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)

(1) Burlington Loan Management Limited
(2) Cvi Gvf (Lux) Master SÀRL
(3) Hutchinson Investors LLC
(4) Wentworth Sons Sub-Debt SÀRL
(5) York Global Finance BDH LLC

— V —

(1) Antony Victor Lomas
(2) Steven Anthony Pearson
(3) Paul David Copley
(4) Russell Downs
(5) Julian Guy Parr (As The Joint Administrators Of Lehman Brothers)

Appeal number: A3/2015/3753 & Ors

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

Appellant's solicitors

For York Global Finance BDH LLC:
Michelmores LLP

Respondent's solicitors

See continuation sheet for the Respondents' Solicitors.

1. Appellant

Appellant's full name: York Global Finance BHD LLC

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

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How would you prefer us to communicate with you?
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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 Lehman Brothers International (Europe) (In Admin.)

Original status:
- ☐ Claimant
- ☐ Defendant
- ☑ Petitioner
- ☐ Respondent
- ☐ Pursuer
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3. Decision being appealed

Name of Court: Court of Appeal (Civil Division)

Names of Judges:
Lady Justice Gloster
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 pages 2 - 4 of the Continuation Sheet.

6. Grounds of appeal

Please see pages 5 -11 of the Continuation Sheet.

Counsel's name or signature:

Tom Smith QC; Robert Amey

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:

Pursuant to section 3 of the Human Rights Act 1998, the Court, when considering the Appeal, is required to interpret the statutory insolvency scheme, and in particular Insolvency Rule 2.88, in a way that is compatible with the protection of Creditors' property rights under Article 1 Protocol 1 of the ECHR.

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

Certificate of Service attached.

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

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

Subject matter catchwords for indexing.

Insolvency - Statutory Interest

Please return your completed form to:

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www.supremecourt.gov.uk

CONTINUATION SHEET

Page 1

Appeal references:
A3/2015/3753; A3/2015/3762; A3/2015/3763; A3/2015/3764; A3/2016/4213; A3/2016/4216; A3/2016/4217; and A3/2017/0043.

Respondents' Solicitors and contact details:

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Page 6

Section 5: Information about the decision being appealed

(1) Factual narrative

1. Lehman Brothers International (Europe) ("**LBIE**") was the principal trading company for the European operations of the Lehman Brothers group. LBIE went into administration on 15 September 2008. Contrary to expectations at the time, having now paid dividends amounting to 100% of the principal value of its debts admitted to proof, it presently has a remaining surplus for distribution estimated at around £7.39 billion.

2. Under the Insolvency Rules 1986 ("**the 1986 Rules**") applicable to an administration, once the proved debts have been paid in full, creditors are entitled to interest on their debts from the date of commencement of the administration: see rule 2.88 of the 1986 Rules (that rule is now Rule 14.23 of the Insolvency Rules 2016 but, for consistency with language used in the prior proceedings is hereinafter referred to as "rule 2.88"). This is often referred to as "*statutory interest*". The right to statutory interest is a key feature of the statutory regime governing the administration and liquidation of companies, although, prior to the present case, it had not been the subject of any detailed consideration by the courts.

3. The issue in the present proceedings concerns the entitlement to statutory interest and, specifically, as to how the interest payable to a creditor is to be calculated. The issue arises because the administration of LBIE has been continuing for some time and over the course of the administration the administrators had paid successive dividends over time which cumulatively had amounted to 100% of the debts admitted to proof. The question is how those dividends are to be treated for the purposes of calculating interest.

4. The proposed Appellant contends that in these circumstances statutory interest should be calculated in the normal commercial way, namely, by treating payments made by the debtor as being made first in discharge of interest and only then in discharge of principal. This would be position if the debtor, LBIE, was not in an insolvency proceeding, and there is no sensible policy justification for creditors being placed in a worse position because the debtor has gone into an insolvency proceeding.

5. The proposed Appellant, York Global Finance BHD LLC ("**York**") is a member of a consortium which holds senior unsecured debt in LBIE with an aggregate value of US$676.25 million.

