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Our Ref
163511-0001 CHWR

21 November 2017

Dear Sir / Madam

***Lomas and Ors v Burlington Loan Management Limited and Ors* [2017] EWCA CIV 1462 (*Waterfall II*) – application to the Supreme Court for permission to appeal**

1. This letter is sent on behalf of CVI GVF (Lux) Master Sarl, Hutchinson Investors LLC, Burlington Loan Management Limited and their relevant affiliates (the ***Senior Creditor Group***). It has been approved by Ropes & Gray International LLP and Morrison & Foerster LLP.

2. We enclose, by way of service, a copy of the Senior Creditor Group's application to the Supreme Court for permission to appeal the Court of Appeal's judgment in Waterfall II.

Yours faithfully

Freshfields Bruckhaus Deringer LLP

Freshfields Bruckhaus Deringer LLP

In the Supreme Court of the United Kingdom

Notice of appeal

(or application for permission to appeal)

On appeal from

The Court of Appeal (Civil Division) (England & Wales)

(1) Burlington Loan Management Limited
(2) CVI GVF (LUX) Master SARL
(3) Hutchinson Investors LLC ((1) to (3) "The Senior Creditor Group")
(4) Wentworth Sons Sub-Debt SARL
(5) York Global Finance BDH LLC

V

(1) Antony Victor Lomas; (2) Steven Anthony Pearson; (3) Paul David Copley; (4) Russell Downs; and (5) Julian Guy Parr (as the Joint Administrators of Lehman Brothers International (Europe) ("LBIE") (In Administration))

Appeal number: A3/2015/3753 and others

Date of filing: 21/NOV/2017
(D D M M M Y Y Y Y)

Appellant's solicitors

(1) Morrison & Foerster LLP
(2) Freshfields Bruckhaus Deringer LLP (lead solicitors for the Senior Creditor Group)
(3) Ropes & Gray LLP

Respondent's solicitors

(4) Kirkland & Ellis LLP
(5) Michelmores LLP
The Joint Administrators of Lehman Brothers International (Europe) (In Administration): Linklaters LLP

1. Appellant

Appellant's full name: The Senior Creditor Group

Original status:
- ☐ Claimant
- ☐ Defendant
- ☐ Petitioner
- ☑ Respondent
- ☐ Pursuer
- ☐ Defender

Solicitor

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How would you prefer us to communicate with you?
- ☐ DX
- ☑ Email
- ☐ Post
- ☐ Other *(please specify)*

Is the appellant in receipt of public funding/legal aid?
- ☐ Yes
- ☑ No

If Yes, please give the certificate number

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2. Respondent

Respondent's full name: The Joint Administrators of LBIE (In Administration) and continuation sheet A

Original status:
- [x] Claimant
- [ ] Defendant
- [ ] Petitioner
- [ ] Respondent
- [ ] Pursuer
- [ ] Defender

Solicitor

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- [ ] Other *(please specify)*

Is the respondent in receipt of public funding/legal aid?
- [ ] Yes
- [x] No

If Yes, please give the certificate number

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Email: daniel.bayfield@southsquare.com

Counsel

Name:

Address:

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Fax no.

DX no.

Postcode:

Email:

3. Decision being appealed

Name of Court: The Court of Appeal (Civil Division) (England & Wales)

Names of Judges:
Lady Justice Gloster (Vice President of the Court of Appeal, Civil Division)
Lord Justice Patten
Lord Briggs of Westbourne

Date of order/ interlocutor/decision: 24/OCT/2017
(D D / M M M / Y Y Y Y)

4. Permission to appeal

If you have permission to appeal complete **Part A** or complete **Part B** if you require permission to appeal.

PART A

Name of Court granting permission

Date permission granted

D D / M M M / Y Y Y Y

Conditions on which permission granted

PART B

☑ The appellant applies to the Supreme Court for permission to appeal.

5. Information about the decision being appealed

Please set out

- Narrative of the facts
- Statutory framework
- Chronology of proceedings
- Orders made in the Courts below
- Issues before the Court appealed from
- Treatment of issues by the Court appealed from
- Issues in the appeal

Please see continuation sheet B.

6. Grounds of appeal

Please see continuation sheet C.

Counsel's name or signature:

Robin Dicker QC and Lord Pannick QC

7. Other information about the appeal

Are you applying for an extension of time?

☐ Yes ☑ No

If Yes, please explain why

What order are you asking the Supreme Court to make?

Order being appealed ☐ set aside ☑ vary

Original order ☐ set aside ☐ restore ☑ vary

Does the appeal raise issues under the:

Human Rights Act 1998? ☑ Yes ☐ No

Are you seeking a declaration of incompatibility?

☐ Yes ☑ No

Are you challenging an act of a public authority?

