IN THE HIGH COURT OF JUSTICE **No. 7942 of 2008**

CHANCERY DIVISION

COMPANIES COURT

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

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 SÀRL
(3) HUTCHINSON INVESTORS LLC
(4) WENTWORTH SONS SUB-DEBT SÀRL
(5) YORK GLOBAL FINANCE BDH LLC

Respondents

SKELETON ARGUMENT OF YORK GLOBAL FINANCE BDH LLC

for the trial of the Waterfall II Part A Issues

commencing 16 February 2015

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INTRODUCTION

1. This skeleton argument is on behalf of the Fifth Respondent, York Global Finance BDH, LLC ("**York**"), and is filed and served pursuant to paragraph 21 of the Order of David Richards J dated 21 November 2014. In accordance with that Order, it deals with Issues 1 to 8, 28 to 33, 37 and 39 in the Application Notice of 12 June 2014.

2. York is one of four co-participants in five claims against Lehman Brothers International (Europe) ("**LBIE**"), legal title to which is held by Banc of America Credit Products, Inc ("**BACP**"). The other co-participants in the claims are RMF Liberty LLC, SCPC Group LLC and OZ LV Holdings LLC. These co-participants have authorised York to act as a respondent to the present application on their behalf.

3. The claims are referred to as the "**LibertyView Claims**" as the original holders of the claims were five funds managed by LibertyView G.P., LLC (the "**LibertyView Funds**"). The claims arise under New York law-governed prime brokerage agreements to which LBIE was a party.

4. The claims are not subject to the Claim Resolution Agreement. However, the claims of each LibertyView Fund are the subject of a separate Claims Determination Deed ("**CDD**") dated 26 March 2013. Pursuant to such CDDs, the claims were agreed as unsecured claims against LBIE in the total amount of US$676.25 million.

5. The LibertyView Funds entered into prime brokerage agreements with Lehman Brothers, Inc ("**LBI**") and LBIE. Four of the funds entered into such documentation in August 2005 and one in July 2007. The documentation for each fund is, for all material purposes, identical. The prime brokerage documentation included:

   (1) a New York law Customer Account Prime Brokerage Agreement ("**PBA**");

   (2) a New York law Margin Lending Agreement ("**MLA**"); and

   (3) a New York law Global Master Securities Lending Agreement ("**GMSLA**"), which was incorporated into the MLA.

6. In summary, pursuant to these agreements the LibertyView Funds deposited cash and securities with LBIE under the MLA, which LBIE held as security for amounts owed to LBIE, particularly in respect of cash margin loans advanced by LBIE under the MLA or securities loans made by LBIE under the GMSLA[1].

7. At the time of the commencement of LBIE's administration on 15 September 2008, a significant proportion of the cash and securities deposited by the LibertyView Funds with LBIE had been the subject of rights of use exercised by LBIE such that, unless and until LBIE returned the cash and/or securities to the custodian accounts, the LibertyView Funds would not have any proprietary interest in such cash and/or securities.

8. Under the agreements, the relevant LibertyView Fund was not entitled to call at any time for delivery of its cash and securities. Under the MLA, LBIE was only obliged to release any of the collateral when all obligations owed by the relevant LibertyView Fund to LBIE (and all other affiliates of LBIE) had been satisfied. Under the terms of the GMSLA, a LibertyView Fund could only close out a securities loan by actually returning the relevant securities to LBIE.

9. The LibertyView Funds did not have a unilateral right to terminate any of the PBA, MLA or GMSLA upon LBIE's administration. In particular, they did not have any right to terminate and close out all outstanding transactions resulting in a single net balance due to or from LBIE.

10. On 26 March 2013 each LibertyView Fund entered into a CDD with LBIE setting out its "Agreed Claim Amount" (in US dollars) that is admitted as an "Admitted Claim" qualifying for dividends from the estate of LBIE.

11. Each of the LibertyView Funds transferred all its rights in respect of the claims to BACP under five separate claims assignment agreements each dated 16 August 2013. On the same day, BACP granted participations in each of the acquired claims in favour of York and the four co-participants.

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1 In practice, all of the LibertyView Funds' assets were held with LBIE under the MLA, even if those assets were initially deposited into the relevant LibertyView Fund's account with LBI opened under the PBA.

STATUTORY INTEREST

Issue 1: Whether Statutory Interest is simple or compound

12. Issue 1 asks:

> *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?*

13. All the parties are agreed that statutory interest is payable on a simple basis where the rate applicable is the Judgments Act rate.

14. In their Position Paper, the Administrators raise a further issue as to the manner in which such interest is to be calculated[2].

15. As to this, York submits that when calculating the daily rate, the annual rate is always divided by 365, even in a leap year. This is because statutory interest in an administration is calculated the same way as statutory interest under the Judgments Act 1838, and statutory interest under the Judgments Act is always based on a 365-day year.

Interest under Rule 2.88 to be calculated the same way as interest under the Judgments Act

16. The intention of rule 2.88 is to give creditors rights equivalent to those they would have had if they had not been prevented by the insolvency proceedings from obtaining judgment which would then carry interest at the judgment rate. As David Richards J said in *Waterfall I* [2014] 3 WLR 466 at [163]:

> *"The justification for statutory interest, even in those cases where the debts do not already carry a right to interest, is that the creditors are prevented by the liquidation regime from obtaining judgment against the company which would then carry interest at judgment rate."*

17. Similarly, commenting shortly after the introduction of statutory interest, Eden says in his *Digest of the Bankrupt Law*, 3rd ed. (1832), p.393:

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2 Joint Administrators Position Paper para. 8.

> *"It may be objected to this provision, that it is giving the creditor what he never contracted for, viz. interest. This is true; but then the bankrupt has taken away from him what he did contract for, viz. the capacity of compelling instant payment by process of law."*

18. Statutory interest should therefore put the creditor in the position he would have been in had he been able to obtain a judgment against the debtor, carrying interest at the Judgments Act rate.

Interest under the Judgments Act always simple

19. Interest under the Judgments Act is always simple. Furthermore, even where the court has discretion to alter the rate (such as the discretion under the Administration of Justice Act 1970 section 44A, where a judgment debt is expressed in a foreign currency), the rate is still simple, and never compound. As Roth J said in *Slocom Trading Ltd* v *Tatik Inc* [2013] EWHC 1201 (Ch) at [44]:

> *"Section 44A does not disapply s. 17 of the Judgments Act 1838 in the case of a foreign currency judgment but merely displaces the rate applicable under that statute with a general discretion to determine the rate. I do not think that alone is sufficient to give the court power to order that the rate be compounded: that would be a significant change which would, in my view, require clearer wording."*

20. This can act harshly on creditors who were entitled to a compound rate under their underlying claim which then merged into the judgment. Even though the Judgments Act rate is 8%, over time, the interest accrued may be less than a lower rate of interest which compounds with regular stops. This led foreign currency judgment creditors to contend for a higher, simple rate of interest in order to mimic the effect of compound interest. However, as Christopher Clarke J held in *Novoship (UK) Limited* v *Mikhaylyuk* [2013] EWHC 89 (Comm):

> *"The fact that compounding will cease is a necessary consequence of the giving of judgment, unless, perhaps, there is an agreement that compounding will apply as well after as before judgment. It does not, in my judgment, constitute a ground, or at any rate a sufficient ground, for selecting a rate different to the one which I propose."*

21. The Court of Appeal unanimously upheld this part of the decision at [2014] EWCA Civ 908.

Daily interest under the Judgments Act always based on a 365-day year

22. The Administrators' Position Paper raises a further question as to the way in which creditors' entitlements to statutory interest should be determined i.e. by converting the annual rate of 8% into a daily rate by dividing it by the number of days in a given calendar year or otherwise[3].

23. When judgment is given on a claim in sterling, it carries interest at 8% from the date of judgment. English law typically calculates simple interest on the basis of a 365-day year. This way, if judgment is given in a leap year but the debt is not paid until the following year, the daily interest rate is the same. This makes sense, since the debt is outstanding for the same amount of time regardless of whether part of the period for which it was outstanding falls in a leap year.

24. It is difficult to find authority for this proposition in respect of post-judgment interest. However, in respect of pre-judgment interest, an article printed 14 times (with relevant updates) since 1992 in the Law Society Gazette has stated that interest is "*paid daily on a 1/365th basis, even in a leap year*".[4]

25. This approach also accords with standard banking practice for temporary loans. As the Bank of England's Non-Investment Products Code (November 2011)[5] states:

> "*Because temporary loans may be repaid in less than one year (but may, of course, be continued for more than a year) interest on temporary money is almost invariably calculated on a daily basis. Thus any period which includes 29 February automatically incorporates that day in the calculation; 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.*"

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3 Joint Administrators Position Paper para. 8.

4 (1992) LS Gaz, 23 Sep, 89 (19); (1993) LS Gaz, 22 Sep, 90 (19); (1994) LS Gaz, 28 Sep, 91 (28); (1995) LS Gaz, 4 Oct, 92 (30); (1996) LS Gaz, 25 Sep, 93 (28); (1999) LS Gaz, 29 Sep, 40; (2003) LS Gaz, 2 Oct, 36; (2005) LS Gaz, 29 Sep, 36; (2006) LS Gaz, 9 Nov, 34; (2008) LS Gaz, 2 Oct, 23; (2009) LS Gaz, 1 Oct, 17; (2010) LS Gaz, 16 Sep, 25; (2011) LS Gaz, 8 Dec, 24; (2013) LS Gaz, 14 Jan, 19.

5 Earlier versions of the code, published in April 2009, December 2007 and January 2006 contain identical wording.

26. The same approach should be taken in respect of interest under rule 2.88. There is no justification for awarding a lesser sum of interest for days which happen to fall in a leap year.

Issue 2: Allocation of dividends to principal and interest

27. Issue 2 asks:

> *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.*

28. York's position is that, even if dividends have been paid in respect of principal, if there is subsequently a surplus in the estate such that post-insolvency interest becomes payable, the rule in *Bower* v *Marris* (1841) Cr & Ph 351 requires that the entitlement to such interest is calculated on the basis that dividends are allocated first to keeping down the interest, and then in reduction of the principal.

Post-insolvency interest

29. It is helpful to begin the analysis by tracing the development of the right to post-insolvency interest.

30. In *Bromley* v *Goodere* (1743) 1 Atkyns 75, the bankruptcy of Sir Stephen Evance had lasted over 30 years. After paying 20s in the £, the assignees discovered that there was a surplus. Creditors under bonds and notes, whose debts carried an entitlement to interest, claimed interest for the period following the commencement of the bankruptcy. Lord Hardwicke LC held that the creditors were entitled to such interest, on the basis that the surplus to be paid over to the bankrupt was only the surplus remaining after the payment of the whole debts i.e. including any interest accruing after commencement of the bankruptcy.

31. For present purposes, it is important to note the form of the order made by the Lord Chancellor:

> *"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 the principal ..."*
>
> (emphasis added)

32. *Bromley* v *Goodere* was applied by Lord Thurlow LC in *Ex parte Morris* (1790) 1 Ves Jun 132, by Lord Loughborough LC in *Ex Parte Mills* (1793) 2 Ves Jun 295 and by Sir William Grant MR in *Butcher* v *Churchill* (1808) 14 Ves Jun 567. In *Ex parte Koch* (1813) 1 V & B 343, 346, Lord Eldon LC made an order in exactly the same form as that made in *Bromley* v *Goodere*.

33. The first express provisions for statutory interest then appeared in the Bankruptcy (England) Act 1824 at section 129. This provided that, in the event of a surplus, creditors were entitled to receive interest at a rate of 4%. This was so whether the creditor had a contractual entitlement to interest or not.

> *"And be it enacted, That the Assignees shall, upon Request made to them by the Bankrupt, declare to him how they have disposed of his Real and Personal Estate, and pay the Surplus, if any, to such Bankrupt, his Executors, Administrators or Assigns; and every such Bankrupt, after the Creditors who have proved under the Commission shall have been paid, may recover the Remainder of the Debts due to him; but the Assignees shall not pay such Surplus, until all Creditors who have proved under the Commission shall have received Interest upon their Debts, to be calculated and paid at the Rate and in the Order following; (that is to say), 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 Proof thereof; 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 Proof at the Rate of Four per Cent."*
>
> (emphasis added)

34. A similar provision was then included in the Bankruptcy (England) Act 1825 at section 132:

> *"And be it enacted, That the Assignees shall, upon Request made to them by the Bankrupt, declare to him how they have disposed of his Real and Personal*

Estate, and pay the Surplus, if any, to such Bankrupt, his Executors, Administrators or Assigns; and every such Bankrupt, after the Creditors who have proved under the Commission shall have been paid, shall be entitled to recover the Remainder of the Debts due to him; but the Assignees shall not pay such Surplus until all Creditors who have proved under the Commission shall have received Interest upon their Debts, to be calculated and paid at the Rate and in the Order following; (that is to say,) 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 Four Pounds per Centum."

(emphasis added)

35. This was the statutory provision in force at the time of the decision in *Bower* v *Marris* in 1841. In that context, it is important to note two points. First, that section 132 provided for the payment of interest after the creditors who proved in the bankruptcy "*shall have been paid*". Secondly, that creditors were entitled to post-insolvency interest, irrespective of whether or not their debt carried a right to interest as a matter of contract.

36. A similar provision to section 132 of the 1825 Act appeared in the Bankruptcy Law Consolidation Act 1849 at section 197.

37. The Bankruptcy Act 1883, section 40(4) and (5) then provided:

"(4) Subject to the provisions of this Act all debts proved in the bankruptcy shall be paid pari passu.

(5) If there is any surplus after payment of the foregoing debts, it shall be applied in payment of interest from the date of the receiving order at the rate of four pounds per centum per annum on all debts proved in the bankruptcy."

(emphasis added)

38. The Bankruptcy Act 1914 section 33(8) was in identical terms.

39. Section 33 of the 1914 Act only applied to bankrupt individuals. Although the Companies Act 1948 section 317 applied the bankruptcy rules to the winding up of

insolvent companies, it was held in *In re Rolls-Royce Co Ltd* [1974] 1 WLR 1584[6] and *Re Lines Bros* [1984] BCLC 215 that the winding up was solvent if there was a surplus, and since section 33(8) of the Bankruptcy Act only applied where there was a surplus, it could therefore never apply to a winding up.

