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

WENTWORTH'S WRITTEN SUBMISSIONS ON THE IMPACT OF THE SUPREME COURT'S JUDGMENT IN WATERFALL I

Introduction

1. On 17 May 2017, the Supreme Court handed down its judgment on the Waterfall I appeal ([2017] UKSC 38) ("the SC Judgment").

2. The SC Judgment has a very considerable impact on the issues before the Court of Appeal on the Waterfall IIA and Waterfall IIB appeals. This can be seen from the tables already provided to the Court which record the positions of the parties on the impact of the SC Judgment[1]. The agreed position of the parties is as follows:

   Waterfall IIA

   (1) The following issue has been determined in Wentworth's favour: Item 3 (non-provable claim to any shortfall between contractual right to interest and Statutory Interest). The SC concluded that Rule 2.88 constitutes a complete code which has replaced pre-existing contractual rights, and precludes any remission to those contractual rights in the event of a surplus emerging: see Lord Neuberger (with whom Lord Kerr and Lord Reed agreed) at [125]-[126];

   (2) The following issues have fallen away in light of the SC Judgment concluding that rule 2.86 represents a complete code for foreign currency debts and, as a consequence, Currency Conversion Claims do not exist: Items 6, 8, 9, 10 and 13;

   (3) Item 7 has fallen away in part following the SC Judgment and the parties are agreed as to the remainder of the item; and

   (4) Items 1, 2, 4, 5, 11 and 12 raise issues which remain live following the SC Judgment.

[1] The tables were provided to the Court by Linklaters' letter dated 9 June 2017.

Waterfall IIB

(5) The Court of Appeal does not need to consider any of the issues raised by the Waterfall IIB appeal:

(a) Items 1, 2 and 4 have fallen away in light of the SC Judgment concluding that rule 2.86 represents a complete code for foreign currency debts and, as a consequence, Currency Conversion Claims do not exist.

(b) Item 3 has fallen away in light of the SC Judgment concluding that rule 2.88(7) represents a complete statutory code for interest and, as a consequence, a creditor is unable to assert a non-provable claim for interest in circumstances where its contractual rights to interest are not fully satisfied by rule 2.88.

3. The SC Judgment supports Wentworth's position on Items 1, 2, 4 and 11 (which remain live) for the reasons developed below. There is nothing of relevance in the SC Judgment to Items 5 and 12.

4. The SCG and York have taken the rather surprising position that the SC Judgment does not affect any of the Items which remain live in the Waterfall IIA appeal. Accordingly, the parties have agreed the following order of submissions (both written and oral, to the extent a hearing is required): Wentworth will make its submissions first, followed by SCG (and, to the extent necessary, York), with Wentworth having a right of reply.

Waterfall IIA, Item 1 (Declaration (iii): application of the approach in *Bower v Marris*) and Item 2 (Declaration (viii): continued compounding of interest after the payment of the final dividend)

5. It is common ground that Items 1 and 2 are questions of statutory construction. To re-cap, Wentworth's case in this regard (which David Richards J accepted) is that:

(1) On the true construction of rule 2.88, it provides a direction to the administrator to utilise any surplus arising after payment of all proved debts in full in paying

interest on the amount of each creditor's proved debt for the period between the commencement of the administration and the date or dates upon which the proved debt was paid by way of dividends from the administration estate.

(2) Rule 2.88 thus provides a comprehensive, self-contained rule for the calculation of interest: directing the principal amount on which it is to be paid (the proved debt), the rate at which it is to be paid (the Judgments Act rate or, if higher, the rate applicable to the debt apart from the administration) and the period for which it is payable (from the Date of Administration until the proved debt, or relevant portion of it, is paid in full).

