

ENGLAND AND WALES / JUDGMENT

Kaupthing Singer & Friedlander Ltd

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Neutral Citation Number: [2009] EWHC 2308 (Ch) IN THE HIGH COURT OF JUSTICE CHANCERY
DIVISION COMPANIES COURT Case No: 8805 OF 2008 Royal Courts of Justice Strand, London,
WC2A 2LL Date: 02/10/2009 Before : MR JUSTICE NORRIS

- ----- IN THE MATTER OF KAUPTHING SINGER & FRIEDLANDER
LIMITED (IN ADMINISTRATION) AND IN THE MATTER OF THE INSOLVENCY ACT 1986
- -----
- ----- Tom Smith (instructed by Freshfields Bruckhaus Deringer) Richard
Fisher (instructed by Kaupthing Singer and Friedlander Limited) Hearing date: 29 July 2009
- -----

Judgment

Page 1 Mr Justice Norris :

1. By an order dated 8 October 2008 Kaupthing Singer & Friedlander Ltd (“KSF”), an authorised deposit taker, entered administration. The present applicants were appointed joint administrators. On the same day the Kaupthing Singer & Friedlander Limited Transfer of Certain Rights and Liabilities Order 2008 (SI 2674 of 2008) was made by HM Treasury in exercise its powers under the Banking (Special Provisions) Act 2008. This order provided for the transfer of certain deposits (known as “the Edge accounts”) from KSF to ING Direct NV and charged the joint administrators with certain overriding objectives in the conduct of the administration. Those obligations have now been performed and the administration is presently being conducted with the objective of achieving a better result for the company’s creditors as a whole than would be likely if the company were wound up.
2. The creditors of KSF consist principally of the following:-
 - (a) the FSCS (on behalf of itself and HM Treasury), which has a claim against KSF in respect of the sums that the FSCS paid to ING so that ING would take over liability to the 170,000 Edge deposit holders who had total deposits of about £2.6 billion;
 - (b) the 3000 non-Edge depositors (individuals, charities, corporate customers, local authorities, building societies, banks, other KSF group companies and others), whose deposits totalled approximately £2.6 billion at the date of the Order;

- (c) trade and other creditors who will rank equally with the FSCS and the non-Edge depositors.
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3. Some of those to whom KSF owes money themselves owe KSF money. There are some 180 depositors with KSF who have also borrowed money from KSF. The total value of their outstanding deposits is approximately £15.5 million, €3 million and US\$5.7 million. But the total value of their outstanding loans is approximately £678.4 million, €147.3 million and US\$164 million (i.e. substantially in excess of their deposits). These loans will typically have been advanced at a floating rate of interest, usually linked to LIBOR. About half of the loans in number are repayable after August 2010 and some of them are not repayable until 2018.
 4. On the making of the administration order the rights of the depositors and others to enforce obligations owed by KSF were statutorily suspended because of the operation of paragraph 43 of Schedule B1 to the Insolvency Act 1986. The rights of KSF to enforce obligations owed by the depositors and others were not so suspended. The period of suspension would ordinarily last until the conclusion of the administration. The administration might conclude in a variety of ways, some of which might permanently alter or bring to an end the contractual and other arrangements between the creditors and KSF. The joint administrators might formulate proposals for a scheme of arrangement under section 899 of the Companies Act 2006 or for a company voluntary arrangement: or they may place KSF into creditors' voluntary liquidation under paragraph 83 of Schedule B1 or otherwise, or they might seek a compulsory liquidation on the discharge of the administration order. These were the usual means of distributing the assets realised in the administration until the advent of the present paragraph 65 of Schedule B1. The introduction of this paragraph enabled an administrator, with the permission of the Court, Page 3 to make a distribution to an unsecured creditor directly (and then to proceed under paragraph 84 of Schedule B1 to a dissolution of the company without the intervening step of a liquidation).
 5. On 24 April 2009 the joint administrators obtained the permission of the Court pursuant to paragraph 65(3) of Schedule B1 to make a distribution to creditors of KSF who were neither secured nor preferential. The joint administrators were obliged by rule 2.95 of the Insolvency Rules 1986 ("IR") to give 28 days' notice of their proposal to make a distribution and were bound to invite creditors (by public advertisement) to prove their debts. On 20 May 2009 the joint administrators gave notice in the London Gazette of their intention to declare a first interim dividend to preferential and unsecured creditors, and the advertisement required such creditors to submit their proofs of debt on or before 18 June 2009. The joint administrators then declared and paid a first interim dividend on 22 July 2009.
 6. The process upon which the joint administrators embarked was a quasi liquidation involving an assessment of the claims of the depositors and other creditors. This was governed by Chapter 10 of the Insolvency Rules 1986. This Chapter in essence adapts the language, concepts and mechanics of the payment of a dividend within a liquidation to the payment of a distribution within an administration. So a creditor claiming to participate in a distribution is referred to as "proving" his debt, and the document by which he seeks to

