Waterfall II Application

No 7942 of 2008

<u>IN THE HIGH COURT OF JUSTICE</u>

<u>CHANCERY DIVISION</u>

<u>COMPANIES COURT</u>

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) ANTHONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) JULIAN GUY PARR

(as the joint administrators of the above named company)

<u>Applicants</u>

- AND -

(1) BURLINGTON LOAN MANAGEMENT LIMITED

(2) CVI GVF (LUX) MASTER S.À R.L

(3) HUTCHINSON INVESTORS LLC

(4) WENTWORTH SONS SUB-DEBT S.À R.L

(5) YORK GLOBAL FINANCE BDH, LLC

<u>Respondents</u>

REPLY SKELETON ARGUMENT ON BEHALF OF THE FOURTH RESPONDENT

Introduction

1. This reply skeleton is not intended to address all of the points made in the more than 250 pages of skeleton served by the SCG and York. It focuses only on certain points upon which the Court may find it useful to have Wentworth's response prior to the hearing. Capitalised terms used but not otherwise defined herein are defined in the Waterfall II Application.

SCG Skeleton: Fundamental Principles (p.4ff)

2. Many of the "*fundamental principles*" which underpin much of the SCG's argument (SCG Skeleton, at [13]) are incorrect or overstated.

3. It is, for example, not a fundamental principle that all of the liabilities of the company that existed prior to insolvency must be satisfied in full before any assets are distributed to shareholders. The correct principle is that all of the liabilities which are required to be satisfied by the statutory scheme (including, to the extent that they are recognised, any non-provable liabilities) are satisfied in full before anything is paid to those lower down the priority waterfall, e.g. holders of subordinated debt or equity.

4. Thus, in *Re Danka Business Systems plc* [2013] Ch 506 the Court of Appeal rejected the argument of a contingent creditor that the liquidator was obliged to set aside a fund to meet contingent claims in full before making a distribution of the surplus to the members. S.107 of the Insolvency Act 1986 requires the surplus, after payment of the company's liabilities, to be distributed to members. Patten LJ held that "*the reference to the company's liabilities in section 107 must be to the liabilities as determined in accordance with the 1986 Rules. Otherwise they serve no useful purpose*."

5. This subtle distinction is particularly relevant in considering creditors' rights to interest relating to the period after the Date of Administration. It is Wentworth's case that the amount of such interest payable to all creditors is a matter of interpretation of Rule 2.88. That rule represents the manner in which the legislature intended that creditors should be compensated for the delay in receiving payment of their debts caused by the administration process. It imposes different and additional burdens on the company/debtor, and grants new and different rights to the creditors as a whole. As such, it covers the entire ground so far as compensation for that delay is concerned, and there is

no question of remitting creditors to such rights to interest as they may otherwise have had.

6. Accordingly, once creditors' rights to interest as defined by Rule 2.88 have been satisfied, claims for compensation for delay are exhausted, and the rights of other creditors at lower levels of the priority waterfall are then addressed.

7. In relation to a typical modern company, those who fall below non-provable liabilities in the priority waterfall may include subordinated creditors (depending on the terms of subordination), preferential equity holders and ordinary equity holders.

8. In working out the extent to which creditors' pre-existing rights to interest relating to the period after the commencement of administration are reflected in the Rules or otherwise preserved, it is unhelpful, and distracting, to have regard to general statements of principle in old cases dealing with the Bankruptcy Acts such as *Bromley v Goodere*. As Lord Hardwicke there noted "*All bankrupts are considered in some degree offenders … and all the acts are made to prevent their defeating and delaying their creditors…*"

9. In contrast, there is no reason to associate those who fall lower down the priority waterfall in a modern company with any "offence". In truth, all of those entitled to participate in the priority waterfall are, equally, *investors* in the company. What distinguishes them from each other is merely the level at which they invested. All of them are entitled to share in those assets, subject only to the satisfaction of the rights which the statutory scheme requires to be satisfied in priority to them. All of them – including subordinated creditors and equity holders (such as Wentworth in the present case) – suffer from the delay in administering the insolvent company's assets.

10. It is perhaps more pertinent to note that in the modern era ordinary creditors are being rewarded for the delay in distributions at an extremely generous rate, compared with prevailing market rates throughout the whole period of delay, whereas there is no reward at all for delay suffered by those investors at the bottom of the waterfall. In this context, the idea (mooted by the SCG) that to deny creditors the benefit of a *Bower v Marris* calculation would incentivise shareholders to delay the conclusion of an administration is perverse.

11. In this regard, the supposed loss to creditors, as represented in the graph at SCG Skeleton, [44], is illusory. It can be seen that the curve has to extend to beyond 2025, relative to the Date of Administration in 2008, before the simple rate (as applied to the ongoing period from 2008) even approaches the interest rate claimed by creditors that reference a prevailing market rate as a benchmark[1]. The comparison with the straight line simple rate (said to result from the principle in *Bower v Marris*) also ignores the language and purpose of Rule 2.88(7), which is to provide a 'baseline' rate of interest applied to the proved debt for the period it is outstanding. There is no loss of that right if the principle in *Bower v Marris* is not applied as the method calculation under Rule 2.88.

12. Coupled with the above points, the SCG's assertion, as fundamental principles, that the liquidation leaves the debts of creditors untouched, and that interest is payable from the insolvency surplus in a manner that respects creditors' underlying rights, simply begs the question which lies at the heart of Issues 2 and 39. As developed in Wentworth's skeleton, Rule 2.88 (and its equivalent in liquidation and bankruptcy) provides new and substantially different rights to creditors, so far as interest relating to the post-insolvency period is concerned, compared with those which they otherwise had.

<u>ISSUE 2</u>

Relevance of *Bower v Marris*

13. The parties all agree that Issue 2 concerns the true construction of Rule 2.88(7). Neither the SCG nor York provides a compelling answer to the points of construction in Wentworth's skeleton. The SCG's assertion that Rule 2.88(7) "*does not stipulate the method for calculating the amount of interest to be paid*" disregards the fact that the rule provides: (a) the rate of interest; (b) the principal sum to which it is to be applied (namely the proved debt); and (c) the period for which it is to be calculated (namely until the proved debt was paid in full).