☐ Yes ☑ No

If you have answered Yes to any of the questions above please give details below:

Insolvency Rules 1986 r.2.88(7) as interpreted by the Court of Appeal violates the rights of ordinary unsecured creditors under Art. 1 of the First Protocol of the ECHR. The Senior Creditor Group does not currently seek a declaration of incompatibility because the remedies under ss.3 and 6 of the HRA appear to be adequate, but it reserves the right to do so should it be suggested that s.4(4)(b) applies.

Court's devolution jurisdiction? ☐ Yes ☑ No

If Yes, please give details below:

Are you asking the Supreme Court to:

depart from one of its own decisions or from one made by the House of Lords?

☐ Yes ☑ No

If Yes, please give details below:

make a reference to the European Court of Justice of the European Communities?

☐ Yes ☑ No

If Yes, please give details below:

Will you or the respondent request an expedited hearing?

☐ Yes ☑ No

If Yes, please give details below:

8. Certificate of Service

Either complete this section or attach a separate certificate

The date on which this form was served on the

1st Respondent ☐☐/☐☐☐/☐☐☐☐ (D D / M M M / Y Y Y Y)

2nd Respondent ☐☐/☐☐☐/☐☐☐☐ (D D / M M M / Y Y Y Y)

I certify that this document was served on

by

by the following method

Signature

9. Other relevant information

Neutral citation of the judgment appealed against e.g. [2009] EWCA Civ 95

2017/EWCA CIV/1462

2015/EWHC 2270/(CH)

2015/EWHC 2269/(CH)

References to Law Report in which any relevant judgment is reported.

First instance - [2015] EWHC 2270 (Ch): [2015] EWHC 2270 (Ch); [2015] B.P.I.R. 1162

First instance - [2015] EWHC 2269 (Ch): [2015] EWHC 2269 (Ch); [2016] Bus. L.R. 17; [2016] B.C.C. 239; [2015] B.P.I.R. 1102

Subject matter catchwords for indexing.

Administration; contracts; contract terms; creditors' rights; debts; distribution; insolvency; interpretation; human rights; possessions; statutory interest

Please return your completed form to:

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Telephone: 020 7960 1991/1992 Fax: 020 7960 1901

email: registry@supremecourt.gsi.gov.uk

www.supremecourt.gov.uk

Continuation sheet A

Section 2 of Form 1: Respondents

1) Wentworth Sons Sub-Debt SARL

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2) York Global Finance BDH LLC

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Continuation sheet B

Section 5 of Form 1: information about the decision being appealed

(1) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER SARL
(3) HUTCHINSON INVESTORS LLC

Appellants

-and-

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

Respondents

Form 1: Continuation Sheet B
Section 5: Information About the Decision Being Appealed

A. The Facts

1. Lehman Brothers International Europe ("**LBIE**") was the principal trading company within the European Lehman Brothers group of companies. It went into administration on 15 September 2008 and was granted permission to become a distributing administration on 2 December 2009.

2. Subsequently, LBIE's joint administrators (the "**Administrators**") paid a number of interim dividends in respect of claims admitted to proof. By April 2014, dividends amounting to 100% by value of the principal amounts of proved and admitted claims had been paid, leaving the Administrators with a substantial surplus. The latest progress report by the Administrators (for the period 15 March to 14 September 2017) shows an estimated surplus (above unsecured unsubordinated claims) of approximately £7.692bn.

3. The Administrators are required to distribute that surplus in accordance with the statutory framework contained in the Insolvency Act 1986 ("**IA**") and Insolvency Rules 1986 ("**IR**").

B. The Directions Application

4. In June 2014, the Administrators applied to the court for directions under para 63 of Sch B1 to the IA on a number of issues relating to the proper distribution of the surplus (the "**Waterfall II Application**"[1]).

5. The parties to the Waterfall II Application represent the interests of different stakeholders in LBIE. The appellants (collectively, the "**Senior Creditor Group**" or "**SCG**") are holders of unsecured debt in LBIE with an aggregate value of over £2.75bn. They represent the interests of ordinary unsecured creditors. Wentworth Sons Sub-Debt SARL ("**Wentworth**") is a holder of subordinated debt and equity, whose interests are adverse to those of ordinary unsecured creditors.

6. In November 2014, David Richards J directed that the issues contained in the Waterfall II Application be sub-divided into three more manageable groups (subsequently referred to as Waterfall IIA, IIB and IIC). This appeal is concerned with two issues arising in the context of Waterfall IIA.

7. Waterfall IIA was primarily concerned with the nature and extent of creditors' rights in an administration to payment of post-insolvency interest under Rules 2.88(7)-(9) IR ("**Statutory Interest**"). In this regard:

   (1) Rule 2.88(7) IR directs 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 into administration*"; and

   (2) Pursuant to Rule 2.88(9) IR, the rate of interest payable under Rule 2.88(7) IR is the greater of the rate specified in section 17 of the Judgments Act 1838 on the date when the company entered administration (being 8% (the "**Judgments Act Rate**")) and "*the rate applicable to the debt apart from the administration*".

