before the company is in liquidation and before a call has been made on the member, all of the member's claims against the company nonetheless rank behind all those of other unsecured creditors, even where its claims are not *qua* member. Effectively, they are arguing that members always come last. By way of example:

   (1) Para 59 of the LBIE Joint Administrators' written opening states: "*The Members are in the position of being at the back of the creditor queue.*"

   (2) The LBIE Joint Administrators and Lydian even submit that the liabilities owed to the Members (in any capacity) rank behind what they call LBIE's non-provable liabilities. Thus Lydian states, at para 28 of its written opening, that "*the Contributory Rule relates to the circumstances that the shareholder, as the person liable to contribute to the fund, is obliged to do so on terms that require its claims to be repaid last, after all the company's debts have been paid*".

3. This overstates the effect of the **Grissell's Case** line of authority, and is contrary to:

   (1) S.74(2)(f), which expressly **only** subordinates claims of members *qua* member, and does not subordinate all claims owed by the company to the member in any capacity.

   (2) Lord Browne-Wilkinson's judgment in **Soden** [1998] AC 398, 324:

   > "Moreover, the construction of the section which I favour accords with principle. **The principle is not "members come last": a member having a cause of action independent of the statutory contract is in no worse a position than any other creditor. The relevant principle is that the rights of members as members come last, i.e. rights founded on the statutory contract are, as the price of limited liability, subordinated to the rights of creditors based on other legal causes of action. The rationale of the section is to ensure that the rights of members as such do not compete with the rights of the general body of creditors**."

   (3) Lord Chelmsford LC's judgment in **Grissell's Case** itself: "*The Act would be a complete snare upon members of companies who are creditors if they were to be postponed to other creditors who are not members.*"

4. The relevant authorities establish that where a company is in liquidation, and a call has been made on the contributory, the fund should be notionally increased by the amount of the contribution, and the contributory's share of that increased fund should be calculated by applying the

appropriate proportion to the notionally increased fund, and distributing to the contributory the amount of the share (so determined) less the amount of the contribution (see the formula set out by Chadwick LJ in **Re SSSL** at [79(1)], quoted at para 65 of the LBL Written Opening). They do not require the contributory's "*claims to be repaid last, after all the company's debts have been paid*". That would unjustifiably extend the scope of s.74(2)(f) which expressly only applies to claims of a member *qua* member.

5. Lord Walker in **Re Kaupthing** referred at [53] to a principle that "*a company's contributories must stand in the queue behind its creditors*". The LBIE Joint Administrators and Lydian refer to this quotation on a number of occasions in their written openings. However, this statement was in the context of explaining, in short form, the line of case law arising from **Grissell's Case** (with which, other than its application in the context of the contributory's insolvency in **Re Auriferous No. 1**, the LBL Joint Administrators do not take issue). However, Lord Walker cannot have been intending to overrule, for example, Lord Browne-Wilkinson's judgment in **Soden**.

6. Further, in their written openings, the LBIE Joint Administrators and Lydian have not identified a single authority that establishes that the principles in **Cherry v Boultbee / Grissell's Case** apply in circumstances where the obligation to contribute to the fund is a future or contingent one. Lydian states (at para 44) that the "Contributory Rule" applies where the company is in administration "*As a matter of principle*" (but no authority is cited). The LBIE Joint Administrators say, at para 159, that for the purposes of the rule in **Cherry v Boultbee** "*it is immaterial that what he owes to the fund is not ascertained*", citing the decision in **Re Rhodesia Goldfields Ltd** [1910] 1 Ch 239. However, as explained at para 46(4) of the LBL Written Opening, **Re Rhodesia Goldfields** was a case where neither the existence nor the amount of the debt to the fund had been established or ascertained, but if there was a debt it would have been presently payable. That is very different from the present situation, where the liability of the Members under s.74 is anything but presently payable; it is subject to a number of contingencies (LBIE going into liquidation, there being a shortfall in LBIE for which the Members are liable to contribute, a call being made on the Members, and the quantum of the call). Further, Swinfen Eady J specifically said in **Re Rhodesia Goldfields**, at 242, "*The company could not set off a future debt, e.g., a future call*".

7. In fact, the authorities establish that the rule in **Cherry v Boultbee,** out of which the rule in **Grissell's Case** (which the LBIE Joint Administrators and Lydian call the "contributory rule") arises, cannot apply in these circumstances: see para 48 of the LBL Written Opening in particular.

8. Accordingly, contrary to para 161 of the LBIE Joint Administrators' written opening, the rule is clearly "*limited to circumstances in which a call has already been made*".

9. The LBIE Joint Administrators do not appear to be suggesting that the Members should make payment to LBIE in respect of any shortfall while LBIE is in administration. If they were to do so, (i) this would be unjustified given the clear terms of s.74 and s.80; and (ii) this may give rise to bizarre consequences, as set out at paras 19-22 of LBHI's written opening.

10. Lydian's written opening submits, at paras 30-33, that in the case of an unlimited company, the availability or otherwise of set-off is irrelevant "*since any set-off between the member (with an unlimited liability for the company's debts) and the company would simply result in the member continuing to have a liability to contribute more until the company was provided with sufficient assets to discharge the independent debts in full*". However, the availability of a set-off in the case of an unlimited company may be significant where the contributory itself is in administration or liquidation.

