**Appeal Numbers A3/2017/0043, A3/2017/4216, A3/2016/4213 and A3/2016/4127**

**IN THE COURT OF APPEAL (CIVIL DIVISION)**

**ON APPEAL FROM THE HIGH COURT OF JUSTICE, CHANCERY DIVISION, COMPANIES COURT (HILDYARD J [2016] EWHC 2417 (Ch) AND DAVID RICHARDS LJ [2016] EWHC 2131 (Ch))**

**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 :**

**YORK GLOBAL FINANCE BDH LLC**

Appellant

**-and-**

**(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)**
**(2) BURLINGTON LOAN MANAGEMENT LIMITED**
**(3) CVI GVF (LUX) MASTER SARL**
**(4) HUTCHINSON INVESTORS LLC**
**(5) WENTWORTH SONS SUB-DEBT SARL**

Respondents

**A N D B E T W E E N :**

**WENTWORTH SONS SUB-DEBT SARL**

Appellant

**-and-**

**(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)**
**(2) BURLINGTON LOAN MANAGEMENT LIMITED**
**(3) CVI GVF (LUX) MASTER SARL**
**(4) HUTCHINSON INVESTORS LLC**
**(5) YORK GLOBAL FINANCE BDH LLC**

Respondents

**A N D B E T W E E N :**

**(1) BURLINGTON LOAN MANAGEMENT LIMITED**
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**(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)**
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**(3) YORK GLOBAL FINANCE BDH LLC**

Respondents

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# ADMINISTRATORS' SKELETON ARGUMENT ON SUPPLEMENTAL ISSUES 1A, 2, 3, 4 AND 5

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## Introduction

1. This skeleton argument has been prepared on behalf of Anthony Victor Lomas, Steven Anthony Pearson, Russell Downs and Julian Guy Parr (the "**Administrators**"), the joint administrators of Lehman Brothers International (Europe) ("**LBIE**"), for the hearing of four appeals against a declaration made by Hildyard J in paragraph (xxvii) of his Order dated 12 December 2016 and declarations made by David Richards LJ (sitting as a High Court Judge) in paragraphs 3, 4, 5 and 6 of his Order dated 17 October 2016.

2. Those declarations provided answers to certain questions posed by Supplemental Issues 1A, 2, 3, 4 and 5 (the "**Supplemental Issues**"), which arose from the decision of David Richards J (as he then was) in *In re Lehman Bros International (Europe) (in administration); Lomas and others v Burlington Loan Management Ltd* [2015] EWHC 2269 (Ch) (the "**Waterfall IIA Judgment**") and *In re Lehman Bros International (Europe) (in administration); Lomas and others v Burlington Loan Management Ltd* [2015] EWHC 2270 (Ch) (the "**Waterfall IIB Judgment**").

3. The appeals in respect of the Supplemental Issues are listed to be heard with the appeals against certain of the declarations made to reflect the Waterfall IIA Judgment and the Waterfall IIB Judgment.

## Background

4. As explained in the Administrators' skeleton argument dated 17 June 2016, the Administrators issued an application for directions under paragraph 63 of Schedule B1 to the Insolvency Act 1986 (the "**Waterfall II Application**") with a view to obtaining the Court's guidance in respect of a variety of issues relating to the proper distribution of the substantial surplus that has arisen in LBIE's administration after all proved debts have been paid or reserved for in full.

5. The Waterfall II Application was divided into three parts: the first two parts ("**Waterfall IIA**" and "**Waterfall IIB**") were heard by David Richards J; whilst the third part ("**Waterfall IIC**") was heard by Hildyard J.

6. David Richards LJ (as he had by then become) answered Supplemental Issues 1B, 1C, 2, 3, 4 and 5 in a decision handed down on 24 August 2016, *In re Lehman Bros International (Europe) (in administration); Lomas and others v Burlington Loan Management Ltd* [2016] EWHC 2131 (Ch); [2017] BCC 1 (the "**Supplemental Issues Judgment**").

7. Hildyard J answered Supplemental Issue 1A in his decision on Waterfall IIC, *In re Lehman Bros International (Europe) (in administration); Lomas and others v Burlington Loan Management Ltd* [2016] EWHC 2417 (Ch) (the "**Waterfall IIC Judgment**").

8. In summary of the Supplemental Issues being appealed[1]:

   (1) Supplemental Issue 1A asks whether the rate of interest under Rule 2.88(9) of the Insolvency Rules 1986 includes a contractual rate of interest which began to run only after the commencement of LBIE's administration (the "**Date of Administration**"), such as a Default Rate under an ISDA Master Agreement entered into before the Date of Administration where the close-out occurs after the Date of Administration.

      (i) Hildyard J held in paragraphs 453 to 529 of the Waterfall IIC Judgment that it can include such a rate and so declared in paragraph (xxvii) of his Order dated 12 December 2016.

      (ii) York appeals against that declaration.

[1] There are no appeals in respect of Supplemental Issues 1B or 1C.

(iii) The Administrators are among the Respondents to York's appeal. The Administrators contend that Hildyard J's conclusion was correct for the reasons that he gave.