Calculation of post-insolvency interest

40. It was the practice in bankruptcy that, where post-insolvency interest is payable in the event of a surplus, interest was calculated as if the dividends already paid had been paid first in satisfaction of interest and then in satisfaction of principal.

41. This was the Order made by Lord Hardwicke LC in *Bromley v Goodere* and by Lord Eldon LC in *Ex parte Koch.*

42. The point was then specifically addressed by Lord Cottenham LC in *Bower v Marris* (1841) Cr & Ph 351. At the start of his judgment, the Lord Chancellor framed the issue as follows:

> *"If there being a surplus of a bankrupt's estate, after paying 20s in the pound upon the debts proved, were not, unfortunately, a rare occurrence, this would be a very important case."*

The issue was therefore being considered expressly in the context that 20s in the pound had been paid on the debts proved.

43. The argument which was advanced in *Bower v Maris* on behalf of the insolvent estate was that the payments made by way of dividend had been appropriated in discharge of principal prior to interest. This argument was, however, rejected by the Lord Chancellor.

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6 Contrary to what Pennycuick VC says at 1589C, there were general provisions for the application of the bankruptcy rules in the winding up of an insolvent company before 1875: see for example the Joint Stock Companies Act 1844 (7 & 8 Vict. c.111, s.11), which provided that "*the law and practice in bankruptcy now in force shall extend, so far as the same may be applicable, to this Act, and to fiats in bankruptcy issued by virtue of this Act, and to all proceedings under such fiats, save and except as may be otherwise directed by this Act.*" That Act had been repealed by the time of *In re Barned's Banking Company* (1867-68) LR 3 Ch App 769, in which the Court of Appeal in Chancery declined to follow the rules of bankruptcy in a winding up case.

44. Lord Cottenham began his analysis by identifying a number of reasons why in principle it would be unjust for post-bankruptcy interest to be calculated other than on the basis that dividend payments were allocated first in satisfaction of interest and then in discharge of principal:

(1) In the normal course, the creditor is entitled to apply payments received from the debtor first in discharge of interest before discharge of principal. If a different rule applied because the payments are under a bankruptcy, then he would suffer a loss as result of the bankruptcy, even though there is a surplus in the bankruptcy.

(2) This would also be to confer a benefit on any solvent co-obligor, who would benefit from the creditor being obliged to treat payments made by the insolvent co-obligor as being applied first in discharge of principal.

(3) This would have the effect of removing part of the creditor's entitlement to his debt, both against the insolvent co-obligor and any solvent co-obligor:

> *"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 ..."*

(4) The purpose of the entitlement to post-bankruptcy interest conferred by section 132 of the 1825 Act must have been to place the creditor in as favourable a position as he would have been in absent the bankruptcy. However, allocating dividends to principal before interest, would place him in a worse position, and would cause the creditor to suffer but the bankrupt to benefit.

45. Lord Cottenham then rejected the contention that there was any appropriation under the Act of the dividend payments to the outstanding principal:

> *"The bankrupt's estate is taken from him by the commission; and, the law, in order to make an equal division amongst the creditors, pays to each a dividend upon the debt proved. But this is merely an arrangement for the convenience of the debtor's creditors. The bankrupt continues indebted for the principal and the interest accrued since the commission, although his certificate, if he obtains one, protects him against the liability to the debt; and,*

> *being so, payments ae made out of his estate to the oblige. Why should such payments have a different effect than they would have if made by a solvent obligor?"*

46. Lord Cottenham thought these reasons sufficient to require allocation of dividends to interest and then to principal for the purposes of calculating post-bankruptcy interest ("*If there had been no decision upon this subject, I should have thought these reasons conclusive in favour of the mode of calculation.*"). But, in any case, the line of authority from *Bromley v Goodere* onwards made clear that this was the position. Accordingly, Lord Cottenham was satisfied on both on principle and on authority that this was the correct result.

47. The position in relation to liquidation was considered in *In re Humber Ironworks and Shipbuilding Company* (1869) 4 Ch App 643. The issue in that case concerned the correct treatment in a liquidation of debts carrying interest. Selwyn LJ, who gave the principal judgment, held that where there was a surplus in the estate, then the entitlement to interest accruing after the date of the winding up order fell to be determined in accordance with the rule in *Bower v Marris*:

> *"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."*
>
> (emphasis added)

48. It is relevant to note (a) that *Bower v Marris* was described as the "*ordinary way*" of determining the account between the company and its creditors and (b) it was held to apply notwithstanding "*whatever manner the payments may have been made*".

49. The application of the rule in a liquidation was considered in *In re Lines Bros (No.2)* [1984] 1 Ch 438, 441G. In that case, the eminent counsel[7] involved all agreed that *Bower* v *Marris* was applicable. There was however an issue as to the manner of its application. As to this, Mervyn Davies J held initially as follows (at p.453):

> *"It is supposed, as I understand, that interest continues to run on the notionally unpaid capital of £589,681.94 thrown up by the Bower v Marris calculations. I am not satisfied that interest ought to be charged in respect of the period after 20 June 1978. I say that because all principal was in fact paid off on 20 June 1978: so that thereafter there was no principal owing that could carry interest. The capital sum of £589,681.94 is, to my mind, merely a notional figure. It is not capable of supporting an interest claim."*

50. The effect of the *Bower v Marris* calculation is that there will be a sum of notional principal remaining outstanding after payment of the dividends. Mervyn Davies J considered that, because this sum was merely notional, interest did not accrue upon it.

51. After Mervyn Davies J gave his first judgment, counsel applied to restore the case on the basis that *Bower* v *Marris* had been incorrectly applied. The agreed submissions of all the parties were that:

> *"interest does continue to be computed on the principal deemed outstanding until further payments have been made satisfying in full that deemed outstanding amount of principal. The reason is that the principle in Bower v Marris aims to bring about payment to the creditor of precisely that sum he would have received had no liquidation taken place by treating dividends paid as ordinary payments on account falling to be appropriated in the first instance to keeping down interest and thereafter to capital. If the Bower v Marris calculator stops at the date of the final dividend the creditor does not get payment in full of his debt and contractual interest and is thus not remitted to his contract in the full sense.*
>
> *"It is plain from the authorities that interest continues to be calculated until the notional principal balance is extinguished by actual payment. See Bromley v Goodere (1743) 1 Atk 75; Ex parte Mills (1793) 2 Ves Jun. 295; Butcher v Churchill (1808) 14 Ves Jun 567; Bower v Marris, Cr. & Ph. 351 and the Humber Ironworks case, LR 4 Ch App 643."*

52. These submissions were accepted by the judge.

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[7] David Graham QC, Robin Potts QC and Martin Moore for the liquidators, William Stubbs QC and Mary Arden for the creditor bank.

Foreign authorities

53. The rule in *Bower* v *Marris* has also long been applied in other common law jurisdictions.

54. In *O'Bierne* v *McMahon* (1835) 1 Jones (Jr Eq) 442, the Irish Court of Exchequer (Joy CB and Pennefather B) directed that payments made by a receiver to a judgment creditor should be allocated first to interest, then to principal, since this was "*the ordinary manner*". Although the judgment was for a sum due under a bond, the interest arose by operation of law, and was in addition to the penalty on the bond. The awarding of interest therefore had nothing to do with remission to contractual rights.

55. *Bower* v *Marris* was subsequently applied by Esten VC sitting in the Upper Canada Court of Chancery in *Re Langstaffe* [1851] OJ 238, 2 Gr 165.

56. *Gourlay* v *Watson* (1900) 2 Ct Session (5th Series) 761 concerned a trust for the benefit of the creditors which was to be "*dealt with in the same way as if the [relevant estate] had been sequestrated and administered by a trustee under the sequestration*" (p.769). The trustees paid 20s in the £, expressing the payment to be in respect of principal, and the creditors had granted a receipt for the final dividend as being "*the balance of the principal of our claim*" (pp.762-764). The creditors subsequently sought to argue, in line with *Bower* v *Marris*, that the payments had been in respect of interest first, then principal.

57. At first instance, the Lord Ordinary held that the creditors' receipt was "*quite inconsistent with their claiming now to go back and add to the principal year by year*" and that the creditors' argument failed because "*the debtors expressly appropriated to principal*" (p.765).

58. The decision was reversed on appeal. Lord Trayner opined at p.679 that

> *"a trustee making payment to creditors of dividends from a bankrupt's estate from time to time as the realisation of the state permits, is making, and only entitled to make, such payments generally towards the extinction of the creditors' claims, and cannot appropriate these payments to any specific part of these claims"*

and applied what he called:

> *"the general rule regarding the effect of appropriated payments – a rule which is the same in England as with us".*

59. It was no obstacle that the relevant statute, the Bankruptcy (Scotland) Act 1856, provided at section 52 that interest was only payable out of "*any residue of the estate after discharging the debts*" (see p.765 fn.3).

60. Lord Young and Lord Kingsburgh agreed, the former saying at p.768 that:

> *"Where a solvent debtor admittedly owes his creditor a certain sum consisting of principal and agreed-on interest to date, the idea of appropriation by him of a payment to account is absurd ... for no creditor would knowingly assent to the payment being otherwise imputed than as a payment to account of what was admittedly owing to him by the payer at the date of it".*

61. Lord Moncrieff also agreed, noting at p.770 that when the payor is solvent, he can agree with the payee how payments are to be appropriated, but

> *"when, as here, an estate is insolvent, or thought to be insolvent, and there is not any present prospect that the creditors will be paid even the principal of their debt in full, payments of dividends are made and accepted on a different footing. For the time the creditors' claim for accruing interest is ignored, and the dividends are paid nominally in extinction of the accumulated debt due at the date of the sequestration or trust for creditors, without any reference on either side to an ultimate claim for interest. Therefore the creditor's acceptance of such payments does not involve his consent to their being appropriated towards extinction of the principal.*
>
> *"But if it transpires that there is a surplus sufficient to pay both principal and interest in full, there is no reason why the creditor should be deprived for the debtor's benefit of any part of his full rights.*
>
> *"The analogy of the law of bankruptcy, both here and in England, is in accordance with this view."*

62. Clearly, even though earlier payments had previously been understood to have been on account of principal, once a surplus was discovered, interest was to be calculated as if those earlier payments had been on account of interest. It did not matter that the right to interest could not have arisen until after the principal was discharged.

63. In *Ohio Savings Bank & Trust Co* v *Willys Corporation* (1925) 8 F.2d 463, the US Court of Appeals for the 2nd Circuit expressly applied *Bower* v *Marris*.

64. In *Mackenzie* v *Rees* (1941) 65 CLR 1, 8-10, the High Court of Australia cited with approval the cases of *Bromley* v *Goodere, Ex parte Mills* and *Re Humber Ironworks*.

65. The Irish High Court applied *Bower* v *Marris* in *Re Hibernian Transport Companies Ltd (No.2)* [1991] 1 IR 271. Notably, the entitlement to interest in that case arose under section 86(1) of the Irish Bankruptcy Act 1988, which provided as follows:

> *"If the estate of any bankrupt is sufficient to pay one pound 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."*

That section applied to company winding up by virtue of section 284 of the Companies Act 1963, which applied the bankruptcy rules to the winding up of insolvent companies.[8] Carroll J ordered a *Bower* v *Marris* calculation.

66. The Supreme Court of New South Wales (McLelland CJ) expressly applied *Bower* v *Marris* in *Midland Montagu* v *Harkness* (1994) 14 ACSR 318.

67. The Ontario Superior Court of Justice applied *Bower* v *Marris* in *Attorney General of Canada* v *Confederation Trust Co* 65 OR (3d) 519. Notably, as in the Irish case of *Re Hibernian Transport Companies Ltd (No.2),* the interest in *Confederation Trust Co* arose under an insolvency statute, in this case, section 95 of the of the Canadian Winding-up and Restructuring Act, RSC 1985, which provided as follows:

> *"(1) The court shall distribute among the persons entitled thereto <u>any surplus that remains after the satisfaction of the debts and liabilities of the company</u> and the winding-up charges, costs and expenses...*
>
> *"(2) Any surplus referred to in subsection (1) shall first be applied in payment of interest from the commencement of the winding-up at the rate of five per cent per annum on all claims proved in the winding-up..."*

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8 English authorities such as *Re Fine Industrial Commodities Ltd* [1956] Ch 256 (which held that a company with a surplus available to pay interest was not insolvent and therefore not subject to bankruptcy law) were distinguished on the basis that the surplus in the Hibernian liquidation had not arisen from a realisation of assets that the company had always owned, but had arisen after the winding up order following payment of bank interest: see the earlier judgment at [1991] 1 IR 263.

(emphasis added)

68. It was argued that since the statute only gave a right to interest after payment in full of all provable claims, Parliament must have intended the opposite approach to a *Bower* v *Marris* calculation. Blair RSJ rejected this contention, and applied *Bower* v *Marris*, saying:

> *[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 ...*
>
> *[31] ... Absent a stipulation as to the manner of allocation of payments on a debt -- by agreement, course of conduct, or statute -- the general rule in debtor-creditor relationships is the same as the general rule in insolvency situations, namely that payments are credited on account of interest first, then principal ...*
>
> *[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 ...*
>
> *[33] ... While I agree with the respondents' submission that there is no inherent policy or goal of maximizing post-liquidation interest so 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 ...*

69. There are three points of note in relation to this:

(1) The statute gave a right to interest but only after the principal debts had been satisfied.

(2) In accordance with that statute, distributions had been made in satisfaction of the principal debts. Nevertheless, where a surplus arose, the entitlement to interest was to be determined on the basis that such payments were allocated first in discharge of interest.

(3) Creditors were to be made "*as whole as possible*" in respect of their claim to interest before members received anything.

