No. 7942 of 2008

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N :

(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 S.A.R.L.
(3) HUTCHINSON INVESTORS LLC
(4) WENTWORTH SONS SUB-DEBT S.A.R.L.
(5) YORK GLOBAL FINANCE BDH, LLC
(6) GOLDMAN SACHS INTERNATIONAL

Respondents

ADMINISTRATORS' WRITTEN SUBMISSIONS
ON SUPPLEMENTAL ISSUES

SUPPLEMENTAL ISSUE 1B

"*How is an independent right to interest that 'arises outside or other than from the administration' to be determined when calculating interest on a non-provable Currency Conversion Claim if such a rate would only accrue on a debt that was contingent or future at the Date of Administration if some action was taken after the Date of Administration? How are such rights to be assessed if the creditor did not in fact exercise such rights?*"

1. This is a question that has been identified by York.

2. The first part of the question is addressing the situation in which:

   (1) As at the commencement of the administration (the "**Date of Administration**"), a creditor has rights under a pre-administration contract with LBIE;

   (2) The contract provides for any sums payable under it to be paid in a foreign currency;

   (3) The contract also provides for a right to interest on any unpaid sums;

   (4) As at the Date of Administration, the creditor's right to be paid anything under the contract was merely contingent;

   (5) In order for the right to payment to accrue, it was necessary for the creditor to take action, such as the service of an early termination notice;

   (6) After the Date of Administration, the creditor took the requisite action so as to cause a debt to become payable under the contract in a foreign currency;

   (7) Pursuant to the terms of the contract, interest began to accrue on that debt at the rate specified in the contract;

   (8) The creditor's proof of debt was admitted in LBIE's administration on the basis of the hindsight principle, with the foreign currency amount of the claim being

converted into Sterling by reference to the exchange rate that prevailed on the Date of Administration, as required by Rule 2.86 of the Insolvency Rules 1986 (the "**Rules**");

(9) The foreign currency appreciated against Sterling after the Date of Administration, so that the Sterling dividend of 100% (when converted into the foreign currency on receipt by the creditor) was not sufficient to discharge the creditor's contractual right to payment in full in the foreign currency; and

(10) Accordingly, the creditor has a Currency Conversion Claim (as defined in the Part A Order) in the form of rights to payment under the contract which have not been discharged.

3. The second part of the question addresses a situation in which the facts are the same, save that the creditor never takes the step required to cause a present right to payment to accrue, with the result that his rights to payment remain contingent and no interest is ever payable under the contract.

4. York's contention, as set out at paragraphs 32 to 44 of its written submissions filed on 22 December 2015, is as follows:

(1) For the purposes of Rule 2.88(9), there is no "rate applicable" to the Currency Conversion Claim, even though, under the contract itself, contractual interest has become applicable;

(2) Alternatively, the contractual rate is applicable even if the creditor never took the action which was required under the contract in order for interest to run.

5. The SCG and Wentworth (by agreement) have not yet filed submissions on this Issue but will be filing their written submissions at the same time as the Administrators.

6. As to York's primary position (i.e. that there is no rate applicable to the Currency Conversion Claim, even though, under the contract itself, contractual interest has become applicable), the steps in York's argument appear to be as follows:

(1) A creditor is entitled to interest on a non-provable claim in accordance with the contractual or other rights which govern its non-provable claim – a position described in paragraph 169 of the Part A Judgment as the creditor's "*entitlement to interest* [which] *is dependent on a remission to contractual or other rights existing apart from the administration*" (York's first proposition);

(2) The concept of rights "*apart from the administration*" is also found in Rule 2.88(9) (York's second proposition);

(3) Whilst Rule 2.88(9) is concerned with statutory interest on provable debts (and not with contractual interest on non-provable debts), the concept of rights "*apart from the administration*" is the same in both contexts (York's third proposition);

(4) In the case of Rule 2.88(9), when addressing the position in respect of foreign judgment rates of interest, David Richards J held that a hypothetical rate which would be applicable to a provable debt if the creditor took certain steps ***after*** the Date of Administration is not a rate of interest applicable to the debt "*apart from the administration*" within Rule 2.88(9) (York's fourth proposition); and

(5) Applying the same reasoning, a contractual rate that begins to run after the Date of Administration (e.g. upon a creditor taking certain steps) is not a rate of interest applicable to the debt "*apart from the administration*" – a conclusion that must apply equally to both interest on provable claims under Rule 2.88(9) and interest on non-provable claims under the contract (York's fifth proposition).

7. The Administrators consider that York's primary position is wrong. In the Administrators' submission, the contractual rate applies to the Currency Conversion Claim in accordance with the terms of the contract, so that interest begins to run from the moment when the creditor first became entitled to contractual interest in accordance with the terms of the contract (e.g. upon the service of a close-out notice). That is what

"*a remission to contractual or other rights existing apart from the administration"* in this context means: the application of the creditor's rights that arise, ignoring the administration, in accordance with the relevant contractual provisions.