14. To the extent that the SCG and York contend that *Bower v Marris* and the numerous cases cited in their skeletons which applied the same principle, demonstrate an approach to construction of statutory provisions which should be applied to Rule 2.88(7), such

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[1] See RSB1/page 9, which set out the work done by Zolfo Cooper.

argument is plainly wrong. As noted in Wentworth's skeleton, the principle applied in *Bower v Marris* had nothing to do with the construction of a statutory provision relating to the payment of interest from an insolvency surplus. In particular:

(1) In many of the cases (e.g. *Bromley v Goodere* and any case concerned with corporate insolvency in England) there was *no* statutory provision dealing with the payment of interest from an insolvency surplus; and

(2) In *Bower v Marris* itself, the only extent to which the Court may be said to have been construing the Bankruptcy Act 1825 was to determine whether the payments made by way of dividend had amounted to an appropriation towards payment of principal. The Court did not purport to impose any construction on that part of s.132 which provided that the surplus should be returned to the bankrupt after payment of interest to creditors.

15. The Administrators, in their skeleton, develop reasons why none of the cases cited by the SCG and York bear on the construction of Rule 2.88(7). Wentworth agrees, and does not repeat those points here.

16. To the extent that the SCG's and York's case depends upon establishing that there is a 'rule in *Bower v Marris*' that requires dividends paid in the administration to be appropriated towards interest on the proved debt relating to the post-administration period before principal (i.e. the proved debt itself), then they are similarly wrong.

17. There is simply no such rule. In fact, the principle which was applied in *Bower v Marris* is merely a *negative* one: that payments made pursuant to a statutory scheme such as distributions from a bankruptcy estate are *not* appropriated towards principal, but are treated as payments on account of both principal and interest then accrued.

18. This was merely a facet of the ordinary principles of appropriation. Those principles are that: (1) where a debtor owes two liabilities, e.g. for principal and interest, he is free to appropriate a payment towards one or the other and if the creditor accepts the payment so appropriated, he must apply it in the manner directed by the debtor; and (2) but if the debtor makes a payment on account of both, then the creditor is entitled to appropriate in his own interests.

19. The default position adopted in *Bower v Marris*, *Humber Ironworks* and later cases (that dividends were appropriated towards interest first) is in fact no more than a presumption. In this regard:

    (1) In *Bower v Marris* itself, in discussing the "*ordinary mode of calculation*" in the case of a solvent debtor (at p.355), Lord Cottenham recognised that the principle was no more than a presumption ("*no creditor would apply any payment to the discharge of the principal while any interest remained due*"), and explained (at p.356) that it was the *creditor* who remained *entitled* to apply payments made on account towards interest. Moreover, this is further reinforced by the way in which he distinguishes *Devaynes v Noble* (1816) 1 Mer 572 (*Clayton's Case*) (at p.360).

    (2) In the same way that a contrary intention in the contract may prevent payments being appropriated first to interest, in the testamentary cases, the presumption is subject to any contrary indication in the will: see *Re Morley's Estate*, per Simmonds J at p.496.

20. The case of *Smith v Law Guarantee and Trust Society* [1904] 2 Ch 569 demonstrates why, even if (contrary to Wentworth's case) the principles of appropriation had any relevance to the construction of Rule 2.88(7), it could not safely be assumed that the default rule applied in *Bower v Marris* would apply here.

21. In *Smith*, although the contract *required* payments to be appropriated first to interest, the court determined that:

    (1) the contractual right was solely for the benefit of the creditors;

    (2) that right was capable of being waived by them;

    (3) it was inevitable, in the circumstances, that the creditors would want to waive that right; and

    (4) accordingly, the payments were to be treated as having been applied first against *principal*.

22. Vaughan-Williams LJ said, at p.575:

> *"Now that it has been absolutely ascertained that there cannot be sufficient to pay the principal in full, it is unnecessary to ask the debenture-holders whether they would prefer that these moneys should be appropriated to interest or to capital, because obviously it is the interest of every one that the payments should be now attributed to capital."*

23. The reason it was in the creditors' interests in *Smith* to apply payments towards principal was that otherwise income tax would have been charged on the payments: see the headnote. In the case of LBIE's administration, the notices of distribution given by the Administrators (referred to at paragraph 7 of the Administrators' skeleton) stated that the Administrators were applying dividends to the payment of principal before interest. In the following sentence of the notice, it was stated that:

> "*LBIE may deduct income tax at source, or apply any other withholding, deduction, levy, impost or duty where such deduction of tax is required under prevailing law in relation to payments made to creditors*"

24. Accordingly, to the extent that a creditor would otherwise have suffered the deduction of tax from the payment made to it (had it been appropriated towards interest first), it cannot be assumed that an appropriation towards interest was in its interests. Indeed, where a creditor had accepted a higher (gross) payment of dividend by reason of the Administrators' stated intention to appropriate the dividend towards principal, it would be strongly arguable that the creditor itself must be taken to have elected to treat the payment as discharging principal. This raises a question of fact that is not for determination in Part A of the Waterfall II Application, but is clearly something that would arise in the event that the principles of appropriation had a role to play in the construction of Rule 2.88(7). It is likely that a large number of additional factual questions would need to be considered in order to determine whether there had, in fact, been an appropriation of the dividend payments to principal as opposed to interest.

25. In summary, once the principle actually applied in *Bower v Marris* is understood, it is clear that:

    (1) The principle has no relevance to the construction of Rule 2.88(7), which involves the question at what rate, for what period, and on what principal sum, is interest to be paid from the insolvency surplus in administration;

(2) The requirement that the creditor has a contractual or other pre-existing right to interest in order for the principle to operate at all, is clearly fundamental: because the concept of appropriation only exists where a payment is made on account of two or more liabilities then due; and

(3) The SCG is mistaken in asserting that Wentworth's argument is one that was rejected in *Bower v Marris*. The argument rejected in *Bower v Marris* was that the payments of dividends did constitute an appropriation towards principal. Wentworth's case does not depend on showing that there has been any particular appropriation.

Application of *Bower v Marris* to subsequent bankruptcy statutes

26. The SCG and York assert that the 'rule in *Bower v Marris*' was held to be consistent with all the subsequent iterations of the bankruptcy acts until 1986: see e.g. SCG Skeleton, at [127(1)]. This is simply wrong, and no authority is cited to support it.

27. In fact, as noted in Wentworth's skeleton and the Administrators' skeleton, there is no reported case in England in which *Bower v Marris* has been applied, or even considered, since the Bankruptcy Act 1883.

28. That date is important because it was in the Bankruptcy Act 1883 that, for the first time, the rule in relation to post-bankruptcy interest provided for a flat rate of interest (4%) to be paid out of a surplus to all creditors. Prior to that date, the legislation merely recognised, before any surplus could be returned to the bankrupt, the rights of creditors with interest-bearing debts to claim interest at their pre-existing (usually contractual) rate, and then only if there was surplus remaining after that, the rights of all other creditors to claim interest at a flat percentage rate.

