IN THE COURT OF APPEAL **A2/2015/3764**

ON APPEAL FROM

No 7942 of 2008

THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

Before: The Honourable Mr Justice David Richards

[2015] EWHC 2269 (Ch)

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) BURLINGTON LOAN MANAGEMENT LIMITED

(2) CVI GVF (LUX) MASTER S.À R.L

(3) HUTCHINSON INVESTORS LLC

Appellant

- AND -

(1) ANTHONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) GUY JULIAN PARR

(as the joint administrators of the above named company)

(6) WENTWORTH SONS SUB-DEBT S.À R.L.

(7) YORK GLOBAL FINANCE BDH, LLC

Respondents

SKELETON ARGUMENT ON BEHALF OF WENTWORTH SONS SUB-DEBT S.A.R.L ("WENTWORTH"), THE SIXTH RESPONDENT

INTRODUCTION

1. On 31 July 2015, David Richards J handed down his judgment in *Waterfall Part IIA* [2015] EWHC 2269 (Ch) (the "Judgment"). The Judgment considers a series of issues arising in relation to the entitlement of creditors to interest on their debts for periods of time after the commencement of the administration of Lehman Brothers International (Europe) on 15 September 2008. The statutory provision governing the payment of interest on debts proved in the administration is rule 2.88 of the Insolvency Rules 1986 ("Rule 2.88"), set out in full by the Judge at [13].[1] The background to the issues arising for determination is summarised by the Judge at [1] to [15].

2. On 9 October 2015, David Richards J made nineteen Declarations which flowed from the conclusions reached in the Judgment.

3. This skeleton is filed by Wentworth in response to the appeal of the First to Third Appellants (the "SCG") against declarations (iii), (iv), (v), (viii), (x), (xviii) and (xix). The relevant declarations are set out in Appendix I to this skeleton for ease of reference.

SECTION 1: Declaration (iii) and SCG Skel/Sections A-I – Issue 2 in the Judgment

4. Declaration (iii) relates primarily to Rule 2.88(7), which provides that "*Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company entered administration*". The issue is whether it requires that any surplus arising after payment of all proved debts in full (and before being used for any other purpose) be utilised:

   (1) (as Wentworth contends and the Judge found) in paying interest on the principal amount of each creditor's proved debt for the period between the commencement of the administration and the date or dates upon which the proved debt was paid by way of dividends from the administration estate; or

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[1] References in this skeleton to paragraph numbers as "[n]" are to the Judgment unless otherwise stated.

(2) (as the SCG contends) in payment of both interest on, and the principal amount of, the proved debts on the assumption that prior dividends are appropriated first towards the discharge of interest on the proved debts relating to the period after the commencement of administration and only subsequently towards the discharge of the principal amount of the proved debt.

5. The issue takes up a large part of the Judgment ([30] to [154]). As the Judge correctly noted, it raises a question of statutory interpretation [30] to [31]. Wentworth contends that the Judge's conclusions are correct, for the reasons he gave. In short:

(1) the terms of Rule 2.88 preclude the interpretation advocated by the SCG; and

(2) the approach in *Bower v Marris* (1841) Cr & Ph 351, 41 ER 525 ("*BvM*"), which forms the bedrock of the SCG's case, has no application to the payment of Statutory Interest under Rule 2.88.

6. As to the first point, the SCG's skeleton provides no reason to doubt the Judge's conclusions as to the interpretation of the language of Rule 2.88 (see below at paragraphs 10-20).

7. As to the second point, the SCG's skeleton misstates both the point for which *BvM* is authority, and the supposed application of the approach in *BvM* in the last 180 years.

Appropriation and the approach in BvM

8. In order to understand the *ratio* of *BvM* and its relevance in an insolvency context, it is necessary to have in mind both the legislative framework in each of the cases where it has been applied, and the principles of appropriation which underlie the decision. The Judge dealt comprehensively with both in his judgment. They can be distilled into the following propositions (with references to the Judgment) each of which is adopted by Wentworth:

(1) Under the principles of appropriation, where a creditor is owed, at the time of payment, two debts, then the right to appropriate the payment to one or other

debt is given first to the debtor and, if the debtor does not exercise that right, to the creditor ([40] to [42]).

(2) Distributions from an insolvency estate are made by operation of law, and not treated as appropriations made by the debtor. Thus the creditor retains such right as it would otherwise have had to appropriate distributions first towards interest due at the date of the distribution. It is assumed, absent a contrary intention,[2] that such payments are appropriated first towards interest. That is the sole point for which *BvM* is authority ([43] to [45], and [63]).

(3) Prior to 1824, there was no statutory provision for interest arising on a surplus in bankruptcy ([46]). All the case law up to and including *BvM* proceeded on the basis that if a surplus emerged, creditors' pre-existing contractual or other rights in respect of interest should be satisfied before anything was returned to the bankrupt and, in that context, the creditor had the right to appropriate payments first towards interest which had continued to accrue during the bankruptcy ([46] to [64]).

