Waterfall III Application

IN THE HIGH COURT OF JUSTICE **No.7942 of 2008**

CHANCERY DIVISION

COMPANIES COURT

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN

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

Applicants

and

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

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

(3) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS EUROPE LIMITED (IN ADMINISTRATION)

(4) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)

Respondents

SKELETON ARGUMENT ON BEHALF OF THE JOINT ADMINISTRATORS OF

LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)

In this skeleton argument, and unless the contrary appears:

a. **References to sections in this skeleton are to sections in the Insolvency Act 1986; and**

b. **References to rules in this skeleton are to rules in the Insolvency Rules 1986, unless the contrary appears.**

An agreed reading list and trial timetable will be lodged in due course.

<u>A Introduction</u>

1. Lehman Brothers International (Europe) ("LBIE") is an unlimited company. This application concerns the statutory liability of LBIE's two members, LB Holdings Intermediate 2 Limited ("LBHI2") and Lehman Brothers Limited ("LBL"), to contribute to LBIE's assets pursuant to the provisions of section 74(1).

2. The issues comprised within part A of the application fall to be determined in the circumstances set out in section A(i) to (v) of this skeleton.

3. The position set out in LBHI2's position paper and the submissions made in this skeleton argument, and to be made orally at the trial of this application, are based on the current judgments in the <u>Waterfall I</u> application (i.e. following the Court of Appeal decision). LBHI2's position and its submissions are subject to change in light of the Supreme Court judgment which is currently awaited.

(i) Members and liability to contribute

4. LBIE's shares are divided into three classes: (a) ordinary shares of $1 each, (b) 5% redeemable preference shares of $1,000 each and (c) 5% redeemable Class B preference shares of $1,000 each. The rights attached to those shares are to be found in LBIE's articles of association at clauses 7A-7C **[2/1/11-18]**.

5. As at 15th September 2008, the date when LBIE went into administration ("the LBIE administration date"), (i) LBL held one ordinary share of US$1, and (ii) LBHI2 held 6,273,113,999 ordinary shares of US$1 each, 2,000,000 5% redeemable preference shares of US$1,000 each and 5,100,000 5% Class B redeemable preference shares of US$1,000 each. The proportions in which the shares are held are, therefore, (i) by reference to the nominal value of the ordinary shares only 1 to 6,273,113,999, (ii) by reference to the nominal value of all shares 1 to 13,373,113,999.

6. By section 74(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."

7. By section 80, the section 74(1) liability

> "…creates a debt (in England and Wales in the nature in the nature of an ordinary contract debt) accruing due from him at the time when his liability commenced, but payable at the times when calls are made for enforcing the liability."

8. The process by which the liability becomes payable comprises the settlement by the court of a list of contributories under section 148, and then a call under section 150 which provides as follows:

> "(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."

9. The court's powers under sections 148 and 150 are delegated to the liquidator in either type of winding up: see sections 160 and 165(4), and rules 4.195 to 4.201 and 4.202 to 4.205 of the Insolvency Rules 1986 respectively.

10. In <u>Waterfall I</u> it was held by the Court of Appeal that, on the true construction of section 74(1), the expression "debts and liabilities" extended to statutory interest payable upon provable claims pursuant to section 189, and to non-provable debts including, in particular, currency conversion claims: **[1/9/52/para 203** *per* Briggs LJ].

11. The section 74(1) liability may be enforced only in a winding up. However, in <u>Waterfall I</u> it was held that, in any distributing administration or winding up of LBHI2 or LBL, LBIE's administrators would be entitled to prove as a contingent creditor in respect of those companies' liabilities under section 74(1), with the valuation of those contingent claims being a matter for estimation: [**1/9/52-61** *per* Briggs LJ and **1/9/35-37** *per* Lewison LJ].

(ii) The subordinated debts

12. LBHI2 is also a creditor of LBIE under the terms of three subordinated loan agreements made on 1 November 2006.[1] As at the LBIE administration date, the sums due under the subordinated loan agreements, converted into sterling in accordance with the provisions of rule 2.86(1), amounted to around £1.254 billion.

13. LBHI2's claim against LBIE is a contingent claim, the contingency being the satisfaction in full of all claims against LBIE having priority to LBHI2's claim in respect of the subordinated debts. LBHI2's claim is nevertheless a debt provable in LBIE's administration, with its value for the purposes of proof again being a matter for estimation: see <u>Waterfall I</u>, [29] and [38] to [41] **[1/9/10 and 13-15]** in the judgment of Lewison LJ (with whom, on this issue, Briggs and Moore-Bick LJJ agreed: see [133] and [246] **[1/9/37 and 63]**), which are reflected as to proof in paragraph 2 of the order made by the Court of Appeal **[1/12/2]**. However, for so long as there is a sufficient absence of certainty that the contingency will be satisfied, the appropriate valuation will be nil: see the judgment of Lewison LJ at [41] **[1/9/14-5]**.

14. LBHI2 has submitted a proof in respect of its claims under the subordinated loan agreements in the sum of £1,254,165,598.48: **[2/1/175].** The LBIE administrators have not yet adjudicated upon the proof.

(iii) The other proofs

15. In addition to LBHI2's proof in to LBIE for the subordinated debt (as explained in the previous paragraph):[2]

    a. LBHI2 has submitted a proof in LBIE's estate for approximately £38 million in respect of the general intercompany unsecured balance;

    b. LBHI2 has submitted a proof on 22 July 2014 in LBL's estate for approximately £257 million in respect of the general intercompany unsecured balance;

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1 Summarised in the <u>Waterfall I</u> statement of agreed facts and issues at **[1/7/6-7]**

2 Summarised in Downs 9 at **[1/21/7-10]**

c. LBL has submitted a proof in LBIE's estate for approximately £363 million and has sought to amend that proof to include various recharges which are the subject matter of Part B of these proceedings;

d. LBIE submitted a proof on 31 October 2014 in LBL's estate for approximately £10.4bn, including £10 billion being its estimate of the value of LBL's liability under section 74(1);

e. Although LBHI2 is not yet in distributing administration or liquidation:

   i. LBL has submitted a proof in LBHI2's estate for £10 billion pursuant to its alleged right to recharge to LBIE LBL's liability under section 74(1); and

   ii. LBIE has submitted a proof in LBHI2's estate in respect of LBHI2's liability under section 74(1), which LBIE has estimated to be £10 billion.

(iv) Claims against LBIE's estate, priority and estimated outcomes

16. In accordance with the decisions in Waterfall I, the claims against LBIE's estate, and the order of priority of those claims (leaving aside costs and expenses), are as follows:

    a. Provable claims;

    b. Statutory interest on provable claims;

    c. Non-provable claims, which include currency conversion claims;

    d. Subordinated debts; and

    e. Members' claims.

17. Following the first instance and Court of Appeal judgments in Waterfall I, further judgments have been given at first instance on applications made by LBIE's administrators for directions on issues which are supplemental to or consequential upon the decisions made in Waterfall I. Those further first instance decisions are those made in the Waterfall II proceedings, which

application was divided into tranches A, B and C.[3] They may be summarised (very briefly) as follows:

a. Waterfall IIA concerned whether dividends should be allocated to principal or interest first and various other matters to do with the entitlement to and calculation of statutory interest;

b. Waterfall IIB concerned the construction and effect of various standard form agreements made between LBIE and large numbers of its creditors since LBIE entered administration, and whether they released or modified the rights of certain creditors in relation to statutory interest or currency conversion claims;

c. Waterfall IIC concerned the scope of the entitlements of certain creditors of LBIE to interest under standard form master agreements governed variously by English, New York or German law.

18. The decisions in Waterfall IIA and IIB are the subject of pending appeals to the Court of Appeal and are due for hearing in April 2017.

19. It is not currently possible to predict with any degree of certainty the final outcome of LBIE's administration, and any winding-up that might follow administration. The variables comprise at least in part the outcomes of the various pending appeals above. Nevertheless:

a. According to figures produced by LBIE's administrators, it is possible that there will be a deficiency above the level of subordinated debts. Thus, if one takes (a) the current predicted "low case" surplus (that is, the surplus after payment in full of proved claims, calculated on the administrators' most pessimistic estimate of available funds) of £6,860,000,000, and (b) the "high cost of funding" figures (that is, claims against the estate calculated on the basis that certain senior creditors can claim post-administration interest at a higher rate than 8% simple p.a.[4]) for statutory interest and non-provable claims of £6,100,000,000 and £2,400,000,000 respectively, there is a deficiency above the subordinated debts level of £1,640,000,000.

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3 The first instance judgment of David Richards J in Waterfall IIA dated 31 July 2015 is at Re Lehman Brothers International (Europe) [2015] EWHC 2269 (Ch), [2016] BCC 239; the first instance judgment of David Richards J in Waterfall IIB dated 31 July 2015 is at Re Lehman Brothers International (Europe) [2015] EWHC 2270 (Ch), [2015] BPIR 1162; the first instance judgment of David Richards J dated 24 August 2016 dealing with six supplemental issues arising out of Waterfall IIA and IIB judgments is at Re Lehman Brothers International (Europe) [2016] EWHC 2131 (Ch); the first instance judgment of Hildyard J in Waterfall IIC dated 5 October 2016 is at Re Lehman Brothers International (Europe) [2016] EWHC 2417 (Ch).

