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

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

Suggested pre-reading:

(1) The joint application for directions issued on 14 February 2013, as amended on 27 March 2013 (the "**Joint Application**") [1/1].
(2) Witness Statement of Anthony Victor Lomas dated 14 February 2013 ("**WS/AVL**") [3/1]
(3) Witness Statement of Michael John Andrew Jervis dated 14 June 2013 ("**WS/MJAJ**") [3/3]
(4) Witness Statement of Derek Anthony Howell dated June 2013 ("**WS/DAH**") [3/4]
(5) First Witness Statement of Elliot Greenberg dated 25 March 2013 ("**WS/EG1**") [3/2]
(6) Second Witness Statement of Elliot Greenberg dated 3 July 2013 ("**WS/EG2**") [3/5]
(7) Fourth Witness Statement of Russell Downs dated 2 August 2013 ("**WS/RD4**") [3/6]
(8) Fourth Witness Statement of Julian Edward Jones dated 6 September 2013 ("**WS/JEJ**") [3/7]
(9) Fifth Witness Statement of Russell Downs dated 25 September 2013 ("**WS/RD5**") [3/8]
(10) Second Witness Statement of Michael John Andrew Jervis dated 9 October 2013 ("**WS/MJAJ2**")
(11) Chronology [1/5]
(12) Statement of Agreed Facts [1/4]
(13) List of Issues [1/3]
(14) The parties' written opening submissions for trial

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Introduction

1. These are the written opening submissions of the LBL Joint Administrators for the trial of the Joint Application. They adopt the definitions in the Joint Application.

2. The Joint Application raises a number of interesting issues of company and insolvency law, in particular relating to the nature and extent of the potential liabilities of the Members of LBIE (an unlimited company), LBL (holding one ordinary $1 share) and LBHI2 (holding 2 million 5% redeemable preference shares of $1000 each, 5.1 million 5% redeemable Class B shares of $1000 each and 6,273,113,999 ordinary shares of $1 each), and as to questions of priority and set-off in the 3 estates (LBIE, LBHI2 and LBL).

3. A key immediate issue is whether LBIE ought (as the Members contend) to be paying distributions to the Members in respect of their unsubordinated claims against LBIE (which are not made *qua* members), along with other unsecured creditors (to whom distributions have been made of 68.5p in the £), or whether the LBIE Joint Administrators are entitled to withhold distributions on the basis of the Members' Potential Liability as Contributory, the liability under s.74 of the Act only arising if LBIE goes into liquidation and is unable from its own assets to pay its debts and liabilities and the expenses of the winding-up. Another very important issue from LBL's perspective is the fact that cash held is now in excess of £170m (the figure contained in the LBL Joint Administrators' latest progress report). This sum is potentially available for distribution to unsecured creditors, and the LBL Joint Administrators are very keen to make a distribution to unsecured creditors. However, in order that they can do so, further clarity as to the nature and extent of LBL's potential liability to LBIE, and its effect, is required.

4. The Court's answers to the questions raised by the Joint Application will provide the respective administrators with clarity as to the assets and liabilities of the three Applicants' estates, and will accordingly have a significant impact upon the funds available for distribution to the Applicants' creditors (including the two Respondents). As the Court will appreciate, the financial value of the issues raised is high (and, in some cases, very high).

5. Whilst there has been a disclosure exercise and each of the parties has filed witness statements, it is not anticipated that the Court will be required to determine any dispute of fact.[1]

6. The questions as formulated in the Joint Application differ slightly from those in the List of

[1] There appears to be a level of disagreement between WS/RD5 and WS/JEJ as to: (i) the reason for repayments of LBHI2 Sub-Debt after 30 November 2007; (ii) whether or not it can be concluded that the LBHI2 Sub-Debt outstanding at LBIE's entry into administration was all drawn under the Short-Term Facility. However, it is not anticipated that these issues will have any material bearing on the Court's determinations.

Issues. These submissions are primarily structured by reference to the questions as formulated in the Joint Application. After a summary of the LBL Joint Administrators' position in relation to those questions, and a detailed consideration of them (in a convenient order), the LBL Joint Administrators' position in relation to the issues as formulated in the List of Issues is set out by way of conclusion.

7. These written opening submissions are lengthy. It is hoped that, given that the issues to be determined are almost entirely questions of law, setting out the position of the LBL Joint Administrators in detail in writing will be of assistance and will enable a speedier trial timetable.

Background

8. There is relatively little by way of factual background that has any real impact on the issues to be determined, and there do not appear to be any material disputes of fact. The key facts which give rise to the Joint Application, all of which are common ground, are as follows:

(1) LBIE is an unlimited company. It re-registered as an unlimited company on 21 December 1992,[2] and it appears this was driven by US tax considerations.[3] Copies of LBIE's most recent Articles and Memorandum of Association are at [4/1-13].

(2) LBIE was the principal trading company within the European Lehman Brothers group of companies.

(3) LBL and LBHI2 are the only shareholders of LBIE:

a. LBL holds one ordinary share of $1; and

b. LBHI2 holds 6,273,113,999 ordinary shares of $1 each, 2 million 5% redeemable preference shares of $1,000 each, and 5.1 million 5% redeemable Class B preference shares of $1,000 each.

(4) On 1 November 2006, LBIE entered into the following subordinated loan agreements with its new direct parent company, LBHI2:

a. A €3bn Long Term Subordinated Loan Facility (the "**Long Term Euro Facility**");

b. A $4.5bn Long Term Subordinated Loan Facility (the "**Long Term Dollar Facility**", and, together with the Long Term Euro Facility, the "**Long Term Facilities**"); and

c. An $8bn Short Term Subordinated Loan Facility (the "**Short Term Facility**", and, together with the Long Term Facilities, the "**LBHI2 Sub-Debt Agreements**").

(5) The LBHI2 Sub-Debt Agreements all contain essentially the same subordination provisions.

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[2] WS/MJAJ at [8]; [8/1/117]; [5A/25-40].
[3] See WS/RD4 at [11]-[12]; [8/1/118-119].

(6) The sums outstanding under the LBHI2 Sub-Debt Agreements were $2.225bn at the date of LBIE's entry into administration (WS/RD4 at [55]).

9. In addition to the sums owing under the LBHI2 Sub-Debt Agreements, there are a number of other inter-company claims, which are summarised in the structure diagram at [4/25]. In summary:

(1) On 21 December 2011, LBL lodged a proof of debt for £362,673,342.99 in LBIE's administration [4/177-194], which figure is the subject of discussions between the Joint Administrators of LBL and LBIE (see WS/MJAJ at [35]-[37]; WS/RD4 at [60]-[61]; WS/MJAJ2 at [6]-[8])[4]. It is clear that LBL will be a creditor of LBIE, and LBL's claim against LBIE appears to relate wholly to the provision of services by LBL for LBIE's benefit (WS/MJAJ at [37]).[5]

(2) On 24 April 2012, LBHI2 lodged a proof of debt in LBIE's administration [4/196-209] in respect of unsecured claims for:

a. £38,089,911.30; and

b. £1,254,165,598.48, pursuant to the LBHI2 Sub-Debt Agreements.

(3) As to the £38 million sum, WS/RD4 states at [63]: "*The quantum of the claim accords with the value stated in both estates' statement of affairs. The transactions comprising the balance are to be the subject of a more detailed review over the coming weeks but the LBIE Administrators' current view is that this amount will not be subject to change.*"

(4) The LBIE Joint Administrators have not yet formally admitted or rejected LBL's and LBHI2's respective proofs in LBIE's administration pending determination of the other relationships between the parties, some of which are the subject of the Joint Application (WS/AVL at [24]).

(5) WS/AVL at [26] says that, according to the Lehman Group accounting system, DBS,

[4] The LBL Joint Administrators' tenth progress report for the period 15 March 2013 to 14 September 2013 provides that LBL has submitted claims in the estate of LBIE and LBEL, which claims are potentially subject to adjustment in respect of both costs incurred by LBL in relation to the provision of services but not recharged prior to administration (e.g. capitalised costs depreciated over time), and accrued costs recharged by LBL prior to administration that may not materialise. It states that LBL is in discussions with the administrators of LBIE and LBEL with the objective of identifying and as far as possible agreeing adjustments to LBL's claims to reflect costs actually incurred by LBL.

[5] LBL also notified LBIE on 13 September 2012 that it reserved the right to make additional claims against LBIE in relation to the deficit in the Pension Scheme [4/195].

LBHI2 has an approximately £257m unsecured inter-company claim in LBL's administration, and that LBHI2 has yet to lodge its proof of debt in LBL's administration in respect of this amount. This claim has not been admitted by the LBL Joint Administrators.

(6) The Second Respondent ("**Lydian**") has lodged an unsecured claim in the amount of £122 million and a contingent unsecured claim in the amount of £25 million in LBIE's administration [7/1-14].

10. As to the progress of the respective administrations:

(1) In relation to LBL:

a. WS/MJAJ at [24] provides that the LBL Joint Administrators presently have net realisations of approximately £160m, which sum is potentially available for distribution to LBL's unsecured creditors, and that total realisations may ultimately be in the region of £300m. The LBL Joint Administrators' tenth progress report for the period 15 March 2013 to 14 September 2013 states that cash held is now £170.1m. Material further realisations are anticipated. One of the issues raised by the Joint Application is whether LBL can prove and receive distributions in LBIE's administration in respect of its claim in LBIE. If it can, this will significantly increase the assets available to be distributed to LBL's creditors.

b. Current estimated unsecured claims into LBL remain uncertain but the possible range of unsecured claims is between £480m and £790m (which does not include any sums in respect of which LBIE may seek to prove in relation to the Potential Liability as Contributory). Preferential claims into LBL are expected to be approximately £1.9m and the LBL Joint Administrators have commenced payment of agreed preferential claims in instances where the creditors have confirmed personal details and have provided relevant bank information for payments. (WS/MJAJ at [26])

c. The High Court granted an order on 2 November 2011 to further extend the period of LBL's administration to 30 November 2013 (WS/MJAJ at [23]).

d. The LBL Joint Administrators are concerned to distribute a meaningful dividend to LBL's creditors as soon as possible but can only do so once there is certainty around what level of reserve, if any, to make for a possible claim by LBIE in relation to LBL's Potential Liability as Contributory: WS/MJAJ at [28]. In particular:

(i) If LBL is not liable to LBIE for any amount, it may ultimately be able to pay a dividend of more than 30p in the £ to its creditors; and potentially more than 50p in the £ if its claim against LBIE is admitted and paid.

(ii) If LBL's Potential Liability as Contributory extends to post-administration interest on LBIE's claims, this will result in LBL being able to pay only a very small dividend of perhaps a few pence in the £ to its creditors. If LBL's Potential Liability as Contributory extends to the LBHI2 Subordinated Debt, the dividend LBL will be able to pay to its creditors will be further reduced. (WS/MJAJ at [30])

(2) In relation to LBIE:

a. The LBIE Joint Administrators have obtained an order extending LBIE's administration until 30 November 2016 [6B/745-748].

b. By order dated 2 December 2009, the LBIE Joint Administrators were granted permission to make a distribution to LBIE's unsecured creditors [4/172]. On 4 December 2009, the LBIE Joint Administrators gave notice of their intention to make a distribution to LBIE's unsecured creditors under Rule 2.95 ([4/176]; WS/AVL at [20]). On 26 November 2012, the LBIE Joint Administrators sent out a notice, pursuant to Rule 2.98, declaring a first interim dividend of 25.2p in the £ (the "**First Interim Dividend**"), to all LBIE's unsecured creditors whose claims have been admitted for dividend purposes. The LBIE Joint Administrators paid the First Interim Dividend to LBIE's unsecured creditors on 30 November 2012. Funds disbursed were approximately £1,611,000,000. (WS/AVL at [25])

c. The LBIE Joint Administrators obtained an order from the court on 26 April 2013 permitting them to make further distributions out of LBIE's administration as they consider appropriate without the need, in each case, to return to the court for further approval [6B/742-744].

d. On 8 May 2013, the LBIE Joint Administrators announced that they intended to pay a second interim dividend (and a first preferential dividend) to LBIE's creditors on or around 28 June 2013 [5B/636-637]. On 19 June 2013, the LBIE Joint Administrators declared a second interim dividend of 43.3p in the £ to be made around 28 June 2013. Thus LBIE has paid dividends to date amounting to 68.5p in the £ (WS/RD4 at [57]).

e. Prices in the secondary debt market for ordinary unsecured LBIE debt have been in excess of 100p in the £, suggesting that the market anticipates there will be a payment of statutory interest to unsecured creditors (see WS/AVL at [9]; WS/MJAJ at [40]; WS/RD4 at [57]).

f. The LBIE Joint Administrators' tenth progress report for the period 15 March 2013 to 14 September 2013 states that:

(i) The LBIE Joint Administrators continue to observe the secondary market pricing for claims against the LBIE estate *"and are aware that many market participants are currently of the view that the eventual return to unsecured creditors will be substantially more than the principal sum owed, on account of the payment of a certain amount of post-Administration interest. Whilst this outcome looks increasingly likely it is by no means assured...."*

(ii) The LBIE Joint Administrators plan to make a third interim distribution to unsecured creditors on or around 29 November 2013. The report states that it is possible that cumulative dividends on unsecured claims are likely to reach 100% some time in 2014.

(iii) Subject to a number of assumptions, the potential range of House[6] recoveries that could eventually be available for distribution to unsecured creditors (not taking into account any contribution from LBHI2 or LBL) is estimated to be between £15.87bn and £18.84bn, and the potential range of claims that are expected to participate in any distribution is estimated to be between £13.59bn and £17.0bn, excluding the Members' claims and claims for the payment of post-administration interest. This leads to a range of (deficiency)/ surplus before the Members' claims and post-administration interest of (£1.13bn) and £5.25bn. The report provides that *"The recent strengthening in the financial position of the Administration now suggests that an outcome close to 100% recovery is likely in the Low case scenario, whilst in the High case scenario there would be sufficient funds to settle in full all ordinary ranking (unsubordinated) claims with a significant surplus available to fund claims by Shareholders and/or other unsecured creditors' claims for post-Administration interest."* The statement is presented on the basis that all potential claims by the

[6] "House"/"House Estate" are defined in the glossary to the report as meaning "*Dealings that relate to LBIE's general unsecured estate*" and the term is so used in this document.

Members are subordinated to other unsecured creditors.

(iv) The LBIE Joint Administrators are developing a methodology for resolving the determination of post-administration interest claims that become payable pursuant to Rule 2.88 and the surplus distribution priorities. The issues are complicated by a number of factors, including: (i) the rate of interest; (ii) the commencement date for the determination of accrued post-administration interest. Because of the delay that would be caused in attempting to obtain resolution of the issues from the High Court, the LBIE Joint Administrators consider that the interests of creditors are best served by them developing a simplifying methodology to determine creditors' post-administration interest claims. It is possible that the chosen post-administration interest resolution mechanism will be implemented by a CVA or a Scheme of Arrangement, alternatively, a consensual solution.

(v) The LBIE Joint Administrators have yet to determine the most appropriate exit.

g. At 8% per annum simple on the balance of any claims at any one time, from the date that LBIE went into administration (15 September 2008), the total amount of post-administration interest on LBIE's claims – if payable - is likely to amount to a significant proportion of the total amount of unsecured claims (WS/MJAJ at [29]). For example, simple interest at 8% for 5 years would amount to 40%, totalling £5.436bn on the low case of £13.59bn for claims in LBIE. This is in excess of the £5.25bn high case of surplus in LBIE (before payment of the Members' claims and post-administration interest) identified in the LBIE Joint Administrators' 10th progress report, as set out above.

(3) In relation to LBHI2:

a. WS/AVL says at [16] that the LBHI2 Joint Administrators have made realisations to date of approximately £22.5m, and that LBHI2's principal assets are its inter-company claims against LBL and LBIE, together with a guarantee claim against LBHI in respect of the balances owed to LBHI2 by LBIE.

b. The LBHI2 Joint Administrators' 9th progress report for the period 14 January to 13 July 2013 provides (*inter alia*) that:

(i) The current administration expires on 30 November 2013, but the

administrators intend to apply for an extension.

(ii) On 11 October 2011, the LBHI2 Joint Administrators entered into a settlement agreement with LBHI, pursuant to which LBHI2 had its claim against LBHI agreed at $2.7m in respect of direct claims and $302m in respect of guarantee claims. Further to previous distributions, LBHI2 received $11.7m from LBHI in respect of its agreed claims, bringing total realisations from LBHI to $34.7m. Further dividends are to be received from LBHI on a six-monthly basis.

c. The press release in respect of LBHI2's commitment letter and heads of terms (the "**Transaction**") with Elliott Management Corporation ("**Elliott**") (and certain affiliates) and King Street Capital Management LP ("**King Street**") (and certain affiliates) and LBHI was before the Court at the PTR. It states, in particular, that the Transaction provides for an initial payment to LBHI2 of approximately £650m along with the right to receive future contingent sums, and that, in turn, Elliott and King Street, alongside LBHI2 will acquire rights with respect to all of LBHI2's claims against LBIE. It also states that the Transaction provides for LBHI2 to share in certain claims against the LBIE estate held by Elliott and King Street.

Summary of the LBL Joint Administrators' position in relation to the questions as formulated in the Joint Application

11. The LBL Joint Administrators' position in relation to the issues raised by the Joint Application, answering the questions as formulated in the Joint Application, is as follows.

12. **Question 1**. Are the members of LBIE (being LBHI2 and LBL) (together, the "**Members**") entitled to prove in LBIE's administration in respect of sums owed by LBIE to the Members (other than in respect of sums owed to LBHI2 pursuant to three subordinated loan agreements entered into on 1 November 2006 between LBHI2 (as lender) and LBIE (as borrower) (the "**LBHI2 Subordinated Debt**")) notwithstanding that LBIE is an unlimited company and, in the event of LBIE being wound up, one or both of the Members may be called upon to contribute, pursuant to Section 74 of the Act, to LBIE's assets an amount sufficient for payment of LBIE's debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories amongst themselves (hereinafter defined in respect of each member as the "**Potential Liability as Contributory**")? In particular, what (if any) is the effect of Section 74(2)(f) of the Act on each of the Members' Potential Liability as Contributory?

    Answer: Yes, LBL is entitled to prove in LBIE's administration in respect of the sum owed by LBIE to it. The Potential Liability as Contributory has no bearing on this question, given in particular that: (i) LBIE is not in liquidation; (ii) it is not clear whether there will be a shortfall in LBIE; and (iii) no call has been made upon LBL (and, in any event, calls can only be made by liquidators, not administrators). The LBIE Joint Administrators are not entitled to withhold payment of a distribution to LBL on the basis of its potential liability to contribute under s.74. It is common ground that s.74(2)(f) does not have the effect of subordinating LBL's claim against LBIE to the claims of LBIE's other creditors, because LBL's claim is not made in its character as a member. Accordingly, LBL's claim against LBIE should rank *pari passu* along with those of LBIE's other unsecured creditors and the LBIE Joint Administrators should pay LBL a catch-up dividend equivalent to that which has been paid to LBIE's other unsecured creditors, and continue to pay LBL dividends in respect of its claim as and when further dividends are distributed to unsecured creditors.

13. **Question 2.** If LBIE were wound-up, would the Members be entitled to prove in LBIE's liquidation in respect of sums owed by LBIE to the Members (other than in respect of the LBHI2 Subordinated Debt)? In particular, to what extent would the Members' ability to prove in a winding-up of LBIE be affected by: (i) each of the Members' Potential Liability as Contributory; and (ii) Section 74(2)(f) of the Act?

Answer: Yes, LBL would be entitled to prove in LBIE's liquidation (if it were wound up) in respect of the sum owed by LBIE to it (to the extent that its claim is not met by distributions in LBIE's administration). It is common ground that s.74(2)(f) does not have the effect of subordinating LBL's claim against LBIE to the claims of LBIE's other creditors, because LBL's claim is not made in its character as a member. Accordingly, LBL's claim against LBIE should rank *pari passu* along with those of LBIE's other unsecured creditors. As to insolvency set-off / **Cherry v Boultbee,** see question 4 below.

14. **Question 3:** Is LBHI2 entitled to prove in LBIE's administration, or would LBHI2 be entitled to prove in any subsequent liquidation of LBIE, in respect of the LBHI2 Subordinated Debt notwithstanding: (i) the terms of the LBHI2 Subordinated Debt; and (ii) LBHI2's Potential Liability as Contributory? What (if any) is the effect of Section 74(2)(f) of the Act?

Answer: In accordance with the terms of the LBHI2 Subordinated Debt, and in particular Standard Term 5 thereof, LBHI2's rights in respect of the LBHI2 Subordinated Debt "*are subordinated to the Senior Liabilities*", which include post-insolvency interest. In the circumstances, as a matter of the contractual terms governing the LBHI2 Subordinated Debt, LBHI2 is not entitled to prove (or receive dividends) in LBIE's administrations in respect of the LBHI2 Subordinated Debt until Senior Liabilities are paid in full. Further, payment of any amount is, under the LBHI2 Subordinated Debt, contractually 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'*". Standard Term 5(2) provides that, for this purpose, LBIE will be "*solvent*" only 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*". As explained below (Question 9), whether LBIE is "*solvent*" for the purposes of the LBHI2 Subordinated Debt must be determined without reference to contributions from the Members. It is uncertain whether LBIE will be able to pay its general, unsecured creditors in respect of both the principal of the debts and liabilities owed to them by LBIE and statutory interest. If it cannot, under the terms of the LBHI2 Subordinated Debt, no payment is due to LBHI2.