8. As to the propositions involved in York's argument (as identified above):

(1) York's first proposition is uncontroversial: a right to interest on a non-provable claim such as a Currency Conversion Claim arises on the basis of "*a remission to contractual or other rights apart from the administration*" (as the Judge put it in paragraph 169 of the Part A Judgment).

(2) York's second proposition is also uncontroversial: the words highlighted by York (namely, the words "*apart from the administration*") are found both in Rule 2.88(9) (dealing with statutory interest on provable debts) and in paragraph 169 of the Part A Judgment (dealing with contractual interest on non-provable debts).

(3) However, York's third proposition is wrong. Rule 2.88(9) applies only to provable debts. The proper construction of the phrase "*apart from the administration*" in Rule 2.88(9) is a matter of statutory construction which has no bearing on the concept of the remission to contractual rights in the case of non-provable debts. In the Administrators' submission, York is wrong to argue, at paragraph 36 of its written submissions, that the Judge's construction of the phrase a "*rate applicable to the debt apart from the administration*" in Rule 2.88(9) has any bearing on the concept of "*a remission to contractual or other rights apart from the administration*" described by the Judge in paragraph 169 of the Part A Judgment. The coincidence that the words "*apart from the administration*" appear both in Rule 2.88(9) and in paragraph 169 of the Part A Judgment does not mean that the underlying concepts are the same. Similarity of language does not, especially when considered in different contexts, lead to parity of reasoning, less still of outcome.

(4) It follows that York's fourth proposition (while accurate as a description of the Judge's reasoning on foreign judgment rates) is actually irrelevant to this Issue

and that York's fifth proposition is, accordingly, wrong. There is no basis for concluding that the position in respect of contractual interest on non-provable claims must necessarily be identical to the position in respect of statutory interest on provable claims. As stated above, the similarity of the language used in Rule 2.88(9) and in paragraph 169 of the Part A Judgment (and in particular the use of the phrase "*apart from the administration*" in both contexts) does not mean that the answer as a matter of statutory construction in respect of Rule 2.88(9) (which applies only to provable debts) is automatically or logically applicable to contractual interest on non-provable claims.

(5) Further, in the Administrators' submission, a contractual rate on a contractual debt that first became due after the Date of Administration is a "*rate of interest applicable to the debt apart from the administration*" for the purpose of Rule 2.88(9); but, in any event, Rule 2.88 has no bearing on the concept of remission to contractual rights which applies in the case of non-provable debts.

(6) In the Administrators' submission, the concept of remission to contractual rights means that the contractual interest rate applies to the Currency Conversion Claim in accordance with the terms of the contract, so that interest begins to run from the moment when the creditor first becomes entitled to contractual interest under the terms of the contract (e.g. upon the serving of a close-out notice).

(7) In order to identify whether a contractual rate is applicable to the Currency Conversion Claim, it is necessary to identify the creditor's actual contractual rights to interest on the sum represented by the Currency Conversion Claim during the post-administration period.

(8) Further, in the Administrators' submission, there is no basis for restricting a creditor's rights to interest on a non-provable claim to those that existed as at the Date of Administration. Even if there were such a basis, however, the Administrators' position in that regard is that a right to interest set out in a contract that exists as at the Date of Administration is a right that exists as at the Date of Administration even if interest has not begun to accrue as at that date.

9. York's alternative position (i.e. that the contractual rate is applicable even if the creditor never took the action which was required of it under the contract in order for interest to run) is also wrong. In particular:

(1) The contractual rate cannot apply in circumstances where the creditor has never become entitled to contractual interest, e.g. where the creditor has never taken the action which was required by the contract in order for interest to run.

(2) The concept of the remission to contractual rights requires an analysis of what the creditors' rights to interest ***actually*** are, rather than an assessment of what the creditors' rights ***might*** have been if (a) there had been no administration and (b) the creditor had taken certain steps which he did not in fact take.

(3) This, it is respectfully submitted, (*contra* York's contention at paragraph 41 of its written submissions) is what was meant by a creditor's entitlement to interest on a non-provable claim being dependent on a remission to contractual or other rights existing apart from the administration (paragraph 169 of the Part A Judgment).

10. Accordingly the Administrators submit that the answer to Supplemental Issue 1B is:

(1) A contractual right to interest that "*arises outside or other than from the administration*" is to be determined by applying the terms of the contract under which the interest in question is payable (including, for instance, the date from which it arises and the rate at, and period for, which it accrues).

(2) If the creditor failed to take a step required for contractual interest to accrue, the creditor will not be entitled to contractual interest.

SUPPLEMENTAL ISSUE 1C

"*In a case where contractual interest first starts to run on a provable debt at some point after the Date of Administration, is the 'rate applicable' for the period from the Date of Administration to the date when contractual interest first starts to run:*
i. the rate of interest which is payable once the interest is running (so that such rate is treated as being applicable for the whole of the post-administration period); or
ii. a zero rate.
Further for the purpose of Rule 2.88(9) should Statutory Interest be calculated by assessing the greater of the 'rate applicable' and the Judgments Act 1838 rate separately for the periods prior to and post the commencement of contractual interest or should such assessment be performed by taking the periods together?"