establish his claim is referred to as his “proof”: and if he so “proves” then that will suffice if the company proceeds from administration into creditors’ voluntary liquidation under paragraph 83. Page 4

7. The rules relating to quantification of claims for the purposes of the distribution are to be found in Section C of Chapter 10. They are very similar to the rules which apply in a winding up and which are to be found in IR 4.86 to IR 4.99. In particular they address the questions that arise out of mutual credits, mutual debts or mutual dealings between the company and any proving creditor in essentially the same way: compare IR 2.85 and IR 4.90. When the joint administrators came to apply these rules to the circumstances of the KSF administration four issues arose on which they sought the directions of the court. On 29 June 2009 Peter Smith J ordered that the directions be given speedily and that, in order that the court giving the directions should have the benefit of adversarial argument,
 - (a) Counsel for the joint administrators was to argue for their preferred construction of the Rules; and
 - (b) the joint administrators were to instruct independent counsel to advance any properly arguable alternative construction that might be in the best interests of those creditors affected by the relevant issue. Mr Tom Smith and Mr Richard Fisher have discharged these respective duties and I am grateful for their help. The need for an instant answer was not as great as had at one time been thought.
8. Before considering the detailed issues that arise in relation to mutual dealings it is useful to refer to certain general matters of policy and history which provide a context within which the technical questions must be answered. Page 5
9. The general and long established rule in liquidations was that where, before a company went into liquidation, there had been mutual credits, mutual debts or mutual dealings between the company and any proving creditor then an account was to be taken of what was due to each party from the other in respect of those dealings, the sums due from one party being set-off against the sums due from the other, and only the balance being provable in the liquidation or being recoverable by the liquidator as part of the assets (depending on how the balance was struck). In *Re M. S. Fashions* [1993] Ch 425 Hoffman LJ (at 432F ff) noted three established features of the rule. (a) Its application was mandatory (“the mandatory principle”). In the Court of Appeal Dillon LJ noted (at 446B) that this principle meant that secured and unsecured debts were set-off. (b) The account was taken at the date of the winding up order (being an application of the wider principle that the realisation and distribution of assets are treated as notionally taking place simultaneously with the date of the order) (“the retroactivity principle”). Dillon LJ noted that this rule supplanted an earlier rule that the set-off took place at the date of presentation of the petition (*ibid* at p. 446G). (c) In taking the account the court has regard to events which have occurred since the date of the winding up (“the hindsight principle”). In *Stein v Blake* [1996] 1 AC 243 at 252E Lord Hoffman explained that this required the Court to take into account everything that had

actually happened between the insolvency date and the moment when it becomes necessary to ascertain what, on that date, was the state of account between the creditor and the insolvent. In that same case at 251E Lord Hoffman drew attention to three further features of insolvency set-off. (d) Unlike legal set-off insolvency set-off affects the Page 6 substantive rights of the parties, enabling the creditor to set-off pound-for- pound what he owes the insolvent and to prove for or pay only the balance. A creditor with relevant mutual dealings is thus treated much more favourably than an unsecured creditor with none. As Professor Roy Goode commented in “Principles of Corporate Insolvency Law” at para 7-22 “Set-off on insolvency represents a major incursion into the pari passu principle, for its effect is that a creditor who owes money to the company on a separate account may resort to self-help by setting off the debt due to him against his own indebtedness to the company, thus [ensuring] payment of his claim pro tanto ahead of other creditors”

