IN THE COURT OF APPEAL

Appeal Ref: 2017/0043

ON APPEAL FROM THE HIGH COURT

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) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER S.A.R.L.
(3) \HUTCHINSON INVESTORS, LLC

Appellants

- and -

(1) ANTONY 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))

(6) WENTWORTH SONS SUB-DEBT S.A.R.L.
(7) YORK GLOBAL FINANCE BDH, LLC

Respondents

SENIOR CREDITOR GROUP'S SUBMISSIONS ON THE IMPACT OF THE SUPREME COURT'S JUDGMENT IN WATERFALL I

INTRODUCTION

1. As a consequence of the Supreme Court decision in the Waterfall I proceedings [2017] UKSC 38 (the "**SC Judgment**"), the SCG accepts that:

   (1) It is not possible to make a non-provable claim against the LBIE surplus referable to Currency Conversion Claims ("**CCC**"), because the Supreme Court held that rule 2.86 of the Insolvency Rules 1986 (the "**Rules**") operates as a complete code for recovery in respect of proved foreign currency claims in an administration (see the SC Judgment at [73]-[96], and [194]). All of the Waterfall IIA and IIB issues predicated on the existence of CCC as non-provable claims therefore fall away and do not require determination by the Court of Appeal[1].

   (2) Nor is it possible for a creditor to make a non-provable claim against the LBIE surplus in respect of any shortfall in interest, because the Supreme Court held that rule 2.88 of the Rules operates as a complete code for the recovery of interest on proved debts in an administration (SC Judgment at [124]-[127]). All of the Waterfall IIA and IIB issues predicated on the existence of a non-provable claim for unpaid interest in respect of proved claims therefore fall away and do not require determination by the Court of Appeal[2].

2. It is common ground that the SC Judgment does not determine any of the other issues before the Court of Appeal, being **Waterfall IIA Items 1, 2, 4, 5, 11 and 12** on the Tables. It is further agreed that there is nothing of relevance in the SC Judgment to **Waterfall IIA Items 5 and 12**. However, the parties differ as to the relevance and impact of the SC Judgment on **Waterfall IIA Items 1, 2, 4 and 11**.

3. For the reasons set out below, the SCG contends that the SC Judgment and the reasoning of their Lordships assists the SCG's position in relation to Waterfall IIA Items 1 and 2, and is neutral or irrelevant in relation to Items 4 and 11.

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1 Being **Waterfall IIA Items 6, 8, 9, 10 and 13,** and **Waterfall IIB Items 1, 2 and 4** on the tables provided to the Court by Linklaters' letter dated 9 June 2017 (the "**Tables**").

2 Being **Waterfall IIA Items 3 and, in part, 7,** and **Waterfall IIB Item 3**. The parties are agreed as to the position in relation to the remainder of Waterfall IIA Item 7 such that the Court can treat the Item as one which does not require any form of determination: see also Wentworth's further written submissions on the impact of the SC Judgment at [35].

WATERFALL IIA: ITEMS 1 AND 2 (Application of *Bower v Marris*, continued compounding of interest after payment of the final dividend)

4. Items 1 and 2 both concern the true construction of rule 2.88. The SC Judgment does not address the meaning of rule 2.88 beyond stating that it provides "*a complete statutory code for the recovery of interest on proved debts in administrations and liquidations, and there is now no room for the Judge-made law which was invoked by Giffard LJ*" (SC Judgment at [124]).

5. *Item* 1: As the Court is aware, the SCG submits that rule 2.88 should be construed in a manner that calculates interest in the ordinary way (and thus gives effect to the rule in *Bower v Marris*) on the basis that:

   (1) Such a construction accords with fundamental principles and policies of company and insolvency law, and the equitable principles underlying *Bower v Marris*. In an insolvency distribution, interest should be calculated in the ordinary way;

   (2) Such a construction gives due and proper weight to the state of the law prior to 1986, and the interpretation of prior provisions and legislative schemes using similar language or principles;

   (3) Nothing in the 1986 pre-legislative materials (such as the Cork Report) indicates an intention to abolish the long standing application of the equitable principle;

   (4) Nothing in the language used in rule 2.88 prevents the equitable principle from being applied;

   (5) Rule 2.88 is intended to provide creditors with the higher of "*the rate applicable to the debt apart from the administration*" and the Judgments Act rate of 8% and should be construed as requiring such interest to be calculated in the ordinary way, including by applying the equitable principle, and not in the unprincipled and uncommercial manner suggested by Wentworth; and

   (6) There is no good reason or policy requirement for concluding that rule 2.88 should operate in a manner contrary to the equitable principle. On the contrary, a failure to apply the equitable principle is likely to lead to real unfairness. Creditors will not receive the full amount of interest to which they are entitled and which they would

have received had the company not gone into administration. A creditor that is entitled to Judgments Act rate interest at 8% because it was prevented from obtaining a judgment by the statutory moratorium will also receive interest at an effective simple rate which is much lower than 8%, which effective rate will decline as delay continues. Equity holders may, for various reasons, be incentivised to delay distribution of the surplus without risk of prejudice (because interest on the existing assets will accrue to their benefit and not that of the creditors)[3].

