IN THE COURT OF APPEAL **Case No: 2015 /3764**

ON APPEAL FROM THE HIGH COURT

CHANCERY DIVISION

DAVID RICHARDS J

[2015] EWHC 2269 (Ch)

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N

(1) BURLINGTON LOAN MANAGEMENT LIMITED

(2) CVI GVF (LUX) MASTER S.A.R.L.

(3) HUTCHINSON INVESTORS, LLC

Appellants

- and -

(1) ANTONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) JULIAN GUY PARR

(THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION))

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

(7) YORK GLOBAL FINANCE BDH, LLC

Respondents

SENIOR CREDITOR GROUP'S SKELETON ARGUMENT FOR APPEAL

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A. INTRODUCTION

1. When LBIE entered administration on 15 September 2008 it was thought to be insolvent. In November 2009 the Administrators were given permission to make a distribution to its unsecured creditors and, from November 2012, paid a number of interim dividends on admitted claims. In the event, by April 2014 dividends amounting to 100% by value of the principal amounts in sterling of proved and admitted claims had been paid.

2. The Administrators have been left with a surplus presently estimated to be between £6.2 and £7.7 billion. In accordance with the statutory scheme of priority in an insolvency, that surplus is now to be applied first in payment of post-insolvency interest and then in payment of any non-provable liabilities. Only after payment in full of such liabilities can any balance remaining be distributed to subordinated creditors and ultimately to the shareholders of LBIE.

3. This appeal concerns the nature and extent of creditors' rights in an administration to payment of post-insolvency interest out of the surplus, either pursuant to rules 2.88(7) to (9) of the Insolvency Rules 1986 or as a non-provable claim.

4. The main issue on the appeal is whether, given the existence of a surplus, creditors are entitled to interest on their claims, calculated in the ordinary way, in accordance with the principle in *Bower v. Marris* (1841) Cr & P 351, 41 ER 525. That principle is a general equitable principle of justice and convenience, reflecting commercial common sense and business practice, which is applicable in the administration of an apparently insolvent estate which ultimately proves to be solvent. It provides that, in these circumstances, interest is to be calculated on the basis that any dividends which were previously made in respect of principal are regarded as having been made on account and notionally treated as having been paid first in respect of interest and then in respect of principal.

5. The effect of applying the principle in *Bower v. Marris* is to ensure that, in the event of a surplus, payments on account have the same effect in an insolvency proceeding as they would in practice have had if debtor had not become insolvent. Absent insolvency, creditors can ensure that any payments are, in the ordinary way, applied first to interest and then to principal. The principle in *Bower v. Marris* ensures that a debtor who turns out to be solvent is not in a better position than he would have been in had he not filed for insolvency, and creditors are not in a worse position.

6. The principle in *Bower v. Marris* was therefore unsurprisingly applied in corporate insolvency, in the event of a surplus, at all times between 1869 and the introduction of the Insolvency Act 1986. It is consistent with fundamental principles and policies of company and insolvency law. It ensures that creditors are not unfairly prejudiced by the time taken to distribute the assets, and that their claims are satisfied in full before any distributions are made to shareholders.

7. The application of this principle is of great economic significance in LBIE's administration. If the principle in *Bower v. Marris* is not applied, and unsecured creditors do not receive any other form of compensation for delay in payment of statutory interest:

    (1) Creditors will generally receive an effective simple interest rate significantly lower than that to which they would otherwise be entitled, or the rules envisage.

    (2) Some £1.3 billion of the surplus that would otherwise be paid to unsecured creditors in respect of interest will instead be distributed to the benefit of LBIE's subordinated creditors and shareholders.

    (3) Every further month that distributions are delayed leads to unsecured creditors being deprived of an additional c.£35 million. By contrast, any value generated to LBIE from delay in distributing the more than £5 billion in cash held by it will accrue to the ultimate benefit of its subordinated creditors and shareholders.

8. The learned Judge held, however, that the principle in *Bower v. Marris* does not apply in the administration of LBIE because it has been repealed by the 1986 Act and Rules. He held that the effect of the provisions providing for post-insolvency interest in the Insolvency Act and Rules swept away creditors' entitlement to have such interest in an insolvency calculated in accordance with the principle in *Bower v. Marris*. He also held that creditors whose underlying rights to interest have not been satisfied in full are not entitled to a non-provable claim for the shortfall before the surplus is distributed to shareholders, because rules 2.88(7) to (9) are also an exhaustive code the effect of which is to extinguish or render unenforceable any other rights to interest.

9. The Senior Creditor Group contends that the Judge was wrong to reach these conclusions and that he erred in four main respects. His approach to construing rules 2.88(7) to (9) gave insufficient weight to the state of the law prior to 1986. He was wrong to have concluded that the language of rules 2.88(7) to (9) was inconsistent with

the application of the principle in *Bower v. Marris*. His reliance on the pre-legislative materials, including the report of the Cork Committee, was flawed, as those materials contain no suggestion that the principle was to be abolished. Finally, he gave insufficient weight to the need the construe the statutory scheme in accordance with fundamental principles and policies of company and insolvency law and with the equitable principles underlying *Bower v. Marris*.

10. The consequences of the Judge's conclusions are striking, and contrary to equity and to fundamental principles and policies of company and insolvency law. If correct, the introduction of the Insolvency Act 1986 in this regard has breached the fundamental principle of company and insolvency law that members come last, and overturned the effect of an established equitable principle which had been consistently applied since at least 1743. Creditors who had an express right to appropriate any payments that they received from the debtor first to interest and then to principal have had such rights extinguished. As a result, such creditors will not receive the full amount of interest to which they are entitled and which they would have received had the company not gone into administration and will have no entitlement to compensation for that shortfall. A creditor who is entitled to the Judgments Act rate of 8%, because he was prevented from obtaining a judgment by the statutory moratorium on claims, will instead receive interest at an effective simple rate which is much lower than that rate. These injustices will happen for reasons which are unsupported by the need to fulfil any policy requirement, and cannot be justified. They demonstrate that the Judge's decision cannot be correct in respect of the declarations now appealed by the Senior Creditor Group.

B. THE BASIC FEATURES OF THE INSOLVENCY REGIME

11. The statutory regime which applies in the event of a surplus, and which requires that surplus to be applied in payment of interest and non-provable claims before any balance that remains is distributed to shareholders, needs to be construed in the context of the 1986 Act as a whole, having regard to the previous state of the law and fundamental principles and policies of company and insolvency law.