4 See explanation given in the LBIE administrators' 14th progress report on p.6

b. If one changes the basis of the calculation, and takes (a) the current "high case surplus" (that is, the same surplus as above, but calculated on the administrators' most optimistic estimate of available funds) of £8,000,000,000, and (b) the "base case cost of funding" figures (that is, the figures for the same claims as above, but calculated on the basis that no senior creditor can claim post-administration interest in excess of the judgment rate[5]) of £5,000,000,000 and £2,000,000,000 respectively, there will be sufficient funds to discharge in full all claims having priority to the subordinated debts. In that case, the event upon which the subordinated debts are contingent will have occurred, with a surplus of £1,000,000,000 available to discharge in part the claims in respect of those debts.[6]

c. It seems unlikely, however, that there will be sufficient funds to discharge all liabilities, including the subordinated debts, in full: see Downs 9 at [10] **[1/21/3-4]**.

20. The court is not on this application being asked to determine whether or not there are or are likely to be sufficient funds in LBIE's estate to discharge in full the claims of creditors in the levels above that of the subordinated debts; nor, therefore, is the court being asked to determine whether the contingency upon which the subordinated debts become payable has been, or will or is likely to be, satisfied. Rather, the possibility that it may be satisfied has given rise to and underlies a number of the issues which the court is asked to determine.

(v) LBHI2 and LBL's estates and estimate outcomes

21. LBHI2 has not sought permission to distribute yet. LBHI2's administrators anticipate that a distribution will be made to unsecured, unsubordinated, non-preferential creditors but the quantum and timing remain contingent upon the outcome of the Waterfall litigation.[7] As set out in the LBHI2 administrators' progress report for the 6 months to 13 January 2016 **[2/1/114]**, the distributions which can be made will depend in part on the recoveries LBHI2 makes from the joint venture it entered into in connection with its claims in LBIE's estate.

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5 See explanation given in the LBIE administrators' 14th progress report on p. 6

6 See the LBIE administrators' most recent progress report (for the six-month period ended 7 October 2016). Low and high surplus estimates over and above unsecured unsubordinated proved debts are £6.86bn and £8bn (p.9 at **[2/1/45]**). In the previous progress report (to 14 March 2016), statutory interest was estimated at £5bn ("base case") or £6.1bn ("high cost of funding case") at pp.14-15 **[2/1/50-51]**; currency conversion claims and interest thereon was estimated at £2bn (base case) or £2.4bn (high cost of funding case) at p.15.

7 LBHI2's administrators' progress report for the period 14 July 2015 to 13 January 2016, p. 2 **[2/1/113]**

22. LBL became a distributing administration in July 2014. It has paid a dividend of 100p in the £ to former employees on admitted preferential unsecured claims for unpaid wages and holiday pay, and declared and paid a first interim dividend of 1.66p in the £ to ordinary unsecured creditors in December 2014. The timing and quantum of any future dividends are currently uncertain.[8]

23. Although the insolvency of LBL and LBHI2 is an important part of the background to the part A issues, and indeed directly gives rise to some of those issues (for example, the double proof point raised by issue eight), the principles by which the issues are governed should capable of applying where appropriate to claims made against solvent or insolvent contributories. That is not to say that the insolvency of a contributory is irrelevant. As explained below, it is or may be highly material in the context of the exercise of the power under section 150 to make calls.

(vi) Assumptions

24. The part A issues are to be argued and decided on the basis of four alternative assumptions of fact, as follows:

    a. LBL is the legal and beneficial owner of a single share in LBIE and is not entitled to rectification of the share register;

    b. LBL is entitled to rectification of the share register with the effect that the single share in LBIE currently registered in LBL's name is (i) cancelled; (ii) registered in the name of LBH; or (iii) registered in the name of LBHI2;

    c. LBL holds the single share in LBIE as nominee for LBH Plc and/or LBHI2 and is entitled to an indemnity from LBH and/or LBHI2 (as appropriate) in respect of its liability under section 74(1); or

    d. LBL is otherwise entitled to recharge its liabilities to LBH (and/or LBIE, LBHI2 and/or LBEL), including its liability to make contribution to LBIE's estate under section 74(1).

25. The factual arguments are to be dealt with in part B of this application (to be heard in September 2017) but, whatever factual findings are made in part B, the basic analysis set out below will remain the same, whichever party is held to be the contributory in respect of the

[8] LBL's administrators' progress report for the period 15 March 2016 to 14 September 2016, p. 9 **[2/1/101]**

share currently registered in LBL's name. The different assumptions are therefore not addressed separately in this skeleton argument.

B The statutory scheme: liability, calls and adjustment

(i) The extent and purpose of the section 74(1) liability

26. The liability under section 74(1) is a liability imposed upon members to contribute amounts sufficient for (i) the payment of the company's debts and liabilities, (ii) the payment of the expenses of the winding up, and (iii) the adjustment of the rights of contributories amongst themselves. The liability is limited by the terms of the subsection and the process by which it is enforced, in the manner more fully described below, and by the provisions of the second and subsequent subsections of section 74. LBL and LBH have relied upon section 74(2)(e) – the contracting out provisions: see LBL's position paper at **[1/14/39]** and reply position paper at **[1/20/15]** and see LBH's position paper at **[1/19/6]**.

27. Section 74, and the provisions which provide for the enforcement of the section 74(1) liability, are an integral and important part of the statutory scheme for the winding up of a company's affairs, the purpose of which is described in, for example, the judgment of David Richards J in Waterfall I at [152] in the following terms **[1/8/40]**:

> "…the purpose of a liquidation is to realise to best advantage all the assets of the company and to distribute the proceeds of sale among those entitled to them in order of priority in which they are entitled to receive them. As the liquidation of a company ends with its dissolution, nothing as a matter of principle should be left unresolved for the future."

28. This passage appears in the section of the judgment dealing with the construction of the expression "debts and liabilities", and whether or not it extended to statutory interest and non-provable liabilities. In the context of the same issue, Lewison LJ, having expressed doubt as to whether or not the power to call is itself the property of the company, said this at [121] **[1/9/35]**:

> "That said, I agree with Briggs LJ that a contributory's liability under section 74 extends to all the liabilities of the company at all stages of the waterfall. If (as section 74 expressly provides) that liability extends to adjusting the rights of contributories, which are at the bottom of the waterfall, the logic is inescapable

that the contributory's liability encompasses liabilities that are higher up the waterfall. It must necessarily follow that the liability encompasses the creation of a surplus out of which to pay statutory interest since that ranks higher than both non-provable claims and also the rights of contributories as between themselves."

29. This issue is dealt with by Briggs LJ at [172] to [234]. In his judgment **[1/9/46-61]**:

    a. The adjustment of rights as between contributories was an aspect of paragraph 8 ("Shareholders") in the category of claims and order of priority set out in the judgment of Lord Neuberger PSC in Re Nortel GmbH [2013] UKSC 52, [2014] AC 209 at [39]. This is recorded as having been common ground between the parties in Waterfall I. In effect, it splits paragraph 8 into two: paragraph 8A for adjustment and paragraph 8B for distribution. The split gives effect to the priority between the two stages which is reflected in the statutory duty imposed by section 154;

    b. The statutory purpose of section 74 and the procedure for making calls is described in this way, at [182] **[1/9/47]**:

        "The provision for winding up, and the making of calls upon contributories, was a substitute for direct enforcement by creditors against members, but was in no way intended to limit the extent of members' liability, unless specifically limited in the ways now set out in sub-sections (2) and (3) of section 74."

30. The right to make calls is an asset available to a liquidator to meet the claims of creditors and to achieve any appropriate adjustment as between members, and the right to make calls (arguably, although there was a difference of opinion on this in the Court of Appeal in Waterfall I) and the proceeds of a call are part of the assets of the company: see Waterfall I, in the judgment of David Richards J at [165] **[1/8/44]** and in the judgment of Briggs LJ at [195] **[1/9/51]**, following the decision of the House of Lords in Webb v Whiffin (1872) LR 5 HL 711. Inter alia for this reason, it was held that a call could be made for the purposes of creating a "surplus" for the purposes of section 189, from which statutory interest could be paid.

31. However one characterises the right to make calls and the proceeds of any call, the right is enforceable only pursuant to and in accordance with the statutory provisions: see Waterfall I in the judgment of David Richards J at [134] to [137] **[1/8/36]** where he distinguishes between the processes for the making of calls before and after winding up. The differences are fundamental: see especially [137], where David Richards J describes the basis for the first as

being contractual whilst the second is statutory (although he caveats the description as being "for convenience", it is submitted that it is fundamentally correct and certainly useful).

(ii) Contributories and calls

32. The liability under section 74(1) is measured and enforceable in accordance with its own terms, and pursuant to the process provided for by the delegated duties and powers:

    a. In section 148 relating to the settlement of the list of contributories, as supplemented by rules 4.195 to 4.201; and

    b. In section 150 relating to the making of calls, as supplemented by sections 151, 152 and 158, and by rules 4.202 to 4.205.

33. The section 74(1) liability is to pay an amount "sufficient for payment of [the company's] debts and liabilities" and the other purposes specified in the subsection. By its terms, section 74(1) contemplates contribution for the purposes of the payment of a debt or liability (or expense) payable in the winding up. The relevant debts and liabilities are not confined to those provable and payable; hence section 74(1) extends to statutory interest and non-provable liabilities: see the judgments in Waterfall I referred to above. Further, the amount of the contribution is to be sufficient for the purposes identified by the subsection; in other words, no less, but equally no more, than is required to achieve those purposes.