6. The meaning of the two aspects of the language of rule 2.88 which focus on the applicable "*rate*" remain unaffected by the SC Judgment. The intended rate of interest that creditors should benefit from is either (i) the rate applicable apart from the administration; or (ii) the 8% simple interest rate provided by the Judgments Act. Statutory Interest should therefore be calculated in the ordinary way so as to ensure that creditors receive either the full interest to which they are entitled by reference to their underlying rights or an effective rate of 8% simple per annum. Any other conclusion contradicts the clear legislative intent of providing that interest be paid at such rates. No aspect of the language of rule 2.88, or the SC Judgment, compels any other conclusion.

7. *Item* 2: For similar reasons, the SCG also submits that rule 2.88 should be construed in a manner that provides for the continued compounding of interest after payment of any final dividend, on the basis that:

(1) Any other interpretation does not properly reflect the nature and effect of a creditor's right to compound interest;

(2) Any other interpretation is uncommercial, producing an unprincipled half-way house that is neither compound interest nor any other recognisable form of commercial interest; and

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3 The LBIE administrators have in this case been unable to progress a proposed consensual interim distribution of interest because of the opposition of Wentworth: see the 23 June 2017 update at https://www.pwc.co.uk/services/business-recovery/administrations/lehman/update-on-various-items-including-waterfall-i-23-06-2017.html (section headed "Interim distribution of statutory interest" – "*the Joint Administrators have been informed by Wentworth that it will not approve the proposal and it will therefore no longer be pursued*").

(3) The language of rule 2.88 is consistent with a right to compound interest in that a debt in relation to which interest is compounding (and therefore capitalising) can be treated as outstanding unless and until the compound interest has been paid.

8. The SC Judgment supports various aspects of the SCG's arguments. Its rejection of CCC does not have any impact on the merits of Waterfall IIA Items 1 or 2 for the reasons developed below.

Fundamental principles and policies continue to be relevant

9. First, the SC Judgment emphasises the importance of construing the Rules (and rule 2.88) in accordance with fundamental principles and the overall purpose of the Rules, and in a manner that is consistent with, and permits the application of, general equitable principles.

10. The principal passages in this regard (cited in full for convenience) are from Lord Neuberger's judgment at [12], [13], [176] and [177]:

> *"12 As anticipated in the White Paper, the 1986 legislation represents a comprehensive overhaul of the insolvency legislation, adding new procedures and new rules and rewriting many of the established procedures and rules. Most, indeed probably all, fundamental principles apply just as they always have done - the pari passu principle is an obvious example. However, when it comes to less fundamental procedures and rules, it cannot be assumed that judicial decisions, even at the highest level, relating to previous insolvency legislation necessarily hold good in relation to the 1986 legislation. Where the wording of a provision in the 1986 legislation has not changed from that of a provision in previous legislation, then, at least prima facie, it may normally be assumed that the effect of the provision was intended to be unaltered, but where the language has been significantly changed, such an assumption may easily lead to error.*
>
> *13 Further, despite its lengthy and detailed provisions, the 1986 legislation does not constitute a complete insolvency code. Certain long-established Judge-made rules, albeit developed at a time when the insolvency legislation was far less detailed, indeed by modern standards sometimes positively exiguous, nonetheless survive. Recently invoked examples include the anti-deprivation principle (see Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd [2012] 1 AC 383), the rule against double-proof (discussed in In re Kaupthing Singer & Friedlander Ltd (in administration) (No 2) [2012] 1 AC 804 , paras 8 to 12), the rule in Cherry v Boultbee (1839) 4 My & Cr 442 (also discussed in Kaupthing (No 2) [2012] 1 AC 804 , paras 13 to 20), and certain rules of fairness (alluded to in In re Nortel GmbH [2014] AC 209 , para 122). Provided that a Judge-made rule is well-established, consistent with the terms and underlying principles of current legislative provisions, and reasonably necessary to achieve justice, it continues to apply. And, as Judge-made rules are ultimately part of the common law, there is no reason in principle why they cannot be developed, or indeed why new rules cannot be formulated. However, particularly in the light of the full and detailed nature of the current insolvency legislation and the need for certainty, any judge should think long and hard before extending or adapting an existing rule, and, even more, before formulating a new rule."*

...

176 As I have already indicated, given the detailed and coherent nature of the 1986 legislation, a judge must think long and hard before laying down a new Judge-made rule to liquidations. However, in this case, the course being contemplated does not involve inventing an entirely new rule. It involves extending an existing rule so that it can apply to what is an analogous, albeit not identical, situation to that to which it previously applied, and doing so in order to achieve precisely the same end for which it was conceived.

