[2020 Gib LR 196]

IN THE MATTER OF ELITE INSURANCE COMPANY LIMITED (in administration)

SUPREME COURT (Restano, J.): July 8th, 2020

Companies—administration—operation of rules of insolvency set-off—rules of set-off in Insolvency Act 2011, ss. 135–140 to apply in administration at date administrators first make distribution under s.72(1)—account for set-off taken as at date statement of distribution of dividend issued to creditors in accordance with Insolvency Rules 2014, r.118

Joint administrators sought directions on the operation of the rules of insolvency set-off contained in the Insolvency Act 2011.

Elite Insurance Company Ltd. ("the company") had been authorized to carry on various types of insurance business in several countries until February 2019, when its authorization was withdrawn. The company was placed into administration in Gibraltar in December 2019. In February 2020, the joint administrators issued their proposals for achieving the purposes of administration, which were subsequently approved at a meeting of creditors.

As part of their investigations, the joint administrators considered the impact that the rules of insolvency set-off might have on claims made by the company against creditors or on claims by creditors against the company. It was a matter of significant practical importance that the joint administrators understood how the rules of set-off were intended to operate in an administration under the Insolvency Act 2011.

The joint administrators applied under s.71(2)(e) of the 2011 Act for directions on the correct interpretation of ss. 135–140 of the 2011 Act.

Section 72 of the 2011 Act provided:

"(1) The administrator of a company may make a distribution—

(a) to a secured creditor or a preferential creditor without the leave of the Court; and

(b) to any other creditor, with the leave of the Court.

(2) Where the administrator makes a distribution under subsection (1), sections 135 to 140 and sections 198 to 208 apply with such modifications as may be specified in the Rules or, to the extent that modifications are not so specified, with such modifications as are appropriate."

Section 135 provided:

"(1) This section applies where, before the relevant time, there have been mutual credits, mutual debts or other mutual dealings

between a debtor and a creditor claiming or intending to claim for a debt in the insolvency proceeding.

(2) Subject to section 136 and subsections (3) to (6)—

(a) where this section applies, an account shall be taken of what is due from each party to the other in respect of the mutual dealings, and the sum due from one party shall be set-off against the sums due from the other party; and

(b) only the balance, if any, of the account owed—

(i) to the creditor may be claimed in the insolvency proceeding; or

(ii) to the debtor shall be paid to the liquidator, or bankruptcy trustee, as part of the assets of the debtor."

Rule 14.24 of the English Insolvency Rules 2016 dealt with set-off in administrations in England and Wales and as far as material provided:

"(1) This rule applies in an administration where the administrator intends to make a distribution and has delivered a notice under rule 14.29.

(2) An account must be taken as at the date of the notice of what is due from the company and a creditor to each other in respect of their mutual dealings and the sums due from the one must be set off against the sums due from the other."

The joint administrators submitted that (a) the set-off rules in administrations were similar in Gibraltar and in England and Wales in that insolvency set-off did not apply immediately on a company's entry into administration but only if and when it became a distributing administration, specifically when the administrator delivered a notice of intention to make a distribution to creditors; (b) the English rules, however, specifically identified the set-off date as the date the set-off account was taken and therefore made clear that the account was taken at the date of the notice of intention to distribute and not backdated to the date of the commencement of the administration or some other point; (c) s.135(2)(a) of the 2011 Act did not specify when the taking of the account should take place; (d) the failure of the 2011 Act to expressly specify that the set-off account had to be taken at the set-off date could be because the insolvency set-off rules which applied to liquidations and bankruptcies aimed at realizing and distributing assets were extended to administrations by s.72(2) of the Act as opposed to there being a specific statutory scheme for administrations as in England and Wales; and (e) despite the omission, the most logical and straightforward reading of ss. 2, 72 and 135 of the Act was that the set-off account should be struck when the administrator made a distribution. There would be many practical and conceptual difficulties with a set-off account in an administration being taken at an earlier stage.