(2) Supplemental Issue 2 asks whether Currency Conversion Claims are capable of arising from the operation of insolvency set-off in administrations.

(i) David Richards LJ held in paragraphs 37 to 47 of the Supplemental Issues Judgment that they are not and so declared in paragraph 3 of his Order dated 17 October 2016. His reasoning was that although insolvency set-off in administration does not take effect under Rule 2.85(3) until the administrators give notice of their intention to make a distribution, insolvency set-off in administration is retroactive in effect, so that it is deemed to have occurred as at the Date of Administration.

(ii) York appeals against that declaration.

(iii) The Administrators are among the Respondents to York's appeal. The Administrators contend that David Richards LJ's conclusion was correct, although for reasons different from those given by the Judge. As explained below, the Administrators have filed a Respondent's Notice in which they set out their different reasons for reaching the Judge's conclusion.

(3) Supplemental Issue 3 asks whether payments of statutory interest operate to reduce or extinguish claims to non-provable interest on Currency Conversion Claims.

(i) David Richards LJ held in paragraphs 48 to 54 of the Supplemental Issues Judgment that they do not and so declared in paragraph 4 of his Order dated 17 October 2016.

(ii) Wentworth appeals against that declaration.

(iii) The Administrators are among the Respondents to Wentworth's appeal. The Administrators contend that David Richards LJ's conclusion was correct for the reasons that he gave.

(4) Supplemental Issue 4 asks whether a claim for non-provable interest on a proved debt would fall within the releases contained in the Claims Resolution Agreement (the "**CRA**") and the Claims Determination Deeds (the "**CDDs**").

(i) David Richards LJ held in paragraphs 55 to 61 of the Supplemental Issues Judgment that it would and so declared in paragraph 5 of his Order dated 17 October 2016.

(ii) The SCG appeals against that declaration.

(iii) The Administrators are among the Respondents to the SCG's appeal. However, consistently with the approach that the Administrators took at first instance, they do not make any submissions on Supplemental Issue 4.

(5) Supplemental Issue 5 asks whether a claim for non-provable interest on a Currency Conversion Claim would fall within the releases contained in the CRA and/or the CDDs.

(i) David Richards LJ held in paragraphs 62 to 68 of the Supplemental Issues Judgment that it would fall within the release contained in the CRA but not within the release contained in the CDDs.

(ii) The SCG appeals against David Richards LJ's decision in respect of the CRA, and Wentworth appeals against David Richards LJ's decision in respect of the CDDs.

(iii) The Administrators are among the Respondents to those appeals. However, consistently with the approach that the Administrators took at first instance, they do not make any submissions on Supplemental Issue 5.

9. The Administrators advanced a positive case in the court below on Supplemental Issues 1A, 2 and 3. If (as the Administrators anticipate) the other Respondents file full skeleton arguments in opposition to the relevant appeals, it may be that the Administrators will not need (fully or at all) to develop orally the arguments set out below. The written arguments set out below are made, prior to the Administrators having had sight of the skeleton arguments of the other Respondents, to ensure that the Court has the benefit of full argument on the appeals relating to Supplemental Issues 1A, 2 and 3.

10. Additionally, and so far as Supplemental Issue 2 is concerned, the Administrators set out their case fully in this skeleton argument for the following further reasons:

(1) None of the parties had argued that set-off under Rule 2.85 operates retroactively and, because the Supplemental Issues were decided on the basis of written submissions only, the Judge's analysis went untested.

(2) The Judge did not refer to his own analysis in the earlier case of *Commissioners for Her Majesty's Revenue & Customs v The Football League Ltd* [2013] BCC 60 which is inconsistent with his reasoning on Supplemental Issue 2.

(3) The issue has wider ramifications in LBIE's administration. On a separate directions application issued by the Administrators, they contend (in their position paper) that the Judge's reasoning in determining Supplemental Issue 2 was erroneous.

(4) The Administrators consider that the Judge was nonetheless correct to make the declaration he made on Supplemental Issue 2, but for the reasons originally advanced by them in their written submissions to the Judge, as explained below.

**Supplemental Issue 1A**

11. By paragraph (xxvii) of his Order dated 12 December 2016, Hildyard J declared:

> "*The words 'the rate applicable to the debt apart from the administration' in Rule 2.88(9) of the* [Insolvency] *Rules* [1986] *include, in the case of a provable debt that is a close-out sum under a contract, a contractual rate of interest that began to accrue only after the close-out sum became due and payable due to action taken by the creditor after the date of the commencement of LBIE's administration*".

12. As mentioned above, York appeals against this declaration, with the permission of Hildyard J. York contends that there is an irreconcilable tension between Hildyard J's conclusion on Supplemental Issue 1A (in paragraphs 453 to 529 of the Waterfall IIC Judgment) and David Richards J's conclusion on Issue 4 (in paragraphs 171 to 183 of the Waterfall IIA Judgment).