11. This issue addresses a situation illustrated by the following example:

(1) A creditor has a contingent claim against a company;

(2) In order for the claim to become presently due and payable, it is necessary for the creditor to take a particular step (e.g. the service of a close-out notice);

(3) The contract provides that, after the taking of that step, and for as long as the debt is due and payable but unpaid, simple interest shall accrue at 15% p.a.;

(4) The debtor company goes into administration;

(5) 363 days after the Date of Administration, the creditor serves a close-out notice with the result that: (i) the debt becomes due and payable in the sum of £1,000,000; and (ii) simple interest begins to run on that amount at 15% p.a. in accordance with the terms of the contract;

(6) On the basis of the hindsight principle, the creditor's claim is admitted in full;

(7) 365 days after the Date of Administration (i.e. only two days after the service of the close-out notice), the administrators pay a dividend of 100p in the £; and

(8) There is a surplus available for the payment of statutory interest.

12. In this example, what is the "*rate applicable to the debt apart from the administration*" for the purposes of Rule 2.88(9) for the first 363 days of the administration?

13. The Respondents' positions on this Issue are as follows:

(1) York's position is that, for the reasons set out in its written submissions and reply submissions on Supplemental Issue 1A, this question does not in fact arise since there is no "*rate applicable*" in respect of statutory interest under Rule 2.88(9) if the relevant debt was a contingent debt on the Date of Administration such that no interest was accruing on it at that date.

(2) The SCG's position is that: (i) the amount of interest is calculated at the simple rate of 15% p.a. (i.e. the "*rate applicable to the debt apart from the administration*") from the Date of Administration and not from the date on which the debt fell due for payment; and (ii) the relevant comparison when assessing the greater of the "*rate applicable to the debt apart from the administration*" and the rate applicable under the Judgments Act 1838 (the "**Judgments Act Rate**") for the purposes of Rule 2.88(9) is between the total amounts of interest that would be payable based on each method of calculation for the entire period of the administration, ignoring the fact that contractual interest would only be payable for part of that period.

(3) Wentworth's position is that where the debt carried no right to interest before it fell due for payment the rate applicable to the debt apart from the administration is zero; and that what is required to be compared for the purposes of Rule 2.88(9) is (a) the total interest that would be payable at the Judgments Act Rate for the relevant period and (b) the total interest that would be payable apart from the administration for that same period, taking into account that contractual interest would only be payable for part of that period.

14. The Administrators' position is aligned with Wentworth's on this Issue. In addition to the Administrators' own submissions (as set out below), the Administrators agree with Wentworth's arguments in support of its position on this Issue, in particular Wentworth's analysis as regards future and contingent debts (paragraphs 4 to 12 of its written submissions).

15. According to declaration (xiv) of the Part A Order, statutory interest is payable in respect of an admitted provable debt which was a contingent debt as at the Date of Administration from the Date of Administration. According to the SCG's reasoning, the creditor in the example set out at paragraph 11 above is entitled to say that the contractual rate of 15% is greater than the Judgments Act Rate and that he is therefore entitled to statutory interest at a rate of 15% p.a. on the full amount of his provable debt for the period of 365 days between the Date of Administration and the payment of the dividend of 100p in the £, notwithstanding that, under the terms of his contract, the rate of 15% p.a. was running for only the final two days of the period and that, according to the terms of the contract, the creditor had no right to interest for the first 363 days of that period.

16. The Administrators submit that such a contention is wrong. In the circumstances postulated by Supplemental Issue 1C, the "*rate applicable*" for the period from the Date of Administration to the date when contractual interest first starts to run is a zero rate. It is not the rate of interest which is payable once the interest is running (so that such rate is treated as being applicable for the whole of the post-administration period).

17. The Administrators submit that declaration (xiv) of the Part A Order does not provide the answer to Supplemental Issue 1C, which has also not been answered by the Part A Judgment. Rather, the Part A Judgment holds that:

    (1) The words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) refer not only to the numerical percentage rate of interest but also to the mode of calculating the rate at which interest accrues on a debt (declaration (vii) of the Part A Order);

(2) For the purposes of establishing "*whichever is the greater of the rate specified under* [Rule 2.88(6)] *and the rate applicable to the debt apart from the administration*" (as required by Rule 2.88(9)), the comparison required is of the total amounts of interest that would be payable under Rule 2.88(7) based on each method of calculation, rather than only the numerical rates themselves (declaration (xi) of the Part A Order); and

(3) For the purpose of establishing "*whichever is the greater of the rate specified under* [Rule 2.88(6)] *and the rate applicable to the debt apart from the administration*" (as required by Rule 2.88(9)), the amount of interest to be calculated based on the latter is to be calculated from the Date of Administration (declaration (xiii) of the Part A Order).

18. Applying these principles to the example provided above:

(1) The words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) refer not only to the contractual rate of 15% p.a. but also to the mode of calculating the rate at which interest accrues. That mode involves: (i) no interest accruing for the first 363 days of the administration; and (ii) interest accruing at a rate of 15% p.a. for the final two days of the period before payment in full.