Question 4: insolvency set-off / Cherry v Boultbee, in the context of LBL proving in LBIE's administration (or a subsequent liquidation)

11. The LBL Joint Administrators agree with the LBHI2 Joint Administrators that unless and until LBIE goes into liquidation and its liquidators make a call on the contributories, the principles on which the LBIE Joint Administrators rely can have no application.

12. As pointed out at paragraphs 62-64 of the LBHI2 Joint Administrators' written opening:

    (1) The justification for the rule in **Cherry v Boultbee** is that "*he who seeks equity must do equity"*, and there is no equity for LBL and LBHI2 to do at present.

    (2) The words "*complete the estate*" also emphasise that the principles on which the LBIE Joint Administrators rely cannot apply when LBIE is in administration. No relevant estate is, at this stage, "incomplete", as: (i) no call has to date been made; and (ii) the estate of LBIE in administration can never be completed by payment in respect of the Potential Liability as Contributory because it is only liquidators that have the power to make a call.

13. However, the LBHI2 Joint Administrators suggest (notwithstanding their acceptance of the correctness of the result in **Ex p Branwhite** at para 55 of their written opening) that the Members' claims and the Potential Liability as Contributory (if provable by LBIE in the Members' insolvencies) will be the subject of insolvency set-off in LBIE's administration, or a subsequent liquidation of LBIE. At para 69 of their written opening, they say that LBIE's administrators should value LBHI2's Potential Liability as Contributory as at the date of its Rule 2.95 notice and employ that (very low) sum in set-off against LBIE's liability to LBHI2.

14. This is contrary to the line of authority stemming from **Grissell's Case**, which establishes that there is no set-off in a company's liquidation between a contributory's liability for calls and an independent claim owed by the company to the contributory, because (as explained at para 61 of LBL's Written Opening), the insolvency legislation contemplates that the proceeds of a call are to be used with the other assets of the company in the *pari passu* payment of the company's debts (c.f. para 142 of the LBIE Joint Administrators' written opening[1]). A set-off in these circumstances would benefit the contributory to the detriment of the company's other creditors, and is not permissible.

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[1] The LBIE Joint Administrators' written opening appears to accept that there is no set-off in LBIE's administration / liquidation in respect of the Members' claims against LBIE and the Potential Liability as Contributory. In light of that, para 120 of their written opening (which states "*if, contrary to the arguments set out in these written opening submissions, the Members were entitled to prove in LBIE's administration and receive distributions, the value of LBIE's contingent claim would be estimated for the purposes of calculating the net debt due to or from LBIE under IR 2.85(8)*") is not understood.

Questions 5 and 6: LBIE's ability to prove in the Members' administrations (or subsequent liquidations) in respect of the Potential Liability as Contributory, and insolvency set-off in this context

Can LBIE prove in the Members' administrations (or subsequent liquidations) in respect of the Potential Liability as Contributory?

15. Para 42 of Lydian's written opening states that the Potential Liability as Contributory is provable in an insolvency of the member, irrespective of whether a call has been made by the liquidators or even of whether the company is in liquidation, citing the case of **Re McMahon** [1900] 1 Ch 173. Para 162 of the LBIE Joint Administrators' written opening also asserts that the Potential Liability as Contributory is provable in the Members' administrations/liquidations and relies upon **Re McMahon**.

16. However, neither of the written openings engages with the statutory provisions cited at para 72 of the LBL Written Opening, which make clear that it is only if a company is wound up and if a call is made by its liquidators that it can prove (through its liquidators) in the insolvency of a corporate contributory. **McMahon** concerned a bankrupt contributory (and the ability of a company to prove in the administration of the insolvent estate of a deceased member for amounts unpaid on the shares of a limited company), in relation to which s.82(4) of the Act (which applies, under s.82(1), *"if a contributory becomes bankrupt, either before or after he has been placed on the list of contributories"*) expressly provides "*There may be proved against the bankrupt's estate the estimated value of his liability to future calls, as well as calls already made."* The Act contains no equivalent for a corporate contributory. Further, the Act contains no equivalent to the power in para 8 of Schedule 4 to the Act for an administrator. Neither of the written openings attempts to explain how a proof can be submitted in the absence of a winding-up of LBIE and a call by its liquidators.

17. Accordingly, for the reasons set out at para 72 of the LBL Written Opening, it would only be if LBIE were wound up and if a call were made by LBIE's liquidators that a proof could be filed in LBL's administration (or a subsequent liquidation) in respect of any liability under s.74.

If LBIE is entitled to prove in the Members' administrations (or any subsequent liquidations), what effect does insolvency set-off have on the Members' respective non-subordinated debt claims?

