Waterfall II Application

No 7942 of 2008

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

<u>CHANCERY DIVISION</u>

<u>COMPANIES COURT</u>

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) ANTHONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) JULIAN GUY PARR

(as the joint administrators of the above named company)

<u>Applicants</u>

- AND -

(1) BURLINGTON LOAN MANAGEMENT LIMITED

(2) CVI GVF (LUX) MASTER S.À R.L

(3) HUTCHINSON INVESTORS LLC

(4) WENTWORTH SONS SUB-DEBT S.À R.L

(5) YORK GLOBAL FINANCE BDH, LLC

<u>Respondents</u>

SKELETON ARGUMENT ON BEHALF OF

THE FOURTH RESPONDENT

INTRODUCTION

1. This skeleton argument is filed on behalf of Wentworth Sons Sub-Debt S.à.r.l. ("**Wentworth**"). Capitalised terms used but not otherwise defined herein are defined in the Waterfall II Application dated 12 June 2014 (the "**Application**").

2. The parties to the Application have agreed that it would be appropriate to structure the hearing by dividing the issues to be determined into groups of related issues as follows. This skeleton follows the same structure:

GROUP I: ISSUES 2 AND 39

ISSUE 2

Whether on the true construction of Rule 2.88(7) of the Rules, Statutory Interest is calculated on the basis of allocating dividends:

> **(i) first to the payment of accrued Statutory Interest at the date of the relevant dividends and then in reduction of the principal;**
>
> **(ii) first to reduction of the principal and then to the payment of accrued statutory interest; or**
>
> **(iii) on the basis of some other sequencing.**

3. Issue 2 concerns the true construction of Rule 2.88(7).

4. The essential debate is whether, on the true construction of the Rule, the principle referred to in the case of *Bower v Marris* (1841) Cr & Ph 351 has any, and if so what, relevance to the calculation of interest payable from the 'insolvency surplus' (i.e. the surplus remaining after payment of all proved debts).

5. The principle referred to in *Bower v Marris* was, in essence, that the creditor was entitled to appropriate dividends received from the insolvency estate in discharge of interest before principal.

6. Wentworth (and the Administrators) contend that it does not have any relevance to the calculation of Statutory Interest payable under Rule 2.88(7). The SCG and York say that it does, and that the amount of interest payable under Rule 2.88(7) is to be calculated on the basis that prior dividends paid are to be appropriated first towards interest and only then towards principal.

7. Wentworth's case can be distilled into the following propositions:

   (1) The nature and extent of a creditor's entitlement to interest from the insolvency surplus is a question of interpretation of the relevant statutory provisions: in the case of an administration, Rule 2.88(7)-(9).

   (2) On the true construction of Rule 2.88(7)-(9), Statutory Interest is calculated on the following basis:

(a) each payment of dividend reduced the quantum of the proved debt;

(b) at the point in time at which interest under Rule 2.88(7) first becomes payable, the whole of the proved debt has been discharged in full; and

(c) Statutory Interest is accordingly payable on the amount of the proved debt, now paid in full, for the period up until it was paid.[1]

(3) The principle referred to in *Bower v Marris* has no relevance to the calculation under Rule 2.88(7).

(4) *Bower v Marris* decided merely that the fact that the payments were made by way of dividend from a bankrupt's estate did not constitute any irrevocable appropriation of those payments to principal, so that the creditor's right of appropriation as against a co-debtor was unaffected.

(5) The statutory regime relating to the payment of interest from an insolvency surplus in England at the time of *Bower v Marris* (and every other case in England which has recognised the same principle) based the creditor's right to such interest upon the premise that (a) the creditor's right to be paid the whole of the principal and interest on its debt subsists throughout the insolvency process, and (b) interest ceases to run at the commencement of the insolvency only as a rule of convenience such that when a surplus emerges creditors are remitted to their contractual rights.

(6) In such statutory context, the principle in *Bower v Marris* applied because the relevant question was how much interest would the creditor have been entitled to pursuant to its contract, or other pre-existing rights, had there been no insolvency.

(7) The basis of creditors' rights to Statutory Interest in England since the 1986 Insolvency Act is fundamentally different.

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1 Where multiple dividends are paid in respect of a proved debt, interest is paid on each portion until payment of such portion.

(8) In the case of administration, Rule 2.88[2] introduced a self-standing and comprehensive code concerning payment of interest in administration.

(9) In particular, Rule 2.88(7) delineates the nature and extent of interest payments to be made from the insolvency surplus, in a manner which does not involve remission to contractual or other pre-insolvency rights (save for the limited extent of incorporating in some circumstances the "*rate*" at which the creditor was entitled to interest but for the administration), and in fact substantively alters those rights.

(10) Accordingly, the right of a creditor in respect of payments made on account of (but without an appropriation between) principal and interest to apply those payments to the discharge of accrued interest before principal has no bearing on the calculation of interest which Rule 2.88(7) directs to be paid from the insolvency surplus.

(11) In any event, the principle in *Bower v Marris* has no application in respect of interest payable to creditors whose debts carried no pre-insolvency right to interest.

(12) There is no basis for a form of non-provable claim for interest calculated on the *Bower v Marris* basis where such a calculation would have led to a higher return for the creditor than the amount of interest it received pursuant to Rule 2.88. That is because the creditors' entitlement to be paid interest since the Date of Administration is wholly defined by Rule 2.88, and there is no room for any non-provable claim for interest calculated on a different basis to that which is applied under Rule 2.88.

<u>Construction of Rule 2.88</u>

8. Rule 2.88(7)-(9) identifies the nature and extent of the estate's liability to pay interest from the insolvency surplus.

9. Its purpose is to compensate creditors for being kept out of their money: see *Waterfall I* [2014] EWHC 704 (Ch) at [86]. The SCG are wrong in stating (paragraph 2(1) of the

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2 Or the equivalent rules in liquidation and bankruptcy introduced by the Insolvency Act 1986.

SCG's position paper) that the purpose is "*to ensure that no person is prejudiced by the effect of the insolvency proceedings*".

10. It is part of new rules relating to interest introduced in 1986 across corporate and personal insolvency. In 1986, for the first time, provisions were introduced relating to interest payable from an insolvency surplus in a corporate insolvency. The provisions for interest in personal and corporate insolvencies were assimilated.

11. The new provisions were intended to be substantively different from that which had gone before, and to produce a streamlined and simpler regime for payment of interest from insolvent estates.

12. The Cork Report, paragraph 1392, concluded that "*there should be one set of rules relating to interest on debts in all forms of insolvency proceedings. In preparing the rules, simplicity and certainty are essential*". In line with that sentiment, it recommended, at paragraph 1394, that in the event of there being a surplus after the payment of all admitted debts and liabilities "*interest should run on all such debts and liabilities until a final dividend is declared, the rate being that currently applicable to judgment debts at the commencement of the insolvency*".

13. This recommendation was substantially implemented, save only that the recommendation that interest be payable in all cases at the Judgments Act Rate was modified so that where apart from the insolvency a debt would have carried a higher rate of interest, then that higher rate was applicable. As the Court noted in Waterfall I (at [18]) the Judgments Act Rate, which is the default rate of Statutory Interest, is significantly in excess of market rates since 2008.

14. The essence of the recommendation that interest should run "*until a final dividend is declared*" was enacted, with the slight variation that interest under Rule 2.88(7) runs until the final dividend has been paid (i.e. until the proved debt ceases to be outstanding).

15. These provisions were described in the 1987 edition of Palmer's Company Law as having "*brought about a complete change in the law concerning the payment of interest on debts proved in a winding up*": 1987 ed. at 88-68A. Gore-Browne on Companies, at 18F states that *"[t]he complex and unsatisfactory rules previously governing proof for interest are*

now completely replaced by s 189 of the Insolvency Act and r 4.93 of the Insolvency Rules." Fletcher, in the Law of Insolvency, at 24-045 likewise states that *"[u]nder the Insolvency Act 1986 a complete change was made to the law concerning the payment of interest on debts proved in a winding up*".

16. Importantly (and in contrast to the regime which previously applied in relation to companies), the regime in liquidation, administration and bankruptcy for payment of interest accruing after the commencement of the insolvency proceedings under the Insolvency Act 1986 operates *otherwise* than by reference to such rights as the creditor had to receive interest apart from the administration (e.g. pursuant to contract) – save only to the limited extent of incorporating the *rate* at which the creditor would have been entitled to interest but for the administration, where that rate is higher than the rate provided for in the Judgments Act.

17. In fact, the regime operates in a way that cuts across such contractual or other rights which creditors had apart from the insolvency. Thus, in the case of administration, Rule 2.88 provides as follows:

(1) Interest is payable from the insolvency surplus to all creditors whether or not their debts were interest-bearing.

(2) In the case of interest-bearing debts where the contractual rate was less than the Judgments Act Rate, interest is payable from the insolvency surplus at a rate higher than that which their contract provided.

(3) Interest is payable from the insolvency surplus on a principal sum which comprises (a) the capital amount of the debt and (b) any interest accrued up to the date of the administration, i.e. a form of compounding even though the creditor would have been entitled only to simple interest on the capital amount of the debt itself.

(4) Interest is payable on a non-sterling debt at the Judgments Act Rate even though a non-sterling debt is entitled to have a different rate applied, if progressed to judgment, under section 44A of the Administration of Justice Act 1970.[3]

[3] Under s.44A the rate is such rate as the Court in its discretion thinks fit.

(5) Interest is payable on a sterling debt at a rate in excess of the Judgments Act Rate, if provided for in the contract, even if there is no non-merger clause in the contract,[4] which is essential to the payment of interest at a rate higher than the Judgments Act Rate, if a judgment should be obtained on that debt.

18. These features of Rule 2.88 constitute a significant alteration to the obligations (contractual or otherwise) of the company to its creditors generally, and a correlative significant alteration to the rights of all creditors.

19. In light of these changes to the contractual obligations (of the company) and contractual rights (of creditors), the correct analysis is that Rule 2.88 was intended to be a complete statement of the extent to which interest is payable from an insolvency surplus.

20. Nothing in the Privy Council decision of *Wight v Eckhardt* [2004] 1 AC 147 detracts from that conclusion. Lord Hoffmann's comment, at [27], that winding up leaves the debts of creditors untouched and merely affects the way in which they can be enforced was not directed at the question of interest from an insolvency surplus under the regime introduced by the 1986 legislation. As noted above, that regime undoubtedly does alter the substantive rights of creditors in respect of interest relating to the period after the commencement of the insolvency.

21. It is true that Rule 2.88(9) makes limited reference to the pre-insolvency rights of creditors, in that it incorporates the rate applicable to the debt apart from administration. The fact that this limited reference is made supports the conclusion that the regime for payment of interest from an insolvency surplus under Rule 2.88(7) does *not* otherwise operate on the basis of remission to creditors' pre-insolvency (including contractual) rights. The incorporation of the rate applicable to the debt apart from administration certainly does not include incorporation of the rule of appropriation referred to in *Bower v Marris*. That rule of appropriation is fundamentally different from the "*rate*" of interest applicable to the debt.

22. Rule 2.88 has the following important features:

(1) Interest is provable as part of the debt up to the Date of Administration.

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4 See CPR, Part 40, White Book at 40.8.3 for the effect of a non-merger clause.

(2) No amount in respect of post-administration interest is payable until *after* all proved debts have been paid.

(3) Once all proved debts have been paid, then interest is payable out of the surplus, on all proved debts.

(4) That interest is payable only for the periods during which the proved debts have been outstanding since the company entered administration.

(5) The rate at which such interest is paid is the higher of (a) the Judgments Act Rate and (b) the rate applicable to the debt apart from administration.

23. On the true construction of Rule 2.88, the rule is inconsistent, in various respects, with the notion that the interest payable pursuant to it is to be calculated on the basis that dividends were paid in discharge of interest before being applied in payment of principal.

24. First, the right to payment of interest from the insolvency surplus arises only after all proved debts have been paid in full. The method for which the SCG contends depends upon an assumption that the proved debts remain at least partially unpaid.

25. Second, the basic requirement in Rule 2.88(7) is that the insolvency surplus be applied in "*paying interest*" on each proved debt. The method for which the SCG contends, however, would result in at least part of the payments made under Rule 2.88 being made for the purpose of paying principal (i.e. the outstanding part of the proved debt which is to be assumed not to have been discharged by payment of dividends).

26. Third, interest is payable under Rule 2.88(7) only for such periods as the proved debts remain "*outstanding*" since the company entered administration, i.e. until they have been paid. Taking the case of a proved debt which had accrued due as at the Date of Administration:

(1) If a single dividend is paid, then interest is payable for the period from the commencement of the administration until the date of that dividend.

(2) If multiple dividends are paid, then interest is payable on each portion of the debt from the Date of Administration until the payment of the dividend in respect of that portion of the debt.

27. In either case, the debt ceases to be outstanding, and the requirement to pay interest on it ceases, as at the date of the final dividend.