15. **Question 4:** In the case of each of questions 1-3 above, to the extent that there is an entitlement to prove, in so proving, is credit required to be given or is any deduction to be made in respect of each of the Members' Potential Liability as Contributory either: (i) by way of insolvency set-off (set out in Rules 2.85 and 4.90 of the Insolvency Rules 1986 (the "**Rules**") as applicable); and/or (ii) pursuant to the rule in *Cherry v Boultbee* 41 ER 171; and/or (iii) otherwise?

Answer: Credit would only be required to be given, or a deduction would only be required to be made, if LBIE goes into liquidation and is unable from its own assets to meet its debts and liabilities or the expenses of the winding up, and if a valid call were made on LBL by LBIE's liquidators. In those circumstances, the LBIE liquidators would be entitled to rely upon the rule in **Cherry v Boultbee**. This would have the effect that the value of LBIE's total pool of assets (including contributions from the Members) should be ascertained, and from that the dividend rate to all creditors (including LBL) should be calculated. If the amount payable to LBL by LBIE at this dividend rate is greater than the contribution from LBL, then the difference should be paid to LBL. If the amount payable to LBL by LBIE at this dividend rate is less than the contribution from LBL, then nothing would be payable to LBL. For the purposes of this calculation, the contribution from LBL to be accounted for is the dividend payable by LBL's estate in respect of the proof by LBIE's liquidators.

16. **Question 5:** Is LBIE entitled to prove in the administrations (or would LBIE be entitled to prove in any subsequent liquidations) of the Members in respect of each of the Members' Potential Liability as Contributory?

Answer: LBIE could only so prove (through its liquidators) in LBL's administration (or any subsequent liquidation) if it went into liquidation and was unable from its own assets to pay its debts and liabilities and the expenses of the winding up, and if a valid call were made on LBL. Further, LBIE's liquidators could only prove in respect of the balance, taking into account the extent to which LBL's claim against LBIE remained unsatisfied.

17. **Question 6**: If LBIE is entitled to prove in the Members' administrations (or any subsequent liquidations) as described in question 5 above, what effect (if any) does:

(1) Insolvency set-off have on the LBHI2 Subordinated Debt?

(2) Insolvency set-off have on the Members' respective non-subordinated debt claims?

(3) The rule in *Cherry v Boultbee* have on the LBHI2 Subordinated Debt?

(4) The rule in *Cherry v Boultbee* have on the Members' respective non-subordinated debt claims?

(5) Any other relevant form of set-off or deduction have on: (a) the LBHI2 Subordinated Debt; and/or (b) the Members' respective non-subordinated debt claims?

Answer: If LBIE is entitled to prove in LBL's administration (or any subsequent liquidation) as described in question 5, insolvency set-off would take effect so as to require an account to be taken of the amount for which LBIE is entitled to prove, and LBL's claim against LBIE (to the extent it remains unsatisfied). Alternatively, the LBL Joint Administrators (or LBL's liquidators) could rely upon the rule in **Cherry v Boultbee**.

18. **Question 7:** What (if any) is the effect of Section 149 of the Act on:

    (1) Any proof submitted by either of the Members in LBIE's administration or (if LBIE were wound-up) liquidation?

    (2) Any proof submitted by LBIE in either of the Members' respective administrations or (if either of the Members were wound-up) liquidations?

    Answer: S.149(1) provides a summary remedy for the recovery of moneys due from a contributory, in its capacity as such, other than money payable by virtue of any call in pursuance of the Companies Act or the Act. It only applies "*at any time after* [the court] *making a winding-up order*". When an order is made under s.149(1), in the case of an unlimited company, the court may allow the contributory by way of set-off any money due to him or the estate which he represents from the company on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit. The Potential Liability as Contributory could not be the subject of an order under s.149(2)(a), because it is a liability to pay money by virtue of a call in pursuance of the Act. The LBIE Joint Administrators' position paper states (at para 7(c)) that the LBIE Joint Administrators do not believe that the Members owe any other obligations to LBIE in their capacity as contributories. If that is correct, s.149(2)(a) would not have any effect on either (i) a proof submitted by either of the Members in LBIE's administration or any subsequent liquidation, or (ii) a proof submitted by LBIE in either of the Members' administrations (or subsequent liquidations).

19. **Question 8:** To the extent that LBIE is entitled to prove in respect of it, or it is required to be brought into the account on any proof which either of the Members is entitled to file in LBIE's administration or a subsequent liquidation, in circumstances in which each Member's Potential Liability as Contributory is contingent, is that Member's Potential Liability as Contributory capable of being ascertained and quantified and, if so, how should the quantum of that Member's Potential Liability as Contributory be quantified?

    Answer: If LBIE were entitled to prove in the Members' administrations/liquidations in respect

of the Potential Liability as Contributory, the Members' administrators/liquidators would have to make a genuine and fair assessment of the likelihood of the contingencies which trigger the liability under s.74 occurring, including: (i) LBIE going into liquidation; (ii) there being a shortfall for which the Members may be liable to contribute under s.74; (iii) a call being made on the contributory; (iv) the quantum of the call on the contributory, as to which the Court's determinations in particular in relation to questions 9 and 10 of the Joint Application will provide guidance. Additionally, for the purposes of any dividend payable to LBIE, there should be a discount to reflect any accelerated receipt pursuant to the formula in Rule 2.105.

20. **Question 9:** Whether, and in what circumstances each of the Member's Potential Liability as Contributory extends to contributing to LBIE's assets an amount sufficient for payment of:

    (a) Interest provable and/or payable pursuant to Rule 2.88 of the Rules on the principal of the debts and liabilities owed to LBIE's creditors by LBIE; and/or

    (b) The LBHI2 Subordinated Debt; and

    (c) Currency Conversion Claims (as defined at question 12 below), to the extent that question 12 is answered in the affirmative.

    Answer: The Members' Potential Liability as Contributory does not extend to any of these items.

21. **Question 10:** In the event that the Members are obliged to contribute to the assets of LBIE pursuant to Section 74 of the Act, and in light of the fact that LBL owns one ordinary share of $1 in LBIE, and LBHI2 owns 2 million 5% redeemable Class A preference shares of $1000 each, 5.1 million 5% redeemable Class B shares of $1000 each and 6,273,113,999 ordinary shares of $1 each in LBIE:

    (a) Whether their obligations are joint, several or otherwise as against LBIE;

    (b) Whether they are entitled to seek a contribution or indemnity from one another in respect of any payments made pursuant to any such obligation and, if so, the nature and extent of such right of contribution or indemnity;

    (c) To what extent any right to contribution or indemnity as referred to in sub-paragraph (b) above is affected by any other claims which LBHI2 and LBL have against one another.

Answer: The liability of the Members as contributories under s.74(1) should be shared rateably between them in proportion to the aggregate nominal value of their shareholdings in LBIE. This has the consequence either that:

(1) If LBIE goes into winding up, LBIE's liquidators, to whom the power in respect of the making of calls is delegated and is exercisable as officers of the court subject to the court's control, should make calls on the Members in proportion to their rateable shares of the shortfall (in accordance with the liquidator's duty to adjust the rights of the contributories among themselves); or

(2) If and to the extent that a call is made on LBL, or a deduction is validly made by LBIE in respect of, the liability (or potential liability) under s.74 in excess of LBL's rateable share of any shortfall in LBIE if it is wound up, LBL is entitled to seek a contribution or indemnity from LBHI2.

22. **Question 11**: In the event that there are sufficient funds in LBIE's administration to permit the LBIE Joint Administrators to make payment in full to LBIE's general, unsecured creditors in respect of the principal of the debts and liabilities owed to them by LBIE, in what order would the LBIE Joint Administrators be required to apply any surplus in discharging the following:

(a) Interest payable on such debts and liabilities in respect of the periods during which they have been outstanding since LBIE entered administration pursuant to Rule 2.88(7) of the Rules;

(b) Currency Conversion Claims (defined at question 12 below), to the extent that question 12 is answered in the affirmative;

(c) To the extent that the Members have been unable to prove in respect of them, debts owed by LBIE to the Members (other than in respect of the LBHI2 Subordinated Debt); and

(d) To the extent that LBHI2 has been unable to prove in respect of it, the LBHI2 Subordinated Debt.

Answer: In the event that there are sufficient funds in LBIE's administration to permit the LBIE Joint Administrators to make payment in full to LBIE's general, unsecured creditors in respect of the principal of the debts and liabilities owed to them by LBIE (which would include unsubordinated claims of the Members which are not *qua* member):

(1) Any surplus should then be applied to the payment of interest on such debts and liabilities

(including the sums owed by LBIE to LBL in respect of the periods during which they have been outstanding since LBIE entered administration), pursuant to Rule 2.88(7) of the Rules.

(2) Under the terms of the LBHI2 Subordinated Debt, if LBIE has no sums remaining after payment of interest pursuant to Rule 2.88(7), nothing is payable to LBHI2.

(3) There is no Currency Conversion Claim.

23. **Question 12:** Is an unsecured creditor, with a contractual entitlement to payment from LBIE in a currency other than sterling (the "**Contractual Currency**"), entitled, following payment in full of:

(i) All creditors' proved debts; and

(ii) Interest on such debts in respect of periods during which they have been outstanding since LBIE entered administration pursuant to Rule 2.88(7) of the Rules;

to payment from LBIE in a sum equal to the difference between (a) the amount of its contractual entitlement to payment in the Contractual Currency and (b) the amount received by it in respect of its proved debt against LBIE, converted into the Contractual Currency as at the date of payment (such claim being referred to as a "**Currency Conversion Claim**")?

Answer: No.

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

24. **Question 1**. Are the members of LBIE (being LBHI2 and LBL) (together, the "**Members**") entitled to prove in LBIE's administration in respect of sums owed by LBIE to the Members (other than in respect of sums owed to LBHI2 pursuant to three subordinated loan agreements entered into on 1 November 2006 between LBHI2 (as lender) and LBIE (as borrower) (the "**LBHI2 Subordinated Debt**")) notwithstanding that LBIE is an unlimited company and, in the event of LBIE being wound up, one or both of the Members may be called upon to contribute, pursuant to Section 74 of the Act, to LBIE's assets an amount sufficient for payment of LBIE's debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories amongst themselves (hereinafter defined in respect of each member as the "**Potential Liability as Contributory**")? In particular, what (if any) is the effect of Section 74(2)(f) of the Act on each of the Members' Potential Liability as Contributory?

25. **Question 2:** If LBIE were wound-up, would the Members be entitled to prove in LBIE's liquidation in respect of sums owed by LBIE to the Members (other than in respect of the LBHI2 Subordinated Debt)? In particular, to what extent would the Members' ability to prove in a winding-up of LBIE be affected by: (i) each of the Members' Potential Liability as Contributory; and (ii) Section 74(2)(f) of the Act?

Introduction

26. LBL, LBHI2 and LBHI all contend that the Members ought to be able to prove and receive dividends in LBIE's administration (or any subsequent liquidation) in respect of debts owed to them (excluding for present purposes the LBHI2 Sub-Debt), along with LBIE's other unsecured creditors, and that the LBIE Joint Administrators are not entitled to withhold distributions from the Members (subject to question 4 below, in the context of a winding-up of LBIE).[7]

27. For the reasons set out below:

    (1) LBL is entitled to prove, and receive dividends, in LBIE's administration (or a subsequent liquidation) in respect of its claim against LBIE along with LBIE's other unsecured creditors. S.74(2)(f) of the Act only subordinates claims of members in their character as members. The insolvency legislation does not establish a general principle that members' claims are subordinated to those of all other creditors.

[7] Certain paragraphs of the LBHI Joint Administrators' and LBHI2 Joint Administrators' position papers are drafted only by reference to LBHI2's unsecured claim against LBIE for c.£38m, but the reasoning applies equally to LBL's claim in LBIE's administration.

(2) The liability to contribute under s.74(2)(f) only arises when a company is wound up. It does not apply and can have no effect unless and until LBIE goes into liquidation and also is unable from its own assets to pay its debts and liabilities and the expenses of the winding up.

28. As stated above, LBL and LBHI2 have filed proofs in LBIE's administration. However, the LBIE Joint Administrators have declined either to formally accept, or to formally reject, LBL's and LBHI2's proofs. It appears from the LBIE Joint Administrators' position paper that they are purporting to withhold payment of distributions to the Members on the basis of an alleged equitable rule that "*a person who owes an estate money cannot claim a share in that estate without first making the contribution which completes it*" (the "**Alleged Equitable Rule**"). The LBIE Joint Administrators contend that:

(1) The Alleged Equitable Rule applies in the case of a liquidation so that a contributory who seeks to prove in the liquidation can receive nothing until he has paid everything that he is liable to pay as a contributory pursuant to s.74 of the Act, and that payment by the contributory of the call is a condition precedent to his participation in any distribution as a creditor.

(2) The Alleged Equitable Rule, and its application in a liquidation, was recently confirmed by the Supreme Court in **Re Kaupthing Singer & Friedlander Ltd (in administration) (No. 2)** [2012] 1 AC 804 at [52].

(3) The Alleged Equitable Rule applies equally in the case of a distributive administration.

(4) The Alleged Equitable Rule dictates that the Members are not entitled to prove in LBIE's administration, alternatively, are not entitled to receive any dividends from the LBIE Joint Administrators, until they have discharged their liabilities (whether actual or contingent) under s.74 of the Act.

(5) The Potential Liability as Contributory is a contingent liability owed by the Members to LBIE, the contingencies being LBIE moving from administration into liquidation in circumstances where the Members will be liable to contribute to LBIE's assets an amount sufficient for payment of LBIE's debts and liabilities and the expenses of its winding up.

29. However, for the reasons set out below:

(1) Before LBIE goes into liquidation, the Alleged Equitable Rule cannot apply. It is not the position that a person cannot claim a share in a fund until it has discharged an unquantified

potential future liability.

(2) The Alleged Equitable Rule could only apply if LBIE were to go into liquidation and if a valid call were made by LBIE's liquidators. In those circumstances, the LBIE liquidators would be entitled rely upon the rule in **Cherry v Boultbee**. However, the effect of this rule would not be to provide LBIE's liquidators with an indefinite right to withhold distributions from LBL until it has discharged its liability. As explained below, a valuation exercise of the claims would have to be carried out.

Is LBL entitled to prove, and receive dividends, in LBIE's administration (or any subsequent liquidation) in respect of its claim against LBIE?

30. For the reasons explained below, LBL is entitled to prove, and receive dividends, in LBIE's administration (or any subsequent liquidation) in respect of its claim against LBIE along with LBIE's other unsecured creditors.

31. S.74 of the Act provides:

> "(1) When a company is wound up, every present and past member is liable to contribute to its assets to any amount sufficient for payment of its debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves.
> (2) This is subject as follows—
> ...
> (f) a sum due to any member of the company (in his character of a member) by way of dividends, profits or otherwise is not deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves.
> ...."

32. S.74(2)(f) subordinates to the claims of other creditors sums due to any member of a company in his character of a member (e.g. by way of dividends). In **Soden v British & Commonwealth Holdings plc** [1998] AC 298, 322,326, Lord Browne-Wilkinson explained that sums due to a member "*in his character as a member*" means sums falling due under and by virtue of the statutory contract between members and the company and the members *inter se,* with the "*statutory contract*" being defined as the bundle of rights and liabilities created by the company's memorandum and articles together with the rights and obligations of members conferred and imposed on members by the Companies Acts. Lord Browne-Wilkinson said at 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."

33. It appears that no sums are due from LBIE to the Members in their character as members,[8] such that there is no subordination by virtue of s.74(2)(f).

34. In light of this, and in accordance with the passage of Lord Browne-Wilkinson's judgment quoted above, LBL's claim against LBIE ought to be subject to the *pari passu* rule, ranking equally along with LBIE's other debts and liabilities to its unsecured creditors:

(1) Rule 2.69 (in the context of administration) provides:

> "Debts other than preferential debts rank equally between themselves in the administration and, after the preferential debts, shall be paid in full unless the assets are insufficient for meeting them, in which case they abate in equal proportions between themselves".[9]

(2) Rule 12.3 provides:

> "(1) 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."

(3) Rule 12.3(2)(b) provides that certain specified matters are not provable in administration, winding up or bankruptcy. Rule 12.3(2A) provides that certain claims 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 238(4)*". Sub-para (c) of that section refers to "*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*".

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[8] See para 1(f) of the LBIE Joint Administrators' position paper and para 1.5 of Lydian's position paper in particular. The LBIE Joint Administrators have been asked for clarification in relation to the payment of dividends and LBL reserves its position accordingly.

[9] C.f.:

(1) S.107 of the Act: "*Subject to the provisions of this Act as to preferential payments, the company's property in a voluntary winding up shall on the winding up be applied in satisfaction of the company's liabilities pari passu and, subject to that application shall (unless the articles otherwise provide) be distributed among the members according to their right and interests in the company*".

(2) Rule 4.181:

"*(NO CVL APPLICATION)*

(1) Debts other than preferential debts rank equally between themselves in the winding up and, after the preferential debts, shall be paid in full unless the assets are insufficient for meeting them, in which case they abate in equal proportions between themselves.

(2) Paragraph (1) applies whether or not the company is unable to pay its debts."

(4) Nothing in the Act, the Rules, or any other enactment states that members' claims against a company in administration (or liquidation) are not provable or are to be postponed (other than s.74(2)(f), in the context of a claim by a member in its character as a member). Accordingly, claims by members which are not made in their character as members are provable and are not to be postponed or subordinated in any way to the claims of other unsecured creditors.

35. LBL should therefore be entitled to prove in respect of its claim in LBIE's administration (or any subsequent liquidation), and LBIE ought to be paying it a dividend at the same rate as it has been paying dividends to LBIE's other unsecured creditors.

The nature of the liability to contribute under s.74

36. Under the express terms of s.74(1), it is only "*When a company is wound up*" that "*every present and past member is liable to contribute...*" under s.74. S.74 does not apply and can have no effect unless and until LBIE goes into liquidation and is unable from its own resources to pay its debts and liabilities and the expenses of the winding up. Further:

(1) Under s.79(1), a "*contributory*" is defined as:
"every person liable to contribute to the assets of a company **in the event of its being wound up**, and for the purposes of all proceedings for determining, and all proceedings prior to the final determination of, the persons who are deemed contributories, including any person alleged to be a contributory".

(2) S.80 provides:
"The liability of a contributory creates a debt (in England and Wales in the nature of [an ordinary contract debt][10]) accruing due from him at the time when his liability commenced, but **payable at the times when calls are made for enforcing the liability**."

37. It is in the context of LBIE's administration that the Alleged Equitable Rule upon which the LBIE Joint Administrators are purporting to rely has the most immediate relevance, because it is on the basis of the Alleged Equitable Rule that, notwithstanding LBL's proof (and LBHI2's proof, excluding for present purposes in respect of the LBHI2 Sub-Debt), the LBIE Joint Administrators are refusing to pay dividends to LBL (and LBHI2) along with other unsecured creditors.

[10] This was amended from "specialty" by the Companies Act 2006 (Consequential Amendments, Transitional Provisions and Savings) Order 2009/1941 Sch 1 para 75(9). Article 11 of SI 2009/1941 provides that the new provisions as to the nature of a contributory's liability apply to liabilities arising on or after 1 October 2009 and the old provisions continue to apply to liabilities arising before that date (and that, for the purposes of the article, a liability is treated as arising when the limitation period starts to run for the purposes of the Limitation Act 1980).

The Alleged Equitable Rule and its proper scope

38. As noted above, the LBIE Joint Administrators contend that the Alleged Equitable Rule and its application in a liquidation was recently confirmed by the Supreme Court in **Re Kaupthing Singer & Friedlander Ltd (in administration) (No. 2)** [2012] 1 AC 804 at [52], such that a contributory who seeks to prove in a liquidation can receive nothing until he has paid everything that he is liable to pay as a contributory pursuant to s.74 of the Act, and that payment by the contributory of the call is a condition precedent to his participation in any distribution as a creditor. The LBIE Joint Administrators and Lydian do not, however, refer in their position papers to any authority which establishes or suggests that there is any such rule which applies before the company is in liquidation.

39. After examining the Alleged Equitable Rule and its proper scope, it will be shown that, for the reasons set out below, the LBIE Joint Administrators are not entitled to withhold distributions in respect of the Members' non-subordinated claims, because the Potential Liability as Contributory will only (if at all) be payable in the future, and only upon the occurrence of a number of conditions.

40. **Re Kaupthing** (sub. nom. **Mills v HSBC**) concerned the rule against double proof in the context of suretyship. The Supreme Court held (reversing the decision of Sir Andrew Morritt, after a leapfrog appeal) that the principle in **Cherry v Boultbee** was trumped by that rule. Lord Walker said, at [8]:

> "The expression "the rule in Cherry v Boultbee" suggests a technical rule of some complexity. Any such impression would be misleading. It is basically a simple technique of netting-off reciprocal monetary obligations, even where there is no room for legal set-off, developed and used by masters in the Court of Chancery in giving directions for the administration of the estates of deceased persons. Complication arises only in a situation of insolvency, where the equitable rule produces a different outcome from that produced by statutory set-off: see para 43 below."

41. At [13], Lord Walker (after introducing the rule against double proof)[11] referenced the description of the equitable rule (frequently described as the rule in **Cherry v Boultbee**, or as a right of "retainer", or a right to appropriate a particular asset as payment) by Kekewich J in **In re Akerman** [1891] 3 Ch 212, 219 as follows:

> "A person who owes an estate money, that is to say, who is bound to increase the general mass of the estate by a contribution of his own, cannot claim an aliquot share given to him out

[11] At [12], Lord Walker explained the effect of the rule against double proof in the surety context: *"The effect of the rule is that so long as C* [the creditor] *has not been paid in full, S* [the surety] *may not compete with C either directly by proving against PD* [the primary debtor] *for an indemnity, or indirectly by setting off his right to an indemnity against any separate debt owed by S to PD."*

of that mass without first making the contribution which completes it. Nothing is in truth retained by the representative of the estate; nothing is in strict language set off; but the contributor is paid by holding in his own hand a part of the mass, which, if the mass were completed, he would receive back. That is expanding what the Lord Chancellor calls in Cherry v Boultbee 'a right to pay out of the fund in hand,' rather than a set-off ..."