18. The LBIE Joint Administrators' written opening (paras 152-155) argues that if there is no insolvency set-off in the insolvency of the company, there can be no insolvency set-off in the insolvency of the contributory. This is a *non sequitur*:

    (1) It is necessary to analyse the application of insolvency set-off in each of the insolvencies (i.e. LBIE's, and the Members') separately:

        a. For the reasons given above at para 14, there can be no set-off in LBIE's administration (or a subsequent liquidation) of the liability under s.74 and LBL's claim against LBIE. Insolvency set-off in LBIE's insolvency would provide the Members, effectively, with payment of their claims against LBIE £ for £, when other creditors are receiving but dividends on their debts, whereas the proceeds of a call ought to be shared rateably by the creditors of LBIE. Pursuant to **Grissell's Case**, there is no set-off in this situation.

        b. However, in the context of LBL's administration (or a subsequent liquidation), any claim of LBIE's administrators or liquidators would rank *pari passu* with LBL's other unsecured creditors. If and to the extent that LBL's claim against LBIE remained unsatisfied, and in particular given that LBIE is in administration, it would be unfair to LBL's other creditors if LBL had to pay LBIE a proof on the full value of any claim LBIE has against LBL, without deduction in respect of LBL's claim against LBIE (which is presently due and payable), because LBL would be writing LBIE a cheque of a higher value than would otherwise be the case (reducing the funds otherwise available to LBL's other creditors).[2]

    (2) As explained in Derham on the Law of Set-Off (4th edn.) at [11.06]-[11.11], it does not follow from the fact that where, in a double insolvency situation, there is no set-off in one of the insolvencies, that there can be no insolvency set-off in the other. Derham gives a number of reasons for this; that analysis is adopted here.

    (3) In **Re Duckworth** (1867) LR 2 Ch App 578, the Court of Appeal held that, when the

[2] That there should be a set-off in the context of LBL's administration (or liquidation) is supported by the extract from Etherton LJ's judgment in **Re Kaupthing** [2011] BCC 555 at [32] quoted at para 77 of the LBHI2 Joint Administrators' written opening, making clear that insolvency set-off is designed to "*promote speedy and efficient administration of the assets so as to enable a distribution to be made to creditors as soon as possible and in a manner which achieves substantial justice between the parties to the set-off and, so far as practicable, equality in the treatment of creditors.*"

liquidator of a company lodges a proof in the bankruptcy of a contributory in respect of a call, the contributory's trustee may bring into account a debt owing by the company to the contributory. This has been applied in a number of cases: see FN 320 of Derham, on p414. Although in **Re Auriferous (No. 1**), Wright J distinguished **Re Duckworth** where the contributory is a company that has gone into liquidation, as opposed to a bankrupt, there is no good reason for the distinction, and **Auriferous (No. 1)** should not be followed on this point (as suggested by Derham at [8.74] and FN 3 on p476).

(4) This is consistent with the fact that para 8 of Schedule 4 to the Act provides that one of a liquidator's powers (exercisable without sanction in any winding up) is "*Power to prove, rank and claim in the bankruptcy, insolvency or sequestration of any contributory for* ***any balance against his estate****, and to receive dividends in the bankruptcy, insolvency or sequestration* ***in respect of that balance****, as a separate debt due from the bankrupt or insolvent, and rateably with the other separate creditors*". This provision makes clear that there **is** a set-off between sums owed by the contributory to the company, and sums owed by the company to the contributory, in the context (and only in the context) of the company proving in the insolvency of the contributory.

(5) The LBIE Joint Administrators suggest, at para 153 of their written opening, that the correctness of **Re Auriferous (No. 1)** was confirmed by the Court of Appeal in **Re White Star Line Ltd** [1938] 1 Ch 458, 480. This is wrong. First, **Re White Star Line** was not a case where the contributory was in liquidation. The case did not concern whether insolvency set-off took effect in the contributory's liquidation (e.g. see 479: "*True it is that if the liquidator claimed that sum in the liquidation of the Royal Mail Co. he might have to be content with his right of proof. He is, however, not claiming any right to share in the assets of the Royal Mail Co."*). Second, at 480, it was **Re Auriferous (No. 2)** that Clauson LJ approved, not **Re Auriferous (No. 1)**.[3] As pointed out at para 44(2) of the LBL Written Opening, **Re Auriferous (No. 2)** was concerned with the ability of A's liquidator, in A's winding up, to withhold a dividend due to G against the liability of G for calls in arrears on its shares in A.

[3] Similarly, the reference in para 46 of the LBHI2 Joint Administrators' written opening to **Auriferous No. 1** as an authority in support of the "Contributory Rule" should be a reference to **Grissell's Case** or to **Auriferous No. 2**, both of which concerned whether there could be a set-off in the company's insolvency. **Auriferous No. 1** concerned whether there was a set-off in the contributory's insolvency. It is submitted that this decision is wrong on this point for the reasons given above and at paragraph 75 of LBL's Written Opening.

Question 3 and 11: the LBHI2 Sub-Debt

19. As regards the LBHI Sub-Debt, the LBHI2 Joint Administrators' written opening focuses upon the statutory scheme of distribution in insolvency, rather than upon the terms of the LBHI2 Sub-Debt themselves. But if there is no reason why a creditor cannot choose to subordinate his debt below the payment of other unsecured debts in the insolvency (see e.g. **Re Maxwell Communications Corp plc (No. 2)** [1993] 1 WLR 1402, *per* Vinelott J), there is no reason why he cannot choose to subordinate it below the payment of statutory interest.[4] The question is therefore whether, on the terms of the LBHI2 Sub-Debt, LBHI2 did so. For the reasons set out in particular in the LBIE Joint Administrators' written opening, LBHI2 did do so.