(2) Chronology of proceedings

6. In February 2013 the joint administrators of LBIE applied to the court for directions on issues relating to the proper distribution of the surplus. These proceedings were known as the **Waterfall I** litigation. One of the issues raised was whether creditors whose claims were denominated in a foreign currency had a so-called "*currency conversion claim*" (i.e. a claim for the difference between the sterling dividends received in the administration, and the full value of their foreign currency debts). The High Court and Court of Appeal held that creditors could assert currency conversion claims, but the Supreme Court disagreed in a judgment of 17 May 2017: [2017] UKSC 38; [2017] 2 WLR 1497.

7. Meanwhile, on 12 June 2014, the administrators made a second application for directions, raising further issues relating to the distribution of the surplus. In November 2014, David Richards J (as he then was) directed that the issues raised by the June 2014 application be sub-divided into three groups. The first of these groups, which has become known as **Waterfall IIA**, concerned the entitlements of creditors to statutory interest.

8. One of the key issues in Waterfall IIA concerned the method of calculation of statutory interest. It was argued on behalf of the unsecured creditors such as York that this interest was to be calculated in the normal commercial way, namely, by treating payments which had been made by LBIE as being first appropriated to interest before principal so that interest would continue to accrue on the unpaid principal. This would ensure that creditors were properly compensated for being out of their money, before any funds were distributed to subordinated creditors and shareholders.

9. This approach to calculating interest was consistent with the approach adopted in a line of authorities concerning the payment of interest from estates, based on the decision in a case called *Bower* v *Marris.*

10. However, the subordinated creditors and shareholders of LBIE (who stand to benefit significantly from reducing the amount of interest payable to ordinary unsecured creditors) argued that the terms of the relevant rule in the Insolvency Rules which provides for the payment of interest – rule 2.88(7) – did not permit interest to be calculated in this way.

Rather, it was said that this rule required interest, unusually, to be calculated by treating payments as being made in discharge of principal before interest. This has the consequence of significantly prejudicing creditors, as they would then receive no compensation for the late payment of interest.

11. On 31 July 2015, David Richards J (as he then was) handed down his judgment in Waterfall IIA (the "**Tranche A Judgment**" [2015] EWHC 2269 (Ch); [2016] Bus LR 17). Relevantly, for present purposes, he agreed with the argument made by the subordinated creditors/shareholders that rule 2.88(7) did not permit interest to be calculated by treating payments made by LBIE as being appropriated first to principal before interest.

12. On appeal, the Court of Appeal upheld the Judge's conclusion on this point. The Court of Appeal considered that the arguments in favour of a calculation on a *Bower v Marris* basis had "*real force*", but ultimately concluded that the language of rule 2.88(7) left no room for a *Bower v Marris* calculation, and that statutory interest is to be calculated on the basis of dividends being applied first to principal, and then to interest: CA Judgment paras 20-38.

(3) Issues in the appeal

13. York seeks permission to appeal against the Court of Appeal's conclusion, namely, that statutory interest is to be calculated on the basis that dividends are first allocated in discharge of principal and then only in discharge of statutory interest.

Page 7

Section 6: Grounds of Appeal

Ground 1: the Bower v Marris approach to the calculation of statutory interest is not excluded by rule 2.88

14. In the ordinary commercial context, outside of insolvency proceedings, the general rule is that interest is calculated on the basis that partial payments of a debt are to be treated first as discharging interest, and secondly as discharging principal. As explained in *Chitty on Contracts* (32nd ed) para.21.069 (citing a long line of authority):

> "Where there is no appropriation by either debtor or creditor in the case of a debt bearing interest, the law will (unless a contrary intention appears) apply the payment to discharge any interest due before applying it to the earliest items of principal."

15. The reason why this is so is because it means that the creditor is properly compensated for the time-value of his money. Where the principal amount of a debt bears interest, but outstanding and unpaid accrued interest does not do so, then it makes commercial sense for any payments received by the creditor from the debtor to be applied first to interest before principal. If payments were to be applied first to principal, then the creditor would be out of pocket as he would not be entitled to interest on the outstanding but unpaid interest.