28. The method for which the SCG contends, however, would result in payments of interest relating to a period long after the date of the final dividend. That is because under the SCG's calculation, there is assumed to be a 'rump' of principal outstanding after the date on which the last dividend in respect of the proved debt is paid, upon which interest continues to accrue, potentially indefinitely. In essence, if payments are appropriated towards interest first, then by definition there will be an element of principal outstanding at the point in time that Statutory Interest becomes payable. As time passes, interest continues to accrue on that principal, and payments of Statutory Interest then go first to discharge such interest before remaining principal. It is only if and when a sufficiently large payment of Statutory Interest is made which extinguishes all the remaining interest and principal that, on the SCG's case, interest stops running.

29. Moreover, as explained in more detail below, the operation of the principle of appropriation in *Bower v Marris* depends on there being an accrued right to interest at the time of the payment of the dividend. Under the regime introduced in 1986, there is no accrued right to interest pursuant to contract, merely an expectation of a right in the future to Statutory Interest in the event that there is an insolvency surplus.

30. This conclusion does not mean that the principle of appropriation applied in *Bower v Marris* has no relevance following the enactment of the 1986 legislation. Indeed, the actual result in *Bower v Marris* (which related only to the effect of dividends on the creditor's rights against a co-debtor) would be the same today. If, therefore, the insolvent company is one of two co-debtors, in respect of an interest-bearing debt, the creditor would be entitled as against the co-debtor to apportion payments received from the insolvent company towards interest before principal. The same would be the case as regards a surety.

31. Wentworth's case is simply that the calculation of the liability *imposed on the insolvency surplus* under Rule 2.88(7) is not based on the rule of appropriation applied in *Bower v Marris*.

The circumstances in which *Bower v Marris* has been applied

What was decided in *Bower v Marris*

32. The actual ratio of *Bower v Marris* is: where a creditor is owed the same interest bearing debt by two co-debtors, one of whom is bankrupt, in determining the amount which the creditor can claim from the solvent co-debtor, the creditor is entitled to appropriate dividends made from the insolvent estate of the bankrupt co-debtor towards the discharge of accrued interest before applying the surplus, if any, in discharge of principal.

33. Lord Cottenham also considered, albeit obiter, that the same conclusion applied as between the creditor and the bankrupt - i.e. that in considering the amounts due from the bankrupt's estate in respect of interest accruing since the bankruptcy, where there was an insolvency surplus, the creditor was entitled to treat the dividends as having discharged interest.

34. Lord Cottenham's reasoning (at pp.355-357) was as follows:

(1) As a general rule where a creditor is owed sums in respect of both principal and interest by a solvent debtor, in the absence of any appropriation by the debtor, the creditor is free to appropriate payments made on account, first, towards accrued interest and second towards principal.

(2) The argument that the dividends from the estate of the bankrupt co-debtor were appropriated by statute towards payment of principal was rejected on the basis that as the payments were made pursuant to a duty to distribute under the statutory scheme, and the doctrine of appropriation depends upon the intention of the debtor and/or creditor, there was no question of appropriation.

(3) If there had been no bankruptcy, there would have been nothing to prevent the creditor appropriating payments on account first in respect of interest. Although interest stopped at the date of bankruptcy, that was an arrangement for the

convenience of the bankrupt's creditors, and the bankrupt continued indebted for principal and the interest accrued since the date of the commission.

(4) The relevant bankruptcy legislation (s.132 of the Bankruptcy Act 1825, 6 G 4, c.16)[5] provided that the bankrupt was not entitled to receive a surplus arising after payment of proved debts until creditors received interest on their debts. That provision was intended to make good to the creditors (with a contractual right to interest) that interest which, by the course of administration in bankruptcy, they had lost. The Act was intended to place the creditor in as favourable a situation as if there had been no bankruptcy.

(5) Accordingly, there was nothing in the statutory scheme which removed the creditor's entitlement to appropriate payments towards interest before principal.[6]

35. Lord Cottenham cited authority in support of his conclusion (at pp.358-359). Of the cases he cited, however, only one (*Bromley v Goodere* (1743) 1 Atk 75) made any reference to the appropriation of dividends first towards interest. The remainder of the cases cited by Lord Cottenham dealt only with the point that creditors with interest-bearing debts were entitled to be paid interest accruing since the date of bankruptcy out of any insolvency surplus, before anything was received by the bankrupt.

36. In *Bromley v Goodere* itself, there was no statutory provision dealing with interest at all. There was instead a rule of practice that in computing creditors' debts, where those debts carried interest, interest was allowed only down to the time of issuing the commission (p.79). Lord Hardwicke concluded that in the case of a surplus, the creditors whose debts carried interest should be entitled to that interest out of the surplus before it was remitted to the bankrupt. In formulating the terms of the order, Lord Hardwicke provided that payments of dividends to creditors should be appropriated "*in the first place to keep down*

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5 S.132 is set out in full, along with all other relevant statutory provisions, in the Appendix to this skeleton.

6 Even if *Bower v Marris* were to apply under Rule 2.88, it is clear that an actual appropriation by the creditor, in respect of dividends made, in satisfaction of principal would be effective. Whether there has in fact been any appropriation of dividends towards payment of principal is beyond the scope of this Application.

the interest, and afterwards in sinking the principal". There was no discussion of or explanation for this part of the order.

37. Accordingly, the only explanation for the application of dividends to interest before principal is that contained in *Bower v Marris* itself.

Subsequent treatment of *Bower v Marris* in English authorities

38. *Bower v Marris* was cited with approval in *re Humber Ironworks and Shipbuilding Company (Warrant Finance Company's Case)* (1869) 4 Ch App 644.

39. As at the date of the Court of Appeal's decision in *Humber Ironworks*, the only (valid) provision dealing with interest on creditors' debts was the first part of Rule 26 of the Winding up Rules 1862, which provided as follows:

> *"Interest on such debts and claims as shall be allowed shall be computed, as to such of them as carry interest, after the rate they respectively carry…"*

40. The remainder of Rule 26 purported to permit interest at 4% to be payable out of an insolvency surplus on debts which did not carry a right to interest. That part of the rule had, however, already been held to be ultra vires in *Re East of England Banking Company* (1868) LR 4 Ch App 14.[7]

41. In *Humber Ironworks*, the Court of Appeal concluded (for the first time in relation to a winding-up) that in the case of an insolvent company dividends were to be paid on interest-bearing debts only upon what was due for principal and interest up to the date of the winding-up. It was only in the case of a subsequent surplus that there could be any claim for subsequent interest and, in that case, the dividends would be treated as applicable first in payment of interest and then in reduction of principal (as per the mode of calculation in *Bower v Marris*).

42. The following points arise from *Humber Ironworks*:

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7 Lord Cairns L.C., at p.19, said "*The Act contemplates calls for payment of debts legally due, and the Court of Chancery was not armed with power to burden the contributories with anything beyond*."

(1) The rule as to what was payable by way of dividend and what was payable out of surplus was judge-made law.

(2) The basis upon which post-liquidation interest was payable was most clearly stated by Giffard LJ: "*as soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is* ***remitted to his rights under his contract****; and, on the other hand, a creditor who has not stipulated for interest does not get it*." (Emphasis added)

(3) Selwyn LJ, at 645, noted that it was because the payments of dividends, when made, were made in process of law that they did not amount to an appropriation (which depended upon the intention of debtor and/or creditor), as found in *Bower v Marris*:

> "*I apprehend that in whatever manner the payments may have been made, whether* ***originally*** *they may have been made in respect of capital or in respect of interest, still,* ***in as much as they have all been paid in process of law****, and* ***without any contract or agreement between the parties****, the account must, in the event of there being an ultimate surplus, be taken as between the company and the creditors in the* ***ordinary way***." (Emphasis added)

(4) Accordingly, because of the remission to pre-liquidation contractual rights, it is unsurprising that in calculating the interest payable from the insolvency surplus, there was no reason to disapply the general rule applicable in the case of a solvent debtor, that the creditor was entitled to appropriate payments on account of principal/interest as first discharging accrued interest.

43. The only reported English case since 1869 in which the calculation of interest payable from an insolvency surplus has been carried out on the basis applied in *Bower v Marris* is *Re Lines Bros* [1984] 1 Ch 438, where it was common ground between the parties that the calculation should be carried out in that way. The applicable statutory regime in *Lines Bros* was materially the same as that in *Humber Ironworks*: importantly, there was no statutory provision for the payment of interest accruing post-liquidation[8], and the basis upon which

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[8] Although successive Bankruptcy Acts had provided an entitlement to statutory interest from a surplus, which, as the years progressed, involved an increasingly complex set of calculations, the cross-reference to those Acts in the Companies Acts from 1862 to 1948 and other Acts (see e.g. Section 10 of the Supreme Court of Judicature Act 1875) were construed so as to not apply in relation to a winding up in which a surplus emerged. The cross-reference, most recently, in Section 317 of the Companies Act 1948 was

a creditor was entitled to interest accruing post-liquidation was that the contractual right to payment of the debt and all interest accruing on it subsisted throughout the insolvency process, such that there was a remission to those contractual rights once the insolvency surplus emerged.

44. From the time of *Bower v Marris*, the Bankruptcy Acts did contain a provision for payment of interest accruing post-bankruptcy at a fixed percentage rate to creditors whose debts were not interest-bearing. However, until 1883, this applied only *after* interest from the insolvency surplus had been paid to creditors with interest-bearing debts[9]. The subordinated statutory right of other creditors to post-bankruptcy interest was not in issue in *Bower v Marris* and was not the subject of any decision.

45. In the Bankruptcy Act 1883, provision was introduced for the payment of interest out of an insolvency surplus from the date of the receiving order on all debts proved at 4%: section 40(5). Section 33(8) of the Bankruptcy Act 1914 is in terms equivalent to Section 40(5) of the 1883 Act[10]. This right was neither dependent on a remission to the contractual rights of creditors nor incorporated a contractual rate. There is, however, no reported case under the 1883, 1890 or 1914 Acts relating to payment of interest from a bankruptcy surplus which has applied, or even referred to, *Bower v Marris* or the method of calculation of interest adopted in it.

46. There is no reference at all to *Bower v Marris*, or the principle of appropriation referred to in it, in any edition of the leading bankruptcy text book, Williams on Bankruptcy (later called Muir Hunter on Bankruptcy).

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construed to apply only to an insolvent winding up and therefore did not apply in the case of a surplus: *Re Rolls-Royce Co Ltd* [1974] 1 WLR 1584, which followed *Re Milan Tramways Co* (1884) 25 Ch D 587 and *Re Fine Industrial Commodities Ltd* [1956] Ch 256.

9 See Bankruptcy Act 1825, section 132; Bankruptcy Act 1849, section 197; Bankruptcy Act 1869, sections 37 and 45 and the Bankruptcy Rules 1870, rules 77 and 137.

10 Section 40(5) of the 1883 Act was not varied by the Bankruptcy Act 1890, which introduced, in addition, by section 23, provision for the proof of interest due but unpaid at a rate of 5 per cent. Any interest due but unpaid in excess of 5 per cent was to be paid after the proved debts and, it was eventually held under the equivalent provisions of the 1914 Act, before statutory interest: *Re Baughan* [1947] Ch 313.

47. In a different bankruptcy text book of the time (which did not survive into the 20th century), Robson, the Law of Bankruptcy (7th ed. 1894), *Bower v Marris* was referred to after the 1883 Act, in connection with s.40(5), as "*the old law*"[11].

Two key propositions derived from the English authorities relating to *Bower v Marris*

48. The following two key propositions are derived from *Bower v Marris* and the other English cases which have referred to it.

49. First, the so-called 'principle' or 'rule' is no more than an application of the general rule applicable between solvent parties that enables the creditor, entitled to receive both principal and interest, to appropriate payments made to it in discharge of interest before principal.

50. Second, the application of that principle to the calculation of interest payable from an insolvency surplus depends upon the fact that the relevant legislation preserved the underlying right of a creditor with an interest-bearing debt to be paid in full, suspending payment of interest as at the date of the commencement of the insolvency proceedings as a rule of convenience only, such that on the emergence of a surplus there was a remission to the creditor's contractual (or other pre-existing) right to receive interest as if there had been no insolvency.

Foreign authorities applying *Bower v Marris*

51. The SCG and York rely upon various Commonwealth and other foreign authorities. In all but two cases, the conclusions and analysis in the relevant decision are consistent with the two key propositions identified above derived from the English authorities. In the two contrary cases, there is no substantive analysis, and such reasoning as there is provides no basis for the Court departing from the principles identified above.

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11 See Robson, The Law of Bankruptcy, (7th ed., 1894) which, in relation to Section 40(5) of the 1883 Act, referred *Bower v Marris* as "*the mode of calculating interest under the old law where there was a surplus*".