20. The suggestion by the LBHI2 Joint Administrators (and LBHI) that LBHI2 can prove in respect of the LBHI2 Sub-Debt before it ranks for dividend in LBIE's insolvency is not understood. If LBHI2 were to so prove (as it has done so) at that stage, LBIE's administrators (or liquidators) would be entitled to reject the proof. Thus, whilst, in practical terms, LBHI2 may be able to submit a proof of claim, that proof must be rejected unless and until Senior Liabilities have been paid in full. Until that date, even if there may be a proof, it is a worthless proof.

[4] This is supported by **Re British & Commonwealth Holdings plc (No. 3)** [1992] BCC 58, 65, as set out at FN 15 of the LBIE Joint Administrators' written opening.

Question 8: quantification of the Members' Potential Liability as Contributory

21. Lydian suggests, at para 40, that "*If the court's conclusion in this case is that the creditors of LBIE will take priority over the claims of members only in the event that LBIE is in, or will subsequently go into, liquidation, there could be no realistic doubt as to whether LBIE would go into liquidation, such that there would be no reason to discount the value of the contingent claim against members*". However:

    (1) This goes further even than the LBIE Joint Administrators' written opening. Para 6 of the LBIE Joint Administrators' written opening confirms – as one might expect – that whether LBIE will be wound up "*will depend upon what is in the creditors' best interests as a whole, taking into account, amongst other matters, the outcome of this Application*". Further, in the conclusion at para 13(a) of the LBIE Joint Administrators' written opening (p55), the LBIE Joint Administrators accept that one of the contingencies to be taken into account is "*LBIE going into liquidation and the making of a call*" (c.f. para 121 of the LBIE Joint Administrators' written opening, which states "*In estimating the value of the contingent claim, the relevant administrators would (at the relevant time) have to take into account the likelihood of LBIE going into liquidation…*").

    (2) LBIE has not suggested in its evidence that, if there is a shortfall for which the Members are liable under s.74, it will necessarily go into liquidation. WS/RD4 at [64]-[65] simply provides:

        > "I understand that, depending upon the outcome of certain issues in the Joint Application, it may, at some stage, be in the interests of LBIE's creditors for LBIE to enter into liquidation.
        > The LBIE Joint Administrators consider that all options are available with regard to whether LBIE might go into liquidation The LBIE Administrators will consider whether, and if so when, to place LBIE into liquidation, including in light of the Court's determination of the issues in the Joint Application. The LBIE Administrators' Proposals (as approved by creditors) expressly contemplate the possibility of a liquidation … Further if it is in the interests of creditors to do so, the costs of moving into liquidation are (relative to the potential sums at stake) de minimis."

    (3) LBIE may have many other reasons for going (or not going) into liquidation. For example, as set out below, if (contrary to the submissions of the LBIE Joint Administrators), post-administration interest under Rule 2.88(7) is not payable when a company moves into liquidation, this may well affect the circumstances in which the Joint Administrators of LBIE would wish to place LBIE into liquidation. If there is a surplus in the hands of the LBIE Joint Administrators, they would not wish to go into liquidation until that surplus has been applied in paying statutory interest under Rule 2.88(7). However, if the LBIE Joint Administrators do not have a surplus for the payment of statutory interest under Rule

2.88(7), and if there is a shortfall for the purposes of meeting LBIE's "*debts and liabilities*" such that it would be desirable to make a call on the Members (which could only be done in liquidation), the LBIE Joint Administrators would have to weigh up the benefit of making a call on the Members as against the effect of going into liquidation on post-administration interest. In either scenario, the LBIE Joint Administrators would be likely to wish to exhaust substantially all funds in their hands and realise substantially all assets in order to try to pay post-administration interest under Rule 2.88(7), before going into liquidation. There may also be e.g. tax considerations of going into liquidation.

22. Accordingly, when it is necessary to value the Potential Liability as Contributory, the relevant office holders would have to make a fair and genuine assessment of the prospect of LBIE going into liquidation, in addition to the other contingencies, and it is not the case (as suggested by Lydian but notably not by LBIE itself) that "*there would be no reason to discount the value of the contingent claim against members*".

23. The LBHI2 Joint Administrators state, at para 87 of their written opening, that the precise formula in Rule 2.105 does not apply for contingent debts, because the actual valuation exercise in relation to a contingent claim is not the same as the straight application of a formula, as is the case for future debts. However, they accept that the relevant administrator should take into account the fact that there is at present nothing due and payable. The LBIE Joint Administrators submit that Rule 2.105 (and Rule 11.13) does not apply to contingent debts and is, therefore, not relevant to the issues raised on the Joint Application (see paras 122-125 of their written opening). However, while Rule 2.105 applies to future debts, if it is clear in respect of a contingent claim that the claim will only be payable in future, and if an estimate can be made of that future date, there is no reason why the 5% p.a. discount in Rule 2.105 should not be applied. Any other approach would provide the party claiming in respect of the contingent claim with a windfall.