8. Many of the creditors of LBIE had existing rights to interest whereby interest would be calculated on a compound basis; or to interest calculated in the normal commercial way such that payments received would be credited first to outstanding interest and then

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1 So called because, as described further below, it followed a previous directions application issued by the Administrators in February 2013.

outstanding principal. Such rights are of considerable value to creditors because they ensure that the value of their claims against a debtor are not diminished if there is a delay in payment of any part of the principal or interest due to the creditor.

9. In circumstances where the relevant legislation mandates payment in full of proved debts before a surplus may be applied in satisfaction of any rights to Statutory Interest (Rule 2.88(7)), the issues comprised in Waterfall IIA included (insofar as relevant to this application for permission to appeal):

(1) Whether Statutory Interest could and should be calculated in the ordinary commercial way (i.e. by treating dividends received as having been credited first to outstanding interest rather than principal) such as to ensure that, as required by Rule 2.88(9), creditors receive interest at the rate that would have applied to their debt apart from the administration and/or receive an effective rate of interest at the Judgments Act Rate, rather than some lesser rate.

In all prior instances of corporate insolvency in which this issue had arisen, the conclusion reached had been that Statutory Interest could and should be calculated in such a manner (see further Section 6 at [15(5)]). In such instances, Statutory Interest was described as being calculated in the manner set out in *Bower v Marris* (1841) Cr & P 351, 41 ER 525, that is, when making that calculation, notionally treating each dividend paid in the administration as if it had been applied in the first place to the payment of post-administration interest, and the surplus (if any) to the reduction of the debt proved (the "***Bower v Marris* Calculation**").

(2) Whether, where a creditor has a right to be paid compound interest on a proved debt apart from the administration, the creditor is entitled to compound interest under Rule 2.88(7) and whether such compounding continues until all of the outstanding debt (including Statutory Interest) has been paid to the creditor (the "**Compound Interest Issue**").

C. The decision of David Richards J

10. The Waterfall IIA application was heard by David Richards J (as he then was) on 18 to 26 February 2015 and 3 March 2015. Judgment was handed down on 31 July 2015 (the "**First Instance Judgment**"). The Order giving effect to the First Instance Judgment was made on 9 October 2015 (the "**First Instance Order**").

11. In relation to the *Bower v Marris* Calculation and the Compound Interest Issue, David Richards J held (in summary) as follows:

(1) **The *Bower v Marris* Calculation** (First Instance Judgment [30] – [154]): The Learned Judge held that creditors' entitlements to interest under Rule 2.88(7) should not be calculated in accordance with the *Bower v Marris* Calculation. The Learned Judge declared that, on the true construction of Rule 2.88(7) IR, such a calculation was not permissible and that Statutory Interest should therefore be calculated on the basis of allocating dividends first to the reduction of the proved debt and then to the payment of accrued post-administration interest (declaration (iii) of the First Instance Order).

(2) **The Compound Interest Issue** (First Instance Judgment [19] – [26]): The Learned Judge accepted what had, by then, become common ground between the parties, namely that creditors with a right to be paid compound interest on a proved debt apart from the administration were entitled to compound interest under Rule 2.88(7) (declaration (vii) of the First Instance Order). However, the Learned Judge also held that, as a consequence of the language of Rule 2.88(7), such interest did not continue to compound following the payment of dividends equal to the amount of the debt proved (declaration (viii) of the First Instance Order).

12. On 9 October 2015, David Richards J granted the Senior Creditor Group permission to appeal against certain of the declarations made in the First Instance Order, including Declarations (iii) and (viii) relating to the *Bower v Marris* Calculation and the Compound Interest Issue.

D. The Decision of the Court of Appeal

13. The Court of Appeal (Gloster, Patten and Briggs LJJ) heard appeals from the First Instance Judgment, along with appeals from issues determined in Waterfall IIB, between 3 and 12 April 2017.

14. After the conclusion of oral submissions, but before the Court of Appeal had given judgment, on 17 May 2017 the Supreme Court handed down judgment in Re Lehman Brothers International (Europe) (In Administration) [2017] UKSC 38 (the "**Waterfall I Judgment**").

15. The Waterfall I Judgment relates to another application issued by the Administrators in February 2013 (the "**Waterfall I Application**"). That application raised a number of issues concerning the proper distribution of the surplus, including whether creditors whose unsecured debts are denominated in a foreign currency are entitled to recover from out of the surplus any shortfall arising as a result of a depreciation in the value of sterling between the date of the commencement of the administration and the date of dividend payments (such an entitlement being referred to as a "currency conversion claim").

16. David Richards J, at first instance, along with a majority of the Court of Appeal (Moore-Bick and Briggs LLJ, Lewison LJ dissenting) had held that, in the event of a surplus, foreign currency creditors were entitled to be paid a non-provable currency conversion claim. In the Waterfall I Judgment, a majority of the Supreme Court (Lord Clarke dissenting) over-turned the Court of Appeal on the existence of currency conversion claims.