13. Issue 4 (which formed part of Waterfall IIA) asked:

> "*Whether the words 'the rate applicable to the debt apart from the administration' in Rule 2.88(9) of the* [Insolvency] *Rules* [1986] *are apt to include (and, if so, in what circumstances) a foreign judgment rate of interest or other statutory rate*".

14. David Richards J held in paragraph 181 of the Waterfall IIA Judgment that "*the rate applicable to the debt apart from the administration is to be determined by reference to the rights of the creditor as at the commencement of the administration*".

15. He declared in paragraph (x) of his Order dated 9 October 2015 that:

> "*The words 'the rate applicable to the debt apart from the administration' in Rule 2.88(9) of the* [Insolvency] *Rules* [1986] *include a foreign judgment rate of interest applicable to a foreign judgment obtained prior to the Date of Administration but do not include (a) a foreign judgment rate of interest applicable to a foreign judgment obtained after the Date of Administration or (b) 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)".*

16. This declaration is appealed by the SCG and York, which appeals will be heard at the same time as the appeals arising out of the Supplemental Issues.

17. York's contention is essentially that it is inconsistent for the words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) to:

    (1) ***exclude*** a rate of interest applicable to a foreign judgment obtained after the Date of Administration (as David Richards J held on Issue 4); but

    (2) ***include*** a contractual rate of interest at which no interest was accruing as at the Date of Administration because interest would only begin to accrue after the close-out sum became due and payable due to action taken by the creditor after the Date of Administration (as Hildyard J held on Supplemental Issue 1A).

18. The Administrators oppose York's appeal. There is no inconsistency. As Hildyard J held at paragraph 518 of the Waterfall IIC Judgment, "[the] *distinction lies in the source of the right or entitlement, and the existence or not of that source as at the date of administration*". In summary, a right to interest derived from a judgment obtained after the Date of Administration is not a right which exists at the Date of Administration, whereas a right to interest derived from a contract entered into before the Date of Administration is a right which exists at the Date of Administration whether or not interest is payable at that time.

19. The key distinction is therefore between:

    (1) a rate of interest which becomes applicable to a debt *pursuant to new rights which were first acquired by the creditor after the Date of Administration*; and

    (2) a rate of interest which becomes applicable to the debt *pursuant to the rights of the creditor which existed as at the Date of Administration*.

20. This dividing line is crucial. The latter is a "*rate applicable to the debt apart from the administration*" for the purposes of Rule 2.88(9). The former is not.

21. A foreign judgment rate of interest payable on a new foreign judgment obtained after the Date of Administration (the issue with which Issue 4 of Waterfall IIA was concerned) falls into the first of these two categories. It becomes payable only as a result of new rights bestowed on the creditor after the Date of Administration by reason of the obtaining of the foreign judgment after the Date of Administration. A judgment rate of interest on such judgment was not a right the creditor had at the commencement of (nor therefore "*apart from*") the administration.

22. By contrast, a right to interest under a pre-administration contract falls into the second category: it is a right which (by definition) existed as at the Date of Administration as part of the pre-administration contract. Even if interest at the contractual rate had not yet started to run at the commencement of the administration, the right to such interest existed as part of the contract between the parties which was binding on them on the Date of Administration; that rate was therefore, as at the Date of Administration, applicable to the debt "*apart from the administration*". In the Administrators' submission, a right to interest under a pre-administration contract is necessarily a right of the creditor as at the commencement of the administration.

23. It follows that (for example), for the period following close-out, the right to interest at the Default Rate under an ISDA Master Agreement entered into before the Date of Administration will be the rate of interest applicable to the debt apart from the administration for the purposes of Rule 2.88(9), even where the close-out occurs after the Date of Administration.

24. The critical question, therefore, is to identify whether the right to interest exists as at the Date of Administration or is created or awarded *de novo* after the Date of Administration.

25. As Hildyard J held at paragraph 521 of the Part C Judgment (agreeing with the Administrators on this point), York's submissions fail to recognise the difference between: (a) the possibility of a future right to the payment of interest; and (b) the existence of a present right to the payment of interest on the fulfilment of a condition.

26. In support of its appeal against Hildyard J's declaration on Supplemental Issue 1A, York raises a new argument, which was not advanced before the Judge (and for which it has not sought permission). York's new argument is essentially that the words "*apart from the administration*" in Rule 2.88(9) require a counter-factual enquiry into what rights to interest a creditor would have had if the administration of LBIE had never occurred.

27. York says in paragraph 33 of its skeleton argument dated 31 January 2017 that, in cases where the condition to the running of contractual interest was a contractual event of default which occurred on LBIE going into administration, the words "*apart from the administration*" make it necessary to ignore the occurrence of that event of default by proceeding as if LBIE had never gone into administration; and that, ignoring the event of default which occurred on LBIE going into administration, the condition to the running of contractual interest was never fulfilled. York contends on this basis that a contractual rate of interest which began to run as a result of LBIE's administration triggering a contractual close-out can never be a rate applicable to the debt apart from the administration for the purposes of Rule 2.88(9).