12. The fundamental features of a liquidation or distributing administration can for present purposes be summarised as follows. For convenience reference is made to liquidation or insolvency, but the same applies to a distributing administration:

(1) A liquidation is a process of collective enforcement of debts. It is concerned with distributing the assets of a company in satisfaction of its debts.

(2) To enable the company's assets to be distributed *pari passu* in satisfaction of debts, provable claims need to be ascertained and valued by reference to a common date. As a result certain claims, such as claims for interest in respect of the period after the commencement of the insolvency or claims based on foreign exchange movements after that date, are non-provable. It is also necessary for there to be a cut-off date for claims, such that any claims which only come into existence after the commencement of the insolvency are not provable.

(3) If there is a surplus, after all provable debts have been paid in full, it is applied first in payment of post-insolvency interest and then in discharge of any remaining liabilities which exist at the date of distribution and which were, for whatever reason, non-provable.

(4) As with any process of enforcement, debts are discharged only to the extent that they are paid. In the case of corporate insolvency, and unlike in bankruptcy, there is no statutory provision for discharge. Subject to certain limited and specific exceptions which are required to enable the insolvency process to be concluded within a reasonable period, the process leaves the legal rights of creditors unaffected, save to the extent of actual payment. If such liabilities have not been satisfied in full, whether provable or non-provable, the company remains liable but, when all the assets have been distributed, there is nothing more against which the liability can be enforced.

(5) If, but only if, there is a surplus after all debts and existing non-provable liabilities have been satisfied in full, it is to be distributed amongst the company's shareholders.

See generally e.g. *Re Nortel GmbH* [2013] UKSC 52 at [34] and [39]; *Wight v. Eckhardt Marine GmbH* [2004] 1 AC 147 at [20]-[35] and *Waterfall I* [2015] EWCA Civ 485 at [138]-[146] and [248]-[252]. The position has been essentially the same since the start of corporate insolvency; see *Oakes v. Turquand* (1867) LR 2 HL 325 at 362-365[1].

1 See also, more specifically in relation to the points in the sub-paragraphs: *Re Humber Ironworks and Shipbuilding Company* (1869) LR 4 Ch App 643 at 645-647; *Re W.W. Duncan & Co* [1905] 1 Ch 307

C. THE PRINCIPLE IN BOWER v MARRIS

13. The principle in *Bower v. Marris* provides a method of calculating the amount of interest which a creditor is entitled to receive in the event that there is a surplus after payment of debts proved. It has been held to apply not merely in the distribution of a surplus in an insolvency, but also to the administration of deceased estates, cases of mortgages, bonds and other securities, and wills and probate cases concerning the rights of a legatee to interest on his legacy.

14. The principle reflects the fact that the ordinary and, from the creditor's perspective, generally commercially sensible approach, is to apply any payment on account first to a non-interest bearing debt (i.e. accrued interest) and then to an interest bearing debt (i.e. principal). It is intended to address the potential effect of the fact that, when a debtor is apparently unable to pay the principal in full, dividend payments are required to be made in respect of principal and not post-insolvency interest so as to ensure that the assets of the insolvent debtor are distributed *pari passu* amongst its creditors. Where it subsequently turns out that the debtor is actually able to pay the principal in full, the principle operates by treating such dividend payments as having been made generally on account and calculating the amount of interest payable by notionally treating the dividends as having been paid in respect of interest rather than principal.

15. The position was explained in the context of corporate insolvency by Selwyn LJ in *Re Humber Ironworks and Shipbuilding Co, Warrant Finance Company's Case* (1869) LR 4 Ch App 643 at 645:

> "*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, inasmuch 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; that is, in the manner pointed out in* Bower v. Marris, *by treating the dividends as ordinary payments on account, and applying each dividend, in the first place to the payment of interest due at the date of such dividend, and the surplus (if any) to the reduction of principal. This disposes of the question where there is a surplus, as to which there is no doubt or difficulty.*"

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at 315; *Re British American Continental Bank* [1922] 2 Ch 575 at 582; *Re Fine Industrial Commodities Ltd* [1956] 1 Ch 256 at 262-263; *Re Dynamics Corporation of America* [1976] 1 WLR 757 at 761-764; *Re R-R Realisations Ltd* [1980] 1WLR 805 at 811-812; *Re Lines Bros (No.1)* [1983] Ch 1 at 16-19; *Re T&N Ltd* [2005] EWHC 2870 at [106]-[107]; *Financial Services Compensation Scheme Ltd v. Larnell (Insurance) Ltd* [2006] QB 808 at 818; *Cambridge Corpn v. Unsecured Creditors* [2006] UKPC 26 at [14]; *Parmalat Capital Finance Ltd v. Food Holdings Ltd* [2008] UKPC 23 at [8]; *Re Danka Business Systems plc* [2013] EWCA Civ 92 at [24]-[38].

16. The principle does not depend on the rules of appropriation. As was emphasised by Lord Cottenham in *Bower v. Marris* itself, the doctrine of appropriation, being based on intention, express or implied, is irrelevant. The principle is a principle of equity which operates for the purpose of calculating interest in circumstances where there cannot have been any appropriation because the payments were made by process of law. Nor does the principle depend on the concept of remission to contractual rights. Although the principle has, from time to time, been explained in this way, such language merely reflects the fact that in such circumstances its application brings about the same result as would occur outside of insolvency where the debtor makes payments generally on account.

17. The principle in *Bower v. Marris* has consistently been applied in insolvency proceedings in relation to the calculation of interest to be paid in the event of a surplus. It is common ground that the principle applied in corporate insolvency between 1869 and 1986. It was first held to apply in corporate insolvency in the series of celebrated cases in 1869 and 1870 involving the liquidations of the Humber Ironworks and Shipbuilding Company and the Joint Stock Discount Company and its continued application was recognised as recently as *Re Lines Brothers* in 1984. It is also common ground that it applied in bankruptcy between 1743 and at least 1883, although the parties have been unable to find any reported bankruptcy authority dealing with the principle after that date. Prior to the present decision by the learned Judge, there is no reported decision in England, whether in relation to corporate insolvency or bankruptcy, which rejected its application. The principle has also been repeatedly referred to and held to apply in the principal common law jurisdictions, including Australia, Canada, Scotland, Ireland, Hong Kong and the United States[2]. In *Attorney General of Canada v Confederation Trust* (2003) 65 OR (3d) 519 at [29], Blair RSJ held that the introduction in Canada of a statutory interest rate of 5% per annum on claims in an insolvency (using language similar to rule 2.88) did not "*alter the traditional rule in insolvency situations that dividends are to be applied first to payment of interest and then to payment of principal*". No common law jurisdiction has ever rejected the principle and all that have considered it have adopted it as reflecting the effect of their statutory insolvency scheme.