- (e) Unlike legal set-off, insolvency set-off operates in relation to sums which are not necessarily due and payable at the date of the bankruptcy or winding up order, but which may be future or contingent. It addresses the problems arising from the adoption of this broad approach by using the hindsight principle and by estimating the value of claims of the creditor. As to claims against the creditor on the other side of the account Lord Hoffman observed (on the state of the law as it then was) (at 253B) “There is no similar machinery for quantifying contingent or unascertained claims against the creditor because it would be unfair upon him to have his liability to pay advanced merely because the trustee wants to wind up the bankrupt’s estate”.
 - (f) Not only is the insolvency set-off mandatory, it is “self-executing” i.e. not dependent upon the taking of any procedural step such as lodgement of a proof.
10. Although this is the general background to the operation of set-off in an insolvency setting it is, of course, the case that the actual operation of set-off in the context of an administration must be governed by the true construction Page 7 of the relevant rules. The principal rule is IR 2.85, originally introduced by the Insolvency (Amendment) Rules 2003 SI 2003/1700 and then modified by the Insolvency (Amendment) Rules 2005 SI 2005/527. The Explanatory Memorandum annexed to the latter instrument stated:- “The rules dealing with set-off in liquidation and administration proceedings have been completely re-cast in order to make them as easily understood and comprehensible as possible. The amended rules have been considered by representatives of the insolvency and legal profession whose comments have been reflected in the drafting”.
11. In its amended form the heart of IR 2.85 states:-
- (1) This Rule applies where the administrator, being authorised to make the distribution in question, has, pursuant to Rule 2.95, given notice that he proposes to make it. (2) In this Rule “mutual dealings” means mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company proving or claiming to prove for a debt in the administration.....

- (3) An account shall be taken as at the date of the notice referred to in paragraph (1) of what is due from each party to the other in respect of the mutual dealings and the sums due from one party shall be set-off against the sums due from the other.
- (4) A sum shall be regarded as due to or from the company for the purposes of paragraph (3) whether it is payable at present or in the future; the obligation by virtue of which it is payable is certain or contingent; or its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion (a) (b) (c)
- (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 Page 8 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.
12. It is to be noted that whereas in a liquidation or a bankruptcy the account is to be taken as at the date when the relevant insolvency regime commences, in an administration the account is taken at the date of the notice of intended distribution, not at the date of entry into administration.
13. The first question to arise in the KSF administration relates to sums due to or from the company in the future. For the purposes of insolvency set-off IR 2.85(7) provides:-
- (7) Rule 2.105 shall apply for the purposes of this Rule to any sum due to or from the company which is payable in the future. This rule therefore applies both to sums due from the company (depositors' claims) and to sums due to the company (borrowers' obligations). IR 2.89 says that in an administration a creditor may prove for a debt payment of which was not due when the company went into administration but "subject to Rule 2.105 (adjustment of dividend where payment made before time)". IR 2.105 (like IR 11.13 which applies to liquidations) therefore deals generally with the treatment of debts payable at a future time (not simply claims in set-off). It does so in these terms:-
- (1) Where a creditor has proved for a debt of which payment is not due at the date of the declaration of the dividend he is entitled to dividend equally with the other creditors but subject as follows. Page 9 (2) For the purpose of dividend (and no other purpose) the amount of the creditor's admitted proof shall be reduced by applying the following formula- $X/105n$ where (a) (b) "X" is the value of the admitted proof; and "n" is the period beginning with the relevant date and ending with the date on which the payment of the creditor's debt would otherwise be due expressed in years and months in decimalised form (3) In paragraph (2) "relevant date" means – (a) in the case of an administration which was not immediately preceded by a winding up, the date that the company entered administration;