17. Since the Court of Appeal had heard argument on the Waterfall IIA and B appeals before the Waterfall I Judgment had been handed down, and as a number of issues arising in the Waterfall IIA and B appeals had been predicated on the existence of currency conversion claims, the Court of Appeal invited the parties to provide written submissions on the impact of the Waterfall I Judgment on the Waterfall IIA and B appeals and heard further oral argument on 25 July 2017.

18. The Court of Appeal handed down judgment on 24 October 2017 (the "**CA Judgment**"). The order giving effect to the CA Judgment was made on the same day

(the "**CA Order**"). The CA Order refused the applications for permission to appeal made by the parties.

19. The Court of Appeal's treatment of the *Bower v Marris* Calculation and the Compound Interest Issue was as follows, in summary:

(1) ***Bower v Marris* Calculation** (CA Judgment [20] – [31]): The Court of Appeal considered that the language of Rule 2.88(7) was inconsistent with the application of the *Bower v Marris* Calculation. The Court of Appeal therefore agreed with the Judge that Statutory Interest should be calculated on the basis that dividends had been paid first to the reduction of the proved debt.

(2) **The Compound Interest Issue** (CA Judgment [39] – [42]): The Court of Appeal agreed with the Judge that where interest accrues at a compound rate under Rule 2.88(9) (i.e. where a creditor has a right, apart from the administration, to compound interest) the language of Rule 2.88(7) meant that such interest ceases to compound following the payment of dividends equal to the amount of the debt proved.

20. The practical impact of such decisions in the LBIE administration is highly significant. If, as the Court of Appeal held, the relevant rules are not to be interpreted to give effect to the *Bower v Marris* Calculation and/or creditors' rights to compound interest:

(1) The "*rate*" at which Statutory Interest is actually paid will be neither 8% nor the rate applicable to a debt apart from the administration.

(2) Once (as occurred in April 2014) final dividends had been paid in respect of the proved debt, creditors will receive no further compensation for any delay in the time taken to pay Statutory Interest.

(3) Creditors will receive in the region of £2billion less in Statutory Interest than would otherwise be the case.

(4) The holders of the subordinated debt or equity in LBIE will have an incentive to seek to delay progression of the administration and thus payment of Statutory

Interest on the basis that creditors will suffer the consequences of such delay without any compensation, whereas the equity holders will benefit from any increase in the value of the assets held by the administrators.

E The Present Application

21. For the reasons set out in the Grounds of Appeal in Section 6, the SCG seeks permission to appeal on the points of law of public importance which ought now to be considered by the Supreme Court arising from the decisions referred to at 19(1) and 19(2) above.

Continuation sheet C

Section 6 of Form 1: grounds of appeal

(1) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER SARL
(3) HUTCHINSON INVESTORS LLC

Appellants

-and-

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

Respondents

Form 1: Continuation Sheet C
Section 6: Grounds

A. Introduction

1. The issues determined by the Court of Appeal concern the meaning and effect of Rule 2.88, having regard to its textual and historical context, and to fundamental principles and policies of company and insolvency law.

2. Rule 2.88(9) provides that the rate of interest payable to creditors, in the event of a surplus, is the greater of the "*rate applicable to the debt apart from the administration*" and the 8% Judgments Act Rate. The clear intention behind Rule 2.88(9) is that creditors are to receive under Rule 2.88, as compensation for delay in payment, at least what they would have received apart from the insolvency process, having regard to any rights to interest existing at the commencement of that process and to the fact that the statutory moratorium prevents creditors from obtaining judgment and thus a right to interest at the Judgments Act Rate.

3. The Court of Appeal's construction of Rule 2.88, and in particular of Rule 2.88(7), produces a result inconsistent with that intention. In particular (as set out below):

(1) Creditors who, apart from the administration would be entitled to have payments received from the debtor applied first to interest and then to principal, have had such entitlements extinguished.

(2) Creditors who are entitled under Rule 2.88(9) to the Judgments Act Rate of 8% because they were prevented from obtaining a judgment by the statutory moratorium, will receive interest at an effective rate that is much lower than that rate.

(3) Creditors with an existing right to compound interest will receive less than they would have received apart from the insolvency process (i.e. compound interest calculated in the usual way).

4. As a result, none of these creditors will receive the full amount of interest which it was intended they should receive and (as detailed further below) creditors are deprived of a property right in a manner which interferes with their right to peaceful enjoyment of possessions under Article 1 of the First Protocol ("**A1P1**") of the European Convention on Human Rights. No sufficient reasons of principle or policy were identified by the Courts below justifying such a result, and none can be identified.

5. The Court of Appeal's decision provides an incentive to equity holders to take steps to further delay the administration of the estate, given that the effect of the Court of Appeal's judgment is that creditors' entitlement to interest was frozen on 30 April 2014, the date on which the final dividend on proved debts was received, notwithstanding the fact that it may (as in this case) still be many months or years before Statutory Interest is distributed.