16. These points are uncontroversial. It is therefore no surprise that in every insolvency case identified by the parties where the point has been argued (except the present case), interest has been calculated in this way:

(i) In bankruptcies prior to the Bankruptcy Act 1883 and in company winding up prior to the Insolvency Act 1986, in the event of a surplus, interest was calculated in this way: see *Bower v Marris* (1841) Cr & P 351, 41 ER 525; Tranche A Judgment paras 87-88; CA Judgment paras 32-33.

(ii) Prior to the present case, there had been no suggestion in any of the authorities, or in any of the pre-legislative materials, that the 1883 Act or the 1986 Act had intended to alter this approach.

(iii) The same approach to the calculation of interest has been applied in corporate insolvencies in Australia, Canada, Ireland and the USA, including in contexts where

the statutory context was similar to the 1986 Act: Tranche A Judgment paras 79-84 and 127; CA Judgment para.37.

(iv) The same approach to the calculation of interest also applies in the administration of the estates of deceased persons, both as regards legacies and the payment of creditors: Tranche A Judgment para.84.

17. Nonetheless, in the present case the Court of Appeal held that this normal approach to the calculation of interest was inconsistent with the language of the legislation and therefore could not be applied. The Court of Appeal's reasoning was in summary as follows:

(i) Rule 2.88(7) provides that interest can only be paid "*after payment of the debts proved*", and can only be paid "*on those debts*". The debt proved in respect of each creditor will be a specific, known figure, ascertained during the course of the administration, prior to the calculation and payment of any statutory interest: CA Judgment paras 26-27.

(ii) Statutory interest is to be calculated by reference to that specific figure. Rule 2.88 identifies, for each proving creditor, the amount of the debt upon which interest is payable, the period or periods during which it is payable and the rate payable. All those easily ascertainable items would fall to be undone and re-calculated if a *Bower v Marris* approach to statutory interest were to be employed: CA Judgment paras 28-30.

(iii) The approach in *Bower v Marris* was developed to fill a lacuna in circumstances where previous Bankruptcy Acts had not contained a statutory right to interest. However, now that the legislation confers a statutory right to interest, that interest is to be calculated according to the words of the rule, and not by reference to pre-existing common law or equitable principles: CA Judgment paras 32-37.

18. It was thus central to the Court of Appeal's reasoning that language of rule 2.88 necessarily excluded the normal approach to the calculation of interest. No other reason was given why the normal approach would not otherwise apply. However, the Court of Appeal was wrong in considering that the language of rule 2.88 necessarily excludes the operation of the approach in *Bower v Marris* to the calculation of statutory interest:

(i) Rule 2.88(7) provides that:

> "Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the relevant date."

(ii) Accordingly, rule 2.88(7) is essentially a direction to the administrator that, once 100% dividends have been paid on all admitted debts (which is what "payment of the debts" clearly means), the surplus assets thereafter arising are then to be used by the administrator in paying statutory interest. It is a direction as to how any surplus in the administrator's hands is to be applied, not a direction to creditors that they are required to treat receipt of 100% dividends as payment "in full" of their pre-administration debts.

(iii) Rule 2.88(7) does not prescribe the way in which the interest to be paid from the surplus is to be calculated. Aside from the applicable rate provided for by rule 2.88(9), the method of calculation of interest is not a matter addressed by rule 2.88.

(iv) The *Bower v Marris* approach to the calculation of statutory interest is not inconsistent with the direction to the administrator provided for in rule 2.88(7). The *Bower v Marris* approach simply provides that, once the requirement on the administrator to pay statutory interest has arisen, then the amount of the interest which is to be paid is *calculated* on the basis that the payments made by the debtor are treated as having discharged interest prior to principal.

(v) The problem with the Court of Appeal's analysis is that it has confused the question of when the obligation on the administrator to pay statutory interest arises (which is dealt with by rule 2.88(7)) with the question of how such interest is to be calculated (on which rule 2.88(7) is silent).