52. The SCG rely upon three cases from Australia: *Mackenzie v Rees* [1941] HCA 21, *Midland Montagu Australia v Harkness* (1994) 124 ALR 407, and *Gerah Imports Pty Ltd v The Duke Group Ltd* (2004) 49 ACSR 660.

53. In two of these, *Mackenzie v Rees* and *Gerah Imports,* no mention is made of *Bower v Marris* or the basis of calculating interest referred to in it. The cases are relevant only for the confirmation that the entitlement to interest from an insolvency surplus in the English authorities (and in Australia) was wholly dependent upon the existence of a pre-existing contractual or analogous right to interest.

54. Thus, in *Mackenzie v Rees,* the issue was whether creditors – whose debts carried an entitlement to interest – were entitled to be paid interest accruing since the bankruptcy before the surplus arising after payment of proved debts was returned to the bankrupt. There was no consideration by the Court of the question whether such interest was to be calculated on the basis set out in *Bower v Marris* (which is not referred to in any of the judgments).

55. The Court was equally divided on the question whether the particular debts in issue did in fact carry a right to interest. All of the judges agreed, however, that interest accrued since the date of bankruptcy was payable at all only if the debt carried a right to interest.

56. Dixon J referred to the English cases (including *Bromley v Goodere* and *Humber Ironworks*) which laid down the principle that interest on debts ceases at the date of bankruptcy but that a creditor with an interest-bearing debt was entitled to claim post-bankruptcy interest from an insolvency surplus. He concluded that the principle was "*one determining the order in which debts are to be discharged in the course of administration; that is, by accepting the more modern view that the rule is one of justice and convenience*". Thus, s.81(1)[12] was taken to include "*intermediate interest*" (interest accruing post-bankruptcy) so that it is not altogether excluded as a claim against the assets, and s.118[13] was regarded as conferring upon the debtor a right to the surplus only after the

12 Section 81 allowed for the proof of future debts without restriction and therefore appeared to extend to future interest.

13 Section 118 entitled the bankrupt to any surplus after *"payment in full of his creditors, and of the costs, charges and expense of the bankruptcy.*"

"*intermediate interest*" had been paid. The principle thus operated "*between these two termini*".

57. In *Gerah Imports*, the only issue was whether the long-standing common law position – that allowed payment from an insolvency surplus of interest accrued since the date of bankruptcy on interest-bearing debts – had been abrogated by Section 439(1) of the Companies (South Australia) Code. That section provided that "*the amount of a debt of a company (including a debt that is or includes interest) is to be computed for the purposes of the winding up as at the relevant date*". The Supreme Court of South Australia held that the section had not altered the common law position, under which the entitlement to interest from an insolvency surplus was based on the creditors' contractual (or other) rights to interest being substantively unaffected by the insolvency process such that on the emergence of a surplus creditors were "*returned to their contractual rights*" (see, e.g. paragraphs [45], [47] and [51]).

58. The one case which considered *Bower v Marris* was *Midland Montagu Australia v Harkness*. In that case, there was no applicable statutory provision relating to payment of interest from the insolvency surplus. The case concerned a scheme of arrangement which provided that claims in respect of interest accruing after a certain fixed date (being the date of the winding-up of the parent scheme company) would be determined in accordance with the rules and principles applicable in the winding up of a company with a surplus of assets over liabilities. In turn, Section 438(2) of the Companies Code applied to the winding up of an insolvent company the rules applicable in bankruptcy. McLelland CJ held that this included the principle in *Bower v Marris* as to the application of payments first in discharge of interest and then principal. The only relevant statutory provision cited, being Section 82(3B) of the Bankruptcy Act 1966, provided simply that "*a debt is not provable in bankruptcy in so far as the debt consists of interest accruing, in respect of a period commencing on or after the date of the bankruptcy*…"

59. This provision was held not to affect the application of the principle in *Bower v Marris*, since it was no more than a recognition of the principle applied at common law since 1729, as explained in *Mackenzie v Rees* (above).

60. McLelland CJ expressly recognised that the underlying premise of the *Bower v Marris* calculation was that the entitlement to interest from the insolvency surplus was based on

the continuing existence of the creditor's contractual (or similar) right to interest apart from the insolvency. It was based, he said, on: "*the proposition that neither bankruptcy nor winding up as such effects a discharge of a debtor's liability for future interest, although each limits the means by which and the assets against which such a liability may be enforced*."

61. Accordingly, the conclusion and reasoning in *Midland Montagu* supports the two key propositions referred to above.

62. The two cases which at first blush provide some support for the SCG's position are the Canadian case of *AG of Canada v Confederation Trust Co* (2003) 65 OR (3d) 519 and the Irish case of *Re Hibernian Transport Companies Ltd (No.2)* [1991] 1 IR 271. In each of them, the Court concluded that interest should be payable from an insolvency surplus on the basis that dividends were allocated towards interest before principal, notwithstanding that the relevant statutory provision did not proceed on the basis that creditors were remitted to their contractual rights and that interest was payable both where the debts were and were not interest-bearing.

63. Each case is distinguishable from the present case and neither provides any sound, reasoned basis for the application of the appropriation principle in *Bower v Marris* to payments of interest under Rule 2.88(7).

64. In *AG of Canada v Confederation Trust Co*, the relevant statutory provision was Section 95(2) of the Winding-up and Restructuring Act, which provided that:

> "*Any surplus [that remains after the satisfaction of the debts and liabilities of the company and the winding up charge, costs and expenses] shall first be applied in payment of interest from the commencement of the winding-up at the rate of 5 per cent per annum on all claims proved in the winding up and according to their priority*."

65. Blair J held that interest was payable under this section to all creditors, irrespective of whether their debts carried a right to interest, and that in all cases interest was to be calculated on the basis that dividends had been applied in satisfaction of interest before principal, i.e. on the basis referred to in *Bower v Marris* and *Humber Ironworks*.

66. Section 95(2) is in materially different terms to Rule 2.88(7), such that Blair J's conclusion is distinguishable from the present case.

67. In any event, it ought not to be followed. Blair J appears wrongly to have assumed a "*traditional rule in insolvency situations*" that dividends are applied first to the payment of interest and then to the payment of principal, citing *Bower v Marris* and *Humber Ironworks* as authority for the proposition that this is "*said to prevent injustice, promote equity amongst the creditors, and protect the contractual relationship between the parties*" (see [29]).

68. In so doing, he paid no regard to the underlying analysis in *Bower v Marris* (as explained above, that creditors' contractual rights subsist and are given effect to once a surplus emerges) which in fact provided no support for his conclusion in relation to s.95(2).

69. That this was also the basis of the entitlement to interest from an insolvency surplus in Canada was made clear in the earlier decision of *Re Langstaffe* [1851] OJ No 238 which was not cited to Blair J. In that case, the issue was whether interest which had accrued since the date of bankruptcy was payable at all, in the event of a surplus, before that surplus was paid to the bankrupt. There was no statutory provision for payment of interest out of the insolvency surplus, the only relevant provision being to the effect that "*after payment of all expenses and the debts proved, the surplus should be restored to the bankrupt*". Esten V.C. referred to the Bankruptcy Acts in England, and to *Bower v Marris*, and noted (at p.172) that "*it was obviously the intent of these acts, that by virtue of the commission and the remedy reserved against the debtor, the creditor should receive full satisfaction in the same way as if no bankruptcy had occurred*". For this purpose it was absolutely necessary that "*the debt should continue in the same plight after the bankruptcy as before, and should yield interest in the same way, and that the payments under the bankruptcy should be applicable firstly in discharge of interest and then in sinking principal*".

70. In *Re Hibernian Transport Companies Ltd (No.2)*, the relevant statutory provision was Section 86(1) of the Bankruptcy Act 1988, which provided that:

> *"If the estate of any bankrupt is sufficient to pay one pound in the pound with interest at the rate currently payable on judgment debts, and to leave a surplus the Court shall order such surplus to be paid or delivered to or vested in the bankrupt, his personal representatives or assigns."*

71. Carroll J noted that (1) until the enactment of this section, the governing section (s.304 of the Irish Bankrupt and Insolvent Act 1857) provided for the payment to the bankrupt of such surplus as remained after payment of debts in full "*with such interest as the Court shall allow*", (2) there was no case in which a creditor with a non-interest bearing debt had been awarded interest under this section, and (3) *Bower v Marris* appeared to be authority for the proposition that in a case where there was an insolvency surplus, creditors' entitlement to interest from that surplus should be calculated on the basis that dividends had been applied first in satisfaction of interest and then principal.

72. Carroll J concluded that the amendment effected by Section 86(1) of the 1988 Act made no distinction between different types of creditors such as judgment creditors, interest creditors or general creditors, and that if statutory interest is payable, it should be computed as "*running interest*" on the basis set out in *Bower v Marris*.

73. This decision is equally distinguishable from the present case, given the different statutory basis for payment of interest from an insolvency surplus.[14] In any event, the conclusion does not provide any support for applying the *Bower v Marris* calculation to the interest payable pursuant to Rule 2.88(7). There is no reasoned basis for the conclusion, and it ignores the analysis which underpins the decision in *Bower v Marris* (i.e. the continued existence of contractual or other rights to interest).

74. York (but not the SCG) also relies on cases concerning the right of a legatee to receive interest on his legacy (see paragraph 3(4) of York's reply position paper). Those cases provide no assistance. The regime for payment of both debts and legacies from a deceased's estate is fundamentally different to that applicable to a bankrupt's estate. In particular, interest payable on legacies is (after one year – the executor's year[15]) due in parallel with the right to the legacy itself, and the rule in bankruptcy (that post-bankruptcy interest is payable only out of a surplus) has no parallel. Accordingly, the testamentary cases involve a straightforward application of the rule of appropriation where, at the time

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14 The decision is in any event of doubtful authority for the following reason. The decision arose from a dispute as to the interpretation of a previous order in which Carroll J had determined that Section 86(2) applied to a surplus arising in a winding-up. That decision was, however, overturned on appeal by the Irish Supreme Court's decision on 13 May 1993, so that the second decision became otiose.

15 See *Sitwell v Bernard* (1801) 1 De M&G 257; 31 ER 1174 for the origins for the entitlement to interest on a legacy.

of payment being made to a creditor, it is made on account of two different entitlements, both of which are accrued due: see, for example: *In re Morley's Estate* [1937] 1 Ch 491.[16]

Inapplicability of *Bower v Marris* to non-interest-bearing debts

75. It is an essential requirement of the principle applied in *Bower v Marris* that payments are due on account of both principal and accruing interest. Otherwise, a necessary ingredient of the creditor's right of appropriation is missing:

(1) The right of appropriation only exists where there are – at the time the payment is made – two distinct debts, e.g., one in respect of interest and one in respect of principal[17].

(2) Where a creditor has no pre-insolvency right to interest, at the time of the payment of each dividend, the creditor has only one right – to be paid its proved debt. No right to interest arises at all unless and until all proved debts have been paid. It is therefore impossible to regard the dividends as payments on account of principal and interest and impossible to apply the doctrine of appropriation.

76. Accordingly, at the time that dividends are paid from the insolvent estate they can only be paid on account of the outstanding principal.

77. There is no English authority which has applied the *Bower v Marris* approach to debts other than interest-bearing debts. The reasoning in *Bower v Marris* itself (as well as the reasoning in each of the Australian cases referred to above) is inconsistent with the application of the principle to anything other than interest-bearing debts.

78. The two cases which have applied the principle in the case of non-interest-bearing debts (*Re Hibernian Transport Companies (No.2)* in Ireland and *AG of Canada v Confederation*

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16 In *Humber Ironworks* (above) Giffard LJ, at p.647, noted that testamentary cases were fundamentally different, noting that "*for some reason or other dead men's estate have been assumed to be solvent, and they have been wound up on that footing*".

17 See, for example, Chitty on Contracts, 31st ed., paragraphs 21-060 to 21-068. The right of appropriation arises where two or more debts are "*due*".

Trust Co in Canada) do not provide any principled basis for doing so and should not be followed.

79. The fact that the principle is incapable of being applied to non-interest-bearing debts further supports the conclusion that it has no application to the calculation of interest payable from the insolvency surplus under Rule 2.88(7), since it would require Rule 2.88(7) to be interpreted differently depending on whether the interest was payable to a creditor with an interest-bearing debt or otherwise. There is no warrant in the language of the rule for such different treatment. The fact that Rule 2.88(9) expressly requires different treatment to the limited extent there set out, suggests that had the draftsman intended there to be any other different treatment relating to the pre-insolvency rights of creditors, then it would have been expressly set out.