29. There is no case under the Acts prior to 1883 which considered the application of *Bower v Marris* to creditors other than those with an interest-bearing debt. To the extent that York suggests that *Bower v Marris* was itself concerned with such creditors (York Skeleton, at [35] and [97(1)]) it is wrong. The reasoning of Lord Cottenham in *Bower v Marris* is applicable only to interest-bearing debts, because it is only on such debts that, but for the bankruptcy, interest continued to accrue and so only in respect of such debts could it be

said, at the time dividends were paid, they were paid on account of principal and interest then due.

30. Under the 1883 Act, there is no reference to an entitlement to post-bankruptcy interest at the rate applicable to the creditor's debt prior to bankruptcy. Instead, all creditors were entitled to interest at 4%. The SCG suggest (SCG Skeleton, at [95 & 96]) that the right of creditors with interest-bearing rates to recover interest at a higher rate than 4% was preserved by s.129 of the 1883 Act (and s.69 of the 1914 Act). That is wrong. Section 65 of the 1883 Act and section 69 of the 1914 Act required that the surplus was to be returned to the bankrupt "*after payment in full of his creditors, with interest, as by this Act provided*". Nowhere does it provide in either Act for interest at a higher rate than 4% for the post-bankruptcy period. To the contrary, and in contrast to section 45 of the 1869 Act[2], from 1883 onwards the trust in bankruptcy, the terms of which were and are[3] supplied by the Act and Rules in force from time to time[4], required the surplus *after* Statutory Interest to be returned to the bankrupt. That change in the bankrupt's entitlement to the surplus corresponded to the removal in 1883 of the remission to contractual rights as regards interest which had previously existed since 1824 in the Act and Rules from time to time in force.

31. Accordingly, by 1986, immediately prior to the introduction of new provisions for Statutory Interest in both corporate and personal insolvency, the position was as follows:

    (1) In winding-up, creditors' rights to interest from the insolvency surplus were regulated solely by reference to their pre-existing rights against the solvent company;

    (2) In bankruptcy, all creditors were entitled to interest from the surplus at the flat rate of 4%;

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[2] "*The bankrupt shall be entitled to any surplus remaining after his creditors, and of the costs, charges, and expenses of the bankruptcy.*"

[3] See in particular Sections 328(4) and 330(5) of the 1986 Act, which are considered further below. The bankruptcy is discharged, under sections 281 and 382 of the 1986 Act, of all "*bankruptcy debts*", which would include any rights to interest notwithstanding that such rights are precluded from proof under Section 322(2) of the 1986 Act.

[4] See *Bird v Philpott* [1900] 1 Ch. 822, 828 *per* Farewell J.

(3) There had been no reported case applying *Bower v Marris* in bankruptcy for over a hundred years; and

(4) The only reported instance of *Bower v Marris* being applied in the corporate context was in *Lines Bros*, where the parties all agreed that *Bower v Marris* should be applied and the position accepted by Mervyn-Davis J was put on the basis of a remission to contractual rights.

Cases cited by the SCG and York

32. The SCG and York cite a number of cases over and above those already addressed in Wentworth's skeleton argument, which they contend support their case on the application of *Bower v Marris* to the calculation of interest payable under Rule 2.88(7).

33. All of those cases, however, are consistent with the two key propositions identified at paragraphs 49 & 50 of Wentworth's skeleton and, as the Administrators note in their skeleton (paragraph 97), none of them is a decision relevant to the construction of Rule 2.88(7).

34. The new cases relied on by the SCG and York are considered very briefly in the Annex to this skeleton.

35. The SCG and York also rely on cases concerning interests on legacies and cases concerning the administration of estates. They seek to draw an analogy between those cases and the regime under the IA 1986. The cases do not, on proper analysis, support the position of the SCG and York. Instead, as outlined in the following paragraphs, the cases are consistent with the principle in *Bower v Marris* simply being a facet of the doctrine of appropriation.

<u>Interest on legacies</u>

36. The origins of the right to interest on a legacy can be traced to *Sitwell v Bernard* (1801) 6 Ves Jun 520, at 539-540; 31 ER 1174. The Court of Equity ordered that interest should be paid at a rate of 4 per cent after one year (the executor's year) reflecting the period which the law *presumed* sufficient for the executor to familiarise himself with the

deceased's affairs and to pay the legacies. Compensation was due after that time at the *presumed* rate of interest earned on the estate.

37. An executor is bound to administer the will in accordance with its terms. Subject to the terms of the will, the doctrine of appropriation applies as between the executor and legatee as regards any payments made to legatees on account of principal and interest. If the payment is made without any appropriation, the principle in *Bower v Marris* applies and the legatee is presumed to have appropriated in the way most favourable to him.

38. The rule is so expressed in Williams, Mortimer & Sunnucks (20th ed.) at 79-05 and 79-06[5]. In particular:

> "*[W]here payment in full of legacies is postponed because it is impossible to realise a testator's estate, the rule of administration, subject to any directions to the contrary by the testator, is that each payment made to legatees* ***on account of principal and interest*** *must be appropriated first to interest and then to the principal.*
>
> ***Thus****, the rule that if a payer of a sum of money is a debtor and the payee a creditor, the payee has the right to treat any sum paid to him* ***without appropriation*** *in respect of the debt primarily as a payment of interest due, applies equally when the payer is an executor and the payee a legatee.*" (Emphasis added.)

39. In each of the cases concerned with interest on legacies, it is clear that at the time of the payment to the legatee, there was outstanding both principal and accrued interest. Thus, the payment was made on account of both, and in the absence of appropriation by the testator, the creditor remained free to appropriate the payments in the way most favourable to him, i.e. to interest first.

40. In *In re Morley's Estate* [1937] Ch 491, for example, the death occurred on 1 February 1920 with probate granted on 27 April 1920. The estate was very large. Following an administration action by the executor for directions (not an application for a decree of administration by the Court, as to which see below) the Court directed payments on account of legacies at a rate of 2.5 per cent in 1922, 1926 and 1930. No order was specified as to the order of payment as between principal and interest which, in

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5 See also Snell's Equity at 35-034 to 35-037.

accordance with the executor's year, had begun to run at 4 per cent per annum from 1 February 1921. Simmonds J said (at 496):

> "*The questions before me are really these. First, what is the rule of administration which, **apart from any special direction**, guides the Court in determining whether **payments made on account of principal and interest** are first to be ascribed to principal, or first to interest, or partly to one and partly to the other, on some and what other basis? Secondly, having ascertained the rule, is there anything either in **the terms of this will or in any orders which have been made**, which prevents me now from applying that rule?*" (Emphasis added.)