(3) Rule 2.88 is flatly inconsistent with the SCG's contention that Statutory Interest is to be calculated on the *Bower v Marris* basis, that is by notionally allocating dividends first to the payment of statutory interest and then in reduction of the principal debt, and then using the surplus to pay the remaining interest and principal, because it would require the surplus to be used for discharging part of the proved debt itself, because it requires the dividends as having been used to pay post-administration interest, and because it would require statutory interest to be paid with respect to a period long after the date the proved debt, or relevant part of it, was paid.

(4) Rule 2.88 is equally inconsistent with the SCG's contention that a creditor with a contractual right to interest at a compound rate, should be entitled to continue to compound interest after the date on which the proved debt, or the relevant portion of it, has been paid, because it would require interest to be paid for a period longer than Rule 2.88 allows.

6. In contrast, the SCG's case, in essence, was that since interest had been paid from a surplus on the *Bower v Marris* basis in the context of prior statutory regimes, in particular in liquidation, it would be surprising if the 1986 legislation had changed that (Transcript, Day 1, p.5, line 20 to p.6, line 15: "*in short, that's not how things had operated in a liquidation between 1869 and 1986*").

7. The SC Judgment supports Wentworth's position on the approach to construction of rule 2.88 and reinforces the argument that the SCG's approach to construction is misconceived.

8. First, the SC Judgment emphasises, on a number of occasions, 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. For example:

   (1) "*…the 1986 legislation represents a comprehensive overhaul of insolvency legislation, adding new procedures and new rules and rewriting many of the established procedures and rules*": see SC Judgment, at [12] *per* Lord Neuberger.

   (2) While fundamental principles such as the *pari passu* principle apply just as they always have done, "*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*": see SC Judgment, at [12] *per* Lord Neuberger.

   (3) "*in 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*": see SC Judgment, at [13] *per* Lord Neuberger.

   (4) "*It is in my opinion dangerous to rely on judicial dicta 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*": see SC Judgment, at [83] *per* Lord Neuberger.

(5) Lord Neuberger, when considering the impact of the pre-1986 authorities on foreign currency claims, states as follows: "*[g]iven that the treatment of foreign currency creditors in corporate insolvencies was expressly dealt with for the first time in the 1986 Rules, it appears to me that there must be a presumption that the new rule 2.86 was intended to spell out the full extent of a foreign currency creditor's rights, particularly, when one bears in mind the fact just mentioned that the purpose of the 1986 legislation was to simplify and clarify the law*": SC Judgment, at [90].

(6) Lord Neuberger cautions that the dicta in cases such as *Re Humber Ironworks* and *Wight v Eckhardt Marine GmbH*, on which the SCG places reliance, should not be read out of their proper context: see SC Judgment, at [99]-[103]. Indeed, Lord Neuberger expressly comments as follows in relation to *Re Humber Ironworks*:

(a) "*[t]he court was concerned with the effect of the absence of any rule for payment [of interest], not with the effect of a rule which stipulated for payment*": see [100].

(b) "*However, as I have also explained, that observation was made in the context of a decision which was wholly based on what Giffard LJ expressly described as "Judge-made law", because the contemporary statutory provisions gave no guidance as to how contractual interest was to be dealt with in a winding-up. The position is, of course, very different now, especially in relation to interest on proved debts in administrations and liquidations. In that connection, I consider that…rules 2.88 and 4.93 and section 189 provide 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*" see [125].

(7) "*It is axiomatic that where the Insolvency Rules deal expressly with some matter in one way, it is not open to the courts to deal with it in a different and inconsistent way*": see SC Judgment, at [194] *per* Lord Sumption.

9. The SCG and York's appeal relating to *Bower v Marris* is founded on contentions that the Judge paid insufficient weight to the state of the Judge-made law prior to the introduction of the 1986 Act and the 1986 Rules (see, for example, SCG's skeleton argument, at [9] [Core A1/12/4-5]) and that the Judge failed to consider whether the legislature intended to abolish *Bower v Marris* (see, for example, [Day 1/Page 7/Line 5-10]).