B. Points of law of general public importance

6. The construction of the Rules contended for by the SCG is plainly arguable for the reasons set out in detail in the grounds of appeal, below, and has been recognised as such in the judgments below. David Richards J recognised the "*powerful submissions*" in support of the *Bower v Marris* Calculation (at [128]) and the Court of Appeal recognised that the SCG's case was "*supported by a wealth of authority and scholarship*" (at [25]) and that certain points had "*real force*" (at [25]).

7. The Court of Appeal's interpretation of Rules 2.88(7) and 2.88(9) will be determinative of the meaning of the relevant rule in administration, liquidation (see section 189 IA) and bankruptcy (see section 328(4) IA) whenever a surplus arises, and is therefore of general public importance.

8. The Court of Appeal's decision also raises wider issues of general public importance regarding the extent to which the rules are to be interpreted in a manner that reflects fundamental principles of company and insolvency law. In particular:

(1) In an insolvency, the basic principle is that creditors' claims have priority over the rights of shareholders *qua* shareholders, with the result that creditors are entitled to be paid what they are owed in full before any distributions can be made to shareholders. These fundamental principles are reflected in the language of Rule 2.88(9) which is predicated (where there is a surplus) on Statutory Interest being payable to a creditor at no less than the rate applicable to its debt apart from the administration.

(2) The interpretation of Rules 2.88(7) and 2.88(9) adopted by the Court of Appeal cuts across these fundamental principles and leads to an outcome whereby, despite the existence of a surplus, many creditors will receive less interest than they would have received outside insolvency. Conversely, application of the normal commercial approach of applying payments to interest first and then principal (as in the *Bower v Marris* Calculation), and/or giving full effect to a creditor's right to compound interest, will ensure that a debtor who turns out to be solvent is not in a better position than it would have been in had it not filed for insolvency, and creditors are not in a worse position.

(3) The construction adopted by the Court of Appeal also gives rise to potential abuse: i.e. to the extent that it is now possible for a debtor to escape its existing obligations to pay interest at a particular rate (whether simple or compound) notwithstanding that it is solvent and able to pay such interest.

9. The issues on the proposed appeal differ materially from those considered by the Supreme Court in the *Waterfall I* decision. In *Waterfall I*, the principal issue was not one of construction of the rules, but whether a non-provable claim could exist as a

consequence of the effect of the rule requiring conversion of foreign currency claims into sterling. By contrast, the Court of Appeal's decision concerns the construction of Rule 2.88 and whether, in circumstance where it is possible to read that rule in a manner consistent with the creditors' underlying rights, it should be so construed.

10. Finally, the proposed appeal also raises issues regarding whether the Court of Appeal's interpretation is contrary to creditors' rights under the Human Rights Act 1998 ("**HRA**"), and in particular amounts to an unjustified interference with the right to the peaceful enjoyment of possessions under A1P1 of the European Convention on Human Rights to the extent that creditors do not receive at least the amount of interest which they would have been entitled to receive but for the intervention of the insolvency process. Such issues are of general public importance.

C. The *Bower v Marris* Calculation: Grounds of Appeal

11. The relevant provisions of Rules 2.88(7) and (9) are:

(1) "*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*" (Rule 2.88(7)).

(2) "*The rate of interest payable under paragraph (7) is whichever is the greater of the rate specified under paragraph (6) or the rate applicable to the debt apart from the administration.*" (Rule 2.88(9)).

12. The Court of Appeal erred in law in holding that the language of Rule 2.88(7) is inconsistent with the normal commercial application of interest ahead of principal as in the *Bower v Marris* Calculation (e.g. at [26] and [37]). The Court of Appeal ought to have held that all Statutory Interest payable in accordance with Rule 2.88, on the true construction of the rule as a whole and in light of prior legislation, authority and fundamental principles of the insolvency regime, is to be calculated in accordance with the *Bower v Marris* Calculation.

13. First, the key provision of Rule 2.88 for these purposes is Rule 2.88(9) which provides for the "*rate*" at which such interest shall be paid; i.e. the greater of either the Judgments Act Rate or the rate applicable to the debt apart from the administration. In that respect:

(1) The proper construction of Rules 2.88(7) to (9) as a whole is necessarily that which gives effect to the clear intention, reflected in Rule 2.88(9), that, in the event of a surplus, creditors should receive the greater of either the Judgments Act Rate or interest at the rate that they would have received on their debt apart from the administration.

(2) Contrary to the approach adopted by the Court of Appeal, it makes no sense (and cannot reflect the legislative intention) to interpret Rule 2.88(7) in a manner that leads to the conclusion that creditors receive no interest at all from the date on which dividends are received until interest is eventually paid and, hence, an effective rate over the whole period at a rate which is lower than either the Judgments Act Rate or the rate that they would have received apart from the administration.

