Neutral Citation Number: [2015] EWHC 2269 (CH)

Case No: 7942 of 2008

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

Royal Courts of Justice
Rolls Building,
London, EC4A 1NL

Date: 31 July 2015

Before :

MR JUSTICE DAVID RICHARDS

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

Between:

(1) ANTHONY VICTOR LOMAS
(2) STEVEN ANTHONY PEARSON
(3) PAUL DAVID COPLEY
(4) RUSSELL DOWNS
(5) JULIAN GUY PARR

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

- and -

(1) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER SÀRL
(3) HUTCHINSON INVESTORS LLC
(4) WENTWORTH SONS SUB-DEBT SÀRL
(5) YORK GLOBAL FINANCE BDH LLC — **Respondents**

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William Trower QC, Daniel Bayfield, Stephen Robins and Alexander Riddiford
(instructed by **Linklaters LLP**) for the **Applicants**

Robin Dicker QC, Richard Fisher and Henry Phillips
(instructed by **Freshfields Bruckhaus Deringer LLP, Ropes & Gray International LLP** and **Schulte Roth & Zabel International LLP**) for the **1st, 2nd and 3rd Respondents**

Antony Zacaroli QC, David Allison QC and Adam Al-Attar
(instructed by **Kirkland & Ellis International LLP**) for the **4th Respondent**

Tom Smith QC and Robert Amey (instructed by **Michelmores LLP**)
for the **5th Respondent**

Hearing dates: 18, 19, 20, 23, 24, 25, 26 February and 9 March 2015

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

....

Mr Justice David Richards:

Introduction

1. This judgment considers issues concerning the entitlement of creditors to interest on their debts for periods after the commencement of the administration of Lehman Brothers International (Europe) (LBIE) on 15 September 2008.

2. These are some of the issues raised by the joint administrators of LBIE in an application for directions issued on 12 June 2014. The application, as amended, contains 40 paragraphs raising a wide variety of different issues. In order to keep the application within manageable bounds, I directed in November 2014 that the questions raised be divided into three groups, each of which would be considered at a separate hearing. The issues dealt with in this judgment constitute the first group (*Waterfall IIA*), while issues concerning the effect of certain post-administration contracts made with creditors on their claims for post-administration interest and currency conversion losses, and generic issues concerning the construction and effect of ISDA Master Agreements and other market standard agreements, were directed to be heard in later, separate hearings (*Waterfall IIB* and *Waterfall IIC* respectively). I have handed down judgment in Waterfall IIB at the same time as this judgment: see [2015] EWHC 2270 (Ch).

3. The need to seek directions on these issues, and also directions on an earlier application (*Waterfall I*), arises because, after paying or providing for all the debts proved in the administration of LBIE, there remains a substantial surplus which the administrators estimate will reach or exceed £7.39 billion. The applications concern the existence of claims to this surplus and the order in which claims are to be satisfied.

4. So far as relevant to the present application, it was held in *Waterfall I,* at first instance and by the Court of Appeal, that the surplus was to be distributed in the order of, first, statutory interest payable under rule 2.88 of the Insolvency Rules 1986 (as amended); secondly, non-provable claims of creditors, including claims to currency exchange losses resulting from a depreciation of sterling against the currency in which creditors' contractual claims were payable between the commencement of the administration and the date on which dividends were paid on such claims; and thirdly, the US $2.27 billion subordinated debt. The judgments in *Waterfall I* are reported at [2014] EWHC 704 (Ch), [2015] Ch 1 and at [2015] EWCA Civ 485.

5. LBIE was the principal trading company for the European operations of the Lehman Brothers group and is a company incorporated under the Companies Acts in England as an unlimited company. LBIE entered administration on 15 September 2008, the same day as Lehman Brothers Holdings Inc, the ultimate holding company of the group, filed for protection under Chapter 11 of the US Bankruptcy Code, and shortly before Lehman Brothers Inc, the principal operating company in the United States, entered into liquidation under the Securities Investor Protection Act on 19 September 2008.

6. In November 2009, on the application of the administrators, an order was made granting permission to make a distribution to the unsecured creditors of LBIE.

7. Since then, dividends amounting to 100% by value of the principal amounts in sterling of the admitted claims have been paid as follows:

   i) a first interim dividend of 25.2 pence in the pound pursuant to a notice given on 26 November 2012;

   ii) a second interim dividend of 43.3 pence in the pound pursuant to a notice given on 19 June 2013;

   iii) a third interim dividend of 23.7 pence in the pound pursuant to a notice given on 21 November 2013; and

   iv) a fourth and final interim dividend of 7.8 pence in the pound pursuant to a notice given on 23 April 2014.

8. It is not in dispute that statutory interest is payable out of the surplus remaining after payment of these dividends, in respect of the admitted claims for the period since the commencement of the administration on 15 September 2008. The payment of this interest is governed by rule 2.88 of the Insolvency Rules 1986 (as amended). Most of the issues covered by this judgment turn on questions of construction of rule 2.88. As interest is payable at the higher of Judgments Act rate (judgment rate) and the rate to which the creditor was otherwise entitled, and given that judgment rate has stood at 8% pa since before 2008 while market interest rates have been at a very low level, a very substantial amount of interest will be payable.

9. Arguments have been raised by different groups of unsecured creditors for the payment of interest on different bases. The general unsecured creditors seek to maximise the interest payable under rule 2.88 or otherwise, while the holders of the subordinated debt, who rank after all interest and non-provable claims, seek to minimise it.

10. The first to third respondents are holders of unsecured debts and are collectively called the Senior Creditor Group (the SCG). Their aggregate holdings have a principal value of over £2.75 billion. The fifth respondent (York) is one of four co-participants in unsecured claims against LBIE with an agreed total value of US $676.25 million. York is authorised by the other co-participants to act on their behalf. Although largely aligned with the SCG, York has on some issues advanced its own submissions. The fourth respondent (Wentworth) is the holder of the subordinated debt.

11. The respondents have not been appointed as representatives of different classes of creditors but they have advanced submissions in effect on behalf of those classes, and the administrators are content to act on directions given by the court on this basis. The administrators uploaded all the position papers of the respondents on the LBIE administration website and invited any creditor who considered there to be relevant positions or arguments not canvassed in those position papers to contact them. On some issues all the respondents have taken the same position and the administrators have been content not to advance any other position where they did not consider that

there was an arguable position to the contrary. Notice of these agreed positions was also given on the administration website, with a similar invitation to creditors who disagreed with those positions to contact the administrators. By contrast, where the administrators considered that there was an arguable alternative to a common position taken by the respondents, they have advanced submissions to that effect. On those issues where the respondents are divided, the administrators have made submissions only where they have considered it necessary to do so in order to ensure that all available arguments are before the court. The administrators have also provided background information, all of which is uncontroversial for the purposes of the issues covered by this judgment.

Rule 2.88

12. Express provision is made in rule 2.88 of the Insolvency Rules for the payment of interest on debts. Interest accruing due in respect of periods prior to the commencement of the administration are capable of proof in the administration and will, if accepted, form part of a creditor's admitted claim. Interest after the commencement of the administration cannot be the subject of proof, but is payable as provided in rule 2.88(7)-(9) out of any surplus remaining after the payment in full of the debts proved in the administration.

13. Rule 2.88, in the form which was in force on 15 September 2008 and which therefore applies in the administration of LBIE, provides as follows:

> "(1) Where a debt proved in the administration bears interest, that interest is provable as part of the debt except in so far as it is payable in respect of any period after the company entered administration or, if the administration was immediately preceded by a winding up, any period after the date that the company went into liquidation.
>
> (2) In the following circumstances the creditor's claim may include interest on the debt for periods before the company entered administration, although not previously reserved or agreed.
>
> (3) If the debt is due by virtue of a written instrument, and payable at a certain time, interest may be claimed for the period from that time to the date when the company entered administration.
>
> (4) If the debt is due otherwise, interest may only be claimed if, before that date, a demand or payment of the debt was made in writing by or on behalf of the creditor, and notice given that interest would be payable from the date of the demand to the date of payment.
>
> (5) Interest under paragraph (4) may only be claimed for the period from the date of the demand to that of the company's entering administration and for all the purposes of the Act and

> the Rules shall be chargeable at a rate not exceeding that mentioned in paragraph (6).
>
> (6) The rate of interest to be claimed under paragraphs (3) and (4) is the rate specified in section 17 of the Judgments Act 1838 on the date when the company entered administration.
>
> (7) Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company entered administration.
>
> (8) All interest payable under paragraph (7) ranks equally whether or not the debts on which it is payable rank equally.
>
> (9) The rate of interest payable under paragraph (7) is whichever is the greater of the rate specified under paragraph (6) or the rate applicable to the debt apart from the administration."

The argument on the present application centres largely on sub-paragraphs (7) to (9).

14. Rule 2.88 was introduced in 2003 as part of the changes required to enable companies in administration to make distributions amongst creditors. Once an administrator, with the permission of the court, gives notice of an intention to make one or more distributions amongst creditors, the procedures in the administration are very similar to those in a liquidation and it becomes what is often called a "distributing administration". Rule 2.88 forms part of Chapter 10 of Part 2 of the Insolvency Rules which contains provisions dealing with distributions to creditors by administrators, including the ranking of claims, the procedure for proving debts, the quantification of claims including set-off, foreign currency debts, interest and the declaration and payment of dividends.

15. The terms of rule 2.88 are in substance the same as the equivalent provisions for the payment of interest in liquidations and bankruptcies, contained in section 189 and section 328 respectively of the Insolvency Act 1986. As will be described in more detail later in this judgment, those provisions were new in the Insolvency Act 1985 and re-enacted in the consolidating Insolvency Act 1986. In large part they gave effect to recommendations made in the Report of the Review Committee on Insolvency Law and Practice chaired by Sir Kenneth Cork (the Cork Committee). The Report (Cmnd. 8558) was published in June 1982. An important purpose was to introduce a uniform regime for interest in all insolvency proceedings, including interest for periods after the commencement of the insolvency proceedings (post-insolvency interest).

The issues

16. There are 10 principal issues dealt with in this judgment. I have numbered the issues for the purposes of this judgment and given references to the relevant paragraph numbers in the application notice. In broad terms the issues cover the following

topics: the meaning of the rate of interest; and the rate applicable to the debt apart from the administration; (Issues 1 and 3-5), the calculation of interest (Issue 2), whether there can be a non-provable claim for interest on proved debts (Issue 2A), interest on contingent and future debts (Issues 6-8) and interest in respect of claims originally denominated in a foreign currency (Issue 10). The references in the Issues to "statutory interest" are to interest payable under rule 2.88(7)-(9).

Issue 1 (paragraph 1 of the application notice)

17. This Issue is:

> "Whether on the true construction of rule 2.88(7) of the rules, Statutory Interest is payable on a simple or compound basis where the rate applicable is the rate specified in section 17 of the Judgments Act 1838? If payable on a compound basis, with what frequency is it to be compounded?"

18. All parties are agreed that, where the applicable rate under rule 2.88(7) is judgment rate, interest is payable under that rule on a simple basis. Given that interest is payable under the Judgments Act on a simple basis, I agree that it must follow that interest payable at that rate under rule 2.88(7) must also be simple. There is one outstanding minor issue, which is whether in computing the daily rate in a leap year, the calculation should be made by reference to a year of 365 days or 366 days. I will deal with this issue (the leap year issue) at the end of this judgment.

Issue 3 (paragraph 3 of the application notice)

19. I am taking this Issue out of turn because it too is agreed. The Issue is:

> "Whether the words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) of the Rules refer:
>
> (i) only to a numerical percentage rate of interest; or
>
> (ii) also to a mode of calculating the rate at which interest accrues on a debt, including compounding of interest, such that where a creditor has a right (beyond any right contained in Rule 2.88) to be paid compound interest, whether under an Original Contract or otherwise, the creditor is entitled to compound interest under Rule 2.88(7)."

20. The parties are agreed that "the rate applicable to the debt apart from the administration" in rule 2.88(9) refers not only to a numerical percentage rate of interest but also to the mode of calculating the rate at which interest accrues on a debt, including the compounding of interest.

21. In its position paper, Wentworth had argued that compound interest was not payable under rule 2.88(7) and that the words "the rate" in the phrase "the rate applicable to the debt apart from the administration" referred only to the numerical percentage figure reserved under the contract or other source of obligation. In its skeleton

argument for the hearing, Wentworth accepted that this was wrong and agreed that the phrase included the compounding of interest.

22. I agree that the position which is now common amongst the parties is correct. There are a number of reasons for this conclusion. First, the expression “rate of interest” is meaningless if expressed only as a number without taking account of the period to which the number applies. So, interest at X% must always be coupled with a period such as a year, a month or a day. The rate of interest informs the parties of the rate at which the debt due increases by the additional or accrual of interest. Whether or not interest compounds at the relevant rests is an integral part of the rate at which interest is added to the debt.

23. Secondly, the contrary position would be capable of producing curious results which cannot sensibly have been intended. A debt which by its terms carried simple interest at 10% pa would, on this basis, entitle the creditor to a larger payment by way of interest than a debt which by its terms carried a right to interest at 8% pa, compounded quarterly.

24. Thirdly, as counsel for the administrators put it in their skeleton argument, the contrary approach results in the creditor receiving a sum by way of interest that is neither one thing nor the other. It is neither the judgment rate nor the full contractual entitlement but is, rather, an unprincipled middle ground with no foundation in logic or law.

25. Finally, the fact that creditors with non-interest bearing debts are entitled under rule 2.88 to interest at the judgment rate, which is a rate of simple interest, provides no reason for limiting “the rate applicable to the debt apart from the administration” to a simple rate of interest where compound interest is otherwise payable.

26. The administrators raised a sub-issue, on which the parties are not agreed. On the basis that “the rate applicable to the debt apart from the administration” includes a compound rate, and assuming that the answer to Issue 2 is that statutory interest is calculated on the basis of allocating dividends first to the reduction of principal, does accrued statutory interest continue to compound following the payment in full of the principal amount through dividends and, if not, does the creditor have a non-provable claim in respect of interest that would have continued to compound on a contractual basis following the payment in full of the principal amount? The arguments relevant to this sub-issue are largely dealt with later in relation to Issue 2A. For the reasons given there, I consider that interest does not compound following the payment in full of the principal amount, because under the terms of rule 2.88(7) interest, whether simple or compound, is payable only for the period that the proved debt, or part of it, is outstanding. The second half of this sub-issue does not therefore arise, but in any event for the reasons given in relation to Issue 2A, I would hold that a creditor would not have a non-provable claim of the type identified.

Issue 5 (paragraph 5 of the application notice)

27. This is also agreed. Issue 5 is:

> “Whether, for the purposes of establishing, as required under Rule 2.88(9) of the Rules, “*whichever is the greater of the rate*

specified under paragraph (6) and the rate applicable to the debt apart from the administration", the comparison required is of:

(i) the total amounts of interest that would be payable under Rule 2.88(7) based on each method of calculation; or

(ii) only the numerical rates themselves,

and in either case, how the total amount of interest is calculated when the "*rate applicable to the debt apart from the administration*" varies from time to time."

28. It follows from the agreement on Issue 3 that there is also agreement on Issue 5 that, for the purposes of establishing the greater of the two rates specified in rule 2.88(9), the comparison is to be made between the total amounts of interest that would be payable under rule 2.88(7) based on each method of calculation, rather than between only the numerical rates themselves.

29. A sub-issue has been identified by the administrators. In the case of a proved debt which comprises two or more separate debts, with a contractual or other rate apart from the administration applicable to some but no such rate applicable to the others, how is the comparison required by rule 2.88(9) to be undertaken? The parties are agreed that the composite proved debt is to be broken down, or disaggregated, into its constituent parts and the appropriate rates of interest are to be applied to each part respectively. I consider this to be the correct approach.

Issue 2 (paragraph 2 of the application notice)

30. Issue 2 is as follows:

"2. Whether on the true construction of Rule 2.88(7) of the Rules, Statutory Interest is calculated on the basis of allocating dividends:

(i) first to the payment of accrued Statutory Interest at the date of the relevant dividends and then in reduction of the principal;

(ii) first to reduction of the principal and then to the payment of accrued Statutory Interest; or

(iii) on the basis of some other sequencing."

31. As all the parties agree, this Issue raises a question of statutory interpretation, as to the meaning and effect of rule 2.88(7).

32. The administrators and Wentworth submit that rule 2.88(7) involves no re-allocation of the dividends previously paid. Having paid the proved debts in full, the surplus is to be applied in the payment of interest for the period or periods during which the proved debts were wholly or partially outstanding, at the rate required by rule 2.88(9).

The SCG and York, by contrast, submit that the interest payable out of the surplus in accordance with rule 2.88(7) is to be calculated on the basis that the prior dividends are notionally treated as having been applied first to interest from the date of the administration to the date of the dividend and, secondly, towards discharge of the principal amount outstanding. On this basis, it follows that, in giving effect to rule 2.88(7), the proved debts will be treated as if they had not been fully discharged by the prior dividends and the surplus will be applied on the same basis, that is to say in discharging interest down to the date of any payment out of surplus with the balance going to discharge or reduce the principal of the proved debt.