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2 See, for example: *Re Langstaff* [1851] OJ No 238; *Gourley v. Watson* (1900) 2 Ct Session (5th series) 761; *Ohio Savings Bank & Trust Co v. Willys Corporation* (1925) 8 F 2d 463; *Mackenzie v. Rees* (1941) 65 CLR 1; *Re Hibernian Transport Companies Ltd* [1991] 1 IR 271 and [1994] IRLM 48; *Midland Montagu Australia Ltd v. Harkness* (1994) 14 ASCR 318; *AG of Canada v. Confederation Trust Company* (2003) 65 OR (3d) 519; *Re Tahore Holdings Pty Ltd*; [2004] NSWSC 397; *Gerah Imports Pty Ltd v. Duke Group Ltd* [2004] SASC 178; *Re Peregrine Investments Holdings Ltd* [2008] HKC 606; *Canada (Attorney General) v. Reliance Insurance Company* [2009] OJ No 3037 at 62-63.

D. THE JUDGMENT

18. The learned Judge held that "*an application of the principle in Bower v. Marris is incompatible with the regime established by rule 2.88*" (at [128]) and ruled that statutory interest under rule 2.88(7) is calculated on the basis of allocating dividends first to reduction of principal and then to the payment of accrued statutory interest. This aspect of his decision concerned Issue 2 of the Application and is reflected in declaration (iii).

19. Having summarised the history and the Senior Creditor Group's submissions at some length at [38] to [127], the Judge set out his reasoning on this issue relatively shortly at [129] to [154]:

    (1) He dealt with the approach to construction at [129] to [133]. He referred to certain authorities which emphasise that the 1986 Act was in many respects a new code and that the new provisions are not to be construed as if the previous law still applied. He concluded that the primary focus must be on the terms of rules 2.88(7) to (9).

    (2) He dealt with the language of rules 2.88(7) to (9) at [134] to [137]. He concluded that the whole tenor of those rules is contrary to the application of the principle in *Bower v. Marris*.

    (3) He dealt with the pre-legislative materials at [138] to [143]. He concluded that the report of the Cork Committee, in particular paragraph 1383, was impossible to read as allowing for the application of the principle in *Bower v. Marris*.

    (4) He dealt with the conceptual basis of the principle in *Bower v. Marris* at [144] to [150]. He stated that it was derived from the legal rules as to appropriation of payments towards debts, and that such rules require that, at the date of payment, there are two outstanding debts payable by the debtor to the creditor. He concluded that the right to interest under rules 2.88(7) to (9) is a purely statutory entitlement, arising once there is a surplus and payable only out of that surplus, with the consequence that, prior to that surplus arising (and therefore at the date of payment of dividends), there was no interest outstanding.

(5) He concluded at [154] that the regime created by rule 2.88 leaves no room for the application of the principle in *Bower v. Marris* and that there is no warrant for any statutory adjustment to that rule.

20. The Senior Creditor Group contends that the Judge was wrong in each aspect of his reasoning and, as a result, wrongly concluded that the effect of the 1986 Act was to repeal the application of the principle in *Bower v. Marris*. This is dealt with in Sections E to I below.

21. The appeal also raises certain further subsidiary issues in relation to the construction of rules 2.88(7) to (9) which are reflected in declarations (iv), (viii) and (x). These issues are dealt with in Sections J to L below.

22. The learned Judge also held that rules 2.88(7) to (9) are an exhaustive code in respect of post-insolvency interest on provable debts, with the result that any creditor who receives less than the full amount of interest to which he is otherwise entitled does not have a non-provable claim for the shortfall. Despite the fact that such creditors' claims have not been satisfied in full, the surplus is to be distributed without paying such claims ultimately to the benefit of the shareholders of LBIE. This aspect of his decision is reflected in declarations (v), (xviii) and (xix). The Senior Creditor Group contends that the Judge was also wrong to have so held. This is dealt with in Section M below.

E. THE APPROACH TO INTERPRETATION

23. The learned Judge dealt with the proper approach to interpretation at [129] to [133]. Although it is correct that rules 2.88(7) to (9) are new rules, he failed to give sufficient weight to the prior law relating to payment of post-insolvency interest and to the continued relevance of the fundamental principles and policies which had informed the prior law.

24. At [130] and [131], the Judge referred to two authorities regarding the approach to construction of the 1986 legislative regime. However, in subsequent cases, the Court of Appeal made clear the continued relevance of the prior law to the interpretative task. In *Mirror Group Newspapers plc v Maxwell* [1993] Ch 1 at pages 20–22. Dillon LJ said:

> "*the primary task of the court is to construe the Insolvency Act 1986 as it stands, without regard to the legislative histories of its various components. See Farrell v Alexander [1977] AC 59.*

Even so, I have found it essential in the present case to consider the legislative antecedents of the 1986 Act, and the cases decided under them, partly to see how certain provisions of the 1986 Act can, in the light of previous decisions under the earlier statutes, be expected to fit together, but even more to see what the mischief was in the old law which the 1986 Act was intended to cure.

I would start with the assumption that the intention of Parliament, in bringing together the law of personal insolvency and the law as to corporate insolvency in a single major Act was, mutatis mutandis, to promote harmony between the two systems."

To similar effect, in *Waterfall I* [2015] BCC 431 Briggs LJ, when considering the effect of the Rules on currency conversion claims, referred to the law as it stood prior to 1986 and to the fact that the 1986 regime was not a complete code, as part of the background against which he held the Rules had to be interpreted, and that "*important judge-made priciples [continue] to be applicable*" (at [138] to [147]); see also Moore Bick LJ at [248].

25. It is also necessary to construe legislation in the field of insolvency so as to give effect to basic principles and sensible policy objectives; *Re Kaupthing Singer & Friedlander (No.2)* [2011] 1 BLB 12 per Etherton LJ at [32]-[33]; see also the reference to "*overarching principle*" in *Mills v. HSBC Trustee (CI) Ltd* [2012] 1 AC 804 at [1]. Equally, on ordinary principles of statutory construction and unless a contrary intention appears, rule 2.88 should be construed so as to continue to give effect to equitable principles; see Bennion on Statutory Interpretation (6th ed.) at sections 327 and 330 (pages 929 and 944).