177 A more difficult question is whether taking such a course would involve extending the contributory rule in a way which is inconsistent with the provisions or principles of the current legislation. There is, at least at first sight, a strong argument that such an extension would be inconsistent with Rule 2.69 (which requires debts to be paid in full unless the assets are insufficient to meet them), and rule 2.88(7) (which requires any surplus remaining after payment of the debts proved to be applied in paying statutory interest "before being applied for any purpose") - see paras 20 and 27 above. The answer to this argument is to be found in the fact that the contributory rule undoubtedly applies in a liquidation - see per Lord Walker in Kaupthing (No 2) [2012] 1 AC 804 , para 20 and per Briggs LJ in this case, [2016] Ch 50, para 243. Yet if the argument is correct, the contributory rule could not apply in a liquidation, as rule 4.181 and section 189(2) are expressed in effectively identical terms to rules 2.69 and 2.88(7) respectively. The true analysis is that the contributory rule is an aspect of a "general equitable principle" which operates as a qualification to the 1986 Rules regarding distributions in liquidations, and is needed to ensure compliance with the overall purpose of those rules (as discussed in McPherson's Law of Company Liquidation , 3rd ed (2013), paras 10.036, 13.097 and 13.099). Precisely those reasons justify the extension of a slightly modified version of the contributory rule to administrations."

11. The SC has therefore reaffirmed the validity of the primary argument made by the SCG: that, where possible, it is necessary to construe rule 2.88, like all legislation in the field of insolvency, so as to give effect to fundamental principles and sensible policy objectives: *Re Kaupthing Singer & Friedlander* [2010] Bus LR 1500 at [32]-[33] [Authorities3/86]; and *Mills v HSBC Trustees* (CI) Ltd [2012] 1 AC 804 at [1] [Authorities3/91]. More generally, legislation should also be construed as to as give effect to equitable principles unless a contrary intention appears: Bennion on Statutory Interpretation at Sections 327 and 330.

12. The ordinary rule of fund administration and interest calculation relied upon by the SCG is a well-established equitable principle of fairness and justice, reflecting common sense: see *Re Humber Ironworks* at 647. The equitable principle has been consistently and universally applied in the field of insolvency. Its application reinforces the insolvency waterfall (SC Judgment at [17]) and the fundamental principle that creditors' underlying rights should be reflected in the insolvency scheme, and satisfied, before funds are returned to shareholders; i.e. creditors first, shareholders last. The good sense in applying the principle is demonstrated by the fact that, prior to this case, no Court, in any Commonwealth jurisdiction, had ever concluded that interest payable in circumstances similar to those at hand should be calculated other than in accordance with the equitable

principle, and all the courts that considered it regarded its application as a matter of justice and fairness.

13. Wentworth seeks to downplay the relevance of such principles and policy objectives to the construction exercise. At [11] of its further written submissions, it argues that the Court should not depart from the words of the relevant rule unless they give rise to a situation which is "*absurd or unworkable*" (relying on the SC Judgment at [142], dealing with the lacuna issue).

14. This fails to reflect accurately the approach to legislative interpretation described by Lord Neuberger at SC Judgment at [12] and [13] and [177], and the SCG's submissions. The question for this Court is what the language of rule 2.88 means. The SCG is not (see the SC Judgment at [142]) asking the Court to adopt an analysis which "*involves re-writing the legislative provision to enable it to achieve a more instinctively likely result than if the actual words used in the provision are construed according to the normal principles of interpretation*". It is asking that, if rule 2.88 can be construed in a way which is consistent with the equitable principle, it should be so construed.

15. Furthermore, if rule 2.88 is construed in a manner that allows a company to pay Statutory Interest to a creditor in an amount less than that which it was obliged to pay apart from the administration, issues of abuse may arise. A company which went into administration because it was unable to pay contractual interest could seek to use the process to escape that obligation. This cannot have been intended and is inconsistent with fundamental principles of insolvency.

16. Therefore, absent a clear and deliberate exclusion of the principle (which there is not), rule 2.88 can and should be construed in a manner that accommodates the operation of the equitable principle.

17. Similarly, in relation to Item 2, the SC Judgment supports the argument that the meaning of "*rate*" in rule 2.88(9) must be given a commercially sensible meaning which accords with fundamental principles, and therefore gives effect to all aspects of the underlying right to compound interest. Anything short of that is a commercial nonsense which cannot reflect the intended effect of the Rules.

Prior authorities are also relevant

18. Second, the Supreme Court re-affirmed that the "*intellectual freight*" arising from prior decisions and regimes dealing with a particular issue may be of relevance when interpreting the Rules, even when concerned with less fundamental procedures or rules (see the last eight lines of the SC Judgment at [12], cited above; and *Somji v Cadbury Schwepps* Plc at [23] and [24] [Authorities 2/67A]).