10. The SC Judgment, as illustrated by the examples set out above, makes clear that there is no basis for such a complaint in circumstances where the old Judge-made law related to fundamentally different statutory regimes, and the matter is comprehensively addressed in detail in the 1986 Rules.

11. Second, the SC Judgment, when finding that statutory interest is not recoverable from a contributory under section 74 of the 1986 Act, emphasises the importance of giving effect to the words actually used by the legislature. Those words should not be departed from unless it gives rise to a situation which is "*absurd or unworkable*": see SC Judgment, at [142] *per* Lord Neuberger, rejecting the Court of Appeal's conclusion that the use in rule 2.88 of the concept of payment out of a surplus was merely a convenient way of identifying liabilities which fall lower than other liabilities in the priorities encapsulated in the waterfall. This analysis erred, "*in 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 normal principles of interpretation*".

12. There is no basis on which the SCG and York can suggest that the construction of the learned Judge, which pays proper regard to the wording of rule 2.88(7), is absurd or unworkable.

13. Third, the SC Judgment makes clear that there is no basis for the SCG's complaint that it cannot have been the intention of the legislation to create a situation in which a creditor may, on a particular set of facts, receive less by way of statutory interest under rule 2.88(7) than it would have received by reference to its pre-insolvency contractual entitlement if these had allowed for the application of the approach in *Bower v Marris* or continued compounding.

14. The SC Judgment concludes that (i) the statutory interest regime provides a complete code so that the company ceases to be liable for contractual interest which falls due after the commencement of the administration, and instead, in the event of a surplus, there is a liability for statutory interest; and (ii) there is no basis for the contractual right of a creditor to revive if rule 2.88(7) leads to a worse outcome for the creditor: see SC Judgment, at [47] and [125]-[127] *per* Lord Neuberger. The point was expressed in the following terms at [125]-[126]:

> "*In that connection, I consider that the legislative provisions discussed above, namely rules 2.88 and 4.93 and section 189 provide 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. It seems to me that this view is consistent with what David Richards J said in In re Lehman Brothers International (Europe) (in administration) [2016] Bus LR 17, para 164, although the point which was there being considered was more limited*."
>
> *This issue has some echoes of the currency conversion claim issue. In each case, I consider that the contractual right (in this case to recover interest and in the case of currency conversion claims, to be paid at a particular rate of exchange) had been replaced by legislative rules. On that basis, there is no room for the contractual right to revive just because those rules contain a casus omissus or because they result in a worse outcome for a creditor than he would have enjoyed under the contract.*"

15. Fourth, the Court will recall that the SCG placed heavy reliance on the Court of Appeal's decision in Waterfall I in relation to Currency Conversion Claims to support its arguments on *Bower v Marris*. The essential submission of the SCG was that in circumstances where the statutory scheme did not interfere with the contractual right of foreign currency creditors to be paid their full entitlement, there was no sensible reason to treat creditors with a right to interest any differently: see, for example, its introductory oral submissions at [Day 1/Page 7/Line 17 to Page 8/Line 9]: "*There isn't a sensible reason why a distinction is to be drawn between, on the one hand, foreign currency creditors and, on the other hand, creditors entitled to interest. General rule*

is: creditor first, members last; you would expect that to be reflected in the statutory scheme and, we say, properly construed, it is."

16. In light of the SC's rejection of Currency Conversion Claims, this argument is turned through 180 degrees. The court's task is to construe the words of the legislation, to determine what rights the legislation provides according to its language, and it is wrong to construe the legislation by reference to what rights a creditor would have had but for the insolvency, and to assume that the legislation intended those rights to be satisfied in full before any return is made to members. Lord Neuberger's comment at [90] of the SC Judgment (quoted above) that it is to be presumed that rule 2.86 was intended to spell out the full extent of a foreign currency creditor's rights, in light of the fact that the treatment of foreign currency creditors was dealt with for the first time in the 1986 legislation, applies equally to statutory interest and rule 2.88.