80. Moreover, different treatment of interest-bearing debts and non-interest-bearing debts would create significant practical problems wherever the insolvency surplus was insufficient to pay interest in full. That is because wherever there is a deficiency in the insolvency surplus, it would need to be distributed *pari passu*. For any *pari passu* distribution to be made it is necessary to know the *maximum* amount claimed by each creditor entitled to participate in the distribution. Otherwise, a distribution to other creditors may turn out to be over-generous in the event that the unknown claim is greater than anticipated. Where a creditor claims, on the basis of *Bower v Marris*, that the principal element of its debt remains unpaid then interest would continue to accrue in favour of that creditor indefinitely, so that the ultimate size of its claim to share in the insolvency surplus is unknown.

Repeal of *Bower v Marris*

81. Both the SCG and York contend that Wentworth's case assumes that the legislature intended to repeal the rule in *Bower v Marris* and that this would involve "*reversing over 150 years of practice and procedure in bankruptcy and corporate insolvency*".[18] They are wrong on both counts.

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18 SCG reply position paper, paragraph 2(8)(d).

82. As already noted above, it is true that Rule 2.88(7) imposed a regime for payment of interest from an insolvency surplus which was new, and which for the first time delineated the nature and extent of the interest that was to be paid from that surplus. It is also true that it differed from previous regimes, in that it was not based on the continuation of the creditors' contractual or other pre-insolvency rights to be paid the debt and interest due on it. That did not involve a repeal of *Bower v Marris,* however. It simply meant that the calculation of what was payable from the insolvency surplus under Rule 2.88(7) (rather than what could be claimed from a solvent co-debtor) did not involve the application of the principle in *Bower v Marris*.

83. So far as the second point is concerned, again as already noted, *Bower v Marris* has been neither followed nor cited in any reported case until *Lines Bros* (where it was treated as common ground), and was not cited in any edition of the leading bankruptcy text books during that period. There is no evidence, therefore, of it forming part of "*150 years of practice and procedure*".

84. There is no evidence that either the drafters of the Cork Report, or the 1986 legislation, had *Bower v Marris* in mind at all.[19]

<u>No non-provable claim for interest on the *Bower v Marris* calculation</u>

85. If and to the extent that the SCG or York contend that if interest payable under Rule 2.88(7) is not to be calculated on the basis in *Bower v Marris* then creditors have a further non-provable claim for the amount of interest which they would have been able to claim – but for the insolvency – on the basis of appropriating all payments towards interest before principal, then such contention should also be rejected.

86. For the reasons set out above, Rule 2.88 introduced a self-contained and comprehensive code for the payment of interest from an administration estate. In so doing it substantively

19 If necessary, Wentworth reserves the right to argue before a higher court that Lord Cottenham was wrong, in *Bower v Marris*, to conclude that the creditor's right to appropriate dividends first to interest was unaffected by the bankruptcy regime. On the contrary, at the time that the dividends were paid, since the right to payment of interest had been suspended, there was only one debt (the principal amount of the proved debt) to which the payment could have been appropriated.

altered the rights of creditors generally, and the obligations of the company towards its creditors, in respect of interest accruing after the Date of Administration.

87. In short, Rule 2.88(7) ‘occupies the field’ in relation to interest payable from the insolvency surplus, and leaves no room for a reversion to creditors’ contractual rights if and to the extent that they would have received more by way of interest but for the administration.

ISSUE 39

Whether a creditor entitled to Statutory Interest, Currency Conversion Claims and/or other non-provable claims is entitled to any form of compensation for or in respect of the time taken for such claim to be discharged and, if so, whether such compensation is taken into account as part of the correct methodology for calculating Statutory Interest and/or the distribution of the surplus, or should take the form of interest at the Judgments Act Rate, damages for loss, restitution or another form.

88. Issue 39 relates to the question of whether creditors are entitled to 'interest on interest', i.e. compensation for the delay in payment of interest under Rule 2.88(7).

89. Two bases of such a claim are advanced by the SCG and York in their position papers:

(1) Creditors have a non-provable claim for damages, on the basis of *Sempra Metals v IRC* [2008] 1 AC 561, caused by the non-payment of Statutory Interest in respect of the period between the date of payment of debts proved and the date on which Statutory Interest is in fact paid[20] (the "**Statutory Interest Claim**").

(2) A creditor with a CCC was entitled to payment in the relevant foreign currency *on the date that his debt fell due for payment*, and thus has a non-provable claim for damages, also on the basis of *Sempra Metals*, for loss suffered as a result of non-payment of the claim *on that date*[21] (the "**Currency Conversion Interest Claim**").

90. Wentworth contends that no such claim arises for the reasons set out below.

The Statutory Interest Claim

91. The Statutory Interest Claim is flawed principally because there is no recognisable cause of action arising from delay in payment of Statutory Interest.

92. Although Statutory Interest constitutes a "*liability*" of the company (as found in the Waterfall I Judgment, at [71]), the company is under no obligation to pay that interest at

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20 SCG position paper, paragraphs 39(1)-(2); SCG reply position paper, paragraphs 39(9)-(14); York position paper, para 23.

21 SCG position paper, paragraph 39(4)-(5); SCG reply position paper, paragraphs 39(3)-(8).

any particular time: Rule 2.88(7) merely requires that the surplus arising after payment of proved debts in full be utilised in paying Statutory Interest *before* it is used for any other purpose.

93. In the absence of a requirement that interest be paid by a particular time, there is no sense in which payment of it can be said to be 'late' or 'delayed', and thus no possibility of a cause of action for damages arising from late or delayed payment.

94. *Sempra Metals* does not provide any assistance to the SCG. While the House of Lords concluded in that case that it is possible to assert a damages claim for loss flowing from a delay in payment, it is a *sine qua non* of such a claim that there was an obligation to make payment by a particular time. In other words, the claimant has to establish that the non-payment by a particular time, or when demanded, constituted a breach of some obligation, whether in statutory duty, tort, contract or restitution.

95. That is not to say that creditors are without remedy in the case of undue delay by a liquidator or administrator in distributing the statutory surplus. But that remedy is through the power of the court to control the exercise of the office-holder's functions.

96. The distribution of an insolvency surplus is part of the office holder's functions, as much as the distribution of the company's assets to creditors with provable claims.

97. In the case of a liquidation, for example, it is the function of the liquidator to get in, realise and distribute the assets to the company's creditors and, if there is a surplus (as against the company's creditors) to the persons entitled to it: Insolvency Act 1986, s.143. The liquidator is granted a wide discretion as to how he carries out those functions: s.168(4). He is ultimately subject to the directions of the court: s.168(5).

98. Similar provisions apply to an administrator, who is similarly subject to the control of the court: see paragraphs 3, 65-68, and 74-75 of Schedule B1 to the Insolvency Act1986.

99. In either case, although the office-holder is not under a duty to act by a particular date or time, if he or she procrastinates in carrying out his or her duties then the court can, on an application by creditors, direct the office-holder to act or, in an appropriate case, impose sanctions on the office-holder personally for failing to act.

100. The SCG, in formulating this claim for interest as that arising in the period between "*the date of payment of proved debts and the date on which Statutory Interest is paid*" (paragraph 39(9) of reply position paper), appear to suggest that the administrator comes under an obligation to pay Statutory Interest the moment that the last of the proved debts is paid in full.

101. There is no warrant for this. Not only does Rule 2.88(7) not impose any such requirement, it is impossible to imply any duty on the administrator to pay Statutory Interest immediately from that moment. There could be myriad reasons why an administrator cannot pay Statutory Interest immediately. For example, even though it may be clear that there is a surplus, the remaining assets of the estate may not yet have been realised so as enable further distributions to be made. In those circumstances it would be impossible to pay Statutory Interest.

102. Alternatively, it may be unclear whether the surplus will be sufficient to pay all Statutory Interest claims in full, such that a *pari passu* distribution will be necessary, but this is as yet impossible because the quantum of certain creditors' interest claims are yet to be determined.

103. Alternatively, as here, there may be genuine dispute between creditors as to how the surplus should be applied.

104. Indeed, the SCG accept (paragraph 39(14)(c) of reply position paper) that the administrators are not in breach of duty in refraining from paying Statutory Interest in the last of these circumstances. They clearly would not be in breach of duty in either of the other situations contemplated above.

105. The SCG's contention that, nevertheless, creditors have a claim for damages because Statutory Interest was not paid "*after payment of proved debts*" (paragraph 39(14)(c) of reply position paper) is a *non sequitur*, and without any basis:

(1) the administrator is, subject to the direction of the Court, in control of all distributions from the insolvency estate, including the payment of Statutory Interest as directed by Rule 2.88(7)

(2) if the time taken to pay Statutory Interest does not give rise to any claim for breach of statutory duty against the administrator, that is an end of the matter; and

(3) there is no sense in which the company has some separate and independent obligation to make payment of Statutory Interest even though its non-payment does not constitute a breach of statutory duty by the person under whose control the payment, and its timing, lies.

106. There is a suggestion of an alternative basis for this claim, at paragraph 39(11) of the SCG's reply position paper, namely that where a creditor had a contractual right to payment of interest then it has a further non-provable claim for the late payment of that contractual interest.

107. This alternative basis is also flawed, because any contractual claim based on the timing of the payment of interest does not survive the regime for Statutory Interest under Rule 2.88. For the reasons set out in relation to Issue 2, the claim to post-administration interest in such greater amount as a creditor might have received but for the administration does not survive, and a claim for damages based on the timing of the payment of post-administration interest certainly does not survive. Rule 2.88 occupies the field so far as compensation for the delay caused by the administration process is concerned, and leaves no room for some further non-provable claim for different loss arising from the same cause.

<u>Currency Conversion Interest Claim</u>

108. This claim is also flawed. It is a claim in the *character* of post-administration interest (since it is a claim for damages arising out of the loss of time value of money for the period after administration), and thus does not survive the regime for the payment of Statutory Interest which – as noted above in relation to Issue 2 – occupies the field so far as compensation for the delay caused by the administration process is concerned.

109. Although the SCG limit this claim to creditors with a currency conversion claim, the fact that a creditor's claim is denominated in a foreign currency is in fact irrelevant.[22] The

[22] The currency conversion claim itself is based on the extent to which there is a shortfall (or loss) *arising from the conversion of the debt for the purposes of proof*: see Group IV below.

claim is for loss arising out of late payment (see paragraph 39(8)(a)-(b) of the SCG's reply position paper: "*a creditor with a claim denominated in a foreign currency was entitled to payment in the relevant foreign currency on the date that his claim fell due for payment. Such a creditor has a claim for any loss and damage suffered as a result of the non-payment of his claim on such date*").

110. If such a claim subsists then it would arise in favour of any creditor whose debt was not paid on time, and has nothing to do with the currency in which the debt was due to be paid.

111. The suggestion that all creditors of an insolvent debtor potentially[23] have a non-provable damages claim for loss arising from the delay in payment caused by the insolvency process is surprising. It is wrong for the simple reason that statute has already provided a comprehensive remedy for such loss, in the form of Rule 2.88(7) in administration, and the equivalent rules in liquidation and bankruptcy.

General

112. The SCG, in both their position paper and reply position paper, suggest a further support for their claims under Issue 39, namely that because the assets in the administration estate are held for creditors, any increase in the value of those assets "*attributable to their non-provable claims*" should be paid to them: SCG's position paper at 39(8); reply position paper at 39(15).

113. Wentworth does not understand the SCG (or York) to be advancing any different *basis* of claim, such as a claim in unjust enrichment. Such a claim would fail for the absence of any factor which rendered the estate's enrichment unjust.

114. This further argument is flawed because the assets of the insolvent estate do not belong to "*the creditors*" (by which SCG mean the creditors in the same position as them).

115. First, under the statutory trust which arises on insolvency, although the company ceases to be the beneficial owner of its assets, beneficial ownership does not vest in the creditors.

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23 Such a claim does not arise automatically from the late payment, because it is essential for a claimant to establish the usual requirements of any claim for damages, namely breach, causation and loss: see *Sempra Metals*, per Lord Hope at [96].

The assets are simply held on a statutory trust for the purposes of carrying out the administration of the insolvency scheme: see the *Waterfall I* Judgment at [71].

116. Second, the purposes of that statutory trust include distribution to all creditors (including creditors subordinated either by contract or by rule of law, such as members), and in the event of any surplus to the persons entitled to it[24]. Thus the persons for whose benefit the statutory purpose trust is administered are not limited to the creditors whose interests the SCG represent, but include subordinated creditors and members, in their character both as creditors and members.

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24 See *Re Nortel GmbH* [2013] 3 WLR 504, per Lord Neuberger at [39].

GROUP II: ISSUES 3 TO 5

ISSUE 3

Whether the words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) of the Rules refer:

- **(i)** **only to a numerical percentage rate of interest; or**
- **(ii)** **also to a mode of calculating the rate at which interest accrues on a debt, including compounding of interest, such that where a creditor has a right (beyond any right contained in Rule 2.88) to be paid compound interest, whether under an Original Contract or otherwise, the creditor is entitled to compound interest under Rule 2.88(7).**

117. As noted above in relation to Issue 2, the regime imposed by Rule 2.88 is a self-contained statutory regime which operates (in contradistinction to the pre-1986 law) otherwise than by remitting creditors to their contractual rights upon a surplus arising.

