17 May 2017

PRESS SUMMARY

The Joint Administrators of LB Holdings Intermediate 2 Limited (Appellant) *v* The Joint Administrators of Lehman Brothers International (Europe) and others (Respondents)
The Joint Administrators of Lehman Brothers Limited (Appellant) *v* Lehman Brothers International (Europe) (In Administration) and others (Respondents)
Lehman Brothers Holdings Inc (Appellant) *v* The Joint Administrators of Lehman Brothers International (Europe) and others (Respondents)
[2017] UKSC 38
On appeal from [2015] EWCA Civ 485

JUSTICES: **Lord Neuberger (President)**, **Lord Kerr**, **Lord Clarke**, **Lord Sumption**, **Lord Reed**

BACKGROUND TO THE APPEAL

This appeal and cross-appeal arise from the 2008 collapse of the Lehman Brothers group ("the Group"). The Group's main trading company in Europe was Lehman Brothers International (Europe) ("LBIE"), an unlimited company. LB Holdings Intermediate 2 Ltd ("LBHI2") holds all LBIE's ordinary and redeemable shares, except one ordinary share which is held by Lehman Brothers Ltd ("LBL"). LBIE, LBL and LBHI2 have all been in administration since January 2009. LBIE appears to be able to repay its external creditors in full. Under the provisions of the Insolvency Act 1986 as amended ("the 1986 Act"), an administrator of a company is permitted to make distributions to creditors. Since December 2009, LBIE has been in a distributing administration. The LBIE administrators declared and paid a first interim dividend to its unsecured creditors in November 2012. The LBIE administrators received proofs of debt from unsecured creditors including LBL and LBHI2 and the LBL administrators received proofs from LBHI2 and LBIE.

A consolidated set of rules regarding corporate insolvency is set out in the 1986 Act and the Insolvency Rules 1986 as amended ("the 1986 Rules") (together, "the 1986 legislation"). Schedule B1 to the 1986 Act contains provisions dealing with administration. Part 2 of the 1986 Rules is concerned with "Administration Procedure" and Chapter 10 of that Part, which includes rules 2.68 to 2.105, deals with "Distributions to Creditors." The 1986 legislation does not constitute a complete insolvency code and certain established judge-made rules may continue to operate. In a distributing administration, as in a liquidation, the duty of the office holder is to gather in and realise the assets of the company and to use them to pay off the company's liabilities. A generalised summary of the distribution priorities in relation to such payments ("the waterfall") is set out in *In re Nortel GmbH* [2014] AC 209 para 39.

In February 2013, the administrators of LBIE, LBL and LBHI2 issued proceedings seeking the determination of the court on issues arising in the administrations. In March 2014, Richards J delivered a judgment, and made ten consequential declarations. The Court of Appeal (Moore-Bick, Lewison and Briggs LJJ) upheld most, but varied some, of them. The Supreme Court now determines the following issues:

- Issue 1 concerns the ranking in the waterfall which can be claimed by LBHI2 in its capacity as holder of three subordinated loans made to LBIE, and in particular whether LBHI2's claims rank ahead of statutory interest payable under rule 2.88(7) and/or non-provable liabilities.

- Issue 2 arises from the fact that LBIE's creditors with debts denominated in a foreign currency will be paid under rule 2.86 at the rate of exchange prevailing at the date LBIE went in to administration, and sterling may have depreciated on the foreign exchange markets between that date and the date of payment. The foreign currency creditors claim that they are entitled to receive any contractual shortfall as a non-provable claim.
- Issue 3 concerns whether a creditor of LBIE who had been entitled to, but had not been paid, statutory interest, can claim such interest in a subsequent liquidation.
- The remaining four issues arise because LBIE is an unlimited company and so its members can be called upon to make contributions under section 74 of the 1986 Act to meet its liabilities if LBIE is in liquidation. Issue 4 is whether such contributions can be sought in respect of liability for statutory interest and for non-provable liabilities of LBIE.
- The other three issues arise because LBHI2 and LBL are creditors of LBIE as well as members of LBIE liable to contribute as such. Issue 5 is whether LBIE can prove in the administrations of LBHI2 and of LBL in respect of their contingent liabilities to make contributions in LBIE's prospective liquidation if they are called on to do so pursuant to section 150 of the 1986 Act.
- If LBIE cannot do this, issue 6 is whether LBIE can exercise a right of set off.
- If not, issue 7 is whether LBIE can invoke the so-called 'contributory rule' which applies in a liquidation, namely that a person cannot recover as a creditor until his liability as a contributory had been discharged.

JUDGMENT

Lord Neuberger writes the lead judgment, with whom (i) Lord Kerr and Lord Reed agree, (ii) save on an obiter issue on Issue 2, Lord Sumption agrees, and (iii) save on Issue 2 on which he dissents, Lord Clarke agrees.