42. Lord Walker went on to note the line of case-law concerned with the ability of holders of shares in limited companies, which are not fully paid up, to claim in the liquidations of the companies:

(1) At [19], Lord Walker referred to the decision of Sargant J in **In re Peruvian Railway Construction Co Ltd** [1915] 2 Ch 144 (upheld by the CA in brief judgments: [1915] 2 Ch 442), and went on to say:

> "20 Sargant J's judgment contains a full review of the authorities. These included *In re Auriferous Properties Ltd (No 2)* [1898] 2 Ch 428 and *In re West Coast Gold Fields Ltd; Rowe's Trustee's Claim* [1905] 1 Ch 597. These cases concerned claims made in liquidations by creditors who were also holders of shares which were not fully paid up. In each case it was held, following the seminal decision of Lord Chelmsford LC and the Lord Justices in *In re Overend Gurney & Co; Grissell's case* (1866) LR 1 Ch App 528 , that the claimant could recover nothing as a creditor until all his liability as a contributory had been discharged. Buckley J said in *In re West Coast Gold Fields Ltd* [1905] 1 Ch 597, 602 (where the shareholder was bankrupt but the company solvent and in voluntary liquidation):
>
> > "The right view is that the person liable as contributory must discharge himself in that character before he can set up that, as a creditor, he is entitled to receive anything, and a fortiori, as it seems to me, before he can set up that, as a contributory, he is entitled to receive anything."
>
> That decision was upheld by the Court of Appeal in a brief judgment of the court [1906] 1 Ch 1. The payment-up of the shares in full was a condition precedent to any participation in the distribution of surplus assets ...."

(2) At [51]-[53], in the context of considering (and disapproving) Chadwick LJ's reasoning in **In re SSSL Realisations (2002) Ltd** [2006] Ch 610, Lord Walker noted that Chadwick LJ's judgment refers at [98] to the line of authority,

> "dealing with the special case of shareholders liable for calls on shares which are not fully paid up. Some of these cases are mentioned in para 20 above. Chadwick LJ sets out a fuller citation of the cases but I have to say, with respect, that he seems to have missed their point.
>
> 52 The situation in this line of authority is that a shareholder is a creditor of an insolvent company, but his shares are not fully paid up, so that he is liable as a contributory. Suppose he has 10,000 £1 shares, 10p paid, and is owed £15,000, but the dividend prospectively payable is only 30p in the pound. If the liquidator calls on him for £9,000 to make his shares fully paid up, he has no right of set-off, and to that extent he is disadvantaged (that is *In re Auriferous Properties Ltd* [1898] 1 Ch 691). If he seeks to prove in the liquidation, the liquidator can rely on the equitable rule as it applies in a case of this sort—that is, that he can receive nothing until he has paid everything that he owes as a contributory. That is *In re Auriferous Properties Ltd (No 2)* [1898] 2 Ch 428 . The rule is also very clearly stated by Buckley J in *In re West Coast Gold Fields Ltd* [1905] 1 Ch 597 , 602 (affirmed [1906] 1 Ch 1, and cited in para 20 above). Payment of the call is a condition precedent to the shareholder's participation in any distribution, and again the shareholder is to that extent

disadvantaged.

53 So the equitable rule may be said to fill the gap left by disapplication of set-off, but it does not work in opposition to set-off. It produces a similar netting-off effect except where some cogent principle of law requires one claim to be given strict priority to another. The principle that a company's contributories must stand in the queue behind its creditors is one such principle.[12] The rule against double proof is another. I would accept Mr Moss's submission that it would be technical, artificial and wrong to treat the rule against double proof as trumping set-off (as it undoubtedly does) but as not trumping the equitable rule."

43. Lord Walker's judgment and the cases referenced are concerned with shareholders of limited liability companies seeking to prove in the liquidation of the company in circumstances where they have not paid a call for the amount unpaid on their shares. The policy behind this line of case law is that, if a contributory were to set off calls against a debt owed to him by the company, he would be paid his claim in full out of the proceeds of calls, which ought to be distributed rateably to the company's creditors. It does not follow from this line of case-law that, before an unlimited company is wound up and in circumstances in which it is not clear whether it will be wound up and whether there will be a shortfall in its assets for the purposes of meeting its debts and liabilities and the expenses of the winding up, a member of the company cannot prove, or cannot receive distributions, in its administration for an independent debt owed to it by the company, when the company is making distributions to its other unsecured creditors.

44. As to the decisions to which Lord Walker referred:

(1) In **In re Overend, Gurney and Co v Grissell's Case** (1865-66) LR 1 Ch App 528, Mr G was a holder of 80 shares in the company of £50 each, on each of which shares £15 had been paid up. He was a creditor of the company for £16,000 lent to the company on deposit with interest. A resolution was passed for the voluntary winding-up of the company and an order was made for continuing it under the supervision of the Court. The liquidators had made a call of £10 per share and at the time of the application it was expected that they would shortly be able to pay a dividend of 4s. or 5s. in the £ on the debts of the company. They informed Mr G that they should refuse to pay the creditors who were shareholders any dividend on their debts until the other creditors had all been paid in full. Two applications were made, and Lord Chelmsford LC summarised them at 533-534 as follows: *"in the first it was asked that the dividend might be paid upon the balance after deducting the call; and in the second, that the*

[12] This must be read in context, and subject to Lord Browne-Wilkinson's comments in **Soden**, in particular the passage at 324 quoted above: *"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."*

dividend might be calculated upon the entire debt due from the company, and then the amount of the call be deducted from the dividend." At 534, Lord Chelmsford LC said that both applications "*may be regarded as raising the question whether a shareholder, who is also a creditor of* ***a limited liability company****, is entitled either to set-off, or to have credit for, so much of his debt as is equal to the amount of calls* ***which have been made upon****, but not paid by, him, and to receive a dividend for the balance".* Lord Chelmsford LC said that "*The question depends entirely upon the construction of the Companies Act, 1862".* His Lordship's reasoning was as follows:

a. S.133 of the 1862 Act provided that, in a winding up, *"the property of the company shall be applied in satisfaction of its liabilities pari passu, and subject thereto shall, unless it be otherwise provided by the regulations of the company, be distributed amongst the members according to their rights and interests in the company".* It appeared to make no distinction between a creditor who is a member of the company and one who is not, and "*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".*

a. S.75 of the 1862 Act provided that the liability of any person to contribute to the assets of a company, in the event of its being wound up, "*shall be deemed to create a debt accruing due from such a person at the time when his liability commenced, but payable at the time or respective times when calls are made as hereinafter mentioned for enforcing such liability"* (c.f. s.80 of the Act). Lord Chelmsford LC noted that:

> "The power to make calls is only to satisfy the debts and liabilities of the company, and the costs, charges, and expenses of winding it up, and for the adjustment of the rights of the contributories amongst themselves. But if the whole of the amount unpaid upon the shares were required to be paid up, more might be raised than would be requisite for these purposes, and it might be that a contributory thus paying in advance might lose all that he had so paid in the event of any of his co-contributories becoming insolvent."

b. The amount of the call not paid could not be set-off against the debt, because "*if a debt due from the company to one of its members should happen to be exactly equal to the call made upon him, he would in this way be paid twenty shillings in the pound upon his debt, while the other creditors might, perhaps receive a small dividend, or even nothing at all".*

c. Because the amount of an unpaid call could not be satisfied by a set-off of an equivalent portion of debt due to the member, it followed that:

> "the amount of such call must be paid before there can be any right to receive a

dividend with the other creditors. The amount of the call being paid, the member of the company stands exactly on the footing of the other creditors with respect to a dividend upon the debt due to him from the company. The dividend will be of course upon the whole debt, and the member of the company will from time to time, when dividends are declared, receive them in like manner **when either no call has been made**, or, having been made, when he has paid the amount of it."

It is clear from Lord Chelmsford LC's judgment that the member can receive dividends from the company when no call has been made.

(2) In **In Re Auriferous Properties Ltd (No. 2)** [1898] 2 Ch 428, G held shares in A, and before either company went into liquidation calls were made on the shares, and A became indebted to G for money lent. A was ordered to be wound up by the Court, and G, which was insolvent, then passed an extraordinary resolution for voluntary winding-up. G proved its claim for debt in the winding up of A. Wright J held that s.10 of the Judicature Act 1875 did not enable the liquidator of G to set off the debt against the calls (**Re Auriferous Properties Ltd (No. 1)** [1898] 1 Ch 691; it is submitted below in the context of Question 6 that this part of the decision should not be followed). Wright J subsequently held that, in the winding-up of A (in circumstances where the liquidator of A was paying a dividend to its creditors), the liquidator was entitled to hold the dividend due to G against the liability of G for calls in arrears on its shares in A. Wright J said:

"Prima facie the Gold Company is entitled to take its dividend. Its claim as a creditor has been duly ascertained in the appropriate proceeding, and it is prima facie immaterial that the creditor happens to be also a debtor to the Auriferous Company. There is no contract for a set-off, nor do the articles of association of either company appear to contain any provision for it, nor do the general statutes of set-off apply. Nor, as it seems, is the doctrine of set-off in bankruptcy, which under s. 10 of the Judicature Act, 1875, is extended to the liquidation of companies—Mersey Steel and Iron Co. v. Naylor, Benzon & Co. —applicable to this case. That doctrine has been held to apply only to cross rights existing at the commencement of the winding-up: Ex parte Theys; **but here the call has been made in the liquidation, and until it was made there was only a contingent liability which might never become enforceable and could not be set off, unless, perhaps, after some process of valuation.** But in my opinion this case is governed by the principle established in Grissell's Case and is within the express terms of the Lord Chancellor's judgment in that case. If the creditor-contributory were allowed to take the dividend without paying the call, he would be receiving payment of a part of the debt which the company owes to him without making his contribution to the fund out of which that debt, with the other debts of the company, was to be paid...."

(3) In **In Re West Coast Gold Fields Ltd** [1905] 1 Ch 597, Mr R was the registered owner of some fully paid shares in the company, and also of 1800 shares, on which only 10s. per share had been paid up. The company made a call of 1s. per share on the 1800 shares. The shareholder was then made bankrupt. The company proved in the bankruptcy for 900l., being 90l. in respect of the call of 1s. on 1800 shares, and as to 810l. in respect of the balance of 9s. per share uncalled on those shares. The trustee in bankruptcy rejected the proof, but on

appeal it was directed to be admitted for 819l., being as to 90l. for the call of 1s. per share, and as to 729l. for the uncalled 810l. less a discount of 10 per cent on the 810l. Upon the proof, 61l. 8s. 6.d had been paid for a dividend. The company then went into voluntary winding up, and after satisfying all its liabilities, there remained assets for distribution among its shareholders (estimated to be sufficient to pay 3s. per share on all the fully paid shares in the company). The trustee in bankruptcy took out an originating summons in the winding-up order, asking whether the 1800 shares ought, for the purpose of any distribution of the assets of the company among its contributories, to be treated as fully paid shares. Thus the question related to the distribution of surplus assets amongst shareholders of a company.[13] It did not concern the case of a creditor who also holds shares (as noted by Buckley J at 600). Buckley J (at 600) summarised **Grissell's Case** as deciding:

> "that where a person is both a creditor of and a shareholder in a company, his shares being partly paid up, he must satisfy all his obligations as a shareholder and contributory, by paying into the common fund all sums **due from him in respect of calls**, before he can say, "As a creditor I am entitled to take something out of the common fund." There can be no set-off; the man must pay in before he can be heard to say that he can take out."

45. These cases all concern distributions in liquidations when calls had in fact been made on the contributories. They have no bearing upon the Members' ability to prove in LBIE's administration, in circumstances where it is not clear that LBIE will go into liquidation or that there will be a shortfall for which the Members will be liable to contribute. In these circumstances, as explained below, the Alleged Equitable Rule can have no application.

46. The additional cases in this context referenced at [98] of Chadwick LJ's judgment in **Re SSSL** [2006] Ch 610 are similarly irrelevant to the critical immediate question, which is whether LBL (and LBHI2 in respect of its non-subordinated claim) should be receiving distributions in LBIE's administration along with LBIE's other unsecured creditors:[14]

(1) In **Re Leeds and Hanley Theatre of Varieties (No. 2)** [1904] 2 Ch 45, the F co and the T co were both in liquidation. The F co were creditors of the T co for 5100l. on debentures of the T co. In the winding up of the F co, all proving creditors of the F co had been paid, and then the T co established their right to 12,000l (for misfeasance, and which claim could not be set-off)

[13] Buckley J's decision was upheld by the Court of Appeal in a brief judgment of the court [1906] 1 Ch 1.

[14] The other case referenced by Chadwick LJ was In **Re White Star Line Ltd** [1938] Ch 458. In this case, R entered into a scheme of arrangement. A call was made on it by the liquidators of W. R purported to satisfy the call by the issue of deferred creditors' certificates equal in nominal amount to the sum due, but the evidence established that to the knowledge of all the parties the certificates were always worth less than their nominal value and the certificates were not accepted as payment of the sum due for calls but as the best that could be saved out of the wreck of R. It was held by the Court of Appeal that R was not entitled to a dividend in the winding up of W in respect of a contract debt found to be due to them until the amount of the calls was paid in full.

and the F co had assets of 7677 remaining to be disposed of. An order was made for the F Co's assets to be transferred to the T co, and the liquidator of the F co accordingly paid the T co, or its liquidator, that 7677l., without prejudice to any right of the F co to prove in the liquidation of the T co. After this, there turned up other creditors of the F co with debts of 5490l. The T Co's assets were 600l, plus the 7677 received from the F co, plus the right to receive the balance of the 12,000l from the F co. The T co had a liability of 5100l. to the F co and 4685l. to other creditors. The question was what should happen to the T Co's assets. Buckley J held as follows (at 51):

> "I am administering the assets of the Theatres Company. There is a person, namely, the Finance Company, who is both a debtor to the fund to be administered and a claimant against that fund. I think that that person cannot come and say "I am entitled to a dividend out of the fund" until he has first made complete the fund out of which he says he is entitled to receive payment.... In point of fact, of course, the Finance Company cannot pay what they owe to the Theatres Company, because they have no money. They are bare at present, and the only question is whether they can get anything out of their proof against the Theatres Company until they have paid what they owe to the fund. I think not.
>
> The proper administration in my judgment, therefore, is this. Notionally treat the Finance Company as having paid the 4323l. to the Theatres Company; take the aggregate notional sum thus arrived at and treat it as applied in payment of a dividend upon all the debts of the Theatres Company—that is to say, upon the 5100l. due to the Finance Company and the 4685l. due to other people. That will attribute to the Finance Company a certain sum. If that sum be greater than the 4323l. that they owe, they will get the difference. If it be less, or equal, they will receive nothing. If the dividend thus arrived at on the 4685l. cannot be satisfied in full (because the notional sum, of course, is not really paid), then the 4685l. would take the whole of the assets of the Theatres Company, although it be less than the notional dividend calculated upon the footing that the Finance Company have paid that which they have not paid."

(2) Again, therefore, the decision does nothing to support the position of the LBIE Joint Administrators that they are entitled not to pay a dividend to LBL on its debt because a call might one day be made on LBL as contributory (if the relevant contingencies materialise, including LBIE going into liquidation).

(3) In **Re National and Provincial Live Stock Insurance Co** [1917] 1 Ch 628, Astbury J held that, where two liquidating companies owed each other a large sum of money (one for balance of accounts and money lent, and the other for arrears of calls), and on the basis of Buckley J's approach in **Re Leeds and Hanley** neither would receive a dividend without satisfying its own debt, there would be no dividend payable to either and the liquidator of each company was authorised to distribute the cash in hand among the other creditors, without retaining anything to meet the debtor company's claims, which would emerge only if it paid in full what it owed.

(4) In **In Re Rhodesia Goldfields** [1910] 1 Ch 239, neither the existence nor the amount of a debt to a fund had been established or ascertained, but if there was a debt it would have been presently payable. Swinfen Eady J held that, pending the ascertainment and establishment of the amount (if any) due to the fund, the share of the fund for which payment was sought should be retained and carried to a separate account. Swinfen Eady J said, however, at 242, that *"The company could not set off a future debt, e.g., a future call"*.

47. Accordingly, not a single one of these cases referred to by Lord Walker in **Re Kaupthing** and by Chadwick LJ in **Re SSSL**, the principles relating to which the LBIE Joint Administrators appear to rely upon, establishes that where a debt is presently due and payable, the administrator of a fund may refuse to make a distribution in respect of it because of a possible future liability which the creditor might one day owe to the fund on the occurrence of one or more conditions.

Does the Alleged Equitable Rule apply so as to prevent LBL from proving, or receiving dividends, in LBIE's administration?

48. In addition to the passages from the judgments quoted above which make clear that the principle only applies where the obligation to contribute to the fund is due and payable (e.g. where a call has actually been made), a number of further authorities also establish that this is the correct position:

(1) Wood, *"English and International Set-Off"* (1989) states at [8-93]: *"The administrator of a fund may not retain a share of a fund against a contribution if the share is presently payable but the contribution is payable in the future"*, explaining in the following paragraph that *"This accords with the principle that a creditor may not exercise a lien or other security interest for a debt not yet due and payable"*.

(2) In **Jeffryes v Agra and Masterman's Bank** (1866) LR 2 Eq 674, 680, Sir W Page Wood VC said *"you cannot retain a sum of money which is actually due against a sum of money which is only becoming due at a future time"*.

(3) In **Re Abrahams** [1908] 2 Ch 69, at the death of a testator a debt was owing to him by a person to whom a share of residue was immediately given by the will, but the debt was payable in instalments. It was held that the executors were not entitled to retain the share of the beneficiary as against future instalments of the debt that may become due, but were bound to pay it to the beneficiary without reference to such instalments. Warrington J applied the earlier case of **Re Rees** (1889) 60 LT 260.

(4) In relation to contingent claims, in **Re SSSL** [2006] Ch 610, Chadwick LJ said at [79] that the following propositions could be derived from the judgments in **In Re Melton** [1918] 1 Ch 37:

> "(1) The general rule applicable in the distribution of a fund is that a person cannot take an aliquot share out of the fund unless he first brings into the fund what he owes.
> ....
> (2) **That general rule is applicable not only where the claimant (X) is indebted to the fund but also where the fund has a right to be indemnified by X against a liability which the fund may be required to meet in the future, as surety for a debt owed by X to a creditor** (Y). It is not necessary that the liability to Y has been satisfied out of the fund: it is enough that it may have to be satisfied in the future."

(5) However, in relation to this passage of Chadwick LJ's judgment, in **Re Kaupthing,** Lord Walker said at [45]:

> "The first principle that Chadwick LJ extracted from *In re Melton* [1918] 1 Ch 37 is the equitable rule itself, which he set out as a mathematical formula. **The second principle is that the rule extends to cases where the fund has a right to be indemnified by the claimant against a liability which the fund may be required to meet in the future. That proposition seems to be too widely stated.** In the passage quoted from the judgment of Warrington LJ in *In re Melton* , at p 55, "that time" refers to the death of Richard Melton in 1907. His settled estate did not become distributable until his widow's death in 1916, and by then there was an immediate right to an indemnity for the £313 paid by the estate. The judgment of Warrington J in *In re Abrahams* [1908] 2 Ch 69, 73, states the correct rule:
>
> > "the debt due to the testator is one which is **not immediately payable**, whereas the right of the debtor to receive the residuary share is an immediate right. I think, therefore, that **the debtor is entitled to receive that share** ..."
>
> Chadwick LJ also relied on Warrington LJ's comments on *In re Binns* [1896] 2 Ch 584. But (as already noted) the facts of *In re Binns* were not identical, or even similar, to those of In re Melton."

(6) Accordingly, there is no right to deny a share of a fund to a creditor on the basis of a debt to the fund that is *"not immediately payable"*; in those circumstances, *"the debtor is entitled to receive that share"*.

49. This is entirely consistent with the scheme of the insolvency legislation, as set out above, which provides for members' claims which are not in made *qua* member to rank *pari passu* with other unsecured creditors. As Lord Chelmsford LC said in **Grissell's Case,** *"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"*. The starting point is that a member who has a claim which is not a claim *qua* member can prove along with other unsecured creditors. Nothing in the legislation suggests that this ceases to be the case simply because there is a theoretical possibility that the member might one day be liable as a contributory.

50. Further, there is no good reason for the approach suggested by the LBIE Joint Administrators:

(1) The LBIE Joint Administrators suggest that the Members must "*discharge*" their contingent liability before any distribution can be made to them. Self-evidently, a contingent liability cannot be discharged: until the relevant conditions are satisfied, there is nothing to discharge. It is far from clear what the LBIE Joint Administrators expect LBL (or LBHI2) to do at this stage. Additionally, it is not yet known whether there will be any shortfall in LBIE (or whether LBIE will be wound up), such that it is not established that the Members will be obliged to "*complete*" LBIE's assets.

(2) The approach suggested by the LBIE Joint Administrators would have the effect of accelerating the liability under s.74, which expressly only arises when a company is wound up.

(3) There is a debt presently payable by LBIE to LBL. It is unprincipled, and unfair to LBL's creditors, for this to be withheld on the basis of the Potential Liability as Contributory, which might never arise.