(4) *BvM* itself addresses only the position so far as it concerns creditors with a pre-existing right to interest. Although s.132 of the Bankruptcy Act 1825 (the "1825 Act") was by then in force (and provided for payment of interest at a flat rate of 4% on all creditors other than – and after payment to – those with a pre-existing right to interest), Lord Cottenham addressed only that part of the section relating to interest payable to creditors with a pre-existing right to interest ([64]).[3]

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2 The fact that the principle responds to a contrary intention of the parties is shown by: its application in legacy cases, where it is subject to a contrary intention in the will (*Re Morley's Estate* [1937] Ch 491, 496; and its application in a debenture trust case, where the court inferred the parties' intention was to appropriate towards *capital* first (i.e. the reverse of *BvM*) (*Smith v Law Guarantee & Trust Society* [1904] 2 Ch 569).

3 On a point of detail, the Judge was wrong to state (at [58]) that the 1825 Act applied to the bankruptcy in question. The relevant bankruptcy had commenced in 1805, and s.132 had no retrospective effect: see s.135 of the 1825 Act and *Ex Parte Sammon* (1831) Mont 253. Accordingly, there was in fact no statutory right to interest at all in the context of the bankruptcy in question in *BvM*.

(5) A fundamental change was made by the Bankruptcy Act 1883 (the "1883 Act"), which by s.40(5) provided for 4% interest to be paid to all creditors irrespective of whether their debt was interest-bearing ([53]). It made no provision for any different rate payable to creditors with a pre-existing contractual right ([55]). And it made no provision for remission to any contractual or other rights to interest in the event of a surplus ([55] & [139] to [140]).

(6) No case has applied *BvM* to the payment of statutory interest under the 1883 Act ([87]) (or the Bankruptcy Act 1914 (the "1914 Act") where the provisions were materially similar). In fact there is no reported English case dealing with the position in bankruptcy since 1832 ([65]). Moreover, there is no reference in the leading bankruptcy text (Williams) to *BvM* since the introduction of a right to statutory interest for all creditors under the 1883 Act ([141]). There is certainly no evidence of any practice of *BvM* being applied in bankruptcy since the 1883 Act (let alone a practice sufficiently established that the legislature must have had it in mind at the time of the Insolvency Act 1986 (the "1986 Act")).

(7) In the case of winding-up, prior to 1986 there was no statutory right to interest accruing after the commencement of a liquidation ([88]). Instead, by a judge-made rule (in *Re Humber Ironworks and Shipbuilding Co, Warrant Finance Company's Case* (1869) LR 4 Ch App 643), where a surplus emerged, creditors with a pre-existing right to interest were remitted to such right (including the right to appropriate dividends towards payment of interest due at the date of the dividend) while other creditors got nothing ([71] to [73] & [88]).

(8) *BvM* has been applied in various foreign jurisdictions, but in all but two first instance cases (both of which the Judge correctly held were wrongly decided)[4]

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[4] The first case, *Re Hibernian Transport Companies Ltd* [1991] 1 IR 263, is of no assistance, given the absence of any analysis, and the reliance on a section from the report of the Bankruptcy Law Committee lifted verbatim from a 1904 textbook which itself contains nothing more than a tentative reference to *BvM* (see [116] to [122]). The Judge was right not to follow the second case, *AG of Canada v Confederation Trust Company* (2003) 65 OR (3d) 519, OJ No. 2754, where arguments akin to those advanced by Wentworth were not put or considered by the judge (see [123] to [128], and in particular [153] of the Judgment).

the relevant legislation contained no provision for payment of interest accruing after the commencement of the bankruptcy/liquidation, and creditors' rights instead depended on the common law rule of a remission to pre-existing contractual or other rights to interest once a surplus emerged, as in *Humber Ironworks* ([66] to [67], [80] to [85]).

(9) The principle of appropriation depends upon there being in existence, at the date of payment, two rights between which it is possible to make an appropriation ([144]). It is thus essential to the operation of the approach in *BvM* that both interest *and* principal were due at the date of the distribution in respect of which the creditor seeks to exercise a right of appropriation ([145] to [147]). Only then can the distribution be analysed as one made "*on account*" of principal *and* interest.

(10) Under the regime for payment of Statutory Interest under the 1986 Act, there is no remission to contractual rights in respect of interest ([149]). Rule 2.88(9) does no more than specify a different rate at which interest under Rule 2.88(7) is payable where the creditor had a contractual or other right to interest apart from administration, but does not involve a remission to contractual rights ([136]). Interest under Rule 2.88(7) is a purely statutory right, arising only if and when all proved debts have been paid in full ([149]). Accordingly, there is simply no room for the application of *BvM* to the payment of Statutory Interest under Rule 2.88 ([149] to [150]).

(11) There was equally no room for the application of *BvM* under the code for payment of statutory interest under the Bankruptcy Act 1883 and its successors up to the 1986 Act as it did not permit any remission to pre-existing contractual or other rights to interest ([139] to [141]).

9. In light of the above, the description of *BvM* in the SCG's skeleton as a principle of equity, providing a method of calculation of interest, applicable in the administration of any apparently insolvent estate which turns out to be solvent, and which requires dividends in all such cases to be treated as paid on account of interest and principal (e.g. SCG Skel/4, 13, & 41(1)], is wrong. In addition, the SCG's contentions that the rules

of appropriation were irrelevant in *BvM* and that the approach in *BvM* does not depend on remission to contractual rights (SCG Skel/16) are plainly wrong, and based on a misreading of the judgment of Lord Cottenham in *BvM*.