19. Moreover, it is in any case common ground that the concept of the applicable "*rate*" in rule 2.88(9) does not simply refer to relevant numerical rate of interest, but also encompasses the relevant *mode* of calculating interest by application of that numerical rate. It is for this reason that compound interest is recoverable under rule 2.88 as the applicable rate includes not only the numerical rate but also the manner in which that rate is to be applied i.e. by compounding at the relevant intervals: Tranche A Judgment paras 19-25. If the concept of the applicable "*rate*" in rule 2.88(9) encompasses not just a numerical rate, but also the relevant method of calculating interest, then there is no reason that the method cannot be the *Bower v Marris* method. It is common ground that the effect of calculating interest on a daily compounding

basis leads to the same total interest payments as applying the rule in Bower v Marris. If one is permitted by rule 2.88, it is hard to see why the other is expressly excluded by the language of the rule.

20. Indeed, many of the objections that the Court of Appeal identified to a *Bower v Marris* approach to the calculation of interest would apply equally to compound interest. For example, it can be argued that the payment of compound interest (which is often described as "*interest on interest*") would not be compatible with the terms the requirement imposed on the administrator by rule 2.88(7) to pay interest on the proved debts i.e. on the principal, and not on interest. However, this is in fact no bar to the recovery of compound interest under rule 2.88. This is because, whilst rule 2.88(7) imposes an obligation on the administrator to pay statutory interest on the proved debts, it does not prescribe the way in which such interest is to be calculated. There is therefore no objection to the recovery of the compound interest, if that is what is provided by the terms applicable to the debt owed by the insolvent debtor to the creditor, and even though this may be said in substance to involve the payment of interest on interest.

21. The Court of Appeal was therefore wrong to hold that rule 2.88 necessarily excludes the *Bower v Marris* approach to the calculation of statutory interest. As noted above, rule 2.88 does not purport to prescribe the way in which statutory interest is to be calculated, once the right to statutory interest has arisen.

22. In these circumstances, there is no reason at all why the normal approach to the calculation of interest payable by a debtor to a creditor should not be allowed and applied.

23. On the contrary, a number of other factors strongly militate in favour of the application of the *Bower v Marris* approach to the calculation of statutory interest:

(1) It is impossible to conceive of any sensible policy reason why the rights of creditors to payment from the debtor should be diminished – and potentially very substantially so – and a corresponding windfall conferred on shareholders – simply because the debtor has gone into an insolvency proceeding. Outside of an insolvency, creditors would be entitled to have any interest due to them calculated in the normal way (i.e. applying payments from the debtor first to interest before principal). Why should they be placed in a worse position because the *debtor* has defaulted and gone into an insolvency? And why should a corresponding windfall be conferred on the shareholders of the debtor? There is no sensible policy justification for this.

(2) On the contrary, it is clear that the intention behind rule 2.88 was to give creditors, in the event of a surplus after payment of the principal of the proved debts, rights to interest equivalent to those that they would have had outside the insolvency process. Outside of insolvency, a creditor with a contractual right to interest would be entitled to calculate such interest in the normal way. Likewise, a creditor without a contractual right to interest could obtain a court judgment carrying interest at the Judgments Act rate, and could then have calculation interest due in the same way. There is no reason why the position should not be the same under rule 2.88.

(3) That creditors should receive, as far as possible, the full benefit of payments they would have received outside the insolvency process, is supported by Article 1 Protocol 1 to the European Convention on Human Rights (A1P1). The interference with creditors' rights under insolvency legislation engages A1P1: *Bäck v Finland* (2005) 40 EHRR 48. In the case where there are insufficient assets to pay all creditors in full, this interference will usually serve a legitimate aim (ibid). However, where there are sufficient assets to pay all creditors in full, with interest, it is difficult to see any legitimate aim in preventing creditors from receiving their full entitlement. To the extent that Rule 2.88 would otherwise exclude the *Bower v Marris* approach to the calculation of interest, the Court should interpret Rule 2.88 (pursuant to section 3 of the Human Rights Act1998) as permitting a *Bower v Marris* calculation.