14. Second, there is nothing in the language of Rule 2.88(7) which supports or mandates any other conclusion. Rather:

(1) The fact that Statutory Interest is only payable "*after payment of the debts proved*" reflects the statutory order of priority; namely that the debtor's assets are to be collected, realised and distributed first pari passu in respect of creditors' proved and admitted claims, excluding for this purpose any claims for interest in respect of the period after the commencement of the insolvency, and only after such claims have been paid in full is any surplus to be paid in respect of Statutory Interest.

(2) The direction in Rule 2.88(7) to pay interest "*in respect of the periods during which they have been outstanding since the company entered administration*" confirms that, in the event of a surplus, creditors are entitled to interest only in respect of the periods after the company entered administration; the word "*outstanding*" confirming that it will be necessary to take into account dividends received. Rule 2.88(7) does not

expressly provide that Statutory Interest is to be calculated on the basis of allocating dividends to principal first, interest first or in some other manner.

15. Third, the Court of Appeal wrongly considered that the continued application of the *Bower v Marris* Calculation is inconsistent with, and did "*violence to*", the necessary starting point for the operation of Rule 2.88(7) (namely that the debts proved have been paid in full (see [28], [31])). That is wrong as a matter of language for the reasons given in paragraph s 13 and 14 above, and incorrect given the following:

(1) There is nothing new in the requirement in Rule 2.88(7) that the debtor's proved debts should be paid, before interest in respect of the period after the commencement of the insolvency is paid. The *Bower v Marris* Calculation has always proceeded on the basis that, before any such interest is paid, proved debts must already have been paid in full, as that has been the effect of the statutory scheme since at least 1743.

(2) The argument that the *Bower v Marris* Calculation is inconsistent with the starting point that debts proved have been paid in full, has been repeatedly raised and consistently rejected in the authorities, including *Bower v Marris* itself, *Re Joint Stock Discounting Company, Warrant Finance Co's Case* (1869) LR 5 Ch App 86 and *Attorney General of Canada v Confederation Trust* (2003) 65 OR (3d) 519.

(3) In the past that argument has been rejected because it fails to recognise that the *Bower v Marris* Calculation only ever applies to the surplus ascertained once debts proved have been paid in full, and is a notional calculation identifying how much interest is to be paid. That is, it operates to inform the application of an already identified surplus by applying a method of calculating the amount of interest which should be paid by notionally re-allocating dividends first to the payment of Statutory Interest and then in reduction of debts proved.

(4) The Court of Appeal's treatment of this point (at [27] – [30]) proceeds by way of a fundamental misunderstanding as to the manner of operation of the *Bower v Marris* Calculation. In particular, the Court of Appeal appears to have assumed that the *Bower v Marris* Calculation requires debts proved to be disaggregated into pre-administration interest and principal before notionally allocating prior

dividends first to pre-administration and post administration interest and, thereafter, to principal. That has never been the manner in which the *Bower v Marris* Calculation has operated.

(5) The justice of applying the *Bower v Marris* Calculation is demonstrated by the fact that it has consistently been applied in insolvency proceedings in relation to the calculation of interest to be paid in the event of a surplus. It was common ground before the Court of Appeal that the calculation applied in corporate insolvency at all times between 1869 and 1986. Its continued application was recognised as recently as *Re Lines Bros* in 1984. It was 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 First Instance Judgment, there was no reported decision in England, whether in relation to corporate insolvency or bankruptcy which rejected its application, or even criticised it. The *Bower v Marris* Calculation 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.

16. Fourth, in considering whether the language of Rule 2.88(7) was inconsistent with the application of the *Bower v Marris* Calculation, the Court of Appeal failed to give adequate weight to the fact that the *Bower v Marris* Calculation has been held to operate in the context of other enactments using substantially the same language, structure and effect as Rule 2.88(7) including:

(1) Section 132 of the Bankruptcy Act 1825 (the enactment in force at the time of the decision in *Bower v Marris* itself);

(2) The 46th order of the Order of August 1841 and Or 55 rr 62 and 63 of the Rules of the Supreme Court (see *Whittingstall v Grover* (1886) 55 LT 213); and

(3) Section 95(2) of the Canadian Winding-up and Restructuring Act 1996 (see *Attorney General of Canada v Confederation Trust* (2003) 65 OR (3d) 519)).

17. Fifth, in construing Rule 2.88 the Court of Appeal failed to have proper regard to the "*intellectual freight*" arising from decisions relating to prior insolvency regimes and their treatment of post-insolvency interest. In particular, the Court of Appeal failed to have proper regard to the fact that:

(1) The *Bower v Marris* Calculation was consistently held in England to be reflected in the insolvency scheme as the fair and correct approach to the calculation of post insolvency interest after the discharge of the principal debts payable out of an estate which had proved to be solvent: see *Bromley v Goodere* (1743) 1 Atk 75; *Re Humber Ironworks and Shipbuilding Co, Warrant Finance Company's case* (1869) LR 4 Ch App 543; *Re Humber Ironworks and Shipbuilding Co, Warrant Finance Company's case (No.2)* (1869) LR 5 Ch App 88 and (1870) LR 10 Eq 11; *Re Lines Bros Ltd (No.2)* [1984] Ch 438.