19. Wentworth is wrong to suggest (see its further written submissions at [8]) that "*the detailed and comprehensive code found in the 1986 Act and 1986 Rules should lead to the Court being careful not to apply the principles developed under a previous insolvency regime or dicta contained in authorities decided under a previous insolvency regime.*" That is not what is said in the SC Judgment at [12] and [13], or any of the other paragraphs to which reference is made by Wentworth.

20. The correct position is that, whilst it cannot be assumed that prior decisions and interpretations of equivalent provisions will necessarily hold good (see the language used at SC Judgment [12]), consideration should be given to whether the new provisions replicate prior provisions, why prior provisions and decisions dealing with the same issue were adopted and interpreted in a particular way, and whether the introduction of new or differing language was intended to alter the approach. In certain cases, it may be right to adopt an "*out with the old, in with the new*" approach and ignore what was said and done under the previous regimes (see SC Judgment at [90]). Whether that is the correct approach depends on the particular provisions in issue.

21. As the SCG submits, certain aspects of the language of rule 2.88 (see paragraph 6 above) indicate that the Court should be seeking to interpret rule 2.88 in a manner that accords with creditors' underlying rights, or provides an effective rate of interest at the Judgments Act rate. As a matter of construction, none of the four elements of the language of rule 2.88 relied upon by the Judge justifies a result which applies a different rate of interest, nor is sufficient to reject the application of the equitable principle: all existed in a materially similar form in the prior English regimes, and were not regarded as preventing application of the equitable principle. See, generally, the SCG skeleton argument at [A1/11-15]; and the appeal hearing transcript at Day 1, pages 16-47 and 135-138; Day 4, pages 62-73.

22. In this case it would therefore be wrong to ignore the intellectual freight arising from decisions relating to the prior regimes and to the treatment of post-insolvency interest.

This is particularly so where there has been a consistent approach both in English decisions and throughout the Commonwealth to resolution of the issue at hand through the application of the equitable principle, and none of the elements of rule 2.88 relied upon by the Judge have been treated (or needs to be treated) as a bar to application of the equitable principle. Thus, as the SCG submits:

(1) Application of the equitable principle has repeatedly been held to be consistent with a requirement to pay proved debts in full before interest; and

(2) The reference in rule 2.88 to "*... the periods during which they have been outstanding...*" can be read simply as reflecting the need to take into account any dividends received. Rule 2.88 does not provide for the manner of calculating interest, nor does it indicate how, for the purpose of conducting the interest calculation, you work out the period for which the proved debts have been, or are to be treated as, outstanding (see appeal hearing transcript Day 1, page 33 lines 5-12).

23. By contrast, that consistency in approach was absent in the few decisions concerning foreign currency claims that existed prior to 1986: see the SC Judgment at [82] and [83]. Lord Neuberger's comment at SC Judgment [83] that "*[i]t is in my opinion dangerous to rely on judicial dicta as to the effect of an earlier insolvency code, given that the 1986 legislation amounts to what Sealy and Milman op cit describe as including "extensive and radical changes in the law and practice of bankruptcy and corporate insolvency, amounting virtually to the introduction of a completely new code*" must be read in the context of the remainder of the paragraph, which makes clear that it was the lack of judicial established practice in relation to the issues raised by foreign currency claims, and the fact that there were principled grounds for supporting either of the two alternative conclusions, which meant that prior decisions were of little relevance for the purpose of interpreting the 1986 rules.

24. Neither factor is present here: there is overwhelming consistency in approach, and no good or principled reason justifying non-application of the equitable principle.

No non-provable claim to provide an alternative means of recovery

25. Third, the fact that the Supreme Court has indicated that the "*escape hatch*" of a non-provable claim is not available, supports the need to construe rule 2.88 in a manner that is

commercially sensible and fulfils creditors' underlying rights rather than cutting across them.

26. If rule 2.88 occupies the field then, whether those underlying rights continue to exist or have been replaced by rule 2.88 (see, by analogy, the differing obiter analyses of Lord Neuberger at SC Judgment [97]-[111] and Lord Sumption at SC Judgment [195]-[201]), it is more important than ever that rule 2.88 reflects a calculation of interest in the ordinary way as provided for by application of the equitable principle.

