**IN THE COURT OF APPEAL** **A2/2015/3763**

**ON APPEAL FROM**

**No 7942 of 2008**

**THE HIGH COURT OF JUSTICE**

**CHANCERY DIVISION**

**COMPANIES COURT**

**Before: Mr Justice David Richards**

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

**AND IN THE MATTER OF THE INSOLVENCY ACT 1986**

**(1) BURLINGTON LOAN MANAGEMENT LIMITED**

**(2) CVI GVF (LUX) MASTER S.À R.L**

**(3) HUTCHINSON INVESTORS LLC**

**Appellant**

**- AND -**

**(1) ANTHONY VICTOR LOMAS**

**(2) STEVEN ANTHONY PEARSON**

**(3) PAUL DAVID COPLEY**

**(4) RUSSELL DOWNS**

**(5) GUY JULIAN PARR**

**(as the joint administrators of the above named company)**

**(6) WENTWORTH SONS SUB-DEBT S.À R.L.**

**(7) YORK GLOBAL FINANCE BDH, LLC**

**Respondents**

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**WENTWORTH'S SUBMISSIONS IN REPLY TO THE SCG AND YORK ON THE IMPACT OF THE SUPREME COURT'S JUDGMENT IN WATERFALL I**

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## **Overview**

1. The SCG's and York's submissions are founded on the twin pillars of: (1) *Bower v Marris* is a long-standing "equitable principle" applicable in insolvency, requiring Statutory Interest to be calculated in the "ordinary way" ; and (2) rule 2.88 is silent as to how Statutory Interest is calculated, so the "equitable principle" is to be applied to it.

2. Neither pillar has any foundation. First, *Bower v Marris* has never been applied in any case in England to the payment of interest pursuant to a statutory provision in insolvency. For reasons already advanced in writing and orally for the main appeal hearing, *Bower v Marris* is authority only for the proposition that payment of a dividend in an insolvency is not to be treated as an appropriation to principal or accrued interest, the payment having been made in process of law, so that the creditor retains the right (*if it had one*) to appropriate the payment as between two debts due to it at the time the dividend had been paid. Second, rule 2.88 explicitly states how interest payable under it is to be calculated, and the so called principle in *Bower v Marris* is inconsistent with it.

## **Response to SCG's seven points on Items 1 and 2**

*First ("fundamental principles and policies continue to be relevant")*

3. Lord Neuberger, at paras 12 and 13 of the SC Judgment, was concerned with "fundamental principles" of insolvency that were judge-made, but which continue to underlie the 1986 legislation. He cited as examples the pari passu rule, the anti-deprivation rule, and the rule against double-proof. *Bower v Marris* cannot on any view be considered in that category. Picking up the language of Lord Neuberger at paragraph 13 of the SC Judgment:

(1) At the risk of repetition of an obvious point (but one which is repeatedly ignored or mischaracterised by the SCG[1]), far from being a "well established" judge-made rule, prior to 1986 *Bower v Marris* had *never* been applied in England to a statutory right to interest in an insolvency such as is contained in Rule 2.88, and had never even been referred to in any edition of Williams, the leading bankruptcy text book (bankruptcy being the only insolvency proceeding in England that included a statutory right to post-insolvency interest).

(2) Its application in corporate insolvency prior to 1986 was in a wholly different context, i.e. where there was *no statutory regime at all* relating to post-insolvency interest[2]. Its application there was a consequence of the reversion to contractual rights as explained in *Humber Ironworks*.

(3) Its application is clearly *inconsistent* with the terms of the current legislative provisions (for reasons developed by Wentworth at the main appeal hearing).

(4) There is no necessity (reasonable or otherwise) to apply *Bower v Marris* so as to achieve justice. The substitution of an equal statutory entitlement for all creditors in place of any pre-insolvency rights to interest for some represents a rational and a fair choice to compensate all creditors equally for the same delay experienced in relation to the distribution of the estate. That is the discernible policy apparent from Rule 2.88 and the pre-legislative materials which preceded the 1986 Act.