17. Fifth, the SC Judgment emphasised that the 1986 Act and the 1986 Rules had the objective of establishing "*effective and straightforward procedures*": see SC Judgment, at [10] *per* Lord Neuberger. It is to be recalled that this objective is expressly stated by the Cork Report in relation to the new regime for statutory interest: see Cork Report, at para 1392 "*simplicity and certainty are essential*" [AUTHS 5/211]. Lord Neuberger, at [89], relied on this objective of simplicity to rule out the possibility of a "*second bite*" for foreign currency creditors. This objective militates against *Bower v Maris* and continued compounding, each of which would introduce the complication that 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. Such complication does not exist on the clear wording of rule 2.88, since once all dividends have been paid, the amount of interest owed to each creditor for the period up to that date is a fixed amount.

18. In addition to its case on the construction of rule 2.88, Wentworth's arguments include the contention that (1) the rule in Bower v Marris is merely a facet of the common law principles of appropriation, (2) an essential requirement of which is that, at the date a payment is made, the creditor has two separate claims as between which the payment may be appropriated, and (3) there is nothing due by way of statutory interest unless and until a surplus arises.

19. It is important, in this regard, to remember that the "principle in *Bower v Marris*" is not a mode of calculation that judges centuries ago simply happened-upon and chose to impose on the parties before them. Courts deal with rights and obligations. The application of *Bower v Marris* necessarily involves a calculation; but that calculation reflects the rights of the parties before the court in the cases in which the principle was first applied, namely the common law rights of appropriation.

20. The SC Judgment reinforces Wentworth's case that there is no room for any principle of appropriation in the context of statutory interest under rule 2.88. At [47] Lord Neuberger stated, in relation to liquidation but noting that the same applied to administration, that "*the effect of section 189 is that a company in liquidation ceases to be liable for contractual interest which falls due after it goes into liquidation, and instead, in the event of a surplus, there is a liability for statutory interest*." At [52] he noted that the company in liquidation cannot be sued for the purpose of enforcing section 189, and no claim against the company can be made if section 189 is infringed, because the relevant claim should be made against the liquidator. While that did not mean that statutory interest was not 'payable or owing' within the meaning of the subordination agreement, his comments 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. This, in turn, provides further support for the conclusion of David Richards J (at [144] to [150] of the Part A Judgment) that the absence of an accruing claim for interest, at the time that dividends in respect of proved debts are paid, is a compelling reason why the approach envisaged by *Bower v Marris* has no place within the regime for statutory interest.

Waterfall IIA: Item 4 (Declaration (iv): further interest or damages in respect of the time taken to pay statutory interest)

21. Item 4 concerns the question of whether a creditor entitled to statutory interest has a non-provable claim for further interest or damages in respect of the time taken for statutory interest to be paid.

22. The SCG accepts that the SC Judgment means a creditor can no longer contend for a non-provable claim to the shortfall, if any, between the amount it would have received

by way of a contractual (or other pre-insolvency) right to interest and the amount of statutory interest received. The SCG does, notwithstanding the SC Judgment, maintain its appeal against David Richards J's conclusion that a creditor entitled to statutory interest is not entitled to any further interest or damages or other form of compensation in respect of the time taken for statutory interest to be paid.

23. Wentworth contends that this is untenable in light of the SC Judgment. As the Court of Appeal will recall, Wentworth's case – without the benefit of the SC Judgment – may be summarised as follows:

(1) There is no obligation in rule 2.88 to pay statutory interest by a particular time such that it would ever be possible to assert a claim for late payment. There is accordingly no basis on which creditors could either seek an order for the payment of statutory interest or damages for any loss said to be suffered as a result of the delay.

(2) There is no provision in the 1986 Act or 1986 Rules for the payment of interest on statutory interest.