(2) The comparison required is of the total amounts of interest that would be payable under Rule 2.88(7) based on each method of calculation, rather than only the numerical rates themselves. Accordingly it is wrong to compare the Judgments Act Rate with the contractual rate of 15% p.a.. Rather, it is appropriate to calculate the total amount that would be payable under Rule 2.88(7) based on each method of calculation. On this basis, the Judgments Act Rate gives rise to a total amount of £80,000 (being 8% p.a. on the provable debt of £1,000,000 from the Date of Administration to the date of payment of the provable debt in full), whilst the terms of the contract give rise to only £821.92 (being 15% p.a. for the two days in which interest was accruing under the contract). Since the amount of interest at the Judgments Act Rate is greater than the amount of interest at the rate applicable apart from the administration, the creditor is entitled to £80,000.

(3) This is not inconsistent with declaration (xiii) of the Part A Order, because the amount of interest at the rate applicable to the debt apart from the administration is being calculated from the Date of Administration. It is simply that, for the first 363 days of that period, the rate applicable to the debt apart from the administration is a zero rate.

(4) The Administrators' answer is also consistent with declaration (xiv) of the Part A Order: the creditor is receiving interest on the provable debt at the Judgments Act Rate (in the sum of £80,000) for the whole of the period from the Date of Administration to the date of payment of the provable debt in full. Statutory interest is thus being paid in respect of an admitted provable debt which was a contingent debt as at the Date of Administration from the Date of Administration.

19. Further, for the purpose of assessing which is the greater, the amount of interest at the Judgments Act Rate should be calculated for the whole of the period, and the amount of interest at the contractual rate should be calculated for the whole of the period. There is no basis in Rule 2.88(9) for saying that a creditor may claim interest at the Judgments Act Rate for part of the period and a contractual rate for the remainder of the period.

20. The Administrators' analysis is supported by the reasoning in the Part A Judgment. In paragraph 22 of that Judgment, the Judge held:

> "*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*" (emphasis added).

21. The Administrators' answer to Supplemental Issue 1C is consistent with this reasoning: the rate of interest applicable to the debt apart from the administration in the example above is 15% p.a. but this is meaningless if expressed only as a number without taking account of the period to which the number applies.

22. In paragraph 23 of the Part A Judgment, the Judge held:

> "*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*".

23. The same reasoning applies to Supplemental Issue 1C. If the Administrators' position were wrong, it would follow that a debt which by its terms carried interest at 15% p.a. **for a period of only two days** would 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% p.a. **for a period of 365 days**.

24. In paragraph 24, the Judge held:

> "*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. In the Administrators' submission, this observation is equally applicable to the SCG's answer to Supplemental Issue 1C: the suggestion that a creditor is entitled to claim a **contractual rate** of 15% p.a. for a **non-contractual period** of 365 days is not in accordance with the contractual entitlement but is unprincipled with no foundation in logic or law.

26. Further, the SCG cannot draw support from paragraph 225 of the Part A Judgment for its contention that the amount of interest is calculated at the "*rate applicable to the debt apart from the administration*" from the Date of Administration regardless of when that rate actually became contractually applicable (paragraph 14(4) of its written submissions). Paragraph 225 was directed specifically at Issues 6, 7 and 8 and it states

only that the exercise of *comparison* between the Judgments Act Rate and the "*rate applicable to the debt apart from the administration*" is referable to the period beginning with the Date of Administration; the Judge did not consider (and was not asked to consider) the discrete question raised by Supplemental Issue 1C. Further, for the reasons set out above (and in Wentworth's written submissions), the Judge's conclusions on Issues 6, 7 and 8 do not mandate the answer to Supplemental Issue 1C contended for by the SCG.

27. Accordingly, the Administrators invite the Court to conclude that, in the circumstances identified by Supplemental Issue 1C, the rate applicable under the contract is a zero rate for any period in which, under the contract, no interest is payable.

28. Further, for the purpose of Rule 2.88(9), statutory interest should be calculated by assessing the greater of the "*rate applicable*" and the Judgments Act Rate for the whole of the period between the Date of Administration and the date of payment in full and not separately for the periods prior to and post the commencement of contractual interest.

29. For completeness, the Administrators wish to draw to the Court's attention the fact that they have considered whether, to ensure that all available arguments are before the Court, it would be appropriate for them to make submissions to the effect that the correct approach is to "disaggregate" the post-administration period into the periods pre- and post- the debt becoming payable so that, prior to the debt becoming due, the Judgments Act Rate applies but, once the debt has become due, the contractual rate (if greater than 8%) applies (the "**Disaggregation Approach**").

30. Their conclusion was that it was not necessary to do so because the Disaggregation Approach is plainly wrong. The comparison required by Rule 2.88(9) is between the Judgments Act Rate and the rate applicable apart from the administration, in each case from the Date of Administration; the wording of Rule 2.88(9) neither mandates nor permits a "mix and match" approach.

SUPPLEMENTAL ISSUE 2

"*Whether and (if so) in what circumstances and in what manner a Currency Conversion Claim can arise from the discharge of a debt by way of set-off pursuant to Rule 2.85(3)*".