Prior legislative materials do not support rejection of the principle

27. Fourth, it is important to contrast the Supreme Court's conclusion regarding the extent to which the issue of CCC had been addressed in the Cork Report and other pre-legislative materials, with the absence of reference to *Bower v Marris* in the Cork Report or any other pre-legislative materials. Thus:

(1) Having reviewed the relevant reports (including Cork), Lord Neuberger at SC Judgment [88] concluded:

> *"Accordingly, it is quite clear that the "Cork Committee" and the Law Commission each carefully addressed this very issue during the five years leading up to the 1986 insolvency legislation, and reached the clearly expressed and firmly held conclusion that foreign currency claims should be dealt with in solvent, as well as insolvent liquidations, in the manner contended for by the LBHI2 administrators in these proceedings. ...."*

See also [194] per Lord Sumption. The Supreme Court concluded that there was, pre-1986, a "*general understanding*" to this effect (SC Judgment at [89]), which would be contradicted if the approach of the majority of the Court of Appeal in Waterfall I was upheld; and

(2) By contrast, there is no mention at all in the Cork Report or other pre-legislative materials prepared in advance of the 1986 reforms of the equitable principle in *Bower v Marris*, and certainly no criticism of the principle or suggestion that its continued application was thought to be objectionable. The absence of critical comment is important in circumstances where David Graham QC was both counsel in *Re Lines Bros (No. 2)* and a co-opted member of the Cork Committee.

Application of the principle is consistent with the general aims of the 1986 regime

28. Fifth, little weight ought to be placed on the objective of "*simplicity*" for the purpose of resolving Items 1 and 2 in circumstances where an interpretation of rule 2.88 which incorporates the rule in *Bower v Marris* better accords with fundamental principles of insolvency and equity. Contrary to Wentworth's further written submissions at [17] and [18], there is nothing that contradicts this in the SC Judgment:

(1) The application of the principle in *Bower v Marris* is consistent with the desire for simplicity:

a. In many cases, the application of the principle will simply involve identifying the interest that would otherwise have been payable to a creditor in accordance with its underlying rights. The calculation required is neither complicated nor overly difficult: it has been conducted for centuries even without the assistance of computers; and

b. Wentworth suggests that a further complication is introduced in a case where administrators want to make interim distributions of interest, because "*the relative rights of creditors to post-administration interest would be constantly fluctuating, requiring a re-evaluation of all creditors' entitlements whenever an interim distribution in respect of interest was to be made*". However, this is not a new problem: it arose equally under prior and other regimes. It is not a problem on the facts of this case: Wentworth has to date refused to agree to or facilitate an interim distribution of interest. Nor is it a problem of real substance: even in a case where the surplus may be insufficient to pay Statutory Interest in full, the problem is not irresolvable (or materially more complicated than that faced by officeholders in relation to cases where there are late or disputed claims). There is no obligation to pay interim dividends of interest and, in any event, a cautious but realistic process of retaining assets (akin to that suggested by the Supreme Court in the context of the contributory rule: see SC Judgment at [180]) will enable any issue to be resolved.

(2) Furthermore, whilst it is correct that achieving "*simplicity*" was one of the objectives identified in the White Paper, it was not the only objective that the reforms pursued.

As noted in the SC Judgment at [10], the objectives identified in both paragraphs 2 and 4 of the White Paper also included the role of the insolvency legislation being to "*establish effective and straightforward procedures for dealing with and settling the affairs of corporate and personal insolvents in the interest of their creditors*". The Cork report was very clear in this respect at [191] under the heading "*The basic objectives of Insolvency Law*":

> *"It is a basic objective of the law to support the maintenance of commercial morality and encourage the fulfilment of financial obligations. Insolvency must not be an easy solution for those who can bear with equanimity the stigma of their own failure or their responsibility for the failure of a company under their management."* (Emphasis added).

If rule 2.88 can be read in a manner that ensures that an insolvent entity will fulfil the financial obligation that it freely entered into in respect of interest, it should be so interpreted.

(3) The Supreme Court did not suggest that simplicity is a principle of overriding importance that justifies fundamental principles or policy objectives being overridden. What is said and relied upon by Wentworth at [17] of its further written submissions must be read in context. Thus, at [89], Lord Neuberger emphasised that "*given the general understanding*" that the Supreme Court had concluded existed prior to 1986 regarding the approach to foreign currency claims (i.e. that creditors ought not, through a CCC or otherwise, to get a second bite at the cherry), it was inconsistent with the drive for simplicity to construe rule 2.86 as permitting CCC to be made as non-provable claims against the surplus; and

(4) The issue posed by rule 2.88 is entirely different. There is no comparable pre-existing general understanding that favours the "*simple*" approach. Wentworth is arguing for an unprecedented result. The desire for (where possible) a straightforward regime does not explain why the principle in *Bower v Marris*, which reflects the ordinary approach and which has been described as a rule of justice and convenience for many years, should not be applicable.