33. The resolution of this issue will make a significant difference to the amount to be paid by way of interest out of the surplus in accordance with rule 2.88(7). The administrators estimate that, if the SCG and York are correct, about £6.4 billion will be distributed by way of interest whereas, if they and Wentworth are correct, about £5.1 billion will be so distributed. Accordingly, if the SCG and York are correct, the non-subordinated creditors will receive an additional sum of approximately £1.3 billion in respect of interest under this rule.

34. In developing their respective submissions, the administrators and Wentworth have concentrated on the terms of rule 2.88 and related provisions in the Insolvency Act and Rules 1986 and the context in which that legislation was made, while the SCG and York have focussed more on the development of the law relating to the payment of post-insolvency interest, in particular a principle of re-allocation of payments to interest and principal which they submit applies to rule 2.88. Both sides rely on policy considerations to support their respective submissions. This being a question of statutory construction, the administrators and Wentworth emphasise that in many respects, including this, the 1986 legislation introduced new provisions and great caution is required in seeking to apply old authorities to them.

35. In very brief summary, the SCG and York submit as follows. First, there is a general equitable principle applicable in the administration of insolvent estates, established by authorities both in England and other jurisdictions, that payments made by process of law in the payment of debts are, when it comes to calculating and paying post-insolvency interest, to be treated as appropriated first to any interest outstanding at the date of the distribution and only then in reduction of the principal amount of the debt. Secondly, this principle was applied to bankruptcy in England, certainly until the Bankruptcy Act 1883, and in the liquidation of companies, certainly until the Insolvency Act 1986. There are no English authorities in bankruptcy since 1883, and there have been no cases in any form of insolvency since the enactment of the Insolvency Act 1986, dealing with this issue. Thirdly, this approach has been applied to bankruptcy and liquidations in other jurisdictions with regimes similar to the English bankruptcy regime before the Bankruptcy Act 1883 and to the English liquidation regime before the Insolvency Act 1986. It has also been applied in three first instance cases, one in Ireland and two in Canada, in the context of legislative regimes similar but not identical to rule 2.88. Fourthly, it is consonant with fairness and justice and with fundamental principles of insolvency law that this principle should apply to rule 2.88 and the similar provisions applicable to bankruptcy and liquidations. Fifthly, there is no reason why this principle should not continue to apply and there is no explanation either before or after 1883 or 1986 why Parliament

should have decided that it should cease to apply or any acknowledgment in any authority or textbook that it has done so.

36. The administrators and Wentworth in large part accept the first three submissions but they submit that rule 2.88 and the equivalent provisions in the Insolvency Act 1986 for liquidation and bankruptcy are irreconcilable with the application of the principle on which the SCG and York rely. They make the same submission with regard to the Bankruptcy Act 1883. The submission is based on the construction of rule 2.88 and the other provisions and on the circumstances in which the principle has been held to apply.

37. I propose to look first at the steps in the submissions of the SCG and York.

38. The SCG and York rely on a substantial body of earlier authority for their submission that rule 2.88 should be construed and applied on the basis that, once a surplus arises, the dividends paid in respect of proved debts are to be treated as appropriated first to interest with a balance of any dividend appropriated to principal. This would result in part of the proved debt being treated as unpaid when there arises a surplus to be applied in accordance with rule 2.88, so that payments out of the surplus will likewise be applied first to interest and then to principal until ultimately there is no longer on this basis any sum, whether principal or interest, left outstanding.

39. The SCG and York rely on the judgment in *Bower v Marris* (1841) Cr&P 351, 41 ER 525 and other authorities as establishing that this is the correct approach to the payment of post-insolvency interest after the discharge of the principal debts payable out of an estate.

40. Developed by the courts of equity, this principle was based on the common law approach to the appropriation of payments. This longstanding approach is summarised in *Chitty on Contracts* (31^{st} ed 2012) in para 21-060:

> "Where several separate debts are due from the debtor to the creditor, the debtor may, when making a payment, appropriate the money paid to a particular debt or debts, and if the creditor accepts the payment so appropriated, he must apply it in the manner directed by the debtor; if, however, the debtor makes no appropriation when making the payment, the creditor may do so."

41. Where a debt carries interest and there is no appropriation by the debtor or creditor, the legal presumption as stated in *Chitty* at para 21-068 is:

> "Where there is no appropriation by either debtor or creditor in the case of a debt bearing interest, the law will (unless a contrary intention appears) apply the payment to discharge any interest due before applying it to the earliest items of principal."

42. This legal presumption is based on what is normally the commercially sensible course that a creditor would take, but it will be displaced if unusually the circumstances indicate otherwise: see *Smith v Law Guarantee & Trust Society Ltd* [1904] 2 Ch 569.

43. Where, in the administration of estates, payments are made in or towards the discharge of principal amounts, it was arguable that such payments were appropriated to principal and accepted as such by the person entitled as payee, so that when it came to the payment of interest out of the surplus, there was no room for the application of the legal presumption that payments were to be appropriated first to interest. In a succession of cases, this approach was rejected by the courts, on the basis that the payments made out of the estate in respect of principal were paid by way of legal process and were to be treated as no more than payments on account of what was due to the payee. This left it open to the payee, once funds were available for the payment of interest, to treat, or be presumed to treat, the payments on account as appropriated first to interest.

44. The development of the principle out of the legal rule and presumption on appropriation is made clear in the judgment of Lord Cottenham LC in *Bower v Marris.*

45. The claim in *Bower v Marris* was by a creditor against one of two joint and several obligors. The other obligor had become bankrupt and the creditor had proved in the bankruptcy for the principal amount of the debt and the small arrears of interest due at the date of the commencement of the bankruptcy. The bankruptcy was a very drawn-out affair but ultimately the creditor received a total of 20 shillings in the pound on his proved debt. The solvent co-obligor died and, under a decree for the administration of his estate, the creditor claimed payment of an amount equal to the interest accruing due after the bankruptcy and, quoting from the judgment:

> "insists that the amount is to be calculated by applying the amount of dividends from time to time received, in discharge of the interest then due, and the surplus, if any, in discharge, *pro tanto*, of the principal. This, no doubt, is the ordinary mode of calculation, and is the general course of dealing in cases of mortgages, bonds, and other securities, as the principal does, and the interest due does not, carry interest. No creditor would apply any payment to the discharge of part of the principal whilst any interest remained due. If, therefore, these had been merely payments on account, there would be no question between the parties; but it is said on behalf of the obligor's estate, that the payments by way of dividends under the bankruptcy of the co-obligor were appropriated and were paid to and received by the obligee on account of so much principal money, and therefore that interest from that time ceased upon the amount of such principal money, although large sums were due for interest at the time.
>
> The question, so far as it is a question of principle, turns upon the accuracy of this view of the case: the proposition rests upon this, that the payments consisted of dividends of so many shillings in the pound, and that the sum upon which such dividends were made, being the debt proved, consisted, except a very small part, of the principal due on the bonds, and therefore that, upon the payment of every dividend, so many

> shillings in each pound of such principal money as the dividends consisted of, was, upon each payment, discharged.
>
> In the first place, as this mode of payment is regulated by acts of parliament, the doctrine of appropriation, which is founded upon the intention, expressed or implied, of the debtor or creditor, cannot have any place in the consideration of the present question. The estate of the obligor under administration is liable to pay all that the obligee has not received from the co-obligor; that is to say, the obligee is entitled to his principal and interest up to the time of payment; and he is entitled to apply all payments on account, to the interest due, before he would be bound to apply any part of it towards discharge of the principal."

46. Before looking in more detail at the application of this principle in bankruptcy, it is convenient first to summarise the relevant legislative background. Although there was a series of Bankrupts Acts starting in the reign of Henry VIII, none of them made provision for the payment of post-bankruptcy interest until the Bankruptcy Act 1824. For many years, the only debts which could be proved in a bankruptcy were those payable at the date of the bankruptcy and, therefore, subsequent instalments of interest due on debts incurred before the bankruptcy could not be the subject of proof. Such interest could continue to be claimed against the debtor but, if a surplus arose in the bankruptcy, the courts developed the practice of allowing post-bankruptcy interest to be paid out of the surplus as a practical alternative to the return of the surplus to the debtor and a claim by the creditor against the debtor.

47. The Bankrupts Act 1705 introduced for the first time a procedure whereby a bankrupt could obtain his discharge. It was argued in *Bromley v Goodere* (1743) 1 Atk.75 that creditors with interest-bearing debts could not as a result of this statute recover interest in respect of the period after the bankruptcy. This was rejected by Lord Hardwicke LC, on the grounds that the discharge did not operate as a discharge of the fund vested in the assignees but extended only to any remedy to be taken against the person of the bankrupt or his future effects. By way of general comment, he said at page 77:

> "All bankrupts are considered in some degree as offenders, they are called so in the old acts, and all the acts are made to prevent their defeating and delaying their creditors, and it would be an extraordinary thing, that the delay of payment should prevent the creditors from having interest out of an estate able to pay it, when interest in all cases is given for delay of payment."

48. In relation to the general principle at issue in the present case, the importance of *Bromley v Goodere* lies in the order made by Lord Hardwicke. He declared that:

> "… all the creditors of Sir Stephen Evance by bonds, contracts or notes carrying interest, are intitled to receive interest out of his estate for the principal sums, which were owing at the time the commission issued, from the day of its issuing, till they

> received full satisfaction, before any surplus shall be conveyed to the representatives of Sir Stephen Evance."

49. The order further provided that:

> "The Master to take an account of what has been paid to such creditors by way of dividends, and what has been so paid to be applied in the first place to keep down the interest, and afterwards in sinking for principal."

There is no discussion in the judgment of this aspect of the order, but similar orders were made in subsequent cases: see, for example, the order made by Lord Eldon LC in *Ex parte Koch* (1813) 1 V & B 342, 35 ER 134.

50. The Bankruptcy Act 1824 introduced for the first time a provision dealing with post-bankruptcy interest. It was re-enacted, in largely the same terms, as section 132 of the Bankruptcy Act 1825 which provided:

> "All creditors whose debts are now by law entitled to carry interest, in the event of a surplus, shall first receive interest on such debts at the rate of interest reserved or by law payable thereon, to be calculated from the date of the commission, and after such interest shall have been paid, all other creditors who have proved under the commission shall receive interest on their debts from the date of the commission at the rate of £4 per centum."

51. The effect was that any surplus after payment of all proved debts should be applied, first, in paying interest on those debts which carried interest apart from the bankruptcy either under the terms of the debt or "by law" (which would include interest under the law merchant: *Re East of England Banking Company* (1868) LR 4 Ch App 14) and, secondly, in paying interest at the rate of 4 per cent per annum on all other debts.

52. Section 132 was re-enacted in similar terms in section 197 of the Bankruptcy Consolidation Act 1849 and, following the Bankruptcy Act 1869, in rule 137 of the Bankruptcy Rules 1870.

53. The provision for the payment of post-bankruptcy interest was substantially re-cast in the Bankruptcy Act 1883. Section 40 dealt both with the payment of debts and the payment of interest. Section 40(1) and (2) provided for the payment of preferential debts. Section 40(4) provided that, subject to the provisions of the Act, "all debts proved in the bankruptcy shall be paid pari passu". Post-bankruptcy interest was dealt with in section 40(5):

> "If there is any surplus after payment of the foregoing debt, it shall be applied in payment of interest from the date of the receiving order at the rate of £4 per centum per annum on all debts proved in the bankruptcy."

54. Section 65 dealt with the remaining surplus as follows:

> "The bankrupt shall be entitled to any surplus remaining after payment in full of his creditors, with interest, as by this Act provided, and of the costs, charges, and expenses of the proceedings under the bankruptcy petition."

55. There was no express provision for the payment of post-bankruptcy interest at any rate other than the rate of 4% pa provided for by section 40(5). Unlike section 132 of the 1825 Act and its re-enactments in the 1849 Act and the 1870 Rules, there was no provision for the payment of interest at the contractual or other rate to which the creditor would be entitled apart from the bankruptcy and no provision for such interest to have priority. All debts, whether or not they otherwise carried interest, were to receive interest at the stipulated rate of 4% pa.

56. The parties are sharply divided as to the effect of sections 40 and 65. The administrators and Wentworth submit that, so far as relevant, it had essentially the same effect as the relevant provisions in the 1986 legislation, leaving no room for the application of the general equitable principle. The SCG and York submit that the principle applied to the 1883 Act as much as to the earlier provisions and, even if it did not, it does apply under the 1986 legislation. I will return to this later.

57. Sections 40 and 65 were re-enacted as sections 33 and 69 of the Bankruptcy Act 1914, which remained in force until the Insolvency Act 1986.

58. Section 132 of the Bankruptcy Act 1825 was in force at the time of *Bower v Marris* and it applied to the bankruptcy in question.

59. As earlier mentioned, Lord Cottenham LC held that the equitable principle should apply to the payments received by the creditor in the bankruptcy, for which he cited the order made in *Bromley v Goodere* and later cases as authority. He addressed the issue in some detail in his judgment and concluded that this was, as a matter of principle, the right approach. He said at page 356:

> "If, therefore, he is bound, because those payments are made under a bankruptcy, to apply them towards discharge of part of the principal which bears interest, and thereby to leave interest due, which does not bear interest, he is a loser by the bankruptcy, although the whole of principal and interest is ultimately paid, and, what is more extraordinary, the co-obligor will, as in the present case, be a gainer by it in the same proportion; for although, being himself bound to pay principal and interest, he could not compel the obligee to accept payment of the principal whilst interest remained unpaid, he would derive the benefit of such payments being so made out of his co-obligor's estate. This would be to give to this mode of payment in bankruptcy the effect of depriving the obligee of part of his debt, and of relieving the obligor from the liability to which he had, by his bond, subjected himself. That would be, manifestly, most unreasonable and unjust, and is attempted to be supported only by the supposed appropriation of the dividends to the payment of so much of the principal: but, in fact, there is no such appropriation."

60. Lord Cottenham went on to ask:

> "Why should such payments [out of the bankruptcy estate] have a different effect, than they would have if made by a solvent obligor? Why should they lessen or destroy the remedy which the obligee would have had against a co-obligor?"

61. As there expressed, it might be said that the Lord Chancellor was focussing solely on the effect of the bankruptcy on the liability not of the bankrupt but of his co-obligor. It is right to note that the case concerned the creditor's rights against the co-obligor, not his rights in the bankruptcy of the other obligor. However, the passage in the judgment continues in a way which makes clear that the Lord Chancellor was applying the same approach to the obligations of the bankrupt:

> "Suppose the bankrupt does not obtain his certificate, but afterwards acquires property, and is sued by the obligee, ought not the obligee to be entitled to compel payment of all he could have demanded if there had not been any bankruptcy? Suppose the assignees realise a surplus of the estate, ought the obligee, in the case supposed, to suffer, and the bankrupt's estate to benefit, by the bankruptcy?"

62. Lord Cottenham considered the effect of section 132 of the Bankruptcy Act 1825 stating that, by that section:

> "the bankrupt is not to receive the surplus until all creditors have received interest on their debts, to be calculated from the date of the commission. This provision obviously intended to make good to the creditors that interest which, by the course of administration in bankruptcy, they had lost. Interest is stopped at the date of the commission, because it is supposed that the estate will be deficient: it proves to be more than sufficient: Why is the creditor to suffer, and the bankrupt to benefit, by attributing the dividends to principal, instead of to the interest due? The creditor in that case will not have received interest upon his debt to the same extent as he would, if there had been no bankruptcy; and yet, the act must have intended to place him in as favourable a situation."

63. The overall effect of the decision is that the payment of dividends in accordance with the statutory scheme involved no appropriation either by the debtor's estate or by the creditor. Therefore, once the estate was in surplus, the creditor was free to treat the dividends that he had received as appropriated to interest rather than capital.

64. As appears from numerous parts of the Lord Cottenham's judgment, his decision assumed that the creditor had a continuing right to interest apart from the bankruptcy. In other words, his debt carried interest either as a matter of contract or by operation of law, and such interest continued to accrue during the bankruptcy. The Lord Chancellor was not considering and did not address the position as regards interest which arose only because of the closing part of section 132.

65. I have not been referred to any English case dealing with the position in bankruptcy decided after *Bower v Marris*. In view of the approach taken to the winding-up of companies in *Re Humber Ironworks & Shipbuilding Co, Warrant Finance Company's Case* (1869) LR 4 Ch App 643, to which I refer below, I do not doubt that the approach in *Bower v Marris* was accepted as correct at least until the Bankruptcy Act 1883.

66. The approach in *Bower v Marris* has been adopted in relation to bankruptcy in other jurisdictions. In *Re Langstaffe* [1851] OJ No. 238, the Upper Canada Court of Chancery held that it applied. At that time, the relevant Canadian legislation did not include any provision for interest and was therefore in the state which applied in England before the Bankruptcy Act 1824.