26. The rules relating to the payment of post-insolvency interest were intended to harmonize the position as between corporate insolvency and bankruptcy. They need to be construed, taking into account that, as set out below, there is no aspect of them that had not previously applied either in corporate insolvency or in bankruptcy; that the fundamental principles and policies of company and insolvency law continue to apply just as much after as before the 1986 Act; and that the equitable considerations of fairness and justice which underlay the application of the principle in *Bower v. Marris* remain equally applicable.

F. THE LANGUAGE OF RULES 2.88(7) TO (9)

27. The learned Judge dealt with the language of rules 2.88(7) to (9) at [134] to [137]. He was wrong to conclude that the terms of those rules were contrary to the principle in *Bower v. Marris* and inconsistent with its application. The terms of those rules, in the form in force at the relevant time, are set out at [13].

28. The learned Judge's first point was that rule 2.88(7) is a direction to the administrator as to how any surplus "*remaining after payment of the debts proved*" is to be applied, and thus assumes, for the purposes of the rule, that the debts proved (i.e. principal) have been paid (at [134]). However, there is nothing new in this:

(1) Prior to 1986, in corporate insolvency the priority of post-insolvency interest was a matter of judge made law, not statutory rule. It was equally true, in the context of such judge made law, that the distribution of any surplus in payment of post-insolvency interest assumed that the debts proved had already been paid. However, this simply reflects the basic priority of proved debts, something which has been a fundamental aspect of the regime since the beginnings of corporate insolvency.

(2) The effect of rule 2.88(7) is, in this respect, also indistinguishable from section 132 of the Bankruptcy Act 1825 (and subsequent re-enactments) which codified similar judge made law which had, prior to that date, applied in bankruptcy in a similar way. Section 132 expressly stated that "*All creditors whose debts are now by law entitled to carry interest, in the event of a surplus, shall first receive interest on such debts … to be calculated from the date of the commission"*. This equally assumed that proved debts had been paid, as a surplus would, of course, only exist after this had occurred and provided for interest to be paid on such debts. Indeed, as the learned Judge himself said in relation to this section, "*the effect was that any surplus after payment of all proved debts should be applied first in paying interest …*" (at [51]).

(3) The purpose of rule 2.88(7) stating that "*any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest …"* was simply to codify, for both corporate insolvency and bankruptcy, the priority of post-insolvency interest after proved debts and before any other payments.

29. The Judge then continued by saying that the fact that the surplus is only applied in respect of post-insolvency interest after the debts proved have been paid is inconsistent with the operation of *Bower v. Marris*, as that principle produces the result that the proved debts are treated as if they have not been paid in full (at [134]). This reasoning is flawed:

(1) In reaching this conclusion the Judge effectively accepted the argument that, because the process of collective enforcement requires proved debts to be paid

first, any post-insolvency interest has to be calculated on the basis that dividend payments had discharged principal. Exactly the same argument was repeatedly raised and consistently rejected in the authorities, including in *Bower v. Marris* itself and in *Re Joint Stock Discounting Company., Warrant Finance Co's Case* (1869) LR 5 Ch App 86 at pages 87-88.

(2) That argument was rejected because it was held that the rules relating to the payment of proved debts are intended to ensure the *pari passu* distribution of the assets of an insolvent entity, and that it would be unjust and unfair for those rules (dealing with payments made by operation of law) to dictate creditors' entitlement to post-insolvency interest in the event that there is a surplus.

(3) The principle in *Bower v. Marris* addresses this issue by treating the dividends paid in respect of proved debts as having been general payments on account and by calculating the amount of interest which should be paid in the ordinary way, by notionally treating those dividend payments as if they had been applied first in respect of interest and then principal. It provides a means of calculating how much interest should be paid in the event that it turns out that the debtor is solvent. It does not mean that proved debts have not been paid in full before interest is paid. It is therefore consistent with the fact that rule 2.88(7) provides that, as a matter of priority and to ensure *pari passu* distribution, proved debts must be paid before post-insolvency interest is paid.

30. The learned Judge's second point relied on the fact that the direction to the administrators in rule 2.88(7) is to pay "*interest on those debts in respect of the periods during which they have been outstanding since the company entered administration*" (at [135]). He concluded that interest is not payable in respect of any period after the relevant distribution, whilst an application of the principle in *Bower v. Marris* would involve the payment of interest in respect of periods long after the distributions in question. This reasoning is also flawed:

(1) The purpose of these words is simply to confirm that, in the event of a surplus, creditors are entitled to interest in respect of the period after the company went into administration and that it will be necessary to take into account dividends received.

(2) Rule 2.88(7) does not specify *how*, in the event of a surplus, one calculates the periods for which the debts have been outstanding for the purpose of quantifying the interest due to a creditor, nor whether this is done by notionally treating dividends as general payments on account to be applied first in payment of interest and then principal or *vice versa*.

(3) A similar point was raised by Mervyn Davies J in *Re Lines Bros (No.2)* [1984] 1 Ch 438 as to whether interest could continue to run after the final dividend because, he suggested it might be said, no part of the proved debt was outstanding after that date. It was common ground on the part of all the very experienced counsel appearing that this was not correct and, following further submissions, Mervyn Davies J agreed.

31. The learned Judge's third point was that, although rule 2.88(9) refers to the fact that a creditor is entitled to interest at the higher of the Judgments Act rate and "*the rate applicable to the debt apart from the administration*", it was in his view clear that the interest was nevertheless not being paid pursuant to the contract (at [136]). The point does not support his conclusion that the principle in *Bower v. Marris* could not apply for two separate reasons:

(1) There is no reason why the principle cannot apply to a statutory right to interest: see paragraph 41(2) below.

(2) The purpose of including the reference to "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) was in any event to reflect and thereby effectively preserve creditors' entitlements to interest apart from the administration. In this respect, the rule codified the law as it existed in relation to corporate insolvency between 1869 and 1986. There is no difficulty in regarding a contractual debt for which a creditor has proved as outstanding save to the extent that dividend payments have actually discharged that debt in accordance with the terms of the contract. It is only in this way that the creditor will receive that interest which, as a result of the administration, they have lost. This is also consistent with the general rule that, subject to certain limited and specific exceptions, the insolvency process leaves the legal rights of creditors unaffected, save to the extent of actual payment.