Construction of Rule 2.88

10. The Judge concluded (at [134] to [137]) that the whole tenor of Rule 2.88 was inconsistent with the application of the approach in *BvM*. He was right to do so. In short:

(1) Rule 2.88(2) provides that no interest accruing after the commencement of administration is provable. The *quid pro quo* is a statutory right to have the surplus arising after payment of all proved debts applied first in payment of interest according to Rule 2.88(7).

(2) That right to interest under Rule 2.88(7) arises only "*after payment of the proved debts*" (i.e. payment in full of the proved debts), whereas the SCG's case requires the proved debts to be treated as *not* having been paid in full.

(3) Rule 2.88(7) requires the surplus to be deployed in paying "*interest*", whereas the SCG's case requires that the surplus be deployed in paying both interest and such part of the amount of proved debts that are assumed to be left unpaid after payment of all dividends. Moreover, it requires Statutory Interest to be paid *before* the proved debts cease to be outstanding, i.e. before they are paid – this is directly contrary to the statutory direction in Rule 2.88(7) to pay interest "*after*" payment of the proved debts in full.

(4) Rule 2.88(7) requires interest to be paid on the proved debts only for "*the periods during which they have been outstanding*" since the commencement of the administration. The reference to periods (plural) is because where interim dividends are paid, different parts of a proved debt remain outstanding for different periods. In other words, the end of the period or periods during which the proved debt is outstanding is necessarily linked to the date by which the dividends are paid in respect of it. The SCG's case, however, would require

payment of interest accruing during periods long after the date of payment of the final dividend (because the essence of their case is that dividends are appropriated to interest first, such that even after the date of actual payment of the final dividend, a '*rump*' of the proved debt is left outstanding, on which interest continues to accrue).

(5) The SCG's contention that the Rule is silent as to the calculation of interest (SCG Skel/32) is plainly wrong: Rule 2.88(7) contains a clear direction as to the rate of interest to paid, upon what principal amount, and for what period.

(6) Accordingly, Rule 2.88 is consistent only with the surplus arising after payment of all proved debts in full being utilised in payment of <u>interest</u> on the proved debt for the period between the commencement of the administration and the date of payment of the final dividend in respect of the proved debt. There is simply no room, on a proper interpretation of Rule 2.88, for calculating interest payable under it in accordance with *BvM*.

11. The SCG addresses the language of Rule 2.88 at paragraphs 27 to 33 of their skeleton.

12. At SCG Skel/28-29, the Judge's reliance on the fact that Rule 2.88(7) applies to the surplus "*remaining after payment of the debts proved*" is criticised, on the basis that there is nothing new in this, since the same was true in the context of the judge-made rule that applied in liquidation prior to 1986, where *BvM* did apply.

13. The argument misses the point. Rule 2.88 marks a fundamental change to the pre-1986 liquidation position, because it provides a statutory rule as to how the surplus is to be distributed, which does not depend merely on remitting creditors to such pre-existing rights they may have had, if any, to interest. The issue is how that new Rule is to be construed. The fact that a point bearing some similarity to that made by the Judge was rejected in *BvM* and *Humber Ironworks* in to the context of fundamentally different statutory regimes is irrelevant. The direction that the surplus be used to pay interest only *after* proved debts have been paid in full is undoubtedly a significant factor pointing towards a construction that requires the surplus to be used in paying interest, and only interest, upon the whole of the amount of the proved debt which has by now

been paid. In any event, the wording seized upon by the SCG is not to be taken in isolation, but to be read with the Rule as a whole.

14. At SCG Skel/30, the Judge's reliance on the fact that Rule 2.88 requires interest to be paid for the period the proved debts remain "*outstanding*" is criticised. It contends that the purpose of the relevant words is to confirm that interest is payable in respect of the period *after* the company went into administration, and that it will be necessary to take into account dividends received. And it contends that Rule 2.88(7) does not state *how* one calculates the periods for which the debts have been outstanding. These contentions are both wrong, and ignore critical wording in the Rule.

15. The wording requiring interest to be paid for the period the proved debts have been "*outstanding*" must be seen in the context of the opening words of Rule 2.88(7) which state that it applies to any surplus remaining after "*payment of the proved debts*". Since the right to payment of interest arises only once the proved debts have been *paid* – i.e. when the final dividend has been paid in respect of the proved debts – it necessarily follows that the proved debt was outstanding until, but no later than, the date the final dividend was paid. In other words, the Rule does indeed specify how one calculates the periods for which the proved debts have been outstanding.

16. At SCG Skel/31, the Judge's conclusion (at [136]) that Rule 2.88 does not permit a remission to contractual rights, despite sub-rule (9) is criticised. The SCG's first point (that there is no reason in principle why *BvM* cannot be applied to a statutory right) depends upon its mistaken interpretation of the approach in *BvM*. In particular it ignores the requirement that for the approach to operate at all there must be an accrued right to interest, as well as principal, at the date of the distribution. The SCG's case fails to recognise that a statutory right to payment of interest, if and when a surplus arises after payment in full of all proved debts, is not an accrued right at the time of the payment of dividends in respect of the proved debts, but arises only if and when all proved debts are paid in full.