67. The Scottish case of *Gourlay v Watson* (1900) 2 Ct Session (5^{th} Series) 761 concerned the proper approach to distributions made under a trust established for the benefit of creditors. The trustees paid several dividends on account of principal debts and a further dividend split between the remaining balance of the principal and a sum on account of interest on the debts from the date of the trust to the date of payment. It appears that the interest arose not by contract but by operation of law. The court accepted the submission on behalf of creditors that the payments previously made by the trustees were not to be treated as appropriated to principal, and accordingly the dividends should be treated as having been paid first in discharge of the interest due at the date of each dividend. The case did not concern a bankruptcy as such but the court applied the analogy of the law of bankruptcy both in Scotland and in England: see page 770. Mr Smith pointed out correctly that this decision was made some time after the enactment of the Bankruptcy Act 1883, but there is no reference to it or discussion of the effect of section 40 of that Act. There was no reason why there should be, as the Scottish bankruptcy legislation contained no equivalent provision and what appears to have been the relevant provision (section 52 of the Bankruptcy (Scotland) Act 1856) simply remitted creditors to their existing rights outside the liquidation.

68. Turning to the position in liquidations, the winding up of companies began for present purposes with the Companies Act 1862. Although there were parallels between the law relating to personal bankruptcy and the law relating to the winding-up of companies, and in due course many of the bankruptcy provisions were incorporated by reference into the winding-up of insolvent companies, they nonetheless developed separately and it was not until 1986 that they were united in one statute. Differences necessarily remain but it was one of the purposes of that Act, as recommend by the Cork Committee, to harmonise these two branches of the law where possible.

69. As regards interest, there was no provision for post-insolvency interest and no equivalent to section 132 of the Bankruptcy Act 1825 in the Companies Act 1862. The Lord Chancellor was empowered by the Act to make rules, by Order of Court, with respect to the winding up of companies. Pursuant to this power, an Order of Court was made, with the advice and consent of the Chancery Judges, on 11 November 1862. Rules 25 and 26 provided:

> "25. The value of such debts and claims as are made admissible to proof by the 158th Section of the said Act, shall, so far as is possible, be estimated according

> to the value thereof at the date of the order to wind up the company.
>
> 26. Interest on such debts and claims as shall be allowed shall be computed, as to such of them as carry interest, after the rate they respectively carry; any creditor whose debt or claim so allowed does not carry interest, shall be entitled to interest, after the rate of 4% per centum per annum, from the date of the order to wind up the company, out of any assets which may remain after satisfying the costs of the winding up, the debts and claims established, and the interest of such debts and claims as by law carry interest."

70. The effect of rule 26 was to apply to a liquidation the provisions of section 197 of the Bankruptcy Consolidation Act 1849 (re–enacting section 132 of the Bankruptcy Act 1825). However, the second part of rule 26 dealing with interest at 4% pa on debts which did not otherwise carry interest was held to be ultra vires: *Re Herefordshire Banking Co* (1867) LR 4 Eq 250.

71. Against this background, the issue arose for decision in *Re Humber Ironworks and Shipbuilding Co, Warrant Finance Company's Case* (1869) LR 4 Ch App 643 whether, in the case of an insolvent company, a creditor with an interest-bearing debt could prove for interest for the period following the commencement of the winding-up. On appeal, it was held that, as in bankruptcy, only interest accrued at the date of the winding-up could be the subject of proof. It was in this context that Selwyn LJ made the celebrated comment in his judgment that "the tree must lie as it falls".

72. It was common ground between the official liquidator and the creditors that, in the event of a surplus, interest accruing after the commencement of the winding-up was payable and that distributions must be applied, first, in payment of interest and, then, in reducing principal. As to this, Selwyn LJ said at page 645:

> "I apprehend that in whatever manner the payments may have been made, whether originally they may have been made in respect of capital or in respect of interest, still, inasmuch as they have all been paid in process of law, and without any contract or agreement between the parties, the account must, in the event of there being an ultimate surplus, be taken as between the company and the creditors in the ordinary way; that is, in the manner pointed out in *Bower v Marris*, by treating the dividends as ordinary payments on account, and applying each dividend, in the first place, to the payment of the interest due at the date of such dividend, and the surplus (if any) to the reduction of the principal. That disposes of the question where there is a surplus, as to which there is no doubt or difficulty."

73. Giffard LJ considered that this approach to interest in the case of a solvent liquidation distributed the assets in the fairest way. He said at page 647:

> "… it works with equal fairness, because, as soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract; and, on the other hand, a creditor who has not stipulated for interest does not get it."

He added, but clearly as a reason for not allowing proof for post-liquidation interest in the case of an insolvent company:

> "I may add another reason, that I do not see with what justice interest can be computed in favour of creditors whose debts carry interest, while creditors whose debts do not carry interest are stayed from recovering judgment, and so obtaining a right to interest."

74. I was referred by Mr Dicker to the further decision in *Re Humber Ironworks and Shipbuilding Co, Warrant Finance Co's Case (No.2)* (1869) LR 5 Ch App 88 and the two decisions in *Re Joint Stock Discount Co., Warrant Finance Co's Case* (1869) LR 5 Ch App 86 and (1870) LR 10 Eq 11. They all reaffirmed that dividends paid in a winding-up were not appropriated to the payment of principal, and so did not affect the right of a creditor to recover the full amount due to him either from a co-obligor or by way of the enforcement of security held for the debt. They were not directly concerned with the effect of the principle on the payment of post-insolvency interest.

75. There appears to have been no further discussion or consideration of the application of the decision in *Bower v Marris* in the winding-up of companies until the decision of Mervyn Davies J in *Re Lines Bros Ltd (No.2)* [1984] Ch 438. In that case, there was a surplus remaining after payment of all proved debts, but it was insufficient to pay all post-liquidation interest. It remained the law that only creditors whose debts carried interest apart from the liquidation could recover any post-liquidation interest. There was no provision applicable to the winding-up of the companies equivalent to section 33(8) of the Bankruptcy Act 1914: see *Re Rolls Royce Ltd* [1974] 1 WLR 1584. The issue was whether a creditor with an interest-bearing debt originally denominated in Swiss francs could claim post-liquidation interest calculated in Swiss francs and converted into sterling when payment was made. As sterling had depreciated against the Swiss franc, this would be a beneficial result for the creditor. It was held that, as there were insufficient funds to satisfy all the post-liquidation interest claims, interest payable to the creditor should be calculated by reference to the value of sterling as at the date of the winding-up.

76. It was common ground between counsel for the liquidators and for the creditor, all of whom were very experienced in corporate insolvency, that the decisions in *Re Humber Ironworks & Shipbuilding Co* and *Bower v Marris* applied to the payment of post-liquidation interest. As it was put in the submissions of counsel for the liquidators at page 441:

> "Under the rules laid down by those authorities dividends are notionally applied first in satisfaction of post-liquidation interest accrued down to the date of the relevant dividend and thereafter to capital. Interest is then calculated on the

> notionally reduced capital balance down to the next dividend and so on."

This common ground was recorded by the judge at page 446.

77. There was one aspect of the application of *Bower v Marris* on which the judge expressed doubts, at page 453. The liquidation commenced on 28 September 1971 and the final dividend on proved debts was paid on 20 June 1978. The calculations of the payments due in respect of post-liquidation interest agreed by the parties showed interest continuing to run after the final dividend on a notionally unpaid balance of capital. Mervyn Davies J said that he was not satisfied that interest ought to be charged in respect of the period after that date because all principal was in fact then paid, so that thereafter there was no principal owing that could carry interest. As this had not been argued before him he gave the parties an opportunity of making submissions. Having heard those submissions, which are recorded at pages 456-457, he accepted that his earlier expressed concerns were not well-founded and he made an order for the payment of interest calculated in the manner agreed by the parties.

78. The application of the principle in *Bower v Marris* to distributions in a liquidation has been upheld in other jurisdictions.

79. I was referred to Australian cases in which the principle was applied.

80. *Midland Montagu Australia Ltd v Harkness* (1994) 14 ACSR 318 concerned a scheme of arrangement between a number of companies in liquidation and their unsecured creditors. The scheme made provision for the payment of debts ascertained as at a fixed date and made further provision for post-fixed date interest. Entitlements to interest were to be determined according to the rules and principles applicable in the winding-up of a company with a surplus of assets over liabilities. There is an extensive discussion in the judgment of *Bower v Marris, Re Humber Ironworks & Shipbuilding Co* and other authorities to which I have earlier referred. As was the case in England before the Insolvency Act 1986, there was no express statutory provision dealing with post-liquidation interest. McLelland CJ in Eq, sitting in the Supreme Court of New South Wales, held that the principle in *Bower v Marris* applied. He said at page 330:

> "One of the premises upon which this rule is based is the proposition that neither bankruptcy nor winding up, as such, effects a discharge of a debtor's liability for future interest, although each limits the means by which, and the asset against which, such a liability may be enforced".

81. *Gerah Imports Pty Ltd v Duke Group Ltd* [2004] SASC 178 is a decision of the Full Court of the Supreme Court of South Australia. A substantial surplus was held by the liquidator following the payment in full of all proved claims. The liquidator called for proofs of debt in relation to post-liquidation interest. The issue was whether section 439(1) of the Companies (South Australia) Code (which provided that the amount of a debt, including a debt that is for or includes interest, was to be computed for the purposes of the winding-up as at the relevant date) barred claims for post-liquidation interest on interest-bearing debts. It was held that section 439(1) was not intended to, and did not, vary or diminish the common law right of creditors with

interest-bearing debts to recover post-liquidation interest in the event of a surplus. The court further held that the liquidator should deal with claims for post-liquidation interest in accordance with principles set out in an affidavit of the liquidator which expressly included the approach adopted in *Bower v Marris* and *Re Humber Ironworks*. There does not appear to have been any argument on this point.

82. There was no statutory provision dealing with post-liquidation interest applicable in the *Gerah Imports* case, so that the position as regards the winding-up of companies was comparable to that in England before the Insolvency Act 1986.

83. Importantly, there are the three first instance decisions, in Ireland and Canada, where it has been held that the principle applies against a statutory background at least partly similar to the relevant provisions of the 1986 legislation in England. I shall refer to those cases later in this judgment.

84. The same approach has been followed in analogous situations outside bankruptcy and company liquidations. It was adopted in relation to the administration of the estates of deceased persons, both as regards legacies (see *Thomas v Montgomery* (1828) 2 Sim 348 and *Re Morley's Estate, Hollenden v Morley* [1937] Ch 491) and the payment of creditors. As regards the payment of creditors of a deceased's estate, I was referred to *Whittingstall v Grover* (1886) 55 LT 213, to which I will refer in greater detail later in this judgment. It was applied to an equitable receivership by the US Court of Appeals for the Second Circuit: *Ohio Savings Bank & Trust Co v Willys Corporation* (1925) 8F 2d 463.

85. Taken overall, these authorities establish a general principle that, where an insolvent estate is administered on the basis that distributions will be made to creditors in respect of the principal of their debts as at the date of commencement of the administration and it subsequently transpires that there is a surplus, the usual rules as to the appropriation of payments to debts revive and the distributions already made are treated as having been appropriated first to the interest accrued at the date of distribution and then, to the extent of any balance, to the principal amount of the debt. This principle has been applied in cases where there is no relevant statutory provision dealing with post-insolvency interest and, in England, in bankruptcies to which the Bankruptcy Act 1825 applied.

86. The position as regards the English cases on bankruptcy and winding-up prior to the Insolvency Act 1986 can be summarised as follows.

87. In bankruptcy, at a time when there was no statutory provision for the payment of interest, creditors with interest-bearing debts were entitled to receive post-bankruptcy interest out of any surplus, with dividends on their proved debts being treated as having been applied first in the payment of interest outstanding at the date of the dividend and secondly in reduction of the principal of their debts: see *Bromley v Goodere*. The same approach applied when a statutory right was introduced for creditors to receive post-bankruptcy interest at the rate to which they were otherwise entitled from any available surplus and, subject thereto, for creditors whose debts did not carry interest to receive interest at the rate of 4% pa. It was held in *Bower v Marris* that creditors in the first category were entitled to treat dividends received on their proved debts in the same way as provided by the order in *Bromley v Goodere*. There was no discussion or decision as to whether the same principle would apply in

the case of those creditors whose only entitlement to interest arose under the statutory provision. There has been no consideration in any English case whether the approach in *Bower v Marris* continued to apply after the introduction of the new regime for post-bankruptcy interest in the Bankruptcy Act 1883 and continued in the Bankruptcy Act 1914.

88. As regards the winding-up of companies, there was no statutory provision for the payment of post-liquidation interest at all until the Insolvency Act 1986. In that respect, the position was similar to that which existed in bankruptcy before the Bankruptcy Act 1825. Against that background, it was common ground in *Re Humber Ironworks & Shipbuilding Co* and *Re Lines Bros Ltd (No.2)* that the decision in *Bower v Marris* applied.

89. Against this background, the issue in the present case is whether the principle applies in cases where there is statutory provision in the terms of rule 2.88 or the equivalent provisions in bankruptcy and liquidation under the Insolvency Act 1986.

90. The Insolvency Act 1986, and the Insolvency Rules 1986 made pursuant to it, introduced a large number of significant changes to the insolvency regime for both individuals and companies, in many cases giving effect to the recommendations of the Report of the Cork Committee.

91. The Report dealt with interest on debts in chapter 31. A significant part of the chapter (paragraphs 1363-1381) dealt with section 66 of the Bankruptcy Act 1914 which made special provision as regards pre-insolvency interest and is not relevant to the present case. Turning to post-insolvency interest the report stated:

> "1383. Section 33(8) of the Act of 1914 provides that if, after all the proving creditors have been paid in full, the bankrupt's estate still has a surplus, it is to be applied first in paying interest from after the date of the receiving order at the rate of 4% per annum on all debts proved in the bankruptcy. Any balance then belongs to the bankrupt.
>
> 1384. There is no similar provision in the winding up code; moreover, unlike section 66 of the Act of 1914, the provisions of section 33(8) are not imported into the Companies Acts. Section 317 of the Act of 1948 which imports the rules in force for the time being in bankruptcy affecting the respective rights of creditors, refers specifically to 'insolvent companies' and case law has distinguished the treatment of creditors of insolvent companies on the one hand and of solvent companies on the other. Provided that there is a surplus after the proving creditors have been paid in full, therefore, the company is to be treated as no longer insolvent. This means that the creditor who is entitled to interest on the debt for which he has proved may recover the interest accruing after the presentation of the winding up petition as if there had been no

> winding up at all. On the other hand, the creditor who is not entitled to interest at the commencement of insolvency proceedings has no means of recovering interest at a later stage even though the company may be in a position to pay."

92. In paragraph 1386, the committee stated that their attention had been drawn to the anomaly between the different types of insolvency proceedings and to suggestions made to them that:

> "there should be a common code of rules for situations which occur both in personal insolvency and in winding up proceedings and that, in particular, interest should be payable on debts in the same way in both administrations. We agree."

93. They recommended a common set of rules for pre-and-post insolvency interest in all forms of insolvency proceedings and as regards the latter they recommended in paragraph 1395(c):

> "during the insolvency, in the event of there being a surplus after payment of all admitted debts and liabilities (including interest prior to the commencement of the insolvency, where applicable) interest should run on all such debts and liabilities until a final dividend is declared, the rate being that currently applicable to judgment debts at the commencement of the insolvency."

94. Essentially, they were recommending that the approach adopted by section 40 of the Bankruptcy Act 1883 should apply to all forms of insolvency, but with the substitution of judgment rate as at the commencement of the insolvency for the flat rate of 4% pa.

95. The government in large part accepted the recommendations of the Cork Committee as regards interest, including post-insolvency interest. The principal change to the recommendation was to provide that post-insolvency interest should be payable at the higher of judgment rate and the contractual or other rate otherwise applicable to the debt.

96. In considering the proper construction of rule 2.88, Mr Dicker correctly submits that, as well as considering the terms of the rule and the prior state of the law, regard must be had to general legal principles, particularly of insolvency law, and the consequences of one construction as against another.

97. Mr Dicker and Mr Smith identify a number of factors to be taken into account.

98. First, the application of *Bower v Marris* to the distribution of a surplus in the payment of interest, after the proved debts have been paid in full, is no more than the ordinary way in which payments made by a debtor to his creditor fall to be treated where there is no appropriation by the debtor. It simply adapts to the particular circumstances of the administration of an estate a longstanding and well-established principle that accords with commercial common sense and "is only common justice" (*Parr's*

Banking Co v Yates [1898] 2 QB 460 at 466 per Rigby LJ, cited with approval by the Privy Council in *Venkatadri Appa Row v Parthasarathi Appa Row* (1921) LR 48 Ind. App. 150).

99. Secondly, they point out that in a number of the authorities, including *Bower v Marris* itself, the courts have considered the approach there adopted as being the just approach. It means that creditors are not prejudiced by delay in the payment of either dividends or eventually the surplus and are entitled to receive the amount of interest they would have been able to receive had the debtor not become subject to insolvency proceedings.