118. Rule 2.88(9) is the sole exception, and is limited in its scope to enabling a creditor whose provable debt carried a contractual right to interest at a *rate* greater than the Judgments Act Rate to claim Statutory Interest on its proved debt at that greater rate.

119. Rule 2.88(9) requires a comparison to be made between two rates – the Judgments Act Rate and the contractual rate of interest to which the creditor would have been entitled apart from the administration. In order to make that comparison, it is necessary that the two rates are comparable.

120. Wentworth accepts (contrary to its position paper) that the reference to "*rate*" in Rule 2.88(9) is broad enough to encompass a compound rate and is not limited to a simple rate.

121. This leaves the sub-issue identified at paragraph 31.1 of the Administrators' position paper – whether accrued Statutory Interest continues to compound following the payment in full of the proved debt and, if not, whether the creditor has a non-provable claim in respect of interest that would have continued to compound on a contractual basis following the payment in full of the principal amount.

122. Wentworth contends that Statutory Interest does not continue to compound following payment in full of the proved debt. Moreover, in the case of multiple dividends, compounding ceases to apply in respect of the part that is paid early, from the date of its

payment. Statutory Interest is payable pursuant to Rule 2.88(7) (whether at a simple or compound rate) only for the period that the proved debt (or such part of it) is outstanding. Indeed, in some cases it would be impossible to determine whether the simple Judgments Act Rate was higher than a contractual compound rate, without the period during which interest accrued being fixed. Accordingly, there can be no question of Statutory Interest continuing to compound following payment in full of the provable debt.

123. Wentworth further contends that the creditor does not have a non-provable claim in respect of interest that would have continued to compound on a contractual basis following the payment in full of the principal amount. It is Wentworth's position (as explained in the sections of the skeleton argument that deal with Issues 2 and 39) that Rule 2.88 provides a statutory entitlement to post-administration interest which substantively alters creditors' rights in respect of interest accruing after the Date of Administration, and that there is thus no scope for remitting creditors to contractual rights in the event that the statutory regime gives them less in respect of interest accruing post-administration than they would have recovered had there been no insolvency.

ISSUE 4

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

124. The main point of dispute under Issue 4 is whether, as the SCG and York contend, a creditor who had not obtained a judgment in some foreign jurisdiction at the Date of Administration can nevertheless claim interest at a rate permitted by statute in that foreign jurisdiction on judgment debts, on the basis that the creditor might have obtained judgment there in the absence of administration.

125. Wentworth answers this question in the negative, for the following reasons.

126. First, as a matter of construction:

(1) Rule 2.88(9) permits Statutory Interest to be paid at a rate higher than the Judgments Act Rate if there was a rate applicable to "*the debt*" apart from administration.

(2) The “*debt*” there referred to is a reference back to the debt in respect of which a proof was submitted, because the rate referred to in Rule 2.88(9) is applied, by Rule 2.88(7) to “*those debts*”, being the debts proved.

(3) On the assumption that no judgment had been obtained as at the Date of Administration, then the debt in respect of which a proof was submitted consists of the creditor’s rights as at that date, be they based on contract, tort or some other branch of the law of obligations.

(4) Any judgment subsequently obtained would be different from such debt: the rights of the creditor after judgment flow from the judgment.

(5) This is reflected in English law in the doctrine of merger: if the creditor *subsequently* obtained judgment, then its existing contractual, or other, debt would be replaced by a new debt: the judgment debt (into which its original debt would merge): see, for example, *Director General of Fair Trading v First National Bank Plc* [2002] 1 A.C. 481, per Lord Bingham at [3], “*It is trite law in England that once a judgment is obtained under a loan agreement for a principal sum and judgment is entered, the contract merges in the judgment and the principal becomes owed under the judgment and not under the contract*”.

(6) This is a concept which would have been well known to the draftsman of the rule, and is relevant context to its interpretation.

(7) Interest which may become payable on a judgment debt to be obtained in the future would therefore not be interest applicable to the proved debt at all, and thus falls outside the scope of Rule 2.88(9).

(8) At best, as at the Date of Administration the creditor has only a contingent right to obtain a foreign judgment (carrying a higher rate of interest) at some point in the future. This is not naturally encompassed within the words “*the rate applicable to the debt apart from the administration*”, but would require those words to be read as ‘*the rate* ***contingently*** *applicable to the debt apart from the administration*’.

(9) Alternatively, the "*debt*" referred to in the "*rate applicable to the debt apart from administration*" refers to the debt that existed as at, and with such characteristics as it had, as at the Date of Administration.[25]

127. Second, there is nothing inconsistent in this conclusion with the fact that the justification for adopting the Judgments Act Rate in Rule 2.88(7) is that creditors are prevented by the liquidation regime from obtaining judgment which would have carried interest at the judgment rate: *Waterfall I* at [163].[26]

128. The fact a creditor could have been entitled to interest at the Judgments Act Rate if it sued to judgment on a sterling debt in England was used as the *justification* for adopting the Judgments Act Rate in Rule 2.88(9)[27]. But that does *not* mean that the legislature intended that a creditor should be free to claim such rate which might have applied to a different judgment which it could have obtained in some other jurisdiction.[28]

129. Indeed, the suggestion that a different rate should be applied where a creditor claims to be entitled to a foreign judgment which might carry a higher rate is illogical:

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25 That is not to say that the rule refers only to the *rate* as at the Date of Administration. Where, for example, the debt carried interest at a fluctuating rate, then the rule refers to that fluctuating rate, because the right to the fluctuating was a characteristic of the debt as at the Date of Administration.

26 At paragraph 4(3) of its reply position paper, the SCG refers to a passage from Giffard LJ in *Humber Ironworks* in support of their argument. However, the passage is quoted out of context. The words quoted by Giffard LJ were cited by him as "*another reason*" (at pp.647-648) why he did not think that the *provable* debt should include interest accruing by contract after the date of liquidation. The Court of Appeal's decision so far as interest from the surplus was concerned, however, is flatly contrary to SCG's case, because it permitted interest from the insolvency surplus only if a creditor had a pre-existing right to interest.

27 Cork Report at paragraphs 1393 and 1395.

28 Contrary to the SCG's argument at paragraph 4(5)(d) of its reply position paper.

(1) The Judgments Act Rate is a sterling rate. The courts and legislature have acknowledged the link between interest rates and currencies: see, for example, *Standard Chartered v Celyon Petroleum* [2011] EWHC 2094 (Comm), at [22][29]:

> *"In the circumstances of the present case I am satisfied that it would be appropriate for the Court to exercise its discretion so as to award interest* ***at a rate suitable for the currency of the judgment****. In particular, the difference between the two rates is significant; it is not due to rapidly fluctuating or highly variable factors; a much lower US dollar interest rate has been established for some time and is likely to continue for the immediately foreseeable future, and SCB has no relevant or sufficient concern with sterling".* (Emphasis added)

(2) It is adopted in Rule 2.88(7) because payment in respect of all proved debts is made in sterling. A foreign currency rate would be inappropriate to a sterling payment.

130. Moreover, if the rationale behind Rule 2.88(9) was to incorporate such rate as a creditor could have obtained if it had sued to judgment, there would be no reason to exclude such *lower* judgment rate that the creditor could have obtained. In this respect, it is important to note that a judgment obtained in England in a foreign currency is entitled to interest, not at the Judgments Act Rate, but at such rate as the court in its discretion thinks fit: Administration of Justice Act 1970, s.44A.

131. Third, at least in respect of all claims denominated in sterling, if the SCG's and York's interpretation is correct, then the Judgment Act Rate would always represent "*the rate applicable to the debt apart from administration*", so the application of the Judgments Act Rate in Rule 2.88(9) would be rendered largely otiose.

132. Fourth, there is no authority to support the proposition that "*the rate applicable to the debt apart from the administration*" includes a rate under a judgment which might have been obtained in the future. The only authority which has referred to the point expressly rejected the idea: see *Re Langstaffe* [1851] OJ No 238 at 176-177.

133. Fifth, the lack of the necessary guidance within the rules as to when and how the possibility of a later foreign judgment should be taken into account militates against a construction of

29 See also *Novoship v Mikhaylyuk* [2013] EWHC 89 (Comm), at [54]: "*The rate fixed by the Lord Chancellor for sterling debts was intended to reflect sterling interest rates prevailing in the United Kingdom…"*

Rule 2.88(9) which permits reliance on such a rate. For example, the rules do not provide for the following:

(1) Whether it is necessary for the creditor to show that it would have pursued the claim to judgment, particularly if the claim was not disputed so that the debt may have been paid voluntarily (in the counterfactual circumstances that there were no insolvency proceedings).

(2) How it is to be determined in *which* jurisdiction the creditor would have sought to obtain a judgment, particularly where (as may well be the case) there are multiple jurisdictions to choose from, or where within one geographical jurisdiction there are multiple procedural jurisdictions in which a claim could be brought[30]).

(3) Whether it is sufficient to establish that the creditor *might* have obtained judgment in any particular jurisdiction (which carries with it the problem of a choice of rates wherever it was *possible* for the creditor to obtain judgment in more than one jurisdiction, with no guidance as to which one to pick) or whether it must be established that the creditor *would* have obtained a particular judgment (which requires a substantial further investigation, and possibly further proceedings, to establish what could, and would, have happened, complexities which are inconsistent with the objective of simplicity which the Cork Report had in mind in relation to the new regime for Statutory Interest introduced in 1986).

(4) Whether – if the question is what would have happened – it is necessary to establish *when* the judgment would have been obtained. For example:

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30 For example, under New York law a party may recover post-judgment interest upon sums awarded arising out of, among other things, a breach of contract: N.Y. C.P.L.R. § 5001(a). In such cases, the default rate of interest is nine per cent per annum: N.Y. C.P.L.R. § 5004. Further, statutory interest under New York law is calculated on a simple interest basis, and cannot generally be compounded: see *Marfia v. T.C. Ziraat Bankasi*, 147 F.3d 83, 90 (2d Cir. 1998) (collecting cases). When a judgment is entered by a federal court, however, the accrual of interest is generally governed by federal law. 28 U.S.C. § 1961. The rate is equal to the "*weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System, for the calendar week preceding*" and is compounded annually. *Id.* Presently, the applicable federal judgment rate is 0.10%. There are internal rules as to which court an action is to be commenced and when a suit filed in a state court can be removed to a federal court: 28 U.S.C. § 1441(b).

(a) If the premise for the right to a rate of interest applicable to a foreign judgment is that it *would* have been obtained, then there is no good reason why an assumption should be made that judgment would have been obtained as at the Date of Administration[31].

(b) In this regard, the fact that Statutory Interest runs at the Judgments Act Rate from the Date of Administration is no help[32].

(c) It applies from that date by reason of statutory rule. Where a creditor is relying on the rate which would have applied apart from the administration, and apart from the administration the applicable rate would have changed at such later point in time as a foreign judgment was obtained, then interest at that higher rate should only be applicable, if at all, from the date that judgment would have been obtained.

(d) Again, this introduces a level of complexity, investigation and potential dispute which is inconsistent with the intention that Rule 2.88 introduced simplicity into this area.

134. The fact that these complexities arise, but are not addressed or catered for in Rule 2.88 indicates that the draftsman of Rule 2.88(9) did not intend it to be interpreted as do the SCG and York.

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31 Contrary to the position adopted by the SCG: see paragraph 4(10) of their reply position paper.

32 Contrary to the argument at paragraph 4(8)(c) of the SCG's reply position paper.

<u>ISSUE 5</u>

Whether, for the purposes of establishing, as required under Rule 2.88(9) of the Rules "*whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*" the comparison required is of:

(i) the total amounts of interest that would be payable under Rule 2.88(7) based on each method of calculation; or

(ii) only the numerical rates themselves,

and in either case, how the total amount of interest is to be calculated when the "*rate applicable to the debt apart from the administration*" varies from time to time.

135. Wentworth accepts (consistently with its revised position on Issue 3) that in determining which is greater, it is not sufficient simply to compare a numerical (simple) rate of interest with, if applicable, a numerical (compound) rate of interest.

136. In order to compare like with like, it is necessary first to identify the simple rate which equates to the compound rate applicable under the contract apart from the administration. Moreover, in order to make a fair comparison where either or both rates (and the amount of the proved debt which remains outstanding) vary over time, it is necessary to take the weighted average of each rate.

137. In practice, Wentworth accepts that this is no different, in result, to calculating which of the two rates (the simple Judgments Act Rate or the compound contractual rate) as applied to the debt, or part of it, that is outstanding from time to time, results in the greatest amount of interest being paid over the period as a whole.

138. In relation to the sub-issue at paragraph 40 of the Administrators' position paper, Wentworth contends that in the case of a proof which combines a number of debts, it is necessary disaggregate the proved debt, such that the comparison between the Judgments Act Rate and the rate applicable apart from administration is carried out separately in relation to each underlying independent debt.