32. The learned Judge concluded this part of his analysis by stating that not only does rule 2.88 contain no suggestion that the principle in *Bower v. Marris* should be applied but rather that in his view the whole tenor of the rule was contrary to it. This was because, he said, "*It is a direction to apply the surplus in the payment of interest. It is not a direction to apply the surplus towards an element of the principal debt through a process of re-allocation*" (at [137]). This point, which is similar to his first point, misunderstands the nature and effect of the principle. The principle results in the surplus being applied in paying interest. It is an interest calculation mechanism, not a principle that requires any actual re-allocation of payments. The rule is silent as to the method of calculating interest.

33. The fundamental flaw in the Judge's approach to the language of rule 2.88(7) is to treat the phrase "*any surplus remaining after payment of the debts proved*" not as a provision which was intended to codify the relative priority of proved debts and post-insolvency interest, but as requiring interest to be calculated on the basis that dividends had in fact repaid principal. This analysis ignores the fact that the purpose of such rules is simply to ensure the *pari passu* distribution of the debtor's assets. They do not require that creditors with an underlying right to interest do not have their claims satisfied in full, or that other creditors should not receive interest at an effective simple rate of 8%.

G. THE PRE-LEGISLATIVE MATERIALS

34. The learned Judge dealt with the pre-legislative materials at [138] to [143]. He wrongly concluded that the report of the Cork Committee, in particular paragraph 1383, was impossible to read as allowing for the application of the principle in *Bower v. Marris*.

35. The Cork Report considered post-insolvency interest at [1383] to [1386]. It identified a difference which then existed between bankruptcy and corporate insolvency in relation to post-insolvency interest. In bankruptcy the surplus was to be applied first in paying post-insolvency interest at 4% on all debts proved whether or not the creditor was otherwise entitled to interest. In contrast, in corporate insolvency the approach was to treat the company as no longer insolvent such that a creditor who had an underlying right to interest on the debt for which he had proved could recover the post-insolvency interest to which he was otherwise entitled as if there had been no winding up at all. The Report described this difference with bankruptcy as unfair and an anomaly, and concluded that interest should be payable in the same way in both regimes i.e. at the rate applicable to judgment debts (see [1395]).

36. The Judge recorded that the Cork Report contains no reference to *Bower v Marris* or positive statement in support of its continued application in all types of insolvency proceedings (at [138]). However:

(1) It can equally be said that there is no suggestion in the Cork Report that the principle in *Bower v. Marris*, which it is common ground had applied in corporate insolvency since 1869, should be repealed. Had the Cork Committee considered that the application of the equitable principle should be repealed, they would have made this clear and explained their reasoning.

(2) This is particularly so given that at [1308] the Cork Report referred to *Re Lines Brothers*. The principle in *Bower v. Marris* was already in play as a result of the liquidators' application in that case by the date of the Cork Report. Although it is not clear whether the reference in the Report is to the initial decision at first instance or in the Court of Appeal, *Bower v. Marris* was cited both before Slade J (125 SJ 426; 15 April 1981) and before the Court of Appeal at [1983] Ch 1, both of which decisions also referred to *Re Humber Ironworks and Shipbuilding*. David Graham QC, who was leading counsel for the liquidators in that case, was also a co-opted member of the Cork Committee.

37. The Judge concluded, however, that it was impossible to read [1383] of the Report as allowing for the principle in *Bower v. Marris* (at [138]). This is incorrect. In [1383] the Report stated "*Section 33(8) of the Act of 1914 provides that if, after all the proving creditors have been paid in full, the bankrupt's estate still has a surplus, it is to be applied first in paying interest from after the date of the receiving order at the rate of 4% per annum on all debts proved in the bankruptcy. Any balance then belongs to the bankrupt*". There is nothing inconsistent with this statement and with the application of the principle in *Bower v. Marris*. The mere fact that interest is to be payable at a rate of 4%, says nothing about whether, in the event of a partial payment, that payment is to be allocated first to interest and then to principal for the purpose of the interest calcualtion or *vice versa*. The two issues are distinct.

38. The Senior Creditor Group contends that the principle in *Bower v. Marris* was applicable in bankruptcy in the period before the 1986 Act. There is no authority to the contrary. It is common ground that it applied in bankruptcy between at least 1743 and 1883 and can be traced back to *Bromley v. Goodere* [1743] 1 Atk 75. Wentworth however submitted that

the principle had been abolished in bankruptcy on the introduction of the 1883 Act. The Judge accepted this submission (at [139] to [142]). He was incorrect to do so:

(1) The Judge concluded that, for broadly the same reasons as apply to the construction of rule 2.88, the principle was inconsistent with section 40(5) of the 1883 Act and section 33(8) of the 1914 Act (at [139]), although he expressed the view that rule 2.88 made the position clearer (at [143]). The Senior Creditor Group contends that, for similar reasons to those set out above in relation to rule 2.88, the language of section 40(5) of the 1883 Act is not inconsistent with the principle in *Bower v. Marris*.

(2) If the legislature had intended to disapply the principle in *Bower v. Marris* when enacting the 1883 Act it would have made this clear. The principle is a long-established equitable principle which is regarded as one of justice and fairness. In *Bower v. Marris* Lord Cottenham referred to a series of cases since 1743 that demonstrated that even by that date the principle was "*so well understood as not to be the subject of question*". The rule was confirmed to apply in corporate insolvency in the celebrated case of *Re Humber Ironworks and Shipbuilding Company* (1868-69) LR 4 Ch App 643. It would be surprising if, little more than 10 years after the principle had been held to apply in corporate insolvency as well as in bankruptcy, it was abolished without comment in bankruptcy.

(3) There is no indication in any of the pre-legislative materials that the introduction of the 1883 Act was intended to disapply the principle in *Bower v. Marris* or prejudice the ability of creditors to obtain satisfaction in full of their existing rights. Although the previous 1869 Act had been universally criticised, those criticisms were substantially directed towards the abolition of the role of the Official Assignee and for the ability of a bankrupt to enter into fraudulent compositions with his creditors without first being subject to independent examination. There was no reference to or criticism of the principle in *Bower v. Marris.*

(4) There is no reported English authority in bankruptcy, after 1883, which held that the principle in *Bower v. Marris* no longer applied in bankruptcy. The principle was applied in 1886, just three years after the introduction of the 1883 Act, by Chitty J in *Whittingstall v. Grover* (1886) 55 LT 213 in the context of the administration of a deceased's estate, without any reference to the principle have been abolished in

bankruptcy. It was assumed by the Court of Session in Scotland in *Gourlay v. Watson* (1900) 2 Ct Session (5^{th} Series) 761 at page 770 that the principle continued to applied to bankruptcy in England.