34. Settlement of a list of contributories is mandatory, see section 148(1) and rule 4.196(1), but subject to the statutory dispensation in section 148(2). By contrast, the power to make a call is discretionary - see section 150(1) and rule 4.202 – and is exercisable only with sanction: see rules 4.203 and 4.204. The purpose of the power and the manner in which it may be exercised is further identified and set out in section 150(1). The call may be made for payment of any money "which the court considers necessary to satisfy the company's debts and liabilities…and for the adjustment of the rights of the contributories…", and it need not be made on all contributories. This latter point is clear from the wording of section 150(1) and is implicit in the provisions of section 150(2) which identify want of means as being one of the potentially relevant factors in the exercise of the discretion conferred by section 150(1): see also the use of the expression "contributories concerned" in rules 4.204(3) and 4.205(1). It should be noted further that a liquidator seeking sanction from the liquidation committee is required to identify both the amount of the call and its purpose: rule 4.203(3). This does not

apply where the sanction of the court is sought, but this is presumably because it is implicit that the purpose will be identified in the evidence in support of the application.

35. In both the settlement of the list and the making of calls, it is expressly provided that the liquidator acts as officer of the court and subject to its control: see rules 4.196(2) and 4.202.

36. The liquidator is required to distinguish between "persons who are contributories in their own right and persons who are contributories as being representatives of or liable for the debts of others": see section 148(3). The purpose of this is to identify two classes of persons who, whilst not members, are expressly declared by statute to be contributories but to whom special rules apply. The classes comprise personal representatives of a deceased member and the trustee of a bankrupt contributory: see sections 81 and 82, and also section 149(1). Accordingly, the significance attached to section 148(3) by LBL in para 77 of its position paper [**1/14/29**] is based upon a misunderstanding of the subsection.

37. Even where a registered shareholder holds his shares in the company as a trustee or nominee, it is nevertheless the registered shareholder (rather than the beneficial owner of the shares) who is liable as the contributory. Accordingly, even if LBL is (at the Part B trial) found to hold its single share in LBIE as nominee for LBH and/or LBHI2, LBL remains liable as contributory (and the basis or terms of the nominee arrangement will determine LBL's right to an indemnity from LBH and/or LBHI2): see McPherson's Law of Company Liquidation, 3rd ed ("McPherson") at para 10-005, citing Muir v City of Glasgow Bank (1879) 4 App. Cas. 337, which was followed in Re City of Glasgow Bank, Buchan's Case (1879) 4 App. Cas. 547. LBL's suggestion to the contrary at paragraph 76.1 of its position paper [**1/14/28**] is incorrect.

38. In principle, there is no reason why a liquidator should not (a) confine calls to one contributory, or one set of contributories, or (b) make calls in differing amounts on different contributories. Equally, and again in principle, there is no reason why the court should not direct the liquidator to do so. Whether or not one or more of these would be the correct course of action will depend upon the circumstances, including ability to pay.

39. The liquidator has a power to make calls but his discretion to do so is limited by the purposes specified in section 150: see McPherson at para 10-025 and Terry v The Carlton and West End Breweries Limited (1896) 22 VLR 33. These essential points about the process of making calls can be illustrated by reference to the judgments in two authorities:

    a. In Helbert v Banner (1872) 5 LR Eq 28 at 34, Lord Hatherley LC said:

> "… the Court, exercising a reasonable discretion, would in no case direct calls to be made if it was clear that there were assets actually in the possession of the liquidator which were sufficient for the payment of the debts. But in the other case, of assets being outstanding, you must consider what would reasonably be required by the Court. It is not pointed out specifically by the statute, but you must trust to the discretion of the Court with respect to it, and all that the Court has to be satisfied of is that there is an improbability (to say the least of it) of the assets being obtained in such a manner, and within such a reasonable time, as to be sufficient for the payment of the debts of the creditors of the company. Because the Court is not bound to allow delay for an indefinite period of time in getting in the assets."

b. And then in King v Tait (1936) CLR 715 at 746, Dixon J observed as follows:

> "… the duty to contribute is not independent of claims on the fund. On the contrary, it depends altogether on the existence of such claims. It is true that the discretionary judgment of the court or liquidator determines the time and amount of the contribution. But calls are not to be made when it is clear that the proceeds will not be required for the purpose of the liquidation".

(iii) Calls and adjustment

40. The section 74(1) liability to contribute for the purposes of adjustment does not create rights and obligations as between the contributories. Rather, it serves to create the fund with which the liquidator can discharge his delegated duty to adjust as between contributories imposed by section 154. As with the payment of creditors, this is the means (and the only means) by which, after winding up, adjustment can take place; as David Richards J described the process in the passage of his judgment in Waterfall I cited in Section B(i) above, but extending it to adjustment, an existing liability as between members is replaced with a statutory liability to contribute to a fund which the liquidator is under a duty to distribute inter alia in a manner which achieves adjustment as between members.

41. Thus:

    a. In Re Shields Marine Insurance Association (1868) 5 Eq 368, Lord Romilly MR said (at 372):

> "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 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 between themselves; and persons are not discharged from all liability as shareholders because all claims against the society have been disposed of, if the society have claims against them for the purpose of setting right the contributions equally amongst the members."

b. And as it is put in McPherson at para 10-025, citing Re Hodges Distillery Co; ex parte Maude (1870) 6 Ch App 51 and Paterson v McFarlane (1875) 2 R 490 (Court of Session):

> "Since the object here is to ensure that losses suffered by the company are distributed rateably among all the members in proportion to the amounts subscribed for and not the amounts paid up, it follows that this is as much a purpose of the liquidation for which, in the absence of a contrary provision in the articles, a call may be made as is the purpose of paying debts and liabilities of the company and discharging the costs and expenses of the winding up."

(iv) The basis for adjustment

42. As between the contributories, the general principle is that losses are shared rateably: see:

a. Gore-Browne (update 94) at para 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 the members contribute rateably".

b. McPherson at para 10-001:

"the liquidator makes and enforces calls on the persons listed if need be to the full extent of their liability where this is necessary in order to discharge the debts of the company or to adjust the rights of the contributories so as to ensure that losses are evenly distributed amongst all the members."

c. McPherson at para 14-001:

> "In the absence … of express provision to the contrary, the general rule is that the assets of a company in liquidation are divisible among the members in proportion to the nominal amounts of their share capital. Underlying this rule is the principle of equality or rateability in the distribution of assets. It is intended to ensure that a member's share of corporate profits or losses in winding up corresponds exactly with their members' fractional interest in the company itself; and where shares are paid up in unequal proportions it necessarily follows that the rights of members must be mutually adjusted, by returning capital or by making calls before any distribution can properly take place."

d. McPherson at para 14-011:

> "The property of a company in liquidation may be more or may be less than sufficient to enable paid up capital to be returned to members. If the former, there has been an accretion to the assets in which the members are entitled to share. If the latter, it becomes a question of apportioning capital losses rather than of distributing any real surplus among the members. In neither case is the matter expressly regulated by the Act, which leaves the actual proportions in which surplus assets are to be shared and losses borne by the members to be determined by what are described as their 'rights and interests in the company'. This, as Lord Herschell observed in Birch v Cropper, leaves unstated what those rights and interests are; but 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."

43. In this case, LBIE's share capital comprises different classes with different rights, including preference shares. Although they may have characteristics or purposes of debt akin to those

of debt securities, they are nevertheless part of the equity: see the judgment of Hildyard J in Waterfall IIC at paragraphs 135 to 139, and footnote 14. Nevertheless, in this case (and as is commonly the case), the preference shares carry no rights to participate in a distribution on a winding up beyond the return of capital: see article 7A(b) of LBIE's articles of association **[2/1/11]**. If, therefore, adjustment is based upon respective rights to participate in the surplus, then (a) as between the preferential shareholders and the ordinary shareholders, the ordinary shareholders ought to bear the liability and (b) as between the ordinary shareholders, the liability should be borne rateably by reference to their respective ordinary shareholdings . In this case, so far as the ordinary shareholders are concerned, this gives a proportion of 6,237,113,999 to 1.

C Issue One: Do LBIE's liabilities under the subordinated debts fall within the terms of section 74(1)

44. LBHI2 considers that, as a matter of statutory construction, LBIE's liabilities under the subordinated debt agreements, whether actual or contingent, are "debts or liabilities" within section 74(1): see the various provisions of rule 13.12 relating to those terms. As such, they fall within the scope of the section 74(1) liability, but the amount of the section 74(1) liability that is attributable to those liabilities (if any) and the manner in which a call may be made in respect of those liabilities is determined by the answers to the subsequent part A issues. As explained below, it does not follow necessarily follow that "an amount" will be attributed to those claims in the calculation of the total amount of the liability under the subsection (1), or that a call can properly be made in respect of those claims. For so long as the claims have a nil value, nothing is required to be paid and there is no necessity to make a call for their satisfaction. Unlike LBIE, therefore, LBHI2 does not consider that there is sharp distinction between liability and value when one asks the question: what is the amount of the section 74(1) liability and what can properly be called under section 150.

45. The second part of issue one relates to the "contracting out" point: whether or not subsection 2(e) applies. LBL and LBH contend that it does; LBIE contends that it does not. LBHI2 does not intend to make submissions on this part of issue one.

D Issue two: insolvency set-off in LBIE's administration

46. The answer to issue two is given in Waterfall I, at [227] to [249] in the judgment of David Richards J **[1/8/60-66]**, which are reflected in declarations (ix) and (x) **[1/11/4]**,and [29] and [38] to [41] of the judgment of Lewison LJ **[1/9/10 and 13-15]**, with whom on this point Briggs and Moore-Bick LJJ agreed ([133] and [246] respectively), and paragraph 2 of the Court of Appeal's order **[1/12/2]**:

    a. The contingent claim of LBIE in respect of the section 74(1) liability is to be included in the insolvency set-off in LBIE's administration (taken as at 4 December 2009) against the provable claims of LBHI2 and LBL; and

    b. LBHI2's contingent claim in respect of the subordinated debts is a claim provable in LBIE's distributing administration and (with its other provable claims) is the subject of mandatory set-off in LBIE's administration against LBIE's contingent claim in respect of the section 74(1) liability.