GROUP III: ISSUES 6-8

139. Issues 6 to 8 are taken together. Issue 6 is addressed after Issues 7 and 8.

ISSUE 7

Whether Statutory Interest is payable in respect of an admitted provable debt which was a contingent debt as at the Date of Administration from:

- **(i) the Date of Administration;**
- **(ii) the date on which the contingent debt ceased to be a contingent debt (including in circumstances where the contract was "closed out" after LBIE entered administration); or**
- **(iii) another date,**

having regard to whether:

- **(i) the contingent debt remained contingent at the time of the payment of:**
  - **(a) the final dividend; or**
  - **(b) Statutory Interest; and/or**
- **(ii) (to the extent applicable) the Joint Administrators revised their previous estimate of the contingent debt by reference to the occurrence of the contingency or contingencies to which the debt was subject.**

140. Wentworth and the Administrators contend that Statutory Interest is payable, in respect of contingent debts, only from the date on which the debt actually arises, i.e. on the occurrence of the contingency.

141. The SCG and York contend that Statutory Interest is payable from the Date of Administration irrespective of when the contingency occurs.

142. This issue turns on the proper construction of the phrase "*in respect of the periods during which they [the proved debts] have been outstanding*" in Rule 2.88(7).

143. Rule 2.88(7) should be construed in accordance with its purpose.

144. Its purpose is to compensate creditors for the delay in payment of their debts caused by the insolvency: see *Waterfall I* at [86].

145. This reflects the purpose of an award of interest generally: "*to compensate a creditor for having been kept out of his money*": *Novotel (UK) Ltd v Nikitin* [2014] EWCA Civ 908, per Longmore LJ at [132] to [133].

146. There is no sense in which a contingent creditor has been kept out of its money at any time prior to the occurrence of the contingency. Prior to that date it is not known whether it will ever become entitled to payment at all.

147. Accordingly, a debt should not be considered "*outstanding*"' for the purpose of a rule designed to compensate creditors for delay in payment of their debts until such time as it comes into being as an actual debt, i.e until the occurrence of the contingency upon which its existence depends.

148. In the language of Jessel MR in *re Northern Counties of England Fire Insurance Company (Macfarlane's claim)* (1880) 17 Ch D 337, 340, any "*liability*" contingent at the date of bankruptcy which "*ripens into a debt*" during the bankruptcy is provable. However:

> *"There is no debt due at the time of adjudication. No doubt a man with whom a contract has been entered into may, in certain cases, treat a declaration of insolvency or an adjudication in bankruptcy of the other party to the contract as a refusal to perform the contract, and may, at his election, treat it as a breach of contract; but that is by election, and the claimant in this case never made any, so that there would be no debt at all according to this argument. It appears to me that that is unanswerable."*

149. The principal response of the SCG and York is that the Rules provide for all claims to be admitted at the amount they bore as at the Date of Administration and that in relation to contingent claims, this involves "*essentially a process of putting a present value on possible future events or outcomes*".

150. Wentworth does not take issue with either of those propositions, but contends that they are irrelevant to the question of the date from which Statutory Interest should run.

151. Pursuant to Rule 2.81 the administrator is required to place an estimated value on a contingent debt, and to revise that estimate from time to time.

152. The estimation process exists so as to enable those who may turn out to be creditors to participate in distributions from the insolvency estate in competition with all other creditors. It is a rough and ready approach, and enables distributions to be made without needing to make reserves for all possible contingencies.

153. In the event that the contingency occurs before a final dividend is paid, then the hindsight principle requires the amount of the *actual* debt to be substituted for the estimated amount.

154. This was explained in *Re MF Global UK Ltd (in special administration)* [2013] EWHC 92 (Ch) at [48] and [54] as follows:

> *"Before coming to these submissions, I will say something about the hindsight principle. It is a principle of general application that where the amount of a contingent or an unascertained claim must be estimated for the purposes of a distribution or payment, and the amount of the claim becomes certain before the distribution or payment, the latter amount will be taken as the claim's value. The process of estimation is designed to value as accurately as possible the prospect of the contingency occurring or the likely amount of the claim. The use of hindsight either removes the need to make the estimate or makes the estimate more accurate and produces what may generally be regarded as fairer values for the purposes of the distribution or payment. In Bwllfa and Merthyr Dale Steam Collieries (1891) Ltd v The Pontypridd Waterworks Co [1903] AC 426, Lord Halsbury LC at p.429 rejected the proposition that "because you could not arrive at the true sum when the notice was given, you should shut your eyes to the true sum now you do know it, because you could not have guessed it then"."*

155. What the estimation process does *not* do is render the contingent creditor's debt in fact payable, and therefore 'outstanding' for the purposes of Rule 2.88(7), at any time prior to the occurrence of the contingency or mean that the creditor is in fact kept out of its money unless and until the contingency occurs.

156. Accordingly, the purpose of the rule permitting payment of Statutory Interest does not require interest to be paid on a contingent debt from the Date of Administration merely because, for the purposes of participating in distributions in competition with other creditors, an estimated value is placed upon the creditors' claim as at the Date of Administration, and *that estimated amount* remains unpaid as from the Date of Administration.

157. York's response is to say that the process of estimation for contingent debts involves discounting the value of the debt back to the Date of Administration to compensate for the time value of money (see paragraph 12 of its reply position paper).

158. The logic of York's argument appears to be that if the value of the debt is discounted back to the Date of Administration, to take account of the time value of money, then the creditor is paid, from dividends, an amount equal to the net present value of the debt as at the Date

of Administration, so that it should share in Statutory Interest payable to all other creditors whose debts were due at the Date of Administration.

159. The logical corollary of York's position is that if the value of a contingent debt is not discounted back to the Date of Administration, then there is no justification for paying Statutory Interest from the Date of Administration. On the contrary, in that event, to allow Statutory Interest from the Date of Administration would result in double-counting: the creditor's debt is not eroded by a discount to reflect the time value of money for the period after the Date of Administration, yet it would receive interest as compensation on the assumption that it had suffered such erosion.

160. A closer analysis of the rules relating to future debts and contingent debts does not support York's analysis.

161. The Insolvency Rules do indeed contain provision for discounting back the value of a debt, to provide a net present value as at the Date of Administration, but this applies only to purely future debts, i.e. debts which are certain to be paid on a particular date in the future. Even then, the discounting back is applied only where the debt remains a future debt at the time of declaration of a dividend: see Rule 2.89 and Rule 2.105.

162. There is no equivalent to Rule 2.105 for contingent debts, i.e. no rule which requires any discount to be made, for the time value of money, on the estimated value of the contingent debt while it remains contingent.

163. There is good reason for that. Where the contingency has not yet occurred, it is not possible to apply a discounting back formula such as that in Rule 2.105, for the simple reason that (save in the probably rare case where the debt is contingent as to its occurrence but not as to the date of payment) the date from which the discounting back should take place is unknown. Thus, the extent to which the debt is being paid early is similarly unknown.

164. Where a dividend is payable on a contingent debt, *after* the contingency has occurred, then York accepts (paragraph 12(2)(c) of its reply position paper) that there is no requirement to apply a discount for the time value of money between the Date of Administration and the date upon which the contingency occurred, '*because the law treats the now quantified*

amount as being the amount due at the commencement of the insolvency', citing *Stein v Blake* [1996] 1 AC 243, 252.

165. This accords with the practice adopted by the Administrators in this case: it is Wentworth's understanding that the Administrators have not sought to apply any discount for the time-value of money to any of the proved contingent debts. The Administrators can no doubt confirm this.

166. It is also consistent with the scheme of the Rules as a whole, since (as noted above) there would be no discounting back, even in the case of a purely future debt, where the debt has fallen due before the declaration of a dividend.

167. In the absence of a rule requiring the discounting back of a contingent debt to the Date of Administration:

(1) It remains the case that, notwithstanding that an amount equal to the estimated amount of the contingent debt is payable from the insolvency estate as from the Date of Administration, the debt itself is not "*outstanding*" until such time as the contingency occurs; and

(2) Payment of Statutory Interest from the Date of Administration would result in double-counting, which provides a strong reason against paying Statutory Interest for the period before the contingency occurred.

168. The Administrators and the SCG have filed witness statements evidencing the different consequences in practice depending on differing agreements reached by creditors as to the valuation of their claims. Thus:

(1) Some creditors, who have entered into the CRA, have agreed that certain, but not all, of their claims will be valued as at a date immediately prior to the administration, with other claims being valued at the date on which their agreements in fact closed out.

(2) Other creditors who did not enter into a CRA have had their claims valued as at the date of the close out of the agreement.

(3) In some cases, where creditors' agreements remained open for a long period after the Date of Administration, the creditor may have benefitted from the delay, by an increase in the value of assets (reflecting movements in the particular market), but in other cases the movements in the market may have disadvantaged the creditor.

169. The question whether the entry into the CRA affects the answer to any of Issues 6 to 8, for the creditors who have entered into the CRA, is raised by Issue 9, which is to be determined in Part B of the Waterfall II Application.

170. As a matter of principle, however, neither an agreement reached with a particular creditor as to the valuation of its claim, nor the fact that a creditor may have benefitted, or may have been disadvantaged, from market movements by waiting to close out its contract and thus crystallise any debt, can be relevant to the construction of Rule 2.88. Irrespective of the loss or gain from market movements, as noted above, in fact no creditor's contingent claim has been reduced by application of a discount reflecting the time value of money between the Date of Administration and the date the debt actually became due.

171. The Administrators suggest that the position adopted by Wentworth on Issue 7 "*might lead one to expect*" that it would take a similar position on Issue 8 (paragraph 47 of their position paper). While it is true that Wentworth advances opposite conclusions on Issues 7 and 8, those conclusions are logically consistent, given the wholly different treatment of contingent and future debts in the rules, as described in this section and the next dealing with Issue 8.

ISSUE 8

Whether Statutory Interest is payable in respect of an admitted provable debt which was a future debt as at the Date of Administration from:

(i) the Date of Administration;

(ii) the date on which the future debt ceased to be a future debt; or

(iii) another date

having regard to whether the future debt remained a future debt at the time of the payment of:

(i) the final dividend; or

(ii) Statutory Interest.

172. Future debts differ from contingent debts in three main respects:

(1) As at the Date of Administration the future debt is certain to become payable.

(2) As a result of the insolvency the future debt is accelerated and treated as payable as of the Date of Administration: see *Hodson v Tea Company* (1880) 14 Ch D 859; *Wallace v Universal Automatic Machine Co* [1894] 2 Ch 547; Goode, Principles of Corporate Insolvency, 4th ed., paragraphs 3-11.

(3) To compensate for that acceleration, there is a discount applied for early receipt, where payment is not due at the date of the declaration of the dividend: Rule 2.105(2).

173. The combination of these features means that the future debt is properly regarded as "*outstanding*" for the purposes of Rule 2.88(7) from the Date of Administration. In particular, the future debt is, through the process of acceleration, rendered due from the Date of Administration as much as any other debt already fallen due at that date, and it is therefore appropriate that, in the event of a surplus, Statutory Interest is payable from that date.

174. There is support for this conclusion in relation to future debts in the fact that Rule 2.105(2) uses the same word ("*outstanding*") as that which appears in Rule 2.88(7) in a context which can only include debts which remain payable in the future.

<u>ISSUE 6</u>

Whether, for the purposes of establishing, as required under Rule 2.88(9) of the Rules, "*whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*", the amount of interest to be calculated based on the latter is calculated from:

(i) the Date of Administration;

(ii) the date on which the debt became due; or

(iii) another date.

175. The answer to Issue 6 depends on the answers to Issues 7 and 8.

176. If Statutory Interest is payable from the Date of Administration in any circumstance on a contingent or future debt, then the comparison under Issue 6 is between the Judgments Act Rate and the rate applicable apart from the administration, in each case from the Date of Administration.

177. If on the other hand, Statutory Interest is payable only from the date on which the contingency occurred or the future debt became due for payment, then it can only be from that date that it is relevant to identify "*the rate applicable apart from the administration*".

GROUP IV: ISSUES 28-30

ISSUE 28

Whether, and if so how, the calculation of a Currency Conversion Claim should take into account the Statutory Interest paid to the relevant creditor by the Joint Administrators.

ISSUE 29

Whether there exists a non-provable claim against LBIE where the total amount of interest received by a creditor applying the Judgments Act Rate on a sterling admitted claim, when converted into the relevant foreign currency on the date of payment, is less than the amount of interest which would accrue applying the Judgments Act Rate to the original foreign currency claim.

ISSUE 30

Whether there exists a non-provable claim against LBIE where the total amount of interest received by a creditor applying a "*rate applicable to the debt apart from the administration*" on a sterling admitted claim, when converted into the relevant foreign currency on the date of payment, is less that the amount of interest which would accrue applying the "rate applicable to the debt apart from the administration" to the original foreign currency claim.