17. The necessity of there being an extant and accruing right to interest at the time of the payment of the relevant dividend is clear from *BvM* itself, per Lord Cottenham at pp.356-357:

> *"The interest stops at the date of the commission, and,* ***though subsequent interest becomes due****, it is not provable under the commission. The bankrupt's estate is taken from him by the commission; and* ***the law****, in order to make an equal division amongst the creditors, pays to each a dividend upon the debt proved. But this is merely an arrangement for the convenience of the debtor's creditors.* ***The bankrupt continues indebted for the principal and the interest accrued since the commission****…and, being so indebted, payments are made out of his estate to the oblige. Why should such payments have a different effect, than they would have if made by a solvent obligor?"* (Emphasis added.)

18. In other words, the contractual right to interest was seen as ticking along throughout the bankruptcy, accruing from time to time, so that dividends could properly be seen as being paid on account of both principal and interest due at the time of the payment of the dividend. There is, in contrast, no right to Statutory Interest under Rule 2.88 ticking along during the administration, and no basis for contending that dividends are paid on account of such interest due at the time of payment of the dividend.

19. The SCG's second point, that sub-rule (9) preserved creditors' entitlements to interest – i.e. all such rights as they would have enjoyed in respect of a contractual or other right to interest apart from administration, is simply wrong. The SCG is in particular wrong to suggest that sub-rule (9) codified the law relating to corporate insolvency prior to 1986. The true position is as follows (again with references to the Judge's treatment of these points):

    (1) The Cork Committee was faced with two different regimes: bankruptcy, where there was a statutory right to a flat rate of 4% interest for all creditors, irrespective of their pre-existing contractual or other rights, to which there was no remission; and liquidation, where creditors with a contractual or other right to interest were remitted to that right, in the event of a surplus, but where others got nothing ([87] to [88]).

    (2) The Cork Committee chose to harmonise the two regimes by adopting that which had applied in bankruptcy, with the modification that the rate should be the Judgments Act Rate[5] ([91] to [94]).

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5 In fact, between 1883 and 1971 the Judgments Act rate *was* 4%.

(3) The subsequent White Paper adopted the Cork Committee's recommendation, that the surplus should be used "*to pay on a pro rata basis post-insolvency interest to all creditors, whether or not interest was previously reserved on their debts, at a minimum rate equivalent to that applicable at the date of the relevant order to judgment debts*", but with one change, being that "*if a higher contractual rate applies to the debt, post-insolvency interest will be chargeable at that rate*."[6] ([95]).

(4) Accordingly, the White Paper recommendation, which became sub-rule (9), was limited to adopting a higher contractual *rate* as the rate at which Statutory Interest would be paid *pro rata* under sub-rule (7), but did not otherwise import a remission to contractual rights generally in respect of interest or otherwise impact upon the requirements of sub-rule (7) that the surplus be utilised (i) to pay interest, not principal, (ii) on the amount of the proved debt, which had by now been paid, and (iii) only in respect of the period up to the date of payment of final dividend.

20. In any event, the SCG's argument based on sub-rule (9) would result in *BvM* being applied only to those creditors with interest bearing debts. This does not work for the additional reason that it would result in the period for which debts were outstanding under sub-rule (7) being different for those creditors with, and those without, a contractual right to interest. Moreover, that would be achieved by reason of the operation of sub-rule (9), whereas it is sub-rule (7) that defines the period for which interest is payable, the only purpose of sub-rule (9) being to identify the *rate* at which interest is payable.

The SCG's four main points

21. The SCG (Skel/9) contends that the Judge erred in four respects: (i) he gave insufficient weight to the pre-1986 law; (ii) he was wrong to conclude that the language of Rule 2.88 was inconsistent with *BvM*; (iii) his reliance on pre-legislative materials was

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6 See "*A Revised Framework for Insolvency Law*", Feb 1984 (the "White Paper"), at [88].

flawed; and (iv) he gave insufficient weight to fundamental principles and policy. The second of these is dealt with above at paragraphs 10-20. The remaining three are considered in turn below.

Pre-1986 law (SCG Skel/23-26)

22. The SCG complains that the Judge ignored authorities which considered the state of the pre-1986 law, as identifying in particular the mischief that the 1986 Act was intended to cure. It is wrong to do so for two main reasons.

23. First, the Judge clearly did have regard to (and made extensive reference to) the pre-1986 law. He did so for the purposes of establishing: (i) there was a diversion of approach pre-1986 between bankruptcy and liquidation; (ii) the position in bankruptcy prior to 1986 (where *BvM* had not in fact been applied since at least 1883) involved no remission to contractual rights, and did not permit of the application of *BvM*; and (iii) the 1986 Act adopted the position in bankruptcy, not liquidation. His conclusion and reasoning on these points is sound.

24. Second, the SCG's contention (at SCG Skel/25) that Rule 2.88 should be construed so as to continue to give effect to "*equitable principles*" is irrelevant, given that the SCG's attempt to elevate *BvM* to a general equitable principle as to how interest payable from an insolvency surplus is calculated is fundamentally flawed (see above at paragraphs 8-9).