100. Thirdly, and closely linked to the second point, any other approach would not only leave the creditor worse off than he would have been if there had not been an insolvency, but it potentially leaves the debtor better off than if there had not been an insolvency. It is, of course, a feature of insolvency law that the rights of creditors are modified and they are to an extent disadvantaged while they remain in competition with each other for payment of what is due to them. But, where the competition is between the creditors and the debtor, there is no reason for not giving effect to the full rights which the law otherwise provides to creditors.

101. Fourthly, there is nothing to suggest that there was any intention to remove the operation of the principle in *Bower v Marris* when enacting the Insolvency Act 1986 or indeed the Bankruptcy Act 1883. In the latter case, it was enacted only some 14 years after the principle had been applied to the winding-up of companies: *Re Humber Ironworks & Shipbuilding Co*. There is no evidence of any criticism of the principle leading up to the enactment of the 1883 Act or in either the Cork Report or in the Government's White Paper preceding the enactment of the Insolvency Act 1986. Neither the Report nor the White Paper contain any mention of it.

102. Fifthly, the effect of not applying the principle in *Bower v Marris* is very marked whenever there is a delay between the payment of dividends and the payment of interest under rule 2.88 out of the surplus. In a case such as LBIE, where interim dividends have been paid, there may be long periods of delay between the receipt of the dividends and the receipt of interest in respect of the period before the payment of such dividend. Likewise, there may necessarily be a delay, perhaps a considerable delay, between the payment of any final dividend and the payment of any interest. The creditor receives no compensation for these periods of delay. This in turn could have the perverse effect of encouraging creditors to delay the submission of proofs until a late stage, thereby ensuring that they receive interest on the full amount of their claim for the maximum period, and reducing the delay between the payment of their principal debt and the receipt of interest on it under rule 2.88. This result would follow also in the case of a creditor which does not deliberately delay submitting its proof but, for reasons outside its control, does not do so until a late stage. In such a case, that creditor would fare better than the general body of creditors who have submitted proofs and received dividends at an earlier stage.

103. Underlying all these points was a submission that it is a fundamental aspect of insolvency law that the claims of creditors should be met in full before there is any return to shareholders or to the bankrupt. Creditors should not be worse off, and the debtor better off, as a result of the operation of an insolvency process. The reference here is, of course, to an insolvency process that involves the realisation of the debtor's

assets and the distribution of the proceeds of sale amongst creditors, rather than an insolvency process which is designed to reconstruct and rescue the debtor. Mr Dicker relied on what was said by Lord Hoffmann in *Wight v Eckhardt* that the insolvency process leaves the contractual rights of the creditors unchanged, save for the purpose of the collective process of realisation and distribution which is for the benefit of the creditors themselves. In the event of a surplus, creditors are remitted to their contractual or other rights apart from the insolvency process and it was on this ground that in *Waterfall I* currency conversion claims were held to lie against a company in administration or liquidation once its proved debts and statutory interest have been paid in full. The reference in rule 2.88 and in the equivalent provisions for bankruptcy and liquidation to the rate of interest apart from the administration, if higher than judgment rate, points the way.

104. As regards the terms of rule 2.88, Mr Dicker and Mr Smith submit that there is nothing essentially new to distinguish it from section 132 of the 1825 Act. Both provide for post-insolvency interest to be paid after all debts have been paid in full. Both provide for the payment of such interest to be made out of the surplus after the proved debts have been paid. Both provide for the interest to be paid in respect of the period since the commencement of the formal insolvency process. While neither provision spells out that there is to be a notional re-allocation of the payments previously made in respect of proved debts, there is nothing in rule 2.88, any more than there was in section 132, which expressly excludes this notional re-allocation. The principle in *Bower v Marris* is concerned with the calculation of interest, and rule 2.88 does not stipulate the method for calculating the amount of interest to be paid.

105. They submit that there is no reason of policy or principle for depriving creditors of the right to treat as re-allocated the dividends paid on their proved debts. Rather, it would run contrary to a basic principle of insolvency law that, as against the debtor, the creditors should have their claims satisfied in full. Legislation, in the field of insolvency as in other fields, should be construed so as to give effect to basic principles and sensible policy objectives: see *Re Kaupthing Singer & Friedlander Ltd (No.2)* [2010] EWCA Civ 518, [2011] 1 BCLC 12 at [32]-[33].

106. In the absence of clear words excluding the effect of the principle in *Bower v Marris*, rule 2.88 should be construed so as to give effect to it.

107. In support of this conclusion, Mr Dicker and Mr Smith rely on *Whittingstall v Grover* and the decisions at first instance in *Re Hibernian Transport Companies Ltd (No.2)* [1991] 1 IR 271 and *AG of Canada v Confederation Trust Company* [2003] OJ No. 2754. The latter was followed at first instance by the Ontario Superior Court of Justice in *The Attorney General of Canada v Reliance Insurance Co* [2009] OJ No.3037.

108. In *Whittingstall v Grover* (1886) 55 LT 213, Chitty J held that *Bower v Marris* applied to the payment of interest on debts in the administration of a deceased's estate. Sufficient had been realised or would be realised in the deceased's estate to pay the principal amount of all debts in full. The situation of the estate was complex because the deceased had carried on a banking business which, following his death, had ceased trading. There were therefore both separate creditors and joint creditors with claims against his estate. The separate creditors enjoyed priority as regards principal over the joint creditors. When it came to interest, it was common ground that those

separate creditors with interest-bearing debts enjoyed priority in respect of interest over both the remaining separate creditors and the joint creditors.

109. By reason of rules of court made first in 1841, following the provision for interest on judgments introduced by the Judgments Act 1837, the court allowed interest at 4% pa from the date of decree for the administration of an estate on all liabilities which did not otherwise carry interest, payable out of any surplus remaining after costs, the principal amount of debts and interest on interest-bearing debts.

110. Chitty J explained the reason for the introduction of the new rule at page 217:

> "Previously to the Orders of 1841, the Court of Chancery did not give interest to a creditor coming in under a decree for the administration of the estate of a deceased person where the debts did not by law carry interest. The orders of 1841, relating to interest, were in substance repeated in the Consolidated Orders of 1861 and are now embodied in the subsisting Rules of Court, Order LV rr.62, 63. The rules of 1841 were founded on [section 17 of the Judgments Act 1837]. Previously to that enactment, a judgment debt did not carry interest at law; and the Court of Chancery had no jurisdiction to give interest to creditors, who came in under its decree for administration, where the debts did not by law carry interest. But the court would not, after such a decree, permit a creditor to proceed at law to recover judgment for his debt. Consequently, after the passing of [the Judgments Act 1837], a court of equity, while interfering with this legal right for the common benefit of all the creditors, was bound, on equitable principles, to put him in the same position as if he had exercised it. Hence the order of 1841. Lord Romilly explained the matter substantially to the same effect when he said, in *Re The Herefordshire Banking Company* (17 LT Rep NS 58; LR 4 Eq 250), that the court allowed interest at 4%. From the date of its decree, because the decree is a judgment in equity for the benefit of all the creditors, and prevents them from getting a judgment at law which would give them interest. The right of the creditor whose debt does not carry interest by law is, therefore based upon the provisions of [the Judgments Act 1837], and the Orders of 1841, and the existing Rules of Court merely give effect to such right."

111. Chitty J held that, as between the joint and separate creditors, the question of interest should be decided in accordance with the established priorities as to principal. He continued:

> "The remaining question relates to the manner in which the dividends received ought to be accounted for, in ascertaining the amount of interest due. All the dividends have been paid in process of law, and the account ought to be taken in the manner pointed out in *Bower v Marris* and *The Warrant Finance Company's Case* …, viz., by treating the dividends as ordinary

> payments on account, and applying each dividend in the first place, to the payment of interest calculated to the day of such dividend and the surplus (if any) to the reduction of the principal."

It would not appear that Chitty J drew any distinction in this respect between interest on interest-bearing debts and interest arising by virtue of the orders or rules of court.

112. At first sight, this decision may provide some support for the submission that *Bower v Marris* applies not only to interest on interest-bearing debts but also to interest payable out of a surplus only by virtue of express statutory or similar provision. However, caution is needed. In the passage from the judgment which I have set out, explaining the background to these particular rules, Chitty J proceeds, as did Lord Romilly, on the basis that a decree for the administration of an estate operates as a judgment in equity, and that the orders of 1841 were made in order to bring a judgment in equity into line with a judgment at law on which interest was payable under the Judgments Act 1837. Interest on a judgment debt accrues due while it is outstanding just as much as interest under a contract.

113. The distinction between the payment of interest on debts in the administration of a deceased's estate and in bankruptcy or winding-up was made clear by Lord Romilly MR in *Re Herefordshire Banking Company* (1867) LR 4 Eq 250 at 252-53:

> "The distinction which was pointed out to me yesterday is very clear, namely, that though in the administration of assets the Court does allow, by its own authority, interest at £4 per cent from the date of the decree, it is because the decree is a judgment in equity in favour of all the creditors, and prevents them from getting a judgment at law which would give them interest. But though a winding-up order is a decree in equity, and therefore a judgment, it is a judgment and decree of a different character. It is in point of fact a decree amongst a great number of co-partners to settle their equities among themselves, and to wind up the affairs of the partnership, but that does not give the creditors of the partners a judgment against the company, or entitle them to any interest in respect of it."

114. The significance of the decision in *Whittingstall v Grover* for the submission of SCG and York was that it might show that the principle in *Bower v Marris* applied to a distribution even though at the time of the distribution no interest had accrued due. As will be seen, it is an important part of the submissions of Wentworth and the administrators that the principle is capable of application only where, at the date of the relevant distribution, a liability to pay interest had accrued due. In the light of the analysis of an administration decree as a judgment in equity in favour of all creditors, analogous to a judgment at law, this decision does not as it seems to me support the submission of the SCG and York.

115. More direct support for the SCG and York is provided by the Irish and Canadian decisions on which they rely.

116. *Re Hibernian Transport Companies Ltd* is a decision of Carroll J sitting in the High Court of the Republic of Ireland. The company went into liquidation in 1970 as an insolvent company. As a result of large amounts of interest earned on funds held by the liquidator following the realisation of its assets, a surplus over proved debts arose. A second and final dividend was paid to creditors in 1986 resulting in the payment in full of their proved debts. After the payment of all costs there was, as at July 1988, a surplus of over £4.7 million.

117. On an application by the liquidator and heard by Carroll J in October 1989, reported at [1991] 1 IR 263, she distinguished the decisions of the English courts in *Re Fine Industrial Commodities Ltd* and *Re Rolls Royce Ltd* and held that the relevant rules of bankruptcy applied to the company. Accordingly, the unsecured creditors were entitled to interest on their proved debts, payable at the rate from time to time payable on judgment debts. She held further, relying on *Re Humber Ironworks & Shipbuilding Co*, that those creditors entitled to contractual interest were entitled to be paid the balance of the sum due for such interest, giving credit for the amount received in respect of statutory interest.

118. On a further application which is the decision directly in point, Carroll J held that the principle in *Bower v Marris* applied to the calculation of post-liquidation interest due to creditors. Having referred to *Bower v Marris* and having summarised its effect, she stated:

> "If statutory interest is payable, it seems to me that it should be computed as running interest (following *Bower v Marris* …). Accordingly the dividends already paid should be applied to payment of statutory interest due on the date of the dividend and the surplus in reduction of principal; no distinction being made between the different creditors."

119. There is no reference to supporting and opposing submissions nor any further analysis of the applicability of the principle to the entitlement to interest under section 86(1) of the Bankruptcy Act 1988 which provided:

> "If the estate of any bankrupt is sufficient to pay £1 in the pound with interest at the rate currently payable on judgment debts, and to leave a surplus the Court shall order such surplus to be paid or delivered to or vested in the bankrupt, his personal representatives or assigns."

120. Carroll J referred to the report of the Bankruptcy Law Committee which reported before the enactment of the 1988 Act. She refers to the view taken in that report that the principle in *Bower v Marris* applied to interest payable under section 40 of the English Bankruptcy Act 1883. In fact, the committee expresses this conclusion in less than conclusive terms ("it is conceived that …"). Although not acknowledged as such, the relevant sentence is in fact taken verbatim from an English text book published in 1904 to which I shall later refer.

121. On appeal, the Supreme Court reversed the decision of Carroll J that the bankruptcy provision for the payment of post-insolvency interest was applicable to a company in

liquidation. It followed that the remainder of the orders made by Carroll J ceased to have effect and there was no consideration of them by the Supreme Court.

122. I do not consider that the decision in *Re Hibernian* is of much assistance in the present case.

123. *AG of Canada v Confederation Trust Company* is a decision of Blair RSJ sitting in the Ontario Superior Court of Justice. The liquidator of Confederation Trust Company anticipated that after the payment of all proved debts there would be a surplus of about CAD 30 million. The liquidator proposed to distribute the surplus in accordance with the provisions of section 95(2) of the Winding-up and Restructuring Act and on the basis of treating the dividends in respect of proved debts as being appropriated first to interest, ie, in accordance with the principle in *Bower v Marris*. This was opposed by the liquidator of the indirect parent company and by the company's largest creditor whose financial interests, for reasons which are not presently material, were opposed to those of the general body of creditors. Before the enactment of section 95(2), the relevant legislation contained no provision for the payment of post-liquidation interest. Section 95 provided as follows:

> "(1) The court shall distribute among the persons entitled thereto any surplus that remains after the satisfaction of the debts and liabilities of the company and the winding-up charges, costs and expenses, and unless otherwise provided by law or by the Act, charter or instrument of incorporation of the company, any property or assets remaining after the satisfaction shall be distributed among the members or shareholders according to their rights and interests in the company.
>
> (2) Any surplus referred to in sub-section (1) shall first be applied in payment of interest from the commencement of the winding-up at the rate of 5% per annum on all claims proved in the winding-up and according to their priority."

124. The wording of section 95(2) is not the same as rule 2.88(7) but it is closer to it than the provision under consideration in *Re Hibernian*.

125. Blair RSJ held that section 95(2) applied to the proper disposal of the surplus, notwithstanding that it had come into force after the commencement of the liquidation. This is not, of course, relevant to the present issue but it is worth noting a passage from that part of his judgment dealing with this issue:

> "[25] To say this is not to give the provision retroactive effect. Although it is not free from doubt, I do not accept the contention that the Claimants [ie the general unsecured creditors] acquired a vested right to post-liquidation interest at the Liquidation Date. In my opinion, they acquired, at best, a contingent right to the payment of post-liquidation interest conditional upon there being a surplus in the liquidated estate after

payment of all the Company's debts and obligations and of the costs associated with the liquidation. The condition cannot be determined and satisfied until the liquidation of the estate is at least substantially completed."

126. In dealing with the issue as to the calculation of interest under section 95(2), Blair RSJ said:

"[29] The traditional rule in insolvency situations is that dividends are to be applied first to the payment of interest and then to the payment of principal. This is said to prevent injustice, promote equity amongst the creditors, and protect the contractual relationship between the parties. See *Bower v Marris*, supra, at pp.527-28 Cr.&Ph; *In re Humber Ironworks and Shipbuilding Company*, supra, at p.645 Ch.App. PricewaterhouseCoopers Inc. submits the traditional rule should be applied to the payment of post-liquidation interest pursuant to subsection 95(2). The respondents contest this interpretation of the provision and contend for the reverse methodology.

[30] There is nothing in the language of s.95 of the Winding-up and Restructuring Act itself to indicate that Parliament intended to alter this traditional methodology in the case of a post-liquidation surplus. The respondents submit, however, that post-liquidation interest is only payable after payment in full of all proven claims and that there is nothing in the legislation to suggest a recalculation is to be done regarding distributions already made (which would be necessary if the interest portion of the surplus is to be distributed on a "payment of interest first" basis). Section 95 therefore mandates that distributions are to be credited, first, to the proven claim amounts, they say. Consistent with its choice of a common and consistent rate of interest (5 per cent), Parliament has chosen not to differentiate between claimants based upon the composition of claims as between principal and interest. Such a methodology is also consistent with the statutory regime of pre-judgment interest under provincial legislation, where interim payments are credited towards payment of unliquidated claims for damages first, then to interest: see, for example, *Downey v Maes* (1992), 8 O.R. (3d) 440 (Gen.Div.); *Illingworth v Elford* [1996] O.J. No.2893 (QL) (Gen.Div.).

[31] ….

[32] I see no reason why s.95 should be interpreted in a fashion that departs from the traditional approach. The general purpose of winding-up legislation is to ensure the rateable distribution of the assets of the insolvent company, in accordance with the creditors' priorities. In the rare circumstance of a winding-up surplus, creditors who have proven their claims ought to be placed – as closely as the surplus permits – in the same position they would have been in if the proven claims had been paid on the date of the winding-up. The comments of Wachowich A.C.J. (as he then was) in *Canada Deposit Insurance Corp v Canadian Commercial Bank* (1993), 21 C.R.B. (3d) 12, 11 Atla. L.R. (3d) 371 (Q.B.), at p.24 C.B.R. are apt:

> The passage of time alone should not alter the ratio of the funds available to the different classes of creditors. In the present circumstances, the priority creditors have been deprived of their funds for nearly a decade. As Mutual Life pointed out, the unsecured creditors as a class will be enriched with every passing year of delay in the distribution of the estate. One might add to Lord Selwyn's statement [Note 8] "that no person should be prejudiced by the accidental delay which, in consequence of the form and proceedings of the Court and other circumstances, actually occur in realizing the assets" a further caution: no person should be so prejudiced by such delay in the distribution of assets.