178. Issues 28 to 30 concern the interplay between a currency conversion claim ("**CCC**") and the payment of Statutory Interest. It raises the issue touched upon in *Waterfall I* at [99]: "*It may well be that in asserting a non-provable currency conversion claim the creditor in this example might have to give credit for the benefits which he has received under the insolvency regime. The existence of these possible difficulties, and I do not accept that they are any more than that, does not in my judgment provide a sound basis for saying that there can be no currency conversion claims arising out of the contractual rights of creditors*."

179. The CCC compensates the creditor for the amount by which the conversion of its debt into sterling has resulted in it receiving less, in the foreign currency, than the amount to which it was contractually entitled.

180. All parties are agreed that the contractual right to be paid interest is relevant to the CCC (to the extent that there is a shortfall by reason of the conversion of the currency in which the interest was to be paid).

181. Wentworth contends that the right to be paid interest in the foreign currency does not create any separate CCC to that applicable to the debt itself. Instead there is only one claim, which depends upon a comparison between (i) the amount of principal and interest at the

contractual rate, in the relevant foreign currency and (ii) all distributions received from the insolvency estate, whether by way of dividend or Statutory Interest. This is referred to in the following paragraphs as the "**aggregated approach**".

182. The other parties contend, broadly, that the calculation of the CCC in respect of a provable debt takes no account of Statutory Interest, but there is a separate "*Foreign Exchange Interest Claim*" (see, e.g. paragraph 28(6) of the SCG's position paper) in relation to the interest aspect of the creditor's claim. This is referred to in the following paragraphs as the "**severable approach**".

183. There is no authority on the point, given that it was only the judgment in Waterfall I that confirmed the existence of a CCC. It is therefore necessary to consider the question as a matter of principle.

184. The essence of the CCC is as follows:

(1) The creditor has a contractual right to be paid in a foreign currency.

(2) The right is converted into Sterling for the purpose of proof only.

(3) The creditor is not entitled to claim any currency shortfall from the insolvency estate while any amount is owed from the insolvency estate to creditors.[33]

(4) Once all creditors have been paid in full – including Statutory Interest – the creditor is entitled to assert its CCC against the surplus, if and to the extent that it has received less than the full amount of its debt in the relevant foreign currency.

(*Waterfall I* judgment, at [94] to [111], particularly [110])

185. In considering which of the aggregated approach or severable approach is correct it is important to bear in mind that the essence of the claim is the extent to which a shortfall arises between the creditor's contractual right to be paid in the foreign currency and the

[33] It follows that the CCC is payable only after all other non-provable debts have been paid.

amounts distributed from the insolvency estate, *by reason of the conversion of the claim into sterling for the purposes of proof*.

186. Thus the essential characteristic of the creditor's rights, which give rise to the claim, is the entitlement to be paid *in the foreign currency*. It matters not whether the amount to which the creditor was entitled relates to principal, interest, or something else (e.g. a fee). It is simply the fact that it was to be paid in a foreign currency, but was not so paid, that gives rise to the claim.

187. This suggests that in addressing the first side of the comparison – what the creditor would have been entitled to in the foreign currency – the aggregated approach is correct. And it follows that the other side of the comparison – the payments received from the insolvency estate – is also to be approached on the aggregated basis: if the only characteristic of the creditor's contractual rights that is relevant to the claim is the right to be paid in the foreign currency, then the characteristics of the payments made from the insolvency estate in respect of the creditor's claim ought not to matter apart from the fact that they are paid in sterling.

188. This is supported by the fact that all payments received from the insolvency estate share two essential characteristics: (1) they are all payments from the statutory scheme for the distribution of an insolvent company's estate, and (2) they all relate to and are made in respect of the proved debt.[34]

189. In many circumstances there is likely to be little difference in outcome between the aggregated approach advocated by Wentworth and the severable approach adopted by the other parties. However, there is scope for significant difference in two particular cases.

190. The first is where there are wide movements in the foreign exchange markets over time. For example:

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34 The Administrators suggest (paragraphs 112 to 115 of their position paper) that Statutory Interest is a distinct claim, arising from Rule 2.88(7) and for that reason is not to be offset against currency losses in respect of the proved debt. But the source of the obligation to pay Statutory Interest should be irrelevant, provided that it is a payment made as a consequence of, and under, the statutory regime for distribution of assets of an insolvency estate to creditors (which it clearly is).

(1) A foreign currency creditor may, in respect of its proved debt, receive sterling which when converted into the foreign currency produces a return of 120%.

(2) Between the date of payment of the final dividend and payment of Statutory Interest, the exchange rate moves against the creditor, such that it receives sterling which when converted into the foreign currency produces a return of 80% in relation to interest.

191. On the aggregated approach, the loss on the interest part of the debt would be mitigated by the gain on the principal part (and vice versa if the currency movements were reversed).

192. On the severable approach advocated by the SCG, York and the Administrators, the creditor would have a CCC in respect of the interest portion, the quantum of which was unaffected by the currency gain made in respect of the proved debt.

193. As noted in the Waterfall I judgment, at [97] to [98] the impact of currency movements can work both for and against different creditors, but where it works in favour of a creditor there is no question of any *claim* for the return of the excess amount from that creditor.

194. That is not to say, however, that foreign currency gains made by a creditor in respect of *part* of its claim should not be offset against currency losses made by the same creditor in relation to a different part of that same claim.

195. As a matter of principle, taking account of currency gains made by the creditor by way of offset against currency losses suffered by the creditor, certainly in relation to the same underlying debt, is more consistent with justice and a fairer reflection of the loss, if any, made by the creditor by reason of the conversion of its claim for the purposes of proof.

196. There can be no dispute that such an offset is to be made in respect of different dividends paid to the creditor at different times. For example a first dividend of 50p/£ is paid at a time when it produces a return of 40% in the foreign currency, and a second dividend of 50p/£ is paid at a time when it produces a return of 60% in the foreign currency; there is no CCC because overall the creditor has received 100% of its foreign currency claim.

197. Moreover, there can be no dispute that such an offset applies even though the proved debt includes both principal and interest accrued up to the Date of Administration. In such a

case, even on the severable approach, the CCC is calculated on the basis of a comparison between the contractual rights of the creditor and the foreign currency equivalent of all dividends paid, notwithstanding that those dividends relate, in part, to interest on the foreign currency debt.

198. If that is so in relation to that part of the creditor's contractual right to interest which is provable, it is difficult to envisage why it should be different in relation to that part of the creditor's contractual right which is not provable.

199. The second circumstance where the difference in approach between Wentworth and the other parties makes a difference is where the creditor's debt either does not bear interest or bears interest at a rate lower than the Judgments Act Rate. In addition to the reasons set out above, the aggregated approach is to be preferred here for the following additional reasons:

(1) It is a necessary requirement, for a foreign currency creditor wishing to participate in the distribution of the company's assets in competition with other creditors (i.e. via the process of submitting proofs of debt), to convert its claim into sterling under Rule 2.86.

(2) As a result of such conversion into Sterling for the purposes of proof, the creditor becomes entitled, in the event of an insolvency surplus, to be paid Statutory Interest on its proved debt.

(3) Statutory Interest is payable to the foreign currency creditor only because its debt is converted for the purpose of proof. (As noted under Issue 4 above, the Judgments Act Rate is a sterling rate, applicable on the basis that it is the appropriate rate for debts payable in sterling, and is thus applied to a foreign currency creditor as a direct consequence of the conversion of its claim into sterling.)

(4) Put another way, by reason of the conversion of its claim for the purposes of proof, a foreign currency creditor with no entitlement to interest, or interest at a rate lower than the Judgments Act Rate, on the one hand loses, to the extent of adverse foreign exchange movements, but, on the other hand, benefits, to the extent that there is a surplus and Statutory Interest is paid.

(5) As a matter of principle it is right to take account of such benefit in calculating the extent to which the shortfall, if any, in its recovery of its foreign currency debt, arose from the conversion of the debt into sterling for the purposes of enabling it to prove in the administration.

200. There is support for this approach in the authorities relating to 'mitigation in fact' (which require certain benefits received by a claimant to be offset against loss incurred in calculating damages for breach of contract).

201. It is irrelevant whether the CCC is properly construed as a claim in debt, or a claim in damages, or both.

202. In *Re Lines Bros Ltd*, 125 SL 426, Slade J said that "*The Miliangos decision decisively rejected the idea that foreign currency is regarded by English law as a commodity, in the sense that, for example, a foreign cow is a commodity. Foreign money is now treated by English law as money, and a claim for a sum which is payable in a foreign currency is none the less a claim for a debt, even if expressed in that foreign currency; it is not a claim for damages*."

203. As against this, it is clear that (following *Sempra Metals*) it is possible to claim consequential damages for the failure to pay a debt on time. As a matter of principle there is nothing to prevent an analogous claim for loss arising as a result of a debt not being paid in the specified currency.[35]

204. In some instances, a creditor may well have a contractual indemnity claim to that effect: see, for example, the 1992 ISDA Master Agreement, at Section 8(a).

205. Whichever is the appropriate analysis of the CCC, it ought to lead to the same calculation of the claim. Any other conclusion would be counter-intuitive, particularly since (1) the root of the claim, under either analysis, is the failure to pay the debt in the agreed currency by reason of its conversion under Rule 2.86 into sterling for the purposes of the statutory

[35] The Administrators draw a further distinction between those cases where the provable debt is itself a pure debt claim, and those cases where the provable debt is a damages claim: see paragraphs 108 to 110 of their position paper. This distinction is irrelevant to the analysis of the CCC. Whatever the underlying basis of the provable debt, it is the fact that the amount payable is converted into Sterling that gives rise to the CCC.

scheme, and (2) the essential inquiry under either analysis is the extent to which the shortfall suffered by the creditor between the foreign currency amount of the claim and the amount received from that statutory scheme results from (1) above.

206. In the case of a claim for damages, the doctrine of mitigation applies. This includes the principle that benefits received by the claimant should be taken into account in assessing the loss arising from the breach, where such benefit arises "…*out of the consequences of the breach and in the ordinary course of business*" (*British Westinghouse Co v Underground Electric Rys Co of London* [1912] AC 673).

207. In more modern times, the principle was stated by Lord Hope, in *Longden v British Coal Corp* [1998] AC 653, at 662, as follows:

> *"There is no doubt that the plaintiff cannot recover under his claim of damages for pension loss any more than the amount of his net loss. The purpose of the award of damages is to compensate him for his loss, not to enrich him. It should leave him no worse off than he was before, nor should he be any better off. As Lord Bridge of Harwich said in Hussain v. New Taplow Paper Mills Ltd. [1988] A.C. 514, 527, the rule is that prima facie the only recoverable loss is the net loss. Financial gains which accrue to the plaintiff which he would not have received but for his accident are prima facie to be taken into account in mitigation of the losses which he has sustained. The principle is that the compensation which he receives by way of the payment of a sum of money as damages should as nearly as possible put him in the same position as he would have been in if he had not sustained the wrong for which he is to be compensated: per Lord Blackburn in Livingstone v. Rawyards Coal Co. (1880) 5 App.Cas. 25, 39."*

208. Accordingly, if the claim is analysed as a breach of contract, the principle of 'mitigation in fact' would require any benefits arising out of the consequences of the breach to be brought into account.

209. When considering the benefits that arise out of the consequences of the breach, the context of the breach is all-important. It is a breach caused by the conversion of the debt into sterling for the purposes of permitting a proof in the administration. One of the benefits arising from the consequences of that breach is the payment of Statutory Interest (or Statutory Interest at a rate) that would otherwise not be paid.

210. Accordingly, as a matter of principle, the CCC should be calculated, if a damages claim, by comparing the amount in the foreign currency to which the creditor was contractually entitled and the foreign currency equivalent of the amount received by it by way of

distributions from the insolvency estate in respect of the proved debt, including dividends and Statutory Interest.

211. As noted above, the same result should be reached if the claim is analysed in debt. The question then is the extent to which the foreign currency debt has been discharged by payments from the insolvency estate. Every payment from the insolvency estate, irrespective of the characterisation placed upon the payment for the purposes of the statutory scheme, is a payment from the property of the debtor to the creditor, referable to the single debt (including principal and interest), and has thus *pro tanto* discharged that debt.

212. The SCG contend that because of the different origins and functions of a CCC and Statutory Interest, the calculation of the CCC should not take into account payments of Statutory Interest (paragraph 28(5) of their position paper,).

213. The SCG expands upon this position in its reply position paper (at paragraph 28(3) and (4)), contending that the result of Wentworth's argument is that since Statutory Interest serves the purpose of compensating creditors for being kept out of their money, unless a creditor receives payment of Statutory Interest in full its right to payment of Statutory Interest will not have been satisfied in full, so that a foreign currency creditor does not or may not receive compensation for delay.