47. There does not appear to be any dispute between LBL, LBHI2, LBIE and LBH on issue two. All agree that a contingent section 74(1) liability is to be included in LBIE's administration set-off account.[9]

48. In summary, this is because:

    a. Insolvency set-off under the rules in both liquidation and a distributing administration is mandatory and self-executing.[10] It is not possible for parties to contract out of it;[11]

    b. Once the account has been taken under rule 2.85 (in a distributing administration),[12] only the net balance is provable (if the net balance is in favour of the creditor; if the

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[9] LBL's position paper dated 30 September 2016 at para 118 **[1/14/43]**; LBIE's position paper dated 18 November 2016 at paras 15-17 **[1/16/8]**; LBH's position paper dated 16 December 2016 at paras 15-17 **[1/19/8-9]**.

[10] Stein v Blake [1996] AC 243 at 254-5 per Lord Hoffmann (dealing in that case with section 323 of the Insolvency Act 1986 on bankruptcy, in the same terms as the rules on set-off in corporate insolvency)

[11] National Westminster Bank Ltd v Halesowen Presswork and Assemblies Ltd [1972] AC 785 at 808 per Lord Simon (dealing in that case with section 31 of the Bankruptcy Act 1914 on bankruptcy, in the same terms as the rules on set-off in corporate insolvency)

[12] The set-off rule in administration is rule 2.85 (which has been in force in this form since 1 April 2005):

"**2.85**— Mutual credits and set-off

(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.…

(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. …

(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."

net balance is in favour of the company, then the 'creditor' (in reality a debtor of the company) must pay the company that net balance when it falls due);

c. LBIE went into administration on 15 September 2008 and its administrators gave their rule 2.95 notice on 4 December 2009. Accordingly, the account taken under rule 2.85(3) was taken as at 4 December 2009 between any "mutual dealings" between LBIE and LBHI2;

d. LBHI2's provable claims against LBIE and its contingent section 74(1) liability to LBIE are "mutual dealings";

e. LBHI2's claims against LBIE (both in respect of the subordinated debts, and for approximately £38 million for an unsecured unsubordinated claim) are provable in LBIE's administration; and

f. LBIE's contingent claim against LBHI2 in respect of its section 74(1) liability is provable in LBHI2's insolvency whilst LBIE is in administration.

E Issue three: estimation of the value of the contingent claim in respect of the section 74(1) liability

49. Issue three relates to the estimation of the value of the contingent section 74(1) liability for the purposes both (a) of proof by the LBIE administrators in any distributing administration or winding up of LBHI2 and LBL, and (b) of set-off in LBIE's administration against the provable claims of LBHI2 and LBL, including in particular LBHI2's contingent claim in respect of the subordinated debts.

50. In summary, LBHI2 submits that the answer to issue three is that the element of the contingent section 74(1) liability that is attributable to LBHI2's claims in respect of the subordinated debts cannot be more than the value attributed to those claims, and therefore the answer is (iii): "some other value".

    a. This is not because "liability" is to be equated with "value". Rather, it is because (a) the section 74(1) liability is to contribute an amount "sufficient for payment" of debts and liabilities, (b) by section 80, the section 74(1) liability is payable by a contributory only when calls are made for enforcing the liability, and (c) by section 150, the power

to make a call can be exercised only "for payment of any money which the court considers necessary to satisfy the company's debts and liabilities…".

b. In this case, the value of LBHI2's claim in respect of the subordinated debts is nil, unless and until it becomes clear that there will be a surplus in LBIE's estate sufficient to discharge all claims having priority to the subordinated debts. For so long as the claims in respect of the subordinated debts are valued at nil, there is no payment due or required to be made, and:

   i. a sum which included the full amount of the contingent liability would be in excess of the amount described in section 74(1) ("an amount sufficient for payment"), and

   ii. a call which purported to include the full amount of the contingent liability would be in excess of the power conferred by section 150 because it would be in excess of "money which the court considers necessary to satisfy the company's debts or liabilities".

c. If, on the other hand, the contingency upon which the subordinated debts are payable is satisfied, the value of the claim in respect of the subordinated debts falls to be re-valued at the full amount of those debts. Without set-off, there is now a payable liability to which the section 74(1) liability extends and which may be the subject of a call under section 150. However, the liability is paid in full by the operation of mandatory and self-executing set-off of LBHI2's claim for the subordinated debts against the part of the contingent section 74(1) claim calculated by reference to that claim for the subordinated debts.

d. The analysis set out above is premised on the basis that the amount of the contingent section 74(1) liability whilst LBIE is in administration is equal in value to the amount of a section 74(1) liability by LBIE in a winding up. However, that over-states the value of the contingent claim which is what falls to be estimated for the purpose of the administration set-off account, because it fails to take into account the relevant contingencies: that the company will go into liquidation and a call will be made. Some discount must be made to reflect that contingency, and that is what underlies the answer given to the issue: that the value of the contingent section 74(1) claim, so far as it relates to the subordinated debts, will always be for a sum equal to or, more

likely, less than the value placed on those debts for the purposes of proof in LBIE's distributing administration.

51. Rule 2.81 sets out the approach to be adopted by an administrator where there is a contingent claim by a creditor against the company.[13] The value of the claim must be estimated by the office-holder (and can be re-valued in future if there is a change of circumstance or further information about the claim becomes available).

52. By rule 2.85(5), rule 2.81 applies to any debts owing to and by the company for the purposes of set-off.[14]

53. Both LBHI2's claim in respect of the subordinated debts claim and any claim by LBIE in respect of the section 74(1) liability are contingent:[15]

    a. LBHI2's subordinated debt claim against LBIE is contingent on the LBIE administrators being able to pay all prior-ranking claims against LBIE in full: see Waterfall I in the Court of Appeal at [38] and [41] *per* Lewison LJ **[1/9/13-15]**; and

    b. If the LBIE administrators are permitted to make a contingent section 74(1) claim in respect of the subordinated debts claim (or any other claim) against one or both of the members, it is a claim contingent on whether (a) LBIE will go into liquidation and (b) a liquidator would make a call under section 150.

54. The Court of Appeal's decision in Waterfall I was that LBHI2's claim for the subordinated debts was a contingent debt which the LBIE office-holder would value at nil when lodged, and would then revalue at the full amount of the liability once it becomes clear that the contingencies are satisfied; that is, that the office-holder has sufficient assets to pay the prior-ranking claims in full.

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13 "**2.81**.— Estimate of quantum

(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."

14 Rule 2.85(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."

15 LBL and LBIE do not dispute this: see LBL's position paper dated 30 September 2016 at para 121 **[1/14/44]** and LBIE's position paper dated 18 November 2016 at para 25(4) **[1/16/11]**. LBH agrees with this position – see position paper dated 16 December 2016 at para 20(iii) and (iv) **[1/19/10]**.

55. LBHI2 submits that the starting point for the value of the subordinated debts element of any contingent claim in respect of a section 74(1) liability must be limited to the estimated value applied to LBHI2's claim for the subordinated debts for the purposes of proof. LBIE's office-holders cannot assert (in estimating the value of LBIE's claim) that it has a liability in respect of the subordinated debts which it values as greater than the value it puts on that same liability when asserted against it by way of LBHI2's proof in LBIE's administration. (LBH appears to agree with this analysis, at least insofar as a contingent claim is asserted or relied upon as against LBHI2 (as opposed to against LBL or LBH)).[16] That is because the first contingency relevant to the valuation of any outgoing claim by LBIE is the same contingency as is relevant to the valuation of the incoming liability asserted by LBHI2; namely, whether LBIE will have sufficient assets to pay its prior-ranking liabilities in full.

56. The value to be placed on LBIE's contingent claim against LBHI2 then falls to be discounted from that starting point to reflect the fact that further contingencies would need to be fulfilled before a liability to pay arose in respect of the section 74(1) liability; namely, LBIE going into liquidation and the liquidator making a call, but whether creditors' interests are best served by LBIE going into liquidation is uncertain and may depend on a number of factors, about which the LBIE administrators have presently given very little information.[17]

57. It follows that the value of LBIE's claims in respect of the section 74(1) liability, for the purposes of proof and set-off, is either nil or necessarily less than the estimated value that the LBIE administrators place on LBHI2's claim in respect of the subordinated debts.[18] The fact that LBIE's contingent claim would therefore be insufficient to satisfy in full any unpaid balance of the value attributed to LBHI2's claim in LBIE's administration is accordingly a consequence of the section 74 liability being dealt with as a contingent claim whilst LBIE remains in administration.[19]

58. LBIE's analysis is different.[20] LBIE submits that LBHI2's contingent claim in respect of the subordinated debts is always to be valued at the full amount of the liabilities arising under the

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16 LBH's position paper dated 16 December 2016 at para 19(i) **[1/19/9]**

17 It is noted that LBIE's position paper at para 25(4) **[1/16/11]** asserts that the Administrators "will cause LBIE to go into liquidation" if it is "necessary" but this does not address the likelihood or otherwise of that happening nor is it evidence in relation to the same; in fact, the latest LBIE Progress Report states that the Administrators "have yet to determine the most appropriate exit" (p.32 of 16th Progress Report for period ended 7 October 2016).