70. In *Re Tahore Holdings Pty Ltd* [2004] NSWSC 397, the Supreme Court of New South Wales considered whether the principles in *Re Humber Ironworks* were applicable to interest payable on a judgment debt (rather than interest payable under a contract). After quoting from the authorities, Barrett J said at paras 11-12:

> *"implicit in those observations is the assumption that an obligation to pay interest will be contractual ... These references to contractual interest do not mean that interest payable by virtue of some other legally binding obligation stands on some different footing and is not comprehended by the principles stated. It is just that the interest obligation before the court in the particular cases was a contractual obligation*
>
> *"... the principles I have outlined by reference to the extract from Re Emilco [an Australian case applying Re Humber Ironworks] above, apply to interest required ... to be paid upon a judgment debt in exactly the same way as they apply to interest required by contract to be paid upon a contractual debt"*

71. The decision in *Re Tahore Holdings Pty Ltd* that there was no relevant difference between contractual interest and statutory interest was approved by a unanimous Supreme Court of South Australia (Mullighan, Nyland and Anderson JJ) *in Gerah Imports Pty Ltd* v *The Duke Group Ltd* [2004] SASC 178 [48]-[54].

Interest on legacies and debts owed by a testamentary estate

72. That the rule in *Bower* v *Marris* applies to statutory interest as well as contractual interest can be seen from the cases where interest is payable on a legacy in a will or in respect of a debt owed by the testamentary estate. In the wills context, interest on legacies typically arises under the rules of the court rather than by way of an express provision in the will.

73. By 1801 at the latest, there was an established rule of the court that legacies would bear interest at 4% from the anniversary of the testator's death: *Sitwell* v *Bernard* (1801) 6 Vesey Junior 520, 540. When the Rules of the Supreme Court were drawn up, the rule was codified in the RSC Ord.LV, moving later to Ord.44 r.19 and then to Ord.44 r.10. Today the rule is found in CPR PD 40A para.15 (see *Snell's Equity*, 33rd ed., 35-034).

74. In *Thomas* v *Montgomery* (1828) 2 Simons 348; 57 ER 819, the testator had died in 1810. In 1817, the court had directed the master to ascertain "*one-fourth part of the legacies and interest*", and pay it out to the legatees. Payment was made. In 1824, the master was directed to take an account of what was due to the legatees, and in so doing, he allocated the payments made in 1817 entirely to interest. The residuary legatees objected that the order had been to pay off both principal and interest. Sir Lancelot Shadwell VC upheld the master's calculation.

75. *Whittingstall* v *Grover* (1886) 55 Law Times 213, 217 concerned debts payable by the deceased. Some interest was payable by contract, other interest was statutory interest, the right to which was by then codified in RSC Ord. LV rr.62-63.[9] The issue in previous proceedings had been priority between the creditors whose debts carried contractual interest and those whose debts did not carry contractual interest. This set of proceedings concerned a dispute between the joint creditors and the several creditors, whose debts did not bear contractual interest, as to the priority of their claims. It was held that the several creditors had priority over the joint creditors, with the contractual interest several creditors having priority over the non-contractual interest several creditors. This was based on RSC Ord. LV rr.62-63, which provided as follows:

> Rule 62: *Where a judgment or order is made directing an account of the debts of a deceased person, unless otherwise ordered, interest shall be computed on such debts as to such of them as carry interest after the rate they respectively*

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9 It was subsequently held in *Re Whitaker* [1904] 1 Ch 299 that although interest in the administration of an estate is normally governed by the RSC, the administration of an insolvent estate (including an estate which is insufficient to pay interest in full) is governed by the Bankruptcy Act. The difference between the two regimes was that the Bankruptcy Act 1883 provided for all interest to be paid at 4%, while the RSC provided for contractual interest to be paid first at the contractual rate. Although this might have had an effect on the outcome of the case, it does not affect the applicability of *Bower* v *Marris*.

carry, and as to all others after the rate of four per cent. per annum from the date of the judgment or order.

Rule 63: *A creditor whose debt does not carry interest, who comes in and establishes the same before the judge in chambers under a judgment or order of the Court or of the judge in chambers, shall be entitled to interest upon his debt at the rate of four per cent. per annum from the date of the judgment or order out of any assets which may remain after satisfying the costs of the cause or matter, the debts established, and the interest of such debts as by law carry interest.*

(emphasis added)

Bower v *Marris* was applied to both the contractual and non-contractual interest, on the basis that all the dividends "*have been paid in process of law*".

76. In *Re Prince* (1935) 51 TLR 526, Clauson J reached the same conclusion in relation to legacies holding that:

> *"the principle in Bower v Marris as between debtor and creditor applies equally when the payer is an executor and the payee a legatee."*

77. In *Re Morley's Estate* [1937] Ch 491, 495 Simonds J considered the following issue (which is almost identical to Issue 2 in the present case):

> *"Whether in the events which have happened payments made to the several persons entitled to legacies under the will and codicils of the said testator on account of such legacies respectively ought to be treated as having been made:*
>
> *(a) In the first place on account of the principal of the said legacies and only when all principal has been satisfied on account of interest thereon; or*
>
> *(b) in the first place in satisfaction of interest on the said legacies accrued due down to the date of each such payment and subject thereto in satisfaction of the principal thereof; or*
>
> *(c) each payment rateably on account of the principal and interest due in respect of the said respective legacies at the date of each such payment."*

78. The court held that option (b) was the correct approach (p.496).

79. The Judge then considered whether previous orders to the effect that previous payments were made "*on account of such legacies and any interest due or to become due thereon*" precluded those payments from being allocated first to interest. He held (at p.498-9):

> *"I find nothing in the language of that order which in any way precludes me from saying that now, when matters can finally be adjusted, the ordinary rule of the Court ought not to be followed. The payments were made on account of legacies and interest, and it appears to me that they were paid in due course of administration, and the ordinary rule to which I have referred should apply ... At the time when those orders were made in respect of those settled legacies it could not be said with any certainty that the whole of the amount of the legacies would be paid."*

80. The court was therefore content to re-allocate payments to interest which had initially been allocated to principal, once it was appreciated that a surplus would arise. The judge concluded that:

> *"payments which have been made on account of the principal and interest in respect of the legacies are to be treated as having been made in the first place in satisfaction of interest on the said legacies accrued due down to the date of each such payment ... and subject thereto in satisfaction of the principal."*

81. Today, there appears to be no doubt among probate lawyers that where interest arises by operation of law on a legacy, payments are to be appropriated first to interest, then to principal.

(1) *Williams on Wills* (10th ed.) explains at para. 32.4 that if "*no special time is fixed for the payment of a general legacy, it carries interest at the basic rate payable for the time being on funds in court ... from the expiration of one year after the testator's death, although expressly made payable out of a particular fund which does not fall in until after a longer period*". Later at para.32.29, it is stated that if "*there are insufficient funds for the payment of legacies when due, the legatees are entitled, when payment is later made, to appropriate such payment first to interest due before appropriating to capital*".

(2) Williams, Mortimer & Sunnucks, *Executors, Administrators & Probate* (20th ed.) similarly discusses interest which "*in the absence of express directions in the will ... begins to run ... from the end of the executors' year*" (para. 79.01) before referring expressly to the rule in *Bower* v *Marris* at para. 79.06.

(3) *Snell's Equity* (32nd ed.) also mentions interest arising by operation of law, before saying at para. 35.037 that "*the general rule is that each payment must be appropriated first to the interest due on the unpaid portion of the legacy and then to princip*al".

(4) *Theobald on Wills* (17th ed.) similarly notes at para. 34.019 that where "*payments on account of principal and interest have been made under orders of the court, each such payment must be treated as having been made first on account of interest, and next on account of principal, unless there is a direction in the will or any order to the contrary*".

Changes made by the 1986 Act

82. The argument of Wentworth and the Administrators accepts that *Bower* v *Marris* was good law in both the individual and corporate insolvency contexts prior to 1986. Their position is solely based on the proposition that the 1986 legislation effected a fundamental change in the position in relation to corporate insolvency in relation to the calculation of post-insolvency interest.

83. However, there was no such fundamental change. The relevant change for present purposes made by the 1986 Act was simply to bring the position in liquidation into line with that in bankruptcy by allowing for post-insolvency interest on debts which did not bear a contractual right to interest, thereby fixing the anomaly which had been identified in *Re Rolls Royce Ltd* [1974] 1 WLR 1584.

84. That this was the intention is clear from the relevant parts of the Cork Report:

(1) At para. 1386, the authors of the Cork Report noted the "*anomaly between the two insolvency codes*" and proposed 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"*

(2) At para. 1392, the report concluded:

> "*We consider that there should be one set of rules relating to the interest on debts in all forms of insolvency proceedings.*"

85. The intention therefore was plainly for there to be a single set of rules applicable in both liquidation and bankruptcy, and that was to be achieved by assimilating the position in liquidation to that already existing in bankruptcy.

86. Section 328 of the 1986 Act, providing for statutory interest in bankruptcy, is in similar form to its predecessors:

> *"(4) Any surplus remaining after the payment of the debts that are preferential or rank equally under subsection (3) shall be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the commencement of the bankruptcy; and interest on preferential debts ranks equally with interest on debts other than preferential debts.*
>
> *(5) The rate of interest payable under subsection (4) in respect of any debt is whichever is the greater of the following—*
>
> > *(a) the rate specified in section 17 of the Judgments Act 1838 at the commencement of the bankruptcy, and*
> >
> > *(b) the rate applicable to that debt apart from the bankruptcy."*

87. Following the recommendation in the Cork Report, statutory interest in a winding up was introduced in the Insolvency Act 1985 section 93,[10] which is in identical form to the current Insolvency Act 1986 section 189:

> *"(1) In a winding up interest is payable in accordance with this section on any debt proved in the winding up, including so much of any such debt as represents interest on the remainder.*

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[10] There had previously been provisions for pre-winding up interest, such as r.100 of the Companies (Winding-up) Rules 1949, which provided that "*On any debt or sum certain, payable at a certain time or otherwise, whereon interest is not reserved or agreed for, and which is overdue at the date of the commencement of the winding-up, the creditor may prove for interest at a rate not exceeding four per centum per annum to that date from the time when the debt or sum was payable*". There appears to be no rule in the 1949 Rules concerning interest payable under a contract, although it clearly must have been payable once provable debts were paid in full: *Re Humber Ironworks* (1869) 4 Ch App 643 and *Re Lines Bros* [1984] BCLC 215.

(2) Any surplus remaining after the payment of the debts proved in a winding up shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company went into liquidation.

(3) All interest under this section ranks equally, whether or not the debts on which it is payable rank equally.

(4) The rate of interest payable under this section in respect of any debt ("the official rate" for the purposes of any provision of this Act in which that expression is used) is whichever is the greater of—

(a) the rate specified in section 17 of the Judgments Act 1838 on the day on which the company went into liquidation, and

(b) the rate applicable to that debt apart from the winding up."

88. The version of rule 2.88 applicable to LBIE is in substantially the same form as section 189(2), providing that:

"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."

89. There is no suggestion at all in the Cork Report that the rule in *Bower v Marris* was intended to be overturned or disapplied. On normal principles of statutory construction, section 328 of IA 1986 should be construed in the same way as its predecessor provisions, preserving the rule in *Bower* v *Marris*:

(1) "*There is ... a presumption that except in so far as they are clearly and unambiguously intended to do so, statutes should not be construed so as to make alterations in the common law*": [1992] 1 AC 425, 439 per Lord Oliver. "*It is a well-established principle of construction that a statute is not to be taken as effecting a fundamental alternation in the general law unless it uses words that point unmistakably to that conclusion*": *National Assistance Board* v *Wilkinson* [1952] 2 QB 648, 661 per Devlin J. Important principles of law "*must be overturned by a clear, definite, and positive enactment, not by an ambiguous one*": *Leach* v *Rex* [1912] AC 305, 311 per Lord Atkinson. See also Bennion, *Statutory Interpretation*, 6th ed., pp.741-745. The presumption that Parliament does not intend to alter the common law was applied in *AG of*

Canada v Confederation Trust Co 65 OR (3d) 519, resulting in a finding that the rule in *Bower* v *Marris* continued to apply in Canada notwithstanding a statute which otherwise might have excluded its application (see para.67 *et seq*).

(2) Where Parliament has the opportunity to alter the effect of a decision on the meaning of a statute, but chooses not to, the implication is that Parliament approves of that decision: Bennion, *Statutory Interpretation*, 6th ed., pp.661-662. In circumstances where Parliament partially amended a statute while saying nothing about a provision which had been judicially interpreted, the court has said that "*Parliament thus gave its blessing to the decision*" (*Denman* v *Essex AHA* [1984] QB 735, 746 per Peter Pain J). Similar arguments succeeded in the House of Lords in *Otter* v *Norman* [1989] AC 129 and the Court of Appeal in *Phillips* v *Mobil Oil Co Ltd* [1989] 1 WLR 888.

90. Since *Bower* v *Marris*, Parliament has re-enacted the relevant provision four times in similar language. The wording in section 328 IA 1986 is almost identical to that in the Bankruptcy Act 1883 section 40(5), except that the 1883 Act provided only for statutory interest at 4% and no higher rate of contractual interest. It is notable that at least two textbooks on the 1883 Act considered that *Bower* v *Marris* still applied to this non-contractual interest, see Robson, *A Treatise on the Law of Bankruptcy*, 7th ed. (1894), p.291 and Wace, *The Law and Practice of Bankruptcy* (1904), p.156.

91. There is no basis for considering that in enacting the 1986 Act Parliament no longer intended *Bower* v *Marris* to apply in the bankruptcy context to interest payable under section 328 IA 1986. There is likewise no basis on which it could be said that Parliament intended to create a separate regime for company liquidations (or that the draftsman of rule 2.88 intended a different regime for administrations). On the contrary, the Cork Report made expressly clear that the intention was to produce a *single* set of rules applicable in both bankruptcy and liquidation.

92. Tellingly, neither Wentworth nor the Administrators have explained whether it is their position that the rule in *Bower v Marris* continues to apply in relation to bankruptcy post the 1986 Act. If it does do so, then on the argument advanced by Wentworth and the Administrators this would lead to an arbitrary and unprincipled distinction

between liquidation/administration and bankruptcy. If it does not do so, then on the argument advanced by Wentworth and the Administrators, it would imply that in the 1986 Act Parliament effected a change in the law by abolishing the rule in *Bower v Marris*. However, there is nothing at all to suggest that this was the intention or effect of the legislation.

Arguments raised by Wentworth and the Administrators

Bower v Marris excluded by rule providing for interest to be paid after payment of debts proved

93. The first argument sought to be relied on by Wentworth and the Administrators is that the relevant provision of the rules (in this case, rule 2.88(7)) provides for interest to be paid from the surplus remaining after payment of the debts proved. It is said that this language effects a statutory appropriation of dividend payments in discharge of principal in priority to interest.