[33] In the circumstances of this case, it is not so much the unsecured creditors who will be enriched by the passing of time as it is Confederation Life in its capacity as the 100 per cent indirect shareholder of Confederation Trust (and CDIC, as a result of the Co-operation Agreement between it and Confederation Life). While I agree with the respondents' submission that there is no inherent policy or goal of maximising post-liquidation interest so [page 530] as to minimize any recovery to the debtor or the shareholder of the debtor pursuant to subsection 95(1) of the Winding-up and Restructuring Act, I do not see why the insolvent company and its shareholders should receive a windfall out of the insolvency before the Claimants have been made as whole as possible in the circumstances. I am satisfied that "the interests of fairness, equality and predictability" amongst the creditors and as between the debtor company and its

> creditors, call for the application of the generally accepted rule for the allocation of payments made: see *In re Cardelucci*, 202 U.S.App.LEXIS 6770 (9th Circ.2002), at p.2."

127. I have thought it right to set out this part of the judgment in full. It comes to a clear conclusion on a provision which is, partly though not completely, similar to rule 2.88. It is fully reasoned and it identifies a number of grounds for the conclusion which also formed part of the submissions on behalf of the SCG and York. In particular the following factors are identified. First, the treatment of dividends as applied to interest first is the traditional rule in the administration of insolvent estates, which has been said to prevent injustice, to promote equity amongst creditors and to protect the contractual relationship between the parties. Secondly, there is nothing in the language of section 95 to indicate that parliament intended to alter the traditional methodology in the case of a post-liquidation surplus. Thirdly, the absence of any requirement in the express terms of section 95 to reallocate the distributions already made and the choice of a common and consistent rate of interest irrespective of the rights of creditors outside the liquidation were not grounds for interpreting section 95 in a way that would depart from the traditional approach. Fourthly, creditors should be placed, as closely as the surplus permits, in the same position as they would have been in if the proved claims had been paid on the date of the winding-up. Fifthly, the contrary interpretation would result in the company and its shareholders receiving a windfall as a result of the insolvency before the creditors had been made as whole as possible in the circumstances. It was therefore in the interests of fairness, equality and predictability that the traditional rule should apply.

128. This decision and its reasoning clearly provides support for the submissions made on behalf of the SCG and York. These are powerful submissions but I have concluded that an application of the principle in *Bower v Marris* is incompatible with the regime established by rule 2.88.

129. It is first important to bear in mind the right approach to the construction of new provisions in the 1986 insolvency legislation. The need to recognise that it is in many respects a new code and that the new provisions are not to be construed as if the previous law still applied has been emphasised in a number of authorities.

130. In *Re A Debtor* [1989] 1 WLR 271, Nicholls LJ said at page 276:

> "Mr Ley, for the debtor, submitted that the test to be applied by the court in determining whether a statutory demand ought to be set aside is the objective one, of whether the demand is calculated to perplex, formerly applied on applications to set aside bankruptcy notices.
>
> I am unable to accept this. I do not think that on this the new bankruptcy code simply incorporates and adopts the same approach as the old code. *The new code has made many changes in the law of bankruptcy, and the court's task, with regard to the new code, must be to construe the new statutory provisions in accordance with the ordinary canons of construction, unfettered by previous authorities.* Those

> authorities, on the setting aside of bankruptcy notices, were concerned with a different scheme, in that the operation of a bankruptcy notice was not, in all respects, the same as the effect of the new statutory demand. For example, unlike bankruptcy notices, the statutory demand can be relied upon by the creditor serving it." (emphasis added)

131. In *re MC Bacon Ltd (No.1)* [1990] BCC 78, a liquidator applied to set aside a debenture as being either a preference under section 239 of the Insolvency Act 1986 or as a transaction at an undervalue under section 238. Section 239 replaced earlier statutory provisions dealing with the setting aside of transactions as preferences. At page 87, Millett J referred to the immediate predecessor (section 44 of the Bankruptcy Act 1914) which, he said, had been replaced and its language entirely recast. He continued:

> "I therefore emphatically protest against the citation of cases decided under the old law. They cannot be of any assistance when the language of the statute has been so completely and deliberately changed. It may be that many of the cases which will come before the courts in future will be decided in the same way that they would have been decided under the old law. That may be so, but the grounds of decision will be different. What the court has to do is to interpret the language of the statute and apply it."

132. There is no doubt that the provisions of the 1986 insolvency legislation dealing with post-insolvency interest were new. As a number of distinguished commentators have observed, section 189 represented a complete change to the law concerning the payment of interest on debts proved in a winding-up: see, for example, *Fletcher: The Law of Insolvency* (4^{th} ed) at 24-045.

133. The primary focus must be on the terms of rule 2.88(7)-(9).

134. Rule 2.88(7) is a direction to the administrator as to how any surplus "remaining after payment of the debts proved" is to be applied. The assumption, for the purposes of the rule, is that the debts proved have been paid. This is the basis on which the rule is to be operated. An application of the principle in *Bower v Marris* produces the result that the proved debts are treated as if they have not been paid, at any rate in full. It is objected by the SCG and York that if the proved debts are treated as paid in full, it would deprive a creditor of rights to recover the full amount due from a co-obligor or by way of the realisation of security. That objection, in my judgment, is not well founded. Rule 2.88 is not concerned with the rights of creditors against co-obligors, guarantors or security. It is concerned only with the payment of interest out of the assets of the company in administration. The words "surplus remaining after payment of the debts proved" have no effect beyond that.

135. The direction given to the administrator is to pay "interest on those debts in respect of the periods during which they have been outstanding since the company entered administration." It is common ground that the plural "periods" is used to cover the case where there is more than one distribution made in respect of proved debts. It is clear that the period in respect of which interest is to be paid commences with the start

of the administration and ceases on the date or the respective dates on which the distribution or distributions is or are made. Importantly, interest is not therefore payable in respect of any period after the relevant distribution. An application of the principle in *Bower v Marris* would involve the payment of interest in respect of periods long after the distribution or distributions in question.

136. Rule 2.88(9) specifies the rate at which interest under rule 2.88(7) is to be paid. In so far as interest is payable at the rate applicable to the debt apart from the administration, because it is higher than judgment rate, it is in my view clear that the interest is nonetheless not being paid pursuant to the contract. The interest remains payable pursuant to rule 2.88, and rule 2.88(9) does no more than specify the rate at which statutory interest is payable.

137. Not only does rule 2.88 contain no suggestion that the principle in *Bower v Marris* should be applied but, in my view, its whole tenor is contrary to it. It is a direction to apply the surplus in the payment of interest. It is not a direction to apply the surplus towards an element of the principal debt through a process of re-allocation. There is no inconsistency here with the agreed position that rule 2.88 provides for the payment of compound interest, where compound interest is payable apart from the administration and produces a higher rate than judgment rate. Compound interest is a rate of interest just as much as simple interest.

138. In considering the context and background to rule 2.88, it is right to take into account the Report of the Cork Committee. I have referred earlier to the relevant parts of the Report. It contains no reference to *Bower v Marris* or any suggestion that it is applicable to the payment of interest in bankruptcy or should be applicable to a common regime for the payment of interest in all types of insolvency process. I find it impossible to read para 1383 of the Report as allowing for the application of the principle in *Bower v Marris*. By way of contrast, para 1384 refers to the pre-1986 entitlement of a creditor with an interest-bearing debt against a company to recover the interest accruing on the debt after the presentation of the winding-up petition "as if there had been no winding up at all."

139. The view taken in para 1383 of the effect of section 33(8) of the Bankruptcy Act 1914, re-enacting section 40 of the Bankruptcy Act 1883, is in my judgment correct. For broadly the same reasons as apply to the construction of rule 2.88, it is my view that the principle in *Bower v Marris* was not applicable to the payment of interest under section 40(5) or section 33(8). Mr Dicker submitted that the discharge of interest in accordance with the principle in *Bower v Marris* was implicit in section 65 of the Bankruptcy Act 1883 which provided that:

> "The bankrupt shall be entitled to any surplus remaining after payment in full of his creditors, with interest, as by this Act provided, and of the costs, charges, and expenses of the proceedings under the bankruptcy petition."

140. It is in my judgment clear that the expression "with interest, as by this Act provided" refers back to, and only to, section 40(5). Mr Dicker submits that the payment of interest in accordance with the principle in *Bower v Marris* comes within the prior words "after payment in full of his creditors". This is not, in my judgment, a maintainable construction. First, it is odd to provide expressly for post-bankruptcy

interest as section 65 clearly does and then to construe prior words as also including such interest. Secondly, if such interest is included in the prior words, it leads to the result that further interest is payable on it in accordance with the words "with interest, as by this Act provided". The simple reading of this section is, I think, the right one: the only provision for post-bankruptcy interest is contained in the words "with interest, as by this Act provided".

141. If section 40(5) of the 1883 Act was intended to keep alive the application of the principle in *Bower v Marris*, it is remarkable that no reference at all is made to the principle or to the case in any of the editions of *Williams on Bankruptcy*, which was and remains the leading text book on personal bankruptcy.

142. Mr Smith referred me to two textbooks published shortly after the 1883 Act, neither of which provides much support for the application of *Bower v Marris* to section 40(5). First, in *A Treatise on the Law on Bankruptcy* by George Robson (7th ed 1894), there is a footnote to the reference to section 40(5) on page 291, reading "as to mode of calculating interest under the old law where there was a surplus, see *Bower v Marris*". If anything, this comment would appear to support the view that the 1883 Act superseded *Bower v Marris*. The authority of this work, and in particular the footnote, is however questionable in the light of a clearly incorrect statement in the footnote as to the effect of section 23 of the Bankruptcy Act 1890. The second textbook, *The Law and Practice of Bankruptcy* by Henry Wace (1904), stated at page 156 that "it is conceived" that interest was to be computed in accordance with *Bower v Marris*. This is the passage repeated in the report of the Irish Bankruptcy Law Committee.

143. The purpose of the recommendations of the Cork Committee, to which effect was given in the 1986 insolvency legislation, was to produce a uniform regime for post-insolvency interest across all the formal insolvency proceedings. The model adopted by the Cork Committee was that which existed in bankruptcy. Whether or not *Bower v Marris* applied in bankruptcy after the 1883 Act does not determine whether it applies following the 1986 legislation. However, if it did not apply in bankruptcy following the 1883 Act, it would be surprising if it now applied in all insolvency proceedings. The terms of rule 2.88, in my view, make it clearer than the terms of section 40(5) that the principle does not now apply.

144. There is a further, strong factor suggesting that *Bower v Marris* does not apply to the payment of post-insolvency interest under the 1986 legislation. As earlier discussed, the principle in that case is derived from the legal rules as to appropriation of payments towards debts. It is a basic part of the application of those rules that at the date when a payment is made, there are two outstanding debts payable by the debtor to the creditor. The source of the debt may be, but need not be, a contract. It may be a judgment carrying interest (see *Re Tahore Holdings Pty Ltd (in liq)* [2004] NSWSC 397) or some other basis of obligation. If only one debt is payable on that date, a payment by the debtor can, in the absence of express agreement between the parties, be applied only to that debt.

145. In applying the rules as to appropriation of payments to the administration of estates, the foundation remains that as at the date of payment from the estate which is treated as being made on account, there are two debts payable by the estate to the creditor. In *Bower v Marris* itself, Lord Cottenham refers to the creditor's claim that the amount

due from the co-obligor is "to be calculated by applying the amount of dividends from time to time received [from the bankruptcy estate of the other co-obligor], in discharge of *the interest then due*, and the surplus, if any, in discharge, pro tanto, of the principal." Referring to the general rule as to appropriation, Lord Cottenham goes on to say that "no creditor would apply any payment to the discharge of part of the principal *whilst any interest remained due*." In commenting on section 132 of the Bankruptcy Act 1825, Lord Cottenham said that it was "obviously intended to make good to the creditors that interest which, by the course of administration in bankruptcy, they had lost." If dividends were to be attributed to principal instead of to "the interest due", the creditor "will not have received interest upon his debt to the same extent as he would, if there had been no bankruptcy." This is necessarily a reference to interest falling due, apart from the insolvency process, during the period of that process.

146. The same basic principle can be seen in all the other insolvency cases, other than *Re Hibernian* and *AG of Canada v Confederation Trust Company*. In *Re Humber Ironworks & Shipbuilding Co*, Selwyn LJ said that in the event of a surplus the account must be taken between the company and the creditors in the ordinary way, that is:

> "in the manner pointed out in *Bower v Marris*, by treating the dividends as ordinary payments on account, and applying each dividend, in the first place, to the payment of the interest due at the date of such dividend, and the surplus (if any) to the reduction of the principal."

147. As Giffard LJ said, "as soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract." A remission to contractual rights means, in this context, a right to receive the interest payable under the contracts on the dates stipulated in the contract.

148. Following a review of the authorities, McLelland CJ in Eq in *Midland Montagu Australia Ltd v Harkness* said at page 330:

> "One of the premises upon which this rule is based is the proposition that neither bankruptcy nor winding up, as such, effects a discharge of a debtor's liability for future interest, although each limits the means by which, and the assets against which, such a liability may be enforced."

149. The right to interest out of a surplus under rule 2.88 is not a right to the payment of interest accruing due from time to time during the period between the commencement of the administration and the payment of the dividend or dividends on the proved debts. The dividends cannot be appropriated between the proved debts and interest accruing due under rule 2.88, because at the date of the dividends no interest was payable at that time pursuant to rule 2.88. The entitlement under rule 2.88 to interest is a purely statutory entitlement, arising once there is a surplus and payable only out of that surplus. The entitlement under rule 2.88 does not involve any remission to contractual or other rights existing apart from the administration. It is a fundamental feature of rule 2.88, and a primary recommendation of the Cork Committee that all creditors should be entitled to receive interest out of surplus in respect of the periods

before payment of dividends on their proved debts, irrespective of whether, apart from the insolvency process, those debts would carry interest.

150. On this basis, the principle in *Bower v Marris* cannot be applied to the payment of interest under rule 2.88.

151. On other issues raised by the application notice, dealt with later in this judgment, the SCG and York submit that interest under rule 2.88 runs on admitted proofs for contingent and future debts from the date of administration. It is difficult to identify the principle on which it would be said that *Bower v Marris* should apply to the interest paid out of the surplus on such debts.

152. In my judgment, the purpose behind the introduction of the new regime for post-insolvency interest in all insolvency proceedings was to introduce a straightforward regime for the payment of such interest. The regime acknowledges that creditors will not be paid their proved debts in full for a period, which may well be an extended period, after the commencement of the insolvency process. Once their proved debts have been paid in full, and there is a surplus available, they will receive interest on those proved debts for the periods commencing with the start of the administration while they were outstanding.

153. It is, of course, the case that a different view was taken at first instance in *AG of Canada v Confederation Trust Company*. I note, however, that the statutory provision in that case was not identical to rule 2.88. It does not expressly refer to the surplus as "remaining after payment of the debts proved", nor does it specify the end date of the period in respect of which interest is to be paid. Moreover, it does not appear that submissions were addressed to the true extent of the principle in *Bower v Marris* and that it was applicable only to interest which had fallen due for payment on the date or dates when distributions were made and treated as payments on account.

154. Mr Dicker submitted that the principle in *Bower v Marris* was more fundamental than simply requiring payments on account to be treated as applicable first to interest payable at the date of those payments. It was, he submitted, intended to reflect an underlying principle that in an insolvency creditors should not be prejudiced by the late payment of their debts. The statutory right to interest arising under rule 2.88 can be regarded, with hindsight, as having accrued on a day to day basis since the commencement of the insolvency process, albeit contingently on there being ultimately a surplus. Once the event occurs, the right to interest is treated as having accrued during the relevant period. I do not accept this submission. It involves saying not only that the principle in *Bower v Marris* is to be applied to the calculation and payment of interest under rule 2.88, but also that the principle itself is to be modified to fit in with the regime created by rule 2.88. As will already be apparent, I do not accept that the regime created by rule 2.88 leaves room for the application of the principle in *Bower v Marris*. I am further satisfied that it contains no warrant for any statutory adjustment to that principle.

Issue 2A (paragraph 39 of the application notice)

155. This Issue, as set out in the application notice is:

> "Whether a creditor entitled to Statutory Interest, Currency Conversion Claims and/or other non-provable claims is entitled to any form of compensation for or in respect of the time taken for such claim to be discharged and, if so, whether such compensation is taken into account as part of the current methodology for calculating Statutory Interest and/or the distribution of the surplus, or should take the form of interest at the Judgments Act Rate, damages for loss, restitution or another form."

156. As drafted, this Issue is confined to the availability of interest or other compensation for the time taken to meet the claims of creditors to statutory interest, currency conversion claims or other non-provable claims. As argued, it broadened beyond that to consider whether creditors who had rights to interest apart from the administration and who recovered less interest under rule 2.88(7) than they might otherwise have done, for example by applying *Bower v Marris*, had a non-provable claim for the balance.