(3) In the absence of such a provision, the natural conclusion is that the legislature intended that the certain and uniform right to interest provided to all creditors under rule 2.88(7) provided the only means of compensation for the delay in the payment of proved debts

24. The SC Judgment provides considerable support for Wentworth's case and seriously undermines the arguments advanced on the appeal by the SCG and York.

25. First, Lord Neuberger, at [125] concluded that rule 2.88 provides "*a complete statutory code for the recovery of interest on proved debts in administrations*". This, combined with the conclusion at [90] (albeit referring to rule 2.86) that where the 1986 legislation dealt with an issue for the first time the presumption is that it intended "*to spell out the full extent*" of creditors' rights, renders it unlikely in the extreme that there can be a further right to interest, about which the legislation was silent.

26. Second, the reasoning behind Lord Neuberger's rejection of a "*second bite*" for foreign currency creditors, as being inconsistent with the legislative objective to simplify the insolvency process (see SC Judgment, at [89]) is directly applicable to Item 4.

27. Third, the SC Judgment makes clear that the company cannot be sued for the purpose of enforcing rule 2.88(7) and indeed that no claim can be made against the company if rule 2.88(7) is infringed as the relevant claim should be made against the administrator: see SC Judgment, at [52]. In the present case, the "*SCG have gone out of their way to say that there has been no breach by the administrators of their duties or any unreasonable delay on their part*": see Judgment of David Richards J, at [166]. Accordingly, 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.

28. Fourth, 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 insolvent estate: see SCG skeleton, at [52(2)] [Core A1/12/25]. In this regard:

    (1) This point was relied upon by the Court of Appeal in *Re Humber Ironworks* to justify a remission to contractual rights to interest on the emergence of a surplus in circumstances where no right to statutory interest was provided by the statutory regime – it was not relied upon to allow a creditor to receive interest on interest.

    (2) The SC Judgment makes clear that the dicta in *Re Humber Ironworks* no longer has any relevance following the introduction of rule 2.88: see SC Judgment, at [125] *per* Lord Neuberger.

Waterfall IIA, Item 11 (Declaration x: foreign judgment rates of interest)

29. David Richards J concluded that the words "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) do not include a foreign judgment rate of interest applicable to a foreign judgment obtained after an administration or a foreign judgment

rate of interest which would have become applicable to the debt if the creditor had obtained a foreign judgment (when it did not in fact do so).

30. As the Court of Appeal will recall, Wentworth's primary case is that a post-administration judgment debt is not the "debt proved" upon which Statutory Interest is payable. Rather, it is the claim of the creditor as at the Date of Administration which is the "debt proved", and upon which interest is payable either at the Judgments Act rate or a higher contractual rate applicable to that debt, if there is one. (This, and the other submissions of Wentworth on item 11 are at [Core A1/16/18-20]).

31. One of Wentworth's additional arguments is that to permit reference to a rate of interest applicable to an actual, or hypothetical, judgment obtained after administration would introduce complexities and uncertainties for which no provision was made in the rules. The SC Judgment's emphasis on the legislative objective of simplicity (see above) reinforces this point. Moreover, the Cork Report expressly notes, at para 1392, that "*simplicity and certainty are essential*" in the context of the regime for statutory interest [AUTHS 5/211].

Waterfall IIA: Item 7 (Declaration (vi): non-provable claims for interest on non-provable claims)

32. Item 7 concerns the question of whether a creditor has a non-provable claim for interest in respect of such interest (if any) as may have accrued on that non-provable claim.

33. The parties are agreed that declaration (vi) of the Waterfall IIA order should be set aside as:

    (1) The issue has fallen away insofar as it concerns interest on Currency Conversion Claims in view of the SC Judgment concluding that rule 2.86 represents a complete code for foreign currency debts and, as a consequence, Currency Conversion Claims do not exist; and

    (2) The question of whether a creditor has a non-provable claim for interest in respect of any other non-provable claim should be determined if and when such

a non-provable claim is identified (no such claims have been identified as existing in the context of the LBIE administration).

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