28. In the Administrators' submission, York's new argument is based on a misreading of Rule 2.88 and is wrong:

    (1) Under Rule 2.88(7), where a surplus arises, creditors are entitled to receive statutory interest on the proved debt at a minimum of the rate specified in section 17 of the Judgments Act 1838 (the "**Judgment Rate**") from the Date of Administration. This is a new right, in the sense that it arises under and in accordance with the statutory administration regime.

    (2) As an alternative to the Judgment Rate, the creditor is entitled to interest on the proved debt at the "*rate applicable to the debt apart from the administration*" (see Rule 2.88(9)) (if that rate is higher than the Judgment Rate). The "*rate applicable to the debt apart from the administration*" is the rate that would have applied under the contract if the new right in Rule 2.88(7) had not become applicable. This is a new right, arising under Rule 2.88, albeit referring to the contractual rate.

(3) The creditor is entitled to statutory interest at the "*rate applicable to the debt apart from the administration*" from the date on which that rate became applicable in accordance with the terms of the contract: see David Richards J's conclusion on Issue 1C in the Supplemental Issues Judgment (which is not being appealed) and paragraph 2 of his Order dated 17 October 2016, which provided:

> "*In a case where contractual interest first starts to run on a proved debt at some point after the Date of Administration, the 'rate applicable to the debt apart from the administration' for the purposes of Rule 2.88(9) of the Insolvency Rules 1986 is zero from the period from the Date of Administration to the date when the contractual interest first starts to run*".

(4) The words "*rate applicable to the debt apart from the administration*" are apt because the new right in Rule 2.88(7) derives from, and depends on, the administration. The rate applicable to the debt apart from the administration is thus the rate which would have applied contractually if Rule 2.88(7) had not applied.

(5) There is nothing in the language or purpose of Rule 2.88 to suggest that it is necessary to conduct a speculative counter-factual enquiry into a hypothetical scenario in order to ascertain the rate which would have become applicable in a parallel universe in which the administration had never occurred.

29. York's new argument should therefore be rejected and its appeal should be dismissed.

**Supplemental Issue 2**

30. By paragraph 3 of his Order dated 17 October 2016, David Richards LJ declared:

> "*A Currency Conversion Claim cannot arise from the discharge of a debt by way of set-off under Rule 2.85(3) of the* [Insolvency] *Rules* [1986]".

31. The term "*Currency Conversion Claim*" was defined in the Order of David Richards J dated 9 October 2015 to mean:

> "[A] *claim for an unpaid portion of a debt that arises if (a) a creditor had a claim enforceable against the company denominated in a foreign currency; (b) that claim is converted into Sterling at the prevailing rate as at the date of administration under Rule 2.88; (c) between that date and the date or dates of the dividends, Sterling depreciates against the foreign currency, with the result that; (d) the dividends paid to the creditor are, when converted into the foreign currency at the respective dates of payment, in aggregate lower than the claim denominated in the foreign currency*".

32. In summary, a Currency Conversion Claim is the residual part of a creditor's right to receive payment in a foreign currency, which has not been discharged by payment of dividends in Sterling, because the total dividends received, when converted into the relevant foreign currency at the exchange rate on the date(s) of payment, are insufficient to discharge that contractual right in full.

33. David Richards LJ's primary ground for the declaration in paragraph 3 of his Order dated 17 October 2016 was his conclusion in paragraph 43 of the Supplemental Issues Judgment that, although insolvency set-off in administration does not take effect under Rule 2.85(1) of the Insolvency Rules 1986 until the date (the "**Notice Date**") on which the administrators give notice under Rule 2.95 of the Insolvency Rules 1986 of their intention to make a distribution (a "**Rule 2.95 Notice**"), insolvency set-off in administration is retroactive in effect, such that it is deemed to have occurred as at the Date of Administration.

34. That was not a ground advanced by the Administrators or any other party in their written submissions and, because the Supplemental Issues were determined on the basis of written submissions only, it was not a ground which was debated at a hearing.

35. York appeals against the declaration in paragraph 3 of David Richards LJ's Order dated 17 October 2016 with the permission of the Judge. It contends that insolvency set-off in administration is not retroactive in effect and that it is not deemed to have occurred as at the Date of Administration. York contends that insolvency set-off in administration occurs, and takes effect, on the Notice Date.

36. The Administrators agree with York that insolvency set-off in administration is not retroactive in effect and is not deemed to have occurred as at the Date of Administration.

37. Rule 2.85(3) provides that "[an] *account shall be taken as at the* [Notice Date] ... *and the sums due from one party shall be set-off against the sums due from the other*". This wording makes clear that both the taking of the account and the setting-off of the sums on each side of the account occur on the Notice Date. There is nothing in the language of the Rule to indicate that the set-off has retroactive effect.

38. In fact, David Richards J (as he then was) had himself reached the same conclusion in *Commissioners for Her Majesty's Revenue & Customs v The Football League Ltd* [2013] BCC 60 at paragraphs 84 to 90.