18 LBL appears to accept this – see reply position paper dated 30 December 2016 at para 9.2 **[1/20/10]**

37 The Waterfall I appeal includes an appeal as to whether LBIE's Joint Administrators are entitled to deal with the section 74 liability.

20 See LBIE's position paper dated 18 November 2016 at paras 20 and 25 **[1/16/9-10]**; LBIE now puts forward a different analysis from the analysis set out in Downs 9 filed in support of the application, which stated that the value of the

subordinated debt agreements, without discount, for the purposes of LBIE's contingent claim in respect the section 74(1) liability. This is so even if the value for the purposes of LBHI2's claim against LBIE is nil, with the consequence that LBHI2's claim against LBIE must always be equal to or less than LBIE's contingent claim against LBHI2.

59. LBIE submits that this is so because section 74 is not limited to the company's debts and liabilities which are immediately payable but includes all those which become payable in the future. In support of this, LBIE relies on two authorities, but neither is on point, particularly because neither deals with contingent debts.

    a. Re Contract Corporation (1866) LR 2 Ch App 95 (Court of Appeal) concerned disputed debts (i.e. there was a question as to how much of the sum of £800,000 which had been asserted against the company in liquidation was in fact likely to be established as a proper claim against the company). Some contributories challenged the level of the calls made on them by the liquidator on the basis that much of the £800,000 was disputed and a call should not be made until the validity and quantum of the debts had been ascertained. It was held that section 102 of the Companies Act 1862 (a predecessor of section 74) was intended "*to provide the means of paying the debts whenever they might be established*" and that the section "*empowers a call to be made immediately after the making of the winding-up order—a time when it clearly cannot have been ascertained whether or not the debts will be established, or what the debts will be. … therefore, the true view of the section is, that where it speaks of debts and liabilities, it must be taken to mean estimated debts and liabilities.*" There is no inconsistency with LBHI2's case. The claim in respect of the subordinated debts is not a disputed debt; it is a contingent debt which can be estimated in accordance with the provisions of rule 2.81, and must currently be estimated at nil. As soon as LBIE's Administrators consider that they are likely to have sufficient assets to pay prior-ranking debts in full, they will re-value the estimate of LBHI2's proof in LBIE's administration for the subordinated debts. Until then, they cannot say that it is likely that LBIE will face a subordinated debts liability of more than nil because they have put (and maintained) a nil value on LBHI2's proof in respect of that liability.

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subordinated debts for the purposes of the section 74(1) liability should not be limited to the value of the subordinated debts for the purposes of proof because otherwise LBIE would not be able to make a claim in respect of that liability for the purpose of enabling itself to repay the subordinated debts to LBHI2. That analysis appears to have been abandoned.

b. Re Barned's Banking Company (1867) 36 LR Ch 215 does not have anything to say about the scope of section 102 of the Companies Act 1862 or valuation of contingent debts for proof and set-off purposes.

60. LBHI2 accepts that a call may in a proper case be made in respect of a future liability, provided also that it is made for the statutory purposes. However, that is very different from LBIE's case here, which is that a call may be made in circumstances where, at the time of the call, the contingency has not occurred and the value placed upon the claim for the purposes of proof and set-off is nil. It is submitted that this is incorrect and inconsistent with the statutory scheme as described above and would not be a proper exercise of the power to make a call. It is, moreover, inconsistent with the decision of the Court of Appeal in Re Danka Business Systems plc [2013] Ch 506 at para 38 *per* Patten LJ.

61. If LBIE is correct, then the consequences are these:

    a. LBIE will be able to prove in any distributing administration or winding up of LBHI2 and LBL for the full amount of the subordinated debts, as well as the debts and liabilities occupying the levels above that of the subordinated debts;

    b. The proceeds of the claim will form part of LBIE's assets, available for payment of all of its creditors, and the costs and expenses of the LBIE administration. The proceeds cannot be charged, in whole or in part, for the satisfaction of any class of creditors: see Webb v Whiffin;

    c. On the hypothesis upon which this analysis is proceeding (valuation of the claim in respect of the subordinated debts at nil because of an absence of certainty to a sufficient degree that the prior-ranking creditors will be paid in full), this means that the funds available to pay the prior ranking creditors will be increased by the amount of the claim which is attributable to the subordinated debts; in other words, to a contingent claim which is valued at nil because it is considered that there will be no funds available for its payment;

    d. It is submitted that this demonstrates the incompatibility of LBIE's position with the statutory scheme, and this is supported by the decisions of the Court of Appeal in Re Blakely Ordnance Company, Brett's Case, and Re Oriental Commercial Bank, Morris' Case (1872) LR 8 Ch App 800 on the re-hearing of the appeals in those cases following the decision of the House of Lords in Webb v Whiffin. The context is a different one – the extent of the liabilities of past members, and whether relevant liabilities should

or should not be reduced by dividends received – but the following comments of Lord Selborne LC at 809 to 810 are in point here:

> "To swell the amount of that indebtedness, by the fictitious process of treating as then due and unpaid any part of the original amount of those debts and liabilities which might have been previously satisfied by dividends out of the property in hand, or by the contributions of present members, or any part thereof which might have been previously released or extinguished—to do this (as it necessarily would be done in such a case as *Brett's*) for the sole purpose of increasing the dividends of those other creditors whose debts were contracted after these past members had left the company, would, as it seems to me, be a violation both of the letter and of the spirit of the 2nd sub-section."

e. Characterising the process as one of estimation does not assist LBIE. First, on this analysis the estimated value attributable to the subordinated debts is nil. Secondly, in making a call upon the basis of an estimation, a relevant factor would be the consequences of the estimate being excessive. Where the contributories are solvent, it matters less because the excess will find its way back to the contributories on a distribution of the surplus. The position is rather different where the contributories are insolvent and the proceeds of any call, even in aggregate, are insufficient to discharge debts and liabilities. Here, an excessive call increases the fund available for distribution, to the benefit of the creditors of the company but at the expense of the creditors of the contributories. The making of a call and the amount of any call are discretionary and not mandatory, and it is submitted that this potential outcome would be a compelling reason for not including within a call any element attributable to the subordinated debts in circumstances where the contingencies upon which those debts rest are such as to require the subordinated debts being given a nil value for the purposes of proof.

62. LBIE's contention can also be tested by reference to the effect of rule 2.101, which sets out what should happen when the value of a proof is increased or decreased after the payment of dividends. At present, the value of LBHI2's subordinated debts claim against LBIE is nil,

because it is not at present clear that LBIE will have sufficient funds to pay all prior-ranking claims in full.[21]

63. On LBIE's analysis, the value of the subordinated debts element of any contingent claim it can make against LBHI2 is the full value of the subordinated debts. The account under rule 2.85(3) is taken in LBIE's administration as at 4 December 2009 and, again on LBIE's analysis, there is then a net balance owing by LBHI2 to LBIE in respect of LBIE's contingent claim which includes an amount equal to the full value of the subordinated debts. If (a) LBHI2 went into a distributing administration or winding up, and then paid dividends on LBIE's proof in respect of its claim, and (b) it then became clear that LBIE was in fact able to pay all prior-ranking claims in full, such that the subordinated debts were then payable, then (c) the re-valuation would take place with the application of the hindsight principle, with (d) the consequence that LBHI2's claim would be re-valued in an amount equal to the full amount of the liabilities due under the subordinated debt agreements, and LBIE's contingent claim would be reduced to nil by set-off in LBIE's administration. LBIE would then be required to pay back the dividends LBHI2 had paid to it (rule 2.101(3)), which demonstrates that it should not have received them in the first place. Further, if that repayment meant that not all the prior-ranking claims (ahead of the subordinated debts) could in fact have been paid in full, then the subordinated debts should never have fallen due for repayment (i.e. should have remained with a value of nil), and there is complete circuity.

64. On LBHI2's analysis, the figure for LBHI2's claim in respect of the subordinated debts will always be equal to or greater than the subordinated debts element of LBIE's contingent claim in respect of the section 74(1) liability. The above circuity is avoided. Either:

    a. The relevant element of LBIE's claim and LBHI2's contingent claim are both valued at nil (when there are insufficient funds to pay outstanding prior-ranking claims); or

    b. They are both valued at full value and set-off against each other thus cancelling each other out (when there are sufficient funds to pay prior-ranking claims); or

    c. They are valued at full value but LBIE's claim is further discounted to reflect the further contingencies that apply to it, such that LBHI2 has a net claim against LBIE.

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[21] That factual situation may change (i) if the Supreme Court allows the appeals against the ranking of the subordinated debts and/or against the existence of Currency Conversion Claims and/or the position on post-administration interest in <u>Waterfall I</u> and/or (ii) depending on the outcomes of certain arguments in <u>Waterfall II</u> and/or (iii) depending on the size of the "Surplus" as defined in LBIE's progress reports and which is specifically stated to be subject to change.

F Issue four: the effect of set-off on a contingent claim in respect of a section 74(1) liability

65. The answer to issue four follows from the analysis given in relation to issue three. Either (a) any set-off that takes place as between LBIE and LBHI2 operates so as to eliminate or reduce the value of the contingent claim in respect of the section 74(1) liability, which is the liability of the contributories collectively; or (b) if LBIE's liabilities under the subordinated debt agreements have been paid or discharged by set-off, there is no liability for whose payment an amount is required to be contributed, and no amount is necessary for its satisfaction and so no call can be made in respect of such an amount under section 150.