4. It is noteworthy that the only authority cited by the SCG in its supplemental submissions (at paragraph 12) for the proposition that *Bower v Marris* is a well-established principle of fairness and justice, is not authority for that proposition at all. They cite *Humber Ironworks* per Giffard LJ at 647. But it is clear from the short judgment of Giffard LJ as a whole that, when referring to the "*rule which my learned*

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[1] C.f. paragraph 12 of the SCG supplemental skeleton: "*the equitable principle has been consistently and universally applied in the field of insolvency*."

[2] Save only for two outlying decisions, in Ireland and Canada, where the statutory provisions were different, and there was limited analysis of the issue.

*brother has laid down*" which he said worked with "*equality and fairness*", he was clearly referring to the judge-made rule that interest stops running on creditors' claims as at the date of winding-up.

5. The suggestion (at paragraph 15 of the SCG skeleton) that construing rule 2.88 in a manner which excludes *Bower v Marris* could lead to abuse is fanciful. It presupposes the far-fetched notion of a company willing to jeopardise its business by unnecessarily going into administration for the sole purpose of avoiding paying interest on a *Bower v Marris* basis to those of its creditors with interest bearing debts, notwithstanding that the very act of going into administration would create a potential liability to interest at 8% to *all* of its creditors.

*Second (prior authorities are also relevant*)

6. The SCG latch on to Lord Neuberger's reference (at p.12 of the SC Judgment) to the fact that it "*cannot be assumed*" that prior authorities are relevant when it comes to "*less fundamental procedures and rules*". This is clutching at straws. As noted above, such authorities as existed prior to 1986 related to regimes which contained *no* statutory right to interest, where such right existed by reason of creditors being remitted to their contractual rights. On any view, s.189 (in liquidation) and rule 2.88 (in administration) constitute an entirely new regime in corporate insolvency.

7. At paragraph 21 of its supplemental submissions, the SCG argues that "certain aspects" of the language of rule 2.88 indicate that the court should be seeking to interpret it in a manner that accords with creditors underlying rights. In fact, the language referred to (at paragraph 6) is the requirement that interest is paid at the Judgments Act "rate" or the "rate" applicable apart from administration.

8. The argument that interest is not paid at the Judgments Act rate, unless *Bower v Marris* is applied, is circular. It assumes a calculation of interest on the proved debt for the period between the date of administration and the date upon which interest is ultimately paid. That, in turn, depends upon the SCG establishing that Statutory Interest is required to be paid in respect of the period *after* the dividends have been paid in full. As found by David Richards J, this would be contrary to the clear terms of rule 2.88.

9. The argument that the "rate" applicable apart from administration requires *Bower v Marris* to be applied is flawed for reasons advanced at the main appeal in Wentworth's skeleton argument at paragraph 31 [1A/16/15-16]– in short because: (1) the fact that the legislature chose to incorporate the "rate" applicable apart from administration and nothing else indicates the opposite: that it was to this limited extent that rights apart from administration were to be incorporated into rule 2.88; and (2) *Bower v Marris* cannot in any sense of the word be described as a "rate" of interest (demonstrated by the fact that it is impossible to apply the calculation required by *Bower v Marris* unless you first know the rate, and thus the amount, of interest to which a payment is to be appropriated).

10. At paragraph 22(2) of its supplemental submissions the SCG contends that "*Rule 2.88* does not provide for the manner of calculating interest". York similarly contends (at paragraph 8 of its supplemental submissions) that "*there is nothing in rule 2.88 to indicate one way or another how the interest is to be calculated*." Both are wrong. All that is required in order to calculate interest are: (1) the principal sum on which it is to be charged, (2) the rate to be applied, and (3) the period in respect of which interest is to be charged. Each of these is plainly and expressly provided for within rule 2.88: see Wentworth's written submissions at paragraphs 10 to 15 [1A/16].