51. Further, the LBIE Joint Administrators have not stated that they have engaged in an exercise of seeking to quantify the value of each of the Members' Potential Liability as Contributory, and comparing it with the value of the Members' claims against LBIE. It appears that the LBIE Joint Administrators contend they have an indefinite right not to pay the Members until they have "discharged" an unquantified potential liability. There is no basis for such an approach.

52. Even if, which is denied, the LBIE Joint Administrators can withhold distributions on the basis of the Potential Liability as Contributory, at the very least, there must be an exercise of comparing an estimate of the Potential Liability as Contributory as against LBL's claim against LBIE, in order to determine whether any balance is payable. LBL cannot be required to pay an amount to LBIE as a condition precedent to receiving any distribution. In addition to the fact that nothing is presently payable to LBIE, a person should not be ordered to pay that part of a liability which would come back to him on a distribution.[15]

53. Accordingly, LBL is entitled to receive distributions in LBIE's administration along with LBIE's other unsecured creditors. Those creditors have, to date, been paid a dividend of 68.5p in the £. If the Court agrees with the LBL Joint Administrators that the LBIE Joint Administrators are not entitled to withhold distributions from LBL on the basis of the Potential Liability as Contributory,

[15] See **Re VGM Holdings Ltd** [1942] 1 Ch 235, 241; **Selangor United Rubber Estates ltd v Craddock (No. 4)** [1969] 1 WLR 1773, in particular at 1779. Note also the approach of Buckley J in **Re Leeds and Hanley**, set out above at para 46(1).

a catch-up dividend should be paid to LBL, and, as and when further distributions are made by the LBIE Joint Administrators, LBL should receive payment *pari passu* with LBIE's other unsecured creditors.

The ability of LBL to prove, and receive dividends, in a winding up of LBIE

54. If LBIE goes into liquidation, if and to the extent that LBL has not been paid 100p in the £ in respect of its claim against LBIE, LBL would be entitled to prove, and receive distributions, in LBIE's winding up. The analysis above as regards the ability of LBL to prove in LBIE's administration applies equally to its ability to prove in LBIE's liquidation. LBL's debt remains provable pursuant to Rules 12.3 and 13.12, and is not postponed (whether by s.12.3(A), s.74(2)(f), or on any other basis) to the claims of other unsecured creditors.

55. The only basis upon which, in a winding up of LBIE, a dividend might not be payable to LBL in respect of its claim along with other unsecured creditors (or a lower dividend might be payable than would otherwise be the case), is if LBIE is unable from its own assets to pay its debts and liabilities and the expenses of the winding up and if a valid call is made on LBL, and if insolvency set-off or the rule in **Cherry v Boultbee** applies in these circumstances. This is considered below.

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

56. **Question 4:** In the case of each of questions 1-3 above, to the extent that there is an entitlement to prove, in so proving, is credit required to be given or is any deduction to be made in respect of each of the Members' Potential Liability as Contributory either: (i) by way of insolvency set-off (set out in Rules 2.85 and 4.90 of the Insolvency Rules 1986 (the "**Rules**") as applicable); and/or (ii) pursuant to the rule in *Cherry v Boultbee* 41 ER 171; and/or (iii) otherwise?

In LBIE's administration, if LBL is entitled to prove in respect of its claim against LBIE, is credit required to be given, or is any deduction to be made, in respect of the Potential Liability as Contributory either: (i) by way of insolvency set-off (set out in Rules 2.85) as applicable); and/or (ii) pursuant to the rule in Cherry v Boultbee 41 ER 171; and/or (iii) otherwise?

Cherry v Boultbee

57. The LBIE Joint Administrators do not appear to rely upon the rule in **Cherry v Boultbee** as giving rise to a need for any credit or deduction as against LBL's claim in LBIE's administration (see para 4 of their position paper). Rather, they appear to contend that the effect of the rule is that they do not need to make payment of distributions to the Members in respect of their non-subordinated claims because of the Potential Liability as Contributory. For the reasons set out at above, the principle in **Cherry v Boultbee** cannot apply in circumstances where the Potential Liability as Contributory will only (if at all) be payable in the future, and only upon the occurrence of a number of conditions.

Insolvency set-off

58. For the reasons set out below, there is no insolvency set-off in LBIE's administration in relation to the Potential Liability as Contributory.

59. Rule 2.85 provides:

> "(1) This Rule applies where the administrator, being authorised to make the distribution in question, has, pursuant to Rule 2.95 given notice that he proposes to make it.
>
> (2) In this Rule "mutual dealings" means mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company proving or claiming to prove for a debt in the administration but does not include any of the following–
> (a) any debt arising out of an obligation incurred after the company entered administration;
> ....
> (3) An account shall be taken as at the date of the notice referred to in paragraph (1) of what is due from each party to the other in respect of the mutual dealings and the sums due from

one party shall be set off against the sums due from the other.

(4) A sum shall be regarded as being due to or from the company for the purposes of paragraph (3) whether–
(a) it is payable at present or in the future;
(b) the obligation by virtue of which it is payable is certain or contingent; or
(c) its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion.

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

(9) In this Rule "obligation" means an obligation however arising, whether by virtue of an agreement, rule of law or otherwise."

60. There is no insolvency set-off in LBIE's administration in relation to the Potential Liability as Contributory:

(1) First, it would be inconsistent with the statutory scheme for there to be a set-off in these circumstances.

(2) Second, the sums are not "*mutual dealings*".

61. As to the first point, it would not be consistent with the regime under which the Potential Liability as Contributory is imposed to conclude that there is a set-off in these circumstances. S.74(1) renders members liable to contribute to a company's assets when it is wound up "*to any amount sufficient for payment of its debts and liabilities...*". Taken as a whole, 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. If sums owed to the contributories were set-off against contributions (or possible future contributions) in the company's insolvency, that would effectively provide the contributories with £ for £ payment in respect of their debts owed by the company, when other creditors are obtaining but a rateable share.[16] That would not be fair to the

[16] See **Black & Co's Case** (1873) 8 Ch App 262, where Lord Selborne LC said:
(1) At 260: *"It is probably enough to say that the law generally has been settled by Grissell's Case upon the interpretation of the Act of Parliament, and of the rules laid down in that Act of Parliament, as to*

company's other creditors, and this was the basis for the decision in **Grissell's Case**, and those authorities following it, as explained above.

62. The second reason why insolvency set-off does not operate in LBIE's administration to require an account to be taken between LBL's claim against LBIE and the Potential Liability as Contributory is because the sums are not mutual dealings. For the reasons set out below (Question 5), LBIE's administrators cannot prove in LBL's administration in respect of the Potential Liability as Contributory. A non-provable claim and a provable claim are not mutual dealings (see **Re SSSL** [2006] Ch 610 at [90]).

63. In light of the Supreme Court's judgment in **In re Nortel GmbH (in administration); In re Lehman Bros International (Europe) (in administration)** [2013] UKSC 52; [2013] 3 WLR 504, it is no longer argued that the liability under s.74 falls within rule 2.85(2) (which provides that "*mutual dealings*" do not include *"any debt arising out of an obligation incurred after the company entered administration"*).

If LBIE were wound up, and if LBL is entitled to prove in LBIE's liquidation respect of its claim against LBIE in LBIE's winding up (to the extent its claim is not satisfied by distributions in LBIE's administration), is credit required to be given, or is any deduction to be made, in respect of the Potential Liability as Contributory either: (i) by way of insolvency set-off (set out in Rule 4.90); and/or (ii) pursuant to the rule in Cherry v Boultbee 41 ER 171; and/or (iii) otherwise?

Cherry v Boultbee

64. If LBIE were wound up, the only circumstances in which – pursuant to the principles established in the case-law summarised above – there could be any credit or deduction applied to LBL's

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the mode in which, under a winding-up, the money arising from calls is to be applied in payment of the debts of the creditors, pari passu , and without preference. That case (being decided by an authority which we ought to treat as binding on ourselves, even if we doubted that it was right) has determined that in general such a set-off is not to be allowed."

(2) At 262: *"The moment that the winding-up takes place, the whole administration is carried on with a view to the payment of the debts of the creditors, and in the first instance to payment pari passu. The different sections of the Act—those which define the liability of limited companies, the 7th, 8th, 23rd, and 38th—those which deal with the administration of assets, the 98th, 101st, and 133rd—those which give the power to make calls, not in the ordinary way, but specially for the purposes of this Act, the 102nd and 133rd—all have in view the payment, pari passu and equally, of the debts due to the creditors; and the hand which receives the calls necessarily receives them as a statutory trustee for the equal and rateable payment of all the creditors. The result of this contention, that one particular creditor may pay himself in full by retaining his own calls and not paying them, would, in effect, be to give him a preference, and to exonerate him from his obligation as a shareholder to contribute towards the payment of the debts of the other creditors. That appears to me to be utterly opposed to the whole principle of the law of set-off, and to all the provisions of the Act which bear on the subject"*

See also Fry J's judgment in **Ex p Branwhite** (1879) 40 LT 652, 654, and Derham on The Law of Set-Off (4th edn.) at [8.77].

claim against LBIE in respect of the Potential Liability as Contributory, would be if LBIE's assets were insufficient to meet its debts and liabilities or the expenses of the winding up and a valid call were made on LBL.

65. If such a call were made, the rule in **Cherry v Boultbee** would apply. The effect of the application of this rule is not, however, to provide the LBIE Joint Administrators with an indefinite right not to pay the Members until they have "discharged" an unquantified potential liability, as they appear to contend. Rather, the proper approach, if a valid call were made on the Members in LBIE's winding up, would be to adopt the notional calculation described by Buckley J in **Re Leeds and Hanley**, as set out above at para 46(1). This was explained by Chadwick LJ in **Re SSSL** at [79(1)] as follows:

> "The general rule applicable in the distribution of a fund is that a person cannot take an aliquot share out of the fund unless he first brings into the fund what he owes. Effect is given to the general rule, as a matter of accounting, by treating the fund as notionally increased by the amount of the contribution; determining the amount of the share by applying the appropriate proportion to the notionally increased fund; and distributing to the claimant the amount of the share (so determined) less the amount of the contribution. The rule can be expressed in the form: D=1/n of (A+C)-C, where 1/n is the proportion which the aliquot share bears to the whole, A is the amount of the assets to be distributed before taking account of the contribution due to the fund from the claimant, C is the amount of the contribution, and D is the amount which the claimant is entitled to receive in the distribution. It can be seen that the claimant will receive nothing by way of distribution if C>1/n of (A+C)."[17]

66. In accordance with this approach, if LBIE were to go into liquidation and if a valid call were made on LBL, the value of LBIE's total pool of assets (including contributions from the Members) should be ascertained, and from that the dividend rate to all creditors (including LBL) should be calculated. If the amount payable to LBL by LBIE at this dividend rate is greater than the contribution from LBL, then the difference should be paid to LBL. If the amount payable to LBL by LBIE at this dividend rate is less than the contribution from LBL, then nothing would be payable to LBL.

67. Further, for the purposes of the calculation set out above, the contribution from LBL that falls to be brought into account is the dividend in LBL's administration (or a subsequent liquidation) on

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[17] In **Re Kaupthing**, Lord Walker said at [43]:
"In his judgment Chadwick LJ was also at pains to explain the operation of the rule in Cherry v Boultbee in mathematical notation which, if I may respectfully say so, tends to suggest that the rule is a branch of rocket science. The disparity between the results of the examples in para 13 of his judgment is simply the difference between netting-off at 100p in the pound and netting-off at the appropriate dividend rate. In the example set-off means that the debtor beneficiary gets £1,818, that is 100p in the pound worth of set-off, and 90·9p in the pound for the balance of £2,000 due from the bankrupt's estate. The equitable rule means that he gets £1,750, that is 91·7p in the pound for the whole £3,000 due to him, with £1,000 treated as already in his hands. Where the equitable rule applies the rate of dividend is marginally higher for everyone, because the differential (in the example, £91 out of the set-off of £1,000) is made available for distribution across the board. The lower the expected rate of dividend, the greater will be the disparity between the two computations."

the s.74 liability that may be proved by LBIE's liquidators, not the full value of the proof. LBL went into administration before LBIE will be wound up, and accordingly, LBIE's liquidators will never be entitled to receive more than a dividend upon the amount they may prove in LBL's administration (or a subsequent liquidation).[18] Any other approach would be unjustified, including because it would provide LBIE with a greater distribution than the dividend rate payable to LBL's other creditors.

Insolvency set-off

68. Rule 4.90 provides: *"This Rule applies where, before the company goes into liquidation there have been mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company proving or claiming to prove for a debt in the liquidation."*

69. For the reasons set out above in the context of Rule 2.85 and insolvency set-off in administration, insolvency set-off would not apply if LBIE went into liquidation so as to require an account to be taken of LBL's claim against LBIE and the Potential Liability as Contributory.

[18] C.f. **Cherry v Boultbee** itself, where the beneficiary became bankrupt before the will took effect, and it was held that the executor could deduct from the legacies only so much of the debt as would have been paid as a dividend in the bankruptcy. In **Re Kaupthing** Lord Walker referred to the fact the bankruptcy took place before the will took effect as explaining the difference between **Cherry v Boultbee** and **Jeffs v Wood** at [17]: "*The reasoning behind the different outcome in the later case appears at p 447: "the bankruptcy of the debtor having taken place in the lifetime of the testatrix, her executors never were entitled to receive from the assignee more than the dividends upon the debt.*" In **Re Kaupthing**, Lord Walker explained at [48]: "*The equitable rule is a technique of netting-off similar to statutory set-off. It is true that in a situation of double insolvency (that is where both PD and S are bankrupt* ***or in insolvent liquidation****) the equitable rule may produce a different result from set-off if PD's insolvency occurred before that of S (that is the difference between Jeffs v Wood 2 P Wms 128 and In re Rhodesia Goldfields Ltd [1910] 1 Ch 239 , on the one hand, and Cherry v Boultbee 4 My & Cr 442 and In re Peruvian Railway Construction Co Ltd [1915] 2 Ch 144; [1915] 2 Ch 442 , on the other hand).*"

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 / Cherry v Boultbee in this context

70. **Question 5:** Is LBIE entitled to prove in the administrations (or would LBIE be entitled to prove in any subsequent liquidations) of the Members in respect of each of the Members' Potential Liability as Contributory?

71. **Question 6**: If LBIE is entitled to prove in the Members' administrations (or any subsequent liquidations) as described in question 5 above, what effect (if any) does:

    (1) Insolvency set-off have on the LBHI2 Subordinated Debt?

    (2) Insolvency set-off have on the Members' respective non-subordinated debt claims?

    (3) The rule in *Cherry v Boultbee* have on the LBHI2 Subordinated Debt?

    (4) The rule in *Cherry v Boultbee* have on the Members' respective non-subordinated debt claims?

    (5) Any other relevant form of set-off or deduction have on: (a) the LBHI2 Subordinated Debt; and/or (b) the Members' respective non-subordinated debt claims?

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

72. 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:

    (1) There is no equivalent in the Act or the Rules in respect of a corporate contributory to s.82(4) of the Act, which 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*". Accordingly, it is not possible to prove in a corporate contributory's insolvency in respect of an estimate of the value of the contributory's liability to future calls.

    (2) Paragraph 8 of Schedule 4 of the Act lists, as one of the powers of a liquidator in a winding up exercisable without sanction in any winding up, "*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 other creditors". Paragraph 11 of Schedule 4 provides the liquidator with "*Power to ...do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot conveniently be done in the name of the company....*" In relation to these paragraphs:

a. The Act does not contain an equivalent power for administrators.[19] Accordingly, administrators are not empowered to prove, rank and claim in the insolvency of any contributory in respect of future calls that may be made in the event that the company is wound up.

b. The reference to a "*balance*" in paragraph 8, and to "*any money due*" in paragraph 11 make clear that it is only when sums are due from the contributory that the liquidator can take the steps mentioned. (Further, as explained below, para. 8 makes clear that it is only the "*balance*" that may be proved in the contributories' insolvency.)

73. Further, if, contrary to LBL's position in relation to questions 1-2 above, the LBIE administrators (or liquidators) are entitled to withhold distributions from LBL in respect of its claim in LBIE's insolvency on the basis of the Potential Liability as Contributory, they cannot also prove in LBL's administration (or a subsequent liquidation), for that would amount to a double-proof on the same debt.[20]

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

Insolvency set-off

74. Rule 2.85(2) provides for a set-off in respect of mutual dealings between the company and *"any creditor of the company proving or claiming to prove for a debt in the administration"* (and similarly Rule 4.90(1) applies to mutual dealings between the company and "*any creditor of the company proving or claiming to prove for a debt in the liquidation*"). Accordingly, it is only if

[19] Para 20 of Schedule 1 of the Act provides administrators with the "*Power to rank and claim in the bankruptcy, insolvency, sequestration or liquidation of any person indebted to the company and to receive dividends, and to accede to trust deeds for the creditors of any such person*". However, before the company is wound up the contributories are not "*indebted to the company*".
[20] See e.g. **Re Whitehouse** (1887) 37 Ch D 683.

LBIE (through its administrators/liquidators) can prove in respect of the Potential Liability as Contributory that it can be subject to insolvency set-off.

75. If LBIE's administrators (or any liquidators that may be appointed) are entitled to prove in LBL's administration, or a subsequent liquidation, there would be a set-off of LBL's claim against LBIE (to the extent that LBL has not received distributions in respect of that claim in LBIE's administration or a subsequent liquidation). The reason why there can be no insolvency set-off as between the two claims in LBIE's administration (or a subsequent liquidation), but there is insolvency set-off in LBL's administration (or a subsequent liquidation), is because:[21]

    (1) As explained above, 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, because that would effectively be providing LBL with payment of its claim against LBIE £ for £, when other creditors are receiving merely dividends upon their debts, and because the proceeds of a call should be shared rateably by the creditors of the company.

    (2) 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).

76. Para. 8 of Schedule 4 of the Act, as noted above, 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*".

77. 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. Accordingly, LBIE's

[21] And c.f. Derham at [11.06]-[11.11] for an explanation as to why, in a double insolvency situation, there may be a set-off in one insolvency but not the other, notwithstanding statements by Chadwick LJ in **Re SSSL** [2006] Ch 610 at [90].

liquidators (if LBIE goes into winding up) could only prove in the Members' insolvencies in relation to the "*balance*" against their estate. For example, if a call on the Member were made for 100, and the sum owed by the company to the Member were 40, the company could only prove (and receive a dividend) on 60. Para 8 of Schedule 4 makes clear that a contribution claim against an insolvent contributory is to share "*rateably with the other separate creditors*": there is no reason why the contributory's other creditors should lose out (and be in a worse position than the creditors of the company whose liquidators are claiming a contribution)[22] simply because the company is a contributory.[23]

78. If, contrary to the above, LBIE's administrators are entitled to prove in the Members' insolvencies in respect of the Potential Liability as Contributory, they cannot be in any better position than para 8 clearly provides in respect of liquidators. Accordingly, the same must follow.

Cherry v Boultbee

79. Alternatively, if, contrary to the above, there is no insolvency set-off in the context of LBL's administration (or liquidation) so as to require an account to be taken between LBL's claim against LBIE and the Potential Liability as Contributory, the rule in **Cherry v Boultbee**, set out above, should apply. As a debtor of LBL, in respect of a debt presently due and payable, LBIE is liable to contribute to the fund constituted by LBL's assets, to be distributed to its creditors. Accordingly, the rule in **Cherry v Boultbee**, as described above, applies. The calculation should be applied in the manner described by Buckley J in **Re Leeds and Hanley** and Chadwick LJ in **Re SSSL**.

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[22] See e.g. Romer LJ in **Re GEB** [1903] 2 KB 340 at 352: "*it is clear that, the judgment debt being one for calls in the winding-up of the company, no set-off could be urged by the debtor in respect of a debt due to him from the company... if the bankruptcy of the debtor were to ensue, there would be a right of set-off, the reason in that case being* ***that the rights of the creditors of company, and the rights of the creditors of the bankrupt have supervened, and you then have to deal with double rights, namely, the rights of the creditors of the company and the rights of the creditors of the bankrupt. Those rights are equal, and the only way of dealing with the difficulty in that case is to treat the mutual rights as if they were the rights, the old rights, of the debtor in his individual capacity and the company in its individual capacity, and so the right of set-off accrues and must be enforced.***"

[23] It will be submitted in this context that the decision in **Re Auriferous (No. 1)** [1898] 1 Ch 691 is wrong, and that Wright J should not have distinguished **Re Duckworth** (1867) LR 2 Ch App 578 (permitting a set-off when the liquidator of the insolvency company proved in the bankruptcy of a contributory for a call). C.f. Derham on the Law of Set-Off (4th end.) at [8.74] ("*It seems difficult to justify this distinction between an incorporated contributory and a contributory who is a natural person, since the right of set-off conferred by the insolvency legislation in a contributory's insolvency applies equally in both cases.*") and at FN 3 on p476.

Question 7: the effect of s.149

80. **Question 7**: What (if any) is the effect of Section 149 of the Act on:

(1) Any proof submitted by either of the Members in LBIE's administration or (if LBIE were wound-up) liquidation?

(2) Any proof submitted by LBIE in either of the Members' respective administrations or (if either of the Members were wound-up) liquidations?