- (b) in the case of an administration which was immediately preceded by a winding up, the date that the company went into liquidation. In a case where there is no insolvency set-off a creditor who has a debt not payable at the date of administration will prove for the whole debt, and he will receive a dividend on the whole debt unless the debt falls due for payment after “the date of the declaration of dividend”, when he will receive a dividend only on a discounted sum. How does this work if there is an insolvency set-off: by reference to what date is it determined whether a debt is “payable in the future”? IR 2.85(3) says that the account is taken as at the date of the notice of distribution, and that a sum is then “due” although only payable in the future, and that IR 2.105 applies. But IR 2.105 itself applies only to debts where payment is not due “at the date of declaration of the dividend”. So how is a debt due to or from KSF to be treated if it falls due for payment between 20 May and 22 July?
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14. The administrators argue that if a debt is “future” at the date of the notice of distribution then the discounting machinery (which carries one back to the commencement of the administration even though the account is struck at a later date) is engaged even if the debt falls due for payment after the date of the notice but before the date of the distribution: they say that the intent of IR 2.85(7) was to adopt the machinery (but not the literal terms) of IR 2.105 so that one can ignore the reference to the debt being “not due at the date of the declaration of the dividend” and read the Rule purposively as if it said “not due at the accounting date”.
 15. The unsecured creditors argue that there is no inconsistency between IR 2.85(3) and IR 2.105 because the former is concerned to identify what debts form part of the account-taking exercise whereas the latter is directed to the process of quantifying debts so identified.
 16. For the purpose of administration generally, a debt is “future” if it was not due for payment at the date of the administration. In my judgment for the purposes of the insolvency set-off in administration, a debt is “future” if it is not due for payment at the date of the notice of intention to make a distribution. This is the date at which the account of mutual dealings is struck and the date upon which (subject to the hindsight principle) it must be determined what is due from and to each party. IR 2.85(4) says that for the purpose of taking the account a sum is to be regarded as then due even if payable in the future. So the whole sum is brought into the account as then due (unless another rule imposes some limitation). IR 2.105 does impose a limitation, but only in respect of debts payable after the date of “the declaration of the dividend”. It was agreed that Page 11 this is the event provided for in IR 2.97. So a future debt payable before the date of the distribution is taken at full value for the purpose of taking the account of mutual dealings. But a future debt payable after the date of the distribution is taken at its discounted value for the purpose of taking that account.
 17. This is in effect the hindsight principle in operation, enabling events occurring after the accounting date but before the distribution date to be brought into the account so as to strike a true balance.

18. It was suggested that this reading will give rise to difficulty when there is more than one distribution within an administration. A consideration of the question and of the range of possible answers has not assisted in my interpretation of IR 2.85(7), and I therefore propose to express no view.
19. The second question arises upon IR 2.85(6). IR 2.85 is concerned to take account of mutual dealings so as to strike a balance, and only that balance is provable in the administration or recoverable by the administrator. IR 2.85(4) deals with the nature of the obligations which form the subject of the account- taking exercise and applies to any sum “due to or from the company”. IR 2.85(5) deals with obligations that are contingent or otherwise of uncertain value, and it applies to “any obligation due to or from the company”. IR 2.85(7) deals with future obligations and it applies to “any sum due to or from the company”. IR 2.85(6) is also concerned with the mechanics of taking the account. But its language is strikingly different. It provides:- “Rules 2.86 to 2.88 shall apply for the purposes of this Rule in relation to any sums due to the company which Page 12 (a) (b) (c) are payable in a currency other than sterling; are of a periodical nature: or bear interest.” (emphasis added). IR 2.86 deals with claims by creditors generally (i.e outside the context of insolvency set-off) in respect sums payable in a currency other than sterling. Its key provision states:- “For the purpose of proving a debt incurred or payable in a currency other than sterling the amount of the debt shall be converted into sterling at the official exchange rate prevailing at the date when the company entered administration...” IR 2.87 deals with claims by creditors generally (i.e outside the context of insolvency set-off) in respect of periodical payments. Its key provision states:- “In the case of rent and other payments of a periodical nature the creditor may prove for any amounts due and unpaid up to the date when the company entered administration....” IR 2.88 deals with interest, and I shall have to consider it further. The question raised by the administrators is whether, for the purposes of the insolvency set- off, IR 2.86 to IR 2.88 ought also to apply to any sums due from KSF even though IR 2.85(6) does not expressly so state. To put it in concrete terms, IR 2.85(6) provides rules for the treatment of loans made by KSF in US \$; but it does not expressly provide for how US\$ deposits are to be treated for the purposes of the account of mutual dealings.
20. In my judgment, although IR 2.85(6) does not expressly apply to sums “due to or from the company” the effect of the Rules read as a whole is to make the same valuation principles apply on each side of the account. In order for the Page 13 provisions of IR 2.85 to be brought into play at all there must be “[a] creditor of the company proving or claiming to prove for a debt in the administration”, and in that event an account is taken of mutual credits, mutual debts or other mutual dealings between himself and the company. But a creditor proving for a debt incurred or payable in a currency other than sterling can only prove in accordance with IR 2.86 or 2.87: he cannot seek to recover anything else from the company. The company, however, is not “proving” anything in the administration and absent IR 2.85(6) would be able to value its debt for the purposes of set-off at any advantageous date it chose. The purpose of IR 2.85(6) is to subject the company to the same valuation rules as those to which the creditor is already subject. That is why it is confined to