11. In the same paragraph, the SCG argues that rule 2.88 does not "*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*." This is an attempt to create uncertainty where none exists. The reading of the rule is simple and straightforward: (1) interest under 2.88(7) is payable on "the debts proved"; (2) it is payable out of the surplus remaining after "payment of the debts proved"; (3) in those circumstances the obvious meaning of the phrase "*for the periods during which they have been outstanding since the company entered administration*" is to refer to the period between the date the company entered administration and the date the relevant proved debt was paid. It has been common ground throughout these proceedings that the plural "period<u>s</u>" is used to cater for the fact that payment in respect of proved debts

will often be made by a combination of interim and final dividends.[3] It is wrong to say (SCG supplemental skeleton at [7]) that in relation to creditors with a right to compound interest, this creates an unprincipled half-way house. There is nothing unprincipled about allowing all creditors – whether the rate at which they can claim interest is simple or compound – to claim interest on the proved debts in respect of the period or periods those debts or such parts of them are outstanding. For such periods, as demonstrated by the schedule handed up by Wentworth at the main appeal hearing[4], compounding operates in a perfectly straightforward way. The wording of the rule categorically precludes Statutory Interest accruing once 100p in the £ has been paid on the relevant proved debt.

*Third (No non-provable claim to provide an alternative means of recovery)*

12. The SCG contends that because there is no 'escape hatch' of a non-provable claim in respect of any contractual rights that are not fulfilled via the statutory regime, then the statutory regime should be construed so as to include those rights. That is not an appropriate approach to statutory construction. In any event, it was clear that no non-provable claim to interest was ever permissible under the Bankruptcy Act 1914 (and it had never been suggested that it did), but it had never, throughout the life of that Act, been suggested, let alone held, that *Bower v Marris* should therefore apply to statutory interest payable under it.

*Fourth (prior legislative materials do not support rejection of the principle)*

13. This submission poses the wrong question. In the absence of any fundamental principle of insolvency law to the effect that payment in respect of post-insolvency interest from an insolvent estate must be appropriated towards outstanding interest first, it is nonsensical to enquire whether the 1986 legislation was intended to abolish 'the

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3 See Wentworth's main skeleton argument at paragraph 10(4) [1A/16]. See also paragraph 30(4) of the SCG's main reply skeleton [1A/15]: "The Rules use the word "outstanding" to recognise that, where proved debts are paid by dividends in instalments, interest is paid on the "outstanding" balance at any time and not on the full proved debt".

4 This was addressed in oral submissions by Wentworth on Day 3 – Transcript p71/line 23 to p72/line 24.

principle'. It follows that it is an irrelevant enquiry to ask whether the pre-legislative materials foreshadowed a legislative intent to abolish it.

*Fifth (Application of the principle is consistent with the general aims of the 1986 regime)*

14. Wentworth does not suggest that 'simplicity' is a principle of overriding importance, merely that it is a factor that points in favour of Wentworth's construction of the rule: see paragraph 17 of its supplemental submissions dated 16 June 2017. While the SCG note that there is no *obligation* to make interim distributions of interest (in which context the complications from application of *Bower v Marris* arise), where funds become available over time an office-holder will no doubt wish to make such distributions.

15. The reference at paragraph 191 of the Cork report to encouraging "*the fulfilment of financial obligations*" as one of the basic objectives of insolvency law has no relevance to the interpretation of the Statutory Interest provisions. It appears in the context of a general point about not making insolvency an "*easy solution for those who can bear with equanimity the stigma*" of failure.

*Sixth (Continued relevance of creditors first, shareholders last)*

16. The SCG mis-states Wentworth's point. Wentworth does not suggest that the general position that creditors' claims are to be satisfied before those of members has been abrogated. Its point is the different one that there is no *a priori* assumption that rights conferred by the statute are intended to reflect pre-existing contractual rights in all respects.