Pre-legislative materials (SCG Skel/34-40)

25. The SCG's submissions under this heading are flawed for the following reasons.

26. First, it repeatedly misconstrues Wentworth's position as being that the 1986 Act and Rules "*repealed*" or "*abolished*" the approach in *BvM*. On the contrary, Wentworth's position (accepted by the Judge) is that since *BvM* does no more than preserve such right of appropriation which a creditor otherwise had, it simply has no application to a

statutory rule for payment of interest that does not remit creditors to their contractual rights. The one thing that the pre-legislative materials (the Cork Report, and the White Paper) certainly recommended was that the pre-1986 position in liquidation, which involved a remission to such contractual rights as creditors had, if any, was to be rejected in favour of a universal right to interest from a surplus, which was not dependent on the creditor's debt being interest bearing.

27. Second, the correct interpretation of the 1883 Bankruptcy Act (as the Judge held) is that the *only* right to interest referable to the period after the commencement of the bankruptcy was the right to have the surplus applied in payment of a flat rate of 4% on the proved debts of all creditors, irrespective of whether their debts were interest bearing. In particular (with references to the Judgment):

(1) S.40(5) of the 1883 Act is the *only* provision in the 1883 Act which permitted interest to be payable in respect of any period after the commencement of the bankruptcy ([53] & [55]).

(2) S.65 of the 1883 Act – which entitled the bankrupt to any surplus remaining after payment in full of his creditors, "*with interest, as by this Act provided*" – did not create any additional entitlement to interest (e.g. a reversion to such contractual right that was not satisfied by payment of interest under s.40(5)), but was solely a reference back to interest payable under s.40(5) ([140] to [141]).[7]

(3) The combination of the fact that the bankrupt was (1) discharged from his bankruptcy debts and (2) entitled to the surplus remaining after the payment of interest under s.40(5) left no room for any remission to any pre-existing contractual or other right to interest that was not satisfied from payment made under s.40(5).

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[7] Similarly, paragraph 18 of Schedule 2 to the 1883 Act (replicated in Schedule 2 to the 1914 Act), in the context of the rights of secured creditors, reiterates that "*a creditor shall in no case receive more than twenty shillings in the pound, and interest as provided by this Act*".

(4) The summary of the existing position in bankruptcy, at paragraph 1318 of the Cork Report, was therefore accurate ([91] & [139]).

(5) To the extent that any case had considered the point, it was consistent with the conclusion that the 1883 Act (and the 1914 Act, where the provisions were materially similar) did not permit any right to interest referable to the period after commencement of the bankruptcy except under s.40(5) of the 1883 Act (s.33(8) of the 1914 Act): see *Re Baughan* [1947] 1 Ch 313, 322 & 325-327 (creditors' claims were treated as being fully "*satisfied*", for the purposes of considering when a right under a marriage settlement, postponed by s.42(2) of the 1914 Act, became payable, once the proved debt and statutory interest under s.33(8) at 4% was paid on them).

28. Accordingly, the Judge was right to conclude that *BvM* had not applied in relation to the statutory right to interest under the Bankruptcy Acts since 1883.

29. Third, the absence of pre-legislative materials at the time of 1883 Act suggesting it was intended to "*abolish*" or "*disapply*" *BvM* is irrelevant: s.40(5) and s.65 of the 1883 Act unambiguously provided a single method for compensating creditors for the time taken to administer the bankruptcy, being a flat rate of 4% on the debts proved if and when a surplus emerges. This was a deliberate change from the pre-existing position,[8] where the surplus was used first to pay interest to those creditors with a contractual or other right to it, and only after that was anything remaining used to pay interest at 4% to all other creditors. The legislative decision to eschew a remission to contractual rights is clear. The fact that there is no pre-legislative material which refers to the fact that one of the facets of a creditors' contractual rights, to which they were no longer to be remitted, was the ability to appropriate payments towards interest/principal is irrelevant, given that the intention to remove the remission to contractual rights altogether is clear from the legislation itself. On the SCG's case, the 1883 Act still would have effected an important change, namely to remove the priority enjoyed under s.132 of the 1825 Act (and its successors) enjoyed by creditors with interest bearing

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[8] Immediately prior to the 1883 Act, the relevant provision was in the same terms as s.132 of the 1825 Act: see [52] of the Judgment.

debts over those entitled only to 4%, yet there is also no pre-legislative material which referred to such a change.

30. Fourth, the SCG's reliance on *Whittingstall v Grover* (1886) 55 LT 213 (a case concerning the administration of a testamentary estate) is irrelevant. The context of that case was wholly different such that it provides no support for the SCG's contention that there is a general equitable principle applicable to the calculation of interest from an insolvent estate, for the reasons explained by the Judge at [108] to [114]. In particular, the case proceeded on the basis that a decree for administration takes effect as an actual *judgment*, upon which interest was actually accruing, and that this (as stated by Lord Romilly MR in *Herefordshire Banking Company* (1867) LR 4 Eq 250, 252-253, citing Lord Westbury in *Hadfield's Patent Cask and Package Co* (1863) 3 De GJ & S, 603) underlies the difference in approach between insolvent estates and administration of testamentary estates.