CONCLUSIONS AND REASONS

Issue 1: LBHI2's contention, which turns on the interpretation of the Subordinated Loan Agreements, is that its claim as subordinated creditor ranks ahead of statutory interest and non-provable liabilities because they are "obligations… not payable… in the insolvency" of LBIE or (in the case of statutory interest) it is not "payable and owing by [LBIE]" within the meaning of the Subordinated Loan Agreements. In agreement with the courts below, the Supreme Court rejects LBHI2's arguments. Statutory interest is plainly an obligation payable in LBIE's insolvency **[48-49]**. It is also "payable and owing by [LBIE]", even though LBIE could not be sued for it **[51-56]**. Secondly, the notion that a liquidator who meets a non-provable liability makes a payment "in the Insolvency" is implied by the provisions of the 1986 Act and by the practical realities **[58-61]**, and the same applies to an administrator **[62]**. Accordingly, statutory interest and non-provable liabilities must be met before any balance can be used for payment of the subordinated loans **[64]**. In agreement with the judge and disagreeing with the Court of Appeal, LBHI2 cannot prove for the subordinated loans until the non-provable liabilities are paid or clearly could be met **[70]**.

Issue 2: Disagreeing with the Judge and the majority of the Court of Appeal, the Supreme Court concludes by a majority of 4 to 1 that rule 2.86, which provides that unsecured debts payable in foreign currencies are to be converted in to sterling at the official rate on the administration date, spells out the full extent of a foreign currency creditor's rights **[90]**, and so foreign currency creditors cannot claim as a non-provable debt the difference between the sterling value of the debt at the administration date and that at the date the debt was paid **[112].** This is consistent with the conclusion reached in reports produced prior to the 1986 legislation **[88]**. It is also supported by the fact that the contrary conclusion would lead to a one-way option in favour of the foreign currency creditors **[91]** and that, in contrast to proofs for certain other debts, there is no provision in the 1986 Rules for their adjustment **[93]**. It is dangerous to rely on judicial dicta regarding a previous insolvency code **[83]**. Lord Clarke dissents on this issue **[206 and 211-221]**.

On the wider issue whether the payment in full of a proved debt satisfies the underlying contractual debt, by a majority of 3 to 2 the Supreme Court inclines to the view that it is inconsistent with Chapter 10 of Part 2 of the 1986 Rules, and the natural meaning of rule 2.72(1), that a debt met in full nonetheless has a component which is capable of resurrection **[104-107]**. Lord Sumption is inclined to disagree on this issue **[195-201]** and Lord Clarke agrees with him.

Issue 3: Rule 2.88(7) only applies to an existing administration and constitutes a direction to an administrator while in office. Section 189(2) and rule 4.93 exclude rule 2.88(7) interest being proved for or paid once a company previously in administration is put in to liquidation **[117]**. In agreement with the Judge and disagreeing with the Court of Appeal, the Supreme Court considers that it is impermissible to have recourse to an entirely new judge-made rule to fill this gap **[120-123]**. Disagreeing with the Judge, the Supreme Court concludes that the contractual right to interest for the post-administration period does not revive or survive in favour of a creditor who has proved for a debt and been paid on his proof in a distributing administration. Rules 2.88, 4.93 and section 189 provide a complete statutory code for recovery of interest on proved debts **[124-5]**.

Issue 4: "Liabilities" in section 74 of the 1986 Act is not limited to those capable of being the subject-matter of a proof and includes non-provable liabilities **[136]**. However, rule 2.88(7) provides that statutory interest is payable only where there is a surplus after payment of the debts proved, and, in disagreement with the Judge and the Court of Appeal, the Supreme Court holds that section 74 cannot be invoked to create a "surplus" from which statutory interest can then be paid **[139]**.

Issue 5: section 150 creates a statutory obligation on a member **[153]** and entitles the liquidator to make the call to fulfil his statutory duties. Contrary to the view of the courts below, the Supreme Court considers that the nature of that obligation is such that it is incapable of being the subject matter of a proof unless the company concerned is in liquidation **[154]**. Any money paid under section 74 forms a statutory fund which can only come into existence once that company is in liquidation **[156]**; if that company not in liquidation, there is no existing person to be identified as a potential creditor, merely a possible future liquidator **[158]**. Further, the alternative would lead to serious difficulties **[160-163]**.

Issue 6: essentially for the same reasons, prospective section 150 liabilities cannot be set off by the LBIE administrators **[171]**.

Issue 7: It is plainly inconsistent with the *pari passu* principle and with the statutory aim of enabling effective calls to be made in a liquidation to allow LBHI2 and LBL to be paid out on their proofs like any other unsecured creditor, given that they are probably insolvent **[172]**. The contributory rule which applies in liquidations can properly be, and should be, extended to a distributing administration, with procedural modifications to achieve consistency with the legislative framework **[180-182]**.

References in square brackets are to paragraphs in the judgment