94. This is wrong.

(1) First, as a matter of policy and principle, this would give rise to a number of odd and arbitrary results. A number of these points were identified by Lord Cottenham in *Bower v Marris* (see paragraph 44 above), and are considered further below (paragraph 98).

(2) Secondly, although Wentworth and the Administrators seek to characterise the point as being only a point of statutory construction, it is important to bear in mind that the 1986 Act and the 1986 Rules are not a code in the civil law sense. There are various important examples of non-statutory principles which operate as glosses on the statutory scheme e.g. the rule against double proof, the anti-deprivation principle, the rule in *Cherry v Boultbee*, and the rules relating to the operation of insolvency set-off (the hindsight principle and the retroactivity principle). In any case, the provisions of the rules have to be construed in the context of the way in which the statutory scheme operates.

(3) Thirdly, the provision that post-insolvency interest is payable after payment of the debts proved was not a new feature in the 1986 Act. Post-insolvency

interest has only ever been payable in the event of there being a surplus in the estate after satisfaction of the debts admissible to proof. The statutes providing for the payment of statutory interest in bankruptcy have thus always specified that interest is payable after 100p in the £ has been paid in respect of proved claims, and this has been never been considered a basis for not calculating the entitlement to post-insolvency interest on the basis that dividends are allocated first towards interest and secondly towards principal.

95. Further, as to the operation of the statutory insolvency scheme:

(1) As explained in the authorities, proving is a mechanism of convenience to facilitate the distribution of the estate of the insolvent debtor on a *pari passu* basis amongst creditors (*In re Humber Ironworks and Shipbuilding Co. (No. 2)* (1868-69) LR 5 Ch App 88, 92). The process of proving in a liquidation does not remove the substantive rights of creditors. "*The winding up leaves the debts of the creditors untouched. It only affects the way in which they can be enforced ... The winding up does not either create new substantive rights in the creditors or destroy old ones.*" (*Wight v Eckhardt* [2004] 1 AC 147 per Lord Hoffmann at [27]). The rights "*are compromised by the insolvency regime only for the purpose of achieving justice among creditors through a pari passu distribution*" (*Waterfall I* [2014] 3 WLR 466).

(2) In a liquidation or distributing administration the position is as follows: (a) the creditor submits a proof in respect of his claim; (b) where the proof is admitted, the creditor becomes entitled to dividends at the declared rate on the admitted proof; (c) payments are then made to the creditor in discharge of his right to receive dividends on his admitted claim. Following the distribution of the estate, and the conclusion of liquidation/administration, all of the creditor's rights against the debtor remain intact except that the creditor is bound to give credit for the dividends which he has actually received in respect of his claim.

(3) There is nothing in this process which deprives a creditor of the right to rely on the usual rule that the law will apply a payment made by a debtor to discharge interest before applying it to the earliest items of the principal. If,

for example, a further asset of the debtor is subsequently discovered the creditor is entitled to recover the full amount of his loss from the debtor by treating the dividends which he has received as having first been allocated to interest.

(4) But, in any case, the language of rule 2.88(7) refers to payment (i.e. in the sense of receipt of dividends on the proved debt), not discharge, and does not remove the ordinary right of a creditor to rely on the usual rule that the law will apply a payment made by a debtor to discharge interest before applying it to the earliest items of the principal.

(5) There is therefore nothing in the statutory language in rule 2.88 which precludes the operation of the rule in *Bower v Marris*.

Bower v Marris not founded on remission to contractual rights

96. The second argument sought to be relied on by Wentworth and the Administrators is that the fact that the 1986 Act extended the right to post-insolvency interest, in the case of corporate insolvency, to creditors who otherwise had no right to interest in respect of their debts. It is said that this extension precludes the application of the rule in *Bower v Marris* because the rule is founded on the concept of remitting a creditor back to his contractual rights.

97. This is, however, fallacious. The rule in *Bower v Marris* is not founded on the concept of remission back to contractual rights, and it is well established that the rule applies where the creditor has no contractual right to interest.

(1) *Bower v Marris* itself was decided under a regime which provided for post-bankruptcy statutory interest. The fact that the particular debts at issue in *Bower v Marris* carried a right to contractual interest is nothing to the point. This formed no part of the reasoning, but instead proceeded on the basis that "*this mode of payment is regulated by Acts of Parliament*".

(2) Authorities from other jurisdictions demonstrate that *Bower v Marris* is applicable to statutory interest just as it is applicable to interest under a contract. Although Wentworth points out that some of the Australian

authorities arose in the context of a regime which did not provide for statutory interest, the same cannot be said of the Scottish, Irish and Canadian authorities. Nor is it true of at least one of the Australian authorities (*Re Tahore Holdings*), where the right to interest arose under a local equivalent of the Judgments Act.

(3) The authorities in the wills and legacies context discussed above clearly demonstrate that *Bower v Marris* applies to statutory i.e. non-contractual interest.

Policy and Principle

98. Aside from the points made above, the approach argued for by Wentworth and the Administrators would lead to a number of odd, arbitrary and unprincipled results. In particular:

(1) The effect of requiring payments made to a creditor by way of dividend to be allocated first to principal would have the effect of placing the creditor in a worse position than he would have been in absent the insolvency, and conferring a corresponding benefit on the insolvent debtor. This would be the case even where there was a surplus in the estate. This would be unwarranted. Why should the insolvent debtor benefit from its own insolvency and be able to inflict a loss on its creditors even where it has sufficient assets to meet all claims in full?

(2) The effect of requiring payments made to a creditor by way of dividend to be allocated first to principal would also have the effect of diminishing the creditor's rights against a solvent co-obligor. There is no principled basis on which a solvent co-obligor should benefit, and the creditor suffer loss, simply because the payments paid by the insolvent co-obligor towards the joint liability were made by way of dividend in an insolvency.

(3) It would also have the effect of diminishing the creditor's rights in the event that further property of the debtor was discovered. If, for example, the liquidation was completed, and the company was dissolved, but a further asset was then discovered which meant that the company was entirely solvent, then

it would be unjust and unprincipled for the creditor's rights to have recourse to that asset to be reduced because the dividend payments received in the liquidation were treated as having been allocated to principal.

99. More generally, the policy underlying the availability of post-insolvency administration is to put the creditor, so far as possible, in the position in which he would have been absent the insolvency. This policy points in favour of construing the legislation so as not to exclude the operation of the usual rule that the creditor is entitled to allocate payments made to him by the debtor first towards interest before principal. By contrast, there is no sensible policy reason for excluding the operation of the rule and thereby causing loss to the creditor in circumstances where there may be sufficient assets to meet all principal and interest claims in full.

Conclusion

100. The rule in *Bower v Marris* therefore remains applicable to the calculation of interest payable under rule 2.88(7).

Issue 3: Whether "*the rate applicable to the debt apart from the administration*" refers only to a numerical percentage rate or also to the mode of calculation

101. Issue 3 asks:

> *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).*

102. The Senior Creditor Group and the Administrators argue that the language in rule 2.88(9) "*the rate applicable to the debt apart from the administration*" is capable of including the mode of calculating the debt including the compounding of interest. York agrees. Amongst other things, this is consistent with the policy of the legislation

being to put, so far as possible, the creditor in the position which he would have been in on a hypothetical individual enforcement action.

103. In light of the letter received from Wentworth's solicitors dated 30 January 2015, it appears that Wentworth has changed its position on this issue and now also agrees that that "*the rate applicable to the debt apart from the administration*" includes a compound rate, where applicable.

104. Whether, as a matter of fact, the rate applicable to the debt apart from the administration includes a compound rate would depend on the position under the hypothetical individual enforcement action which the creditor would have brought for which the collective process of insolvency acted as a substitute. Accordingly, where, for example, enforcement would have involved obtaining a judgment and there would have been no right to compound interest following the obtaining of the judgment, then it would follow that the rate applicable to the debt apart from the administration does not include a compound rate.

105. Given this issue now appears to be common ground between the parties and that the issue of compounding does not directly affect the LibertyView claims (since they carry no contractual entitlement to compound interest), York does not intend to make its own submissions on Issue 3.

106. York notes that the sub-issues referred to at para. 31 of the Administrators' Position Paper (whether interest continues to compound following payment in full of the principal amount) would not arise if, as York contends in response to Issue 2, dividends are allocated first to interest and then to principal.

Issue 4: whether "the rate applicable to the debt apart from the administration" can be a foreign judgment or other statutory rate

107. Issue 4 asks:

> *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 rate.*

108. York's position (in common with that of the Senior Creditor Group and the Administrators) is that a foreign judgment rate of interest is capable of being "*the rate applicable to the debt apart from the administration*".

109. As a matter of policy:

(1) The purpose of allowing statutory interest in an insolvency at the Judgments Act rate is to put the creditor in the position he would have been had he obtained an ordinary civil judgment at the commencement of the insolvency: *Waterfall I* [2014] 3 WLR 466 at [163].

(2) This policy follows from the fact that the entry into insolvency limits the creditors' ordinary rights to enforce their claims by process against the company or its assets (see *In Re International Tin Council* [1987] Ch 419, 456) and instead provides for a process of collective enforcement (see, for example, *In re Lines Bros Ltd* [1983] 1 Ch 1, 14: "*liquidation is a form of collective enforcement*", approved in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 at [26]: "*Winding up is ... 'a process of collective enforcement of debts'*").

(3) However, the creditor should, so far as possible, not be prejudiced by the substitute of collective enforcement for individual enforcement and accordingly, where there is a surplus, he should be entitled to interest at the rate which he would been able to obtain through individual enforcement action.

(4) There is no policy reason why a creditor should be made worse off because he is required to enforce his claim through the collective enforcement process, rather than through an individual enforcement process.

110. To paraphrase Eden (see paragraph 17 above) a contractual counterparty who has not bargained for contractual interest has nonetheless bargained for the right to compel payment by process of law and to claim interest at the Judgments Act rate. A party who has bargained for New York governing law and New York jurisdiction has bargained for the right to compel payment by process of law in New York and to be paid the New York judgments rate.

111. It would be wrong in principle for creditors who had bargained for contractual interest to receive interest at that higher rate, but for creditors who had bargained for the right to access the higher judgments rate in another jurisdiction to be denied that right. Such a result would give the creditors with contractual interest a windfall at the expense of creditors whose contracts did not provide for interest, or whose claims did not arise under contracts.

112. There is also no good reason why a foreign currency creditor who happened to have obtained a judgment in advance of the commencement of an insolvency should be in a better position than a foreign currency creditor who had not obtained such a judgment. Moreover, if the entitlement to the foreign judgment rate of interest does turn on whether or not the foreign currency creditor had actually obtained a judgment by the date of commencement of the administration, then this would have the undesirable effect of causing such creditors to rush for judgment in circumstances where the insolvency of the counterparty was thought to be potentially likely to happen.

113. In its Position Paper, Wentworth argues that the "*rate applicable to the debt apart from the administration*" must mean the rate applicable to the debt "*pursuant to such rights as existed as at the date of administration*"[11]. This is said to be because the commencement of the administration is the notional date of proof and distribution.

114. Similarly, Wentworth also argues that to allow a creditor a foreign judgment rate of interest is to give the creditor something it could only get by breaching the stay on commencing proceedings[12].

115. Both these arguments are misconceived. In particular:

(1) They confuse and conflate the position absent the liquidation/administration (i.e. "*apart from the administration*") with the position under the liquidation/administration itself.

(2) The language "*the rate applicable to the debt apart from the administration*" is directed at what the position would have been if the collective enforcement

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11 Wentworth Position Paper para. 28.

12 Wentworth Position Paper para. 29(2).

process of insolvency had *not* taken place and instead the creditor had been liberty to bring individual enforcement action.

(3) Accordingly, the points made at para. 29 of Wentworth's Position Paper, including the point that a creditor should not be able to retain the fruits of an individual enforcement action brought in breach of the stay arising from liquidation/administration therefore miss the point, as the language in rule 2.88(9) is directed to the hypothetical situation where there is no collective insolvency process and therefore no stay in place.

116. The whole object of statutory interest is, so far as possible, to give the creditor what he would have received if the company had not gone into an insolvency process (see *Waterfall I* and Eden at paragraphs 16-18 above).

117. Wentworth's approach in its Reply Position Paper also involves taking an unduly narrow approach to the language used in the rule 2.88(9): "*the rate applicable to the debt apart from the administration*". It asserts that the "*debt*" referred to is only the provable debt and not any subsequent judgment debt into which the original debt is merged[13]. However:

(1) As a matter of language, the reference to the "*debt*" is capable of including not only the debt in its original form but also the debt as subsequently merged into a judgment.

(2) Alternatively, the rate "*applicable*" to a debt may be said to include the rate of interest which would accrue on the debt following its merger into a judgment.

(3) In any case, Wentworth's point only applies where the true juridical nature of the relevant judgment is that the original cause of action becomes merged into the judgment. This may or may not be the case with foreign judgments, or with arbitration awards[14]. This is a pointer against Wentworth's approach

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13 Wentworth Reply Position Paper, para. 24.

14 There is some debate as to whether the doctrine of merger applies to arbitration awards; see Mustill & Boyd *Commercial Arbitration*, 2nd ed., p.410 and Phipson, *The Law of Evidence*, 17th ed., 43-22. In the case of foreign judgments, section 34 of the Civil Jurisdiction and Judgments Act 1982 provides that "No proceedings may be brought by a person in England and Wales or Northern Ireland on a cause of action in respect of which a judgment has been given in his favour in

being correct since it is unlikely that it was intended that the right to interest would depend on these type of technical distinctions.

118. A further point sought to be made by Wentworth is that if the approach of the Senior Creditor Group, York and the Administrators is correct[15]:

> *"... then it follows that interest payable under a judgment which the creditor might obtain in England would equally qualify. That would mean that every creditor could, by relying upon the rate 'apart from the administration', claim Statutory Interest at the Judgments Act Rate. Such a construction cannot have been intended, however, since it would render otiose the entitlement to interest, in the alternative to the rate 'apart from the administration', at the Judgments Act Rate."*

119. This point is wrong. The entitlement to interest at the Judgments Act rate is not otiose on York's approach. It would be relevant if, for example, the creditor's right to sue is exclusively in a foreign jurisdiction and the rate applicable to a judgment in that jurisdiction is less than 8% (as it might well be).