81. S.149 of the Act provides:

> "(1) The court may, at any time after making a winding-up order, make an order on any contributory for the time being on the list of contributories to pay, in manner directed by the order, any money due from him (or from the estate of the person who he represents) to the company, exclusive of any money payable by him or the estate by virtue of any call [in pursuance of the Companies Act or this Act][24].
>
> (2) The court in making such an order may—
> (a) in the case of an unlimited company, allow to the contributory by way of set-off any

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[24] These words were repealed by the Companies Act 2006 (Consequential Amendments, Transitional Provisions and Savings) Order 2009/1941, but article 8 of that order provides:
"(1) The amendments by this Order of the Insolvency Act 1986 ("the 1986 Act") and the Insolvency (Northern Ireland) Order 1989 ("the 1989 Order") apply as follows.
(2) They apply where, in a company voluntary arrangement, a moratorium comes into force in relation to a company on or after 1st October 2009.
(3) They apply where a company enters administration on or after 1st October 2009, except where—
(a) it enters administration by virtue of an administration order under paragraph 10 of Schedule B1 to the 1986 Act (or paragraph 11 of Schedule B1 to the 1989 Order) on an application made before 1st October 2009,
(b) the administration is immediately preceded by a voluntary liquidation in respect of which the resolution to wind up was passed before 1st October 2009, or
(c) the administration is immediately preceded by a liquidation on the making of a winding-up order on a petition which was presented before 1st October 2009.
(4) They apply where, in a receivership, a receiver or manager is appointed in respect of a company on or after 1st October 2009.
(5) They apply where a company goes into liquidation upon the passing on or after 1st October 2009 of a resolution to wind up.
(6) They apply where a company goes into voluntary liquidation under paragraph 83 of Schedule B1 to the 1986 Act (or paragraph 84 of Schedule B1 to the 1989 Order), except where the preceding administration—
(a) commenced before 1st October 2009, or
(b) is an administration which commenced by virtue of an administration order under paragraph 10 of Schedule B1 to the 1986 Act (or paragraph 11 of Schedule B1 to the 1989 Order) on an application which was made before 1st October 2009.

(7) They apply where a company goes into liquidation on the making of a winding-up order on a petition presented on or after 1st October 2009, except where the liquidation is immediately preceded by—
(a) an administration under paragraph 10 of Schedule B1 to the 1986 Act (or paragraph 11 of Schedule B1 to the 1989 Order) where the administration order was made on an application made before 1st October 2009,
(b) an administration in respect of which the appointment of an administrator under paragraph 14 or 22 of Schedule B1 to the 1986 Act (or paragraph 15 or 23 of Schedule B1 to the 1989 Order) took effect before 1st October 2009, or
(c) a voluntary liquidation in respect of which the resolution to wind up was passed before 1st October 2009."

money due to him or the estate which he represents from the company on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit, and
(b) in the case of a limited company, make to any director or manager whose liability is unlimited or to his estate the like allowance.

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

82. S.149(1) provides a summary remedy for the recovery of moneys due from a contributory, in its capacity as such,[25] other than money payable by virtue of any call in pursuance of the Companies Act or the Act. It only applies "*at any time after making a winding-up order*". When an order is made under s.149(1), in the case of an unlimited company, the court may allow the contributory by way of set-off any money due to him or the estate which he represents from the company on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit. The Potential Liability as Contributory could not be the subject of an order under s.149(2)(a), because it is a liability to pay money by virtue of a call in pursuance of the Act.

83. The LBIE Joint Administrators' position paper states (at para 7(c)) that the LBIE Joint Administrators do not believe that the Members owe any other obligations to LBIE in their capacity as contributories.[26] If that is correct, it is not understood how s.149(2)(a) could have any effect on either (i) a proof submitted by either of the Members in LBIE's administration or any subsequent liquidation, or (ii) a proof submitted by LBIE in either of the Members' administrations (or subsequent liquidations).

[25] **Re Marlborough Club Co** (1868) LR 5 Eq. 365
[26] The LBIE Joint Administrators have been asked for clarification of whether the allotted shares in LBIE are paid up. The LBL Joint Administrators' position as to the impact of this is reserved.

Question 3: LBHI2's ability to prove and receive distributions in LBIE's administration (and any subsequent liquidation) in respect of the LBHI2 Sub-Debt

84. **Question 3**: Is LBHI2 entitled to prove in LBIE's administration, or would LBHI2 be entitled to prove in any subsequent liquidation of LBIE, in respect of the LBHI2 Subordinated Debt notwithstanding: (i) the terms of the LBHI2 Subordinated Debt; and (ii) LBHI2's Potential Liability as Contributory? What (if any) is the effect of Section 74(2)(f) of the Act?

85. Because this issue is principally one between LBHI2 and LBIE, the LBL Joint Administrators will not make detailed submissions in relation to it at this stage. The LBL Joint Administrators reserve the right to address this issue further in due course.

86. It appears that it is common ground that, in light of the subordination provisions in the Sub-Debt Agreements, at the very least, LBHI2's claim in respect of the LBHI2 Sub-Debt will not rank for dividend until all unsubordinated provable debts have been paid in full (see e.g. para 5.3 of LBHI's position paper).

87. The primary issues in dispute as regards the LBHI2 Sub-Debt appear to be, and in particular in light of the terms of the LBHI2 Sub-Debt Agreements:

    (1) Whether or not LBHI2 is entitled to prove in respect of the LBHI2 Sub-Debt before that claim ranks for dividend in LBIE's estate;

    (2) Whether the LBHI2 Sub-Debt ranks in priority in LBIE's insolvency ahead of post-administration or post-liquidation interest.

88. As to these issues, the LBL Joint Administrators are in agreement with the positions of LBIE and Lydian as set out in their position papers, namely that in light of the subordination provisions in the LBHI2 Sub-Debt provisions (in particular Standard Term 5, and the definitions of "*Liabilities*", and "*Senior Liabilities*"):

    (1) LBHI2 is not entitled to prove in LBIE's administration or any subsequent liquidation before the LBHI2 Sub-Debt ranks for dividend; and

    (2) Post-administration or post-liquidation interest ranks in priority in LBIE's administration (or any subsequent liquidation) ahead of the LBHI2 Sub-Debt, such that LBHI2's claim in respect of the LBHI2 Sub-Debt will not rank for dividend in LBIE's administration (or any

subsequent liquidation) unless and until such interest is paid in full. In accordance with the terms of the LBHI2 Subordinated Debt, and in particular Standard Term 5 thereof, LBHI2's rights in respect of the LBHI2 Subordinated Debt *"are subordinated to the Senior Liabilities"*, which include post-insolvency interest.

89. In the circumstances, under the terms of the LBHI2 Subordinated Debt, LBHI2 is not entitled to prove (or receive dividends) in LBIE's administrations in respect of the LBHI2 Subordinated Debt until Senior Liabilities (including post-insolvency interest) are paid in full.

90. For the avoidance of doubt, as explained below, the LBL Joint Administrators do not agree with the LBIE Joint Administrators as to the scope of the Potential Liability as Contributory (including in relation to the LBHI2 Sub-Debt and statutory interest). Additionally, as explained below in the context of Question 9, payment of any amount is, under the LBHI2 Subordinated Debt, contractually 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'"*. Standard Term 5(2) provides that for this purpose, LBIE will be *"solvent"* only if it is *"able to pay is 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"*. As explained below, whether LBIE is *"solvent"* for the purposes of the LBHI2 Subordinated Debt must be determined without reference to contributions from the Members. It remains uncertain whether there is any prospect of LBIE being able to pay its general, unsecured creditors in respect of both the principal of the debts and liabilities owed to them by LBIE and statutory interest (see WS/RD4 at [58]-[59] and para 10(2)g above). If it cannot, under the terms of the LBHI2 Subordinated Debt, no payment is due to LBHI2.

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

91. **Question 8:** To the extent that LBIE is entitled to prove in respect of it, or it is required to be brought into the account on any proof which either of the Members is entitled to file in LBIE's administration or a subsequent liquidation, in circumstances in which each Member's Potential Liability as Contributory is contingent, is that Member's Potential Liability as Contributory capable of being ascertained and quantified and, if so, how should the quantum of that Member's Potential Liability as Contributory be quantified?

LBIE proving in the Members' administrations/liquidations

92. Rule 13.12(3) provides:

> "For the purposes of references in any provision of the Act or the Rules about winding up to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, or whether its amount is 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."[27]

93. In an administration, in respect of debts which do not bear a certain value, Rule 2.81 provides (and Rule 4.86 is equivalent in the case of a liquidation):

> "(1) The administrator **shall estimate the value of any debt which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value**; and he may revise any estimate previously made, if he thinks fit by reference to any change of circumstances or to information becoming available to him. He shall inform the creditor as to his estimate and any revision of it.
>
> (2) **Where the value of a debt is estimated under this Rule, the amount provable in the administration in the case of that debt is that of the estimate for the time being.**"

94. It appears that Rules 2.81 and Rule 4.86 are drafted on the assumption that "*any*" contingent claim is capable of valuation,[28] and that, in respect of such claims, the administrator or liquidator must estimate the value of the debt in order for it to be admitted to proof.

95. A number of points concerning the approach to contingent claims in a liquidation were considered by the Court of Appeal in **In re Danka Business Systems plc (in members' voluntary liquidation) Ricoh Europe Holdings BV and others v Spratt & or** [2013] EWCA Civ 92; [2013] 2 WLR 1398:

(1) The applicants purchased from the company the issued share capital of various European

[27] Rule 13.12(5) makes clear that the Rule applies where a company is in administration.
[28] See e.g. Patten LJ in **In re Danka Business Systems plc (in members' voluntary liquidation) Ricoh Europe Holdings BV and others v Spratt & or** [2013] EWCA Civ 92; [2013] 2 WLR 1398 at [36].

companies and the company agreed to indemnify the applicants for a period of seven years in respect of some of the companies' pre-completion tax liabilities. Shortly thereafter the company, which was solvent, was put into voluntary members' liquidation. Under the indemnities the applicants had contingent claims against the company, consisting of potential tax liabilities in four European jurisdictions, the quantification of each liability being dependent on the outcome of an uncompleted tax audit or investigation by the relevant authority. The company's liquidators gave notice to the company's creditors, pursuant to Rule 4.182A, informing them that they proposed to make a final distribution to creditors. The applicants proved for their debts but asked the liquidators to defer taking any further steps in the liquidation until all of the tax liabilities had been determined and to ring-fence, prior to any distribution to other creditors and members, a reserve of nearly €12m out of which their contingent claims under the indemnities, once crystallised, could be paid. The liquidators refused that request, admitted the applicants' contingent claims to proof and proceeded to value them, pursuant to Rule 4.86 of the 1986 Rules, at €268,961. The applicants applied (i) under section 112 of the Insolvency Act 1986 for an order requiring the liquidators to make a retention of £11m which would not become available for distribution to members until either the applicants' contingent claims had crystallised or the end of the seven-year indemnity period, whichever was the sooner, alternatively (ii) under Rule 4.83 of the 1986 Rules challenging the liquidators' valuation of their contingent claims.

(2) The Court of Appeal held that a liquidator in a members' voluntary liquidation was under an obligation to complete the liquidation even though the effect of the winding up might be to defeat the contingent claims of its creditors; that such a liquidator who had already valued a contingent claim and so admitted it to proof in the amount of the valuation was not therefore obliged to provide for the contingency in full by making a reserve against any distribution to the members; and that, therefore, the liquidators were entitled to proceed to a distribution to members under section 107 of the Insolvency Act 1986 on the basis of the debts admitted to proof.

(3) Patten LJ provided valuable guidance as to the valuation of contingent liabilities at [43]:

> "It seems to me that any valuation of a contingent liability must be based on a genuine and fair assessment of the chances of the liability occurring. The very concept of valuing a contingency implies the need to make an assessment of how likely are the chances of the event occurring. The liquidator must therefore use his own expertise and that of any relevant advisers to make a realistic estimate of the likelihood of the Infotec companies sustaining the tax liabilities. Where some material change in the relevant factual position occurs it must be taken into account. But the liquidator is not, in my opinion, required simply to wait and see. That is the opposite of valuation. In the case of indemnity, it is true of course that the contractual liability of the party offering the indemnity operates as a kind of insurance against the

prospective loss. But in the hands of a liquidator who must make a current assessment of the risk of that event occurring, the nature of the indemnity is irrelevant to the assessment of that outcome. There is nothing in rule 4.86 which requires the liquidator to guarantee a 100% return on the indemnity by assuming a worst-case scenario in favour of the creditors. To do so would produce a valuation which, by definition, was unfair to the company and its other creditors and members. The valuation provisions must apply in the same form to both solvent and insolvent liquidations. I cannot see particularly in the case of an insolvent liquidation how such a valuation could ever be regarded as appropriate."

96. Accordingly, if LBIE were (contrary to the above) entitled to prove in the Members' administrations/liquidations in respect of the Potential Liability as Contributory prior to its winding-up, the Members' administrators/liquidators would not have to assume a worse-case scenario in favour of LBIE, but rather would have to make a genuine and fair current assessment of the likelihood of the contingencies which trigger the liability under s.74 occurring, including:

(1) LBIE going into liquidation;

(2) There being a shortfall for which the Members may be liable to contribute under s.74;

(3) A call being made on the contributory;

(4) The quantum of the call on the contributory, as to which the Court's determinations in particular in relation to questions 9 and 10 of the Joint Application will provide invaluable guidance as to the scope of the Potential Liability as Contributory. Up-to-date information will also be required as to the claims in, and assets of, LBIE.

97. WS/DAH states, *inter alia*, that "*there is no evidence to support the proposition that LBIE's administrators have a settled intention to proceed to liquidation*" (para 7(c)) and that "*If creditors are to be paid by way of distributions out of the administration, there are no obvious arguments supporting the proposition that LBIE's administrators would wish to convert the administration into liquidation*" (para 7(d)). However, it is noted that WS/RD4 states:

(1) At [64]: "*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.*"

(2) At [65]: "*The LBIE Administrators consider that all options are available with regard to whether LBIE might in due course 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 (a copy of the Proposals is at ***pages 353-355 of RD1****). 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."*

98. Accordingly, at the appropriate time, the relevant administrators/liquidators would have to make a genuine and fair assessment of the prospect of LBIE going into liquidation (and of the other contingencies set out above, which would apply equally if LBIE were to prove in respect of the Potential Liability as Contributory after it went into liquidation). This is likely to be a complex exercise.

99. Rule 2.89 (and Rule 4.94 is similar in the context of a winding up) provides that a creditor may prove for a debt of which payment was not yet due on the relevant date, subject to Rule 2.105. The calculation in Rule 2.105 (or Rule 11.13) is then used to take account of accelerated receipt (effectively discounting the amount of the admitted proof at 5% per annum).[29] One of the elements in the formula in Rule 2.105 is the "n" period, which is *"the period beginning with the relevant date and ending with the date on which the payment of the creditor's debt would otherwise be due expressed in years and months in a decimalised form."* Here, it is not known if and when LBIE may enter into a winding up and when a call may be made (which is when contributions are payable). However, as a matter of principle, if (contrary to the above) LBIE is entitled to prove in the Members' estates before calls are made by its liquidators, for the purposes of any dividend payable to LBIE, there should be a discount to reflect accelerated receipt. An estimate would have to be made of when (if at all) LBIE would go into liquidation and when (if at all) a call would be made, and the formula for accelerated receipt should then be applied.

100. The administrators/liquidators would be able to call for any document or other evidence to be produced, where it is thought necessary for the purpose of substantiating the whole or any part of

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[29] Rule 2.105 provides (and Rule 11.13 is similar in the context of a winding up):
"(1) Where a creditor has proved for a debt of which payment is not due at the date of the declaration of dividend, he is entitled to dividend equally with other creditors, but subject as follows.
(2) For the purpose of dividend (and no other purpose) the amount of the creditor's admitted proof (or, if a distribution has previously been made to him, the amount remaining outstanding in respect of his admitted proof) shall be reduced by applying the following formula–

$$\frac{X}{1.05^n}$$

where–
(a) "X" is the value of the admitted proof; and
(b) "n" is the period beginning with the relevant date and ending with the date on which the payment of the creditor's debt would otherwise be due expressed in years and months in a decimalised form.
(3) In paragraph (2) "relevant date" means–
(a) in the case of an administration which was not immediately preceded by a winding up, the date that the company entered administration;
(b) in the case of an administration which was immediately preceded by a winding up, the date that the company went into liquidation."

the claim made in the proof (see Rule 2.72(5), Rule 4.75(3) (no CVL application), and Rule 4.76).

101. It is noted that Rules 2.81 and 4.86 provide that the administrator/liquidator "*may revise any estimate previously made, if he thinks fit by reference to any change of circumstances or to information becoming available to him.*" Further, a creditor's proof may at any time, by agreement between himself and the administrator/liquidator, be withdrawn or varied as to the amount claimed (see Rule 2.79 and Rule 4.84).

102. However, Rule 2.101 provides (and Rule 11.8 is similar in the context of a liquidation):

> "(1) If after payment of dividend the amount claimed by a creditor in his proof is increased, the creditor is not entitled to disturb the distribution of the dividend; but he is entitled to be paid, out of any money for the time being available for the payment of any further dividend, any dividend or dividends which he has failed to receive.
>
> (2) Any dividend or dividends payable under paragraph (1) shall be paid before the money there referred to is applied to the payment of any such further dividend.
>
> (3) If, after a creditor's proof has been admitted, the proof is withdrawn or expunged, or the amount is reduced, the creditor is liable to repay to the administrator any amount overpaid by way of dividend."

Quantification of the Potential Liability as Contributory for the purposes of insolvency set-off

103. If, contrary to the above, insolvency set-off operates in the context of LBIE's administration (or a subsequent liquidation), the Potential Liability as Contributory will fall to be valued in the same way as set out above in the context of LBIE proving in the Members' estates:

(1) Rule 2.85(5) makes clear that Rule 2.81 shall apply for the purposes of the rule "*to any obligation to or from the company which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value*".[30]

(2) Rule 2.85(7) provides that Rule 2.105 shall apply for the purposes of the Rule "*to any sum due to or from the company which is payable in the future*".[31]

(3) Rule 2.85(8) provides that:[32]

> "the balance (if any) owed to the company shall be paid to the administrator as part of the assets **except where all or part of that balance results from a contingent or prospective debt owed by the creditor and in such a case the balance (or that part of**

[30] Rule 4.90(5) is equivalent in relation to a liquidation, referencing Rule 4.86.
[31] Rule 4.90(7) is equivalent in relation to a liquidation, referencing Rule 11.13.
[32] Rule 4.90(8) is equivalent in relation to a liquidation.

it which results from the contingent or prospective debt) shall be paid if and when that debt becomes due and payable".

Question 9: the extent of the Potential Liability as Contributory

104. **Question 9:** Whether, and in what circumstances each of the Member's Potential Liability as Contributory extends to contributing to LBIE's assets an amount sufficient for payment of:

(a) Interest provable and/or payable pursuant to Rule 2.88 of the Rules on the principal of the debts and liabilities owed to LBIE's creditors by LBIE; and/or

(b) The LBHI2 Subordinated Debt; and

(c) Currency Conversion Claims (as defined at question 12 below), to the extent that question 12 is answered in the affirmative.

S.74

105. S.74(1) provides that the scope of the liability under that section for which a contributory is liable to contribute extends to the company's *"debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves."*

106. The *"debts and liabilities"* referenced in this section can only mean provable debts (in respect of which the company is liable to pay distributions):

(1) Rule 13.12(1) defines, *"in relation to the winding up of a company"* (or, by virtue of Rule 13.12(5), an administration), a *"Debt"*, and it is in respect of *"Debts"* that creditors can prove in a distributing administration or a liquidation. The reference in s.74 to *"debts and liabilities"* must be read by reference to the definition of *"Debt"* in Rule 13.12(1), which itself (at sub-paras (a) and (b)) references *"liabilities"*. The word *"liabilities"* in s.74 should not be read in isolation.

(2) Contributories are liable to contribute to make up the shortfall in the company of which they are members; that shortfall can only be created by provable debts.

(3) The company (through its office holders) should not be able to prove (and receive distributions) in the contributories' insolvencies for sums which are not provable in its own insolvency. There is no reason why the company's contributories should be in any worse position than the company itself, to the detriment of the contributories' creditors.

(4) The fact that s.74(1) specifically references *"the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves"*, supports the construction

that "*debts and liabilities*" is confined to provable debts.

Post-administration/post-liquidation interest

107. Rule 2.88(7) provides that 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.

108. This provision (like s.189(2) in the context of a winding-up) does not impose upon the company a liability. It merely states what the administrator (or liquidator) is to do with "*Any surplus remaining after the payment of the debts proved in a winding up*". Even if Rule 13.12(4), and the definition therein of "*liabilities*", were relevant for present purposes, post-insolvency interest is not "*a liability to pay money or money's worth, including any liability under an enactment...*". Post-insolvency interest simply concerns what the administrator/liquidator should do with a surplus. Further:

(1) As stated at Rule 2.88(8) and s.189(3), "*All interest payable under [paragraph (7)/this section] ranks equally whether or not the debts on which it is payable rank equally*". If the status of interest liabilities under the debts were left unchanged, then it is difficult to see why interest should rank equally regardless of whether the debts rank equally.

(2) The fact that post-administration/post-liquidation interest accrues at the greater of the Judgments Act Rate (8%), and the rate applicable to the debt apart from the administration/winding-up, supports, rather than detracts from, the position contended for by the LBL Joint Administrators. It does not mean that "*the contractual liability to pay interest in respect of the post-administration period survives*", as suggested by the LBIE Joint Administrators in their position paper.

109. If calls need to be made on the contributories, there is no surplus. A surplus should be regarded only as amounts the insolvent entity itself can distribute.

110. If the Potential Liability as Contributory were to extend to post-insolvency interest, anomalous results would follow. For example:

(1) If a proof could be made by the company's liquidator in the contributory's insolvency in respect of post-liquidation interest, in circumstances where the contributory itself does not have a surplus to pay its own creditors post-insolvency interest, the company's creditors

would be placed in a better position than the contributories' own creditors.