sums due to the company. The difference in language between IR 2.85(6) and 2.85(7) is curious. But I am clear in my view that the difference was not intended to mean that a creditor with a dollar or euro deposit should be subject to the valuation rules in IR 2.86 unless he had also borrowed money from KSF in euros or dollars (in which event KSF would be bound by those valuation rules but the creditor would be bound by none).

21. The third question relates to the treatment for set-off purposes of interest payable by depositors who are also borrowers from KSF. IR 2.85(6)(c) says that IR 2.88 is to apply in relation to any sums due to the company that bear interest. IR 2.88 deals with interest on any sums due from the company. It provides in paragraph (1) that pre-administration interest is provable as part of the debt, but that interest arising post-administration may not be proved for. Paragraphs (2) to (4) inclusive then deal with two sets of circumstances in which the creditor may prove for interest “although not previously reserved or Page 14 agreed” i.e. for non-contractual interest. The period for which and the rate at which such interest “not previously reserved or agreed” is provable are then set out in paragraphs (5) and (6). Paragraph (7) then deals with the possibility that there is a surplus in the administration after the payment in full of all proved debts. It says that the surplus shall first be applied in paying interest on “those debts” (i.e. all proved debts which bear interest or on which interest can be claimed although not previously reserved or agreed) in respect of the periods for which they were outstanding after the administration date. Paragraph (9) says that the rate at which such subordinated post-administration interest is paid is the greater of judgment debt rate and “the rate applicable to the debt apart from the administration” (i.e. the contractual rate). These are the rules that apply generally to any sums due to creditors from the company (i.e. to deposits repayable by KSF to creditors). It is these rules that IR 2.85(6) says must apply to any sums due to the company which bear interest (i.e. to loans payable by borrower/creditors to KSF) for the purpose of implementing the insolvency set-off.
22. The joint administrators contend that that, for the purpose of conducting the account of mutual dealings, post-administration interest payable by creditors on loans due to KSF must be taken into account for the purpose of set-off. They submit that IR 2.88 is incapable of literal application to sums due to KSF: it is for example meaningless to think of a “surplus” existing in the assets of borrowers out of which subordinated post-administration interest could be payable to KSF. So one has to identify those bits of the rules relating to interest claims by creditors that were meant to apply to interest claims by the company. They submit that the exclusion from proof of post- Page 15 administration interest due to a creditor was not intended to exclude from the company’s set-off claim in taking the account post-administration interest due to the company - because that would be productive of significant anomaly.
23. This is the alleged anomaly. Where KSF has a claim to repayment of a loan from a borrower who is not also a depositor then there is no doubt that KSF can recover from the customer all interest due (including post-administration interest). The administration does not affect

claims by the company, only claims against the company. So why should it make any difference if the borrower is also a depositor? Customer A has borrowed £100 from KSF. He must repay £100 plus interest from the date of administration. Customer B has borrowed £100 and deposited £1. Insolvency set-off applies at the date of the notice of intention to distribute. Can it be right that for the purpose of taking the account at that date all interest accruing due on the £100 loan since the date of the administration must be ignored because in relation to the depositor's £1 "interest is provable as part of the debt except insofar as it is payable in respect of any period after the company entered administration"?