(2) No court in a common law jurisdiction has ever rejected the principle and all that have considered it have adopted it reflecting the effect of their statutory insolvency schemes: 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.

18. Sixth, in construing Rule 2.88(7) the Court of Appeal failed to give sufficient weight to the fact that neither the Report of the Cork Committee nor the Government's White Paper preceding the enactment of the insolvency Act indicated that the introduction of the 1986 Act was intended to abolish the application of the *Bower v Marris* Calculation. Had the Cork Committee wished to disapply the *Bower v Marris* Calculation, they would have made this clear and explained why. This is particularly so given that at [1308] the Cork Report referred to *Re Lines Brothers*, where *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.

19. Seventh, in holding that the language of Rule 2.88(7) was inconsistent with the application of the *Bower v Marris* Calculation, the Court of Appeal failed to have proper regard to the fundamental principles of company and insolvency law. In particular:

(1) A creditor who, apart from the administration, is entitled to interest calculated in the ordinary way (i.e. by appropriating payments received first towards interest and then towards principal) will receive Statutory Interest calculated under Rule 2.88 in a manner which does not reflect fully the rate otherwise applicable to its debt apart from the administration (as required by Rule 2.88(9)). Since Rule 2.88 constitutes a complete code for the payment of interest (see *Waterfall I Judgment* ibid. at [126] *per* Lord Neuberger) such a creditor will not have a non-provable claim in respect of its unsatisfied entitlement to interest.

(2) As a consequence, funds will be returned to shareholders (or, in bankruptcy, to the discharged debtor) at a point when the claims of creditors to interest have not been fully satisfied, placing shareholders and discharged debtors in a better position than they would have been were it not for the intervention of an insolvency process.

(3) Creditors will be deprived of any compensation for any delay between the payment of dividends and the payment of Statutory Interest, thus undermining creditors' minimum entitlement to Statutory Interest at the Judgments Act Rate as a result of the imposition of the moratorium.

20. Eighth, the Court of Appeal wrongly considered that the continued application of the *Bower v Marris* Calculation is inconsistent with the Supreme Court's decision in *Waterfall I*. In this regard:

(1) The Court of Appeal's (e.g. at [36] and [37]) reliance on Lord Neuberger's conclusion at [126] of the *Waterfall I* Judgment that Rule 2.88 operates as a complete code insofar as creditors' rights to interest are concerned was misplaced. The fact that Rule 2.88 operates as a complete code to the exclusion of reliance on any underlying rights, says nothing about the content or construction of the code enacted by Rule 2.88.

(2) The Court of Appeal appear to have proceeded on the assumption that the *Bower v Marris* Calculation was somehow dependent upon, or "*fuelled by*" a "*reversion to contract analysis*" (at [12]) and that such an analysis "*must be taken to be, for now at least, almost completely dead and buried*" (at [15]). However, the *Bower v Marris* Calculation does not depend on the concept of a remission to contractual rights. If it did, it could not have been applied in the context of the statutory regimes in *Whittingstall v Grover ibid.* and *Attorney General of Canada v Confederation Trust ibid.*

(3) Further and in any event, the Court of Appeal was wrong to conclude that the Supreme Court's decision in *Waterfall I* precludes any reversion to contract analysis. In *Waterfall I* the members of the Supreme Court expressed different *obiter* views over whether the statutory regime in the IA 1986 replaces or effects a general compromise of creditors' underlying contractual rights, thereby precluding a reversion to contract analysis (see, in particular, the difference of opinion between Lord Neuberger (in the majority) at [97] – [111] and Lord Sumption (in the minority) at [195] – [201] supported by Lord Clarke at [222]). The SCG would argue in this regard that Lord Sumption's opinion is to be preferred. If Lord Sumption's opinion is correct, it provides an additional reason for reading Rule 2.88 in a manner that is consistent with creditors' underlying rights.

(4) The Court of Appeal gave insufficient weight, in the context of considering the effect of the *Waterfall I* Judgment, to the fact that the Cork Report and the Law Commission had expressly concluded that no currency conversion claim should exist. No similar pre-legislative indication exists in this case (see 18 above).