157. The SCG and York submitted that both the issue as drafted and the wider issue should be answered in the affirmative. Wentworth and the administrators submitted that both questions should be answered in the negative. If the SCG and York were correct in their submissions on Issue 2, so that *Bower v Marris* applied to the payment of interest under rule 2.88(7), Mr Dicker and Mr Smith made clear that the extent of any claim under this Issue would be much reduced.

158. By way of general background, and underpinning their submissions, Mr Dicker and Mr Smith relied on the general principle applicable in insolvency, as expressed by Selwyn LJ in *Re Humber Ironworks & Shipbuilding Co (No.1)*, that "… no person should be prejudiced by the accidental delay which, in consequence of the necessary forms and proceedings of the Court, actually takes place in realising the assets …". In support of the submission that creditors should be entitled to a non-provable claim for a shortfall in their rights to contractual or other interest, reliance is placed on the principle that, before there can be any return to shareholders, the rights of creditors should be satisfied in full and, to the extent that they are not satisfied through the statutory process, they are remitted to their contractual or other rights.

159. The starting point for the submission of the SCG and York on the broader issue is that where the sums paid to a creditor pursuant to the insolvency process have not satisfied its claims in full, it has a non-provable claim for the shortfall. It does not matter whether the underlying right is contractual, statutory, tortious or other. If, having received all that it is entitled to under the statutory scheme, the creditor has not received the full amount of principal and interest to which he would otherwise be entitled, he has a non-provable claim for the balance. In the context of a claim based on a contractual or other right to interest, this would involve both the application of *Bower v Marris* to payments made pursuant to the statutory scheme and also provide interest down to the time when the rights of the creditor were fully satisfied. As it is a claim for the balance, the creditor is necessarily giving credit for the interest it will have received pursuant to rule 2.88(7). Although the issue is most likely to arise in relation to contractual or other rights to payment of interest, the right to be compensated for the delay in payment could take another form, for example a claim for damages in accordance with the decision of the House of Lords in *Sempra Metals*

Ltd v Inland Revenue Commissioners [2008] 1 AC 561. To the extent that such a claim related to delay after the commencement of the administration and is thus akin to interest, the SCG accepts that it would not be provable. Insolvency law looks to the substance, rather than the form, of a claim in circumstances such as these.

160. Wentworth and the administrators submit that, as regards interest on proved debts, the rights of creditors are exhaustively stated in rule 2.88(7)-(9). In a liquidation, or in an administration where notice to make distributions has been given, the statutory rights conferred by section 189 or rule 2.88 supplant such contractual or other rights as creditors might otherwise have to the payment of interest on their proved debts. There is accordingly no room for a non-provable claim if and to the extent that recoveries under rule 2.88 are less than the full amount of interest to which the creditor would otherwise have been entitled.

161. In advancing this submission, Mr Zacaroli on behalf of Wentworth emphasised that the provisions of rule 2.88, like the equivalent provisions for liquidation and bankruptcy, represent a common code introduced on the recommendation of the Cork Committee. In the case of liquidation, the new provisions represent a complete break with the regime as it previously existed for the payment of post-liquidation interest. The same new regime was adopted for administrations in 2003 when it became possible to make distributions to creditors generally in an administration. I have earlier referred to the Committee's recommendations, including in particular their recommendation that "there should be one set of rules relating to interest on debts in all forms of insolvency proceedings" and "that interest should run on all such [admitted] debts and liabilities until a final dividend is declared." I have also referred to commentary that these provisions brought about a complete change to the law concerning the payment of interest on proved debts.

162. Mr Zacaroli correctly submits that the regime introduced by rule 2.88 and the equivalent provisions for liquidation and bankruptcy cut across such contractual or other rights as creditors would otherwise have to the payment of interest. First, interest is payable from the surplus after the payment of all proved debts to all creditors, whether or not their debts were otherwise interest-bearing. Secondly, in the case of interest-bearing debts where the contractual rate was less than judgment rate, interest is payable at a rate higher than the rate to which they were otherwise entitled. Thirdly, interest is payable on a principal sum which comprises both the capital amount of the debt and any interest accrued up to the date of administration, whether or not the debt carried any right to interest or any right to compound interest. Fourthly, judgment rate interest is payable on foreign currency debts converted into sterling, although if a judgment were entered for the foreign currency debt, interest would be awarded under section 44A of the Administration of Justice Act 1970 at such rate as the court thought fit, which is likely to be at a commercial rate, rather than judgment rate: see *Novoship (UK) Ltd v Nikitin* [2014] EWCA Civ 908.

163. The SCG and York respond to this by saying that removing the right to recover such part of a creditor's right to contractual or other interest to the extent not discharged by statutory interest under rule 2.88(7), would represent a very significant change and a departure from the basic principle that creditors are entitled to make a full recovery before any funds are paid to shareholders. Clear words should be required to make such a change, and they are not to be found in rule 2.88. The concept of remission to rights remains once the statutory scheme has run its course, as was held by the Court

of Appeal in *Re Humber Ironworks & Shipbuilding Co*. Reliance is placed also on what Lord Hoffmann said in *Wight v Eckhardt Marine GmbH* at [27]:

> "The winding up leaves the debts of the creditors untouched. It only affects the way in which they can be enforced. When the order is made, ordinary proceedings against the company are stayed (although the stay can be enforced only against creditors subject to the personal jurisdiction of the court). The creditors are confined to a collective enforcement procedure that results in pari passu distribution of the company's assets. The winding up does not either create new substantive rights in the creditors or destroy the old ones. Their debts if they are owing, remain debts throughout. They are discharged by the winding up only to the extent that they are paid out of dividends."

164. In my judgment, Wentworth and the administrators are right in their submission that rule 2.88 represents a complete code for the payment of post-administration interest. The new approach introduced by the 1986 legislation for post-liquidation interest was intended to replace the previous law, as stated in *Re Humber Ironworks & Shipbuilding Co*. Rule 2.88 is not a partial measure for dealing with post-insolvency interest. If it was only a partial measure, why provide that interest is payable at the rate applicable apart from the administration, if higher than judgment rate? If the SCG and York were right, the effect of the legislation is to prescribe one regime for the payment of interest as a first charge out of the surplus remaining after the payment of proved debts in full, leaving without any explicit recognition the possibility of the payment of further post-insolvency interest as a non-provable debt out of the surplus remaining after the satisfaction of creditors' rights to statutory interest. I do not think that rule 2.88 can be read in this way.

165. I turn now to the question as posed by paragraph 39 of the application notice. Dealing first with statutory interest, is a creditor who has been paid statutory interest out of the surplus entitled to any form of compensation for the time taken to pay statutory interest? The SCG and York submit that creditors are entitled to compensation in respect of the loss caused by the time taken to distribute the surplus. A significant period could elapse between the payment of all proved debts and the payment of statutory interest, as indeed will be the case for creditors of LBIE. If paid a considerable time later, the interest no longer represents the compensation for which rule 2.88 provides. Any prejudice suffered by creditors as a result of delay in the administration of the estate should be remedied out of the estate before any sums are distributed to shareholders. In these circumstances, statutory interest should be treated as being due for payment as soon as the proved debts have been paid or provided for in full.

166. In my judgment, this submission faces two obstacles. First, while statutory interest is payable out of the surplus remaining after the payment in full of proved debts, rule 2.88 does not stipulate the time at which such payment is to be made. The reason it does not do so is that, while administrators are obliged to proceed with the administration with all reasonable speed, there may, as in the present case, be very good reasons why they cannot immediately proceed to the payment of statutory interest. The SCG have gone out of their way to say that there has been no breach by the administrators of their duties or any unreasonable or culpable delay on their part.

If there had been, creditors have their remedies against the administrators under the provisions of schedule B1 to the Insolvency Act 1986. It cannot in the present case be said that there has been any breach of the obligation to pay statutory interest or that the due date for payment has yet arrived. There is therefore no basis on which creditors could either seek an order for the payment of statutory interest or damages for any loss said to be suffered as a result of delay.

167. The second obstacle is that the legislation makes no provision for the payment of interest on statutory interest. In the absence of a breach of an obligation to pay the statutory interest, no jurisdiction exists to award interest or damages in respect of the time taken to pay the statutory interest. If it had been intended that a further sum by way of interest should be paid, on the amount of statutory interest due under rule 2.88 from the date on which all proved debts were paid or provided for in full or from some other date to the date of payment of the interest, a provision to that effect would have been included in the Rules.

168. Whether a creditor entitled to a currency conversion claim is entitled to any form of compensation for the time taken to discharge such claim raises rather different issues. A currency conversion claim arises if (a) a creditor has a claim enforceable against the company denominated in a foreign currency; (b) that claim is converted into sterling at the prevailing rate as at the date of administration under rule 2.86; (c) between that date and the date or dates of the dividends, sterling depreciates against the foreign currency, with the result that (d) the debt due to the creditor is not fully discharged by the dividend payments. The creditor has a claim for the shortfall, payable as a non-provable debt after the payment in full of statutory interest. It is a case where the creditor is remitted to his contractual rights. His claim is for the unpaid portion of the debt due to him.

169. There is no provision in the legislation for the payment of interest on such non-provable claims. Rule 2.88 applies to the payment of interest on proved, not non-provable, debts. If the contract between the company and the creditor provides for interest on any unpaid part of the debt, the creditor is in my judgment entitled to include such interest as part of his non-provable claim. The position of rule 2.88 as a complete code relating to the payment of post-administration interest does not, in my judgment, interfere with the enforcement of this contractual right as part of a non-provable claim. Neither explicitly nor implicitly does it interfere with a creditor's contractual right to interest on a non-provable debt. This entitlement to interest is dependent on a remission to contractual or other rights existing apart from the administration and it follows that no interest is payable on a currency conversion claim where the underlying foreign currency obligation is not itself interest-bearing.

170. I am not aware of any types of non-provable claims in the administration of LBIE other than currency conversion claims but the approach set out above in relation to currency conversion claims should be similarly applicable.

Issue 4 (paragraph 4 of the application notice)

171. The Issue is:

> "Whether the words "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) of the Rules are apt to

include (and, if so, in what circumstances) a foreign judgment rate of interest or other statutory interest rate."

172. The parties are agreed that if a creditor has obtained a foreign judgment before the commencement of the administration, and that judgment carries interest at a rate higher than English judgment rate, the foreign judgment rate will be "the rate applicable to the debt". This may be a real issue, because judgment rate under New York law has been 9% since a date before the commencement of the administration of LBIE. I should say, though it is almost certainly not an issue in relation to LBIE, that if an English judgment were entered before the commencement of an administration at a time when judgment rate was higher than at the commencement of the administration, the former would be the applicable rate of interest, given that interest on a judgment is fixed by reference to judgment rate at the date of the judgment.

173. There are two questions which have been argued in relation to Issue 4. First, the SCG and York submit that the words "the rate applicable to the debt apart from the administration" are apt to include not only a rate which is in fact applicable to the debt but also a rate which would be applicable to the debt if the creditor obtained judgment for it. Secondly, but this is not their preferred position, the SCG and York submit that if a creditor obtains a foreign judgment in the course of the administration, the rate of interest applicable to that judgment, such as 9% on a judgment entered in New York, is the rate applicable to the debt for the purposes of rule 2.88(9).

174. In support of the first proposition, Mr Dicker submitted, first, that a creditor should not, so far as possible, be prejudiced by being forced to participate in a process of collective enforcement rather than individual enforcement and, where there is a surplus, it should be entitled to interest at the rate it had a right to obtain through individual enforcement action, even if it did not in fact obtain a judgment.

175. Secondly, assuming that the SCG and York are correct on the second question, Mr Dicker submitted that it would produce an unsatisfactory situation where those creditors who in fact obtained a foreign judgment after the commencement of the administration would be entitled to interest at the foreign judgment rate, but those who did not do so would not be entitled to that rate. Such an outcome would likely trigger a scramble for foreign judgments, in circumstances where the foreign judgment rate was higher than the English judgment rate. The same could arise where judgment rate in England and Wales is lower at the commencement of the administration than at the date on which a post-administration judgment was entered. He submitted that the intention of the rule cannot have been to allow the scheme to operate in this way which would be inefficient, unnecessarily expensive and unfair. This result could in large part be avoided as regards proceedings in this jurisdiction, because the statutory moratorium prevents the commencement or continuation of proceedings without the leave of the court and, in circumstances where the court considered it appropriate otherwise to grant leave, it could do so on terms that would prevent the creditor from enforcing a higher rate of interest. The moratorium does not apply to the commencement of foreign proceedings and this mechanism would not therefore be available to prevent or reduce unfair consequences.

176. Thirdly, Mr Dicker and Mr Smith submitted that this approach would give proper effect to the rights of a creditor who had bargained for a New York jurisdiction clause. Its contractual right is to compel payment by process of law in New York

and to be paid the New York judgment rate of interest while the judgment remains unsatisfied.

177. In my judgment, the first proposition advanced by the SCG and York is not sustainable on the terms of rule 2.88(9). The words “the rate applicable to the debt apart from the administration” cannot be read as including a hypothetical rate which would be applicable to a debt if the creditor took certain steps. Suppose a debt governed by New York law carries interest under the contract at a rate of x%. Clearly that is a rate applicable to the debt apart from the administration. If the SCG and York were right, it would follow that in any case where New York judgment rate was more than x%, the creditor was entitled to substitute the New York judgment rate for x% without obtaining judgment in New York. Difficulties would also arise if the creditor had a choice of jurisdiction in which to bring proceedings or where the appropriate jurisdiction was uncertain. Moreover, I do not see why the logic of the position of the SCG and York would not also apply in circumstances where English judgment rate is increased after the commencement of the administration. Creditors would be entitled to be treated as if they had brought proceedings in England and obtained judgment on which the higher rate of interest would be payable. These examples do no more than demonstrate why the words “the rate applicable to the debt apart from the administration” should be given their obvious meaning of the rate in fact applicable to the debt.

178. The second submission made by the SCG and York, which as I have said is not their preferred position, is based on an actual judgment rate, but one applicable to a judgment obtained after the commencement of the administration.

179. Wentworth submits that “the rate applicable to the debt apart from the administration” refers to the rate applicable to the debt by reason of the rights of the creditor as at the commencement of the administration. If, by reason of its contractual rights, the creditor is entitled to a higher rate of interest for a period after the commencement of the administration than the rate applicable at the date of administration, Wentworth accepts that the creditor is entitled to be paid interest under rule 2.88(7) taking account of that higher rate. For example, if a contract stipulates for a fluctuating rate of interest, such as one linked to US LIBOR, that is the applicable rate for the purposes of rule 2.88(9). This does not apply to a creditor who obtains a judgment after the commencement of the administration, because at the date of the administration he had no right to interest at the relevant judgment rate.

180. Mr Zacaroli for Wentworth relies on a number of grounds in support of this submission. First, it is as necessary for the operation of rule 2.88 as it is for the ascertainment of provable debts that there should be a single cut-off date for ascertaining the rights of creditors. Rule 2.88 creates a statutory scheme for the payment of interest on proved debts. Rule 2.88(8) provides that all interest payable under rule 2.88(7) ranks equally. In the event of an insufficient amount to pay all interest due under the rule, the entitlement of creditors to statutory interest will abate rateably. Secondly, his submission is consistent with the requirement of rule 2.88(9) that the default rate is judgment rate as at the date of the administration. This further suggests a comparison with a rate to which the creditor may otherwise be entitled under rights existing as at that date. Thirdly, it is consistent with the extension of the provision for statutory interest beyond the recommendation of the Cork Committee of a single rate applicable to all debts of judgment rate as at the date of liquidation or

administration, to include the alternative of the rate applicable to the debt apart from the liquidation or administration. The White Paper preceding the new insolvency legislation, *A Revised Framework for Insolvency Law* (Cmnd. 9175) published in February 1984, stated that if "a higher contractual rate applies to the debt, post-insolvency interest will be chargeable at that rate". While the wording in the relevant provisions of the Insolvency Act 1986 is wider than that, and clearly includes interest at the relevant rate on a judgment entered before the commencement of the administration, it suggests that it was not intended to include rates of interest for which no right existed at the commencement of the relevant insolvency proceeding. Fourthly, the submissions made by Mr Dicker in relation to the inefficiency and unfairness of permitting creditors who obtain foreign judgments after the commencement of the administration to payment of interest at the rate applicable to such a judgment support the proposition that the rights to interest are to be determined as at the commencement of the administration. Fifthly, as a matter of construction of sub-rules (7) and (9) of rule 2.88, the words "the rate applicable to the debt apart from the administration" refers back to "the debts proved" in sub-rule (7). If the creditor does not have a judgment at the date of the administration, the debt proved by the creditor is not a judgment subsequently obtained but the debt as at the date of administration. In the case of an unascertained claim, the later judgment quantifies the claim but it is not the judgment debt which is the subject of proof.