24. In my judgment this approach is not correct. The very nature of insolvency set-off greatly advantages those who can avail themselves of it as against ordinary creditors: see paragraph 9 above. Given that the insolvency set-off exists, is mandatory and self-executing, the task in hand is to see what the rules that embody it mean: see paragraph 10 above. IR 2.85(6) says that IR 2.88 shall apply: it does not say that "paragraphs (2) to (6) of Rule 2.88 shall apply" (i.e. the provisions that deal with non-contractual interest), which is the way the joint administrators want the Rule read. It is the rule as a whole that Page 16 applies so far as conceptually possible. When IR 2.85(6) says that IR 2.88 shall apply for the purposes of the insolvency set-off to any sums due to the company it requires one to substitute in IR 2.88 for the expression "debt proved in the administration" and cognate expressions an expression such as "sum due to the company", for terms such as "provable" expressions such as "allowable in the account" and for the word "creditor" the word "company" wherever the sense permits: in other words, to apply to one side of the account as nearly as possible the rules as regards interest that apply on the other. In my judgment IR 2.88(1) as applied by IR 2.85(7) means that where a sum due to the company bears interest, then interest is allowable in the account on set-off as part of the sum due except in so far as it is payable in respect of any period after the company entered administration. So, for the purpose of striking the balance of mutual dealings, post-administration interest is left out of consideration on both sides of the account.
25. Once the account is taken there will be a balance: either a balance provable by the creditor in the administration or a balance recoverable by the company. The balance will itself be an interest bearing debt (the part of the deposit or of the loan not extinguished on set-off). The joint administrators raise a secondary question as to how this should be treated. If the balance is due to the creditor then the position is clear: the balance will already include any pre-administration interest, and under the general rule applicable in the administration the creditor is not permitted to prove for post-administration interest (save by way of the subordinated claim in the event of a surplus in the administration). If the balance is due to the company the position as regards interest is said to be less clear. The administrators say that the balance bears Page 17 interest in accordance with the terms of the loan, and that interest on that balance remains recoverable. The creditors submit that the process of taking the account destroys any right to interest which arises post-administration (even though a borrower who had no cross-claim is undoubtedly liable for post-administration interest).

26. In my judgment the joint administrators are right. The creditor cannot recover post-administration interest on his deposit because IR 2.88 imposes a general bar on his right to claim it. There is no such general bar on the right of the company to claim and recover post-administration loan interest. The only inhibition is on claiming post-administration interest in the process of taking the account of mutual dealings. IR 2.85(6) says that “Rule ...2.88 shall apply for the purposes of this Rule in relation to any sums due to the company” i.e. for the purposes of conducting the insolvency set-off and nothing else. Once the balance is struck then IR 2.85(8) says:- “..the balance...owed to the company shall be paid to the administrator as part of the assets...” But there is no need to read this as if it said “and the balance shall not bear interest notwithstanding what the contract says”. The balance is not a newly created liability, the novel product of a statutory process. It is the balance due under a contract, the remainder of which has been extinguished in the insolvency set-off. Indeed it is quite plain that “the balance” continues to be subject to the terms of the contract under which it arises, for in the case of a contingent or prospective debt the Rule goes on to say that such a balance Page 18 “shall be paid if and when that debt becomes due and payable” (i.e. under the contract, on the loan maturity date or earlier under any default provisions).
27. The creditors say that allowing post-administration interest to be claimed on the balance is productive of great difficulty. First, what if the borrower has several loans with differing interest terms? How does one know which have been satisfied by set-off and which continue as part of the balance? I acknowledge that they are difficult questions: but I do not have to decide them. I think they are capable of answer by reference to the rules as to appropriation of payments or by resort to the technical rules of equity matching payments into and out of a running account: and the difficulties are not so great as to persuade me that the framers of the rules intended that the process of insolvency set-off should completely extinguish a borrower’s liability for interest on the entire balance of his loan for the duration of that loan.
28. Second, from what date is interest due on the balance? Interest is payable on the loan notwithstanding the administration. It is only the notice of intention to distribute which triggers the insolvency set-off at that date. In the insolvency set-off (on my reading of IR 2.85(6)) the rules require the balance to be struck on the footing that no post-administration interest is payable. Once ascertained, the balance bears contractual interest. But is interest to be paid on that balance from the date of administration (on the footing that it was always due)? Or is such interest to be paid only from the date of the notice of distribution, being the accounting date (on the footing that a creditor with a cross claim can say that the statutory account proceeds on the footing that post Page 19 administration interest is not payable on debts due to the company)? Again I readily acknowledge the difficulty, and confess that I do not find the rules as easily understood and comprehensible as the framers (and the members of the insolvency and legal profession who considered them) hoped. I think the answer is that IR 2.85(6) only requires the statutory account to be conducted on a particular footing as regards post-administration interest arising before the date of the taking of the account: it does not purport to alter the actual liability for interest. A depositor who is also a borrower will therefore have to pay interest on the balance found by conducting the

insolvency set-off as from the date of the administration (not simply as from the date of the notice of distribution). He will have to be credited with any interest that he has paid since the date of administration on so much of his borrowing as was extinguished by the process of set-off. But the balance has always been an interest bearing debt on which the administrators have been entitled to recover interest under the loan contract.