Continued relevance of creditors first, shareholders last

29. Sixth, the rejection of CCC as non-provable claims against the surplus does not support an argument that the "*creditors first, shareholders last*" principle no longer applies, or should not inform the construction of rule 2.88:

(1) At [13], [14] and [16] of Wentworth's further written submissions, Wentworth argues that the SC Judgment at [47], [90] and [125]-[127] supports its position and suggests that "*it is wrong to construe the legislation by reference to what rights a creditor would have had but for the insolvency, and assume that the legislation intended those rights to be satisfied before any return is made to members*";

(2) This is incorrect. The "*creditors first*" principle remains a fundamental principle of insolvency, and the Supreme Court has assumed that creditors' underlying rights to interest would be reflected in the relevant provisions dealing with post-insolvency interest. Thus, at SC Judgment [53], Lord Neuberger described section 189(2) of the Insolvency Act 1986 (i.e. the equivalent provision dealing with interest in a liquidation) as operating in a manner which would provide for payment of the interest that would otherwise have been contractually due to the creditor, or the 8% judgment rate, whichever is the higher:

> "*53 Section 189(2) effectively confirms that interest, which would, in the absence of the liquidation, normally be expected to be contractually payable by the company from the liquidation date until repayment of the principal, is payable in the liquidation, but only if there is a surplus. Possibly because the effect of a liquidation is thought to be like that of a judgment in that it stops contractual interest running, or possibly as compensation for such interest ranking below unsecured provable debts, section 189(4) gives a creditor the option of claiming such interest at the judgment debt rate rather than the contractual rate.*

(3) Ultimately, the rejection of CCC was founded on a simple point: that rule 2.86 was inconsistent with the existence of CCC as non-provable claims against the surplus: SC Judgment at [81], [96] and [194]. Lord Neuberger commented on the surprising absence of a provision which enabled changes in exchange rates to be taken into account where a surplus existed in order to ensure that creditors would be paid in full (SC Judgment at [96]), but concluded that the language of rule 2.86 compelled the conclusion which was being reached. Unlike in the case of rule 2.88, there was

no scope to argue that rule 2.86 provided for such claims or could be interpreted in a manner consistent with such claims;

(4) The position in respect of CCC is wholly different to Waterfall IIA Items 1 and 2. These items are concerned with the interpretation of rule 2.88, not with whether a non-provable claim outside the scope of the Rules exists. No equivalent "*hybrid*" or "*one-way bet*" issue arises in relation to the underlying entitlement to post-insolvency interest. The interpretation of rule 2.88 advanced by the SCG is consistent with the pre-1986 position and with the language adopted in the rule. There is no indication of any intention to alter the application of the equitable principle;

(5) The nature of CCC was always different to a claim to post-administration interest, and self-evidently potentially more problematic. The hybrid nature of the claim being made was a point that both Lord Neuberger and Lord Sumption commented on in the Supreme Court at [104] and [194] respectively (and Lord Neuberger agreed with Lord Sumption's comment at [96]):

> *"104 … In other words, the notion of a category of hybrid debt with a presently provable element seems improbable, particularly bearing in mind that the 1986 legislation was intended to simplify and that its policy was to render as many debts as possible provable …"*
>
> *194. … Non-provable debts are normally debts for which no provision is made in the statutory mechanism of proof and distribution. But the Insolvency Rules do provide for foreign currency debts. Rules 2.86 and 4.91 provide that they are to be valued at the cut-off date and that distributions are to be made in accordance with that valuation. The limitations of these provisions are as much part of the statutory scheme as their positive enactments. It follows that if a debt is provable but the limited character of these provisions nonetheless leaves part of it unsatisfied, the creditor cannot recover more in respect of the same debt by reference to the Judge-made rules governing non-provable debts. A foreign currency debt is a provable debt. It is both inherently implausible and inconsistent with the language of the Rules to suppose that the legislator envisaged that the same debt could at one and the same time be recoverable as to part as a provable debt and as to the rest as a non-provable, conditionally on there being a surplus. That this limit on the recoverability of such debts was deliberate is strongly suggested by the fact that both the Law Commission and the Cork Committee, whose reports were the basis of the 1986 legislation, concluded that the unsatisfied balance of a foreign currency debt should not be recoverable, even if there was a surplus from which to pay it. …"*

(6) The substance of the SC Judgment does not suggest that the "*creditors first*" principle has been abrogated. The paragraphs relied upon by Wentworth do not support the proposition for which they are being cited: they are not concerned with the approach to construction of the Rules. They are concerned with the effect of the inclusion of

rule 2.86 as part of the statutory scheme. The fact that rule 2.88 operates as a complete code to the exclusion of reliance on any underlying rights (the point made by Lord Neuberger at SC Judgment [126]) tells us nothing about the content and construction of rule 2.88. Cases such as *Re Humber Ironworks* remain relevant precisely because they are decisions which gave effect (in other contexts, or under other schemes) to the creditors' first principle even if the solution available in those cases was not the same as the solution adopted under the 1986 regime; and

(7) Wentworth's submission is, ultimately, circular and assumes what it needs to prove. It is circular because it argues that: rule 2.88 is a complete code; if rule 2.88 does not satisfy the creditor's underlying rights, the creditor is unable to rely on its underlying rights to make a non-provable claim; and therefore rule 2.88 should be interpreted in a way which does not satisfy the creditor's underlying rights. It assumes that rule 2.88 does not reflect a creditor's underlying rights (and cannot accommodate either the rule in *Bower v Marris* or compound interest) without explaining why it should be so interpreted.