Held, ruling as follows:

(1) While there was no express statement in the Insolvency Act 2011 that a set-off account had to be taken when a distribution was made in an administration, a combined reading of the relevant provisions made it

plain that this was the case. Section 135 was only triggered when an administrator made a distribution within the meaning of s.72(2) of the Act. Where s.135 had effect, it applied where there had been mutual dealings pre-administration and an account had to be taken of what "is due" in respect of those pre-administration dealings. This meant that only those pre-administration debts which remained due as at the date from which s.135 had effect (*i.e.* the date of distribution) were included in the set-off account. The legislative intention must therefore have been for the set-off account to be struck when the administrator made a distribution to creditors, more specifically, the date when a statement of distribution of dividend was issued to creditors in accordance with r.118 of the Insolvency Rules 2014. This construction was consistent with the emphasis on rescue in administrations as it meant that the set-off rules were only engaged once the administrator had concluded that the rescue of the company was not possible and that the administration should instead be used to make distributions to creditors. Were the set-off rules to apply at an earlier date, it would have the effect of freezing positions which might then prevent the administrator from being able to continue to trade, which would be at odds with the aims of administration (paras. 11–12).

(2) The applicants applied pursuant to s.71(2)(e) of the 2011 Act, which provided that an administrator of a company may "apply to the Court for directions in respect of the administration of the company." This jurisdiction was materially the same as the power to give directions under English law and which had been recognized as being expressed in very wide terms. There was no objection in principle why this application should not be entertained. Although the application was wide in that it sought clarification of a general question of statutory construction, it concerned a question which affected the running of this administration and therefore fell within the scope of the directions jurisdiction in s.71(2)(e) of the 2011 Act. As the application had proceeded without notifying any creditor or debtor, any interested party who wished to challenge the judgment should have the opportunity to do so in due course. The joint administrators should use their best efforts to bring this judgment to the attention of the company's creditors and debtors (paras. 13–15; para. 17).

Cases cited:

(1) *Lehman Brothers Intl. Europe*, *Re*, [2013] EWHC 1664 (Ch); [2014] BCC 132, considered.

(2) *Lomas* v. *Burlington Loan Management Ltd.*, [2015] EWHC 2269 (Ch); [2016] Bus. L.R. 17, considered.

(3) *Stein* v. *Blake*, [1996] 1 A.C. 243, referred to.

Legislation construed:

Insolvency Act 2011, s.71(2)(e): The relevant terms of this provision are set out at para. 13.

s.72(1): The relevant terms of this sub-section are set out at para. 6.

s.135: The relevant terms of this section are set out at para. 4.

Insolvency (England & Wales) Rules 2016, r.14.24: The relevant terms of this rule are set out at para. 7.

T. Smith, *Q.C.* and *R. Triay* for the applicants.

1 **RESTANO, J.:**

Introduction

Edgar Lavarello and Dan Yoram Schwarzmann in their capacity as joint administrators of Elite Insurance Company Ltd. (in administration) ("Elite") have made an application for directions on the operation of the rules of insolvency set-off contained in the Insolvency Act 2011 ("the Act"). The application was heard on July 1st, 2020 by way of a remote hearing which I directed following a request made by the applicants on the grounds that the application raised a novel point of law which warranted the appearance of specialist London leading counsel whose attendance in court would have not have been practicable given the ongoing difficulties with international travel due to the Covid-19 pandemic.

2 The application has been made under s.71(2)(e) of the Act and the joint administrators seek a direction as to the correct interpretation of ss. 135–140 of the Act as they apply to administrations under the Act and from which they say means that the rules of insolvency set-off are engaged, and the account for set-off purposes is taken as at the date on which the statement of distribution of dividend is issued to creditors. Alternatively, they seek directions confirming that it is appropriate for the applicants to treat the rules contained in ss. 135–140 of the Act as modified pursuant to the power under s.72(2) of the Act to the same effect.

3 The application is supported by the witness statement of Edgar Lavarello dated June 23rd, 2020 which sets out the background to the application and which can be summarized as follows: Elite was authorized to carry on various types of insurance business in several countries until February 1st, 2019 when its authorization to conduct insurance business was withdrawn. The company was placed into administration in Gibraltar on December 11th, 2019. On February 9th, 2020, the joint administrators issued their proposals for achieving the purposes of administration which were approved at a meeting of creditors on April 3rd, 2020. As part of their investigations, the joint administrators have been considering the impact that the rules of insolvency set-off might have on claims which are made by Elite against creditors or on claims by creditors against Elite. The investigations have resulted in the joint administrators establishing that at least one party currently holds multiple "after the event" insurance policies with Elite which means that money may become due to, or due from Elite in relation to various policies. The joint administrators have also established that Elite carried out significant insurance business in

France and that this book of business is such that there is a significant possibility that mutual debts, credits and other mutual dealings exist between Elite and other insurance undertakings which might be said to be amenable to set-off. It is therefore a matter of significant practical importance that the joint administrators understand how the rules of set-off are intended to operate in an administration under the Act.