66. It also follows that, in the event where LBIE's contingent section 74(1) claim is smaller than LBHI2's claim for the subordinated debts so that LBHI2 has a net claim against LBIE which remains unpaid, the section 74(1) liability asserted by LBIE's Administrators as a contingent claim is nonetheless finally discharged so that, if LBIE subsequently went into liquidation, the liquidator(s) of LBIE would not be able to assert a further section 74(1) claim against either of the contributories because no section 74(1) liability would remain undischarged.

G Issues five and six: the operation of set-off in successive insolvencies

67. The answers to issues five and six are straightforward, and have been agreed. The mandatory and self-executing nature of the set-off which is first in time results in a net balance, one way or the other, which can be affected by revaluation in the estate in which has set-off has occurred, but cannot be disturbed by subsequent set-off in another estate.

68. By way of slight amplification of the agreed position:

    a. Insolvency set-off as between two parties with mutual dealings does and can only happen once, extinguishing the two cross-claims and leaving one net balance.[22] LBIE's and LBH's analyses are the same as LBHI2's on this point and LBEL advances the same analysis in relation to issue six which concerns the effect of set-off as between its claims and LBL's (and on which LBHI2 takes no position).[23]

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22 Stein v Blake [1996] 1 AC 243 at 255 per Lord Hoffmann

23 LBIE's position paper dated 18 November 2016 at para 33-35 **[1/16/15-6]**; LBH's position paper dated 16 December 2016 at paras 27-8 **[1/19/12]**; LBEL's position paper dated 18 November 2016 at paras 22-26 **[1/18/8-9]**.

b. The actual value of the claims on either side of the rule 2.85(3) set-off account may be re-valued over time (where they are or are required to be estimated) in accordance with the hindsight principle set out by Hoffmann LJ in MS Fashions v BCCI SA (in liquidation) [1993] Ch 425, at 432.[24] Although LBL and LBIE both make the same submission on this point,[25] LBL incorrectly states that the hindsight principle effectively causes insolvency set-off to operate multiple times. The figure for the single net balance between the parties may be re-drawn in accordance with the hindsight principle but it does not mean that there is more than one account and one accounting date; still less that there can be a second set-off between the same liabilities in a second distributing administration/liquidation.

H Issue seven: the liabilities of individual members

69. In relation to the questions posed by Issue 7, LBHI2's submissions (which largely follow from submissions already made as to the nature and effect of the statutory scheme) are as follows.

70. The section 74(1) liability is a statutory liability imposed separately on all contributories to pay the amount as defined in the subsection.[26] Whether, and if so in what amounts, a call or calls will be made is a separate issue. Further, there is no basis for construing section 74(1) so as to limit the liability of individual contributories by reference to the number or nominal value of the shares held by each contributory. There is nothing in the wording of section 74(1), or elsewhere, that would justify that construction. As explained above and submitted below, the nature and amount of the members' respective interests in a company are reflected in an adjustment as between members and not in an apportionment of liability.

71. Nevertheless: –

a. the section 74(1) liability is to pay amounts sufficient to achieve all of the purposes identified in the subsection: payment of liabilities and expenses and adjustment as between contributories,

[24] "The hindsight principle is pervasive in the valuation of claims and the taking of accounts in bankruptcy and in winding up." *per* Hoffmann LJ

[25] LBL's position paper dated 30 September 2016 at para 131 **[1/14/46-7]**; LBIE's position paper dated 18 November 2016 at para 35 **[1/16/16]**.

[26] LBIE and LBH adopt the same position: see LBIE's position paper at **[1/16/17]** and see LBH's position paper at **[1/19/13]**

b. by section 80 the liability is payable only upon call, and

c. by section 150(1), a call may only be made when and to the extent that the court considers it "necessary" to achieve those statutory purposes, and it may be made on all or any of the contributories.

If, therefore, the statutory purposes can be achieved by a call on a single contributory, then that is the course that should be taken. Whether that is possible obviously depends upon the circumstances of the individual case.

72. A payment made by one contributory in respect of the section 74(1) liability, whether pursuant to a call and/or by way of the operation of set-off, goes to reduce the amount specified in the subsection, and therefore the liability of the other contributories and the amount of any call that can properly be made on them.

73. As between the contributories themselves, the section 74(1) liability is apportioned rateably in accordance (in this case) with the nominal value of the ordinary shares held by them. Apportionment is achieved by adjustment and, where necessary for that purpose, calls. Payments made by one contributory in respect of a section 74(1) liability will be relevant to, and must be taken into account in, the process of any adjustment to achieve the rateable apportionment.

74. Rights as between the contributories are dealt with by the performance by the court of the duty to adjust imposed by section 154. Each has a statutory liability to contribute for this purpose, and the court may make a call where necessary to achieve it. That statutory process of adjustment is a substitute for whatever direct rights may have existed as between the contributories, whether by way of indemnity or contribution, and whether contractual, equitable or otherwise.[27]

75. Since the right to make calls and any proceeds are part of the assets of the company, to be dealt with by the liquidator in accordance with his statutory duties, there is no set-off as between a section 74(1) liability and a claim which one contributory might have against another, whether by way of contribution, indemnity or otherwise. The necessary mutuality is lacking.

[27] LBIE and LBH adopt the same position: see LBH's position paper at **[1/19/13]** and see LBIE's position paper at **[1/16/18]**

76. The final question asks in summary whether the Court should direct the LBIE administrators to assert less than 100% of the amount of the section 74(1) liability as against LBHI2 and LBL and, if so, by how much and on what basis. The answer to the question as framed) is (having regard to the wording of issue 7(v)) “no”, because the LBIE administrators are not asserting that liability. What the LBIE administrators are doing is estimating, for the purpose of calculating the net balance resulting from the set-off account taken as at 4 December 2009 (the date of LBIE’s rule 2.95 notice), the value of LBIE’s contingent claim in respect of the section 74(1) liability and the value of LBHI2’s contingent claim in respect of the subordinated debts. Given that the section 74(1) liability is enforceable only by a liquidator, the estimate has to be made by reference to what might have happened in a hypothetical winding up as at that date, although in estimating the value of the contingent claim, they are required to have regard to further relevant information becoming available thereafter (such as, in this case, the extent of LBIE’s liabilities and the assets available to meet them). The question, therefore, is whether the liquidator in such a hypothetical winding up would properly have made a call on LBHI2 and/or LBL for less than the full amount of the section 74(1) liability, or would have been directed by the Court to do so, and, if so, upon what hypothetical basis and with what hypothetical effects. The answer or answers to those questions are then highly material to the estimation of the value of LBIE’s contingent claim in respect of the section 74(1) liability.

77. LBHI2 submits that, in principle, there is no reason why a liquidator should not, or should not be directed to, make different calls in different amounts at different times on contributories where that would achieve the purposes identified in section 74(1) and section 150. As already set out, the relevant sections and rules expressly contemplate that this might be the right course and further that, in the exercise of his powers, the hypothetical liquidator acts as officer of the court and is subject to its control. Whether that is the correct course, however, depends upon the circumstances.

78. If in this case -

    a. LBIE’s assets are sufficient to pay all debts and liabilities ranking in priority to the subordinated debts without the need for a call, so that

    b. the only liability then remaining is LBHI2’s claim in respect of the subordinated debt, and

    c. any section 74(1) liability in respect of that claim would be extinguished by set-off, then

d. the only purpose in making a call would be for the purposes of an adjustment, but

e. that call would be made only against LBL, then

it would be for a de minimis amount (£0.16 for each £1 billion contributed by LBHI2) and would be essentially worthless.

79. At present, it is not clear whether this is or will be the case. However, if and for so long as that uncertainty exists, and in accordance with the submissions made in answer to issue three, for the purposes of valuing both LBIE's contingent claim in respect of the section 74(1) liability (so far as it relates to LBIE's contingent liability to LBHI2 in respect of the subordinated debts) and LBHI2's proof in respect of the subordinated debts, a nil value should be attributed to both.

80. In the event that it emerged that LBIE had a much larger shortfall of assets to satisfy LBIE's liabilities, so that a call was to be made in respect of funds to pay the debts and liabilities ranking above LBHI2's subordinated debt claims, then in that case a call could be made by a liquidator of LBIE against LBL but it would not include any claim in respect of LBIE's liability to LBHI2 in respect of the subordinated debts because either (i) the prior-ranking claims would in any event not be paid in full so the value of the subordinated debt claims would be nil, or (ii) the subordinated debt claims would become payable because sufficient sums would be realised through the call process to pay the prior-ranking claims, but in that case the part of the call in respect of the subordinated debts would necessarily have been discharged through the operation of set-off against LBHI2's claims in respect of the subordinated debts and accordingly no call in respect of the subordinated debt part of the shortfall should be made on LBL.

I Issue eight: the rule against double proof

81. Issue eight assumes (contrary to LBHI2's submissions made in respect of issue seven) that LBL would be entitled to make a direct claim for an indemnity or a contribution in respect of any sum which it pays to LBIE in respect of LBIE's contingent claim in respect of the section 74(1) liability. In those circumstances, and until LBIE's claim was satisfied in full, it is submitted that the rule against double proof would preclude such a claim being made.

82. This issue concerns how (if at all) the rule against double proof would affect any claims between the members (as dealt with in Section D above) in circumstances where LBIE had not yet been paid in full for any section 74(1) claim made.