The rules of appropriation are irrelevant

30. Seventh, nothing in the SC Judgment gives any support to Wentworth's arguments regarding appropriation. As the Court will recall, the SCG submits that:

(1) The rule in *Bower v Marris*, as explained by the Lord Chancellor in that case, is not a rule or "*facet*" of the common law principles of appropriation: it is an equitable principle of fund administration which operates where, by reason of payments by process of law, appropriation has not been possible. Wentworth's suggestion that it is only concerned with legal rights and obligations and common law appropriation (see Wentworth's further written submissions at [18] and [19]) is wrong;

(2) There is no requirement for interest to have been technically due and payable at the time of any dividend payment in order for the equitable principle to apply: the principle operates on the basis of a fiction (i.e. that dividends paid in respect of principal can, for the purpose of calculating interest, be treated as if they were paid in respect of interest), and that fiction can equally extend to treating interest as due

as at the date of payment of a dividend, whether or not it was technically due at that date. That is to say, it suffices if it can be said, at the point when the principle is to be applied, that interest was (or can be treated as having been) due as at the date of payment of the dividend; and

(3) If, contrary to (2), interest had to be due at the time of payment of the relevant dividend, rule 2.88 operates in a manner whereby interest can be treated as having been due at the relevant time, or as being a contingent obligation (dependent on the existence of a surplus) such that it can be said with hindsight that, at the time that the equitable principle is applied, interest was due to the creditor at the date of the dividend.

31. Wentworth now says (see its further written submissions at [20]) that the SC Judgment and comments of Lord Neuberger at [47] and [52] of the SC Judgment "*reinforce the conclusion that unless and until a surplus arises there is no question of there being any accruing claim to interest at the time that dividends in respect of proved debts are paid*". However:

(1) The Supreme Court found that the Statutory Interest obligation was "*payable and owing*" within the meaning of the subordination agreement (see SC Judgment [52]) and it would be artificial to suggest that the liability to pay Statutory Interest (see SC Judgment at [47]) would not be regarded as a liability of the Company for the purpose of the equitable *Bower v Marris* calculation; and

(2) There is no reason why, at the point at which the equitable principle is applied, and it is known that a surplus exists, Statutory Interest cannot be regarded as having been accruing throughout the relevant period. Nothing in the SC Judgment assists Wentworth's case in this regard, or improves the appropriation argument. On the contrary, and c/f the Judge's approach at first instance at [154], the SC Judgment supports the argument that (were it necessary) it is proper to extend the equitable principle in a manner which accommodates the language of rule 2.88 in order to achieve the same end for which the equitable principle was conceived if that accords with the overall purpose of the Rules: see the SC Judgment at [176]-[177] concerning the contributory rule.

WATERFALL IIA: ITEM 4 (further interest or damages in respect of the time taken to pay statutory interest)

32. Item 4 is concerned with whether, in the event that (as the Judge held) the amount of Statutory Interest is fixed at the point when the final dividend is paid, and there is then a delay in distributing Statutory Interest, creditors are entitled to any form of compensation for that delay, in addition to the Statutory Interest payable, in order to ensure that they will receive an effective rate of compensation of 8% per annum or the rate otherwise applicable.

33. As the SCG submits, it cannot have been the intention of those drafting the legislative scheme that Statutory Interest could be retained for a period of years, diminishing the value of the creditor's right to Statutory Interest, and simultaneously benefitting shareholders (through the accrual of interest on the cash/increase in value of the assets being held). A creditor should therefore be entitled to assert a claim for compensation in respect of the time taken for such interest to be paid.

34. In that regard, there is a simple solution. Rule 2.88(7) makes clear that, once debts proved have been paid, the surplus is to be applied in paying interest; i.e. in this case, as at April 2014, the Statutory Interest became due and payable. If that liability is due and payable as from April 2014, and there is a delay in payment of Statutory Interest, it follows that creditors will have a claim for damages: *Sempra Metals Ltd v Inland Revenue Commissioners* [2008] 1 AC 561.

35. Nothing in the SC Judgment affects this common law damages analysis, which ultimately depends on the construction of rule 2.88; i.e., whether Statutory Interest can be said to have become due and payable once proved debts have been paid in full.

36. Wentworth suggests, however, that the SC Judgment "*seriously undermines*" the SCG's arguments for four reasons (see paragraphs 24-28 of Wentworth's further written submissions). None of the points made have any merit.