29. This brings me to the final issue. It involves a consideration of the interrelationship between the provisions for the payment of future debts in rule 2.105(2) and the interest provisions as I have interpreted them. Assume that a creditor has made a £100 two-year term deposit at 4% repayable on 8 October 2009, and that the borrower has taken a £100 two-year loan at 6% repayable on 8 October 2009. These are both future interest-bearing debts. How are they treated?
30. Rule 2.105(2) contains the formula for the discounting of debts payable at a future time by reference to “X”, which the rule itself defines as “the value of Page 20 the admitted proof”. Its most straightforward application is in relation to a simple claim by a creditor. In the example I have given above the creditor will be able to prove for the amount of his two-year term deposit plus accrued but unpaid interest up to the date of the administration, but his dividend will be adjusted because it is being paid before the deposit matured. (Even the part of his admitted proof which represents interest payable before the administration date will be discounted: because the formula operates by reference to the admitted proof as a whole). His debt does not include any post-administration interest (because that cannot form part of the “admitted proof”), and the discount is calculated by reference to the commencement of the administration (not date of the declaration of the dividend on 22 July 2009).
31. If the depositor is also a borrower the position is exactly the same on his side of the account in the operation of the insolvency set-off. Thus although the account is taken as at 20 May 2009 the discount period is still calculated by reference to the commencement of the administration on 8 October 2008.
32. Likewise a claim by the company against a borrower who is not also a depositor is perfectly straightforward. The terms of the loan contract remain enforceable by KSF, and the mere fact of the administration and the desire of the joint administrators to realise KSF’s assets for the purposes of distribution do not accelerate the borrower’s liability. On the other hand, he remains liable to pay interest on his loan on the dates and at the rate provided for under the loan contract.
33. The case which causes the joint administrators concern is a claim by KSF where the depositor is also a borrower. An insolvency set-off applies. Both IR Page 21 2.85(6) and IR 2.85(7) appear to apply because the loan is both future and interest-bearing. How do the provisions interrelate? In particular the question is whether the value of “X” as used in the formula should be an amount which is inclusive or exclusive of interest to the scheduled future payment date.

34. The matter is put in this way in the witness statement of Mr Brazzill: “By way of example, if a creditor owes a loan debt of £100 in principal sum to KSF, payable in 2015 and also has a deposit of £100, will the “X” as used in rule 2.105(2) of the rules include simply the £100 as principal sum or also the interest that will accrue on the £100 up until the final repayment date in 2015?... If “X” is to be exclusive of interest until the final repayment date then there seems to be a double discount..... This is because “X” would already represent the value of the relevant sum as at the date of the administration i.e. the principal of £100 only in the above example) pursuant to Rule 2.88. It would then be discounted a second time to present value in using the formula as set out in Rule 2.105(2) of the Rules.” The suggested way in which this perceived difficulty is to be overcome is to treat IR 2.85(7) as applying IR 2.105 only to non-interest-bearing debts.
35. In my judgment “X” is exclusive of interest (other than accrued interest as at the date of administration) when the formula is applied to discount an unmatured loan due to the company for the purpose of finding the balance on the account to be taken for the purposes of insolvency set-off.
36. First, there is no warrant in the language of IR 2.85(7) for treating it as confined only to non-interest-bearing debts. It expressly says that it applies to “any sum” due from the company which is payable in the future. Second, it seems to me that the principle upon which Rule 2.85 proceeds is that in the taking of the account on the insolvency set-off the same system of categorisation of recoverable/allowable items and the same valuation approach is to apply on each side of the account. “X” does not include interest on the Page 22 depositor’s side of the account and I do not see why as a matter of construction “X” should include interest on the company’s side. Third, I have already held that Rule 2.88 is to be read as excluding post-administration interest from the sums allowable to the company in ascertaining the balance on the insolvency set-off: it would be inconsistent with that to hold that in the formula to be used to discount to present value “X” is to include post- administration interest.
37. I acknowledge that this reading might have unfortunate consequences for the general body of creditors. When the account is taken, sums payable in the future are entered in the account on each side. In each case interest arising after the administration and before the date of the intended distribution is left out of account. In each case the sums that are to be set off against one another are reduced to their present value. The accounting exercise will produce a balance one way or the other. If the balance is in favour of the depositor the depositor will receive a dividend only upon the unextinguished part of the present value of his deposit, because he is being paid early. If the balance is in favour of the company, however, the company is not entitled to demand immediate payment of the unextinguished part of its loan, even though the loan has been reduced to present values. That discounted loan remains outstanding until the contractual maturity date, bearing contractual interest.
38. To take a concrete example: a customer has deposited £100 repayable in July 2010 and borrowed £1000 repayable in July 2018. Set-off is necessary. Both deposit and loan are future debts and must be discounted to present value. The £100 is discounted by one year. The