39. There is a separate issue as to whether in bankruptcy after 1883 a creditor was solely entitled to interest at 4% or whether he was also entitled to payment of his claim in full before any surplus was returned to the bankrupt. The Judge dealt with this issue at [139] and [140] where he concluded that the 1883 Act limited creditors to interest at 4%. This was also incorrect. It would have severely undermined creditors' existing rights contrary to fundamental principle and there is no indication in any pre-legislative materials that this is what the legislature intended.

40. In any event, whatever may have been the views of the Cork Committee, the approach eventually adopted by the legislature was different. The Government's White Paper, entitled a Revised Framework for Insolvency Law, was published in 1984. By this time the Court had considered the position in relation to post-insolvency interest in corporate insolvency and had confirmed in *Re Lines Bros (No.2)* [1984] 1 Ch 438 that the principle in *Bower v. Marris* applied. The White Paper accepted the recommendation in the Cork Report that all creditors should be entitled to interest, whether or not interest was previously reserved on their debts, at a rate equivalent to that applicable to judgment debts. However, the White Paper also stated at [88]-[89] that, if a higher contractual rate applied, post-insolvency interest would be chargeable at that rate. The effect of the White Paper was therefore to combine existing aspects of both bankruptcy and corporate insolvency. This dual approach was reflected in rule 2.88(9) which entitles creditors to the greater of the Judgment Act rate and the rate applicable to the debt apart from the administration. The Judge did not consider the effect of the White Paper in his discussion of the pre-legislative materials at [138] to [143]; although he previously referred to it at [95].

H. APPROPRIATION AND REVERSION TO RIGHTS

41. The learned Judge dealt with the basis of the principle in *Bower v. Marris* at [144] to [150]. He stated that it was derived from the legal rules as to appropriation of payments towards debts, and that such rules require that, at the date of payment, there are two outstanding debts payable by the debtor to the creditor (at [144]-[145]). He held that dividends cannot be appropriated between the proved debts and interest accruing under rule 2.88

because, at the date of such dividends, no interest is payable pursuant to rule 2.88 (at [149]). On this basis he concluded that *Bower v. Marris* could not be applied to the payment of interest under rule 2.88 (at [150]). The Judge was wrong so to conclude:

(1) The principle in *Bower v. Marris* is not dependent on the rules of appropriation. As was emphasised in *Bower v. Marris* itself, the doctrine of appropriation "*cannot have any place in the consideration of the present question*". The principle is a principle of equity which operates where there has been no appropriation because payments have been made by operation of law, in order to achieve fairness in the distribution of the fund. Nor does the principle depend on any concept of remission to contractual rights. Whilst many of the cases, not surprisingly given when they were decided, involve creditors with a contractual right to interest, its application is not limited to cases involving a contractual right to interest. Whilst in such cases the application of the principle can also be justified on the basis that it ensures creditors receive the interest to which they are contractually entitled, as the Judge himself recognised, the principle also operates in the context of judgments carrying interest (at [144]).

(2) The principle in *Bower v. Marris* has been held to apply in cases, analogous with the present case, where a statute provides for the payment of interest in the event of a surplus to a creditor who is not otherwise entitled to interest, despite the fact that on the Judge's analysis it could be said that such interest was not due at the time that the dividend was paid. The principle in *Bower v. Marris* was applied to the calculation of interest in such a situation by Chitty J in *Whittingstall v. Grover* (1886) 55 LT 213. The 46th Order of 1841 was made in recognition of the fact that a decree for the administration of a deceased's estate prevented creditors from obtaining a decree at law in circumstances where, had they been able to do so, they would be entitled to statutory interest under section 17 of the 1837 Act. The reason for that Order was analogous to the reason for the grant of the right to interest at the Judgments Act rate in rule 2.88(9). That case is therefore an example of the principle in *Bower v. Marris* being applied to a right to statutory interest even though, at the date of dividends, on the Judge's approach no interest had accrued due. The Judge was wrong to conclude to the contrary at [114]. The principle was also applied in such a situation by Blair RSJ sitting in the Ontario Supreme Court of Justice in *AG of Canada v. Confederation Trust* [2009] OJ No. 3037, in respect of

which the Judge accepted "*This decision and its reasoning clearly provides support for the submissions made on behalf of the [Senior Creditor Group] …*" (at [128]).

(3) The Judge's conclusion that the principle in *Bower v. Marris* cannot apply because "*the entitlement under rule 2.88 to interest is a purely statutory entitlement, arising once there is a surplus and payable only out of that surplus*" (at [149]; see also [112]) is artificial. There is, for example, no difficulty in regarding a creditor who has an existing contractual right to interest and who is entitled to interest under rule 2.88(9) at "*the rate applicable to the debt apart from the administration*" as having been entitled to interest which was due at the date of the dividend payments. That simply reflects his contractual rights. The mere fact that rule 2.88(9) confirms his entitlement to be paid such interest at the rate provided for by the creditor's underlying rights in the event of a surplus, cannot mean that it ceased to be due at the relevant time. This is particularly so given the general rule that the process of collective execution leaves the legal rights of creditors unaffected, save to the extent of actual payment.

(4) Nor is the position materially different in relation to a creditor who has no existing right to interest, but who is entitled to interest under rule 2.88(9) at the Judgments Act rate. The basic rationale for this provision is that it would be unjust for creditors not to be properly compensated for the delay in payment of their debts caused by the insolvency process. The commencement of the insolvency brings into force a moratorium on claims which prevents creditors from obtaining a judgment and a right to interest at the Judgment Act rate. To remedy this prejudice, rule 2.88(9) entitles all creditors to interest, in the event of a surplus, at the Judgment Act rate as if they had obtained a judgment. If, as the Judge accepted, interest on a judgment debt accrues due while it is outstanding and the principle in *Bower v. Marris* can apply in relation to interest on a judgment, there is no sensible policy reason why it should not equally be applicable to the right provided by rule 2.88(9) to interest at the Judgment Act rate as if one had a judgment. Indeed, section 132 of the Bankruptcy Act 1825 and subsequent re-enactments, in addition to providing that creditors were entitled to interest at the rate reserved or by law payable, provided that, after all such interest had been paid, all other creditors "*shall receive interest on their debts from the date of commission at the rate of £4 per centum*" and it never appears to have been suggested, in any of the reported bankruptcy authorities, that the principle in *Bower v. Marris* did not also apply to the calculation of such interest.