39. In that case, the Judge held at paragraph 84 that:

> "*The ascertainment of provable debts is as at the date when the company entered administration. However, the set-off of mutual debts is as at the date on which the administrator gives notice that he proposes to make a distribution: r.2.85.*"

40. He added at paragraph 90:

> *"It is, in my judgment, significant that insolvency set-off applies in an administration to debts as at the date of such notice, and not earlier. It indicates that it is at that date and not before that the pari passu regime is to operate."*

41. This is consistent with the fact that a company's entry into administration does not prevent creditors from exercising contractual rights of set-off (including multilateral set-off) before the date of the Rule 2.95 Notice. If insolvency set-off operated retrospectively, then contractual rights of set-off would be ineffective from the date of administration. This would be undesirable and contrary to principle. See the Financial Markets Law Committee's November 2007 paper on *Administration Set-Off and Expenses*, Issue 108:

> "*[2.6] When the concept of a mandatory and self-executing administration set-off rule was first raised in the consultations regarding the Enterprise Act 2002, some concern was expressed at the idea that such a rule might apply from the commencement of the administration. This would have had the effect of freezing positions (for example, under running accounts or hedging agreements) and could have prevented the administrator from being able to continue to trade. While such a set-off rule may have been appropriate in the case of a liquidation (where there is unlikely to be significant trading activity), it was hardly in keeping with the emphasis on rescue in respect of the new administration provisions (where the administrator may well want to encourage counterparties to continue to deal with the company in administration in order to achieve the rescue or the continuation of the business as a going concern). It was agreed that the administration set-off rule was only necessary once the administrator had concluded that a rescue of the company was not possible and that the administration should be used, instead, to make distributions to creditors (i.e. a liquidating administration). This is why r.2.85 does not apply automatically from the moment of administration (as r.4.90 does in a liquidation).* ***The rule only applies if and when the administrator gives notice under r.2.95 that he proposes to make a distribution … Up to that point, the usual contractual, transaction or independent set-off rights will continue to apply.***
> *[2.7] However, if the administrator does decide that he is going to make a distribution (thus bringing the administration set-off rule into play), the cut-off date (preventing the build-up of set-off rights) is back-dated to the date of the commencement of the administration (or earlier date of notice as referred to above). Any claims incurred or acquired after this date will not be available for set-off under r.2.85*" (emphasis added).

42. In this respect, set-off in an administration is different from set-off in a liquidation. This is necessarily so, because the administrator may wish to continue trading. See also Lightman & Moss, *The Law of Administrators and Receivers of Companies* (5th edition) at paragraph 22-039:

> "*The account for set-off purposes is therefore taken at the date the administrator gives notice of the distribution (i.e. the 'set-off date' is the date of notice of the distribution); it is not backdated to the date of administration*".

43. The Administrators submit that the declaration in paragraph 3 of the Order of David Richards LJ dated 17 October 2016 was nevertheless correct and that David Richards LJ reached the correct answer as a matter of law, albeit principally in reliance on reasoning which, in the Administrators' submission, was wrong.

44. The Administrators therefore filed and served a Respondent's Notice identifying the different grounds on which they rely to support paragraph 3 of the Judge's Order dated 17 October 2016 to the effect that a Currency Conversion Claim cannot arise in the case of insolvency set-off.

45. The grounds on which the Administrators rely relate to the substantive nature of insolvency set-off (as explained below).

46. In paragraph 46 of the Supplemental Issues Judgment, David Richards LJ held that the substantive effect of insolvency set-off "*provides a* [further] *ground for rejecting York's submissions, but it might produce an unfair result if the set-off was deemed to take place not at the Date of Administration but at the account date*". His concern in respect of fairness led to him preferring his own route based on retroactivity.

47. The Administrators submit that the substantive effect of insolvency set-off ***without more*** provides a sufficient basis for upholding David Richards LJ's answer to Supplemental Issue 2. Further, the Administrators submit that no issue of fairness undermines the Administrators' reliance on the substantive effect of insolvency set-off, which is mandatory, automatic and self-executing and cannot be dis-applied on the basis that the result is considered by the Court to be unfair (or potentially unfair) to a particular person.

48. York has expressed disagreement with the argument contained in the Administrators' Respondent's Notice. York argues that, if discharge by payment can give rise to a Currency Conversion Claim, discharge by set-off must produce the same result. York says that "[both] *payment of the dividend and set-off have substantive, permanent effect on the underlying debt*". However, York's response misunderstands the Administrators' argument, which is as follows:

    (1) There is an important and well-established distinction between the ***substantive*** and ***non-substantive*** parts of the statutory insolvency code.

        (i) The substantive parts of the statutory insolvency code do not apply solely for the purpose of the insolvency proceedings but have the effect of

permanently altering the parties' rights. During and after the conclusion of the insolvency proceedings, the parties' rights survive (if at all) only in their altered form.

(ii) The non-substantive parts, by contrast, apply solely for the purpose of the insolvency proceedings. In the case of non-substantive parts of the insolvency code, the rights of the parties are not permanently altered and survive the insolvency process.