31. Fifth, the SCG's contention (at SCG Skel/40) that the Judge did not consider the effect of the White Paper (which led to the introduction of Rule 2.88(9), permitting a creditor to claim Statutory Interest at a higher rate if its rights apart from administration included a right to interest at such a rate) is also wrong. There is no doubt that the Judge had in mind the White Paper: he referred to it at [95], noting that it modified the approach advocated in the Cork Report, by permitting Statutory Interest to be chargeable at a rate higher than the Judgments Act Rate, to reflect a higher contractual rate to which the creditor had been entitled. He also correctly concluded (at [136]) that Rule 2.88(9) did no more than specify the *rate* at which Statutory Interest is payable and did not import a general remission to contractual rights. The terms of the White Paper do not detract from the conclusion the Judge reached on the basis of the wording of sub-rule (9).

Principle and policy (SCG Skel/42-46)

32. The SCG's contention that the Judge's conclusion is unsupported by any sensible policy reason (SCG Skel/44) should be rejected. Rule 2.88 represents a clear policy choice, as recommended by the Cork Report, to create a simplified, harmonised basis for compensating *all* creditors for the delay in administration of an insolvent estate (which affected all creditors equally), via a single statutory right applicable across all forms of

insolvency proceeding payable from such surplus as arose after paying all proved debts. Moreover, there was a very clear policy to *reject* the previous liquidation model, which had discriminated between creditors with, and those without, interest bearing debts.

33. It is beside the point to complain, as the SCG does, that this new right did not include a right which previously existed under statutory regimes based on a remission to contractual rights. The fact is that the statutory right to interest created by the 1986 Act involved substantive departures from the contractual rights of both the debtor and its creditors (in the four ways noted by the Judge at [162] in dealing with Issue 2A in the Judgment). Thus, for example, the debtor's estate is burdened with the cost of paying interest to *all* creditors, whether or not they had a right to interest and, conversely, those creditors who previously had no right to interest acquired such an entitlement for the first time. In those circumstances, it is irrelevant that a right to appropriate between interest/principal that some (but not all) creditors would have had in the absence of the insolvency is *not* incorporated into the statutory rule.

34. In any event, the SCG's reliance on the so-called "*fundamental*" principles does not withstand scrutiny. The principle that creditors "*should not be prejudiced*" (SCG Skel/43(2)) by the delay in paying their debts does no more than provide the foundation for the existence of a right to be compensated for that delay. It does not assist in construing the nature of the right in fact provided by the legislation.

35. As to the principle that "*creditors come first*" (SCG Skel/43(1)), this merely underpins the conclusion (which is uncontroversial) that when distributing assets from an insolvent estate in accordance with the priority 'waterfall' laid down by the legislation, the rights of creditors at each level of the waterfall must be fully satisfied before moving on to the next level, and so on down the waterfall until reaching ordinary equity at the bottom. It, too, provides no assistance in the construction of the rights that exist at each level of the waterfall.

36. Moreover, "*creditors come first*" or "*members come last*" (SCG Skel/10) are far too simplistic concepts to be of any use in construing the terms of Rule 2.88. In the modern world, there are potentially a number of levels in the waterfall below ordinary unsecured creditors (to whom by Rule 2.88 interest Statutory Interest is payable from a surplus

arising after paying their proved debts in full, before the surplus is used for any other purpose) before any question of distribution to members arises. Thus, there may be subordinated creditors, then creditors with non-provable claims, then creditors with some form of preferential equity, or hybrid debt/equity instruments, before reaching ordinary equity. In other words, the Judge's construction of rights at the level of the priority waterfall concerned with post-administration interest on proved debts stands to benefit not members, but others such as subordinated creditors, or those with non-provable claims, save only where it is certain that the surplus is so large that all such lower ranking claims will in any event be paid in full. The SCG's approach would, correspondingly, advantage some creditors at the expense of other creditors who cannot in any way be equated with the debtor or its shareholders.

37. Finally, while 'the debtor comes last' might have been an understandable driver for construing the Bankruptcy Acts as requiring creditors to be paid interest from any surplus before anything was paid to the debtor, in an age when (as Lord Hardwicke LC commented in *Bromley v Goodere* (1743) 1 Atk 75, cited by the Judge at [47]) "*All bankrupts are considered in some degree as offenders*", it loses any force as a driver for construing Rule 2.88, in circumstances where the various creditors and members are all alike *investors* in the company, the difference between them being merely the measure of risk, and thus position in the priority waterfall, they are prepared to accept.

38. The contention (SCG Skel/45) that *BvM* should apply to Rule 2.88 because creditors have been prevented by the moratorium from obtaining a judgment, to which they would have been entitled to apply the approach in *BvM*, should be rejected. Even if the rationale for adopting the Judgments Act Rate in the calculation of Statutory Interest is that creditors are prevented from obtaining their own judgment, it does not follow that all rights which a creditor would have had, in the event that it obtained judgment, should be incorporated into Rule 2.88, in the process overriding the wording of the Rule. In any event, a very substantial proportion of claims against an insolvent debtor will be relatively small, where such creditors would otherwise have obtained a County Court judgment, and it is expressly provided in relation to County Court judgments that any payments under it are appropriated first towards <u>principal</u> (i.e. the reverse of *BvM*): see the County Courts (Interest on Judgment Debts) Order 1991, paragraph 6(2).