Question 9: the extent of the Potential Liability as Contributory

The liability under s.74 only extends to provable debts

24. The LBL Joint Administrators' position is that "*debts and liabilities*" in s.74 only encompasses debts provable in the company's liquidation. This is supported by the fact that other references in the Act to "*liabilities*" are to provable liabilities (as set out at para 57 of LBHI's written opening). It is also supported by the fact that the contributory's liability under s.74 in respect of future and contingent debts must, as set out at paras 70-73 of LBHI's written opening, be calculated by reference to the amounts for which such debts are provable in the company's liquidation, and by the fact that (as set out para 74 of LBHI's written opening) non-provable debts such as those which are statute-barred cannot fall within the liability under s.74.

25. Para 37 of Lydian's written opening argues that, because the liability under s.74 extends to adjusting "*the rights of the contributories among themselves*", "*it must follow that their obligation extends to any and all liabilities which rank for payment ahead of such payments to shareholders, including therefore any non-provable liabilities*". The LBIE Joint Administrators make a similar argument at paras 91 and 100 of their written opening. This is a *non sequitur*. It does not follow from the fact that calls may be made to adjust the rights of the contributories between themselves, that amounts which are not provable in LBIE's insolvency fall within the Members' liability under s.74. In particular, as explained in the LBL Written Opening (para 106), it must be the case that the liability under s.74 only extends to provable claims because the Members (and their creditors) cannot be placed in a worse position than the company itself.

Interest under s.189(2)

26. Interest under s.189(2) is not a "*debt or liability*" under s.74.

27. A number of other provisions of the Act expressly reference statutory interest, where it is intended to be taken into account (as set out at paras 58-59 of LBHI's written opening). Accordingly, the LBIE Joint Administrators' reliance upon the references to "*interest at the official rate*" in the context of s.89(1) and s.149(3) (at para 92 of its written opening) does not assist their position. On the contrary, the provisions suggest that, had it been intended that statutory interest would be included within the scope of the liability under s.74, s.74 would have expressly said so.

28. The LBIE Joint Administrators suggest at para 95 of their written opening that the fact that, in **Re Overnight Ltd** [2010] BCC 808, Roth J proceeded on the assumption that the liability to contribute to the assets of the company in the context of a fraudulent trading claim under s.213

included the liability of the company in respect of statutory interest, supports the argument that the liability under s.74(1) extends to statutory interest. However:

(1) S.213 provides:

> "(1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.
>
> (2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper."

(2) This provision concerns the liability of a person knowingly party to the carrying on of business for a fraudulent purpose. S.213(2) provides that the Court may declare such persons "*liable to make such contributions (if any)* ***to the company's assets as the court thinks proper***". It does not use the "*debts and liabilities*" language of s.74(1). Further, there may be good reasons of policy for subjecting those involved in fraudulent trading to extensive liability.

(3) Accordingly, whether or not the contributions that may be ordered under s.213 may extend to statutory interest is irrelevant to the scope of the liability of contributories carefully circumscribed under s.74(1).

(4) In any event, there does not appear to have been any argument in **Re Overnight Ltd** as to whether the contributions that may be ordered under s.213 may extend to statutory interest.

29. The LBIE Joint Administrators state, at para 101 of their written opening, that *"members must contribute an amount sufficient to ensure there is a surplus out of which post-administration interest can be paid*". But the suggestion that the Members must ensure "*there is a surplus*" does not make sense: it is not the function of a call to create a surplus. A surplus is something that is left over, not something that is brought in.[5] Further, in **Re Lines Bros Ltd** [1984] BCLC 215, Mervyn Davis J stated, at 223, in relation to the obligation to pay interest under s.33(8) of the Bankruptcy Act 1914:

> "At no stage can statutory interest be regarded as a debt or liability of the company. A liquidator's obligation under s 33(8) to pay interest out of a surplus is pursuant to a statutory direction to him, being an obligation which is part of the statutory scheme for dealing with a company's assets which comes into operation at the outset of the winding up."

[5] See e.g. the dictionary definition of a "surplus" (Shorter Oxford English Dictionary on Historical Principles, 5th edn.), viz. "*What remains in excess of what is needed or already used; an amount left over; spec. an excess of income or assets over expenditure or liabilities"*.

Interest under Rule 2.88(7)

30. The LBIE Joint Administrators argue that Rule 2.88(7) (post-administration) interest is payable in a winding up. They suggest, at para 104 of their written opening, that: "*Parliament clearly intended that: (i) creditors should be entitled to interest accruing during an administration before any return was made to members; and (ii) creditors should be entitled to interest accruing during a winding-up before any return was made to members. There is no logical or policy reason to permit assets of the insolvent company to be returned to members in priority to creditors' rights to interest accruing during the period of administration, simply because the administration is converted into winding-up before distribution is made*". They go on to argue, at para 107, that to "*avoid an obvious lacuna*", if an administrator has given notice of an intention to make a distribution to creditors, and the company subsequently goes into liquidation before all proofs of debt have been paid, but there is then a surplus (in the hands of the liquidator) after payment of all the debts proved, then either:

    (1) Rule 2.88(7) should be construed as applying to all creditors who actually prove thereafter (whether during the administration or after, there being no temporal limit as regards proving within the sub-rule) and s.189 is "*simply unnecessary*"; or