The statutory framework

4 Sections 135–140 of the Act come under the heading "Liquidation and bankruptcy" and contain the rules on insolvency set-off. In particular, s.135 contains the core provision which provides as follows:

> "135.(1) This section applies where, before the relevant time, there have been mutual credits, mutual debts or other mutual dealings between a debtor and a creditor claiming or intending to claim for a debt in the insolvency proceeding.
>
> (2) Subject to section 136 and subsections (3) to (6)—
>
> (a) where this section applies, an account shall be taken of what is due from each party to the other in respect of the mutual dealings, and the sum due from one party shall be set-off against the sums due from the other party; and
>
> (b) only the balance, if any, of the account owed
>
> (i) to the creditor may be claimed in the insolvency proceeding; or
>
> (ii) to the debtor shall be paid to the liquidator, or bankruptcy trustee, as part of the assets of the debtor."

5 The "relevant time" as referred to in s.135(1) of the Act is defined in s.2 of the Act both for liquidations and administrations. In the case of a liquidation not preceded by an administration, the relevant time is the commencement of the liquidation. This means that wherever there have been pre-liquidation dealings with a company which has gone into liquidation, an account is automatically taken and set-off occurs. This allows the insolvent debtor's creditor to use his indebtedness to the debtor as a form of security and instead of having to prove with other creditors for the whole of his debt in the insolvency, he can set off pound for pound what he owes the company in the liquidation and prove for or pay only the balance: *Stein* v. *Blake* (3) ([1996] 1 A.C. at 251). The position under English law is materially the same: see r.14.25 of the English Insolvency Rules 2016 ("the English Rules").

6 Section 72 of the Act extends the above rules to administrations and states as follows:

"72.(1) The administrator of a company may make a distribution

(a) to a secured creditor or a preferential creditor without the leave of the Court; and

(b) to any other creditor, with the leave of the Court.

(2) Where the administrator makes a distribution under subsection (1), sections 135 to 140 and sections 198 to 208 apply with such modifications as may be specified in the Rules or, to the extent that modifications are not so specified, with such modifications as are appropriate."

7 Rule 14.24 of the English Rules deals with set-off in administrations in England and Wales and insofar as this is material, it provides as follows:

"14.24.—(1) This rule applies in an administration where the administrator intends to make a distribution and has delivered a notice under rule 14.29.

(2) An account must be taken as at the date of the notice of what is due from the company and a creditor to each other in respect of their mutual dealings and the sums due from the one must be set off against the sums due from the other."

Submissions

8 Mr. Smith submits that the set-off rules in administrations are similar in Gibraltar and in England and Wales in that insolvency set-off does not apply immediately upon a company's entry into administration but only comes into play if and when it becomes a distributing administration, specifically when the administrator has delivered a notice of intention to make a distribution to creditors. The English Rules, however, specifically identify the set-off date as the date when the set-off account is taken. The English regime therefore makes it clear that the account is taken at the date of notice of intention to distribute, and is not backdated to the date of commencement of the administration or some other point. Mr. Smith points out that the analogue provision in Gibraltar (s.135(2)(a) of the Act) does not specify when the taking of the account should take place only that "an account shall be taken of what is due from one party to the other in respect of the mutual dealings." In particular, it does not refer to the account being taken "as at the date of the notice" as provided for in r.14.24(2) of the English Rules.

9 Mr. Smith further submits that the Act's failure to expressly specify that the set-off account must be taken at the set-off date may well be because the insolvency set-off rules which apply to liquidations and bankruptcies aimed at realizing and distributing assets are extended to

administrations by virtue of s.72(2) of the Act with such modifications as may be appropriate. This is to be contrasted with the position in England and Wales where there is a specific statutory scheme catering for administrations.