Conclusion

39. The Judge was right to conclude that the terms of Rule 2.88 preclude the interpretation advocated by the SCG and that the approach in *BvM* has no application to the payment of Statutory Interest under Rule 2.88.

SECTION 2: Declaration (viii) and SCG Skel/Section J – Compound Interest

40. At SCG Skel/47-49, the SCG contends that the Judge was wrong (at [26]) to conclude that interest does not compound (in favour of a creditor with a contractual right to compound interest) beyond the date of payment of the final dividend in respect of the proved debt.

41. The Judge was correct to reject the SCG's contention, because it directly conflicted with the requirement in Rule 2.88(7) that Statutory Interest be paid for the periods the proved debt was "*outstanding*". As noted above, the meaning of that word is informed by the earlier wording of the Rule, which relates it to the period between the commencement of administration and the dates upon which dividends are paid in respect of the proved debt. To permit a creditor with a debt bearing interest at a compound rate to continue to charge interest for the period after the proved debt had been paid in full would not only contradict the wording of the Rule, but would require the period identified in sub-rule (7) for which interest is payable to be interpreted differently depending on whether or not a creditor had a contractual right to compound interest. That is not permissible, given that it is sub-rule (7) that identifies the period during which interest is payable, whereas the scope of sub-rule (9) is limited to identifying the *rate* at which interest is payable under sub-rule (7).

SECTION 3: Declaration (x) and SCG Skel/Section K – Foreign Judgments Act Rate

42. The SCG contends (at SCG Skel/50) that where a creditor *obtains* a foreign judgment after the commencement of the administration, upon which it is entitled pursuant to the applicable foreign law to interest at more than the Judgments Act Rate, then such higher rate is "*the rate applicable to the debt apart from administration*" for the purposes of Rule 2.88(9).

43. This should be rejected, for the reasons advanced by Wentworth, and accepted by the Judge (at [179] to [181]). In particular:

(1) Sub-rule (9) requires the rate to be one "*applicable to the debt*", which can only mean the debt referred to in sub-rule (7), being the debt proved. A subsequently obtained judgment is not the proved debt, so the rate of interest which applies to that subsequently obtained "*judgment debt*" is not a rate of interest applicable to the proved debt.

(2) The "*rate applicable*" must be a rate which attached to the debt (whether actually or contingently) as at the date of the commencement of the administration. The importance of that date is reflected in the fact that it is the Judgments Act Rate *as of the date of the commencement of administration* that applies under Rule 2.88(7), even if the Judgments Act Rate were subsequently to change: see the final words of Rule 2.88(6), which reflects precisely the recommendation in the White Paper, paragraphs 88 & 89.

44. The contention that a rate of interest under a foreign judgment was a *contingent* right as at the commencement of the administration should be rejected. As the Judge noted, a subsequently obtained judgment crystallises the value of the already proved debt. The SCG's contention confuses the identification of the rate *applicable* to the proved debt (i.e. such rights in relation to interest as attached to the proved debt as at the date of administration) and the identification of the proved debt itself. While it is theoretically possible to contemplate a creditor proving, not its existing debt, but its contingent right to obtain a judgment debt in the future, it would be highly unusual for a creditor to do so, given that the chances of obtaining a judgment are greatly restricted in light of the moratorium on claims following the commencement of administration, and the estimation of the contingency would have to take account of the low probability of obtaining such a judgment. It is highly unlikely the draftsman had such a possibility in contemplation in the context of sub-rule (9). In short, the Judge's conclusion (at [182]) that "*the rather ethereal contingent right to which [the SCG] refers cannot on any basis, in my view, be described as the rate of interest applicable to the debt apart from administration*" is clearly correct.

45. The above reasoning also answers the SCG's contention that "*the rate applicable to the debt apart from administration*" even extends to a rate which would have applied to a future judgment which the creditor could have obtained, but in fact never did obtain. That contention is in addition to be rejected for the reasons the Judge gave at [177]).

SECTION 5: Declaration (iv) and SCG Skel/Section L – Compensation for Delay in Paying Statutory Interest

46. The SCG's arguments in this respect (Skel/52) should be rejected (as the Judge concluded at [166] to [167]):

(1) First, because there is not, and never has been, in applicable insolvency legislation, any right to interest *on interest*. If that had ever been parliament's intention, it would have required express provision. The SCG's reliance on the general proposition (from *Humber Ironworks*) that no person should be prejudiced by the accidental delay in administering assets in an insolvency proceeding is misplaced, since the legislature's response to that principle is to require Statutory Interest to be paid, pursuant to Rule 2.88, but no more.

(2) Second, because there is no obligation in Rule 2.88 (or elsewhere) to pay Statutory Interest on any particular date, and thus no ground for any claim in damages or otherwise for breach of the obligation to pay Statutory Interest on a certain date. The necessary premise for a claim for compensation for late payment (such as in *Sempra Metals*)[9] is thus missing.

(3) The SGC does not suggest the Joint Administrators have acted in breach of duty or that there is any culpable delay on the part of the Joint Administrators. Accordingly, the Judge was correct to find that there has been no breach of any obligation to pay Statutory Interest and there is no basis on which the creditors can seek damages for any loss said to be suffered as a result of the delay.

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9 *Sempra Metals Ltd v Inland Revenue Commissioners* [2008] 1 AC 561.