(5) Even if rules 2.88(7) to (9) are to be treated as a purely statutory right arising once there is a surplus and payable only out of that surplus, such right can be regarded, with hindsight, as having accrued on a day to day basis since the commencement of the insolvency process, albeit contingently on there being ultimately a surplus; see *Canada (AG) v. Confederation Trust Co* (2003) 65 OR (3d) 519 at [25]. The Judge was wrong to have rejected this alternative submission at [154].

I. PRINCIPLE AND POLICY

42. The learned Judge said little about either principle or policy when he came to explain why, in his view, an application of the principle in *Bower v. Marris* was incompatible with the regime established by rules 2.88(7) to (9) (at [128] to [154]). He stated that the purpose behind the introduction of the new regime for post-insolvency interest in all insolvency proceedings was to introduce a straightforward regime for the payment of such interest (at [152]). However, the desire for a straightforward regime does not explain why the principle in *Bower v. Marris*, which reflects the ordinary approach and which has been described as a rule of justice and convenience, should not be applicable.

43. More importantly, the Judge did not, when explaining why he concluded that the 1986 Act had rejected the application of the principle in *Bower v Marris*, expressly seek to check this conclusion in the light of fundamental principles and policies of company and insolvency law. In particular:

(1) It is a fundamental principle that creditors come first. The effect of the Judge's judgment is, however, that a creditor who has a contractual right to interest calculated on the basis that any payments are allocated first to interest and then to principal, will not receive under the rules the full amount of interest to which he is entitled, despite the fact that rule 2.88(9) expressly states that he is entitled to interest "*at the rate applicable to the debt apart from the administration*".

(2) It is a fundamental principle that in the event of a surplus creditors should not be prejudiced by the delay in paying their debts arising as a result of the insolvency process. Reflecting this, rule 2.88(9) entitles all creditors, in the event of a surplus, to interest at the Judgment Act rate of 8%, as if they had a judgment. The effect of the Judge's judgment is, however, that, although rule 2.88(9) entitles all creditors to

interest at the rate of 8%, they will not receive interest at an effective simple rate of 8% but only at a much lower rate.

44. There is no sensible policy reason for these consequences. The rules as to which debts are provable and which are not and which provide that the debtor's assets are to be applied first in respect of proved debts, are designed to ensure the *pari passu* distribution of assets amongst creditors. The rationale for such rules ceases to apply if and when proved debts have been paid in full leaving a surplus. Just as liabilities which were not provable because they only came into existence after the cut-off date must nevertheless be paid before any assets are distributed to shareholders, so too must creditors' rights in respect of post-insolvency interest be satisfied.

45. Nor did the Judge seek to check his conclusion in the light of the general considerations of justice and fairness which underlie the equitable principle in *Bower v. Marris*, which are just as applicable to a corporate insolvency after as they were before the introduction of the 1986 Act. Had he done so, he should have concluded that his construction has consequences which are neither just nor fair. Creditors have been prevented by the moratorium from obtaining judgment against LBIE and have been required instead to participate in a process of collective enforcement. They have had to wait to be paid dividends on their proved debts and they have been prevented from receiving any interest during the administration. They have lost the opportunity to use the money that was owed by LBIE in their business and continue to bear the risks caused by uncertainty over the extent and timing of the distribution of the assets. It is neither fair nor just in such circumstances to construe rules 2.88(7) to (9) in a way which prevents creditors from having the benefit of the equitable principle in *Bower v. Marris* and the full amount of interest to which they would otherwise have been entitled or which the rules intended them to receive.

46. In the absence of clear language indicating an intention by the legislature to disapply the principle in *Bower v. Marris*, rules 2.88(7) to (9) should be construed in a way that is consistent with its continued application.

J. COMPOUND INTEREST (Declaration (viii))

47. The learned Judge accepted that the concept of "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) refers not only to a numerical percentage rate of interest but

also to the mode of calculating the rate at which interest accrues, including compounding (at [20]-[25]; declaration (vii)). However, he also concluded that the language of rule 2.88(7) means that interest cannot continue to compound following the payment of dividends equal to the principal amount (at [26]; declaration (viii)). As a consequence, a creditor who is entitled to compound interest in accordance with rule 2.88 will receive significantly less interest than it is entitled to receive as a matter of underlying right absent the administration.

48. The Judge's interpretation of rule 2.88 was, in this regard, wrong:

(1) Where interest is payable at a compound rate, it is fundamental to the nature of compound interest that interest accrues on the entirety of the amount owed from time to time. Interest, once accrued, is treated as part of the principal such that it also bears interest.

(2) Since the word "*rate*" in rule 2.88(9) extends to all aspects of the calculation methodology which affect "*the rate at which the debt increases by the addition or accrual of interest*" (at [22]), it follows that the rule must also be capable of enabling interest to be calculated in the normal way where a compound rate is applicable; i.e. such that interest continues to accrue on the unpaid balance unless and until the entire sum has been paid in full.

(3) The policy and common sense reasons that led the Judge to conclude that the rate of interest extends to compound interest also lead to the conclusion that interest must be calculated in a way that gives full effect to that right to compound interest. Otherwise, to use the Judge's own language (at [24]), the rules produce an "*unprincipled middle ground*" that is "*neither the judgment rate nor the full contractual entitlement*".

(4) The language of rule 2.88(7) relied upon by the learned Judge (i.e. that the surplus shall be applied in paying interest on the relevant debts "*in respect of the periods during which they have been outstanding since the company entered administration*") does not require the contrary conclusion.

49. The Judge held that a creditor who is entitled to compound interest and who, as a result of his conclusion on rule 2.88, does not receive the full amount of interest to which he is

contractually entitled, also does not have a non-provable claim for the balance (at [26]). For the reasons set out in Section M below this is also incorrect.

K. FOREIGN JUDGMENTS ACT RATE (Declaration (x))

50. The learned Judge also held that the words "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) cannot include a rate of interest applicable to a foreign judgment which is obtained after the date of administration (at [171] to [183]; declaration (x)). He was wrong to do so:

(1) Where a creditor obtains a foreign judgment and a right to interest payable at the foreign judgment rate, that rate becomes "*the rate applicable to the debt apart from the administration*", being the counter-factual situation that rule 2.88(9) requires to be identified.

(2) On its true construction rule 2.88(9) captures such a rate. Such a construction reflects the language of the rule, which does not require or state that the rate must be a rate which was applicable on the date of administration. It reflects as far as possible the actual rights of the creditor. It avoids a rush to judgment pre-administration and the arbitrary distinctions that would otherwise arise between those who did and who did not obtain such a judgment. It is also consistent with the fact that creditors have always been entitled to have claims which only came into existence after the commencement of the insolvency satisfied in full before any distribution is made to shareholders.