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

31. However, for the reasons set out at paras 50-55 of LBHI's written opening, the legislative provisions do not provide for this. There is a clear regime for post-administration interest to be payable in an administration out of a surplus in the hands of the administrator, and for post-liquidation interest to be payable in a liquidation out of a surplus in the hands of the liquidator. In particular:

    (1) Part 2 of the Rules is entitled "*Administration Procedure*". Rule 2.68(1) provides that chapter 10 of the Rules (which contains Rule 2.88) "*applies where the administrator makes, or proposes to make, a distribution to any class of creditors other than secured creditors….*". Section B of Chapter 10 provides the machinery of proving a debt in an administration. Rule 2.72(1) provides that "*A person claiming to be a creditor of the company and wishing to recover his debt in whole or in part must (subject to any order of the court to the contrary) submit his claim in writing to the administrator*"; Rule 2.72(2) provides that "*A creditor who claims is referred to as "*proving*" for his debt and a document by which he seeks to establish his claim is his "proof"*". The remainder of the chapter goes on to set out the procedure for proving a debt in an administration, and the

rules for quantifying certain types of claim (e.g. Rule 2.86 for debts in foreign currencies) and for set-off (Rule 2.85). In that context, Rule 2.88(7) provides *"Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company entered administration."* The *"surplus"* referred to in Rule 2.88(7) can only be construed as being the surplus in the hands of the administrator.

(2) Part 4 of the Rules concerns companies winding up, and Part 9 is entitled "*Proof of Debts in a Liquidation"*. Rule 4.73(8) provides: "*Where a winding up is immediately preceded by an administration, a creditor proving in the administration shall be deemed to have proved in the winding up*". Rule 4.93 provides for the proving of interest in respect of debts proved in the liquidation which bear interest, insofar as that interest is for periods before the relevant date. Rule 4.93(1) (in the terms in force when LBIE went into administration) provides:

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

(3) S.189 is contained in Chapter VIII of the Act ("*Provisions of General Application in Winding up"*). S.189(1)-(2) provide:

> "(1) In a winding up interest is payable in accordance with this section on any debt proved in the winding up, including so much of any such debt as represents interest on the remainder.
>
> (2) Any surplus remaining after the payment of the debts proved in a winding up shall, before being applied for any other purpose, be applied in paying interest on those debts **in respect of the periods during which they have been outstanding since the company went into liquidation.**"

(4) This provision can only be construed as applying to a surplus in the hands of the liquidator after payments of the debts proved in the winding up. Further, it clearly circumscribes what a liquidator should do with such a surplus. It cannot be treated as "*simply unnecessary"*, as suggested by the LBIE Joint Administrators.

(5) The whole structure of these provisions is that Rule 2.88(7) only applies to the surplus in the administration, and s.189(2) applies to the surplus in the liquidation.

(6) LBIE's argument that Rule 2.88(7) somehow survives the company's moving from administration into liquidation cannot be squared with the relevant provisions.

(7) It is also difficult to see how it could apply in practice. It would cause confusion, for example, if a company moves from administration into liquidation and it is only when the liquidators realise a large asset that there emerges a "*surplus*" under s.189(2). In those

circumstances, s.189(2) clearly provides that the surplus is to be applied to "*pay interest on [the debts proved in the winding up] in respect of the periods during which they have been outstanding since the company went into liquidation*". Rule 4.73(8) deems a creditor who proved in the administration to have proved in the winding up. Accordingly, under the clear words of s.189(2), that creditor's claims will only be payable from the surplus in respect of the period during which it has been outstanding "*since the company went into liquidation*". Rule 4.73(8) renders the LBIE Joint Administrators' alternative argument unsustainable.

(8) This is reinforced by the fact that, as is clear from Rule 2.88(1) in the version as it applies to LBIE's administration, interest is provable as part of the debt "*except in so far as it is payable in respect of any period after the company entered administration* ***or, if the administration was immediately preceded by a winding up, any period after the date that the company went into liquidation***". The absence of any equivalent wording in s.189 means that the LBIE Joint Administrators' argument is untenable.

(9) Accordingly, the LBIE Joint Administrators' argument that Rule 2.88(7) does not cease to apply because the administration is succeeded by a winding up (para 107(3) of their written opening) cannot be squared with the language of the relevant provisions.

32. While this result may appear unsatisfactory, that is what the provisions clearly provide. In this context it is worth noting the judgment of Briggs J in **Bloom v The Pensions Regulator** [2011] BCC 277. It was submitted in that case that the pre-2010 version of Rule 13.12 should be construed as if it had always provided for an administration cut-off date in the context of proof of debts in an immediately following liquidation (in accordance with the amendments made in 2010). Briggs J rejected this argument. The relevant passage is at [111]-[123]. In particular:

(1) At [111], Briggs J explained that:

> "Proof of debt and distribution to creditors within administration was introduced by the Enterprise Act 2002 . This led directly to the amendment of rule 13.12 by the addition of sub-paragraph (5), to which I have already referred. The Enterprise Act 2002 also introduced the facility for a company to move from administration into liquidation, and from liquidation into administration. This led to further amendments to the regime for quantification and proof of debt, in the Insolvency (Amendment) Rules 2005 (SI 2005/527)."