SECTION 6: Declarations (v), (xviii) and (xix) and SCG Skel/Section M – Non-provable Claims to Interest

47. The SCG contends that if and to the extent that a creditor's contractual right to interest is not satisfied by the payment of Statutory Interest under Rule 2.88 (for example by reference to *BvM* or the continuation of compounding interest, pursuant to contractual rights), then there is a non-provable claim for such shortfall.

48. The Judge rejected that claim at [160] to [164] for reasons which Wentworth contends were correct. The SCG's contention that none of the Judge's reasons are valid (SCG Skel/55) should be rejected. In addition to the points made in the Judgment:

(1) It is important to note that not only do the rights granted to creditors by Rule 2.88 cut across, or differ materially from, the contractual rights of certain of the creditors, but also that the obligations imposed on the debtor company, as regards the collective body of its creditors, are substantially different from its obligations prior to and apart from the administration. To allow a claim for the shortfall between the full panoply of contractual rights to interest (including that it be calculated on the basis in *BvM* or that compounding continues after payment of the final dividend) and the total amount of Statutory Interest received would increase the overall burden of the insolvent debtor, as against the general body of creditors, beyond the aggregate of its prior contractual obligations.

(2) In addition to the point noted by the Judge that the rights granted by Rule 2.88 are entirely new in the context of corporate insolvency, and reflect a positive decision to discard the pre-1986 approach based on a remission to contractual rights, the conclusion that Rule 2.88 does not leave room for an additional, second-round of non-provable claims, it is important to note that this was very clearly the position pertaining in bankruptcy prior to 1986. As noted above:

(a) s.69 of the 1914 Act (reflecting s.65 of the 1883 Act) required the surplus, after payment of proved debts and "*interest, as by this Act provided*", to be paid to the bankrupt;

(b) the only interest "*as by this Act provided*" was a flat rate of 4% on all proved debts, there being no provision either reflecting, or involving a remission to, contractual rights of creditors; and

(c) accordingly, there was no 'gap' between the surplus being used to pay Statutory Interest at 4% and the remainder being returned to the bankrupt (who was otherwise released from bankruptcy debts) and thus no possibility of any non-provable claim in respect of interest.

(3) Finally, the requirement that the surplus be used to pay interest, before being used for "any purpose" supports the Judge's conclusion. In context, "any purpose" means "any purpose *other than the payment of interest pursuant to Rule 2.88*". The purpose of Statutory Interest is to compensate creditors for the delay in payment of dividends. It would be highly surprising if the draftsman intended by "*any [other] purpose*" to encompass a payment for the very same purpose (compensation for delay in payment of proved debts) as that for which he has just made provision.

CONCLUSION

49. For the above reasons, the Court is respectfully invited to dismiss the SCG's appeal against Declarations (iii), (iv), (v), (viii), (x), (xviii) and (xix).

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APPENDIX I: THE RELEVANT DECLARATIONS

(1) Declaration (iii): the Judge declared that on a true construction of Rule 2.88(7), Statutory Interest is to be calculated on the basis of allocating dividends first to the reduction of the proved debt and then to the payment of Statutory Interest; and is not to be calculated on the basis of notionally allocating dividends first to the payment of Statutory Interest and then in reduction of the proved debt.

(2) Declaration (iv): the Judge declared that a creditor entitled to Statutory Interest is not entitled to any further interest or damages or any form of compensation in respect of the time taken for Statutory Interest to be paid.

(3) Declaration (v): the Judge declared that if and to the extent that Statutory Interest paid to a creditor on a proved debt under Rule 2.88(7) is less than the amount of interest to which that creditor would otherwise have been entitled in respect of that debt, the creditor does not have a non-provable claim for the difference.

(4) Declaration (viii): the Judge declared that where Statutory Interest is payable at a "*rate applicable to the debt apart from the administration*" and such rate is a compounding rate, accrued Statutory Interest does not continue to compound following payment in full of the proved debt through dividends.

(5) Declaration (x): the Judge declared that the words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) include a foreign judgment rate of interest applicable to a foreign judgment obtained prior to the date of administration but do not include (i) a foreign judgment rate of interest applicable to a foreign judgment obtained after the date of administration; or (ii) a foreign judgment rate of interest which would have become applicable to the debt if the creditor had obtained a foreign judgment (when it did not in fact do so).

(6) Declaration (xviii): the Judge declared that where a creditor with a claim originally denominated in a foreign currency receives Statutory Interest on a

Sterling admitted claim at the Judgments Act Rate and such Statutory Interest is less than the amount of interest at the Judgments Act Rate which the creditor would have received on his claim in the original foreign currency, the creditor has no non-provable claim in respect of the difference (without prejudice to any non-provable claim to interest that such creditor may have pursuant to Declaration (vi)).

(7) Declaration (xix): the Judge declared that where a creditor with a claim originally denominated in a foreign currency receives Statutory Interest on a Sterling admitted claim at the "*rate applicable to the debt apart from the administration*" and such Statutory Interest is less than the amount of contractual interest which the creditor would have received on his claim in the original foreign currency, the creditor has no non-provable claim for the difference (without prejudice to any non-provable claim to interest that such creditor may have pursuant to Declaration (vi)).