31. The Respondents' positions on this Issue, which are considered more fully below, are as follows:

    (1) York says that a Currency Conversion Claim can arise from the discharge of a debt by way of set-off pursuant to Rule 2.85(3) where Sterling has depreciated against the foreign currency of the claim in the period between the Date of Administration and the set-off date (even where the claim and the cross-claim were both originally in the same foreign currency);

    (2) The SCG's written submissions refer back to the preliminary position adopted by it in paragraphs 442 and 443 of its Part A skeleton argument and it proposes to develop its position on this Issue after reviewing the arguments advanced by the other parties. The SCG's preliminary position was broadly to the same effect as that now contended for by York; and

    (3) Wentworth's position is that no Currency Conversion Claim arises from the discharge of a debt by way of set-off because set-off has substantive effect, discharging both the creditor's claim against the company and the company's claim against the creditor, with the balance payable one way or the other being the only substantive surviving debt.

32. Like Wentworth, the Administrators submit that a Currency Conversion Claim cannot arise from the discharge of a debt by way of set-off pursuant to Rule 2.85(3).

Substantive and non-substantive provisions of insolvency law

33. In the Administrators' submission, the starting point in the analysis is the distinction between the ***substantive*** and ***non-substantive*** parts of the statutory insolvency code.

(1) The substantive parts have the effect of permanently altering the rights of the parties. They do not apply solely for the purpose of the insolvency proceedings. After the conclusion of the insolvency proceedings, the rights of the parties survive (if at all) only in their altered form.

(2) The non-substantive parts, by contrast, apply solely for the purpose of the insolvency proceedings. In the case of non-substantive parts of the insolvency code, the rights of the parties are not permanently altered and may be resumed in their original form at the end of the insolvency process.

34. It is well established that the statutory process of *pari passu* distribution is generally non-substantive in effect. It "*leaves the debts of the creditors untouched*" and "*does not either create new substantive rights in the creditors or destroy the old ones*" (*Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 per Lord Hoffmann at [27]).

35. This means that, when the process of *pari passu* distribution comes to an end, the creditor is "*remitted to his rights under his contract*" (*Re Humber Ironworks & Shipbuilding Co* (1869) LR 4 Ch App 643 per Sir G M Giffard LJ at [647]).

36. By contrast, insolvency set-off under Rules 2.85 and 4.90 does have substantive effect by permanently extinguishing rights: see *Stein v Blake* [1996] AC 243 per Lord Hoffmann at [251] ("*Bankruptcy set-off, on the other hand, affects the substantive rights of the parties*"). See also *Re Lehman Bros International (Europe) (in administration) (No 4)* [2015] 3 WLR 1205 per Briggs LJ at [150], holding that "*the regime for insolvency set-off in rule 4.90 provides by way of contrast a useful example of a rule which does have substantive permanent effect, and it is couched in terms which make no mention of any limited purpose*".

37. Accordingly, where part of a creditor's claim has been discharged by operation of insolvency set-off, the creditor is not remitted to those former rights at the end of the process of distribution. Rather, since the effect of the set-off is substantive, the discharged part of the claim has gone forever.

Conversion of foreign currency claims

38. The conversion of foreign currency into Sterling is also part of the statutory insolvency code. However, it is meaningless to ask in the abstract whether currency conversion is substantive or non-substantive. Conversion is only ever performed for a purpose.

39. This is clear from the Rules themselves: Rule 2.85(6) requires conversion to occur "*for the purpose of* [Rule 2.85]" (i.e. for the purposes of a process with substantive effect); whilst Rule 2.86(1) requires conversion to occur "[for] *the purpose of proving a debt incurred or payable in a currency other than sterling*" (i.e. for the purpose of a process with a non-substantive effect). See also *Re Lehman Bros International (Europe) (in administration) (No 4)* [2015] 3 WLR 1205 per Briggs LJ at [149] –[150], emphasising the importance of the draftsman's reference to conversion for a specific "purpose".

40. In other words, the conversion of foreign currency claims into Sterling takes place not for its own sake but as an integral part of some wider process.

41. In the Administrators' submission, it is the nature of this wider process that will determine whether the effects are substantive or non-substantive.

Conversion for a non-substantive purpose

42. First, if the conversion of foreign currency claims into Sterling is taking place for the purpose of the *pari passu* payment of dividends on provable claims, it is clear that there is no substantive effect on creditors' rights.

43. This is because the process of *pari passu* distribution is not a substantive one; and it follows that the conversion which takes place for the purpose of that process is not substantive either. See, for example, *Re Lehman Bros International (Europe) (in administration) (No 4)* [2015] 3 WLR 1205 per Moore-Bick LJ at [250], rejecting Lewison LJ's "*proposition that the conversion of a foreign currency debt into sterling* ***for the purposes of proof*** *has a substantive effect*" (emphasis added).

44. Accordingly, in the case of conversion for the purpose of the *pari passu* payment of dividends on provable claims, there remains the possibility of remission to contractual rights, so as to give rise to a Currency Conversion Claim. "*If the foreign currency debt has not been fully discharged by payment out of dividends […] there is no reason why the creditor should not recover the balance as an unprovable claim*" (*Re Lehman Bros International (Europe) (in administration) (No 4)* [2015] 3 WLR 1205 per Moore-Bick LJ at [251]).