(3) Alternatively, if the rate applicable to the debt apart from the administration is to be determined by reference to the existing rights of the creditor as at the commencement of the administration, it is sufficient if such a right is a contingent right in the sense described in *Re Nortel GmbH* [2014] AC 209.

51. If a creditor who does obtain a foreign judgment after the commencement of the insolvency is entitled for the purpose of rules 2.88(7) to (9) to interest at that foreign judgment act rate, the same analysis is capable of being applied (and ought to apply) to a creditor who was entitled to obtain a foreign judgment with a foreign judgment rate of interest, but did not in fact do so. Such a construction of rule 2.88(9) is consistent with the hypothetical scenario which that rule requires one to envisage, avoids a rush to post-

administration judgment, and provides proper and full compensation to the creditor at the rate that it would have been compensated at apart from the administration. It protects a creditor's bargained for rights to, for example, obtain a judgment from a New York court (and therefore interest in accordance with New York law).

L. COMPENSATION FOR DELAY IN PAYING STATUTORY INTEREST

52. On the learned Judge's interpretation of rules 2.88(7) to (9), and the post-insolvency interest regime generally, no creditor receives any interest or compensation for delay in respect of the time taken to make payment of statutory interest to LBIE's creditors (at [165] to [167]; and declaration (iv)). This is incorrect:

(1) There is no good reason or policy justification for creditors to suffer prejudice in this way, which has the effect of undermining their right to an effective simple rate of interest at the rate prescribed by rule 2.88. A creditor should be entitled to assert a claim for further interest or damages or compensation in respect of the time taken for such interest to be paid. Rules 2.88(7) to (9) should be interpreted in a manner which provides for such a right or which is consistent with a common law right to damages in respect of any prejudice suffered.

(2) Delay in the receipt of money, absent compensation, prejudices creditors in a manner that English law recognises can and should be compensated: *Sempra Metals Ltd v Inland Revenue Commissioners* [2008] 1 AC 561. It is also a general principle of insolvency law that no person should be prejudiced by the accidental delay which, in consequence of the steps necessary to administer assets in an insolvency proceeding, takes place in realising assets or distributing assets: *Re Humber Ironworks and Shipbuilding Company (no.1)* at 646; *Canada Deposit Insurance Corp v Canadian Commercial Bank* (1993) 21 CBR (3d) 12.

(3) Rule 2.88(7) provides that statutory interest becomes payable as soon as all proved debts have been paid or provided for in full. It is capable of being due, irrespective of whether there is a dispute as to how the surplus should be applied and irrespective of the fact that, pending resolution of that dispute, the office holder will not be in breach of duty for failing to distribute the surplus. Accordingly, creditors will have a right to damages for late payment of statutory interest.

M. NON-PROVABLE CLAIMS (declarations (v), (xviii) and (xix))

53. It is and has always been a fundamental principle of insolvency law that creditors' claims must be satisfied in full before any distribution can be made to the shareholders. It would be an extraordinary thing if the effect of the process is to prevent creditors from obtaining the interest to which they are entitled out of an estate able to pay it.

54. If and to the extent that, for some reason and contrary to the above, rules 2.88(7) to (9) cannot be interpreted in a manner which leads to the satisfaction of a creditor's underlying rights to interest in full, the conventional and principled analysis is that a non-provable claim for any shortfall will then exist, which will have to be satisfied in full before funds can be distributed to shareholders. This was ultimately the basis for the conclusion of the majority of the Court of Appeal in *Waterfall I* [2015] BCC 431 that creditors were entitled to payment in full of the non-provable balance of a claim denominated in a foreign currency before any sums were distributed to shareholders: see Briggs LJ at [139], [144]-[146], [154]-[156], [165]; and Moore-Bick LJ at [249]-[252]. As Moore-Bick LJ concluded at [252] when considering where the justice of the case lay in that instance, "*nor is there any reason in principle why any balance outstanding after all proved debts have been paid in full should not be the subject of an unprovable claim*".

55. None of the reasons given by the Judge (at [155] to [164]) for his conclusion that no such claim can exist because rule 2.88 constitutes an exclusive code which operates to extinguish any unsatisfied rights to post-insolvency interest are valid. He should have reached the opposite conclusion because neither the language of rule 2.88 nor its purpose justifies it being construed as extinguishing any underlying right or entitlement to interest which is not fully satisfied by virtue of rule 2.88(7):

(1) There is no other aspect of the insolvency code which has this anomalous and prejudicial effect on creditors' underlying rights, and there is no material distinction in this regard between creditors' rights to interest and other rights.

(2) The Judge wrongly accepted the submission that rules 2.88(7) to (9) "*cut across*" the contractual or other rights that creditors would otherwise have to payment of interest, such as to indicate that it was intended to be exhaustive (at [162]). None of the four matters identified by the Judge were inconsistent with, or cut across, the continuation of a creditor's underlying rights to interest or compensation for delay.

In broad terms, all either reflected creditors' existing rights or rights which a creditor could have obtained absent the insolvency but was prevented from doing so.

(3) There is no indication in any of the pre-legislative materials that the 1986 Act and Rules were intended to alter fundamental principles of insolvency law and extinguish creditors' underlying rights to interest if and to the extent not otherwise satisfied through the operation of the insolvency regime and permit the surplus to be distributed instead to shareholders. Such an outcome would be unjust.

56. The Judge should have concluded that a non-provable claim for any shortfall exists whenever the statutory scheme operates in a manner which does not satisfy a creditor's underlying rights to interest in full and should have rejected the submission that the effect of rules 2.88(7) to (9) was to extinguish such rights or condemn them to some form of legal black hole thereby providing a windfall to shareholders.

N. CONCLUSION

57. The Senior Creditor Group respectfully submits that, for the reasons summarised above, the appeal in respect of declarations (iii), (iv), (v), (viii), (x), (xviii) and (xix) should be allowed.

ROBIN DICKER Q.C.
RICHARD FISHER
HENRY PHILLIPS

1 February 2016

South Square
Gray's Inn

No: 2015/3764

<u>IN THE COURT OF APPEAL</u>
<u>ON APPEAL FROM THE HIGH COURT</u>
<u>CHANCERY DIVISION</u>
<u>DAVID RICHARDS J</u>
<u>[2015] EWHC 2269 (Ch)</u>

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

<u>WATERFALL II DIRECTIONS APPLICATION</u>

<u>SENIOR CREDITOR GROUP'S SKELETON ARGUMENT FOR APPEAL</u>

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