21. Finally, the application of Rule 2.88(7) as interpreted by the Court of Appeal amounts to a violation of the A1P1 rights of the ordinary unsecured creditors under the HRA. Section 3 of the HRA requires that, so far as it is possible to do so, Rule 2.88(7) must be read and given effect in a way which is compatible with A1P1. Even if a compatible interpretation of Rule 2.88(7) is not possible, the Court is nevertheless obliged by Section 6 of the HRA not to act in a way which is incompatible with A1P1. This is a point which was not raised below, but is a pure point of law which the Court is invited to consider now:

(1) A1P1 protects the right to the peaceful enjoyment of possessions. An interference with that right must strike a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights. As described by Lord Sumption in *Bank Mellat v HM Treasury (No.2)* [2013] UKSC 39; [2014] A.C. 700 at [20], "*... the question depends on an exacting analysis of the factual case advanced in defence of the measure, in order to determine (i) whether its objective is sufficiently important to justify the limitation of a fundamental right; (ii) whether it is rationally connected to the objective; (iii) whether a less intrusive measure could have been used; and (iv) whether, having regard to these matters and to the severity of the consequences, a fair balance has been struck between the rights of the individual and the interests of the community.*"

(2) An existing debt is a "possession", and so is an entitlement to interest, whether contractual or otherwise: *Sud Parisienne de Construction v France* (33704/04, 11 February 2010); *BAT Industries plc v HMRC* [2017] UKFTT 0558 (TC).

(3) The insolvency regime routinely interferes with creditors' possessions, and in the vast majority of cases that interference is a fully justified and proportionate means of promoting the public interest: e.g. *Bäck v Finland* (2005) 40 E.H.R.R. 48. However, the application of Rule 2.88(7) in the unusual circumstances of the present case leads to a different conclusion:

(a) Unsecured creditors with a contractual entitlement to interest have had that possession replaced with a right to statutory interest. For some such creditors, that statutory interest is (on the Court of Appeal's view of the law) less valuable than their pre-existing entitlement. Where there is a surplus of assets in the estate, no discernible public interest is served by effecting a transfer of property from such creditors to those lower down the waterfall. Rule 2.88(7) would interfere with their possessions in an unjustified and disproportionate manner; and

(b) More generally, the insolvency regime interferes with creditors' possessions (the debts) by preventing the creditors from enforcing their claims during an administration. The statutory moratorium not only prevents creditors from getting paid: it prevents them from pursuing their claims to judgment and

triggering a right to post-judgment interest under Judgments Act 1838 s.17 (to which, it is submitted, the *Bower v Marris* Calculation would be applicable). In general terms, this interference promotes important public interests such as promoting corporate rescue, preventing a scramble for assets, and ensuring equitable treatment of creditors. The law recognises that, in the event of a surplus, creditors who have been prevented from obtaining judgment should be compensated by an entitlement to statutory interest at the Judgments Act Rate. The Court of Appeal's approach, however, means that such interest does not provide such compensation. It means that creditors are left worse off than they would have been if there had been no administration preventing them from obtaining a judgment. This outcome, when there is an ample surplus which will accrue to the holders of subordinated debt and equity at the expense of the ordinary unsecured creditors, serves no legitimate public purpose and does not strike a fair balance between the interests of the creditors and the public interest.

(4) In *Bower v Marris*, Lord Cottenham posed the rhetorical question, "*Why is the creditor to suffer, and the bankrupt to benefit, by attributing the dividends to principal, instead of to the interest due?*" A1P1 demands an answer to that question, if Rule 2.88(7), as interpreted by the Court of Appeal, is to survive scrutiny under the HRA.

D. The Compound Interest Issue: Grounds of Appeal

22. The Court of Appeal also erred in law in holding that, where the "*rate applicable to the debt apart from the administration*" under Rule 2.88(9) is a compounding rate, Statutory Interest does not continue to compound following the payment in full of the debts proved by way of dividends (e.g. at [39]-[41]). The Court of Appeal ought to have held that where the "*rate applicable to the debt apart from the administration*" under Rule 2.88(9) is a compounding rate, Statutory Interest continues to compound in full, for so long as the creditor's right to interest has not been satisfied in full:

(1) It was common ground before the Court of Appeal that, as the Learned Judge had held, 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, including any element of compounding. That being the case,

the Court of Appeal ought to have concluded 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, whether principal or interest, unless and until the entire sum, including interest, has been paid in full.

(2) The Court of Appeal ought to have recognised that the policy and common sense reasons that led the Learned Judge to conclude that the reference to the "*rate*" of interest in Rule 2.88(9) extends to compound interest, must also lead to the conclusion that interest must be calculated in a way that gives proper effect to that right to compound interest. In failing to do so, the conclusion of the Court of Appeal partially defeats creditors' entitlements to receive compound interest and gives rise to an unprincipled and arbitrary middle ground in which creditors receive some but not all of the compound interest to which they are entitled.

23. The same arguments as are identified in paragraph 21 regarding inconsistency with A1P1 arise in relation to a construction of Rule 2.88 which deprives a creditor of part of its existing right to compound interest.

24. If creditors are entitled, under Rule 2.88(7) and (9), to compound interest calculated in the normal way, the same construction of those rules ought also to apply to give effect to the *Bower v Marris* Calculation, and vice-versa.