37. First, Wentworth relies on the complete code interpretation of rule 2.88 and suggests that, combined with the presumption that rule 2.88 spells out the full extent of creditors' rights,

this renders "*it unlikely in the extreme that there can be a further right to interest, about which the legislation was silent*". However:

(1) The SCG is not seeking to argue that the right to Statutory Interest under the Rules is anything other than the interest provided by rule 2.88. The point being made is that, if that interest is not paid when it falls due, creditors will be entitled to the usual compensation provided by English law to a person who experiences delay in the receipt of money;

(2) The comments in the SC Judgment regarding rule 2.88 constituting a complete code were made in the context of rejecting the argument that any unsatisfied element of an underlying right to interest could be enforced by way of a non-provable claim. The rejection of that argument (on the basis that rule 2.88 contains a complete statement of the Statutory Interest to which a creditor is entitled in respect of proved debts under the rules) was not directed at, and does not assist with, the question of what happens if payment of the Statutory Interest payable under rule 2.88 is itself delayed beyond the point at which it falls due; and

(3) As regards what should happen where delay in distributing Statutory Interest occurs, interpreting the Rules in a manner which permits a form of compensation to be paid for delayed payment of Statutory Interest, such that the creditors' compensation will be at the effective rate anticipated by the legislature, is a more logical and coherent approach to the construction of rule 2.88 than an interpretation which requires creditors to bear the cost of open-ended delay.

38. Second, Wentworth relies on the "*simplicity*" objective (see paragraph 30 above). However, the fact that it would be "*simpler*" for there not to be a claim for compensation for delay in payment does not begin to justify construing the rules in a manner that would be contrary to the interests of the creditors entitled to Statutory Interest, or contrary to the usual principle of English law that delayed payment should entitle a creditor to damages.

39. Third, Wentworth seeks to argue that, because any claim for failure to pay statutory interest would have to be directed to the officeholder, rather than being made against the company, and the SCG have not asserted to date any breach of obligation by the Administrators, "*there is no basis on which it could be said that there has been a breach of an obligation to pay statutory*

interest by a certain time which is capable of founding a claim for compensation" (see Wentworth's further written submissions at [27]). This confuses two separate questions:

(1) Whether rule 2.88 provides (on its true construction) for a time at which Statutory Interest becomes due and payable by the company; and

(2) Whether the officeholder is in breach of duty for failing to pay a debt which has become due and payable.

40. As to the first, rule 2.88 does provide for a time at which Statutory Interest becomes due and payable, being the point at which the proved debts have been paid in full. If this is right, there is no logical reason why a common law damages claim for late payment cannot be made by creditors (c/f [167] of the Judge's first instance decision). The Rules do not prohibit or exclude any such claim.

41. As to the second, the SCG does not allege breach of obligation against the administrators for failure to pay a debt which has become due and payable. Nor does it need to. Its argument is simply that, by reason of not paying the "*liability for statutory interest*" (see SC Judgment at [47]) when that liability fell due and payable, creditors have a non-provable claim against the surplus for damage suffered as a consequence of that failure to pay. The SCG maintains that the liability to pay Statutory Interest is to be regarded as a liability of the company for these purposes (see the point left open by the SC Judgment at [145], having concluded that Statutory Interest was "*payable and owing*" by the Company for the purpose of the subordination agreement).

42. Fourth, Wentworth suggests that the SC Judgment *"makes clear that the SCG is unable to rely on the dicta in Re Humber Ironworks regarding no creditor being forced to suffer from a delay in the distribution of the insolvency estate*" (see Wentworth's further written submissions at [28]). This is also wrong:

(1) The underlying point made in *Re Humber Ironworks* [Authorities 1/16] and *Canada Deposit Insurance* [Authorities 2/58] is that no person should be prejudiced by the accidental delay which, in consequence of the steps necessary to administer assets in an insolvency proceeding, takes place in realising assets or distributing assets; and

(2) That proposition remains good, and is not criticised or reversed by the SC Judgment (at [125] of elsewhere). What is rejected by the Supreme Court is the solution adopted in *Humber Ironworks* (reversion to rights) in circumstances where rule 2.88 now provides a codified set of rights defining Statutory Interest.

WATERFALL IIA: ITEM 11 (foreign judgment rate of interest)

43. In relation to Item 11, the only additional point relied upon by Wentworth from the SC Judgment is what it describes as the "*emphasis on legislative objective of simplicity*".

44. This has been addressed above (see paragraph 29). Simplicity is not the only objective of the 1986 reforms. For the purpose of rule 2.88, the need (in the interests of creditors, and in order to achieve a sensible commercial policy objective) to construe rule 2.88 in a manner that fully replicates the rights that creditors would have had but for the administration should take priority over the plea to simplicity.

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30 June 2017

IN THE COURT OF APPEAL **Appeal Ref: 2017/0043**

ON APPEAL FROM THE HIGH COURT

CHANCERY DIVISION

COMPANIES COURT

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

SENIOR CREDITOR GROUP'S SUBMISSIONS ON THE IMPACT OF THE SUPREME COURT'S JUDGMENT IN WATERFALL I

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