120. Wentworth also says that the approach of the Senior Creditor Group, York and the Administrators would lead to uncertainty and a need to engage in speculation. This is wrong. The rate applicable by virtue of a foreign judgment would be a matter of foreign law and would be capable of being identified through evidence of that foreign law. In the usual way, the burden would lie on the creditor to make good his claim to such interest. There would be no need to engage in speculation.

<u>Circumstances in which the right to claim a foreign judgments rate of interest will arise</u>

121. A creditor should be entitled to interest at a rate equivalent to the rate which he would have been able to obtain if he had commenced a hypothetical individual enforcement process in respect of his claim against the debtor rather than being forced to enforce his claim through the collective enforcement process of insolvency.

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proceedings between the same parties, or their privies, in a court in another part of the United Kingdom or in a court of an overseas country, unless that judgment is not enforceable or entitled to recognition in England and Wales or, as the case may be, in Northern Ireland." However, this is not regarded as enacting a statutory rule of merger in relation to foreign judgments: Dicey, Morris & Collins, *The Conflict of Laws*, 15th ed., 14-041 and *Republic of India v India Steamship Co Ltd* [1993] AC 410, 423-424.

15 Wentworth Reply Position Paper para. 25.

122. There is therefore a claim to interest at the foreign judgments rate in every case where the creditor could have sued in a foreign jurisdiction (or commenced an arbitration) and obtained judgment which would have attracted the application of interest under the applicable foreign law rules, but has instead pursued this claim through the collective enforcement process of insolvency.

123. In circumstances where a company in liquidation or administration is subject to a claim which would otherwise be justiciable in a foreign court or in arbitration, for the purposes of determining "*the rate applicable to the debt apart from the administration*", it does not matter whether:

(1) the creditor was legally prevented by the statutory moratorium from suing;

(2) it would have served no practical purpose for the creditor to sue and obtain judgment given the insolvency of the debtor; or

(3) the creditor simply elected not to sue and to enforce his claim through the collective process of insolvency.

124. In each of these cases, the collective enforcement process of insolvency has in effect been substituted for the creditor's individual enforcement rights. Moreover, as a matter of policy and principle, it would be perverse if there was an incentive for creditors to seek to maintain and pursue individual enforcement actions notwithstanding the commencement of the insolvency.

125. In the case of a contingent or future debt, it is important not to confuse the question of the *rate* of interest applicable to a debt with the *time* from which such interest begins to accrue.

(1) The language "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) of the 1986 Rules is concerned with the former, not the latter. The latter question of the period during which interest accrues is dealt with by rule 2.88(7) (and by Issues 7 and 8 below).

(2) For the purposes of rule 2.88(9), in the case of a contingent and future debt, it is sufficient to identify the rate of interest which would have been applicable if

and when the creditor was able to sue, irrespective of whether the creditor was in fact able to do so at the date of commencement of the administration

(3) Rule 2.88(9) directs an inquiry as to the position on a hypothetical individual enforcement action brought by the creditor, for which the collective enforcement process is a substitute. Since the collective process of insolvency has the effect of treating future and contingent claims as being admissible to proof as at the date of the commencement of the insolvency, it is appropriate for the inquiry as to the position on the individual enforcement action to be on the same hypothesis i.e. that the contingent or future claim is capable of being the subject of enforcement action as at the date of the commencement of the insolvency.

Issue 5: Determining the greater rate of interest: amount

126. In common with the Senior Creditor Group and the Administrators, York submits that, for the purpose of establishing whichever is the greater of the Judgments Act rate and the rate applicable to the debt apart from the administration, the comparison required is of the total amounts of interest payable under rule 2.88(7) under each alternative. As Wentworth accepts, this necessarily follows if the rate applicable to the debt apart from the administration includes a compound rate[16].

Issue 6: Determining the greater rate of interest: date

127. Issue 6 asks:

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.

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16 Wentworth Position Paper para. 33.

128. It follows from York's position in relation to Issues 7 and 8, that the amount of interest based on the rate applicable to the debt apart from the administration is calculated from the date of the commencement of the administration. In circumstances where the right to interest arises as from the date of the administration, there is no logical or principled basis for calculating the relevant amount of interest pursuant to the rate applicable to the debt apart from the administration for the purposes of rule 2.88(9) as accruing from some other date. In particular:

(1) To do otherwise would mean that the comparison exercise under rule 2.88(9) would be wholly artificial since one would not be comparing like with like;

(2) In any case, it would be contrary to the principle that the purpose of statutory interest is to put a creditor in the position he would have been in if he had obtained a judgment at the commencement of the insolvency.

129. The sub-issue identified at paragraph 52 of the Administrators' Position Paper only arises if York is wrong on Issue 6 (and interest runs from the later of the date on which the debt became due and the date of administration) but correct on Issues 7-8 (and interest runs on contingent and future debts from the Date of administration). If that were the case, then the Administrators' proposed solution (to compare the contractual interest that would accrue from the date on which the debt became due with the Judgments Act interest which would accrue from the date of the administration) appears to be the logical approach.

Issue 7: Date from which interest payable on contingent debts

130. Issue 7 asks:

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.

131. York's position is that 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. This is because contingent debts become "*outstanding*" within the meaning of rule 2.88(7) from the date of the commencement of the administration and remain outstanding except to the extent discharged by distributions from the insolvent estate.

132. To understand why this is so, it is necessary to consider the scheme for distribution of a debtor's assets amongst its creditors in a winding up and in a distributing administration.

Statutory Scheme

133. The statutory scheme in a winding up operates as follows.

134. A creditor who wishes to make a claim against the debtor company in respect of his debt may submit a proof in respect of that debt.

135. There is then a liquidation and distribution of the insolvent company's assets amongst the claims which are admitted to proof. This liquidation and distribution is deemed to take place as at the date of the winding up order. The reason for this is to allow a *pari passu* distribution of the company's assets amongst its creditors, which necessarily requires that all of the creditors are ascertained and valued as at the same date.

136. This operation of the statutory scheme of winding up is well established and has been explained in the authorities:

(1) *"But when is the property of the debtor company subjected to equal distribution among the creditors? At the date of the winding up order."* - *In re European Assurance Society Arbitration (Wallberg's case)* (1872) 17 SJ 69, 70

(2) *"I think the tree must lie as it falls; that it must be ascertained what are the debts as they exist at the date of the winding-up, and that all dividends in the case of an insolvent estate must be declared in respect of the debts so ascertained"* –*In re Humber Ironworks and Shipbuilding Co.* 646-647.

(3) *"[T]he liquidation and the distribution are to be treated as notionally simultaneous"* –*In re Dynamics Corporation of America* [1976] 1 WLR 757, 762

(4) *"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 liability is the notional date of discharge of that liability ..."* –*In re Dynamics Corporation of America* [1976] 1 WLR 757, 774.

(5) *"[T]he liquidation and distribution of the assets of the insolvent company are treated as notionally taking place simultaneously on the date of the winding up order"* – *M.S. Fashions Ltd* v *BCCI SA* [1993] Ch 425, 432.

(6) *"[T]he debts of the bankrupt are treated as having been ascertained and his assets simultaneously distributed among his creditors on the bankruptcy date"* – *Stein* v *Blake* [1996] 1 AC 243, 252.

137. It follows from the notional liquidation and distribution on the date of the winding up order that the debts which rank for proof are ascertained as at that date. The ascertainment of the debts at a fixed date, i.e. the date of the winding up order, enables a *pari passu* distribution to be made amongst creditors. The debts as ascertained as at

the date of the winding up order are then entitled to rank for, and be paid, dividends accordingly.

138. Thus, for the purposes of the statutory scheme, provable debts (including contingent and future debts) become outstanding as from the date of the winding up order. This is the date on which such debts are valued and ascertained and the date on which they are notionally enforced through the collective process against the company's assets, and the date on which the entitlement to a share of those assets arises.

139. The same analysis applies in a distributing administration with the date of administration being substituted for the date of the winding up order.

140. Although a distributing administration only comes into effect on the giving of a notice under rule 2.95, the statutory scheme of collective enforcement and distribution takes effect retroactively as from the date of the commencement of the administration.

141. This is apparent from the rules governing a distributing administration:

(1) Rules 2.72(3)(b)(ii): proof to state value of claim "*as at the date on which the company entered administration*";

(2) Rule 2.86: foreign currency debts to be converted to sterling at the exchange rate prevailing on the date when the company entered administration;

(3) Rule 2.88(1): provable debts may include interest up to the date when the company entered administration;

(4) Rule 2.89: creditor may prove for a debt which was future at the date of entry into the administration;

(5) Rule 13.12(1): debts include any debt or liability to which the company was subject at the date when it went into administration.

Contingent debts

142. The debts of the company as at the date of the commencement of the winding up or administration which can be proved include debts which were contingent at that time. It would be unfair to exclude contingent liabilities from claiming a share of the insolvent company's assets alongside other creditors. Accordingly, the rules make it clear that contingent claims can be proved for:

(1) Under rule 13.12(1), where a company goes into winding up, debts are defined "*as any debt or liability to which the company is subject ... at the date on which the company went into liquidation*".

(2) By rule 13.12(3), this expressly includes contingent debts.

(3) Rule 12.3(1) further makes clear that debts which are contingent are provable against the company.

143. This is consistent with the old form of the proof of debt, by which a creditor, even if his claim was contingent on an event which had not yet happened, deposed that the company "*was at the date of the commencement of the winding up, and still is, justly and truly indebted*": see, for example, *In re Trepca Mines Ltd* [1960] 1 WLR 1273.

144. In the case of administration, by rule 13.12(5), the entirety of rule 13.12 "*shall apply where a company is in administration and shall be read as if ... references to going into liquidation were references to entering administration*". Accordingly, it is also clear that where a company is in administration, the debts of the company for the purposes of the Rules include the debts to which the company was subject at that date including any debts which were contingent at that time.

145. As noted above, the process of collecting and distributing the assets of the company amongst the creditors is deemed to take place *uno flatu* on the date of the commencement of the insolvency. For these purposes, it is necessary to accelerate contingent claims so that they crystallise as at the commencement of the insolvency and so that they rank *pari passu* for distribution alongside the other claims against the company at this date.

146. Accordingly:

(1) Consistently with the operation of the statutory scheme, contingent claims also fall to be valued as at the date of the winding up: *Wight v Eckhardt*, paras. 29-30. In the case of administration, the claims fall to be valued at the equivalent of the date of the winding up, being the commencement of the administration

(2) The value of such debts as at the date of administration may be estimated by the administrator. Rule 2.81 of the 1986 Rules provides that:

> *"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 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."*

(3) Where the contingency will only be satisfied in the future, so that the debt will only become payable in the future, such estimation will include a discount for futurity so as to produce a net present value for the debt: see Goode, *Principles of Corporate Insolvency*, 4th ed., at [4.39] and *Re MF Global UK* [2013] EWHC 92 (Ch) at [54]:

> *"It is relevant to emphasise a feature of the hindsight principle which is of particular significance to the present case. It applies where claims are being estimated. The process of estimation aims to assess the likelihood of the occurrence of the relevant contingency and the amount likely to become due on such occurrence or to predict the outcome of a process of quantifying a sum which is unascertained at the relevant date. It is essentially a process of putting a present value on future claims or outcomes."*

(4) The administrator may revise any estimate previously made if he thinks fit by reference to any change of circumstances or to information becoming available to him;

(5) In particular, in valuing claims at the date of the administration, or taking the account for the purposes of set-off (as to which see further below), the court has regard to events which have occurred at the date of distribution or payment since the date of the winding up (*the hindsight principle*): *M.S.*

Fashions Ltd v BCCI SA at pp.432-433; *Re MF Global UK Ltd* [2013] EWHC 92 at [48]-[55].

147. Accordingly, in the same way as with present debts, debts which are contingent at the date of the commencement of the winding up are provable in the administration. For these purposes, the value of such claims is ascertained as at the date of the commencement of the administration, and they are enforced against the company's assets through the collective insolvency process which notionally takes place on that date. They become entitled to a share of the assets in the insolvent estate from that date. It follows that contingent claims are also "*outstanding*" from the date of the commencement of the administration.

Set-off

148. In addition to the treatment of claims against the company where there is no cross-claim, it is also necessary to take into account the operation of insolvency set-off where it applies.

149. Consistent with the operation of the statutory scheme, in winding up mandatory insolvency set-off applies automatically as at the date of the winding up order: *Stein v Blake*, 252; *In re Bank of Credit and Commerce International S.A. (No. 8)* [1998] AC 214, 223. Set-off operates to produce a net balance which, if due to the creditor, is outstanding from the date of the winding up order. Further, the operation of set-off extends to debts which were contingent at the date of the winding up.

150. Lord Hoffmann explained the application of insolvency set-off in respect of contingent claims as follows in *Stein* v *Blake* (at 252-253):

> *"Bankruptcy set-off therefore requires an account to be taken of liabilities which, at the time of bankruptcy, may be due but not yet payable or may be unascertained in amount or subject to contingency. Nevertheless, the law says that the account shall be deemed to have been taken and the sums due from one party set off against the other as at the date of the bankruptcy ...*
>
> *"How does the law deal with the conundrum of having to set off, as of the bankruptcy date, 'sums due' which may not yet be due or which may become owing upon contingencies which have not yet occurred? It employs two techniques. 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 ...

"But the winding up of the estate of a bankrupt or an insolvent company cannot always wait until all possible contingencies have happened and all the actual or potential liabilities which existed at the bankruptcy date have been quantified. Therefore the law adopts a second technique, which is to make an estimation of the value of the claim ...

"This enables the trustee to quantify a creditor's contingent or unascertained claim, for the purposes of set-off or proof, in a way which will enable the trustee safely to distribute the estate, even if subsequent events show that the claim was worth more."

(emphasis added)

151. Accordingly, insolvency set-off applies to liabilities where were contingent at the date of the commencement of the insolvency and, for these purposes, the law values the liability as at the date of the commencement of the insolvency by either applying the hindsight principle to take account of subsequent events or estimating the value of the contingent liability.