entire £1000 is discounted by nine years, Page 23 even though only the present value of £100 is needed to set-off against the deposit, and even though the assumed present payment of the remaining £900 cannot occur. But I feel compelled to this conclusion because of the terms of the statutory formula, and because the rules apply to “all sums” due to the company (not simply to so much of the sums due to the company as are required to match the depositor’s claim in the account). There is an undoubted tension between the principles underlying IR 2.85(7) (requiring a reduction to present values not only of future sums required for the purposes of set-off but of any sum due from the company in the future) and IR 2.85(8) (which says that that present value cannot be demanded immediately but must be left outstanding).

39. Because in my judgment “X” excludes the interest payable until maturity, no difficulties are occasioned by the fact that many of the loans are by reference to a floating rate of interest linked to LIBOR. (If X included the interest payable until maturity it would have been necessary to identify some principles to enable “X” to be ascertained now when the rates applicable between the present and 2018 are unknown).
40. My reading of IR 2.105 as applied to insolvency set-off by IR 2.85 proceeds on the footing that discounting rules are applied to the sums that are entered on either side of the account: this was the basis upon which the case was argued before me. Neither Counsel thought that any particular importance was to be attached to the words “for the purpose of dividend (and no other purpose)”, reading them as meaning (in the context of an insolvency set-off) “for the purpose of giving value for the debt proved”. Page 24
41. I have nonetheless considered whether the framers of the Rule intended that the set-off exercise should be conducted on the basis of the gross sums (not reduced to present value) and that the provisions of IR 2.105 should apply only to the resulting balance, that balance being the amount “provable” under IR 2.85(8). But I concluded that that was not the way that the scheme was intended to work, and that Counsel’s approach was correct. If it had been intended that the discount to present value should only occur in relation to the balance due after operating the insolvency set-off then IR 2.85(7) would not have applied IR 2.105 to any sums due to the company. Under IR 2.85(8) such a sum (the unextinguished balance of a future debt) can never become presently payable. It is only to be paid to the administrator “if and when that debt becomes due and payable”. So if IR 2.105 was intended to apply only to the balance resulting from the operation of the insolvency set-off then its terms could never apply to sums due to the company. Since IR 2.105 expressly applies to sums due to the company the reference must be to the sum that is “due” under IR 2.85(3). So Counsel argued the case on the correct basis.
42. For these reasons I hold
 - (a) In the conduct of the insolvency set-off debts falling due for payment before the distribution date are given full value, and debts falling due for payment after the distribution date are discounted;

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- (b) The quantification rules in IR 2.86 to 2.88 apply as much to sums due from KSF as they do to sums due to KSF;
- (c) For the purpose of trying to ascertain the balance arising from mutual dealings between creditor and company post-administration interest is Page 25 ignored on each side, but the company remains able to claim interest on the balance so found from the date of administration;
- (d) In striking the balance on insolvency set-off relation to interest-bearing debts which are also future debts, the discount formula is applied to the debt (ascertained in accordance with the other provisions of IR 2.85) as it stands at the date of the notice of distribution, and the company cannot add in interest arising between that date and the maturity date of the loan. Mr Justice Norris.....2 October 2009 Page 26
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