(2) Payment of a dividend is non-substantive. The effect of the payment of a dividend is the same as the payment of any other sum of money under the general law: it will discharge the debt to the extent of the payment and no further. This is the point that Lord Hoffmann made in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 at paragraph 27 when he said that the winding-up "*leaves the debts of the creditors untouched*" and "*does not either create new substantive rights in the creditors or destroy the old ones.* ***Their debts … are discharged by the winding up only to the extent that they are paid out of dividends***" (emphasis added). Where the dividend is insufficient to discharge the creditor's contractual rights in full, those contractual rights continue to exist. On this basis, when the process of payment of dividends comes to an end, the creditor is "*remitted to his rights under his contract*": *Re Humber Ironworks & Shipbuilding Co* (1869) LR 4 Ch App 643 per Sir G M Giffard LJ at page 647.

(3) Consequently, at the end of the process of distribution, creditors with claims denominated in foreign currencies who have not been paid in full in those foreign currencies may seek payment of the unpaid part of their claims. "*If the foreign currency debt has not been fully discharged by payment out of dividends … there is no reason why the creditor should not recover the balance as an unprovable claim*": *Re Lehman Bros International (Europe) (in administration) (No 4)* [2015] 3 WLR 1205 (the "**Waterfall I Judgment**") per Moore-Bick LJ at paragraph 251.

(4) The idea of a remission to the creditor's contractual rights is the conceptual basis of a Currency Conversion Claim, as explained above.

(5) By contrast, insolvency set-off under Rules 2.85 and 4.90 has a particular substantive effect prescribed by statute, permanently extinguishing the parties' original rights (to the extent of the set-off) and leaving only a net balance.

(6) The substantive effect of insolvency set-off has been recognised at the highest levels. See, for example:

(i) *Stein v Blake* [1996] AC 243 per Lord Hoffmann at page 251: "*Bankruptcy set-off, on the other hand, affects the substantive rights of the parties*".

(ii) The Waterfall I Judgment per Briggs LJ at paragraph 150 (holding that "*the regime for insolvency set-off in rule 4.90 provides … a useful example of a rule which does have substantive permanent effect*"); and per Lewison LJ at paragraph 94 (saying that Lord Hoffmann "*held in* Stein v Blake ... *that insolvency set-off ... did have substantive effect on the underlying debt. Another example in the insolvency code is the disclaimer of onerous property. If onerous property is disclaimed the creditor's right to future payments (say payment of future rent) is converted into a right to prove in the insolvency for loss; and that loss is assessed as if it were a claim for damages. Once the loss has been assessed in that way, that is all that the creditor is entitled to*"). See also Moore-Bick LJ at paragraphs 250 to 251.

(7) Therefore, where all or part of a creditor's claim has been discharged by insolvency set-off, the creditor's original rights in respect of that part of the claim have been extinguished, leaving only the net balance (if any) payable (or, if the balance is in favour of the creditor, provable) one way or the other.

(8) Since the effect of the set-off is substantive, there is no remaining contractual right in respect of the extinguished part of the claim to which the creditor may subsequently be remitted. The part of the creditor's foreign currency debt appropriated for the purpose of the set-off is forever extinguished and, as a consequence, it is impossible for the creditor subsequently to be remitted to it. The conceptual basis of a Currency Conversion Claim is therefore missing.

49. It follows that there can be no Currency Conversion Claim arising from insolvency set-off. The substantive nature of the set-off means that there can be no remission to contractual rights in respect of that part of the claim that has been extinguished.

50. In the Administrators' submission, it is no answer for York to say that claims denominated in a foreign currency are converted into Sterling both for the payment of a dividend and for the purposes of set-off and that, if conversion for payment can give rise to a Currency Conversion Claim, conversion for set-off must do so too. In summary:

    (1) It is meaningless to ask in the abstract whether currency conversion is substantive or non-substantive. Conversion of foreign currency claims into Sterling is only ever performed for a purpose. It takes place not for its own sake but as an integral part of a wider process. This is clear from the Insolvency Rules themselves: Rule 2.85(6) requires conversion to occur "*for the purpose of* [Rule 2.85]" (i.e. for the purposes of a process with substantive effect); whilst Rule 2.86(1) requires conversion to occur "[for] *the purpose of proving a debt incurred or payable in a currency other than Sterling*" (i.e. for the purpose of a process with a non-substantive effect). See also Briggs LJ at paragraphs 149 to 150 of the Waterfall I Judgment, emphasising the importance of the draftsman's reference to conversion for a specific "*purpose*".

    (2) In the Administrators' submission, it is the nature of this wider process that will determine whether the effects are substantive or non-substantive:

        (i) If the conversion of foreign currency claims into Sterling is taking place for the purpose of the *pari passu* payment of dividends on provable claims, there is no substantive effect on creditors' rights, because the process of *pari passu* distribution is not a substantive one; and it follows that the conversion which takes place for the purpose of, and which forms part of, that process is not substantive either. See, for example, Moore-Bick LJ at paragraph 250 of the Waterfall I Judgment, rejecting the "*proposition that*

*the conversion of a foreign currency debt into Sterling* ***for the purposes of proof*** *has a substantive effect*" (emphasis added).