41. There was nothing in the will or any orders which appropriated the payments to principal or interest. The legacies were therefore presumed to have been appropriated by the legatees in the way most favourable to them. Simmonds J said (at 496):

> "*That is the rule which I must apply in this case, treating that which is paid as paid first in satisfaction of interest, and then in satisfaction of principal, unless there is something in the will or something has happened in the administration of the estate which precludes me from doing so. The authority to which I refer is Thomas v. Montgomery. (1) Although Thomas v. Montgomery (1) was not cited, the principle was referred to recently in In re Prince (2) and has never been questioned or doubted.*"

42. The earlier cases of *In re Prince* and *Thomas v Montgomery* make clear that the application of the principle in *Bower v Marris* in legacy cases is a facet of the doctrine of appropriation. *In re Prince* (1935) 51 LT 526, Clauson J had said, at 526-27:

> "*[From Bower v Marris] I may clearly infer that, if the payer of a sum of money is a debtor and the payee a creditor, the payee has the right to treat any sum paid to him **without any appropriation** in respect of the debt primarily as a payment of interest due…The pecuniary legatee therefore have the right **at their discretion to appropriate** these payment in favour of interest due to them **at the time of payment on account of such legacies***" (Emphasis added.)

43. Just as in *In re Morley*, *In re Prince* had concerned payments on account made by the executors "*without any appropriation*" in 1933 and 1934.

44. In *Thomas v Montgomery* (1828) 2 Sim 347, Shadwell VC accepted the submission that, in a case where "*principal and interest are due*", the payment made without appropriation was on account of both principal and interest due and, "*according to the custom of all mankind*" it was presumed to have been appropriated by the legatees first to "*the discharge of that which is not productive to him*", i.e. interest (at p.351-352).

Interest on testamentary debts.

45. The SCG and York cite one case that applied the principle in *Bower v Marris* to interest accruing on testamentary debts: *Whittingstall v Grover*. This case too, however, demonstrates that *Bower v Marris* is merely a facet of the doctrine of appropriation. It is consistent with Wentworth's case.

46. The main argument in *Whittingstall v Grover* concerned priority as between the creditors of the separate estate of the deceased (which, although apparently insolvent was not being administered in bankruptcy) and the creditors of the joint estate of the banking business carried on by the deceased and another, who was bankrupt.

47. It is only the final paragraph in Chitty J's judgment which addresses briefly the calculation of interest and *Bower v Marris*.

48. In order to understand the application of the principle in *Bower v Marris* to the facts of *Whittingstall v Grover*, it is important to understand the following:

(1) The interest to which the *Bower v Marris* calculation applied was the interest due to the creditors of the separate estate of the deceased;

(2) Those creditors' right to interest derived from a **judgment** which arose in the following circumstances;

(3) On 26 January 1857, in an action for the administration of the estate of the deceased, the court ordered the usual accounts and enquiries to be taken;

(4) This order was treated, in the law relating to the administration of estates, as "*a judgment in equity for the benefit of all the creditors*" (Chitty J, at p.217);

(5) At the time of that order, rules of court (being the rules of 1841) applied. Chitty J noted that those rules were in the same form as Rules 62 & 63 of the then subsisting Rules of Court, Order LV. Relevantly Rule 62 provided as follows:

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

(6) This rule itself depended upon the Judgments Act 1838, which for the first time conferred an entitlement to interest upon a judgment. Chitty J noted, therefore, (at p.217) that "*the right of the creditor whose debt does not carry interest by law is, therefore, based upon the provisions of the statute 1&2 Vict 110 [i.e. the Judgments Act 1838] and the Order of 1841*"

(7) Critically, the right to interest arose in favour of all creditors whose debts did not bear interest at the date of the original decree, and therefore subsisted throughout the period when distributions were being made from the estate.

49. Accordingly, the application of *Bower v Marris* in those circumstances was no more than the ordinary application of the rule of appropriation that, since there had been no appropriation by the (deceased) debtor, distributions were payments on account of both principal and interest accrued due at the time payment was made, and the creditor remained entitled to appropriate those payments in his own best interests: see the final few lines of Chitty J's judgment, at p.217:

> "*The remaining question relates to the manner in which the dividends received ought to be accounted for, in ascertaining the amount of interest due.* ***All the dividends have been paid in process of law****, and the account ought to be taken in the manner pointed out in Bower v Marris ...* ***viz by treating the dividends as ordinary payments on account****, and applying each dividend, in the first place, to the payment of interest calculated to the day of such dividend, and the surplus (if any) to the reduction of principal*" (Emphasis added.)

50. The fundamentally different treatment of creditors in bankruptcy, and creditors in the administration of a deceased's estate was noted by Lord Romilly MR (cited by Chitty J in *Whittingstall v Grover*) in *Re Herefordshire Banking Company* (1867) L.R. 4 Eq. 250, at 252-53:

> "*The distinction which was pointed out to me yesterday is very clear, namely, that though* ***in the administration of assets*** *the Court does allow,* ***by its own authority****, interest at £4 per cent. from the date of the decree, it is because* ***the decree is a judgment in equity*** *in favour of all the creditors, and prevents them from getting a judgment at law which would give them interest.* ***But though a winding-up order is a decree in equity, and therefore a judgment, it is a judgment and decree of a different character.*** *It is in point of fact a decree amongst a great number of co-partners to settle their equities among themselves, and to wind up*

the affairs of the partnership, but ***that does not give the creditors of the partners a judgment against the company, or entitle them to any interest in respect of it.***" (Emphasis added.)

51. There is no reported case in which *Whittingstall v Grover* has been applied since 1886. In fact the circumstances in that case could not have been repeated in the case of a death after 1883. From that date, if the estate was found to be insolvent, it was transferred on the application of a personal representative or creditor of the deceased to be administered in bankruptcy: *Re York* (1887) 36 Ch D 233 (under section 125 of the Bankruptcy Act 1883); *Re Hay* [1915] 2 Ch 198 (under section 130 of the Bankruptcy Act 1914).