214. These contentions are wrong, as demonstrated as follows in the context of a creditor with a non-interest bearing debt:

(1) The foreign creditor with a non-interest-bearing debt, by definition, has no contractual right to compensation for the delay in payment.

(2) Rule 2.88(7) applies only to provable debts, and that applies (by definition) only to the claim once converted into sterling.

(3) In the event that there is a sufficient surplus to pay Statutory Interest in full, the foreign currency creditor will receive Statutory Interest in full, on its proved debt, along with all other creditors.

(4) The foreign currency creditor without an interest-bearing debt therefore receives the same measure of compensation, for the delay in payment of its proved debt, as every other creditor with a non-interest bearing debt, and it is wrong to suggest (as do the SCG) that he "*does or may not receive any compensation for delay*".[36]

(5) The absence of any further or additional compensation for delay for the foreign currency creditor with a non-interest-bearing debt is not a consequence of the conversion of its debt, because – but for that conversion – it would have had no contractual entitlement to compensation for delay.

(6) Accordingly, there is no basis on which the lack of any further or additional compensation for delay is caused by the conversion of its debt into sterling.

Issue 29

215. Given Wentworth's approach to the calculation of a CCC, the question raised in Issue 29 (which concerns a separate foreign currency claim in relation to interest only) does not arise.

216. In any event, insofar as it may be suggested that the question in Issue 29 is relevant to the CCC on the aggregated basis advocated by Wentworth, the situation envisaged by it does not arise in practice. Specifically, it envisages the circumstance that Statutory Interest at the Judgments Act Rate is less than the interest accruing on the foreign currency debt applying the Judgments Act Rate.

217. On this point, Wentworth agrees with the Administrators (paragraphs 121-127 of their position paper) that, absent the co-incidence that the creditor had a contractual entitlement to be paid interest at the Judgments Act Rate[37], the creditor would never have been entitled to receive interest at the Judgments Act Rate on its foreign currency debt. As noted above,

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[36] The Administrators' suggestion (paragraph 117 of their position paper) that a foreign currency creditor will have received less Statutory Interest than sterling creditors is also therefore wrong.

[37] Note that if the creditor had obtained a judgment it would not be entitled to interest at the Judgments Act Rate, since a judgment in respect of a debt payable in a foreign currency carries interest at such rate as the court thinks fit: s.44A of the Administration of Justice Act 1970.

since the Judgments Act Rate is a sterling rate, there is no basis on which a foreign currency creditor would have been entitled to apply it to their foreign currency claim.

218. If a creditor did have a contractual right to interest at the Judgments Act Rate, then this is taken into account in the calculation of its CCC on the aggregated approach for which Wentworth contends.

Issue 30

219. All parties agree that in the circumstances envisaged in Issue 30 there exists a CCC. Those circumstances are where the foreign currency equivalent of Statutory Interest (applying the rate apart from administration) received by the creditor is less than the amount of interest at the contractual rate on the original foreign currency debt.

220. For the avoidance of doubt, however, Wentworth contends that this is not a separate claim, but is subsumed within the CCC on the aggregated approach referred to above.

Post-script: *Bower v Marris*

221. There is a suggestion, in York's position paper (but not that of the SCG or the Administrators) that the calculation of the CCC where the creditor's debt bears interest should be done on the basis that any payments to the creditor are applied first in the discharge of interest, on the basis of *Bower v Marris*.

222. York relies on the alternative calculations in *Re Lines Bros* (paragraphs 63 – 65 of its position paper).

223. For the reasons developed under Issue 2, the application of *Bower v Marris* in the context of the statutory scheme applicable in *Lines Bros* does not require it to be applied in calculating the amount of interest payable from the insolvency surplus under Rule 2.88(7).

224. Moreover, for the reasons similar to those referred to under Issues 2 and 39 (mainly because any contractual rights to compensation for the time value of money relating to the period after administration are superseded by the regime for Statutory Interest) there is no scope for a further non-provable claim for such amount of interest as the creditor would have been entitled to receive, but for the insolvency, on the basis of a *Bower v Marris* calculation.

225. If it is suggested by York that the non-provable CCC should nevertheless be calculated on the basis that the quantum of its contractual right to be paid in the foreign currency is to be calculated on the basis that all distributions from the insolvency estate should be applied first against interest, then such suggestion is wrong.

226. In the first place, it would be highly anomalous (if Wentworth is correct in respect of Issue 2 and/or Issue 39) that *Bower v Marris* plays no part in the calculation of the amount of Statutory Interest payable from the insolvency estate and gives no right, generally, to a further non-provable claim, that creditors whose debts happen to be payable in a foreign currency can by a back-door route take advantage of the *Bower v Marris* method of calculating entitlement to interest.

227. Secondly, the reason why the CCC does not involve a calculation of the creditor's contractual right on the basis of *Bower v Marris* is that the cause of the non-application of *Bower v Marris* is the statutory rules on payment of interest from the insolvency surplus; it does not flow from the fact that the creditor's claim is paid in sterling, as opposed to the relevant foreign currency.

228. As noted above, the essence of the CCC is the extent to which the foreign currency equivalent of the amount received by the creditor from the statutory regime for the distribution of assets from the insolvency estate is caused by the non-payment of the foreign currency as a result of its conversion under Rule 2.86. The inability to apply a *Bower v Marris* calculation is therefore outside the scope of the CCC, which is limited to the shortfall arising by virtue of the conversion of the debt into sterling.

GROUP V: ISSUES 31 AND 32

ISSUE 31

Whether:

(i) in relation to a GMSLA for which the "Base Currency" is a currency other than sterling, a Currency Conversion Claim can arise in respect of the "Base Currency" if the schedule to that agreement states that paragraph 10 of that agreement will only apply if LBIE's counterparty is the "Defaulting Party";

(ii) in relation to a GMRA for which the "Base Currency" (as distinct from the "Contractual Currency") is a currency other than sterling, a Currency Conversion Claim can arise in respect of the "Base Currency" if the schedule to that agreement states that paragraph 10 of that agreement will only apply if LBIE's counterparty is the "Defaulting Party"; and

(iii) in relation to other master agreements, a Currency Conversion Claim can arise if the relevant contractual terms state that the termination and close-out netting provisions which would result in a payment obligation in a non-sterling currency by one party to the other do not apply other than upon the default of LBIE's counterparty.

229. Wentworth contends that the counterparty does not have any contractual entitlement to be paid in a foreign currency under the netting or payment provisions of the Global Master Securities Lending Agreement ("**GMSLA**"), the margin lending agreement ("**MLA**") or the prime brokerage agreement ("**PB**") (together the "**Agreements**")[38]. Accordingly, the counterparties are unable to rely on the netting or payment provisions of the GMSLA, the MLA or the PB as giving rise to a Currency Conversion Claim.

230. The relationship between, and effect of, the Agreements may be summarised as follows:

(1) The PB is the basic document governing the relationship between LBIE and its counterparty.

(2) The PB was supplemented by the MLA as regards loans of margin by LBIE to its counterparty.

(3) The GMSLA was entered into for the purpose of stock lending by LBIE to its counterparty. The GMSLA was intended to be, and was, used only for such loans,

[38] Wentworth has, pursuant to paragraph 2 of the order of David Richards J dated 26 June 2014, provided redacted copies of the following agreements to the other parties to the Application: (i) a GMSLA for which the "*Base Currency*", as defined therein, is a non-sterling currency; (ii) a PB; and (iii) a MLA.

even though, on its face, the GMSLA envisages loans of securities by Party A or Party B.

(4) The Schedule to the GMSLA subjected its terms to terms of the MLA and modified the following provisions of the GMSLA, amongst others:

(a) The Event of Default and close-out provisions at paragraph 10 are modified such that: "*Paragraph 10 of this Agreement will only apply if Party B is the Defaulting Party*", i.e. if LBIE's counterparty is the "*Defaulting Party*" and not if LBIE is the Defaulting Party.

(b) The termination provision at paragraph 9.2 is modified so as not to apply to "*Loans of Loaned Securities*".

(c) Paragraph 10, if it applied, would entitle LBIE's counterparty to close-out all transactions on LBIE's default and calculate a close-out amount denominated in a foreign currency. Such amount would thus give rise to an entitlement to be paid in a foreign currency. The disapplication of paragraph 10 thus prevents such a contractual entitlement from arising.

(5) Paragraph 9.2, if it applied, would entitle LBIE's counterparty to terminate particular transactions and to calculate an amount due upon termination of the transaction, payable in a foreign currency. To the extent that this resulted in a payment due to the counterparty it would thus give rise to an entitlement to be paid an amount in a foreign currency. The disapplication of paragraph 9.2 thus prevents such a contractual entitlement from arising.

(6) The disapplication of the right to terminate under paragraph 9.2 of the GMSLA is to be read together with the disapplication of the simultaneous delivery obligations under paragraph 8.4 (which would otherwise favour the Borrower, LBIE's counterparty) and the terms of the MLA, to which paragraph 1 of the Schedule subjects the GMSLA as regards collateral and margin.

(7) Taken together, the effect is that the right of LBIE's counterparty (i.e. the Borrower) to recover collateral and/or invoke a netting process on LBIE's failure to redeliver collateral is removed, leaving it only with the right under clause 5(d)

of the MLA. That right is to recover any excess collateral once all of its obligations to LBIE have been satisfied.

(8) Critically, the counterparty's right is merely the right to recover collateral. It is not a right to be paid any amount in a foreign currency. Moreover, if LBIE fails to comply with the obligation to deliver collateral, the counterparty's right to recover damages does not amount to a contractual entitlement to be paid in a foreign currency.

(9) Accordingly, LBIE's counterparty has no entitlement under any netting or payment provisions of the GMSLA, the MLA or the PB and thus can have no Currency Conversion Claim.

ISSUE 32

If the answer to question 31(i), (ii) and/or (iii) is in the negative, whether a Currency Conversion Claim can arise (and if so in what circumstances) in respect of such a GMSLA, GMRA or other master agreements.

231. Issue 32 arises for consideration in circumstances where the answer to Issue 31 is that the counterparty does not have any entitlement to be paid in a foreign currency under the netting or payment provisions of the GMSLA, the MLA or the PB.

232. The question of whether any damages established by the counterparty are payable in Sterling or some other currency is to be resolved by determining which currency most appropriately or justly reflects the recoverable loss suffered by the counterparty: see *The Despina R* [1979] AC 685.

233. Wentworth recognises that this is a fact sensitive question to be determined on a case by case basis and, as such, is not capable of resolution at a general level on the Waterfall II Application.

GROUP VI: ISSUES 33 AND 37

ISSUE 33

Whether a Currency Conversion Claim can be established by a creditor where the creditor's right is derived from a transfer (whether or not by way of legal assignment) by LBIE's original counterparty (or any assignee of the original counterparty) which only transferred:

(i) the provable debt;

(ii) the right to receive a dividend on the provable debt; or

(iii) the Agreed Claim Amount defined as a numerical amount in a CDD

and, if not, whether either the original counterparty or the assignee is capable of having a valid Currency Conversion Claim.

234. Issue 33 is premised upon an assignment of only limited rights, which do not include the right to be paid in the relevant foreign currency. In those circumstances, does the assignor itself have an entitlement to make a CCC?

235. Issue 33 was originally to be included in Part A of the Waterfall II Application. On a further review of this issue, it is believed that the question of the assignor's continuing right to assert a currency conversion claim will in many cases be bound up with the interpretation of the commonly used agreement entered into by, amongst others, an assignor of a claim and the Administrators (the "**Assignor Letter**") pursuant to which the assignor released any claims that they may have against LBIE.

236. It can be seen therefore that Issue 33 raises questions that are closely related to the waiver questions already raised by Issues 34 and 35 relating to the CRA and CDDs, including potentially similar issues of fact as raised by those issues.

237. Accordingly, Wentworth does not intend to pursue this issue at this hearing; but intends to raise the question of its inclusion within Part B of the Waterfall II Application at the CMC due to be fixed in March 2015.

ISSUE 37

How are claims to be calculated where a CDD (or any other agreement pursuant to which an unsecured claim is agreed or admitted) compromises a number of claims, with differing rates of interest applicable or in different currencies, without indicating how the agreed or admitted claim amount in the CDD (or any other agreement) derives from and relates to those underlying claims?

238. Wentworth contends that, in circumstances where it is not possible to ascertain how the agreed or admitted amount in the CDD (or other agreement) derives from and relates to the underlying claims, the claims are to be calculated on a pro rata basis by reference to the underlying claims.

239. By letter dated 28 January 2015, Linklaters set out a number of possible methodologies that could be adopted by the Administrators when calculating a creditor's entitlement in respect of Statutory Interest and CCC in circumstances where a CDD does not record how the Agreed Claim is derived from a number of underlying claims held by the creditor.

240. Wentworth will give consideration to these possible methodologies and communicate its position to the other parties in advance of the hearing.

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