(ii) By contrast, if the conversion is taking place as part of the process of insolvency set-off, which does have substantive effect, the outcome will be different. Since the conversion occurs as an integral part of a process with substantive effect, the creditor's rights will permanently be altered and the notion of remission to the creditor's rights will be conceptually impossible, since those rights will have been extinguished to the extent of the set-off. When applied in the context of a mandatory set-off account, the conversion determines the extent of the debt that is set off and extinguished.

51. In the Administrators' submission, this explains why insolvency set-off cannot give rise to Currency Conversion Claims. The set-off is substantive in effect: it results in part of the creditor's original rights being permanently extinguished. It follows that there can be no remission to that part of those rights at the end of the insolvency proceedings: they have been extinguished permanently and cannot be revived.

52. The fact that claims in foreign currencies may be converted to Sterling for the purpose of set-off does not affect this analysis. The set-off has substantive effect whether the original claims were denominated in Sterling or a foreign currency.

53. Further, the fact that conversion of foreign currency claims into Sterling gives rise to the prospect of remission to contractual rights in *non-substantive* contexts does not mean that conversion *always* gives rise to such a prospect or that it does so when it takes place as part of a process with *substantive* effect.

54. The conclusion that conversion for the purpose of set-off has a substantive effect is clear from Briggs LJ's conclusion at paragraph 152 of the Waterfall I Judgment:

> "*There is […] no logical reason why a provision for conversion into Sterling of a foreign currency amount by reference to a historical date should necessarily operate as a substantive permanent alteration of the creditor's contractual rights,* ***except only to the extent that set-off is involved***" (emphasis added).

55. Further, Briggs LJ held at paragraph 153:

> "*The potential for injustice caused by the permanent conversion of a foreign currency debt into Sterling is entirely the result of the inevitable gap in time between the conversion date and the payment of dividends … But* ***absent set-off*** *there is no reason why the conversion for the purpose of proof should be anything more than a means of part-payment which is fair as between all proving creditors, leaving the foreign currency creditor with a remedy against a surplus if (but only if) Sterling has depreciated in the meantime, and after all proving creditors have been paid in full with statutory interest*" (emphasis added).

56. In the Administrators' submission, the substantive effect of set-off involving conversion may be illustrated by a simple example:

(1) Assume that, at the Date of Administration, LBIE owed US$100 to a creditor, which owed £50 to LBIE, and that the exchange rate was US$2 to £1.

(2) The creditor's claim against LBIE is converted into Sterling at that rate for the purpose of set-off and is therefore worth £50. For the purposes of insolvency set-off, the creditor's claim against LBIE is worth the same amount as LBIE's claim against the creditor.

(3) These sums are set off against each other and the result is that both claims are extinguished. After the set-off, LBIE's rights against the creditor have gone forever; and the creditor's rights against LBIE have gone forever. Neither has any claim against the other.

(4) Set-off has a substantive effect. There is no basis for saying that, as a result of currency movements, the creditor's rights against LBIE might subsequently revive, any more than there is for saying that, if the exchange rate were to move the other way, LBIE's claim against the creditor might revive.

(5) As a result of the substantive effect of set-off, there is nothing remaining to which either of the parties may subsequently claim to have been remitted.

57. In the Administrators' submission, the outcome is the same whether the claims were both originally in Sterling (such that, e.g., £50 is set off against £50) or the claims were originally denominated in different foreign currencies (such that, e.g., $100 is converted to £50 in one direction and, say, €75 is converted to £50 in the other). The substantive effect of set-off causes the two claims to be extinguished.

58. Further, the substantive nature of the set-off means that the creditor cannot claim that the part of his foreign currency debt subject to insolvency set-off was extinguished for the purpose of the insolvency proceedings but not otherwise. Rather, as a result of the substantive nature of the set-off, the part of the creditor's foreign currency claim that was appropriated for the purpose of the set-off account is extinguished for all purposes.

59. Further and in any event, York's arguments prove too much: York contends that a Currency Conversion Claim may arise from insolvency set-off even where the claim and the cross-claim are both denominated in the same foreign currency (and, seemingly, even where they are both identical in amount). York gives the example in paragraph 58 of its skeleton argument dated 31 January 2017 of a claim of US$100 and a cross-claim also of US$100. York says that, when the claim and the cross-claim are set off against each other under Rule 2.85, the creditor may obtain a Currency Conversion Claim. In York's example, the amount of this Currency Conversion Claim is US$5.

60. In the Administrators' submission, such a result would be absurd and is wrong. Since the claim of US$100 has been set off against the cross-claim of US$100, the creditor has obtained full value for his debt (in that example, whether considered in its original currency or in Sterling), which has been extinguished. There is no justification for a Currency Conversion Claim in such circumstances. Further, since both claims are originally denominated in US Dollars, the exchange rate used to convert them into Sterling should make no difference, since it is the same exchange rate on both sides of the equation.