152. The position is the same in administration. In the case of a distributing administration:

(1) Rule 2.85(3) provides that:

"An account shall be taken as at the date of the notice referred to in paragraph (1) [notice of distribution] of what is due from each party to the other in respect of the mutual dealings and the sums due from one party shall be set off against the sums due from the other."

(2) Rule 2.85(5) specifically provides that for the purposes of insolvency set-off contingent claims may be estimated:

"Rule 2.81 shall apply for the purposes of this Rule to any obligation to or from the company which, by reason of its being subject to any contingency or for any other reasons, does not bear a certain value."

(3) Rule 2.85(8) has provided (since 2005) that:

"Only the balance (if any) of the account owed to the creditor is provable in the administration. Alternatively the balance (if any) owed to the company shall be paid to the administrator as part of the assets except where all or part of the balance results from a contingent or prospective debt owed by the creditor and in such a case the balance (or that part of it which results from the contingent or prospective debt) shall be paid if and when that debt becomes due and payable."

153. Even though the account is to be taken as at the date of the notice of intended distribution given under rule 2.95:

(1) Insolvency set-off is treated as having taken place on the date of commencement of the insolvency (the retroactivity principle). See for example:

M.S. Fashions Ltd v BCCI SA (p.432):

> *"... the account is taken as at the date of the winding up order ("the retroactivity principle"). This is only one manifestation of a wider principle of insolvency law, namely, that the liquidation and distribution of the assets of the insolvent company are treated as notionally taking place simultaneously on the date of the winding up order ..."*

In re Bank of Credit and Commerce International S.A. (No. 8) (p.223):

> *"When the conditions of the rule are satisfied, a set-off is treated as having taken place automatically on the bankruptcy date. The original claims are extinguished and only the net balance remains owing one way or the other ..."*

(2) The claim of the creditor for the purposes of the set-off is the debt for which the creditor is entitled to prove: *Stein v Blake* (p.253); *In re Bank of Credit and Commerce International S.A. (No. 8)* (p.228) ("*It is clear that for the purposes of the rule, the claim by the creditor against the insolvency company must be a provable debt.*"). Accordingly, amongst other things, post-administration interest is excluded from the operation of the set-off: rule 2.85(6)(c).

(3) The net balance resulting from the operation of the set-off (assuming a net amount is due to the creditor) is then provable by the creditor in the administration.

154. In these circumstances, the actual taking of the account itself is merely the process of calculation of the balance due in accordance with the principles of insolvency law i.e. in the case of a distributing administration, as at the date of commencement of the administration: *Stein v Blake* (p.253):

> *".. the taking of the account really means no more than the calculation of the balance due in accordance with the principles of insolvency law."*

155. Therefore, the account, taken as at the date of the notice given under rule 2.95, establishes the net balance which was owing as at the date of commencement of the administration and, if such net balance is due to the creditor, that is the amount which the creditor is entitled to prove for and which is outstanding as from the date of commencement of the administration.

Meaning of "*outstanding*"

156. The points above as to the operation of the statutory scheme show that provable claims, including contingent claims, are outstanding under the scheme from the date of the winding up order or, in the case of administration, from the date of commencement of the administration. This conclusion is also reinforced by the language actually used in rule 2.88(7).

157. Rule 2.88(7), read in conjunction with rule 2.88(1), provides for statutory interest to be payable on debts "*in respect of the periods during which they have been outstanding since [the date on which the company entered administration].*"

158. There are a number of points which follow in relation to the construction of this provision, particularly in regard to the assertion made by Wentworth that a contingent debt cannot be "*outstanding*" until the contingency actually occurs[17]:

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[17] Wentworth Position Paper para. 41.

(1) First, the Insolvency Rules draw a distinction between a debt which is "*outstanding*" and a debt which is "*due*". Rule 2.105(2), which provides the formula for discounting future debts, provides that the amount "*outstanding*" shall be discounted according to the date on which payment would otherwise be "*due*". If those two words meant the same thing, then rule 2.105 would make no sense, because there would be no amount "*outstanding*" in respect of future debts until that debt actually fell due, by which time there would be no need to discount it. In the context of rule 2.105, "*outstanding*" was clearly not used to mean "*due*".

(2) Secondly, as a matter of ordinary language, "*outstanding*" is not synonymous with "*due*". It is normal to speak of "*outstanding*" principal under a loan facility which does not fall "*due*" until a future date. Moreover, it is established that "*outstanding*" is capable of including a contingent debt: see *Crystal Palace FC (2000) Ltd v Paterson* [2005] EWCA Civ 180 at [52]-[53]:

> "*The definition of "outstanding" in the fifth edition of the Shorter Oxford Dictionary includes, "unresolved, pending; esp (of a debt etc) unsettled." In the first edition it includes, "... that stands over; that remains undetermined, unsettled, or unpaid." In these circumstances the judge was, as it seems to me, entitled to hold that an ordinary meaning of the word is wide enough to include contingent debts which had not yet become due and payable.*"

(3) Thirdly, the language of rule 2.88(7) refers to "*the period*" (not "*any period*") during which the debts "*have been*" outstanding "*since*" the date of the commencement of the administration.

(a) The natural reading of this language is that it is directed at identifying a period of time, the start date of which is the commencement of the administration, and the end date of which is the period on which the debt ceased to be outstanding.

(b) It is implicit in the language that all debts are outstanding at the start of that period, the question being when they cease to be outstanding thereafter.

(c) On the approach of Wentworth and the Joint Administrators (i.e. that "*outstanding*" is synonymous with "*due*"), a more natural approach for the draftsman to have adopted to the drafting of rule 2.88(7) would have been:

"in respect of any period, after the date on which the company entered administration, during which they have been outstanding."

But, even then, the draftsman would have used "*due*" instead of "*outstanding*" if that had been his intention.

159. These points as to the language of rule 2.88(7) support York's contention that "*outstanding*" does not mean "*due*", but instead means that part of the proved claim which has not been satisfied by payment of a dividend.

Position of Wentworth and the Administrators

160. Wentworth argues at para. 51(3) of its Position Paper that if a creditor has a contingent claim in respect of which the contingency has not yet occurred, his debt is not "*outstanding*" for the purposes of rule 2.88(7). By contrast, Wentworth accepts at paras 54-55 of its Position Paper that future debts are "*outstanding*" from the date of the administration order, partly because the Insolvency Rules provide a discounting mechanism to take account of the futurity of the debt.

161. By contrast, the Administrators argue that in the case of both contingent and future debts the debt is not "*outstanding*" until it falls due.

162. As to the position adopted by Wentworth, it accepts that, in both liquidation and administration, the proof and distribution process notionally occurs on the date of commencement of the liquidation or administration and that claims are valued as at the date of the commencement of the liquidation or administration[18]. Wentworth also appears to accept, as it has to given the terms of rule 13.12, that debts which are contingent or future at the date of the commencement of the liquidation or administration are provable as "*debts*" and for these purposes are valued at the date of the commencement of the liquidation or administration.

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[18] Wentworth Position Paper, para. 43.

163. As explained above, it follows for the purposes of the statutory scheme that claims, including contingent and future claims, are "*outstanding*" from the date of the commencement of the liquidation or administration and that creditors are kept out of their money from that date. Wentworth nevertheless asserts that this is not the case.

164. As to this:

(1) Wentworth firstly asserts that "*outstanding*" means "*due*" as a matter of ordinary language[19]. This is not so. It would, for example, be normal to speak of the presently "*outstanding*" principal under a term loan facility which does not mature and become repayable until some time in the future. But, in any case, "*outstanding*" was clearly not used by the draftsman in the sense of "*due*" in the 1986 Rules: see rule 2.105(2)[20] and paragraph 158 above.

(2) Wentworth secondly asserts that certain "*adjustments*" can be made in relation to the payment of statutory interest in order, it says, to give proper effect to the principle that claims for statutory interest should rank *pari passu*. However, these points misunderstand the nature and effect of the statutory scheme applicable in liquidation and administration. In particular:

(a) Wentworth asserts that in the case of a contingent claim, as at the date of the commencement of the winding up, the "*entitlement to be paid any money has not yet arisen*"[21]. This is, however, wrong, and confuses and conflates the position under the insolvency with the position absent the insolvency.

(b) Where the company is in liquidation or in a distributing administration then the effect of the statutory scheme, as explained above, is that the contingent claim is treated as due as at the date of the commencement of the liquidation or administration, as the case may be, in the sense that it is enforceable through the collective process against the company's assets as at that date. The claim is ascertained as that date

19 Wentworth Position Paper para. 41.
20 See also rule 6.217(3)(b) of the 1986 Rules.
21 Wentworth Position Paper para. 42.

and becomes entitlement to a share of the assets of the insolvent estate from that date.

(c) Wentworth is therefore wrong to assert that a contingent creditor is not kept out of his money from the date of the liquidation or administration or that the debt is not due from that date. This ignores the way in which the claim of the creditor is treated for the purposes of the scheme.

(3) Wentworth also does not address the effect of insolvency set-off which applies to contingent and future claims against the company and operates to produce a net balance owed to the creditor as at the date of the commencement of the administration which is provable in the administration. On any view, this net balance is a liability which is not contingent and which is outstanding from the date of the administration. This point goes beyond those claims where insolvency set-off applies and is a point against Wentworth's approach in relation to all claims. In particular, there would not appear to be any reason why, as a matter of principle, a contingent creditor's entitlement to statutory interest should depend on whether the company has a cross-claim against him.

165. As to the position adopted by the Administrators:

(1) The Administrators accept that a debt which is contingent at the date of the administration can be admitted to proof[22]. However, they do not address the consequences of the operation of the statutory scheme including the notional distribution of the debtor's assets on the date of the liquidation/administration.

(2) The Administrators assert that if statutory interest was payable from the date of administration certain contingent creditors would receive a windfall. However:

(a) As noted above, debts which are contingent as at the date of commencement of the administration are subject to estimation under

[22] Joint Administrators' Position Paper at para.44.1.

rule 2.81 of the 1986 Rules, and such estimation may include a discount for futurity so as to produce a net present value for the debt.

(b) Where the contingency has not occurred at the time of the declaration of dividend, then the creditor will receive a dividend on the estimated value of his claim, which will include a discount for futurity.

(c) Where the contingency has occurred by the date of declaration of dividend, then by the operation of the hindsight principle the estimated value of the debt will fall to be revised as the amount now quantified following the occurrence of the contingency. In this case, there is no discount for futurity but that is because the law treats the now quantified amount as being the amount due at the date of commencement of the insolvency: "*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.*" (*Stein v Blake* [1996] 1 AC 243, 252)

(d) Where the contingency has not occurred at the date of declaration of dividend, and by that date will never occur, then by operation of the hindsight principle the estimated value of the debt will fall to be revised to zero. Such a creditor therefore will receive no dividend and no interest.

(e) If contingent creditors in the situations described in (b) and (c) were denied post-insolvency interest on their claims from the date of commencement of the liquidation or administration, then this would in fact result in a windfall for other creditors.

(3) Finally, like Wentworth, the Administrators do not deal with the operation of insolvency set-off.

Treatment of contingent claims

166. Although the Administrators assert that if statutory interest was payable from the date of administration certain contingent creditors would receive a windfall, it is to be

noted that their own approach would result in a number of arbitrary and unjust outcomes.

167. Take one example: assume that LBIE issued a credit-linked note to X on 15 September 2006, to be repaid on or before 15 September 2010. The principal amount payable on the note can reduce (potentially to nil) as and when events of default occur on a basket of underlying securities. Any reduction in principal takes effect each quarter. The underlying securities are extremely risky, and at all material times it is uncertain whether LBIE will be obliged to repay any principal on the notes. The interest rate is 10% per annum on the principal due on the note for the time being in each quarter. It is clear that X is entitled to prove for interest accruing on the note between 15 September 2006 and 15 September 2008 (rule 2.88(1)). X is not entitled to prove for interest accruing on the debt from 15 September 2008, being the date of administration (*ibid*). On the position of Wentworth and the Administrators, X is entitled to claim statutory interest accruing on the note at the contractual rate of 10% from 15 September 2010 until the note is paid in full (rule 2.88(7), (9)). X's right to be paid statutory interest for the latter period is non-provable, and ranks immediately behind unsecured provable debts (rule 2.88(7)).

168. This example gives rise to an obvious question: what happened to the period between 15 September 2008 and 15 September 2010? On Wentworth's and the Administrators' position, X has no right to receive statutory interest and no right to prove for contractual interest during this two-year twilight zone. More generally, no creditor is entitled to receive statutory interest or to prove for contractual interest in respect of the period between the onset of insolvency proceedings and the time when the debt ceases to be contingent. It is difficult to imagine a plausible policy rationale for such a gap.

169. Other illustrations of the arbitrary outcomes resulting from the position of Wentworth and the Administrators in relation to the facts of the present case are given in Andrea Zambelli's second witness statement at paras. 10-20 [2/6/3-7]. In particular:

(1) There is no good reason why the CRA Creditor (whose claim was valued pursuant to the CRA as at the business day before the date of the

administration), should receive less interest than the Benchmark Creditor (whose claim was closed out on the date of administration).

(2) Similarly, there is no good reason why the Cash Creditor (whose claim relates to an outstanding cash balance owed by LBIE) should receive less interest than the Benchmark Creditor.

(3) There is also no good reason why the Decreased Creditor (the value of whose claim decreased between the date of administration and the date of close out) should be denied interest from the earlier date, thereby increasing its loss compared to the Benchmark Creditor.

170. Further, if contingent creditors were denied statutory interest from the date of the administration, this would create a perverse incentive for officeholders to delay causing contingent claims to become crystallised into actual claims, where this lay only within the power of the insolvent estate.

171. In this type of situation, it would be wholly unjust and unprincipled if statutory interest did not accrue from the date of the administration such that the administrator could generate a benefit for the insolvent estate, and cause loss to the creditor, by delaying the crystallisation of the contingent claim into an actual claim.

172. Moreover, even where the contingent creditor has a right to close out the relevant agreements himself, and thereby crystallise a contingent claim into an actual claim, it cannot be assumed either that this would necessarily result in an increase in the creditor's claim against the estate (as opposed to a decrease) or that the decision of the creditor to close out was made for the purpose of seeking to enhance its claim, as opposed to other purposes: see Zambelli 2, paras. 21-48 [2/6/7-16].