52. It was the fact that, prior to the 1883 Act, there was no separate provision made for an insolvent deceased's estate, that prompted Giffard LJ's comment in *Humber Ironworks*, in distinguishing the rule applied in testamentary cases at p.647 that "*for some reason or other dead men's estates have been assumed to be solvent…*"

53. The modern equivalent of the rules of court as they existed at the time of *Whittingstall v Grover* is to be found in the practice direction CPR 40PD. They apply in the event of an "administration order" (in the testamentary sense), which is the modern equivalent of the decree for an account referred to in Rule 62 applied in *Whittingstall v Grover*. The rules apply only to solvent estates. The modern rules reflect a bright-line between solvent and insolvent estates: see Snell's Equity at 32-002 to 32-003 and 34-002.

54. It is noteworthy that in discussing the administration of insolvent estates Snell's Equity (at 32-004 and 32-019) states the rules as to interest without reference to *Bower v Marris*, referring only to the Act and Rules in terms consistent with Wentworth's case, and in contrast to the treatment of legacies in the same work to which the rule in *Bower v Marris* can properly be applied, as noted above.

55. The SCG contends that in the same way that a decree in equity was treated as a judgment in favour of all creditors in reliance, in part at least, on the fact that creditors were precluded from obtaining their own judgment, a bankruptcy order, administration order or winding-up order similarly precludes creditors from obtaining their own judgment (without leave of the court), and thus creditors should be treated "*as if*" they were judgment creditors.

56. The deployment of such a legal fiction is, however, contrary to both the purpose and language of Rule 2.88. That rule does not confer a judgment debt in place of a simple debt, and its purpose does not warrant such a fictional treatment. The following authorities have rejected such an analogy.

57. First, in *Re Langstaffe* [1851] OJ No 238, Esten VC rejected the submission that debts which carried no right to interest but which, if sued upon to judgment, might have permitted a jury to award interest by way of damages had any entitlement to share in the surplus as against provable debts. He said (at 176-177):

> "*I do not consider that interest, not arising by force of any contract express or implied, but* ***merely capable of being awarded in their discretion by a jury****, as a debt provable under the commission…so as to be chargeable on the bankrupt's estate before the over-plus of it is handed to the bankrupt.*" (Emphasis added.)

58. Secondly, the process of insolvency has never been treated "*as if*" conferring a judgment debt, and any analogy with the historical position in Chancery as regards estates has been consistently rejected. See: In the *Warrant Finance Company's Case* (1869) LR 4 Ch App 643, where Giffard LJ stated as follows (at 647-48):

> "*I think it quite clear that the 170th section of the Companies Act has no reference to the matter before us; nor can I consider that anything in Kellock's Case (1) affects the present question.* ***The only argument really adduced in favour of computing interest subsequent to the winding-up is, that it has been the rule which has been adopted as to dead men's estates.*** *For some reason or other dead men's estates have been assumed to be solvent, and they have been wound up on that footing; but* ***so unjust*** *has that been found, that it has been necessary to have* ***a positive enactment to give interest from the date of the decree*** *to simple contract creditors whose debts do not bear interest. I think, therefore, that the reason of the thing is rather against the rule which has been adopted as to dead men's estates than in favour of it. As to the rule which my learned brother has laid down, it is the rule in bankruptcy. That rule was, as has been said, Judge-made law; but it was made after great consideration, and no doubt because it works with equality and fairness between the parties; and if we are to consider convenience, it is quite clear that, where an estate is insolvent, convenience is in favour of stopping all the computations at the date of the winding-up.*
>
> *For these reasons I am of opinion that dividends ought to be paid on the debts as they stand at the date of the winding-up; for when the estate is insolvent this rule distributes the assets in the fairest way; and* ***where the estate is solvent, it works with equal fairness, because, as soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract; and, on the other hand, a creditor who has not stipulated for interest***

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

59. See also the passage from the judgment of Lord Romilly MR in *Re Herefordshire Banking Company* cited above.

Policy reasons supporting Wentworth's construction of Rule 2.88(7)

60. The SCG and York both contend that there is no policy reason that creditors should not be able to appropriate the dividends paid in the administration in respect of their proved debts towards interest first and then to principal. As explained above, this misses the point as Rule 2.88(7) contains a complete statement of the extent to which Statutory Interest is payable on proved debts from an insolvency surplus.

61. Moreover, it is important to recall that Rule 2.88(7) does so in a way which provides valuable new entitlements for creditors with provable debts which are not based on the continuation of their contractual or other pre-insolvency rights and thereby imposes a simple and certain regime for all creditors: these are enumerated in Wentworth's skeleton at [17]. To those new entitlements it may be appropriate to add (depending on the Court's answer to Issues 7 and 8) the fact that interest is payable on future debts from the Date of Administration, even where the value of the future debt is not discounted back for dividend purposes, which may be a substantial variation to the creditor's right otherwise to be paid interest only from when the payment fell due. A similar point may be made (again depending on the Court's answer to Issue 7) in relation to contingent debts.

62. It is also important to keep in mind the correlative point that, as against its creditors as a whole, the company is subjected to different, and additional, obligations to that which it was subject prior to the insolvency.

63. It is common ground that one of the recommendations of the Cork Report that was implemented in 1986 was to extend the right of all creditors to a flat rate of interest, which had existed in Bankruptcy since 1883, to corporate insolvency. As already noted, there is no reported instance of *Bower v Marris* being applied in bankruptcy since 1883, and the leading bankruptcy text book made no reference to it throughout the period 1883 to 1986. It is true that there is no case which rejected its application. The arguments of

Wentworth and the Administrators before this Court would logically, however, have led to the rejection of *Bower v Marris* in bankruptcy from 1883.

64. Even outside the realms of bankruptcy, there is no universal assumption that payments on account would be appropriated towards interest first. In the vast majority of bankruptcies, most of the debts are likely to be below the County Court threshold. In relation to County Court judgments, the rule is that "*Money paid by the debtor in respect of any judgment debt shall be appropriated first to discharge or reduce the principal debt and then towards the interest*": SI 1991/1184, paragraph 6(2).

65. Moreover, the application of the principle in *Bower v Marris* would be directly contrary to the recommendations of the Cork Report that there should be a simple and certain statutory scheme governing the payment of interest in insolvency proceedings: see the Cork Report, at paragraph 1392. In addition to the points made at [28] and [80] of Wentworth's skeleton, an additional complication is that noted above, where the tax consequences of payments relating to interest as opposed to capital have been recognised and acted upon, thus giving rise to actual appropriation of dividends to principal. Indeed, the *re-characterisation* of earlier dividends as having been referable to interest (once Statutory Interest is much later paid) may itself create further serious difficulties. Wentworth notes that the Administrators, highly experienced insolvency practitioners, agree that the application of *Bower v Marris* would create very serious difficulties.