(2) At [112], Briggs J referenced the explanatory note of the Insolvency Service:

> ""As a result of the changes made to the law on administration by the Enterprise Act 2002 (c 40) a company can move between liquidation and administration or between administration and liquidation. Both of these procedures enable creditors to prove their debts at the date of the administration or liquidation respectively. By way of clarification of the existing rules, the amendments provide that the relevant date is the date of the first insolvency procedure commenced."

+-The rules affected are: rules 2.86, 2.87, 2.88, 2.89, 4.91, 4.92, 4.93 and 4.94."

(3) Briggs J went on, at [112], to explain that:

> "Part 2 of the Rules concerns administration procedure. Part 4 concerns winding up. Rules 2.86 and 4.91 both concern the debts in foreign currency, and provide for conversion into sterling on the relevant cut-off date. Rules 2.87 and 4.92 concern periodic payments, which are provable in relation to amounts due and unpaid up to the relevant cut-off date. Rules 2.88 and 4.93 concern interest, and prohibits proof of interest in respect of any period after the relevant cut-off date. Rules 2.89 and 4.94 concern future debts, and enable a creditor to prove for such a debt even if not due on the relevant cut-off date. In each case, the amendments introduced in 2005 do, as the explanatory note states, provide that, in relation to any proof of debt in an insolvency process (be it liquidation or administration) which is immediately preceded by the other type of insolvency process (administration or liquidation) the cut-off date is that applicable to the first of those two consecutive insolvency processes."

(4) Importantly, no relevant amendment was made to s.189(2) in this context.

(5) At [115], Briggs J referenced the submission that Rule 13.12 should be construed as always having contained the amendment introduced non-retrospectively in 2010 on the ground that the failure to introduce it earlier was an obvious drafting mistake, and to a passage of Lord Nicholls' speech in **Inco Europe Ltd v First Choice Distribution** [2000] 1 WLR 586, 592.

(6) "*Sorely tempted*" ([116]) though he was to accede to the submission, Briggs J concluded that it would not be a permissible exercise of the court's interpretive function, in particular because:

a. While he thought it probable that the failure to amend rule 13.12 in 2005 was a mistake, the result was that rule 13.12 was not amended in 2005. *"This is not therefore a question of correcting a drafting mistake in an amendment actually made to rule 13.12 , but rather the insertion of a whole new and important provision which is, quite simply, not there."* ([117])

b. The alteration in language required was very far-reaching in its effect, because Rule 13.12 is the primary rule governing the identification of the cut-off date for the purposes of proof in insolvency processes. ([118])

c. Although the omission was probably a mistake, he was not "*abundantly sure*" of that, the requisite standard laid down by Lord Nicholls. ([119])

d. At [120]:

> "there is in my view a subtle dividing line between dealing with drafting mistakes by construction, which is a task for the court, and dealing with them by subsequent

> amendment, which is a task for the legislature. In my judgment the present task falls clearly on the legislative side of that dividing line. The statutory provisions in question consist of important parts of a highly sophisticated and technical code set out in rules which have to be applied on a daily basis by busy insolvency practitioners who ought, in principle, to be entitled to read the rules and apply them in accordance with their language, at least where it is unambiguous. Rule 13.12, in its pre-April 2010 form, is unambiguous in that respect. It clearly provides that the cut-off date in a liquidation, and in an administration, is in each case the date of the commencement of that insolvency process. No ordinary process of construction would lead to the conclusion that, where for example liquidation immediately follows an administration, proof in that liquidation is governed by the administration cut-off date. On the contrary, a careful comparison between rule 13.12 and the amended rules in Parts 2 and 4 to which I have referred would suggest that the legislature had quite deliberately made a cautious and limited alteration to the general principle, in relation only to specific aspects of the proof regime."

e. At [121]:

> "I have no doubt that there will have been numerous cases between 2005 and 2010 of administrations followed by liquidation, in which the liquidators have dealt with creditors' claims upon the basis that the relevant cut-off date was the commencement of the liquidation, as unambiguously described by rule 13.12 in its then form. The decision not to make the 2010 amendments to rule 13.12 applicable to existing insolvency processes demonstrates to me that the draftsman (and therefore the legislature) must have thought so as well, and proceeded on the basis that, from 2005 until 2010, rule 13.12 did indeed mean what it clearly said."

f. At [122], treating rule 13.12 as always having contained, since 2005, the 2010 amendments would, in relation to such intervening insolvency processes "*cause an unacceptable degree of potential chaos*".

33. Many of the same reasons as given by Briggs J apply in this case so as to preclude the argument now made by the LBIE Joint Administrators about Rule 2.88(7). Accordingly, as LBIE would not be obliged to pay Rule 2.88(7) interest in the event of its going into liquidation, it must follow that, even assuming the Members are otherwise potentially liable to contribute pursuant to s.74, they have no potential liability to contribute extending to Rule 2.88(7) interest, contingent or otherwise.