Issue 8: Date from which interest payable on future debts

173. Issue 8 asks:

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.

174. York's position, in common with that of the Senior Creditor Group and Wentworth, is that statutory interest is payable in respect of an admitted provable debt which was a future debt as at the date of administration from the date of administration.

175. This is essentially for the same reasons that contingent debts are outstanding from the commencement of the administration. However, an examination of the statutory history of interest on future debts supports the analysis.

Statutory history

176. Prior to the Bankrupts Act 1720, future debts were not provable. By that Act, they were made provable subject to a discount of 5% p.a. "*to be computed from the actual Payment thereof to the Time such Debt, Duty or Sum of Money should or would have become due and payable*".

177. On its introduction in 2003, rule 2.105 provided as follows:

"(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 a percentage calculated as follows–

$$\frac{I \times M}{12}$$

where I is 5 per cent and M is the number of months (expressed, if need be, as or as including, fractions of months) between the declaration of dividend and the date when payment of the creditor's debt would otherwise be due.

(3) Other creditors are not entitled to interest out of surplus funds under Rule 2.88 until any creditor to whom paragraphs (1) and (2) apply has been paid the full amount of his debt."

178. The effect of this rule (which was in largely the same form as the 1720 Act) was that where a debt had fallen due at the date the dividend was declared, it was no longer a future debt, and would not be discounted, but if it fell due at some date after the declaration of the dividend, it would be discounted back to the date of the declaration.

179. When rule 2.88(7) was first introduced, it provided that:

> *"Subject to Rule 2.105(3), 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."*
>
> (emphasis added)

180. There was therefore no question of interest accruing on future debts from the commencement of the administration. First, future debts were only discounted back to the declaration of the dividend, not back to the commencement of the administration. Secondly, creditors with future debts which had been discounted were entitled to receive the undiscounted amount of their debts before statutory interest was paid (see rule 2.105(3)).

181. However, the combination of rules 2.88 and 2.105 in their original form had two undesirable consequences, both of which were heavily criticised by Lord Millett in *Re Park Air Services plc* [2000] 2 AC 172, 188.

(1) First, a creditor with a future debt was entitled to receive his full, undiscounted debt, before any other creditors were entitled to interest. Creditors whose debts would not fall due for many years would receive a windfall at the expense of creditors who had been kept out of debts which had fallen due many years previously.

(2) Secondly, a creditor with a future debt falling due 20 years in the future would see his debt reduced to zero, even though debts falling due in 20 years' time will often have substantial commercial value.

182. Both rules were therefore amended with effect from 1 April 2005. The revised rule 2.88(7) removed the (now-redundant) words "*Subject to Rule 2.105(3)*" and rule 2.105 was amended to provide as follows:

> *"(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."*

183. In modifying rules 2.88 and 2.105 in this way, the draftsman intended to remove the windfall previously enjoyed by creditors with future debts, and to fix the anomaly identified by Lord Millett in *Re Park Air Services plc*.

Operation of the rule

184. Unlike the former version of the rule, the revised version of rule 2.105 requires the future debt to be discounted back to the commencement of the administration (not the declaration of the dividend), and removes the creditor's right to receive the undiscounted value of his debt before statutory interest is paid.

185. In these circumstances, the same principles as set out above in relation to contingent debts apply:

(1) The general principle is that the debts which can be admitted for proof are ascertained as they exist as at the date of the winding up order or the date of commencement of the administration applies. For these purposes, the rules contain machinery enabling future debts to be valued as at the date of commencement of the insolvency.

(2) In effect, as with future contingent debts, the winding up has the effect of accelerating the liability and making it presently enforceable through the collective process against the company's assets

McPherson's Law of Company Liquidation (3rd ed.) para.12-018:

> *"winding up has the effect of accelerating the date for repayment, so that the full amount of principal together with interest to date automatically becomes due on winding up irrespective of the date fixed for payment under the contract."*

Goode, *Principles of Corporate Insolvency Law* (4th ed.), 3-11:

> ***"Tenth principle: liquidation accelerates creditors' rights to payment***
>
> *When a company goes into liquidation, its liability for payment of unmatured debts becomes notionally accelerated to the extent that it has already been earned by performance. This results from the fact that a creditor has an immediate right of proof not only for debts already due to him, but for those payable in future or on a contingency ... However, a claim qualifies as a debt for this purpose only to the extent that it has been earned, in the sense that consideration for it is executed. For example, the principle of acceleration applies to a loan made before winding up but maturing three years later ..."*

(3) Similarly, mandatory insolvency set-off of future debts owed to a creditor will take place as at the date of commencement of the winding up or administration.

(4) Rule 2.105 of the 1986 Rules applies where payment of the debt is not due at the date of declaration of the dividend. In these circumstances, for the purpose of dividend (and no other purpose) the amount of the creditor's admitted proof (or the amount remaining outstanding in respect of his proof) is reduced applying the specified formula: rule 2.105(2).

(5) Rule 2.105 also applies for the purposes of insolvency set-off: rule 2.85(7). In particular, rule 2.105 applies to value the relevant part of the future debt as required for the purposes of set-off: *Re Kaupthing Singer & Friedlander Ltd* [2011] 1 BCLC 12.

(6) Since rule 2.105 discounts the future debt to a present value as at the date of the commencement of the administration, it is logical for post-administration interest to run from the same date.

186. Moreover, rule 2.105 applies to 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 the admitted proof. The word "*outstanding*", as used in this context, clearly means an amount that is unpaid rather than an amount which is due and payable (since rule 2.105 applies to debts payable at a future time) and there is no reason that the same word "*outstanding*" as used in rule 2.88(7) should have a different meaning.

Position of Wentworth and the Administrators

Wentworth

187. Wentworth accepts that in the case of future debts statutory interest is payable from the date of the administration[23].

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[23] Wentworth Position Paper para. 52.

188. However:

(1) Contrary to Wentworth's assertion, there is no relevant distinction between a future debt and a contingent debt for these purposes. It is irrelevant that a future debt is certain to fall due for payment, whereas a contingent debt may not. This is because both types of debts are admissible to proof under the rules, and as part of that process are ascertained at the date of the commencement of the insolvency and become entitled to a share of the insolvent's assets as from that date.

(2) Similarly, it also irrelevant for these purposes that there is a specific discounting mechanism in the rule for future debts, but not for contingent debts. The discounting mechanism in rule 2.105 could not be applied to contingent debts, given the uncertainty as to when the contingency would be satisfied. As explained above, contingent debts are therefore dealt with in a different way under the rules. However, this does not give to any valid distinction for the purposes of when the debts become "*outstanding*" within the meaning of rule 2.88(7).

(3) Wentworth's point about the meaning of "*outstanding*" in rule 2.105(2) is also misplaced[24]. Wentworth accepts (correctly) that in the context of rule 2.105(2) "*outstanding*" cannot mean "*due*". However, it says that in rule 2.105(2) it "*can only include debts which are payable in the future*". As to this, it is of course correct that rule 2.105 only applies to debts which are payable in the future and that therefore, as used in rule 2.105(2), the word "*outstanding*" will only in fact apply to debts which are payable in the future. However, it does not follow from that the meaning of "*outstanding*" is limited in this way, or that it does not bear the meaning for which York contends.

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[24] Wentworth Position Paper para. 54.

The Administrators

189. The Administrators take a different position from Wentworth. They contend that it is "*arguable*" that interest only becomes payable in respect of a future debt from the date on which the future debt ceased to be a future debt[25].

190. This position is wrong for the reasons given above. It would also give rise to serious anomalies and injustices if it were correct.

191. In particular, the Administrators' approach gives rise to a bizarre "*twilight zone*" in which contractual rights to receive interest on future debts are suspended – without any justification.

192. Suppose, for example, that X lent LBIE £100 on 15 September 2006, to be repaid on 15 September 2010, with interest payable at a rate of 10% per annum. It is clear that X is entitled to prove for interest accruing on the debt between 15 September 2006 and 15 September 2008 (rule 2.88(1)). X is not entitled to prove for interest accruing on the debt from 15 September 2008, being the date of administration (*ibid*). On the Administrators' position, X is entitled to claim statutory interest accruing on the debt at the contractual rate of 10% from 15 September 2010 until the debt is paid in full (rule 2.88(7), (9)). X's right to be paid statutory interest for the latter period is non-provable, and ranks immediately behind unsecured provable debts (rule 2.88(7)).

193. The foregoing analysis generates an obvious question: what happened to the period between 15 September 2008 and 15 September 2010? On the Administrators' position, X has no right to receive statutory interest and no right to prove for contractual interest during this two-year twilight zone. More generally, no creditor is entitled to receive statutory interest or to prove for contractual interest in respect of the period, if any, between the onset of insolvency proceedings and the maturity of the debt. It is difficult to imagine any plausible policy rationale for such a gap.

194. This point is a compelling reason against the Administrators' position.

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25 Joint Administrators' Position Paper para. 48.

195. The Administrators' argument also fails to deal with the fact that the word "*outstanding*" as used in rule 2.105(2) does not mean "*due and payable*", and that it would be extremely odd for the word to have a different meaning in rule 2.88(7).

The Administrators' "windfall" argument

196. In their Position Paper, the Administrators refer to an anomaly which they say arises on the approach of the Senior Creditor Group, York and Wentworth[26]. They say that a future creditor would receive a windfall if statutory interest were payable from the date of administration.

197. However, this ignores the effect of rule 2.105. Where it applies, rule 2.105 discounts the value of a creditor's future debt to a present value as at the date of the commencement of the administration. In these circumstances, the only windfall which can be said to arise relates to the fact that statutory interest is a minimum of 8%, whereas the discounting takes place at a rate of 5%. But that is merely a consequence of the level at which Parliament was chosen to set the two rates.

198. There is one anomaly which arises from the way in which rule 2.105 is drafted. By sub-para.1, future debts are discounted if they have not fallen due at the date of the declaration of dividend. This wording made sense when future debts were discounted back to that date, but when the draftsman altered the rest of the rule to provide for discounting back to the commencement of the administration, it appears that he may have neglected to amend sub-para.1.

199. It is possible that this is an error or oversight in the rule. However, it does not justify departing from the conclusion, which follows from the operation of the statutory scheme, that provable debts (including future debts) are treated as outstanding from the commencement of the administration. To depart from that conclusion would prejudice the creditors whose debts had not yet fallen due at the date of the declaration of dividend, requiring their debts to be discounted to the commencement of the administration, without their having in the event of a surplus any entitlement to post-administration interest between the date of the administration and the date when their debt would otherwise have fallen due.

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[26] Joint Administrators' Position Paper paras. 48.4 and 48.6.

CURRENCY CONVERSION CLAIMS

Issue 28: Effect of statutory interest on currency conversion claims

200. Issue 28 asks:

> *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.*

201. For these purposes, a "Currency Conversion Claim" is defined as:

> *"A non-provable claim against LBIE arising out of the difference between: (i) the amount of the creditor's entitlement to payment in a foreign currency; and (ii) the amount received by it in respect of is proved debt, converted into the foreign currency as at the date of payment."*

202. As to the nature of this claim:

(1) Under the statutory scheme, for the purposes of proving, foreign currency debts are converted into sterling at the official exchange rate prevailing on the date when the company entered into administration: rule 2.86. As a result, the creditor receives payments in sterling which may be less than the foreign currency payments which he was entitled to receive.

(2) The existence of a claim by a creditor against the company for currency losses suffered by him from the date of liquidation is recognised in the authorities: *In re Lines Bros Ltd* [1983] Ch. 1 C.A., 20-21, 26; *Waterfall I* [2014] 3 WLR 466 at [110]-[111].

(3) Essentially, the claim is based on the creditor being entitled to assert his underlying contractual rights against the company for payment in a foreign currency on the due date. Once the proved debts and interest has been paid, there is no reason why the creditors should not be at liberty to assert these claims.

Re Lines Bros (No. 2)

203. *Re Lines Bros (No.2)* followed the decision of the Court of Appeal in *Re Lines Bros* to the effect that post-liquidation interest must be paid in full before currency conversion claims may be made. The court in *Re Lines Bros (No.2)* was therefore concerned purely with the correct method of calculating post-liquidation interest. Although, as counsel acknowledged, a currency conversion claim might exist where there was a surplus of assets for return to contributories (a proposition now confirmed by *Waterfall I*), in that case there was no such surplus (see pp.440F-441A). Mervyn Davies J confirmed at p.448B that he was not dealing with a claim for currency losses on principal.

204. In *Re Lines Bros (No. 2)* the Court identified two methods for the calculation of post-insolvency interest applying the rule in *Bower v Marris*, as set out in Appendices A and B to the judgment.

(1) *Appendix A*: applying the rule in *Bower v Marris*, sterling dividend payments are credited first to interest and subsequently to principal. This results in the creditor having sterling payments credited against his proved debt as converted to sterling at the date of commencement of the administration with accrued interest in sterling thereon.

(2) *Appendix B*: under the Appendix B approach, the creditor's claim remains in its original foreign currency both for the purposes of (a) determining the amount on which post-administration interest accrues and (b) the "*notional principal*" amount that, following appropriation in accordance with the rule in *Bower v Marris*, needs to be paid so as to stop statutory interest accruing on the unpaid notional principal balance.

205. The court ordered that the calculation of interest be carried out on the Appendix A basis. Mervyn Davies J gave his reasons for this at 451G-453D.

206. York considers that in principle there is a basis for applying the Appendix B approach. The Court of Appeal in *Re Lines Bros*, held that currency conversion claims should rank behind statutory interest essentially on the basis that Sterling interest claimants should not have their claims reduced by movements in foreign

currency exchange rates. However, it is not clear why this is not permissible, in circumstances where it is permissible for fixed rate interest claimants to have their claims reduced by claims which carry a floating rate. Why would the law prioritise the rights of a creditor who bargained for high contractual interest over the rights of a creditor who bargained for payment in a foreign currency?

207. That said, before this Court, York recognises that the decision of the Court of Appeal in *Re Lines Bros* is binding authority. The Court is therefore required to apply the Appendix A approach. The following paragraphs proceed on this basis. York, however, reserves the right to argue for an Appendix B approach in a higher court.