10 In Mr. Smith's submission, despite this omission the most logical and straightforward combined reading of ss. 2, 72 and 135 of the Act is that the set-off account should be struck when the administrator makes a distribution. Indeed, he submits that there are many practical and conceptual difficulties with a set-off account in an administration being taken at an earlier stage such as the commencement of the administration rather than when administrators make a distribution. In particular, if the set-off date is backdated to the commencement of the administration, this would have the effect of freezing positions and could well prevent the administrator from trading or selling receivables and rescuing the company as a going concern which is one of the statutory objectives of administration: see s.46 of the Act. This is supported by *Lightman & Moss on the Law of Administrators & Receivers of Companies*, 6th ed., at para. 22–079 (2017), which states that the emphasis in administrations is on the rescue of a company as a going concern, unlike liquidations which concern terminal insolvency proceedings aimed at the realization and distribution of assets. Thus, if mandatory and self-executing set-off applied at the commencement of the administration in relation to all debts (including prospective and contingent debts) that might serve to undermine ongoing trading and the objective which lies behind administrations.

Analysis

11 Whilst there is no express statement in the Act that a set-off account must be taken when a distribution is made in an administration, in my view a combined reading of the relevant provisions makes it plain that this is the case. Section 135 is only triggered when an administrator makes a distribution within the meaning of s.72(2) of the Act. Where s.135 has effect, it applies where there have been mutual dealings pre-administration and an account must be taken of what "is due" in respect of those pre-administration dealings. This means that only those pre-administration debts which remain due as at the date from which s.135 has effect (*i.e.* the date of distribution) are included in the set-off account. This means that the legislative intention must have been for the set-off account to be struck when the administrator makes a distribution to creditors, more specifically, the date when a statement of distribution of dividend is issued to creditors in accordance with r.118 of the Insolvency Rules 2014 ("the Rules").

12 This construction is consistent with the emphasis on rescue in administrations as it means that the set-off rules are only engaged once the administrator has concluded that the rescue of the company is not possible

and that the administration should be used instead to make distributions to creditors. Were the set-off rules to apply at an earlier date, it would have the effect of freezing positions, for example under running accounts or hedging agreements which might then prevent the administrator from being able to continue to trade and which would be at odds with the aims of administration.

Jurisdiction

13 The applicants have made this application pursuant to s.71(2)(e) of the Act which provides that an administrator of a company may "apply to the Court for directions in respect of the administration of the company." This jurisdiction is materially the same as the power to give directions under English law (see para. 63 of Schedule B1 to the English Insolvency Act 1986) and which has been recognized as being expressed in very wide terms.

14 In *Re Lehman Brothers Intl. Europe* (1), the English High Court granted an application for directions made by the joint administrators of Lehman Brothers International Europe confirming that they could perform their obligations under a settlement agreement with the trustee appointed in the United States for the liquidation for Lehman Brothers Inc. That, however, was a slightly different sort of case as it concerned obtaining the court's blessing for the performance of an agreement entered into by the joint administrators and not the determination of a point of statutory construction. In *Lomas* v. *Burlington Loan Management Ltd.* (2), an application for directions was made for the purposes of clarifying the entitlement of creditors to interest on their debts pursuant to r.2.88 of the Insolvency Rules 1986 for periods after the commencement of the administration of Lehman Brothers International Europe. In my view, the circumstances which gave rise to that application are more akin to the present application in that they both involved the resolution of a point of statutory construction. Further, I do not consider that there is any objection in principle why this application should not be entertained. Although this application is wide in its terms in that it seeks clarification on a general question of statutory construction, it concerns one which affects the running of this administration and I therefore consider that it falls within the scope of the directions jurisdiction contained in s.71(2)(e) of the Act.

15 This application has proceeded without any creditor or debtor being notified about this application. Mr. Smith submits that whilst two books of business have been identified as being affected by the way in which the rules of insolvency set-off operate, the far-reaching nature of the direction sought means that there is a large number of creditors who could potentially be affected by this application and that it would not have been practicable to proceed in any other way. In my view, this means that any

interested party who wishes to challenge this judgment should have the opportunity to do so in due course and the order to be drawn up consequent on this judgment should provide for that.

Conclusion

16 I consider that the rules of set-off contained in ss. 135–140 of the Act apply in an administration where the administrators first make a distribution under s.72(1) of the Act. Further, properly construed, these provisions mean that the account for set-off purposes is taken as at the date on which the statement of distribution of dividend is issued to creditors in accordance with r.118 of the Rules.

17 For the reasons given above, the order to be drawn consequent of this judgment should reflect the fact that I grant liberty to apply, so that creditors or debtors of Elite should have the opportunity to challenge this decision should they so wish. Further, the joint administrators should use their best efforts to bring this judgment to the attention of Elite's creditors and debtors.

Order accordingly.