181. In my judgment, these grounds make a compelling case for the proposition that the rate applicable to the debt apart from the administration is to be determined by reference to the rights of the creditor as at the commencement of the administration. Mr Dicker submitted that the words "the rate applicable to the debt apart from the administration" were capable of including a rate applicable at or at any time after the commencement of the administration. I agree that as a matter of language this is correct but, having regard to the factors on which Mr Zacaroli relies, I consider that his suggested construction is to be preferred.

182. Mr Dicker also submitted that the creditor with a right to bring proceedings in a particular court, for example under a jurisdiction clause in a contract, has at the date of the administration a contingent right to obtain a judgment in that court and accordingly a contingent right to interest on that judgment at the relevant judgment rate. This argument is developed by reference to the broad interpretation of the test applicable for determining the existence of contingent debts for the purposes of proof in the decision of the Supreme Court in *Re Nortel GmbH* [2014] AC 209. I do not accept this argument. The determination of the existence of debts and liabilities for the purposes of proof, governed by rule 13.12, is irrelevant to the meaning of the phrase "the rate applicable to the debt apart from the administration" in rule 2.88(9). Even if Mr Dicker's submission was correct in relation to rule 13.12, although I should say that I have the gravest doubts that it is, the rather ethereal contingent right to which he refers cannot on any basis, in my view, be described as the rate of interest applicable to the debt apart from the administration.

183. I conclude therefore that the words "the rate applicable to the debt apart from the administration" in rule 2.88(9) do not include interest on a judgment entered after the commencement of the administration nor, still less, do they include interest at a rate which would have been applicable to a judgment entered after the commencement of the administration but which is not in fact entered.

Issues 6-8 (paragraphs 6-8 of the application notice)

184. These Issues concern the application of rule 2.88(7) to future and contingent debts.

185. The Issues are stated as follows in the application notice:

> "6. Whether, for the purposes of establishing, as required under Rule 2.88(9) of the Rules, "*whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*", the amount of interest to be calculated based on the latter is calculated from:
>
> (i) the Date of Administration;
>
> (ii) the date on which the debt became due; or
>
> (iii) another date.
>
> 7. Whether Statutory Interest is payable in respect of an admitted provable debt which was a contingent debt as at the Date of Administration from:
>
> (i) the Date of Administration;
>
> (ii) the date on which the contingent debt ceased to be a contingent debt (including in circumstances where the contract was "closed out" after LBIE entered administration); or
>
> (iii) another date,
>
> having regard to whether:
>
> (i) the contingent debt remained contingent at the time of the payment of
>
> a) the final dividend; or
>
> b) Statutory Interest; and/or
>
> (ii) (to the extent applicable) the Joint Administrators revised their previous estimate of the contingent debt by reference to the occurrence of the contingency or contingencies to which the debt was subject.
>
> 8. Whether Statutory Interest is payable in respect of an admitted provable debt which was a future debt as at the Date of Administration from:
>
> (i) the Date of Administration;

(ii) the date on which the future debt ceased to be a future debt; or

(iii) another date,

having regard to whether the future debt remained a future debt at the time of the payment of:

(i) the final dividend; or

(ii) Statutory Interest."

186. It will be convenient to take Issues 7 and 8 (paragraphs 7 and 8 of the application notice) before Issue 6. As with most of the other Issues, the consequences are very significant in financial terms. If statutory interest is payable on contingent claims from the date of administration, it will increase the amount of interest payable by approximately £500 million.

187. The application of rule 2.88(7) to debts payable at the commencement of the administration causes no problem in terms of the period or periods for which interest is payable under the sub-rule. Interest is payable for the period(s) from the date of commencement until the date or dates on which the debt is paid by means of dividends in the administration. By definition, however, contingent and future debts are not payable as at the date of administration. Future debts will become payable at a later date, which may or may not fall before the payment of dividends. Contingent debts will become payable only upon the occurrence of the relevant contingency, which may never occur or may occur either before or after the date or dates on which dividends are paid.

188. The administrators submit that interest is payable under rule 2.88(7) on future and contingent debts only from the date on which the creditor has a complete cause of action to sue for the debt, ie, on the date on which a future debt by its terms becomes payable or on the date, if ever, on which a contingent debt becomes payable. They submit that such debts are "outstanding" only once they would become payable if there were no administration. Wentworth agrees with this submission as regards contingent debts, but it submits that, in the case of future debts, interest is payable under the sub-rule from the commencement of the administration. The SCG and York submit that, in the case of both future and contingent debts, interest under the sub-rule is payable from the commencement of the administration.

189. As all parties agree, this is an issue of construction of rule 2.88(7) which must be approached in the context of the scheme established by the legislation.

190. An administration need not involve any realisation of assets or distribution to creditors at all but, if the administrator gives notice of intention to make a distribution to creditors, the provisions governing the proof of debts and distributions contained in chapter 10 of the Insolvency Rules 1986 apply. In large part they reflect the equivalent rules applicable to liquidations and bankruptcies.

191. There is a common definition of "debt" for liquidations and administrations in rule 13.12. In the form which was in force when LBIE went into administration and

therefore applies to its administration, rule 13.12 provided, so far as relevant, as follows:

> "(1) "Debt", in relation to the winding up of a company, means (subject to the next paragraph) any of the following –
>
> (a) any debt or liability to which the company is subject at the date on which it goes into liquidation;
>
> (b) any debt or liability to which the company may become subject after that date by reason of any obligation incurred before that date; and
>
> (c) any interest provable as mentioned in Rule 4.93(1).
>
> (2) …
>
> (3) For the purposes of references in any provision of the Act or the Rules about winding up to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, or whether its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion; and references in any such provision to owing a debt are to be read accordingly.
>
> (4) In any provision of the Act or the Rules about winding up, except in so far as the context otherwise requires, "liability" means (subject to paragraph (3) above) a liability to pay money or money's worth, including any liability under an enactment, any liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution.
>
> (5) This Rule shall apply where a company is in administration and shall be read as if references to the winding-up were a reference to administration."

192. This makes clear that future and contingent debts are "debts" for the purposes of proof and distribution. It also provides that there is a debt for these purposes even though it is one capable of being ascertained only "as a matter of opinion".

193. All debts other than preferential debts rank pari passu for the purposes of dividends: rule 2.69. A person claiming to be a creditor of the company and wishing to recover his debt in whole or in part must submit his claim in writing to the administrator. He is referred to as "proving" for his debt: rule 2.72. It is the duty of the administrator to examine the proofs and to admit or reject them, in whole or in part: rule 2.77. A

dissatisfied creditor may apply to the court for the administrator's decision to be reversed or varied: rule 2.78.

194. The quantification of claims which do not have a certain value is governed by rule 2.81 which provides:

> "(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."

195. Rule 2.89 makes provision for creditors to prove for future debts:

> "A creditor may prove for a debt of which payment was not yet due on the date when the company entered administration, or, if the administration was immediately preceded by a winding-up, up to the date that the company went into liquidation subject to Rule 2.105 (adjustment of dividend where payment made before time)."

196. Rule 2.105 provides:

> "(1) Where a creditor has proved for a debt of which payment is not due at the date of the declaration of dividend, he is entitled to dividend equally with other creditors, but subject as follows.
>
> (2) For the purpose of dividend (and no other purpose) the amount of the creditor's admitted proof (or, if a distribution has previously been made to him, the amount remaining outstanding in respect of his admitted proof) shall be reduced by applying the following formula –
>
> $$\frac{X}{1.05^n}$$
>
> where –
>
> (a) "X" is the value of the admitted proof; and
>
> (b) "n" is the period beginning with the relevant date and ending with the date on which the payment of the

creditor's debt would otherwise be due expressed in years and months in a decimalised form.

(3) In paragraph (2) "relevant date" means –

(a) in the case of an administration which was not immediately preceded by a winding up, the date that the company entered administration;

(b) in the case of an administration which was immediately preceded by a winding up, the date that the company went into liquidation."

197. Accordingly, a creditor proves for the full amount of a future debt but for the purpose of dividend (and no other purpose) the amount of the admitted proof is reduced at a rate of 5% per annum beginning with the commencement of the administration and ending with "the date on which the payment of the creditor's debt would otherwise be due". This does not apply where the debt has become payable before the declaration of the relevant dividend. In that case, no discount is applied, even though the debt was not by its terms payable for a period, perhaps a long period, after the commencement of the administration.

198. The estimation of the value of contingent debts necessarily involves matters of opinion and judgment. To take the simple paradigm of a guarantee of a third party's debt, the estimate will involve a view as to the prospect of the guarantee being called. This will involve an analysis of the likely ability of the principal debtor to pay the debt over the period during which the guarantee may be called. The longer the period, the greater will be the uncertainty. Submissions were made as to the extent to which the amount of the estimate is affected by the duration of the contingent debt. It is clear to me that, in some cases, it must play a part. To take the most obvious example, if the contingent debt cannot fall due for payment for a period of, say, 5 years, the estimate of the liability must include an element of discount for that period. Equally, the estimate of a contingent liability which may be outstanding over a long period may include some element of discount. It is all a question of judgment in the circumstances of the particular debt. There is no express provision in the rules, equivalent to rule 2.105, for the application of a mechanistic discount.

199. There are two factors in particular which may assist in the estimation of the value of a contingent debt. First, if a market exists for the provision of the protection represented by the contingent liability of the debtor company, the market price for an equivalent product provides an obvious basis for valuing the debt. If a market existed for providing guarantees of debts and the guarantee provided by the company had an unexpired period of, say, 2 years for a total liability of £1 million, a price for a substitute guarantee would provide a value for the purposes of proof. A parallel may be found in the Market Quotation provisions in the ISDA Master Agreements.

200. Secondly, the application of the hindsight principle provides assistance. If events occur following the commencement of the administration which assist in estimating the value of the debt, account must be taken of those events. If they occur before the administrator has estimated the value of the debt, he must take them into account at that stage. If they occur after he has done so, the administrator may, as provided in

rule 2.81, revise the estimate previously made. If the contingency occurs, so that an ascertained claim becomes payable by the company, that amount is substituted for the previous estimate. Submissions were made to me, which I will consider, that in those circumstances a discount should be applied to the value of the debt for the period between the commencement of the administration and the date on which the debt became payable. The hindsight principle has been discussed in a number of authorities which I need only mention at this stage: see *MS Fashions Ltd v Bank of Credit and Commerce SA* [1993] Ch 425, *Stein v Blake* [1996] AC 243, *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 and *Re MF Global UK Ltd (No.2)* [2013] Bus LR 1030.

201. Once claims have been admitted to proof for particular amounts, whether in respect of presently payable debts, future debts or contingent or unascertained claims, those amounts rank pari passu for distributions in the administration. A single date for the ascertainment of claims, even though account may be taken of subsequent events through the hindsight principle, is essential for a pari passu distribution. The date chosen by the legislation is the commencement of the administration. It is for that reason that foreign currency claims are converted into sterling for the purposes of proof as at that date.

202. It is a principle of insolvency law that the realisation of assets and the distribution of the proceeds among creditors are treated as notionally taking place simultaneously on the date of the commencement of the liquidation or administration: see *MS Fashions Ltd v Bank of Credit and Commerce International SA* at page 432G per Hoffmann LJ (sitting at first instance). In *Re Dynamics Corporation of America* [1976] 1 WLR 757, Oliver J said at page 774G-H:

> "What the court is seeking to do in a winding up is to ascertain the liabilities of the company at a particular date and to distribute the available assets as at that date pro rata according to the amounts of those liabilities. In practice the process cannot be immediate, but notionally I think it is, and, as it seems to me, it has to be treated as if it were, although subsequent events can be taken into account in quantifying what the liabilities were at the relevant date. In the context of a liquidation, therefore, the relevant date for the ascertainment of the amount of liability is the notional date of discharge of that liability, and, despite what was said by Lord Wilberforce and Lord Cross by way of illustration, that date must, in my judgment, be the same for all creditors and it must be "the date of payment" for the purposes of any judgment which has been entered for the sterling equivalent at the date of payment of a sum expressed in foreign currency."

203. At the same time, the courts apply the principle in order to give effect to the underlying purpose of a fair distribution between creditors pari passu and not as a rigid rule. It does not go so far as to entitle a person who was a creditor at the date of administration but had ceased to be so before the date of a dividend to participate in the dividend: see *Wight v Eckhardt Marine GmbH* at [29] per Lord Hoffmann.

204. With these provisions and principles in mind, I turn to the construction of rule 2.88(7). The issue in short is whether in providing that interest is to be paid "on those debts" in respect of the periods during which they have been "outstanding" since the company entered administration, the sub-rule is referring to the underlying debts giving rise to the admitted proofs or whether it is referring to the debts as admitted to proof. The administrators and Wentworth submit that, in the case of contingent debts, it is referring to the former and the administrators make the same submission as regards future debts. A contingent or future debt is properly regarded as "outstanding" only when the creditor has a complete cause of action for payment of the debt. The purpose of paying interest, they submit, is to compensate the creditor for not receiving payment of its debt at the time that it would otherwise be paid the debt in the absence of the administration.

205. The position of the administrators and Wentworth can be illustrated by some stark examples of contingent debts. Suppose a debt which is contingent at the commencement of the administration remains contingent for a lengthy period. A month before a dividend is paid, the contingency occurs and the debt becomes payable. In accordance with the hindsight principle, the estimate of the contingent debt for the purposes of proof is revised to take account of the occurrence of the contingency and, on one view at any rate, the debt is admitted to proof for its full amount. In those circumstances, they submit that it would be very surprising if interest is paid to that debtor under rule 2.88(7) for the whole period since the commencement of the administration. The creditor has, in truth, been deprived of its money for only one month. Another example is that of the contingent debt which always remains contingent. The creditor was never entitled to any payment. Why should it receive any interest?

206. I do not consider that this is the right approach to rule 2.88(7). The distribution in the administration is being made to creditors pari passu in discharge of their proved debts, not their underlying claims. They are not the same thing, as clearly illustrated by the examples of an estimate of the value of a contingent debt for the purposes of proof and the admission to proof of a sterling sum in place of a debt otherwise due in a foreign currency.

207. The purpose of rule 2.88(7), as earlier discussed in this judgment, is to provide for interest to be paid to all creditors, irrespective of whether they had any entitlement to interest apart from the administration. What they are being compensated for by the payment of interest under rule 2.88(7) is the delay since the commencement of the administration in the payment of their admitted "debts", as ascertained or estimated in accordance with the legislation. It is not, in my judgment, compensation for the non payment of the underlying debt although I accept, as I stated in *Waterfall I,* that the rationale for the choice of judgment rate as the minimum rate of interest payable is that the commencement of an administration or liquidation will or may prevent creditors from taking proceedings and obtaining judgment against the company.

208. It is true that in some parts of rule 2.88, references to "debt" appear to be references to the underlying debt rather than the debt as admitted to proof. For example, rule 2.88(1) provides that "where a debt proved in the administration bears interest, that interest is provable as part of the debt" in respect of pre-administration periods. The "debt" there would appear to be the underlying debt. That is not, however, true of rule 2.88(7). It opens by referring to "any surplus remaining after payment of the

debts proved". That can only be, in my view, a reference to the debts as admitted to proof. The surplus arises not after the underlying debts and claims have been paid but after the admitted or proved debts have been paid. That necessarily includes future debts and estimates of contingent or other unascertained debts. They are among "the debts proved" and they are therefore "those debts" on which interest is to be paid in accordance with rule 2.88(7).

209. As Mr Smith pointed out, there are further indications in rule 2.88 that support the conclusion that interest is payable under rule 2.88(7) from the commencement of the administration. First, interest on interest-bearing debts is provable down to the date of administration and the same is true in the case of certain non-interest bearing debts: rule 2.88(1)-(4). That suggests that interest under rule 2.88(7) should therefore run from the commencement of the administration. It would be particularly extraordinary if a creditor with a future debt bearing interest in the meantime (surely the most common example) who can prove for interest down to the commencement of the administration, would not then be entitled to the payment of interest from the commencement of the administration to the date on which his debt would otherwise become due. Secondly, rule 2.88(6) provides for the relevant judgment rate to be that in force as at the date of the administration, not the date from which interest is to be paid on any particular debt.

210. Mr Trower referred, by way of contrast, to a phrase in rule 2.105(2):

> "… the amount of the creditor's admitted proof (or, if a distribution has previously been made to him, the amount remaining outstanding in respect of his admitted proof) ..."

By using the expression "the amount of the creditor's admitted proof" the draftsman made clear that the reference was not to the underlying debt but to the admitted debt. I do not find this difference in drafting persuasive, given the terms and context of rule 2.88(7). Against Mr Trower, the draftsman has used "outstanding" in relation to an admitted proof. Telling also is that the draftsman has used the expression "the date on which the payment of the creditor's debt would otherwise be due" in the definition of "n" for the purposes of the formula in rule 2.105(2). If it had been used in rule 2.88(7), it would give effect to the administrators' proposed construction.

211. Although for reasons given earlier in this judgment, I am cautious about referring to equivalent provisions under the previous law, it is the case that under section 33(8) of the Bankruptcy Act 1914 the surplus was to be applied in the payment of interest "from the date of the receiving order". That left no room for doubt and, in my judgment, the equivalent phrases used in the new legislation, "outstanding since the commencement of the bankruptcy" in section 328(4) or "outstanding since the company entered administration" in rule 2.88(7), carry the same meaning.