66. The difficulties to which the application of *Bower v Marris* gives rise, would operate perversely so as to incentivise creditors entitled to Statutory Interest to litigate each and every issue which could prevent the distribution of the surplus and thereby guarantee a virtually riskless minimum return of 8% p.a. during this extended period. This would directly prejudice the prospect of any return in respect of claims ranking lower down the insolvency payment waterfall.

ISSUE 39

67. The arguments on Issue 39 in the skeleton arguments of the SCG and York suffer from a number of obvious difficulties. Wentworth highlights the following points by way of reply.

68. First, the SCG wrongly contends that their argument is supported by general principle of policy: see SCG Skeleton, at [448]-[450]. The matters relied upon by the SCG do not provide any justification for a non-provable claim. In addition to the points made above at paragraphs 2-12, the passage from Selwyn LJ's judgment in *Re Humber Ironworks* must be read in its proper context. The case was concerned with whether interest should be paid on proved debts in circumstances where the statute did not provide for any such interest. The case is not addressing the possibility of interest on interest.

69. Second, the attempt of the SCG (SCG Skeleton, at [458]) to assert that a creditor without a right to contractual interest may also have a non-provable claim for damages, provides a good demonstration of why the SCG's analysis of non-provable claims is wrong. The common law claim for damages which they envisage might, but for the insolvency, have provided a claim for interest as damages (although each such claim would only arise if all the ingredients of a damages claim could be established). But it cannot seriously be said that such a claim could exist in parallel to Rule 2.88, which is designed to compensate for precisely the same thing. Where the delay is caused by the insolvency scheme, then the compensation which the insolvency scheme specifically allows for that delay is surely all that the creditor could ever be entitled to.

70. Third, any non-provable claim for damages caused by the non-payment of Statutory Interest in respect of the period between the date of payment of debts proved and the date on which Statutory Interest is paid would be inconsistent with the statutory regime governing post-administration interest. Rule 2.88(7)-(9) provides a new and different bundle of rights to that which creditors might already have had as regards post-administration interest. Moreover, Rule 2.88(7) requires that the surplus arising after payment of proved debts in full be utilised in paying Statutory Interest *before* it is used for "*any* [other] *purpose*", i.e. "*any purpose*" other than paying Statutory Interest on the proved debts for the period such debts were outstanding. At that point, there is a liberty to apply the remainder in accordance with any rights that may have claims upon it. There is no contemplation by the draftsman that a surplus against Statutory Interest *must* be used

to compensate for the delay in paying Statutory Interest. Such a claim would, logically, be the *next* ranking claim after Statutory Interest, and it would so easily have been expressed had it been intended. The contemplation by the draftsman that the surplus against Statutory Interest is at liberty to be applied to "*any* [other] *purpose*", in accordance with whatever *rights* may have claims upon it, is flatly inconsistent with the implication of a claim for *interest on Statutory Interest* as a necessary claim following immediately after the payment of Statutory Interest[6]. In those circumstances, it must be taken to have substantively altered the rights of creditors, so that there can be no remission to those rights just because Rule 2.88 gives them less than they might otherwise have got.

71. Fourth, the assimilation of the position as regards Statutory Interest in a corporate insolvency with that in bankruptcy is a powerful indication that the draftsman did not intend that there should be a non-provable claim for interest after the payment of Statutory Interest. The key point to be made here is that the discharge of the bankrupt from bankruptcy debts precludes any non-provable claim for interest after the payment of Statutory Interest. Instead, the surplus is returned to the bankrupt under section 330(5). The identical language of Rule 2.88(7) and Section 328(4) (which provides for the payment of Statutory Interest in a bankruptcy), supports Wentworth's position that Statutory Interest is a creditor's only entitlement to compensation for the delay in administering the statutory trust.

72. Fifth, there is no basis for the suggestion by the SCG that the absence of a non-provable claim would defeat the intention that interest is paid at the Judgments Act Rate: see SCG Skeleton, at [461]. Rule 2.88(7) clearly requires interest to be paid only for the period<u>s</u> the proved debts are outstanding. The reference to "*periods*" is to take account of the fact that interim dividends may be paid (something which the SCG accept at SCG Skeleton, [267]). So it is common ground that interest is paid on (say) the £50 which is paid after one year, only for the period up to when that £50 is paid. Rule 2.88(7) necessarily envisages that there will be a delay until the proved debt is paid in full, and

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[6] Such a claim would not achieve its purpose if merely a further claim ranking with other non-provable claims. This is because the compensation for delay in paying Statutory Interest would be diluted by other claims. Such a claim, had it been intended, would have had to have been expressed as a prior ranking claim in order to achieve its purpose of compensating for *the delay in paying Statutory Interest*. The Court has no power to rank such a claim (were it to recognise it) in priority to other non-provable claims. The fact that a mere further non-provable claim would not achieve the economic purpose said (by the SCG and York) to justify a claim for interest on Statutory Interest is a reason against its acceptance.

thus recognizes that there will be a delay before the interest due on the first £50 can be paid. The statutory purpose of paying interest at the Judgments Act Rate thus countenances that very delay.

73. Sixth, the argument that a non-provable claim is necessary in order to ensure a *pari passu* distribution (SCG Skeleton, at [462]) goes nowhere as it is based on the flawed premise that those with a contractual right to compensation do have a non-provable claim. In any event, even if they do, then there is no breach of the *pari passu* principle if those without a contractual right to compensation do not have a non-provable claim: the difference in distribution merely reflects their different rights: one set had bargained for interest, the other had not.

74. Seventh, the matters relied upon in the SCG Skeleton, at [463] fail to meet the argument in Wentworth's skeleton argument that interest is payable only if there is a recognisable cause of action and that there is no such cause of action in the present case. The fact that the court will have established, by the end of this application, who is entitled to interest and on what basis cannot give rise to a cause of action for the non-payment of interest before the action was resolved.

75. Eighth, the SCG appears to advance a non-provable claim for any loss and damage that has resulted from the creditor not receiving payment on the date of administration: see SCG's Skeleton, at [457(2)]. This claim is flawed as:

(1) Any loss and damage suffered by the creditor will form part of its provable debt (e.g. its damages for breach of contract) provided it does not amount to, in substance, a claim for post-administration interest which is not capable of proof.

(2) Those parts of the claim which, in substance, amount to an attempt to recover post-administration interest will not rank as a non-provable claim. As Wentworth explains in relation to Issue 2, such a claim does not survive the regime for the payment of Statutory Interest.