61. In any event, as explained above, Rules 2.85(6) and 2.86 make clear that the exchange rate to be used to convert the claim and the cross-claim into Sterling is the exchange rate as at the Date of the Administration. Applying that exchange rate, the Sterling

amount of the claim will be the same as the Sterling amount of the cross-claim. The two amounts being equal, they will cancel each other out. The idea that the creditor can obtain a Currency Conversion Claim in such circumstances demonstrates the illogicality of York's argument on this point.

62. In the Administrators' submission, the financial outcome of insolvency set-off will not vary by reference to the date on which it takes place. Rather, the financial outcome for the creditor is fixed by the Insolvency Rules 1986 and will always be determined by reference to the exchange rates as they stood as at the Date of Administration: see Rules 2.85(6) and 2.86 of the Insolvency Rules 1986. Consequently, whether there is a long or a short period between the Date of Administration and that Notice Date, and whether movements in exchange rates have caused Sterling's value to diminish or appreciate in that period, the result of the set-off calculation will be the same.

63. It follows that David Richard LJ's conclusion was correct, albeit for a different reason from that relied upon by him, and that York's appeal should be dismissed.

**Supplemental Issue 3**

64. By paragraph 4 of his Order dated 17 October 2016, David Richards LJ declared:

> "*A non-provable claim to interest on a Currency Conversion Claim is not to be reduced by statutory interest paid to the creditor under Rule 2.88(7) of the* [Insolvency] *Rules* [1986]".

65. Wentworth appeals against this declaration with the permission of David Richards LJ.

66. Wentworth submits that, although the Currency Conversion Claim is spoken of as a claim distinct from the creditor's proved claim, there is in fact only one debt owed to the creditor and, therefore, any interest for the period after the date of administration, whether statutory or contractual, is payable in respect of the same debt. In its skeleton argument dated 31 January 2017, Wentworth's central point appears to be its contention that:

> "*…the proved debt is the single, indivisible obligation owed to the creditor. The conversion of the debt into Sterling for the purpose of proof does not create a new, separate obligation. Any payment, whether by way of dividend or statutory interest, is referable to that single, indivisible obligation*".

67. In the Administrators' submission:

    (1) Statutory interest is paid on the proved debt. It is not paid in satisfaction of a creditor's contractual entitlements to interest. As David Richards LJ held in paragraph 53 of the Supplemental Issues Judgment, statutory interest is payable by law on the proved debt and is referable only to the proved debt. That is what Rule 2.88(7) provides.

    (2) It follows that there can be no obligation to give any credit for statutory interest received when calculating either Currency Conversion Claims or non-provable claims for contractual interest on Currency Conversion Claims.

68. Wentworth's reasoning proceeds on the incorrect premise that statutory interest is paid in reduction of a right to contractual interest. This is incorrect. In summary:

    (1) Statutory interest is not dependent on the existence of a contractual right to interest. A creditor whose debt bears no right to contractual interest will nevertheless be entitled to statutory interest at a rate of 8 per cent per annum.

    (2) Statutory interest is not paid in discharge of a contractual right to interest. Rather, it replaces any contractual right to interest on the proved debt in Sterling.

    (3) Rule 2.88(7) is expressly concerned with statutory interest on proved debts. It does not apply to (and has no bearing on) non-provable liabilities.

    (4) Rule 2.88(7) therefore has no bearing on the non-provable remainder of the creditor's claim, which does not attract statutory interest.

    (5) Since it does not attract statutory interest, a contractual right to interest on that non-provable remainder cannot have been replaced by statutory interest.

(6) Since the right to interest on the non-provable remainder has not been replaced by statutory interest, it continues to survive and may be claimed as part of the creditor's non-provable claim against LBIE.

69. As David Richards J held in paragraph 228 of the Waterfall IIA Judgment, the Currency Conversion Claim should not take into account the payment of statutory interest under Rule 2.88, which is payable only on proved debts and is not paid in or towards the satisfaction of a creditor's contractual right to payment in a foreign currency. As David Richards J concluded in paragraph 231, "*the calculation of a currency conversion claim should not take into account the statutory interest paid to the relevant creditor*".

70. In the Administrators' submission, the same reasoning applies to non-provable claims for contractual interest on non-provable Currency Conversion Claims: the non-provable interest is part of the total amount of the non-provable claim, which is not reduced by the payment of statutory interest on the proved debt. It follows that a non-provable claim to interest on a Currency Conversion Claim should not be reduced by interest received by the creditor pursuant to Rule 2.88(7) on its proved debt, which is a separate matter.

71. In the Administrators' submission, David Richards LJ was therefore correct to hold in paragraph 52 of the Supplemental Issues Judgment that Rule 2.88:

> "*…is a complete code for the payment of interest on proved debts. Its purpose is to compensate creditors for the delay occasioned by the insolvency in the payment of the proved debts which are all notionally payable as at the commencement of the insolvency. It is unconnected with any right to interest under the contract or to the lack of any such contractual right, save for the purpose of determining the rate at which statutory interest is to be paid*".

72. For these reasons, Wentworth's appeal should be dismissed.

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