212. For the reasons given earlier, the conclusion that interest is payable from the commencement of the administration on the debts as proved is entirely consistent with the underlying principles of insolvency law. It may be illustrated by an example. If the estimate placed on a contingent debt is the cost of a replacement transaction, the creditor needed the replacement transaction from the commencement of the administration. Even if the value is not estimated as accurately as market prices for substitute transactions permit, the estimate of the value of the contingent claim is the

compensation due to the creditor for the loss from the commencement of the administration of the protection provided by his contingent claim.

213. The treatment of future debts is different by virtue of the provisions of rule 2.105. It applies to a creditor who has proved for a debt "of which payment is not due at the date of the declaration of dividend", not where the debt was a future debt as at the date of administration. The discount of 5% per annum is applied to the period beginning with the date of administration and ending on the date on which the debt will become payable. This provision causes some difficulty for the administrators' argument as it applies to future debts. On the one hand, a discount is applied to the debt to reflect that it has not yet fallen due for payment but, on the other hand, if the administrators' submissions are correct, the creditor will receive no interest pursuant to rule 2.88(7). This would appear to involve a double loss for the creditor. This would be an unjustified result even in the case of a future debt which did not carry interest but, as earlier observed, it would produce an extraordinary result in the case of interest-bearing future debts. I agree with Mr Zacaroli that, even if the administrators were correct on the application of rule 2.88(7) to contingent claims, these factors strongly suggest that it is not applicable to future debts.

214. Mr Trower pointed to one case in which rule 2.105 results in a windfall, if interest is payable under rule 2.88(7) from the commencement of the administration. In the case of a future debt which does not bear interest but which falls due for payment before the declaration of a dividend, no discount under rule 2.105 applies and therefore the creditor receives interest under rule 2.88(7) for a period during which the debt was not, by its terms, payable to him. I accept that this produces an advantageous result for the creditor, assuming at any rate that there was a significant period before the debt fell due for payment and a relatively short period between that date and the payment of the dividend. But it is important to analyse why, in that particular example, an advantage accrues to the creditor.

215. Unless a future debt has fallen due for payment before the declaration of a dividend, all such debts are discounted back to the date of commencement of the administration. As Mr Dicker said, this is readily understandable as, in terms of the time value of money, it produces a value which ranks pari passu with all other creditors. On that basis, in the case of a future debt which fell due for payment before the declaration of a dividend, there would be a logic in still applying the discount for the period between the commencement of the administration and the date on which it fell due for payment. Why has this approach not been adopted? I think the answer lies in this consideration. If the future debt has fallen due for payment before the declaration of a dividend, the creditor is at that point entitled to the full amount of his debt. He is then as much entitled to the payment in full of his debt as any other creditor with a presently payable debt. If a dividend is then paid, it might well seem unjust that this creditor should not receive a dividend on the full amount of his debt. True it is that this may produce an advantageous result in the particular circumstances instanced by Mr Trower, but it is difficult to construct a scheme which can produce a perfect solution in all circumstances and, given that in reality most future debts carry interest in the meantime, the injustice of applying Mr Trower's submissions in those circumstances may well be considered to outweigh the advantage in the particular case instanced by him.

216. Similar considerations lead me to conclude that, in the case of a contingent debt which becomes an actual liability before the payment of a dividend, there is no scope for admitting it to proof at a sum which represents a discount back to the commencement of the administration. Precisely the same considerations are in play. On the one hand, a discount back to the commencement of the administration would, in terms of the time value of money, produce a value which ranked pari passu with all other creditors. On the other hand, it would involve discriminating in the amount of dividend paid on different types of debt all of which were presently payable at the date of the dividend. Given that rule 2.105 does not discount future debts which have matured before the declaration of a dividend, it would produce an inconsistent result without justification to apply such a discount to a contingent debt which had become an actual debt before a dividend.

217. It was Mr Dicker for the SCG and Mr Smith for York who argued in favour of discounting contingent debts, even when they had become due for payment before a dividend, while Mr Zacaroli and Mr Trower submitted that no such discount was permissible. This no doubt was because each considered that, with some reason, it would make it easier to argue for their clients' basic position.

218. There are, as it seems to me, a number of reasons why a discount cannot be applied to a contingent debt which has matured into an actual debt before a dividend.

219. First, I do not consider that there is any authority to do so in the legislation. Reliance is placed on rule 2.81, providing for the estimate of the value of any debt which is subject to a contingency or does not bear a certain value. It applies to "any debt which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value". If a contingent debt has become payable it does bear a certain value and it is no longer subject to any contingency. If the contingency has occurred before the administrator has considered the proof of debt, there is no basis for him to estimate the value of the debt pursuant to rule 2.81. If the contingency had not occurred at the time that the administrator considered the proof, then he will have estimated its value in accordance with rule 2.81. The occurrence of the contingency is clearly a change of circumstances requiring a revision to the estimate previously made. It would clearly be inconsistent to use the power to revise an estimate to discount the debt when such a power could not be used in the case of a contingent debt which has become an actual debt before the administrator has considered the proof.

220. Secondly, if the legislation envisaged that in these circumstances a discount should nonetheless be applied, express provision would be made, as it is in relation to un-matured future debts by rule 2.105.

221. Thirdly, it would be extraordinary if matured contingent debts were the subject of a discount but, as is clearly the case by reason of the terms of rule 2.105, matured future debts are not subject to any such discount.

222. For all these reasons, although this particular topic was not the subject of consideration in that case, Lord Hoffmann covered the point when, describing the hindsight principle in *Stein v Blake* at page 252 E-F he said:

> "The first is to take into account everything which has actually happened between the bankruptcy date and the moment when it becomes necessary to ascertain what, on that date, was the state of account between the creditor and the bankrupt. If by that time the contingency has occurred and the claim has been quantified, then that is the amount which is treated as having been due at the bankruptcy date."

223. I was referred to three authorities in which the value of a matured contingent debt had been discounted back to the commencement of the insolvency process: *Hill v Bridges* (1881) 17 ChD 342, *Re Law Car and General Insurance Corporation* [1913] 2 Ch 103, and *Ellis and Company's Trustee v Dixon-Johnson* [1924] 1 Ch 342. The last of these can be disregarded, because the comments made on the subject by the judge at first instance were expressly not approved on appeal and were in any event considered to be obiter: see [1924] 2 Ch 451 at 471 and 473.

224. *Re Law Car* is a decision of the Court of Appeal, containing discussion as to the valuation of debts which were contingent at the commencement of a winding-up, principally under the legislative provisions applicable in the previous 60 years. The discussion was obiter, because special provision had by the time of this case been made as regards current insurance policies. The discussion contains a clear suggestion that a discount would be applied under that legislation to a debt which was contingent at the commencement of the winding up but which subsequently became an actual liability. The decision in *Hill v Bridges*, a bankruptcy case, is to similar effect. These cases are not altogether easy to follow, particularly because each relies quite heavily on *MacFarlane's Claim* (1880) 17 ChD 337 which involved no discount at all. The important point about these cases is that the legislative regime was different in a number of respects from the current regime. In particular, there was no equivalent to rule 2.105, providing in effect that no discount was to be applied in respect of a future debt which had become payable before a dividend.

225. I conclude therefore on Issues 7 and 8 that, in the case of both future and contingent debts, interest is payable under rule 2.88(7) from the date that the company entered administration, not from the date (if any) on which any such debt fell due for payment in accordance with its terms. The parties are agreed that it follows that the comparison under Issue 6 is between judgment rate and the rate applicable apart from the administration, in each case from the date of administration.

Issue 10 (paragraph 28 of the application notice)

226. The Issue is:

> "Whether, and if so how, the calculation of a Currency Conversion Claim should take into account the Statutory Interest paid to the relevant creditor by the Joint Administrators."

227. It was held in *Waterfall I* that a creditor with a foreign currency debt, which for the purposes of proof must be converted into sterling at the ruling rate at the commencement of the administration, had a non-provable claim to recover the currency loss resulting from any depreciation of sterling against the currency of the

debt between the date of administration and the date or dates of dividends which were and were required to be paid in sterling. Wentworth submits that the currency conversion claim should take into account the payment of statutory interest. Accordingly, the loss is calculated by comparing the aggregate of the creditor's contractual rights to both principal and interest expressed in the relevant foreign currency with the aggregate amount of such foreign currency resulting from a conversion of the sterling amounts received by it in respect of both principal and interest at the rates prevailing on the dates of payment. Wentworth submits that a foreign currency creditor has only one claim apart from the administration, its contractual right to be paid its principal and interest in the foreign currency. In the absence of the insolvency, it is a single contractual right and claim.

228. If, as I have held, Wentworth is right in its submissions on Issue 2A (paragraph 39 of the application notice), I do not see how this submission can run. Rule 2.88 is a complete code for the payment of post-administration interest and it replaces all prior rights, including contractual rights. The only right of the creditor, whether its original debt was in sterling or in a foreign currency, is to receive interest in accordance with rule 2.88(7)-(9) on its admitted debt, which necessarily is expressed in sterling, from the date of administration. The creditor is not receiving that interest in or towards satisfaction of its contractual right to interest and there is no comparison to be made between the foreign currency equivalent of the statutory interest and the foreign currency interest to which it was entitled under its contract.

229. Even if Wentworth were wrong in its submission on Issue 2A, I would reject its submission on this point. The creditor does not have a single composite claim, comprising principal and interest. It has separate claims for payment of the principal and for payment of interest on the principal, as the application of limitation periods makes clear.

230. If the contractual right of the creditor was to receive, say, US $1 million on a particular date and if it received dividends equivalent to US $900,000, there remains outstanding a debt of US $100,000. A currency conversion claim is not a claim for damages, it is a claim for payment of the unpaid portion of its debt. A subsequent payment of interest in sterling which, if converted at the prevailing rate on the day of payment, produced a higher sum than the contractual entitlement, does not discharge the earlier unpaid debt.

231. I therefore conclude that the calculation of a currency conversion claim should not take into account the statutory interest paid to the relevant creditor.

Leap Year

232. When dealing with Issue 1, I mentioned that there was one outstanding issue, concerning the impact of leap years on the calculation of interest. This issue concerns interest at judgment rate, either because the creditor has proved a judgment debt or, more usually, because it is the default rate under rule 2.88. Its impact on contractual interest will depend on the terms of the contract.

233. The position adopted by the administrators and notified to the parties was that they would calculate interest on the basis that the annual rate, for example judgment rate of 8% pa, would, where necessary, be converted into a daily rate on the basis of dividing

the amount of interest produced by the annual rate by the number of days in the year in question. For example, an admitted debt of £1 million will carry the right under rule 2.88(7) to interest of £80,000 for each complete year that elapses between the commencement of the administration and the date of payment. The need to calculate a daily rate arises where, as will normally be the case, the relevant period includes a part of a year. The approach proposed by the administrators is that, where that year includes 29 February, the daily rate will be £80,000 divided by 366, whereas in other years it will be £80,000 divided by 365.

234. Neither the SCG nor Wentworth took issue with this approach, but York submits that the daily rate should always be calculated on the basis of a year of 365 days, even if it includes 29 February. The result is that in a year which includes 29 February, the daily rate, if grossed up to a full year, would result in the payment of an extra day's interest, so that the amount of interest paid on an annualised basis would be just over £80,092.

235. In support of its submission, York relies on a decision of the High Court of Ireland in *Harrahill v Kennedy* [2013] IEHC 539. In presenting a bankruptcy petition, the Irish Revenue had included within the petition debt interest on a judgment which allowed for a leap year falling within the period of 6 years since the judgment "thereby introducing a 366th day". The issue was whether the 6 year limitation period permitted the Revenue to include the extra day's interest. Dunne J held that there was no breach of the Statute of Limitations 1957 by the inclusion of a 366th day for one of the 6 years to account for the occurrence of a leap year. The judge said:

> "Assuming for the sake of argument that a six year limitation period is applicable to the Revenue, I cannot see any breach of the Statute of Limitations by the inclusion of a 366th day for one of the six years to account for the occurrence of a leap year. In any six year period, obviously, there will be a leap year. Thus, in calculating interest for a six year period, I can see nothing intrinsically wrong in allowing for the fact that one of the years concerned is a leap year. It is not adding on an extra day which would not have occurred within the six year period. If one was considering whether or not an action was statute barred after a six year period, one would not, in calculating the period of six years do so on the basis of disregarding the leap year and the extra day that occurs within the six year period by virtue of the leap year. In other words, one would not calculate the period of six years by carrying out an exercise of calculating the six year period on the basis that 6 years = 365 days multiplied by 6."

236. It is not entirely clear whether the primary issue considered by the judge was whether the inclusion of the 366th day in the leap year meant that the claim for interest was statute-barred in respect of one day or whether this involved a miscalculation of interest by the Revenue. I am inclined to the view that the judge was dealing with both these issues.

237. York also relied on a document published by the Bank of England entitled The Non-Investment Products Code for Principals and Broking Firms in the Wholesale

Markets. There have been at least 4 editions of this Code, the latest in November 2011, all in the same terms so far as relevant. The Foreword explains that the Code has been drawn up by market practitioners in the United Kingdom representing principals and brokers in the foreign exchange, money and bullion markets, with participation by the Bank of England and the Financial Services Authority. It applies to trading in the wholesale markets in non-investment products. The foreword also explains that its provisions are intended only as guidance on what is currently believed to constitute good practice in those markets, and that it has no statutory underpinning except where it refers to existing legal requirements.

238. Annex 1 concerns the sterling wholesale deposit market and it states that the calculation of interest in a leap year depends on whether interest falls to be calculated on a daily or an annual basis, which may differ as between temporary and longer-term loans. It states that temporary loans are almost invariably calculated on a daily basis, with the result that any period which includes 29 February automatically incorporates that day in the calculation. It states:

> "In calculating the appropriate amount of interest, the number of days in the period since the last payment of interest is expressed as a fraction of a normal 365-day year, not the 366 days of a leap year, which ensures that full value is given for the "extra" day."

Examples are then given which demonstrate how this works in practice.

239. A similar approach is adopted to longer-term loans which cannot be repaid in less than one year. It states that the procedure was agreed between the British Bankers Association and the Chartered Institute of Public Finance and Accountancy in December 1978. It states that:

> "Normal practice for the calculation of interest in leap years is to disregard 29 February if it falls within one of the complete calendar years. Only when it falls within the remaining period is it counted as an additional day with the divisor remaining at 365."

240. The issue which here arises is one of statutory construction, directly of rule 2.88 and indirectly of section 17 of the Judgments Act 1838. Section 17(1) provides that:

> "Every judgment debt shall carry interest at the rate of £8 per centum per annum from such time as shall be prescribed by rules of court until the same shall be satisfied …"

241. The important point for present purposes under section 17 is that the judgment creditor is entitled to interest at the rate of 8% pa for each complete year that the judgment debt is outstanding. No distinction is made for these purposes between an ordinary year and a leap year. I cannot therefore see that the position should be any different when it is sought to apply the annual rate to part of a year. If a creditor with a judgment of £1 million is entitled to £80,000 for a complete year, whether or not it is a leap year, he is not, in my judgment, entitled to an extra day's interest for

part of a year which happens to include 29 February. This would be to give the creditor interest at a slightly higher rate than that prescribed by the Act.

242. Accordingly, the administrators are, in my judgment, correct to approach the calculation of interest for a year which includes 29 February by reference to a daily rate calculated on the basis of 366 days. In all cases, the start date for the calculation of interest is 15 September 2008, the commencement of the administration of LBIE. A year therefore starts on 15 September and ends on the following 14 September. Interest for part of any such year which includes 29 February should therefore be calculated on the basis of a year comprising 366 days.

Conclusion

243. On the principal contentious issues dealt with in this judgment, I conclude that

i) *Bower v Marris* does not apply to the calculation of post-administration interest under rule 2.88(7)-(9);

ii) rule 2.88 represents a complete code for the payment of post-administration interest on proved debts, leaving no room for any non-provable claim for further interest;

iii) interest is not payable on statutory interest in respect of the period between the payment in full of the debts proved and the date or dates on which statutory interest is paid;

iv) "the rate applicable to the debt apart from the administration" in rule 2.88(9) does not include judgment rate on a judgment obtained after the commencement of the administration or the judgment rate which would apply to a debt if the creditor had obtained judgment for it but did not in fact do so;

v) statutory interest is payable on future debts and on the amount admitted to proof in respect of contingent debts from the date of the commencement of the administration; and,

vi) the calculation of currency conversion claims should not take into account the statutory interest paid to the relevant creditor.

244. As in *Waterfall I*, I have been greatly assisted in considering these difficult and unusual issues by the contributions of the parties, their solicitors and counsel. As regards the submissions of counsel, "the case was argued with all the ability of the Bar", as Lord Loughborough LC put it in one of the cases to which I was referred, *Ex parte Mills* (1793) 2 Ves Jun 295, 30 ER 640.