83. The rule against double proof is the principle that one insolvency estate should not pay two dividends in respect of what is in substance the same debt (and, accordingly, there should not be a double proof of what is in substance the same debt against one insolvency estate): In re Kaupthing Singer & Friedlander Ltd (in administration) (No.2) [2012] 1 AC 804 at [10]-[11] *per* Lord Walker, citing In re Oriental Commercial Bank (1871) LR 7 Ch App 99 at 103-104 *per* Mellish LJ:

> "But the principle itself—that an insolvent estate, whether wound up in Chancery or in Bankruptcy, ought not to pay two dividends in respect of the same debt—appears to me to be a perfectly sound principle. If it were not so, a creditor could always manage, by getting his debtor to enter into several distinct contracts with different people for the same debt, to obtain higher dividends than the other creditors, and perhaps get his debt paid in full. I apprehend that is what the law does not allow; the true principle is, that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts."

84. In Re MF Global UK Ltd (in special administration) (No 4); Heis and others v Attestor Value Master Fund LP ([2013] EWHC 2556 (Ch) at [72] and [73], David Richards J described the rule as follows:

> "72 The rule against double proof is a long standing and well-established feature of insolvency law. As explained by Oliver LJ in *Barclays Bank Ltd v TOSG Trust Fund Ltd* [1984] AC 626, 636, it 'stems from the fundamental rule of all insolvency administration that, subject to certain statutory priorities, the debtor's available assets are to be applied pari passu in discharge of the debtor's liabilities'. This fundamental rule is undermined if two or more proofs are admitted in respect of the same liability.
>
> 73 The rule is not however restricted to proofs in respect of what is strictly the same liability. Oliver LJ said, at p 636 d–f:
>
> > 'Secondly, it is, as I think, a fallacy to argue—and this is really the basis of [counsel for the plaintiff's] argument—that because overlapping liabilities result from separate and independent contracts with the debtor, that, by itself, is determinative of whether the rule can apply. The test is in my judgment a much broader one which transcends a close jurisprudential analysis of the persons by and to whom the duties are owed. It is simply

> whether the two competing claims are, in substance, claims for payment of the same debt twice over. It will be necessary to look more closely at the substance of the transactions which have given rise to the problems in the context of which claimant has the better right, but for the moment I accept [counsel for the defendant's] broad general proposition that the rule against double proofs in respect of two liabilities of an insolvent debtor is going to apply wherever the existence of one liability is dependent on and referable only to the liability to the other and where to allow both liabilities to rank independently for dividend would produce injustice to the other unsecured creditors.'

It is a test of substance, not form. The court must look closely at the relevant transactions to determine whether the rule applies";

85. The primary purpose of the rule, therefore, is the protection of other creditors of the insolvent estate against unfair treatment in circumstances where there are multiple creditors in respect of what is in substance the same debt. So, for example, in the context of a principal debtor (D) whose obligations to a creditor (C) are guaranteed by a guarantor (G), such that G has a right of indemnity against D if G discharges the obligation owed to C, the effect of the rule if D goes into insolvency is that, so long as C has not been paid in full, G may not compete with C either directly by proving in D's insolvency for an indemnity in respect of the debt owed to C, or indirectly by setting off his right to an indemnity against any separate debt owed by G to D: Kaupthing No.2 at [12].

86. Accordingly, even if (contrary to LBHI2's position set out at above) one member could in principle claim against the other for a contribution or indemnity in respect of its section 74(1) liability, in circumstances where LBIE had not yet been paid in full in respect of its contingent claim, neither LBHI2 nor LBL could pursue a claim for a contribution or indemnity from the other in respect of its liability to pay that claim, including by proving for such a claim in the other's administration or liquidation.[28] It follows that set-off as between LBHI2 and LBL would not include any claim for such a contribution or indemnity against or from the other unless and until LBIE had been paid its contingent claim in full.

[28] LBH adopts the same position – see position paper dated 16 December 2016 at para 36(iii) **[1/19/17]**

87. A call for the purpose of the adjustment of the rights of the contributories among themselves is a claim of a different and statutory nature (as explained above). Accordingly, the rule against double proof does not apply to such a claim, because the right of adjustment is provided for by the liquidator (exercising the power delegated to him by the Court) after the payment of the other liabilities in respect of which the members are required to contribute, so there is no risk of the adjustment of the rights of contributories competing with the prior-ranking liabilities.

<u>J Issues nine - preliminary issue – and 10: recharge and contracting out</u>

88. The issue nine preliminary issue and issue ten raise questions as to (a) the lawfulness or enforceability of the recharge agreement alleged by LBL to have existed as between LBIE and LBL, and to extend to its contingent or actual liabilities under section 74(1), and (b) the effect of such a recharge.

89. LBL contends that a recharge agreement of the nature described above existed and is effective. Part A of this application proceeds upon the assumption that such an agreement existed (whether it did or not and if so on what terms is a matter left over to part B). LBL contends that such an agreement is effective[29]. LBHI2 submits that it is not. LBIE agrees with LBHI2.[30]

90. The section 74(1) liability is imposed by statute. It is not possible to "get out" of that statutory obligation (whether by contract or in some other way, such as a resolution in general meeting). This has been illustrated in several cases, cited in <u>McPherson</u>, para 10-011. In particular:

    a. <u>Re Cordova Union Gold Company</u> [1891] 2 Ch 580 (Chancery Division) was an example of contributories seeking to rely on contractual rights (entered into before the winding-up order) to defer payment of calls on their shares. The case dealt with section 102 of the Companies Act 1862 (a predecessor of section 150 of the Insolvency Act 1986), which gave the Court the power to make calls on contributories "*to the*

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29 See LBL's position paper dated 30 September 2016 at paras 92-95 **[1/14/32-4]**, although these paragraphs do not specifically address the reasons why, as a matter of law, such avoidance of a statutory obligation is permissible in this case, because Preliminary Issue 9 was only added to the Application at a CMC held in early November 2016. LBL's reply position paper dated 30 December 2016 (paras 21-23 **[1/20/15-6]**) does not provide any authority or statutory basis which contradicts the analysis set out in this section of LBHI2's skeleton argument.

30 See LBIE's position paper dated 18 November 2016 at paras 51-53 **[1/16/24-6]**

extent of their liability, for payment of all or any sums it deems necessary 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". There was an agreement between the Union Gold Company Ltd and the Cordova Union Gold Company dated October 1888 under which any member of the Union Gold Company Ltd who had paid up shares was entitled to require the Cordova Company to allot him shares in the Cordova Company deemed to be partly paid up and that, in respect of the amount not paid up, to pay the outstanding amount in instalments on the 1 February and 1 August in 1889, 1890, 1891 and February 1892. The Cordova Company was wound up on 15 March 1890 before all the instalments were paid. Some of the contributories opposed the call and argued that they were not obliged to make any payment on their partly paid shares until the dates set out in the agreement. Kekewich J held that the contract was determined on the making of the winding-up order and that "*the extent of their liability*" in section 102 was the extent of their liability as contributories as defined in the Act itself.

b. Further and to similar effect, a clause in the articles whereby shares are to be paid for in instalments ceases to operate if liquidation intervenes before the date on which the instalments become due and payable: "*The effect of the section is that upon the happening of a contingency, namely, a winding up of a company, any provisions, whether contained in the articles of association or any express agreement whereby payment for shares in the whole or in part is delayed beyond the commencement of winding up proceedings, are abrogated, and the shareholder is bound to pay in accordance with the terms prescribed by statute.*" Re Irma Co-operative Co [1925] DLR 27 at 32, per Tweedie J.

91. McPherson accurately describes the rationale behind this inability to get out of a liability to contribute under section 74(1) whilst the debts and liabilities of the company and the costs of the winding-up are still to be satisfied[31] (relying in particular on Ooregum Gold Mining Co v Roper [1892] AC 125 (House of Lords) at 145 *per* Lord Macnaghten):

> "The stringency with which the courts have maintained the liability of contributories to its fullest extent stems from the paramount necessity for ensuring that there will be funds capable of meeting the debts and liabilities of the company and the costs and charges of

[31] Although the position is slightly different when those have all been satisfied in full and the court/office-holder is dealing with the adjustment of the rights of contributories only.

winding up. Once these claims have been satisfied, however, this consideration ceases to prevail, and, in dealing with adjustment of the rights of contributories, the courts have relaxed their insistence upon strict compliance with the terms of the section. At that stage the only remaining object is to equalise losses and produce a proportionate distribution of any surplus assets, and, since it is only the interests of contributories that are affected, there is no principle of policy which forbids exclusion of liability for this purpose alone.

Accordingly, in King v Tait[32] the Australian High Court upheld the validity of a clause in the articles of a company which stipulated that no call should be made upon the holders of partly paid up shares except for the purpose of paying and discharging the debts and liabilities of the company and the costs and charges of winding up. It does not seem to matter much whether this is treated as a real exception to the liability imposed by section 74(1) or simply, as Dixon J. in King v Tait preferred to regard it, as an exercise by the company of its freedom to prescribe the proportions in which losses of capital are to be borne by the members. In the words of that learned judge, an article in this form: "assumes that all other claims on the fund are out of the way. In that event, and only in that event, it proceeds to deal with the title of the contributories or members to the uncalled capital. It deprives them of any title to it, or, to put it in another way, it allocates uncalled capital among the contributories precisely in accordance with their respective liabilities therefor. It does not attempt to forbid the calling up of capital though an adjustment may be necessary. But it excludes the possibility of any cause for adjustment arising, and, in the course of, and for the purpose of, doing so, provides against calls for that object."" (para 10-012)

92. If LBIE is entitled to make a claim against LBL in respect of the section 74 liability, and if LBL does have a recharge claim in respect of that liability, there then arises the question: how does the recharge claim on the one hand, and LBHI2's claim in respect of the subordinated debts on the other hand, rank as between themselves for the purposes of distributions from LBIE's estate.