(2) If the company's liquidators could make a call upon, and prove in the insolvency of, the contributories for any amount necessary to meet all provable debts and also post-liquidation interest, if the contributory were only able to pay a dividend on the proof at less than 100p in the £, a dividend will have been paid upon the entire sum proved (including post-liquidation interest), but it may be that the company, even upon receipt of the dividend, does not have a "*surplus*" within the meaning of s.189. In those circumstances, if the company were to use the dividend only to pay provable debts, and not post-liquidation interest, then there would be a discrepancy between the dividend paid to the company by the contributory (calculated on a basis including post-liquidation interest) and the use by the company of the dividend as regards distributions.

111. Additionally, as mentioned above Rule 13.12(1)(c) specifically states that "*Debt*" includes "*any interest provable as mentioned in Rule 4.93(1)*", i.e. it includes pre-administration/pre-liquidation interest. Such interest is provable (and therefore within the scope of the Potential Liability as Contributory) (see Rules 2.88(1) and 4.93(1): "*that interest is provable as part of the debt...*"). On the other hand, there is no mention in s.74(1) of post-insolvency interest, which is expressly not a provable debt.

112. As to the other provisions referenced by the LBIE Joint Administrators in their position paper:

(1) The relevance of s.89(1) is not understood. This provision provides that a statutory declaration of solvency for the purposes 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*". Solvency is of course defined without reference to contributions from members, so the reference in this provision to interest at the official rate has no bearing upon the scope of the Potential Liability as Contributory. Further, the fact that s.89(1) refers to "*interest at the official rate*" as distinct from the company's "*debts*" supports the proposition that post-insolvency interest is not a "*debt or liability*" of the company within s.74(1).

(2) S.149(3) extends to "*any money due on any account whatever to a contributory from the company*". Accordingly, it would permit a set-off against subsequent calls as regards sums owed to the contributory *qua* member. Such sums are, as mentioned above, subordinated under s.74(2)(f). The reference in s.149(3) to "*interest at the official rate*" simply ensures, therefore, that post-insolvency interest is paid before contributories seek to set-off calls on them against claims they have against the company *qua* member.

(3) The fact that s.74(1) provides that members are liable to contribute to any amount sufficient *"for the adjustment of the rights of the contributories among themselves"* is similarly beside the point. The LBIE Joint Administrators state in their position paper that such an adjustment would, pursuant to s.107 (voluntary winding up) or s.154 (compulsory winding up) only occur once all the sums due to creditors, including interest under rule 2.88(7), have been paid in full. S.107 provides:

> "Subject to the provisions of this Act as to preferential payments, the company's property in a voluntary winding up shall on the winding up be applied in satisfaction of the company's liabilities pari passu and, subject to that application, shall (unless the articles otherwise provide) be distributed among the members according to their rights and interests in the company."

S.154 provides:

> "The court shall adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled to it."

Under s.74, the contributories' liability to contribute to any amount sufficient *"for the adjustment of the rights of the contributories among themselves"* arises when the company is wound up. Whilst it may be that (other than in respect of claims by the members which are not *qua* member) no sums are paid to the members by the company out of any surplus until after sums due to creditors, including any interest payable under rule 2.88(7), are paid in full, it does not follow that: (i) the contributories are not liable prior to that point to contribute to any amount sufficient for the adjustment of the rights of the contributories among themselves; or that (ii) the Potential Liability as Contributory extends to post-administration (or post-liquidation) interest.

Currency Conversion Claim

113. As explained below, there is no Currency Conversion Claim. Accordingly there is no *"debt or liability"* within s.74(1).

114. But even if, contrary to the LBL Joint Administrators' position, there is a Currency Conversion Claim, it is common ground that it is not a provable claim. Accordingly, because only provable claims fall within *"debts and liabilities"* under s.74(1), as explained above, any Currency Conversion Claim is not within the scope of the Potential Liability as Contributory. This accords with the fact that the dicta of Brightman LJ in **In Re Lines Bros Ltd (No. 1)** [1983] Ch 1, in particular at 21, upon which LBIE and Lydian rely, and which left open the question of a possible residual Currency Conversion Claim if statutory interest were paid in full, were concerned with *"the duty of the liquidator, in the case of* ***a wholly solvent liquidation****, if a foreign*

currency creditor has been paid less than his contractual foreign currency debt". If a call needs to be made on the contributories, the liquidation is not a *"wholly solvent"* one and, accordingly, even if there is a Currency Conversion Claim in certain circumstances, it does not fall within the scope of the Potential Liability as Contributory.

115. Furthermore, it is *"When a company is wound up"* that the obligation under s.74(1) arises. It is at that date that the companies' debts and liabilities are assessed, and at that date that foreign currency claims are converted into sterling. It would be unfair and unprincipled for a residual Currency Conversion Claim to arise for which the company may look to its contributories. For example, the LBIE Joint Administrators do not suggest that, if the currency conversion at the date of liquidation worked to the benefit of the company's creditor, the company would have a claim against the creditor for the difference. Additionally, it is not clear how a liability to contribute in respect of Currency Conversion Claims would fall to be valued (in particular the relevant date at which future exchange rates would have to be estimated).

The LBHI2 Sub-Debt

116. The LBHI2 Sub-Debt Agreement provide, at paragraph 5 of the Standard Terms:

> "(1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of Subordinated Liabilities are subordinated to the Senior Lenders and accordingly **payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon-**
> (a) .....
>
> (b) **the Borrower being "solvent" at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be "solvent".**
>
> (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be "solvent" if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
>
> (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
>
> (b) the Excluded Liabilities.
>
> (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
>
> (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency or Insolvency.

...."

117. Accordingly, pursuant to para 5(1)(b), payment of any amount under the LBHI2 Sub-Debt Agreements is conditional upon the Borrower being *"solvent"* at the time of, and immediately after, the payment by the Borrower, and no such amount which would otherwise fall due for payment is payable except to the extent that the Borrower could make such payment and still be *"solvent"*.

118. For the purposes of assessing whether the Borrower is *"solvent"*, under para 5(2), solvency must be defined by reference to what the Borrower (LBIE) itself can pay, and without reference to any contributions that may be made by LBIE's members. It cannot be the case, for example, that at the very moment when the Borrower is wound up, it becomes solvent by virtue of the members' liability to contribute.

119. Whether or not LBIE would be solvent at the relevant times will depend upon the application of para 5(2) (and, as explained below, *"Senior Liabilities"* under the LBHI2 Sub-Debt Agreements includes post-insolvency interest). It remains uncertain whether, if post-insolvency interest ranks in priority ahead of the LBHI2 Sub-Debt, LBIE will have any funds remaining for payment in respect of the LBHI2 Sub-Debt (see WS/RD4 at [58]; and this conclusion appears to remain correct in light of the forecasts in the LBIE Joint Administrators' tenth progress report: see para 10(2)g above). If it would not, then nothing will be payable to LBHI2 in respect of the LBHI2 Sub-Debt.

120. In these circumstances, even if, therefore, the LBHI Sub-Debt is a *"debt or liability"* under s.74(1), the value of it would be 0. Another way of looking at it is that, in these circumstances, there is no further amount required *"for payment of [LBIE's] debts and liabilities"*, and thus no *"amount sufficient for payment of its debts and liabilities"* for which the members are liable under s.74(1).

121. Accordingly, the Potential Liability as Contributory does not extend to the LBHI2 Sub-Debt.

122. Additionally, in circumstances where the only members are LBL and LBHI2, it is difficult to see how any calls could be made in respect of an amount representing the LBHI2 Sub-Debt:

(1) LBHI says in its position paper that LBHI2's Potential Liability as Contributory extends to the LBHI2 Sub-Debt if it is provable; LBHI2's position paper states at para 18 that if LBIE were to go into liquidation and the LBIE liquidators were to consider claiming a sum from LBHI2 as contributory in the event of a shortfall in LBIE's assets, LBIE's liquidators should,

in ascertaining the total shortfall to which LBHI2 may have to contribute under s.74(1) of the Act, take into account both the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt. The purpose of this (from LBHI2's perspective) would appear to be to ensure that, if something were to be paid by LBHI2 to LBIE by way of a contribution, some of that may come back to LBHI2 in respect of the LBHI2 Sub-Debt. However, if the dividend paid by LBHI2 on a proof by LBIE's office holders in respect of a shortfall in LBIE (including an amount necessary to make payment of the LBHI2 Sub-Debt) were to be insufficient to allow LBIE to make payment in full to all its creditors in respect of their unsecured debts, then either: (i) if all of the dividend paid by LBHI2 on the proof in respect of the s.74(1) liability were distributed by LBIE's officeholders in respect of unsecured claims, there would be a discrepancy between the dividend paid to the company by LBHI2 (calculated on a basis including the LBHI2 Sub-Debt) and the use by the company of the dividend as regards distributions (not used to pay down the LBHI2 Sub-Debt); or (ii) if the dividend paid by LBHI2 on the proof in respect of the s.74(1) liability were distributed in respect of all the claims used to quantify the proof (including the LBHI2 Sub-Debt), with each creditor (including LBHI2) rateably receiving a dividend of less than 100p in the £, then that would contradict the subordination provisions in the LBHI2 Sub-Debt Agreements.

(2) In relation to LBL, as explained below, as far as possible contributions between the Members should be shared rateably. Either calls should be made in proportion to the aggregate nominal value of the shares held by each member, or, at the very least, there is a contribution claim between co-contributors such that they share the shortfall in proportion to the aggregate nominal value of the shares held by them. Further, LBIE's liquidators have the duty to make calls to adjust the rights of the contributories among themselves. Accordingly, given that LBL's % shareholding in LBIE (in proportion to the aggregate nominal value of the allotted shares) is but 0.0000000000747769%, a call should not be made upon LBL insofar as it extends to the LBHI2 Sub-Debt.

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

123. **Question 10:** In the event that the Members are obliged to contribute to the assets of LBIE pursuant to Section 74 of the Act, and in light of the fact that LBL owns one ordinary share of $1 in LBIE, and LBHI2 owns 2 million 5% redeemable Class A preference shares of $1000 each, 5.1 million 5% redeemable Class B shares of $1000 each and 6,273,113,999 ordinary shares of $1 each in LBIE:

(a) Whether their obligations are joint, several or otherwise as against LBIE;

(b) Whether they are entitled to seek a contribution or indemnity from one another in respect of any payments made pursuant to any such obligation and, if so, the nature and extent of such right of contribution or indemnity;

(c) To what extent any right to contribution or indemnity as referred to in sub-paragraph (b) above is affected by any other claims which LBHI2 and LBL have against one another.

Factual background

124. LBL has only ever held one ordinary share in LBIE (WS/MJAJ at [13]; WS/MJAJ2 at [5]). Between 23 November 1994 and 1 May 1997, it held a single ordinary £1 share as a nominee for LBH Plc. On 1 May 1997, LBIE resolved to cancel and extinguish all sterling shares,[33] including the single sterling share held by LBL [8/1/145], and the LBIE board resolved to allot to LBL a single $1 ordinary share, which is the share that LBL continues to hold [8/1/141-148].

125. Further history as to the shareholdings in LBIE is set out in WS/RD4 at [13], [34], [37], and [53], and in the chronology. In particular:

(1) Between 5 October 1990 and 2 October 1991, Martin William Cornish (Chief Legal Officer and the LBIE Company Secretary) held a single $1 ordinary share in LBIE. Between 2 October 1991 and 22 September 1992, Peter Sherratt (who succeeded Mr Cornish as Chief Legal Officer and as LBIE's Company Secretary) held the single $1 ordinary share in LBIE previously held by Mr Cornish (it appears as nominee for SLB Holdings PLC: see [8/1/129 and 131]).

[33] It appears because the sterling shares had originally been issued to cover LBIE's investment in Lehman Brothers Money Brokers Limited and Lehman Brothers Gilts Limited, which were sold on 28 May 1996 and 1 May 1997, respectively: see [5B/404].

(2) From 30 November 1990 until the 2006 restructuring, LBH PLC held the majority, if not all, the shares of LBIE (holding between 59,999,999 ordinary $1 shares in November 1990 and 4,098,113,999 ordinary $1 shares in 2006; also holding a number of £1 ordinary shares between 10 December 1992 and 1 May 1997).

(3) Between 22 September 1992 and 23 November 1994, LBIE had only one shareholder, being LBH PLC.

(4) As part of the 2006 restructuring (described in detail in WS/RD4), LBHI2 became LBIE's majority shareholder, holding all but one of the ordinary $1 shares in LBIE. Also as part of the 2006 restructuring, LBIE replaced $2bn of subordinated debt with $2bn non-cumulative preference shares (WS/RD4 at [34.1]). Thus, on 1 November 2006, LBHI2 acquired 2m 5% redeemable preference shares of $1,000 each (WS/RD4 at [34.2]).

(5) In 2007, LBIE allotted to LBHI2, as consideration for the discharge of $5.1 billion of LBHI2 Sub-Debt (being the majority of the balance of LBHI2 Sub-Debt outstanding as at 1 May 2007), 5.1m 5% redeemable Class B preference shares of $1,000 each (see in particular [8/1/301-305]).

126. As at the date of LBIE's entry into administration, LBL continued to hold a single $1 ordinary share in LBIE, and LBHI2 held 2 million 5% redeemable preference shares of $1000 each, 5.1 million 5% redeemable Class B shares of $1000 each and 6,273,113,999 ordinary shares of $1 each in LBIE. Thus LBL owns 1 out of a total of 6,280,214,000 shares in LBIE, or 0.0000000000747769% in terms of the aggregate nominal value of LBIE's allotted shares.

127. As the holder in one share in LBIE, LBL's potential liability would not have been apparent to any third parties dealing with LBL other than from a review of documents filed by LBIE at Companies House. In addition LBL received no significant benefit, or possibly any benefit at all, by way of dividends.

128. The witnesses jointly interviewed by the parties were asked why LBL held a share in LBIE. As to this:

(1) Jackie Dolby stated that (i) as an unlimited company, LBIE required 2 shareholders; and (ii) at the time the Lehman UK group was very small with only around 4 UK companies in existence, and LBL was likely the only UK company eligible to take the 1 share in LBIE (Ms Dolby's interview p10 line 8-p12 line 5 [10/3/3]).

(2) Dominic Gibb stated that he thought that it was a requirement of company law that two shareholders were required (see his interview at p4 line 18- p5 line 3 [10/7/1-2]).

(3) Margaret Smith said that she thought it was required, or that it was assumed that it was required, that there be two shareholders (see her interview at p10, lines 11-19 [10/8/3]).

(4) Mr Gamester said that, although he did "*get a little bit hazy*", he thought that:[34]

> "The logic is that if LBIE was an unlimited liability company with more than two shareholders, and I think the shareholders were PLC and LBL, it would be regarded as a partnership for US tax purposes. Therefore, the profits or rather the losses of LBIE would be regarded as losses of LBL and PLC for US tax purposes. That meant those losses could offset those profits for US tax purposes. So in other words, LBIE for US tax purposes became a look through (?) vehicle. Now, to be treated effectively as a partnership for US tax purposes at that time, there were a number of tests that had to be looked at to see whether the entity would be regarded as a company or as a partnership. One of the most important of those tests was this question of unlimited liability; if the shareholder had unlimited liability and there were more than two shareholders, then it was regarded as a partnership."
>
> ....
>
> "CRISPIN JONES: Okay. Now you've mentioned that it was also that there was losses running LBIE at the time and that's why you could gain the benefit of certain tax advantages. As it then transpired, the mechanism in which chares *[sic.]* were held in LBIE was that they were held predominantly by PLC and Lehman Brothers Limited held one share. Do you recall any reason for the shares being held in that way? i.e. that there (overspeaking).
>
> PETER GAMESTER: Well, there's two answers to that. The first is as I mentioned earlier, we wanted the shares to be held by profitable companies so that for US purposes, the losses of LBIE could be offset against those profits. Now PLC and LBL were two UK companies which regularly generated profits and were seen to be comparatively stable. Secondly, PLC was the main UK holding company at that time, so naturally it held the majority of the shares, well, virtually all of them. LBL was an unregulated company, so it would have been no impact on LBL owning a share in an unlimited liability company. So that was the reason really why those two companies were chosen.
>
> CRISPIN JONES: Yeah. Do you know why they were chosen, though, in the way that one company held one share and the other company held – well, ultimately in the region of 6 billion shares?
>
> PETER GAMESTER: Well as you can appreciate PCL was the holding company in the structure, so naturally you would expect it to hold the majority of the shares. LBL was there really for the reasons that I mentioned; we had to show more than one shareholder to achieve the US tax benefits."

129. The common theme of these answers is that, in taking the share in LBIE, LBL was essentially making up the numbers, whether for the purposes of UK companies law or for US tax reasons. Given the size of LBL's shareholding, it can never have been expected that it would derive any real benefit from it.

[34] See his interview at pp7-10 [10/9/2-3].

130. When LBIE was incorporated, the legislation in force (s.1(1) of the Companies Act 1985), provided that "*Any **two or more persons** associated for a lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability.*"[35] S.24 of the Companies Act 1985 also provided:

> "If a company carries on business without having at least two members and does so for more than 6 months, a person who, for the whole or any part of the period that it so carries on business after those 6 months—
> (a) is a member of the company, and
> (b) knows that it is carrying on business with only one member,
> is liable (jointly and severally with the company) for the payment of the company's debts contracted during the period or, as the case may be, that part of it."[36]

131. S.24 of the Companies Act 1985 (as amended) was repealed by the Companies Act 2006, with effect from 1 October 2009.[37] Thus, it appears likely that LBL held a share in LBIE at least in part in order to avoid the application of s.24 of the 1985 Act (which would have had the effect of making LBHI2, if it were the sole shareholder, jointly and severally liable with the company

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[35] The Companies (Single Member Private Limited Companies) Regulations subsequently inserted a s.1(3A) to s.1 of the 1985 Act, providing that "*one person may, for a lawful purpose, by subscribing his name to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company being a private company limited by shares or by guarantee.*"
The Companies Act 2006, s.7(1) now provides that a company is formed under the Act by one or more persons subscribing their names to a memorandum of association and complying with the requirements of the Act as to registration. S.38 of the 2006 Act provides: *"Any enactment or rule of law applicable to companies formed by two or more persons or having two or more members applies with any necessary modification in relation to a company formed by one person or having only one person as a member."*

[36] The Companies (Single Member Private Limited Companies) Regulations 1992 inserted the exclusion "*other than a private company limited by shares or by guarantee*" into s.24. The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 inserted a further exclusion where the company itself is a member only by virtue of its holding shares as treasury shares.

[37] S.123 of the 2006 Act provides:
"(1) If a limited company is formed under this Act with only one member there shall be entered in the company's register of members, with the name and address of the sole member, a statement that the company has only one member.
(2) If the number of members of a limited company falls to one, or if an unlimited company with only one member becomes a limited company on reregistration, there shall upon the occurrence of that event be entered in the company's register of members, with the name and address of the sole member–
(a) a statement that the company has only one member, and
(b) the date on which the company became a company having only one member.
(3) If the membership of a limited company increases from one to two or more members, there shall upon the occurrence of that event be entered in the company's register of members, with the name and address of the person who was formerly the sole member–
(a) a statement that the company has ceased to have only one member, and
(b) the date on which that event occurred.
(4) If a company makes default in complying with this section, an offence is committed by–
(a) the company, and
(b) every officer of the company who is in default.
(5) A person guilty of an offence under this section is liable on summary conviction to a fine not exceeding level 3 on the standard scale and, for continued contravention, a daily default fine not exceeding one-tenth of level 3 on the standard scale."

for the payment of the company's debts contracted during the period after 6 months in which the company carried on business without having at least two members).

132. As set out at paras 17-18 of WS/MJAJ:

(1) LBIE's Annual Statutory Accounts from 1991-2007 show that:

a. LBIE had allotted the following fully paid up ordinary $1 shares:

(i) 590m shares by the financial year ending November 1997; and

(ii) 830m shares by the financial years ending November 1998, 1999 and 2000.

b. During this period LBIE paid the following dividends:

(i) $130m in 1997;

(ii) $140m in 1998;

(iii) $170m in 1999; and

(iv) $85m in 2000.

(2) As LBL held only one ordinary $1 share in in LBIE out of a total of 590m-830m ordinary $1 shares allotted between 1997 and 2000, on any view dividends paid to LBL would have been very small (less than $1 as compared to a total of $525m paid to LBH Plc as the then majority shareholder).[38]

133. In addition to the fact that LBL was essentially just making up the numbers, and derived no significant benefit from the shareholding in LBIE, LBL's share in LBIE was also ignored for some purposes. In particular:

(1) There was a written resolution of LBHI2, said to be the sole member of LBIE, dated 29 February 2008 resolving (*inter alia*) that the authorised share capital of LBIE be increased from US$13.1bn to US$18.1bn by the creation of 5bn new ordinary shares of US$1 each [11/7], and the minutes of a meeting of the Board of LBIE on 29 February 2008 referred to

[38] The LBIE Joint Administrators have been asked for clarification as to dividends paid and LBL reserves its position accordingly.

that resolution and referred to LBHI2, at para 3, as the "*sole shareholder of the Company*" 11/8].

(2) Minutes of a meeting of the Board of LBIE on 1 November 2006 state, at para 2, that "*the Company's parent company, Lehman Brothers Holdings Plc ("**LBH**"), had executed stock transfer forms transferring the **entire issued share capital of the Company held by LBH** to LB Holdings Intermediate 1 Limited ("**LBH1**"), which is a wholly owned subsidiary of LBH. Further, LBH1 had subsequently transferred the **entire issued share capital of the Company held by LBH1** to LB Holdings Intermediate 2 Limited ("LBH2).*". The minutes record that the directors resolved that "*the transfer of the **entire** issued share capital of the Company held by LBH from LBH to LBH1 and the subsequent transfer of the entire issued share capital of Company held by LBH1 to LBH2 shall be approved for registration*" [8/1/221].