Conversion for a substantive purpose

45. By contrast, if the conversion is taking place as part of the process of insolvency set-off, which does have substantive effect, the outcome will be different.

46. Since the conversion in that context occurs as an integral part of a process with substantive effect, the creditor's rights will be permanently altered and the notion of remission to the creditor's former rights will be conceptually impossible.

Set-off cannot give rise to Currency Conversion Claims

47. For this reason it is submitted that set-off cannot give rise to Currency Conversion Claims. The set-off is substantive in effect: it results in part of the creditor's original rights being permanently extinguished or discharged. It follows that there can be no remission to that part of those rights at the end of the insolvency proceedings: they have been extinguished permanently and cannot be revived.

48. The fact that claims in foreign currencies may be converted to Sterling for the purpose of set-off does not affect this analysis. The set-off has substantive effect whether the original claims were denominated in Sterling or a foreign currency.

49. Further, the fact that conversion of foreign currency claims into Sterling gives rise to the prospect of remission to contractual rights in *non-substantive* contexts does not mean that conversion *always* gives rise to such a prospect or that it does so when it takes place as part of a process with *substantive* effect.

50. In other words, where foreign currency claims are converted for the purpose of set-off, it is not the process of conversion which has substantive effect. Rather, it is the set-off which has substantive effect. The consequence of the taking of the set-off account is that a part of the creditor's pre-insolvency rights has permanently gone, with the result that the creditor cannot thereafter be remitted to it.

51. This is consistent with the reasoning of both the majority and the minority of the Court of Appeal in *Re Lehman Bros International (Europe) (in administration) (No 4)* [2015] 3 WLR 1205. Lewison, Briggs and Moore-Bick LJJ agreed that set-off had substantive effect: see [94], [150] and [250]-[251]. The question was whether conversion *for the purposes of proof* would also have substantive effect. Lewison LJ held that conversion in the proof process would have substantive effect; Briggs and Moore-Bick LJJ held that it would not have substantive effect, because it was not occurring in that context for any substantive purpose; rather, it was occurring as part of the process of *pari passu* distribution which did not produce substantive effect.

52. The conclusion that conversion for the purpose of set-off produces substantive effects is clear from Briggs LJ's judgment at [152]:

> "*There is […] no logical reason why a provision for conversion into sterling of a foreign currency amount by reference to a historical date should necessarily operate as a substantive permanent alteration of the creditor's contractual rights,* ***except only to the extent that set-off is involved***" (emphasis added).

53. Further, Briggs LJ held at [153]:

> "*The potential for injustice caused by the permanent conversion of a foreign currency debt into sterling is entirely the result of the inevitable gap in time between the conversion date and the payment of dividends … But* ***absent set-off*** *there is no reason why the conversion for the purpose of proof should be anything more than a means of part-payment which is fair as between all proving creditors, leaving the foreign currency creditor with a remedy against a surplus if (but only if) sterling has depreciated in the meantime, and after all proving creditors have been paid in full with statutory interest*" (emphasis added).

54. The substantive effect of set-off involving conversion may be illustrated with a simple example. Assume that, at the Date of Administration, LBIE owed US$100 to a creditor, which owed £50 to LBIE. Assume further that, at the Date of Administration, the exchange rate was US$2 to £1. The creditor's claim against LBIE is converted into Sterling at that rate for the purpose of set-off and it is worth £50. As a result of insolvency set-off, the creditor's claim against LBIE is worth the same amount as LBIE's claim against the creditor. These sums are set off against each other and the result is that both claims are extinguished. After the set-off, LBIE's rights against the creditor have gone forever; and the creditor's rights against LBIE have gone forever. Set-off has a substantive effect. There is no basis for saying that, as a result of currency movements, the creditor's rights against LBIE might subsequently revive, any more than there is for saying that, if the exchange rate were to move the other way, LBIE's claim against the creditor might revive. The reality is that, as a result of substantive set-off, there is nothing remaining to which either of the parties may subsequently claim to have been remitted.[1]

55. Further, the substantive nature of the set-off means that the creditor cannot claim that part of his foreign currency debt was extinguished by insolvency set-off for the purpose of the insolvency proceedings but not otherwise. Rather, as a result of the substantive nature of the set-off, the part of the creditor's foreign currency claim that was appropriated for the purpose of the set-off account is extinguished for all purposes.

York's contentions

56. York argues that insolvency set-off can give rise to a Currency Conversion Claim.

57. In the Administrators' submission, York's arguments are wrong.

58. York's main point appears to be that set-off is the equivalent of payment and that, if payment can give rise to a Currency Conversion Claim, set-off must also be able to

[1] The outcome is the same, of course, if the claims were both originally in Sterling (such that, e.g., £50 is set off against £50), or if the claims were both originally denominated in a foreign currency (such that, e.g., $100 is converted to £50 in one direction and €75 is converted to £50 in the other). The substantive effect of set-off causes the two claims to be extinguished.

give rise to a Currency Conversion Claim. York refers to "*payment by way of set-off, rather than solely by way of dividends*" (York's written submissions at [11]) and asserts that "*a recovery made by the creditor by way of set-off is the same as a recovery made by way of dividends on proved debts*" (ibid. at [15]). York says that, in circumstances where a foreign currency claim may arise on the payment of a dividend, "[the] *position is the same where the foreign currency creditor receives payment of his claim by way of set-off rather than by way of dividends*" (ibid. at [24]).