(4) The Court of Appeal reinforced their conclusions on the interpretation of rule 2.88 (7) by reference to the Supreme Court decision in Waterfall I that rule 2.86 precluded creditors from having non-provable currency conversion claims. The Supreme Court decision was very heavily based on the idea that rule 2.86 and the other aspects of the insolvency scheme introduced in 1986 were justified on the basis of a need for "simplicity". However, it was not argued before the Supreme Court that the insolvency scheme must be interpreted so far as possible to be consistent with human rights protections, even when the legislation pre-dates the introduction of the Human Rights Act 1998. It is hard to see how the insolvency scheme can simply discharge completely rights of creditors so as to speed up the return of a "surplus" (artificially created by removing creditor rights) to a debtor's lower ranking creditors or shareholders. There is no public or general interest in discharging creditor rights that a debtor is able to pay out of the genuine surplus assets determined to be available after the application of the first pari passu distribution phase of the insolvency scheme.

Ground 2: Rule 2.88 does not assume that principal must be paid before interest

24. Further or alternatively, the Court of Appeal was wrong in holding that the words in rule 2.88(7) "*contain all you need to know*" and "*contain a built-in assumption that the whole of the principal of the relevant debts will already have been paid by dividend, since otherwise there will be no surplus*" (CA Judgment paras 26-27).

25. As explained above, the effect of rule 2.88(7) is that an administrator is directed to use any surplus remaining after payment of the debts proved to pay interest on those debts. By its terms, the rule is directed at the administrator and is concerned with the making of payments from the remaining surplus.

26. One of the reasons which the Court of Appeal gave for holding that the *Bower v Marris* approach cannot apply to the calculation of interest under rule 2.88 is that dividends cannot be appropriated to interest before principal, because no right to interest exists until after all dividends have been paid (CA Judgment para.27). This is reasoning is unsound because there is nothing in the *Bower v Marris* approach to the calculation of interest that requires the creditor to have a right to appropriate payments between principal and interest at the time when the payment is made. There is no reason why, at the time when it becomes necessary to calculate the amount of interest due, interest cannot be calculated on the basis that payments previously made are treated as having been applied first in discharge of interest before principal.

27. But in any case the Court of Appeal's assumption that, prior to the existence of a surplus, the creditor has no right to appropriate is unsound. Rule 2.88 simply specifies the point in time at which an administrator becomes entitled (and obliged) to make payments in respect of interest (the 'trigger' for the payment of interest), but does not specify the point at which the right to interest begins to accrue.

28. It is clear from the terms of rule 2.88 that the right to interest applies from the commencement of the administration. It is true that the right to payment of such interest is contingent on there being a surplus after payment of the proved debts in full. However, it does not follow that, prior to the existence of such a surplus, a creditor has no right to interest. Rather, the creditor does have a right to interest, albeit no entitlement to receive *payment* until a surplus has arisen.

29. Since a right to interest can arise prior to the payment of dividends (even though the administrator's obligation to pay that interest has not yet been triggered), there is nothing to prevent a creditor who receives a dividend appropriating that dividend to interest (ie, the approach in *Bower v Marris*).

Conclusion

30. The Supreme Court is therefore respectfully invited to grant permission to appeal on the issue identified above. The issue raises arguable points of law of general public importance which ought to be considered by the Supreme Court at this time. In particular:

(i) The issues have not previously been the subject of judicial determination.

(ii) The outcome of this case will be of direct relevance to the large number of LBIE creditors worldwide, not just the parties to the present proceedings, and very large sums of money are at stake.

(iii) More generally, the appeal raises issues of general public importance as to the correct distribution of a surplus in insolvency proceedings and the extent to which the insolvency scheme can discharge creditors' property rights without breaching human rights protections for those property rights.

TOM SMITH QC
ROBERT AMEY