How are calls on LBHI2 and LBL to be made if LBIE is wound up?

134. The duty to settle a list of contributories is placed on the court (s.148), but this duty is delegated to the liquidator under Rule 4.195 (compulsory liquidation) and s.165(4)(a) (voluntary liquidation). In a winding-up, the power of making calls is vested in the Court. S.150 provides:

> "(1) The court may, at any time after making a winding-up order, and either before or after it has ascertained the sufficiency of the company's assets, make calls on all or any of the contributories for the time being settled on the list of the contributories to the extent of their liability, for payment of any money which the court considers necessary to satisfy the company's debts and liabilities, and the expenses of winding up, and for the adjustment of the rights of the contributories among themselves, and make an order for payment of any calls so made.
> (2) In making a call the court may take into consideration the probability that some of the contributories may partly or wholly fail to pay it."

135. However, the power of making calls is delegated to the liquidator. This is by virtue of:

(1) S.160(1)(d) and Rule 4.202 in the context of compulsory liquidation. S.160(2) provides that the "*liquidator ...shall not make any call without either [the special leave of the court] or the sanction of the liquidation committee*" (and see Rules 4.203 and 4.204). Rule 4.202 provides that "*the powers conferred by the Act with respect to the making of calls on contributories are exercisable by the liquidator as an officer of the court subject to the court's control*"; and

(2) S.165(4)(b) in the context of voluntary liquidations.

136. Gore-Browne on Companies (45th edn.) states at [21-16]:

> "in an unlimited company the members are liable while the company is a going concern to pay to it the nominal amount of the shares (if any) held by them as and when called up, together with any premium payable on issue, **and upon a winding up to pay whatever amount is necessary to satisfy the debts of the company and the costs of liquidation; but as far as possible all the members contribute rateably".**

137. This is in line with core principles of equity, including that equality is equity, and correspondence between benefit and burden. Thus:

(1) McPherson's Law of Company Liquidation (2nd Edn.) provides at p902:

> "whether it be regarded as an expression of the principle that equality is equity, or as implicit in the general scheme of the Act itself, the rule is clear that, in the absence of provision to the contrary, both surplus assets and capital losses must be distributed rateably; that is, in direct proportion to the nominal amounts of the shares held by members at the commencement of winding up".

(2) In **Ex parte Maude** (1870) 6 Ch App 51, the articles contained no express provision for regulating the distribution of surplus assets. The shares had been unequally called up (the whole £25 was paid by some shareholders and only £20 by the others, and dividends had been paid, in accordance with the articles, on the amounts so paid). After payment of the debts and expenses there remained a balance insufficient for the return of all the paid-up capital. It was held that the real question was not how profits should be distributed, but how a loss should be borne, and that the uncalled capital was as much liable to be called up for the purpose of meeting this loss as it would have been for the payment of debts. The result was that after the capital account had been equalised by calling up or treating as called up unpaid capital, the whole resulting balance was returned in proportion to the amount paid up on each share and every shareholder lost the same percentage of what he had subscribed and paid. Sir G. Mellish LJ held that *"the surplus ought, according to the true construction of the Act, and of the articles of association of this company, to be distributed so as to divide the losses equally among the two descriptions of shareholders".*

138. Accordingly, losses should be shared among the contributories in proportion to the aggregate nominal value of their shareholdings in LBIE. The contributories should contribute rateably.[39]

139. S.154 provides: *"The court shall adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled to it."* S.165(5) provides (in the context of

[39] The LBIE Joint Administrators have been asked for clarification of whether the allotted shares in LBIE are paid up. The LBL Joint Administrators' position as to the impact of this is reserved.

voluntary winding up), "*The liquidator shall pay the company's debts and adjust the rights of the contributories among themselves.*" Further, s.150(2) provides that, in making a call, the court may take into consideration the probability that some of the contributories may partly or wholly fail to pay it.

140. LBL holds but 0.0000000000747769% in terms of the aggregate nominal value of LBIE's shares and could never expect any significant profit from LBIE. As set out above, in holding the share in LBIE, it was essentially making up the numbers. Further, LBHI2, LBL's co-contributory, is in administration. Thus LBL may not itself be able to recover £ for £ in LBHI2's estate in respect of any contribution claim (see below).

141. In these circumstances, calls should only be made upon LBL and LBHI2 by LBIE's liquidators, to whom the power in respect of the making of calls is delegated and is exercisable as officers of the court subject to the court's control, in proportion to the aggregate nominal value of the Members' shareholdings. LBIE's liquidators will be subject to a duty to adjust "*the rights of the contributories among themselves*". In exercising their power to make calls, they must do so having regard to that duty, and the Members' contribution claim (see below), and the fact that the Members are themselves in administration.

142. Accordingly, calls should be made upon the contributories in proportion to the rateable shares in which they should contribute to the company's shortfall. That would best give effect to the liquidator's duty to "*adjust the rights of the contributories among themselves*" under s.154 and s.165(5),[40] taking into account the liquidator's power under s.150(2) to take into consideration the

[40] In this context, reference is made to the following authorities (albeit in the more usual case of limited companies):

(1) **Shields Marine Insurance Association, Re (1868) 5 Eq 368**, per Sir John Romilly MR: *"in a company of limited liability, where there are many shares, some of which are paid up and the rest not paid up, the persons who have paid up in full are not required to be on the list of contributories, but as soon as it is found that there are assets more than sufficient to pay all the debts, then calls may still be made on the persons who have not paid up in full, in order to adjust the rights of the shareholders among themselves; and persons are not discharged from all liability as shareholders because all claims against the partnership are disposed of if the partners have claims against them for the purpose of setting right the contributions equally among the members".*

(2) **Re Lancashire Brick & Tile Co, Re** (1865) 55 ER 662: Sir John Romilly MR: *"The principle on which the Court proceeds is this:—When a shareholder in a limited company has paid up the full amount of his shares, it is obvious, if the company is perfectly insolvent, that he has no interest at all in the matter, and is not entitled to have the concern wound up. But a person who has fully paid up his shares is interested to this extent:—If it appears that the debts are inconsiderable, that the business has stopped, and that it is not intended to carry it on, and the debts are thrown on the Petitioners and two or three other persons, to the exoneration of the general body of shareholders, then I think he is entitled to come for a winding up, on the principle that equality is equity, and that he is entitled to compel the other shareholders to contribute towards the payment of the debts of the concern. Thus, if the Petitioner has 100 shares which he has fully paid up, and there are debts of £1000, the whole of which have been paid out of his contribution, while there are, perhaps, two or three hundred other shareholders who have not paid a penny on their shares, he is entitled to compel those other shareholders to contribute towards the payment of the debts of the*

probability that some of the contributories may partly or wholly fail to pay it.

Contribution claim by LBL against LBHI2

143. Alternatively, if, contrary to the above, a call is validly made on LBL, or a deduction is validly made by LBIE in respect of, the Potential Liability as Contributory in excess of LBL's rateable share of any shortfall in LBIE if it is wound up (in proportion to the aggregate nominal value of each of the Members' shareholding in LBIE), LBL is entitled to seek a contribution or indemnity from LBHI2.

144. As to the right of contribution:

(1) As set out above, in **Ex Parte Maude**, it was established that where, in a winding up, there remains a balance after payments of debts and costs, but the balance is insufficient for a complete return of capital paid up, the capital account must be equalised by a call on the partly paid shares, and the assets must then, in the absence of any different provision, be distributed according to the nominal amount of the shares. In **Birch v Copper** (1889) 14 App Case 525, the House of Lords held that after equalisation of the capital account the assets must be distributed according to the nominal amount of the shares. These decisions were applied in **Re Driffield Gas Light Co** [1898] 1 Ch 451, where Wright J held that, failing any specific provision, the distribution of a surplus is in proportion to the contributories' holdings of nominal capital. Reference is also made to **Shields Marine Insurance** and **Lancashire Brick & Tile Co** (see FN [42] above).

(2) In light of the need to ensure correspondence between benefit and burden, both in the distribution of profits while LBIE was a going concern, and in the distribution of any surplus, sharing the liability to contribute rateably is the only equitable solution. In **Bonner v Tottenham & Edmonton Permanent Benefit BS** [1899] 1 QB 161, 176, Vaughan Williams LJ held that in a reimbursement claim:

> "[T]he plaintiff may be entitled to recover within the equitable principle, if he has been compelled to pay or bear the burden, and can establish that the defendant has such an interest or benefit as to make the maximum apply 'Qui sentit commodum sentire debt et onus'....The equitable principle seems to me based upon natural justice requiring that equity should neutralise "inter se" the accident that the burden has been borne by one for the benefit of others associated with him in interest...".

As noted in Goff & Jones, "*The Law of Unjust Enrichment*" (8th edn.) at [20-94]: "*The*

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company, and to exonerate him from all beyond his due share of the liability. The same rule would apply to an unlimited company."

principle which it encapsulates has been applied in many cases, to allocate responsibility between the parties by reference to the benefits which they have derived from the transactions which have given rise to their respective liabilities".

(3) The right of contribution is analogous to that applicable in relation to guarantors,[41] partners,[42] and other contexts.[43]

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[41] See e.g. **Stimpson v Smith** [1999] Ch 340 per Peter Gibson LJ at 348: *"Let me start by setting out certain uncontroversial principles applicable in this area of the law. (1) Where more than one person guarantee to the creditor the payment of the same debt, an equity arises such that if one of them pays more than his due proportion of the debt, he is entitled to a contribution from his co-guarantor or co-guarantors. (2) It is immaterial whether the co-guarantors are bound jointly or severally or jointly and severally by the same instrument or by separate instruments or in the same sum or different sums or at the same time or different times or whether the co-guarantor making payment knows of the existence of the other co-guarantor or co-guarantors, as the right of contribution is not dependent upon agreement, express or implied. (3) Normally an action for contribution cannot be brought until payment has been made by a co-guarantor of more than his share of the common liability. (4) In particular circumstances an action for contribution will lie even before payment is made; thus when judgment has been entered by the creditor against one guarantor, who has paid nothing in respect of the judgment, he can maintain an action in equity against his co-guarantor and obtain an order requiring payment of the co-guarantor's due share to the creditor (if a party to the action) or (if the creditor is not a party) an order that the co-guarantor indemnify the judgment debtor, on payment of his own share, against further liability: Wolmershausen v. Gullick [1893] 2 Ch. 514 . These principles are all subject to any contractual terms which may limit or extend the entitlement of an interested person. No such term is to be found in the guarantee."*

[42] See s.24(1) and s.44 of the Partnership Act 1890. S.24(1) provides that "*The interests of partners in the partnership property and their rights and duties in relation to the partnership shall be determined, subject to any agreement express or implied between the partners, by the following rules: - (1) All the partners are entitled to share equally in the capital and profits of the business, and most contribute equally towards the loses whether of capital or otherwise sustained by the firm."* S.44 provides: *"In settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed: (a) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits...."*
See **Re Albion Life Assurance Society** (1880) 16 Ch D 83, 87-88, per Jessell MR. In **Robinson's Executor's Case** (1856) 6 De GM & G 572, Lord Cranworth LC said, at 588: *"When, indeed, the money has been raised and the demands on the partnership have been liquidated, the shareholder who has paid a sum exceeding his rateable proportion, calculated on the number of his shares, will have a right of contribution against the other shareholders, and the extent of that right must be measured according to the provisions contained in the 3d clause of the deed."*

[43] See e.g. Chitty at [29-125]: *"a right to contribution will only arise when a person, who owes with another a duty to a third party and is liable with that other to a common demand, discharges more than his proportionate share of that duty"*, and Chitty at [17-027]-[17-028] in the context of joint and joint and several debtors.
In **Moule v Garrett** (1872) LR 7 Ex. 101, 104, Cockburn C.J. approved the following statement from *Leake on Contracts*: *"Where the plaintiff has been compelled by law to pay, or, being compellable by law, has paid money which the defendant was ultimately liable to pay, so that the latter obtains the benefit of the payment by the discharge of his liability; under such circumstances the defendant is held indebted to the plaintiff in the amount."*
This passage was in turn quoted with approval in **Brook's Wharf and Bull Wharf Ltd v Goodman Brothers** [1937] 1 K.B. 534, 543-544*)*, where Lord Wright MR said, at 544: *"The essence of the rule is that there is a liability for the same debt resting on the plaintiff and the defendant and the plaintiff has been legally compelled to pay, but the defendant gets the benefit of the payment, because his debt is discharged either entirely or pro tanto, whereas the defendant is primarily liable to pay as between himself and the plaintiff. The case is analogous to that of a payment by a surety which has the effect of discharging the principal's debt and which, therefore, gives a right of indemnity against the principal....These statements of the principle do not put the obligation on any ground of implied contract or of constructive or notional contract. The obligation is imposed by the Court simply under the circumstances of the case and on what the Court decides is just and reasonable, having regard to the relationship of the parties. It is a debt or obligation constituted by the act of the law, apart from any consent or intention of the parties or any privity of contract."*

(4) As stated in **Whitham v Bullock** [1939] 2 KB 81, 85 per Clauson LJ (delivering the judgment of the Court and citing Rowlatt Principal and Surety (3rd edn., 1936, p173)):

> "If as between several persons or properties all equally liable at law to the same demand, it would be equitable that the burden should fall in a certain way, the court will so far as possible, having regard to the solvency of the different parties, see that, if the burden is placed inequitably by the exercise of the legal right, its incidence should be afterwards readjusted".

Question 11: priority of distributions by LBIE

145. **Question 11:** In the event that there are sufficient funds in LBIE's administration to permit the LBIE Joint Administrators to make payment in full to LBIE's general, unsecured creditors in respect of the principal of the debts and liabilities owed to them by LBIE, in what order would the LBIE Joint Administrators be required to apply any surplus in discharging the following:

(a) Interest payable on such debts and liabilities in respect of the periods during which they have been outstanding since LBIE entered administration pursuant to Rule 2.88(7) of the Rules;

(b) Currency Conversion Claims (defined at question 12 below), to the extent that question 12 is answered in the affirmative;

(c) To the extent that the Members have been unable to prove in respect of them, debts owed by LBIE to the Members (other than in respect of the LBHI2 Subordinated Debt); and

(d) To the extent that LBHI2 has been unable to prove in respect of it, the LBHI2 Subordinated Debt.

146. As explained above, given that LBL's claim against LBIE is not subordinated under s.74(2)(f) (as is common ground), subject to any questions of set-off or the application of **Cherry v Boultbee** (see above), LBL ought to be receiving distributions in LBIE's administration (or a subsequent liquidation) rateably with LBIE's other unsecured creditors. The LBIE Joint Administrators' reliance on the "Alleged Equitable Rule" is, for the reasons set out above, misplaced. Accordingly, the debt owed by LBIE to LBL should not be outstanding when payment in full has been made to "*LBIE's general, unsecured creditors in respect of the principal of the debts and liabilities owed to them by LBIE*". Similarly, LBL should, in respect of its claim, receive interest under rule 2.88(7) (or s.189(2)) along with LBIE's other unsecured creditors.

147. Further, as explained below, there is no Currency Conversion Claim. In any event:

(1) It is conceded by Lydian that any Currency Conversion Claims could only rank in priority behind post-insolvency interest. According to WS/RD4 at [58] (and the same conclusion appears to follow in light of the forecasts in the LBIE Joint Administrators' tenth progress report: see para 10(2)g above), there would be no further monies available after payment of statutory interest. Further, for the reasons explained above, the Potential Liability as Contributory does not extend to the Currency Conversion Claim. Thus, even if there is a Currency Conversion Claim as a matter of principle, it remains uncertain whether there will be any sums to satisfy any such claim.

(2) Lydian says in its position paper that an unsecured creditor is entitled to payment from LBIE in respect of a Currency Conversion Claim once the provable debts (other than, to the extent they may be provable, debts of the Members who had yet to contribute amounts owed by them pursuant to their Potential Liability as Contributory, or the LBHI2 Subordinated Debt) and statutory interest thereon have been paid by LBIE. For the reasons set out above, subject to any questions of insolvency set-off or the application of the rule in **Cherry v Boultbee**, the Members are entitled to prove and receive distributions in LBIE's administration (or a subsequent liquidation) along with LBIE's other unsecured creditors. Further, if members had yet to contribute amounts owed by them under s.74, the liquidation would not be a *"wholly solvent"* one, and thus Brightman LJ's dicta in **Re Lines Bros (No. 1)** do not arise.

148. Accordingly, the only issue that falls to be considered is the priority as between post-administration (or post-liquidation) interest, and the LBHI2 Sub-Debt. As to this point, in light of the terms of the LBHI2 Sub-Debt, and in particular Standard Term 5 and the definitions of *"Liabilities"*, and *"Senior Liabilities"*, the LBHI2 Sub-Debt is subordinated behind post-insolvency interest. *"Senior Liabilities"*, on its proper construction, includes interest payable under rule 2.88(7) (or s.189(2)). This is a question of interpretation of the LBHI2 Sub-Debt Agreements. The fact that, for example, Rule 2.88(8) and s.189(3) provide that interest thereunder ranks equally regardless of whether or not the debts on which it is payable rank equally is irrelevant in circumstances where the debt is not, under its own terms, payable. However, as this is largely an issue between LBHI2 and LBIE, the LBL Joint Administrators do not propose to address this issue in further detail at this stage (but reserve their rights to do so further in due course).

Question 12: Currency Conversion Claim

149. **Question 12:** Is an unsecured creditor, with a contractual entitlement to payment from LBIE in a currency other than sterling (the "**Contractual Currency**"), entitled, following payment in full of:

(i) All creditors' proved debts; and

(ii) Interest on such debts in respect of periods during which they have been outstanding since LBIE entered administration pursuant to Rule 2.88(7) of the Rules;

to payment from LBIE in a sum equal to the difference between (a) the amount of its contractual entitlement to payment in the Contractual Currency and (b) the amount received by it in respect of its proved debt against LBIE, converted into the Contractual Currency as at the date of payment (such claim being referred to as a "**Currency Conversion Claim**")?

150. The background to Lydian's claim is set out in WS/EG1 and WS/EG2. In particular:

(1) Lydian submitted a proof of debt to the LBIE Joint Administrators on or around 19 July 2012 [7/1-14]. The proof which Lydian has filed in LBIE's administration includes the following unsecured principal amounts (the GBP amounts based upon conversion of the US$ amounts as at 15 September 2008 using the Bank of England spot rate on that date):

a. An over the counter derivatives claim for US$9,077,763 (£5,060,914.87).

b. An unsecured prime brokerage claim for US$209,462,020.61 (£116,776,507.00);

totalling US$218,539,783.61 (£121,837,421.87); and

c. A contingent claim in respect of certain trust assets for US$45,648,338.38 (£25,449,260.40),

giving a total unsecured claim of US$264,188,121.99 (£147,286,682.27).

(2) Lydian contends that the contracts referenced in WS/EG1 upon which Lydian's claim is based provide for payment of early termination amounts and other amounts calculated as owing under them in US$.

(3) The quantum of Lydian's claims has not yet been agreed by the LBIE Joint Administrators. As yet, no dividend has been paid to Lydian (WS/EG1 at [11]). However, the LBIE Joint Administrators have indicated, in a letter from Linklaters LLP dated 25 June 2013 [7/15] that, for the purposes of the Joint Application, the LBIE Joint Administrators are prepared to assume that Lydian has a valid unsecured claim in the LBIE administration.

(4) The £ has depreciated against the US$ in the period since 15 September 2008, when LBIE went into administration, such that Lydian claims that the effect of Rule 2.86(1) is that if LBIE were to pay Lydian in GBP now, there would remain a substantial shortfall in the amount owed by LBIE to Lydian pursuant to the terms of the relevant contracts. WS/EG2 [16] states: "*Given that foreign exchange rates continue to fluctuate, the quantum of such claim may be grater or less* [than the numbers set out in paras 17-18], *by the time Lydian receives its distributions in the LBIE administration but it is unlikely that foreign exchange rates will move sufficiently for there to be no such claim*".

151. Lydian contends that it should be able to make a claim in respect of this shortfall against the LBIE estate, and that such a claim should be paid, as a non-provable claim, after the payment of provable debts and post-administration interest to LBIE's unsecured creditors, but before any payment is made to LBIE's shareholders (either in their capacity as shareholders or as unsecured creditors).

152. As a preliminary matter, Lydian concedes (as it must) that the alleged Currency Conversion Claim could only rank in priority behind post-administration interest under Rule 2.88. The dicta of Brightman LJ in **Re Lines Bros (No. 1)** [1983] Ch 1, upon which Lydian relies, were concerned with a "*wholly solvent liquidation*". It remains uncertain whether there will be any surplus remaining in LBIE after payment of post-administration interest: see WS/RD4 at [58]-[59] and para 10(2)g above.

153. But in any event, there can be no Currency Conversion Claim. In **Re Lines Bros (No. 1)**, the Court of Appeal held that a foreign currency debt should be proved in a liquidation according to its sterling value as at the date of the commencement of the winding up, since that was in accordance with the general rule for the valuation of liabilities on a winding up and, also, liquidation being a process of collective enforcement of a company's liabilities, with the practice of converting a foreign currency judgment debt into sterling as at the date when leave to enforce was given. It was also held that a surplus was not available to discharge the shortfall suffered by the bank if their sterling dividends were converted into Swiss francs as at the respective dates of payment, since the sterling creditors entitled to recover post-liquidation interest should not have that right diminished because of movements in exchange rates.