59. This is wrong for the reasons explained above. The important difference between set-off and payment, which York fails to address, is that set-off is substantive, resulting in the extinction of rights, whereas the payment of a dividend in corporate insolvency proceedings is not substantive. The payment of dividends is not the equivalent of the discharge of a personal bankrupt which extinguishes his debts (see *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 per Lord Hoffmann at [27]).

60. York relies on the fact that, in administrations, there is a timing difference between the currency conversion date and the set-off date: see York's written submissions at [21]-[22]. In summary, York says that, whilst the conversion takes place by reference to the exchange rate on the date of the appointment of the administrator (see Rule 2.86(1)), the set-off occurs on the date of the administrator's notice of intention to make a distribution (see Rule 2.85(3)).

61. York is of course correct to say that the conversion takes place by reference to the exchange rate on the date of the appointment of the administrator. This applies to both the claim and the cross-claim. Rule 2.86 provides for the creditor's claim against the company to be converted into Sterling at the official exchange rate prevailing on the date when the company entered administration; and Rule 2.85(6) provides that the company's claim against the creditor shall also be converted into Sterling at the official exchange rate prevailing on the date when the company entered administration. The same exchange rate (namely, the exchange rate as at the Date of Administration) is therefore applicable to both the claim and the cross-claim.

62. However, the timing difference in administration between the currency conversion date and the set-off date does not change the substantive nature of the extinction which

occurs as a result of insolvency set-off. The part of the creditor's foreign currency debt appropriated for the purpose of the set-off is forever extinguished and, as a consequence, it is impossible for the creditor subsequently to be remitted to it.

63. Further, the fact that York's contentions are wrong is demonstrated by paragraph 27 of York's own written submissions, in which York contends that a Currency Conversion Claim may arise from insolvency set-off even where the claim and the cross-claim are both denominated in the same foreign currency (and even where they are both identical in amount). York gives the example in paragraph 27 of its written submissions of a claim of US$100 and a cross-claim also of US$100. York says that, when the claim and the cross-claim are set off against each other under Rule 2.85, the creditor may obtain a Currency Conversion Claim. In York's example, the amount of this Currency Conversion Claim is US$8.01.

64. In the Administrators' submission, this is wrong. Since the claim of US$100 has been set off against the cross-claim of US$100, the creditor has obtained full value for his debt (whether considered in its original currency or in Sterling), which has been extinguished. There is no possibility of a Currency Conversion Claim in such circumstances. Further, since both claims are originally denominated in US Dollars, the precise exchange rate used to convert them into Sterling should make no difference, since it is the same exchange rate on both sides of the equation. Whether one compares the two claims in Sterling or in their original currency, they are of the same value; there is a zero net balance and no surviving right to which any party can be remitted.

65. In any event, as explained above, Rules 2.85(6) and 2.86 make clear that the exchange rate to be used to convert the claim and the cross-claim into Sterling is the exchange rate as at the Date of the Administration. Applying that exchange rate, the Sterling amount of the claim will be the same as the Sterling amount of the cross-claim. The two amounts being equal, they will cancel each other out. The idea that the creditor can obtain a Currency Conversion Claim in such circumstances is, in the Administrators' submission, without foundation, and demonstrates the illogicality of, and lack of principle in, York's argument on this point.

66. Further, the financial outcome of insolvency set-off will not vary by reference to the date on which it takes place. Rather, the financial outcome for the creditor is fixed by the Rules and will always be determined by reference to the exchange rates as they stood as at the Date of Administration: see Rules 2.85(6) and 2.86 of the Rules. Consequently, whether there is a long or a short period between the Date of Administration and that of the Rule 2.95 notice, and whether movements in exchange rates have caused Sterling's value to diminish or appreciate in that period, the result of the set-off calculation will be the same.

The SCG's contentions

67. The SCG has previously argued that insolvency set-off can give rise to a currency conversion.

68. It argued in paragraphs 442(4) and (5) of its Part A first skeleton that, in the set-off context, "*the creditor's foreign currency claim is converted to sterling at the exchange rate prevailing on the date when the company entered administration and is* ***paid (to the extent of the applicable set-off)*** *as at the date of the notice of proposed distribution*" (emphasis added).

69. This reasoning also involves the mistake of assuming that set-off is equivalent to payment. The reality (as explained above) is that there is an important difference: insolvency set-off results in the substantive extinction of the creditor's underlying rights whereas the payment of a dividend does not.

Wentworth's position

70. Wentworth says that a Currency Conversion Claim will never arise from insolvency set-off.

71. For the reasons set out above, the Administrators consider Wentworth's position to be correct.

72. In particular, Wentworth is correct in stating that set-off has substantive effect (see Wentworth's written submissions at [26]).