17. The SC's approach in its consideration of rule 2.86 shows that there is no assumption – when assessing the only critical question, namely the true construction of the relevant statutory provision – that the rights provided by the provision must have been intended to accord with such rights as creditors had but for the insolvency. The passing reference of Lord Neuberger (quoted in paragraph 29(2)) to s.189(2) confirming that interest which would in the absence of liquidation "normally be expected to be contractually payable" is payable cannot be taken to be any indication that the SC concluded that

s.189(2) (or, by extension, rule 2.88) required all contractual rights of creditors in respect of post-insolvency interest to be satisfied pursuant to the rule. As the rest of the paragraph goes on to make clear, his comment was addressing merely the fact that s.189(2) permits the creditor to recover interest – where it is higher than the Judgments Act rate – at the *rate* applicable to its contract.

18. Similarly, the charge of circularity (at paragraph 29(7)) is aimed at an argument Wentworth does not make.

*Seventh (The rules of appropriation are irrelevant)*

19. At paragraph 30(1) the SCG mis-state the Lord Chancellor's words in *Bower v Marris*. His comment [Tab 6, p.355] that the doctrine of appropriation has "*nothing to do with it*" meant only that because dividends were paid by operation of law, they could not be treated as having been appropriated towards principal. But the consequence of that (as the remainder of the judgment shows, as demonstrated in Wentworth's submissions on the main hearing of the appeal at paragraphs 16 to 18 [1A/16/9-10]) is that if the creditor had a contractual right to interest accruing post-bankruptcy, then it remained open to it to appropriate the dividends made in satisfaction of such interest as had accrued at the date of payment before principal. For reasons again advanced in detail at the hearing of the appeal (and set out in the judgment of David Richards J at paragraphs [71] to [74] and [85]) such a right of appropriation depends upon there being in existence at the date of the relevant payment two or more due debts (thereby giving rise to the choice on the part of the creditor as to which is to be paid).

20. The SCG's point, at paragraph 30(2), that the 'equitable principle' can apply on the basis of a fiction that interest *was* due at the time dividends on proved debts were paid, requires the rationale for its application (as set out in *Bower v Marris*, and all other English cases in which it has been applied) to be jettisoned. In other words, the existence of two or more due debts as at the time of the relevant payment to be appropriated is a fundamental requirement of the right to appropriation, and thus of the principle in the first place.

21. The point is not saved by the convoluted, and ultimately failed, attempt to deploy the "hindsight principle" for a purpose for which it was never intended, in paragraph 30(3).

**Response to SCG's submissions on Item 4 (further interest or damages in respect of the time taken to pay statutory interest)**

22. None of the points made by the SCG overcome the clear conclusion of the SC that rule 2.88 is a complete code in respect of interest payable in the period post-administration. That code contains no right to interest on 'late' payment of interest, and so no such right exists. Nor is there anything in their supplemental skeleton to overcome the obstacle that nothing in rule 2.88 imposes an obligation to pay interest at a particular time.[5]

23. The SCG's arguments are in any event internally inconsistent. Their case on Item 4 is that there is an obligation to pay Statutory Interest at the time that proved debts have been paid in full (paragraph 34 of its supplemental skeleton). However, at paragraph 28(1)(b) they note that there is "no obligation" to pay interim dividends of interest (notwithstanding that the possibility of paying *any* interim dividend only arises after all proved debts have been paid in full).

24. Moreover, the suggestion that an obligation to pay Statutory Interest arises at the moment when dividends have been paid in full makes the wholly unrealistic assumption that there is, at that moment, sufficient surplus cash or immediately realisable assets with which to pay all Statutory Interest. It fails to cater for the much more likely scenario, that the assets of the estate continue to be increased by realisations or settlements after that date, meaning that (as happened with LBIE) the quantum of the available surplus fluctuates over time.

25. Finally, it should be noted that it is now common ground that any such claim to interest in respect of the time taken to pay statutory interest would have been released by the terms of the CRA and the CDDs.

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5 See Wentworth's main skeleton argument at paragraphs 46 to 48 [1A/16/21-20].

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