Calculation of Currency Conversion Claim

208. York's primary position is that, in principle, the Currency Conversion Claim should be the difference between (a) the amount of the total sterling payments which a creditor receives in respect of principal and interest as against (b) the total foreign currency payments which a creditor would have been entitled to receive in respect of principal and interest absent the administration.

209. To this extent, York's position is similar to that taken by Wentworth[27].

210. However, this is on the footing that the total foreign currency payments which a creditor would have been entitled to receive in respect of interest absent the administration are not (as Wentworth asserts) limited to interest received pursuant to contractual rate of interest but also includes interest which would have been received pursuant to the foreign judgment rate of interest or, if that is not applicable, the Judgments Act rate.

211. This raises a similar question to that raised by Issue 4 – the question of what is capable of constituting "*the rate applicable to the debt apart from the administration*".

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27 Wentworth Position Paper para. 138.

212. As explained above in relation to Issue 4:

(1) The purpose of allowing statutory interest in an insolvency at the Judgments Act rate is to put the creditor in the position he would have been had he obtained an ordinary civil judgment at the commencement of the insolvency: *Waterfall I* [2014] 3 WLR 466 at [163].

(2) The creditor should, so far as possible, not be prejudiced by the substitution of collective enforcement for individual enforcement and accordingly, where there is a surplus, he should be entitled to interest at the rate which he would been able to obtain through individual enforcement action.

(3) It would be wrong in principle for creditors who had bargained for contractual interest to receive interest at that higher rate, but for creditors who had bargained for the right to access the higher judgments rate in another jurisdiction to be denied that right. This would give the creditors with contractual interest a windfall at the expense of creditors whose contracts did not provide for interest, or whose claims did not arise under contracts.

213. These considerations apply equally when determining the amount of a creditor's Currency Conversion Claim.

214. In the context of Issue 4, contrary to York, the Senior Creditor Group and the Administrators, Wentworth argues that the "*rate applicable to the debt apart from the administration*" is not capable of including a foreign judgment, unless the creditor in fact had the benefit of a foreign judgment at the commencement of the administration[28].

215. Wentworth's position in relation to Issue 4 is wrong for the reasons given above. Equally, and for the same reasons, its position is wrong in relation to the similar question which arises in the context of Issue 28.

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[28] Wentworth Position Paper para. 25.

216. In addition to the points set out above, the misconceived nature of Wentworth's position is highlighted by the consequences which would follow in relation to Issue 28 – the calculation of the Currency Conversion Claim. In particular:

(1) On Wentworth's approach, a foreign currency creditor whose debt carries a contractual rate of interest is entitled (a) to recover post-administration interest in full at the contractual rate and (b) to recover full compensation for all foreign currency losses in respect of principal and interest.

(2) By contrast, on Wentworth's approach, a foreign currency creditor whose debt does not carry a contractual rate of interest is entitled (a) to recover post-administration interest at the Judgments Act rate but (b) the foreign currency conversion claim in respect of principal and interest is calculated on the footing that the creditor would not have received any interest absent the administration.

(3) The effect of this is that, in relation to the foreign currency creditor whose debt does not carry a contractual rate of interest, receipt of statutory interest off-sets the foreign currency conversion claim in respect of the principal. Accordingly, he is denied full compensation of his currency losses on the principal.

217. The effect of this, so far as a foreign currency creditor whose debt does not carry a contractual rate of interest is concerned, is arbitrary, unjust and impossible to justify. It places a foreign currency creditor whose debt happens to carry a contractual rate of interest in a far better position, and significantly prejudices a foreign currency creditor who bargained not to rely on a contractual rate of interest but on the rate of interest which would attach to the relevant arbitration award or foreign judgment.

218. The answer to this point is that Wentworth's position on Issue 28 (like its position on Issue 4) is wrong and that the rate of interest which the foreign currency creditor would have been entitled to receive absent the administration encompasses a foreign judgment rate of interest and is not limited to a contractual rate of interest.

219. If, however, York is wrong about this, then York's alternative approach in relation to Issue 28 is that the only way to deal with the serious injustices which would otherwise

result – as highlighted in paragraph 216 above – would be to treat the Currency Conversion Claim in respect of principal and the Currency Conversion in respect of interest as separate claims – as the Senior Creditor Group and the Administrators contend.

Issue 29: Currency conversion claim where interest paid at Judgments Act rate

220. Issue 29 asks:

> *Whether there exists a non-provable claim against LBIE where the total amount of interest received by a creditor applying the Judgments Act Rate on a sterling admitted claim, when converted into the relevant foreign currency on the date of payment, is less than the amount of interest which would accrue applying the Judgments Act Rate to the original foreign currency claim.*

221. In common with the Senior Creditor Group, York's position is that there would be a non-provable claim against LBIE in these circumstances where the Judgments Act rate is the rate applicable to the debt apart from the administration. The question of what may constitute "*the rate applicable to the debt apart from the administration*" is addressed under Issue 4. York's position (in common with that of the Senior Creditor Group and the Administrators) is that it is not limited to a contractual rate.

Issue 30: Currency conversion claim where interest paid at the rate applicable apart from the administration

222. Issue 30 asks:

> *Whether there exists a non-provable claim against LBIE where the total amount of interest received by a creditor applying a "rate applicable to the debt apart from the administration" on a sterling admitted claim, when converted into the relevant foreign currency on the date of payment, is less than the amount of interest which would accrue applying the "rate applicable to the debt apart from the administration" to the original foreign currency claim.*

223. The parties are all agreed that the creditor would have a non-provable currency conversion claim in these circumstances.

224. In relation to the point raised at para. 129 of the Administrators' Position Paper, it should not matter for these purposes whether the interest on the sterling admitted

claim is at the rate applicable to the debt apart from the administration or the Judgments Act rate. All that is necessary for a currency conversion claim to arise is that a difference exists between the amount of interest in fact received and the amount of interest which the creditor would have been entitled to receive but for the administration.

Issues 31-33: Currency conversion claims arising in relation to master agreements with a non-sterling base currency

225. York takes no position on these issues.

EFFECT OF POST-ADMINISTRATION CONTRACTS

Issue 37: Calculation of claims where a CDD compromises a number of claims with differing interest rates or currencies

226. York takes no position on this issue. The issue raises certain practical and evidential points which do not directly affect the LibertyView claims.

COMPENSATION FOR TIME TAKEN TO DISCHARGE NON-PROVABLE CLAIMS

Issue 39: Whether creditors entitled to compensation for late payment

227. Issue 39 asks:

> *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 to be taken into account as part of the correct 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.*

228. The relevance of this issue in practice depends on the answer to earlier issues (particularly Issue 2 concerning the application of the rule in *Bower v Marris* applies

to the calculation of statutory interest) and the extent to which the answers to these issues means that a creditor is already compensated for late payment,

229. However, to the extent that a creditor is not compensated for late payment as a result of the answers to the other issues, then York contends that creditors have a non-provable claim for damages for loss caused by non-payment of statutory interest in the period from when such interest became due (i.e. once there was a surplus remaining after payment of the debts proved) until it was in fact paid by the estate.

230. As to the position regarding claims for damages for the late payment of money:

(1) The general rule under English law is that as a claimant can recover damages for losses caused by a breach of contract or a tort which satisfy the usual remoteness tests: *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners* [2008] 1 AC 561 at [74].

(2) This general rule was subject to an exception in the case of late payments of a debt. Damages were not recoverable for breach of a contract to pay a debt: *London, Chatham and Dover Railway Co v South Eastern Railway Co* [1893] AC 429. However, in the *Sempra Metals* case this exception was overruled and abolished by the House of Lords: see [94]:

> *"... the House should now hold that, in principle, it is always open to a claimant to plead and prove his actual interest losses caused by late payment of a debt. These losses will be recoverable, subject to the principles governing all claims for damages for breach of contract, such as remoteness, failure to mitigate and so forth."*

(3) Accordingly, following *Sempra Metals*, at common law, subject to the ordinary rules of remoteness, a claimant is entitled to recover damages for the loss which he has suffered as a result of the late payment of money.

231. In fact, the situation in *Sempra Metals* itself did not concern late payment of a debt. Rather, the interest losses were claimed as damages for breach of statutory duty. Accordingly, the exception derived from the *London, Chatham* case did not in any event apply, and Sempra was entitled to plead and prove a claim for loss caused by breach of that statutory duty in the usual way. As Lord Nicholls observed (at [90]):

"In the present case Sempra is not claiming damages for interest losses caused by late payment of a debt. Sempra is claiming interest losses as damages for breach of a statutory duty. As such Sempra's claim does not fall within the exception to the general common law rules. Accordingly Sempra's damages claim is subject to the same rules as apply generally to damages claims in tort. Subject to satisfying those rules Sempra is entitled to recover damages in respect of the losses of interest, whether simple or compound, it sustained by reason of the wrongful levying of ACT."

232. The House of Lords did, however, emphasise that general damages are not recoverable, and that any loss resulting from late payment must be pleaded and proved (at [96]):

"But an unparticularised and unproved claim simply for "damages" will not suffice. General damages are not recoverable. The common law does not assume that delay in payment of a debt will of itself cause damage. Loss must be proved."

233. Turning to the position in the present case, the terms of rule 2.88(7) give rise to a statutory obligation to pay statutory interest once a surplus has arisen, and a corresponding right of creditors to have the surplus applied to pay that interest. The obligation was described as follows in the judgment in *Waterfall I* [2014] 3 WLR 466 (at [71]):

"As to whether rule 2.88(7) creates a debt or liability, it is no doubt true to say that it constitutes a direction to the administrator. It does not follow that it does not create a debt or liability of the company for the purposes of the subordination agreement. The assets constituting the surplus to which rule 2.88(7) applies are assets of the company in administration, albeit that their beneficial ownership is or may well be in suspense: Revenue and Customs Comrs v Football League Ltd (Football Association Premier League Ltd intervening) [2012] Bus LR 1539 , paras 101–102. The effect of the direction in rule 2.88(7) is to create a right in favour of creditors to have the relevant surplus applied in the payment of statutory interest. It does not create a proprietary or equitable interest in the surplus in favour of those creditors. It is in my judgment in no sense a misuse of language to say that it creates a concomitant liability or obligation. The definition of Liabilities includes liabilities and obligations "payable or owing by the Borrower". If the rule creates a liability or obligation, it is in my judgment rightly characterised as a right or obligation of the borrower for the purposes of this agreement."

(emphasis added)

234. From the perspective of the creditor:

(1) Where a surplus arises, a creditor acquires a statutory right to interest at either the Judgments Act rate or the rate applicable to the debt apart from the administration. The right accrues once there is a surplus remaining after payment of the debts proved.

(2) In these circumstances, rule 2.88(7) can either be characterised as giving rise to a statutory debt in respect of such interest or as imposing a statutory duty on the administrator to apply the surplus in paying such interest.

(3) In either case, in accordance with the principles in *Sempra Metals*, the creditor has a right to damages for loss caused by late payment: either by direct analogy with the position in relation to late payment of a contractual debt or by analogy with a right to damages for breach of statutory duty in making late payment (cf. *X v Bedfordshire CC* [1995] 2 AC 633, 731-732).

235. Moreover, in circumstances where there is a surplus in the estate, there is no reason why such claims should not be capable of being asserted. As stated in the *Waterfall I* judgment [2014] 3 WLR 466 at [98], in an insolvency process, the aim is:

> "*to achieve a broad justice, and in achieving that some creditors may find themselves in a worse position but equally other creditors may find themselves in a better position than their strict contractual rights .... But I do not understand why it should prevent those creditors who have not received their contractual entitlement from pressing their claims against the company once the statutory regime for pari passu distributions has run its course. It is no answer to a creditor with a contractual claim which has not been met to say either that, in other circumstances, he might have done better, or that other creditors have in fact done better. As Brightman LJ made clear in In re Lines Bros Ltd, individual creditors may not achieve their full contractual rights when they are in competition with other creditors, but there is no justice in them not doing so when they are in competition only with the debtor.*"

236. For its part, Wentworth contends that there is no damages claim to interest because there is no relevant breach of any obligation and, in particular, it says that statutory interest is not payable on any particular date[29]. However, this contention is wrong.

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[29] Wentworth Reply Position Paper para. 71.

(1) Under rule 2.88(7) the right to receive statutory interest accrues at the moment there is a surplus after payment of the debts proved.

(2) Since there is no provision which defers the payment of such interest to a later date, it follows that the right to receive payment of such interest arises at the same time.

(3) It is true that in practice an administrator may need to spend time, following a surplus having arisen, investigating interest claims. But it does not follow from this that, once such claims are established, whether as a result of such investigations or court decision, they are not treated as having accrued and become payable at the moment the surplus arose. In effect, the outcome of the investigations or the court decision would be declaratory of the rights which accrued and became payable at the time the surplus arose.

237. Finally, if the position was that neither the rule in *Bower v Marris* applies nor a creditor has any entitlement to compensation for late payment of statutory interest, then such creditors would suffer a loss, since they would not be compensated for their true loss, and the insolvent estate would be correspondingly enriched at their expense. Moreover:

(1) There would be no incentive on officeholders to deal and pay statutory interest claims expeditiously.

(2) Shareholders and subordinated creditors would in effect gain a "free option" to dispute such claims and to delay the administration of the estate.

238. There is no principled basis for denying proper compensation to creditors, and thereby enriching the insolvent estate (including, for example, the shareholders in the insolvent company). Why should shareholders benefit from the cash earned by the insolvent estate on cash which it holds in circumstances where creditors are denied compensation for the delay in satisfying their rights arising under the statutory scheme to receive interest? These considerations strongly point in favour of a right to compensation for late payment of statutory interest being available, in event that the rule in *Bower v Marris* does not apply.

239. In relation to late payment of a currency conversion claim, in practice a creditor is likely to be fully compensated by (a) statutory interest (either calculated in accordance with the rule in *Bower v Marris* or with a claim for loss for late payment as described above), (b) a currency conversion claim in respect of principal and (c) a currency conversion claim in respect of interest. However, to the extent that this does not fully compensate the creditor, then he would have a claim for damages for loss caused by late payment.

240. The juridical basis of the claim is the same as that of the currency conversion claim itself, namely, that the creditor is entitled to assert his underlying contractual rights for payment in a foreign currency on the due date. To the extent that right was not satisfied, including where the sums were received after the due date, the creditor is entitled to compensation for the loss and damage which he has suffered as a result.

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