73. Wentworth also notes that the time-lag in administrations between the conversion date and the insolvency set-off date "*has no impact on the substantive nature of set-off*" (ibid. at [30]). The Administrators agree with this observation for the reasons set out above.

Conclusion

74. For these reasons, the Administrators submit that a Currency Conversion Claim cannot arise in the case of insolvency set-off.

75. In any event, the Administrators submit that a Currency Conversion Claim cannot arise from the application of insolvency set-off where the claim and the cross-claim are both originally denominated in the same foreign currency, as the exchange rate for conversion purposes is the same for both.

SUPPLEMENTAL ISSUE 3

"*Whether, and if so to what extent, a non-provable claim to interest on a currency conversion claim should be reduced by interest received by the creditor pursuant to Rule 2.88 on its proved debt*".

76. The Respondents' positions on this Issue are as follows:

    (1) The SCG contends that there should be no reduction of a non-provable claim to interest on a Currency Conversion Claim by reference to interest received pursuant to Rule 2.88(7);

    (2) Wentworth contends that there should be such a reduction; and

    (3) York takes no position.

77. The Administrators, consistent with the SCG's position, consider that there should be no such reduction. In addition to the Administrators' own submissions (as set out below), the Administrators agree with the SCG's arguments in support of its position on this Issue.

78. Statutory interest is paid on the proved debt. It is not paid in satisfaction of a creditor's contractual entitlements to interest. There can be no obligation to give any credit for statutory interest received when calculating either Currency Conversion Claims, or non-provable claims for interest payable on Currency Conversion Claims (on which no statutory interest has been paid).

79. Declaration (xvii) of the Part A Order states: *"The calculation of a non-provable claim … should not take into account (nor, therefore, be reduced by) the Statutory Interest paid to a relevant creditor*". That declaration is worded to include (without limitation) non-provable Currency Conversion Claims, but the reasoning applies equally to other types of non-provable claims including non-provable claims to interest.

80. Further, the Administrators submit that there are three parts of the Part A Judgment which are particularly relevant to this Issue:

(1) First, the Judge held at paragraph 164 of the Part A Judgment that Rule 2.88 is a "*complete code*" for interest on proved debts after the Date of Administration. There is no connection between statutory interest on a proved debt in Sterling and any contractual interest on a non-provable debt in a foreign currency. Since there is no connection there is no need to give credit for statutory interest when calculating interest on non-provable debts.

(2) Secondly, the Judge held at paragraph 169 of the Part A Judgment that the existence of a complete code for interest on proved debts does not interfere with the enforcement of this contractual right as part of a non-provable claim. Accordingly, if the contract between the company and the creditor provides for interest on any unpaid part of the debt, the creditor is entitled to include such interest as part of his non-provable claim. This entitlement to interest is dependent on a remission to contractual or other rights existing apart from the administration and is not affected by Rule 2.88(7).

(3) Thirdly, in paragraph 228 of the Part A Judgment, the Judge rejected Wentworth's submission that the Currency Conversion Claim should take into account the payment of statutory interest. The Judge held that statutory interest under Rule 2.88 is payable only on proved debts and that it is not paid in or towards the satisfaction of a creditor's contractual right to interest and concluded in paragraph 231 that "*the calculation of a currency conversion claim should not take into account the statutory interest paid to the relevant creditor*".

81. Wentworth's argument at paragraph 36 of its written submissions – that there is "*in fact only ever one debt owed to the creditor and, therefore, any interest relating to the period after the Date of Administration, whether it be Statutory Interest pursuant to Rule 2.88 or interest on the Currency Conversion Claim, is payable in respect of the same debt from the same date*" – is fundamentally misconceived because it cuts across each of the Judge's findings as set out in the paragraph above.

82. In the Administrators' submission, it follows that a non-provable claim to interest on a Currency Conversion Claim should not be reduced by interest received by the creditor pursuant to Rule 2.88(7) on its proved debt.

SUPPLEMENTAL ISSUES 4 AND 5

83. Consistent with the approach that the Administrators took in Part B generally, they do not make any submissions on Supplemental Issues 4 and 5.

84. However, in case it is of any assistance to the Court, the Administrators wish to explain the origin and purpose of Supplemental Issues 4 and 5.

85. Supplemental Issue 4 relates to the impact of releases under the CRA and/or CDDs on non-provable claims to interest, which the Judge found do not exist in his Judgment on Issue 2A (paragraph 39 of the application notice). The Judge accepted at the consequential hearing on 9 October 2015 that it may be desirable to have this question determined now in order to cater for the possibility of that decision being reversed on appeal. The Judge further indicated that he would consider whether to make such declarations having been reminded by the parties of the submissions made to him on this question previously.

86. Supplemental Issue 5 relates to the impact of releases under the CRA and or CDDs on a non-provable claim to interest on a CCC. Submissions were not made on this issue at first instance, as the possibility of such a claim has only arisen from the Part A Judgment itself (see, in particular, paragraph 169 of the Part A Judgment).

87. As stated above, the Administrators do not propose to make any substantive submissions on either of these Supplemental Issues but would be assisted by the Court's determination of them.

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