93. LBL's position is that this issue probably will not arise because there would be set-off between the respective claims of LBIE and LBHI2, and between the respective claims of LBIE and LBL, which would effectively cancel out both LBIE's claims against LBHI2 and LBL in respect of the section 74(1) liability, and any claims LBHI2 and LBL had against LBIE.[33]

94. LBIE's position is also that the issue will not arise because:

[32] (1936) 57 CLR 715

[33] See LBL's position paper dated 30 September 2016 at para 136 **[1/14/48]**

a. As a matter of law, it is not possible for LBL to recharge its section 74 liability (actual or contingent) to LBIE or any other entity;

b. Alternatively, LBHI2 will never have a claim for the subordinated debts against LBIE because the subordinated debts and any subordinated debts claim under section 74(1) will be set-off against each other, thus cancelling each other out;

c. Alternatively, LBL will never have a recharge claim for the subordinated debts part of a claim under section 74(1) against LBIE because the recharge claim and the subordinated debts part of a claim under section 74(1) will be set-off against each other, thus cancelling each other out;

d. Alternatively, LBL's recharge claim is bad for circuity;

e. But if a recharge claim does exist, then it is a provable debt in LBIE's insolvency and would thus rank ahead of the subordinated debts.[34]

95. LBHI2 submits that the position is as follows:

a. This issue does not arise because it is not possible as a matter of law for LBL to recharge its section 74 liability to LBIE or any other entity (see above);

b. It should be noted that LBIE's submission that LBHI2 will never have a claim for the subordinated debts because of set-off between LBHI2's claim in respect of the subordinated debts and LBIE's claim in respect of the section 74(1) liability is not accepted; for the reasons already given, LBHI2's claim will necessarily be the same as or greater than LBIE's claim in each case, so far as they relate to the subordinated debts. LBHI2 may have (depending on valuation) a residual claim for the net balance against LBIE after set-off;

c. However, if there were to be a claim by LBIE against LBL, and a recharge in respect of the same by LBL against LBIE, it would rank below the subordinated debts for payment out of LBIE's insolvency estate;

d. It makes no sense for LBL's recharge claim, so far as it relates to the subordinated debts, to rank ahead of the subordinated debts in circumstances where a claim in respect of a section 74(1) liability (and so also a recharge in respect of the same) will

[34] See LBIE's position paper dated 18 November 2016 at paras 55-56 **[1/16/26-8]**

only be made in the event of a shortfall in assets in the LBIE estate for the discharge by LBIE of the subordinated debts;

e. LBIE's insolvency estate must not be put in a position of having to pay two dividends in respect of what is in substance the same debt because that prejudices LBIE's other creditors: that is what the rule against double proof prohibits.[35] The two claims (the one made in respect of the section 74(1) liability and the recharge claim) are in essence the same debt, with the latter only being triggered in the event of the first not being satisfied in full. Accordingly, whilst any part of the subordinated debts claim remains outstanding, the principal obligation on LBIE is to collect in funds sufficient to discharge that; if it were to seek to collect in those funds from LBL and LBL were to assert a recharge against that by way of proof in LBIE's insolvency, then there would essentially be two proofs against LBIE in respect of the same debt;

f. Further, a recharge agreement may upon its true construction fall within the terms of section 74(2)(f).The meaning of sums due to a member "in his character of a member" in section 74(2)(f) was said in Soden v British & Commonwealth Holdings plc [1998] AC 298 at 323-4 *per* Lord Browne-Wilkinson to be sums due as part of the bundle of rights which are inseparable from or characteristic of membership (such as, but not limited to, dividends and profits). Such a recharge may be considered to be a right inseparable from LBL's membership of LBIE. Such a claim could not rank *pari passu* with other creditors in circumstances where section 74 exists for the benefit of those creditors.

K Issue twelve: LBEL and set-off within LBIE

96. Issue twelve raises an issue between LBL and LBEL, and LBHI2 does not seek to make submissions in respect of this issue.

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[35] Re Oriental Commercial Bank (1871) LR 7 Ch App 99 at 103-4 *per* Mellish LJ; Re Kaupthing Singer & Friedlander Ltd (in administration) (No.2) [2012] 1 AC 804 at paras 10-12 *per* Lord Walker

<u>L Conclusion</u>

97. For the reasons set out above, LBHI2 submits that the answers to the issues that fall to be decided at this Part A hearing are as follows:

    a. **<u>Issue one:</u>** LBIE's liabilities under the subordinated debt agreements are "debts or liabilities" within section 74(1) and accordingly fall within the scope of the section 74(1) liability, subject to the application of section 74(2)(e) as to which LBHI2 makes no submissions.

    b. **<u>Issue two:</u>** LBIE's contingent claim in respect of the section 74(1) liability is to be included in the insolvency set-off account in LBIE's administration against the provable claims of LBHI2 and LBL.

    c. **<u>Issue three:</u>** The element of the contingent section 74(1) liability that is attributable to LBHI2's claims in respect of the subordinated debts cannot be more than the value attributed to those claims, and must also be discounted to reflect the relevant contingencies: that LBIE will go into liquidation and that a call will be made.

    d. **<u>Issue four:</u>** Either any set-off that takes place as between LBIE and LBHI2 operates so as to eliminate or reduce the value of the contingent claim in respect of the section 74(1) liability, which is the liability of the contributories collectively; or, if LBIE's liabilities under the subordinated debt agreements have been paid or discharged by set-off, there is no liability for whose payment an amount is required to be contributed, and no amount is necessary for its satisfaction and so no call can be made in respect of such an amount under section 150.

    e. **<u>Issue five:</u>** The mandatory and self-executing nature of the set-off which is first in time results in a net balance, one way or the other, which can be affected by revaluation in the estate in which the set-off has occurred, but cannot be disturbed by subsequent set-off in another estate.

    f. **<u>Issue six:</u>** LBHI2 takes no position on this issue

    g. **<u>Issue seven:</u>**

        i. The section 74(1) liability is a statutory liability and is the individual liability of each contributory.

ii. No. As between the contributories themselves, the section 74(1) liability is apportioned rateably in accordance (in this case) with the nominal value of the ordinary shares held by them. Apportionment is achieved by adjustment.

iii. As contributories, LBL and LBHI2 are liable to contribute such sums as may be necessary to adjust the rights of contributories amongst themselves in accordance with the provisions of section 74(1) and section 150.

iv. In making the adjustment provided for by Sections 74 and 150, the liquidator does not take into account any other claims which LBHI2 and LBL have against one another or any other party. The adjustment provided for by Sections 74 and 150 is concerned with the members' interests as such and as creditors and/or debtors of LBIE, but not otherwise.

v. As to this:

(1) The administrators of LBIE are not asserting the section 74(1) liability but estimating the value of LBIE's contingent claim for the section 74(1) liability and the value of LBHI2's contingent claim in respect of the subordinated debts for the purpose of calculating the net balance resulting from the set-off account taken as at 4 December 2009 in LBIE's administration.

(2) In carrying out this exercise, it is material that there is no reason why a liquidator should not be directed to make different calls in different amounts at different times on contributories.

(3) If LBIE's assets are sufficient to pay all debts and liabilities ranking in priority to the subordinated debts without the need for a call, so that (because any subordinated debt element of the call would be extinguished by set-off against LBHI2's claims for the subordinated debt) the only purpose in making a call would be for the purposes of an adjustment, then as that call would be only against LBL, it would be de minimis and essentially worthless.

(4) So long as it remains the case that it is not clear whether or not LBIE will have sufficient assets to pay all debts and liabilities ranking in priority to the subordinated debts without the need for a call, a nil

value should be attributed to both LBIE's contingent claim for the section 74(1) liability (so far as it relates to LBIE's contingent liability to LBHI2 in respect of the subordinated debts) and LBHI2's proof in respect of the subordinated debts.

(5) If LBIE's assets were insufficient to pay all debts and liabilities ranking in priority to the subordinated debts, so that a call was to be made in respect of funds to pay such liabilities, then a call could be made by a liquidator against LBL but would not include any claim in respect of LBIE's liability to LBHI2 in respect of the subordinated debts because either (a) the prior-ranking claims would not be paid in full so the value of the subordinated debt claims would be nil or (b) the subordinated debt claims would become payable because sufficient sums would be realised through the call process, but in that case the part of the call in respect of the subordinated debt claims would necessarily be discharged through the operation of set-off against LBHI2's claims in respect of the subordinated debts, and accordingly no call in respect of the subordinated debt part of the shortfall should be made on LBL.

h. **<u>Issue eight:</u>** Until LBIE's contingent claim in respect of the section 74(1) liability was satisfied in full, the rule against double-proof would preclude any claim by LBL for an indemnity or contribution in respect of any sum which it pays to LBIE in respect of that contingent claim.

i. **<u>Issue nine preliminary issue:</u>** The recharge agreement alleged by LBL to have existed and to extend to LBL's contingent or actual liabilities under section 74(1), would (assuming for the purposes of this hearing that it existed) not be effective. The section 74(1) liability is imposed by statute and cannot be avoided.

j. **<u>Issue ten:</u>** Assuming the existence of a recharge agreement between LBIE and LBL, LBL's claim for a recharge from LBIE would rank below the subordinated debts for payment out of LBIE's insolvency estate.

k. **<u>Issue twelve:</u>** LBHI2 takes no position on this issue.

PETER ARDEN QC

LOUISE HUTTON

ROSANNA FOSKETT

23 January 2017