76. Ninth, Wentworth notes that the SCG has not developed any separate legal reasoning to support a non-provable claim in favour of a creditor with a CCC based on damages for loss suffered as a result of the non-payment of the claim on the date the claim fell due for payment. As outlined in Wentworth's skeleton argument, such a claim is flawed as it is a

claim in the *character* of post-administration interest (since it is a claim for damages arising out of the loss of time value of money for the period after administration), and thus does not survive the regime for the payment of Statutory Interest.

77. Tenth, the SCG is misguided in its attempt to found its argument on the reasoning in *Waterfall I*, at [127]. The reasoning of the Judge must be seen in its proper context, namely the conclusion of the Judge that there was a statutory lacuna such that where an administration is immediately followed by a liquidation, interest for the period of the administration is neither provable nor payable as statutory interest in the liquidation: see *Waterfall I*, at [112]-[126]. The reasoning of the Judge is, on proper analysis, supportive of Wentworth's case that Rule 2.88(7) provides a complete code for the payment of Statutory Interest in an administration; just as section 189(2) IA 1986 provides a complete code for the payment of Statutory Interest in a liquidation.

78. Eleventh, all parties acknowledge (in relation to Issue 1) that compound interest is not payable on a judgment under the Judgments Act. This points against any non-provable claim existing for interest on Statutory Interest.

79. Finally, if Wentworth is wrong generally in relation to non-provable claims in respect of interest based on failure to satisfy creditors' prior rights, then Wentworth's position is as follows:

    (1) It can only be creditors with a contractual (or similar) right to interest at a greater amount than they get from the statutory regime under Rule 2.88 that have such a claim;

    (2) Any non-provable claim has been released under the wide release provisions included in the CRA and the CDDs entered into by creditors when agreeing their claims against LBIE.

ISSUE 3

80. It is common ground between the parties that the reference to "*rate*" in Rule 2.88(9) encompasses a compound rate and is not limited to a simple rate.

81. Wentworth rejects any suggestion that the reference to "*rate*" includes a calculation according to the principle in *Bower v Marris*. The principle is irrelevant to the operation of Rule 2.88 for the reasons given by Wentworth in its case on Issue 2.

ISSUE 4

82. For the reasons set out in Wentworth's skeleton argument, a creditor who had not obtained a judgment in a foreign jurisdiction at the Date of Administration is unable to claim interest at a rate permitted by statute in that foreign jurisdiction on judgment debts, on the basis that the creditor might have obtained judgment there in the absence of administration.

83. The contrary arguments contained in the skeleton arguments of the SCG and York suffer from a number of obvious difficulties[7]. Wentworth highlights seven points by way of reply.

84. First, the arguments of the SCG and York fail to pay proper regard to the fact that the "*debt*" referred to in Rule 2.88(9) is (as acknowledged in the SCG Skeleton, at [290]), a reference back to the debt in respect of which a proof was submitted, because the rate referred to in 2.88(9) is applied, by 2.88(7) to "*those debts*", being the debts proved.

85. The "*debt*" in respect of which a proof was submitted consists of the creditor's rights as at that date, be they based on contract, tort or some other branch of the law of obligations. It is by reference to those rights alone that the question of whether the debt is subject to a rate greater than the Judgments Act Rate must be determined. The words cannot sensibly be construed as including a rate which *might* be applicable to a judgment which there was a mere hope of obtaining as at the Date of Administration.

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[7] Wentworth notes that the Administrators do not take a position on Issue 4: see Administrators' Skeleton, at [133].

86. Second, the argument of the SCG and York that Rule 2.88(9) requires one to consider the counterfactual of what would have occurred if there had been no administration is internally inconsistent. It can be seen that they contend, on the one hand, that it is necessary to answer a whole series of hypothetical questions in relation to events which may have occurred after the Date of Administration in order to see whether a creditor would have achieved a judgment in a foreign jurisdiction with a rate of interest greater than the Judgments Act Rate, but they contend, on the other hand, that this greater rate would be applicable from the Date of Administration even in circumstances where it would have taken several years to have secured the judgment in the foreign jurisdiction. This internal inconsistency serves to illustrate why the argument of the SCG and York should be rejected.

87. Third, for the reasons set out in Wentworth's skeleton at [133], the case advanced by the SCG and York is directly contrary to the recommendation of the Cork Report (at paragraph 1392) that, in preparing the rules for interest on proved debts, "*simplicity and certainty are essential*".

88. Fourth, the SCG and York are wrong to contend that Wentworth's interpretation of Rule 2.88(9) involves an arbitrary cut-off as at the Date of Administration. The date of the commencement of insolvency proceedings has a fundamental role to play in respect of many aspects of the Insolvency Act and Rules, not least as concerns the valuation of claims against the company so as to ensure a *pari passu* distribution of the assets of the company. Indeed, the importance of a single cut-off date is emphasised elsewhere in the SCG and York skeleton arguments. Most importantly, the Date of Administration is the cut-off for the purpose of determining whether a claim is provable and therefore the Statutory Interest that is payable on the proved debts. Accordingly, it is consistent with the statutory scheme that the Date of Administration operates as the cut-off date for ascertaining which rights of a creditor are relevant for determining whether the proved debt is subject to a rate greater than the Judgments Act Rate.

89. Fifth, the attempt of the SCG and York to place reliance on the statutory moratorium on proceedings against the company is misguided. The imposition of the moratorium to give breathing space in an administration is one important aspect of the statutory regime in return for which the creditors receive new rights as a *quid pro quo*, including, in a

distributing administration, an entitlement to a minimum rate of interest at the Judgments Act Rate.

90. Sixth, in any event, the SCG and York are wrong to contend that a simple rate of 9% p.a. interest would be awarded as part of a judgment secured against LBIE in New York. In this regard:

(1) A New York court would be likely to apply the Default Rate on any claim under an ISDA Master Agreement after judgment, even if it is below 9%, because the ISDA Master Agreement recognises that the Default Rate should apply both prior to and following judgment.

(2) Where the Federal Courts have jurisdiction over claims, they would award a judgment rate at the Federal Rate. This is a fluctuating rate which is currently 0.21% compounded annually (it was 1.69% compounded annually when LBIE entered into administration in 2008).

91. Seventh, yet further complications arise in circumstances where a creditor (an example is provided by Liberty View Funds in which York is interested) has agreed under the relevant contractual framework to arbitrate all disputes with LBIE. There is no basis for a conclusion that such a creditor would have been entitled to prejudgment or post-judgment interest at 9% p.a..