Post-administration contractual claims for interest

34. The LBIE Joint Administrators suggest that winding up leaves the underlying liability, including in respect of interest, untouched (save to the extent it is paid out of dividends). See in particular paras 45-50 of their written opening. The LBIE Joint Administrators suggest that whilst post-administration interest is not provable, the contractual right to interest is not extinguished. At para 105 of their written opening, the LBIE Joint Administrators argue that where creditors have a contractual entitlement to interest, that liability, even though not provable, remains a liability of

the company and must be paid once all proved debts and statutory interest have been paid. These arguments cannot succeed, for the reasons set out at paras 82-88 of LBHI's written opening.

Question 10: how is the Members' Potential Liability as Contributory to be shared?

35. The LBHI2 Joint Administrators' written opening, at paras 93-98, does not engage with the position of the LBL Joint Administrators as regards the manner in which the liability under s.74 should be shared between the Members. Whilst para 96 states that the liquidator can "*adjust the position (to do justice between the contributories) in the event that, for whatever reason, one contributory has contributed significantly more than another*", and para 97 states that the liquidator can make "*relevant adjustments as between the contributories*", the LBHI2 Joint Administrators' written opening does not explain what those "*relevant adjustments*" would be.

36. The LBHI2 Joint Administrators also state, at para 96, that:

> "Each individual call liability is an individual liability (subject to the amount being challenged by the contributory against whom enforcement is sought) and, although it is fair to say that, overall the liability of contributories as a group to the liquidator of a company in liquidation who has made a call is 'joint and several' in the sense that payment by one contributory reduces the amount that would be needed from any other contributory it is not 'joint and several' in the sense that it gives a right, as between the contributories, for the contributories to claim contributions and/or indemnities from each other. Indeed, if contributories could do so, it would upset the statutory mechanism which is in place for the orderly collection of assets and their distribution in the circumstances of a liquidation."

37. The LBIE Joint Administrators' written opening refers, at para 75, to the liquidators' duty to adjust the "*rights of contributories so as to ensure that losses are evenly distributed amongst all the members*". This appears to envisage a contribution claim and/or acceptance that the shortfall should abate rateably.

38. If LBL pays more than its rateable share of any shortfall in LBIE, or a deduction is validly made by LBIE from LBL's claim against LBIE for more than that share, then, for the reasons set out in the LBL Written Opening, LBL is entitled to seek a contribution or indemnity from LBHI2. There is no reason why this would upset the statutory mechanism for collection and distribution of assets in a liquidation.

Question 12: Currency Conversion Claim

39. The LBIE Joint Administrators set out the alleged basis for the Currency Conversion Claim at para 52 of their written opening. At para 52(1), they state that:

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

40. This analysis is misconceived. A creditor has no contractual entitlement as to the means in which judgment and execution are obtained. Those are matters of enforcement, which are matters for the Court. In the context of claiming in an insolvency, the Rules now expressly set out the date for conversion of a foreign currency claim. The legislative background to Rules 4.91 and 2.86 set out at paras 136-140 of LBHI's written opening demonstrate that there can be no Currency Conversion Claim. In particular, para 3.47 of the Law Commission's Working Paper No. 80 Private International Law Foreign Money Matters [1981] EWLC C 80 makes clear 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…*". This was supported by the Cork Committee in particular at para 1309 of the Cork report. The "*once-for-all*" approach can be the only appropriate one, in particular given that – as set out at para 90 of the LBHI2 Joint Administrators' written opening – Lydian's approach appears to envisage that foreign currency creditors have an "upside only" option in this respect.

41. Lydian's written opening, at para 19, refers to authorities recognising a category of liabilities which are non-provable and which rank for payment following the discharge of provable debts and statutory interest, but prior to sums being returnable to members. As to these:

    (1) **Re Humber Ironworks & Shipbuilding Co** (1869) LR 4 Ch App 643 concerned post-liquidation interest, which is now expressly provided for in s.189(2).

    (2) **In Re T&N Ltd** [2006] 3 All ER 697 concerned tort claimants who did not suffer actionable damage until after the commencement of the winding-up, which is again now expressly provided for in Rule 13.12(2).

    (3) Whilst in **Re Nortel** [2013] 3 WLR 504, the Supreme Court recognised a category of non-provable liabilities to be discharged after statutory interest, they did not state what was encompassed within that category.

(4) Rule 12.3(2A) expressly provides:

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

(5) Accordingly, the legislative regime expressly recognises a category of non-provable claims payable when all other claims of creditors in the insolvency proceedings have been paid in full with interest. The Currency Conversion Claim does not fall within sub-para (a) of this Rule. It also does not fall within sub-para (c), "*any claim which by virtue of the Act or any other enactment is a claim the payment of which in a bankruptcy, an administration or a winding up is to be postponed.*" Rather than the Rules "*postponing*" Currency Conversion Claims, nothing in them recognises or supports the existence of such claims. On the contrary, the express provisions making clear that foreign currency claims are to be converted into sterling on the relevant date, together with silence as to any claim arising from any possible "loss" sustained by such conversion, strongly suggest that there are no such claims. It is also significant, as pointed out at para 125 of LBHI's written opening, that the provisions of Chapter 9 of part 4 of the Rules, including Rule 4.91, apply in a members' (solvent) voluntary winding up, in the same way as they apply in a creditors' voluntary winding up (Rule 4.1(1)).

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