154. Although in **Re Lines Bros (No. 1)**, at pp20-22, Brightman LJ left open the question whether, in the case of a wholly solvent liquidation, any surplus remaining after the payment of post-liquidation interest should be paid in respect of currency losses arising from conversion in respect of foreign currency claims taking place at the date of the winding up:

(1) Since that decision, Rule 2.86(1) was enacted (and c.f. Rule 4.91 in the context of a liquidation), providing: *"For the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company entered administration...."* This applies whether or not the administration is solvent or insolvent. As Lydian concedes, the Currency Conversion Claim is not a provable debt, as a result of the provisions in Rules 2.86 (administration) and 4.91 (liquidation) (see para 12.1 of its position paper).

(2) The conversion under Rule 2.86 of non-sterling debts into their sterling value at the date of the commencement of the insolvency arrangement to give the value of that creditor's claim in the insolvency arrangement gives effect to the *pari passu* principle of distribution between creditors. See e.g. **Re Telewest Communications Plc (No. 1)** [2004] BCC 342, per David Richards J at [36];[44] **Re Dynamics Corporation of America** [1976] 1 WLR 757 per Oliver J at 764.

(3) Rule 2.72 provides (in the context of administration):[45]

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

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[44] In the context of applications under s.425(1) of the Companies Act 1985 for leave to convene meetings of creditors for the purposes of considering schemes of arrangement, the issues arose whether currency conversion on the date the company went into liquidation for the purposes of proof represented a right of creditors, such that departure from it in a scheme to the detriment of one group of creditors is capable of making that group a separate class. David Richards J held that currency conversion on the date the company went into liquidation did represent a right of creditors, and rejected the submission that it was simply part of the mechanics of a liquidation. See in particular [31]-[36].

[45] See Rule 4.73 in the context of liquidation:
"(1) Where a company is being wound up by the court, 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 under Rule 4.67(2)) submit his claim in writing to the liquidator. (NO CVL APPLICATION)
(2-CVL) In a voluntary winding up (whether members' or creditors') the liquidator may require a person claiming to be a creditor of the company and wishing to recover his debt in whole or in part, to submit the claim in writing to him.
(3) A creditor who claims (whether or not in writing) is referred to as "proving" for his debt; and a document by which he seeks to establish his claim is his "proof"."

(4) The Rules do not provide any mechanism or procedure for a claim to be made by, or a distribution to be made to, a person claiming to be a creditor of a company in administration and wishing to recover his debt in whole or in part, other than through the circumscribed procedure of proving.[46]

(5) In **Re Lines Bros (No. 1)**, Brightman LJ noted, at pp20-21, the principle on which a creditor could claim post-liquidation interest, and drew an analogy with a Contractual Currency Claim. However, the Rules make express provision for post-administration (or post-liquidation) interest. By way of contrast, there is no provision in the Rules for any residual claim by the creditor for any loss suffered by reason of the conversion to sterling (or, likewise, for the creditor's proof to be adjusted thereafter should the conversion later transpire to have been beneficial to the creditor by reason of later currency movements).

(6) The final valuation of claims by creditors with a contractual entitlement to payment in the Contractual Currency as at the date of administration (or winding up) has the benefit of certainty, finality and simplicity.

(7) It has not been suggested by Lydian that, if the £ appreciated against the $ to a sufficient degree, such that payment of the £ amount of its claim converted at the date of LBIE's administration would buy it more $ than its claim, it would return the surplus to LBIE, or that LBIE would have a claim against it for the surplus. A claim that would work only to the advantage of the creditor cannot be permissible.

(8) Additionally, it is very difficult to see how the set-off provisions in the Rules could work if there were a Currency Conversion Claim.

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[46] C.f. Lawton LJ in **Re Lines Bros (No. 1)** at [14]:
"As I have already said, liquidation is a form of collective enforcement of liabilities under English law. Liabilities are what the court will enforce. It will not enforce judgments for debts in Swiss francs but their equivalents in sterling at the dates when leave to enforce is given. Liquidation affects the contractual relationship between debtor and creditor. When the liquidation starts, no further liabilities under contract become payable until such time as it is clear that the pre-liquidation liabilities have been satisfied in full: see In re Humber Ironworks and Shipbuilding Co., L.R. 4 Ch.App. 643 . The beneficial interest in the company's assets is transferred to the liquidator. In Ayerst v. C. & K. (Construction) Ltd. [1976] A.C. 167 the House of Lords had to consider the legal effect of a winding up order. Lord Diplock delivered the leading speech with which the other members of the Appellate Committee agreed. He pointed out that the making of a winding up order brings into operation a statutory scheme for dealing with the assets of a company which is being wound up. It matters not whether the winding up is by order or pursuant to a resolution. The assets of the company when realised provide a fund which the liquidator administers in many respects, but not in all, as if he were managing a trust fund. Creditors' contractual rights to be paid by the company become under the statutory scheme a statutory right to a share in the trust fund. The size of this fund has to be ascertained as soon as possible because until it is ascertained it cannot be applied in satisfaction of the company's liabilities; and, as like has to be compared with like, the valuation of the fund has to be in sterling."

Conclusion: the LBL Joint Administrators' position as regards the issues as formulated in the List of Issues

155. **Issue 1**: Where a company is in liquidation, is it the case that either:

a. a contributory is not entitled to prove in the company's liquidation until he has contributed everything that he is liable to contribute as a contributory pursuant to section 74; or

b. a contributory who seeks to prove in the company's liquidation can receive nothing until he has contributed everything that he is liable to contribute as a contributory pursuant to section 74,

on the basis of an equitable rule that a person who owes money to an estate cannot claim a share in that estate without first making the contribution which completes it (the "**Alleged Equitable Rule**")?

Answer: No. If LBIE goes into liquidation and is unable from its own assets to meet its debts and liabilities and the expenses of the winding up, and if a valid call were made by LBIE's liquidators, the LBIE liquidators would be entitled rely upon the rule in **Cherry v Boultbee**. This would have the effect that the value of LBIE's total pool of assets (including contributions from the Members) should be ascertained, and from that the dividend rate to all creditors (including LBL) should be calculated. If the amount payable to LBL by LBIE at this dividend rate is greater than the contribution from LBL, then the difference should be paid to LBL. If the amount payable to LBL by LBIE at this dividend rate is less than the contribution from LBL, then nothing would be payable to LBL. For the purposes of this calculation, the contribution from LBL to be accounted for is the dividend payable by LBL's estate in respect of the proof by LBIE's liquidators.

156. **Issue 2:** What, if any, is the effect on the answers to Issues 1(a) and (b) above of the fact that a call has not been made on the contributory by the company's liquidator(s)?

Answer: See the answer to question 1, above. Before a call is made, the rule in **Cherry v Boultbee** cannot apply.

157. **Issue 3:** If the answer to Issues 1(a) and (b) is no, and the contributory is entitled to prove and (*prima facie*) to receive distributions in the company's liquidation, is credit required to be given in respect of the contributory's liability to contribute pursuant to section 74 of the Act, either (i) by

way of insolvency set-off; and/or (ii) pursuant to the rule in *Cherry v Boultbee* 41 ER 171; and/or (iii) otherwise? If so, in what circumstances is credit required to be given and how? In particular:

a. Is credit only required to be given if a call is made on the contributory by the company's liquidator(s)?

b. How should the potential liability of the contributory be valued for the purposes of giving credit by the company's liquidator(s)?

c. What, if any, is the effect of the proving contributory itself being in administration or liquidation?

Answer: See the answer to Issue 1 above. Insolvency set-off does not operate in the company's liquidation as between the liability under s.74 and debts owed by the company to the contributories. The rule in **Cherry v Boultbee** would apply in the circumstances and in the manner set out in the answer to Issue 1.

158. **Issue 4:** Is a contributory *contingently* liable to contribute to the company's assets in an amount sufficient for payment of its debts and liabilities, and the expenses of the winding-up, where the company: (i) is in administration; but (ii) might subsequently move into liquidation; and (iii) might have a shortfall in respect of which the members might be liable to contribute under section 74 of the Act?

Answer: If the relevant contingencies materialise, the contributory will be liable to contribute under section 74 of the Act.

159. **Issue 5**: If the answer to Issue 4 is yes, is it the case that either:

a. a contributory is not entitled to prove in the company's administration until he has contributed everything that he is contingently liable to contribute as a contributory pursuant to section 74 of the Act; or

b. a contributory who seeks to prove in the company's administration can receive nothing until he has contributed everything that he is contingently liable to contribute as a contributory pursuant to section 74 of the Act

on the basis of the Alleged Equitable Rule?

Answer: No.

160. **Issue 6**: If the answer to Issue 5 is no, and the contributory is entitled to prove and (*prima facie*) to receive distributions in the administration, is credit required to be given in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act, either (i) by way of insolvency set-off; and/or (ii) pursuant to the rule in *Cherry v Boultbee* 41 ER 171; and/or (iii) otherwise? If so, in what circumstances is credit required to be given or is any deduction to be made and how? In particular:

a. What, if any, is the effect of the proving contributory itself being in administration or liquidation?

b. Should credit only be given if the company submits a proof of debt in respect of the contributory's potential liability to the company under section 74 of the Act?

c. Should credit only be given once the contributory's administrator(s) or liquidator(s) have placed a value upon the potential liability to the company under section 74 of the Act?

Answer: In the administration, no such credit is to be required in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act.

161. **Issue 7**: Does section 149 of the Act have any bearing on the answers to Issues 1 to 6? If so, in what respect is it relevant on the basis of the facts as set out in the Statement of Agreed Facts?

Answer: S.149(1) provides a summary remedy for the recovery of moneys due from a contributory, in its capacity as such, other than money payable by virtue of any call in pursuance of the Companies Act or the Act. It only applies "*at any time after making a winding-up order*". When an order is made under s.149(1), in the case of an unlimited company, the court may allow the contributory by way of set-off any money due to him or the estate which he represents from the company on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit. The Potential Liability as Contributory could not be the subject of an order under s.149(2)(a), because it is a liability to pay money by virtue of a call in pursuance of the Act. The LBIE Joint Administrators' position paper states (at para 7(c)) that the LBIE Joint Administrators do not believe that the Members owe any other obligations to LBIE in their capacity as contributories. If that is correct, s.149(2)(a) would not have any effect on either (i) a proof submitted by either of the Members in LBIE's administration or any subsequent liquidation, or (ii) a proof submitted by LBIE in either of the Members' administrations (or subsequent liquidations).

162. **Issue 8**: Does section 74(2)(f) of the Act have any bearing on Issues 1 to 6 above? If so, in what respects is it relevant in light of the fact that it is common ground that no sums are due to LBL or LBHI2 in their capacity as Members?

Answer: It is common ground that the Members' claims are not subordinated by virtue of s.74(2)(f). The only relevance of s.74(2)(f) is that it makes clear that claims by members which are not *qua* member rank equally with the claims of the company's other unsecured creditors.

163. **Issue 9:** Is a company, acting by its administrator or liquidator, entitled to prove in the administration (or any subsequent liquidation) of a contributory in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act? In this regard:

a. For the purposes of rule 13.12(1)(b) of the Rules, did the contributory incur an obligation to contribute to the company's assets to an amount sufficient for payment of its debts and liabilities, and the expenses of the winding-up, at a time when it became a member of the company (or at any later time prior to the contributory going into administration)?

b. Is the quantum of the contributory's contingent liability to be calculated in the same way as it is under Issue 13 below? If not, how is it to be calculated?

Answer: The company is only entitled to prove in the administration (or any subsequent liquidation) in respect of the liability under s.74 when the company has gone into liquidation and is unable from its own assets to meet its debts and liabilities and the expenses of the winding up and once a call has been made in respect of the liability. The quantum of the liability under s.74 is to be calculated in the same way as it is under Issue 13 below.

164. **Issue 10:** If the company, acting by its administrator, is entitled to prove in the administration (or any subsequent liquidation) of its contributory, is its claim liable to be reduced by insolvency set-off, or by the rule in *Cherry v Boultbee* (or otherwise) in circumstances where:

a. the contributory's cross-claim is contractually subordinated on the terms of the Sub-Debt Agreements; and/or

b. the company's claim is in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act; and/or

c. no call has been made by the company's liquidator(s) in respect of the contributory's liability to contribute

and, if so, how?

Answer: If LBIE is entitled to prove (acting by its administrator/liquidator) in the administration (or any subsequent liquidation) of LBL, its claim is to be reduced by insolvency set-off by virtue of LBL's claim against LBIE. Alternatively, the LBL Joint Administrators (or any liquidators that may subsequently be appointed) would be entitled to rely upon the rule in **Cherry v Boultbee**.

165. **Issue 11**: Does section 149 of the Act have any bearing on the answers to Issues 9 and 10? If so, in what respects is it relevant on the basis of the facts as set out in the Statement of Agreed Facts?

Answer: As to s.149 of the Act, see the answer to Issue 7 above.

166. **Issue 12**: Does section 74(2)(f) of the Act have any bearing on Issues 9 and 10 above? If so, in what respects is it relevant in light of the fact that it is common ground that no sums are due to LBL or LBHI2 in their capacity as Members?

Answer: No.

167. **Issue 13:** How is the quantum of the contributory's contingent liability to contribute calculated? In this regard:

a. What are the contingencies which have to be taken into account (e.g. LBIE going into liquidation, there being a shortfall for which the Members may be liable to contribute under section 74(1), a call being made on the Members and/or any others) and how are the prospects of those contingencies occurring to be estimated?

b. Is rule 2.105 of the Rules relevant to the calculation of the quantum of the contributory's contingent liability and, if so, how can the formula in this rule for accelerated receipt in respect of future debts be applied, given that it is not known when, if at all, LBIE will be wound up?

c. Does the contributory's contingent liability extend to any interest accruing during the period of the administration under rule 2.88(7) of the Rules or otherwise?

d. Does the contributory's contingent liability extend to the Currency Conversion Claim (if Issue 22 below is answered in the affirmative)?

e. Does the contributory's contingent liability extend to liabilities of the company which have been contractually subordinated on the terms of the Sub-Debt Agreements?

f. Does the contributory's contingent liability extend to interest payable in the liquidation under section 189(2) of the Act or otherwise? In this regard, if the administrator is in the process of making distributions to the company's general, unsecured creditors and it appears that he will be able to pay the company's provable debts in full, what, if any, interest will be payable under section 189(2) of the Act if the company subsequently moves from administration into liquidation and does any such interest form part of the contributory's contingent liability to the company?

Answer:

a. The contingencies to be taken into account, and for which a genuine and fair assessment would have to be made, would be: (i) the company going into liquidation; (ii) there being a shortfall for which the contributory may be liable to contribute under s.74; (iii) a call being made on the contributory; (iv) the quantum of the call on the contributory.

b. There should be a discount to reflect accelerated receipt pursuant to the formula in Rule 2.105. An estimate would have to be made of when (if at all) LBIE would go into liquidation and when its liquidators would make a call on the contributory, and the formula for accelerated receipt should then be applied.

c. No. Further, post-administration interest is only payable under Rule 2.88(7) of the Rules.

d. No.

e. No.

f. No. S.189(2) provides: *"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."* Accordingly, if distributions are made in LBIE's administration and its unsecured creditors are paid in full in respect of their provable debts, if LBIE subsequently moves into liquidation those debts will not have been *"outstanding since the company went into liquidation"* and no interest will be payable in respect of them under s.189(2).

168. **Issue 14**: How is the quantum of the contributory's liability to contribute to be calculated if LBIE were placed into liquidation?

Answer: In the same way as set out in answer to Issue 13, save that it would not be necessary to estimate the likelihood of LBIE going into liquidation.

169. **Issue 15**: In the event that the Members are obliged to contribute to the assets of LBIE pursuant to Section 74 of the Act, and in light of the Members' respective shareholdings:

a. are their obligations joint, several or otherwise as against LBIE;

b. are they entitled to seek a contribution or indemnity from one another in respect of any payments made pursuant to any such obligation and, if so, what is the nature and extent of such right of contribution or indemnity; and

c. to what extent is any right to contribution or indemnity as referred to in sub-paragraph (b) above affected by any other claims which LBHI2 and LBL have against one another?

Answer: The liability of the Members as contributories under s.74(1) should be shared rateably between them in proportion to the aggregate nominal value of their shareholdings in LBIE. This has the consequence either that:

(1) If LBIE goes into winding up, LBIE's liquidators, to whom the power in respect of the making of calls is delegated and is exercisable as officers of the court subject to the court's control, should make calls on the Members in proportion to their rateable shares of the shortfall (in accordance with the liquidator's duty to adjust the rights of the contributories among themselves); or

(2) If and to the extent that a call is made on LBL, or a deduction is validly made by LBIE in respect of, the liability (or potential liability) under s.74 in excess of LBL's rateable share of any shortfall in LBIE if it is wound up, LBL is entitled to seek a contribution or indemnity from LBHI2.

170. **Issue 16**: What effect do the answers to Issue 15 above have upon the value of LBIE's proof in the administrations (or subsequent liquidations) of the Members, if any, (if the answer to Issue 9 above is yes)?

Answer: To the extent that LBIE can prove in the Members' administrations (or subsequent liquidations), it can only prove in respect of the amount for which it can make a call on the Members.

171. **Issue 17**: Is the effect of the contractual subordination of LBIE's liability to LBHI2 under paragraph 5 of the Standard Terms of the Sub-Debt Agreements

a. such that LBHI2 is entitled to: (i) prove; but (ii) not receive any dividends payable, in LBIE's administration (or a subsequent liquidation) in respect of the Sub-Debt until LBIE's creditors with provable claims which do not arise out of contracts containing subordination provisions have received full payment of the principal amount of those provable claims, but then receive dividends payable before:

i. interest payable under rule 2.88(7) of the Rules (and, in a subsequent liquidation, any interest payable under section 189(2) of the Act) has been paid in full;

ii. Currency Conversion Clams (to the extent that Issue 22 below is answered in the affirmative) have been paid in full; and

iii. debts owed to members (potentially including itself) which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule referred to in Issue 2 above have been paid in full?

or

b. such that LBHI2 is not entitled to: (i) prove; or (ii) receive any dividends payable, in LBIE's administration (or a subsequent liquidation) in respect of the Sub-Debt until:

i. LBIE's creditors with provable claims have received full payment of the principal amounts of those provable claims;

ii. interest payable under rule 2.88(7) of the Rules (and, in a subsequent liquidation, any interest payable under section 189(2) of the Act) has been paid in full;

iii. Currency Conversion Claims (to the extent that Issue 22 below is answered in the affirmative) have been paid in full; and

iv. debts owed to members (potentially including itself) which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule have been paid in full?

172. **Issue 18:** If the constructions of the Sub-Debt Agreements set out at Issue 17 above are not correct, what is the extent of the contractual subordination contained in the Sub-Debt Agreements?

Answer to questions 17 and 18: The effect of the contractual subordination of LBIE's liability to LBHI2 under paragraph 5 of the Standard Terms of the Sub-Debt Agreements is that LBHI2 is not entitled to prove or receive dividends in LBIE's administration (or a subsequent liquidation) in respect of the Sub-Debt until *"Senior Liabilities"* have been paid in full. *"Senior Liabilities"* includes, in particular, unsubordinated unsecured claims, and post-insolvency interest.

173. **Issue 19**: In the event of a surplus having discharged or reserved for provable debts, in what order of priority are the following payable by an administrator:

a. post-administration interest payable under Rule 2.88(7) of the Rules or otherwise;

b. the Currency Conversion Claim (if Issue 22 below is answered in the affirmative);

c. any debts owed to the members which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule; and

d. to the extent that it is not provable, the contractually subordinated debt (on the terms of the Sub-Debt Agreements) (as to which see Issues 17 and 18 above)?

Answer: In the event that there are sufficient funds in LBIE's administration to permit the LBIE Joint Administrators to make payment in full to LBIE's general, unsecured creditors in respect of the principal of the debts and liabilities owed to them by LBIE (which would include unsubordinated claims of the members which are not *qua* member):

(1) Any surplus should then be applied to the payment of interest on such debts and liabilities (including the sums owed by LBIE to LBL in respect of the periods during which they have been outstanding since LBIE entered administration), pursuant to Rule 2.88(7) of the Rules.

(2) Under the terms of the LBHI2 Subordinated Debt, if LBIE has no sums remaining after payment of interest pursuant to Rule 2.88(7), nothing is payable to LBHI2.

(3) There is no Currency Conversion Claim.

174. **Issue 20**: Is the order of priority for payment by a liquidator the same as for an administrator (as to which see Issue 19 above)?

Answer: Yes.

175. **Issue 21**: Might interest be payable under rule 2.88(7) of the Rules and/or section 189(2) of the Act notwithstanding that, as a result of the application of the Alleged Equitable Rule and/or contractual subordination, not all debts proved in the administration have been paid in full or at all?

Answer: Post-insolvency interest under rule 2.88(7) and/or section 189(2) ranks ahead of the LBHI Sub-Debt in priority. Accordingly, it would be payable notwithstanding that the LBHI2 Sub-Debt has not been paid in full. However, interest would not be payable under Rule 2.88(7) of the Rules and/or section 189(2) of the Act if (contrary to the above), as a result of the application of the Alleged Equitable Rule, not all debts proved in the administration have been paid in full or at all.

176. **Issue 22**: Is an unsecured creditor, with a contractual entitlement to payment in a currency other than sterling (the "Contractual Currency"), entitled, following payment in full of:

a. all provable debts; and

b. interest payable pursuant to rule 2.88(7) of the Rules,

to payment in a sum equal to the difference between: (i) the amount of its contractual entitlement to payment in the Contractual Currency; and (ii) the amount received by it in respect of its proved debt, converted into the Contractual Currency as at the date(s) of payment (such claim being referred to as a "Currency Conversion Claim")?

Answer: No.

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