92. The above matters serve to illustrate further the difficulties that would be involved in determining what foreign judgment rate *might* have been applicable to the claim of the creditor if it had chosen to bring proceedings in a foreign jurisdiction.

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13 February 2015

ADDITIONAL AUTHORITIES RELIED ON BY THE SCG AND YORK IN RELATION TO THE APPLICATION OF BOWER V MARRIS

Triden Contractors Pty Ltd v CE Heath Casual (1996) 9 ANZ Inc Cas 61-356 [SCG/1032[

1. There is nothing of any relevance in this case. It concerned the rights of a contractor, who had obtained a judgment against an employer prior to the winding-up of the employer, to assert a claim for interest against an insurance fund which was charged with payment of the judgment. The Supreme Court of New South Wales held that interest payable on a judgment debt under a statute, the Supreme Court Act 1970 (NSW), was a right capable of assertion against the fund. Sheller JA (without making any comment about the rule in Bower v Marris) simply said, at 76-944:

> "*Interest payable pursuant to s95(1) of the Supreme Court Act is intended to compensate the judgment creditor for the loss of the use of money suffered by non-payment of the judgment or order. Had Timalco not been in liquidation, interest would have been payable pursuant to s95(1) on the amount it was ordered to pay Contractors on 8 June 1994. By its professional indemnity policy Heath agreed to indemnify Timalco against claims made against Timalco for breach of its professional duty.* ***There is no reason why this indemnity would not extend to cover interest which accrued on and became part of the claim.*** *In particular, Heath had agreed in the policy to pay costs and expenses incurred in Timalco's defence of Contractors' claim.*
>
> *…*
>
> *The winding up did not discharge Timalco from* ***its liability under s 95(1) of the Supreme Court Act to pay interest*** *to the extent that could be paid from other sources, in this case, the insurance moneys charged.*"

2. Section 95(1) of the Supreme Court Act is the New South Wales equivalent of the Judgments Act. Triden is therefore a case concerned with a non-contractual right to interest against an indemnity which extended to that right.

Re Emilco Pty Ltd (2002) 43 ACSR 536 [SCG/102]

3. In this case, the question was as to the correct treatment of "*a provable debt that carried interest by virtue of the terms of the relevant contract*" (at [4]). Barrett J, at [15], applied Giffard LJ's statement, as to remission to contractual rights, in the *Warrant Finance Company's* case, and said at [17]:

> "*If a surplus does remain — that is, there has been payment of 100c in the dollar in respect of all admitted claims and the liquidator still has funds in hand —* ***the creditor with a claim for post-commencement interest referable to an obligation incurred by the company before commencement is entitled to assert his or her contractual right against the company****. This is the position in bankruptcy (Re Hyman (1930) 3 ABC 61) and also in winding up: Re Fine Industrial Commodities Ltd [1956] Ch 256.*"

Re Tahore Holdings Pty Ltd (2004) 49 ACSR 550 [SCG/101(1)]

4. The only relevance of this case is that it confirmed that, whereas it had previously been held in Australia that the relevant insolvency legislation permitted creditors to assert *contractual* claims to interest against a surplus arising after payment of proved debts, the same applied where a creditor had a pre-existing entitlement to interest by virtue of having a judgment debt entered before the winding-up.

Re Kershaw [2005] NSWSC 313 [SCG/102]

5. This case, too, was concerned only with the rights of creditors with interest bearing-debts to claim their contractual entitlement once dividends were paid in full. Barrett J, at [19-20], said that the principle concerned those creditors whose debts carried interest according to their terms, and concluded that the principle "*proceeds on the basis that, after all proved and admitted claims have been satisfied in full, a creditors it* ***remitted*** *to any inadmissible balance of his or her claim*."

Canada (Attorney General) v Reliance Insurance Company [2009] OJ No 3037 [SCG/105]

6. In this case, the Judge merely followed (without any discussion) the approach adopted in the *Confederation Life* case (which is dealt with at paragraphs 64-69 of Wentworth's skeleton).

Gourlay v Watson & Co (1900) 2 Ct Session (5th series) 761 [SCG/107(1)]

7. The Court of Session was concerned with whether payments under a trust for creditors had discharged principal in priority to interest such that the creditors had a lesser claim to the surplus than if accrued interest had been discharged first. The submissions were in terms of the trustee having made an appropriation. Lord Young, at 767-68, rejected that submission for two reasons:

(1) The creditor had a right to principal and simple interest, which rights allowed him to appropriate part payment by the debtor first to interest, upon assenting to the trust for creditors. The trust was not to be construed as taking away any part of that entitlement.

(2) There was no appropriation by the debtor:

(a) The payments were not by the debtor but by the trustees pursuant to the trust which was to be construed as Lord Young had explained.

(b) The doctrine of appropriation would have no part to play, as regards a debtor in default, as between interest and principal because a creditor would refuse a payment appropriated by the debtor to interest. The payment by the trustee's should not be regarded differently.

(c) The trustees did not in fact appropriate first to principal because an honest trustee could not; therefore, the trustees were to be taken not to have so appropriated.

8. Nothing of any authority (persuasive or otherwise) can be read into the obiter comment of Lord Moncreiff at p.770 that "*the analogy of bankruptcy, both here and in England, is in accordance with this view*".

Re Peregrine Investments Holdings Ltd [2008] HKC 606 [SCG/197(3)]

9. *Bower v Marris* and the *Warrant Finance Company's* case were relied on by Chu J in support of his decision that a secured creditor with both provable and non-provable claims in a bankruptcy was entitled to appropriate security realisations towards the non-provable debt.

Ohio Savings Bank & Trust Co v Willys Corporations (1925) 8 F 2d 463 [SCG/107(4)]

10. In this case, Rogers CJ applied *Stone v Seymour* (1863) 15 Wend. 19, in which Chancellor Walworth in New York had affirmed that the doctrine of appropriation was part of New York law, to the calculation of interest in a US receivership. Rogers CJ was

not concerned with any statutory rule. Walworth C had that rule by which appropriation was first made to interest applied: -

> "*when partial payment have been made upon accounts or demands drawing interest, and where* ***both principal and interest were due at the time of such payment***."

11. As the passage from the decision of Rogers CJ cited by the SCG at paragraph 107(4), the view from the United States as to the principles to be derived from *Bower v Maris* and *Humber Ironworks* was that payments made to creditors in a receivership were payments on account, "*without prejudice to the inherent right of adjustment that always exists in cases of this nature*".