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IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE (CHANCERY DIVISION)
COMPANIES COURT
MR JUSTICE DAVID RICHARDS
[2015] EWHC 2269 (Ch); [2015] EWHC 2270 (Ch); and, [2016] EWHC 2131 (Ch)
MR JUSTICE HILDYARD
[2016] EWHC 2417 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 24/10/2017

Before :

LADY JUSTICE GLOSTER
Vice-President of the Court of Appeal, Civil Division
LORD JUSTICE PATTEN
and
LORD BRIGGS OF WESTBOURNE

- -

Between :

(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

Appellants

- and -

(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 INTERNATIONAL (EUROPE) (IN ADMINISTRATION))

Respondents

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Mr Robin Dicker QC, Mr Richard Fisher, and Mr Henry Phillips (instructed by **Morrison & Foerster LLP, Freshfields Bruckhaus Deringer LLP, and Ropes & Gray International LLP**) for the **1st, 2nd and 3rd Appellants**
Mr Antony Zacaroli QC, Mr David Allison QC and Mr Adam Al-Attar (instructed by **Kirkland & Ellis International LLP**) for the **4th Appellant**
Mr Tom Smith QC and Mr Robert Amey (instructed by **Michelmores LLP**) for the **5th Appellant**
Mr Daniel Bayfield QC and Mr Stephen Robins (instructed by **Linklaters LLP**) for the **Respondents**

Hearing dates : 3 - 6 April 2017; 10 - 12 April 2017; and, 25 July 2017

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Approved Judgment

1. This is the judgment of the court.

Introduction

2. This appeal forms the latest instalment in the protracted sequence of litigation which has arisen in the wake of the collapse of Lehman Brothers International (Europe) ("**LBIE**") in 2008. The facts surrounding LBIE's collapse, and subsequent entry into a distributing administration, have by now been well rehearsed in a number of judgments, most recently by the Supreme Court in *Waterfall I* [2017] UKSC 38. For present purposes, it is enough to recall that when LBIE entered into administration on 15th September 2008, it was thought to be insolvent by nearly all concerned. As it turned out, after fully paying or providing for all the debts proved in LBIE's administration, and for administration expenses, there remained a surplus estimated at around £7.39bn.

3. The active parties to this appeal are representative creditors of LBIE whose interest is to ensure that they receive as great a share of that surplus as possible. The Senior Creditor Group ("**the SCG**") is comprised of Burlington Loan Management Limited, CVI GVF (Lux) Master SARL and Hutchinson Investors LLC. They are all holders of unsecured debt in LBIE with an aggregate value of over £2.75bn. York Global Finance BHD LLC ("**York**") is one of four co-participants in unsecured claims against LBIE, with a total aggregate value of US$676.25m. Throughout most of this appeal, York has largely adopted, and where appropriate amplified, the submissions of the SCG. Wentworth Sons Sub-Debt SARL ("**Wentworth**") is a holder of subordinated debt, and therefore ranks below both the SCG and York in the statutory waterfall. The joint administrators of LBIE, whose application for directions in relation to the surplus gave rise to the current litigation, have remained neutral, participating in the proceedings only to the extent necessary to ensure that all the possible arguments are given a proper airing before the court.

The 1986 insolvency regime

4. The background to the 1986 insolvency regime is set out in detail in the judgment of Lord Neuberger in *Waterfall I* (at [10]-[15]). For present purposes, it is necessary only to set out the relevant provisions of the Insolvency Rules 1986 ("**the 1986 Rules**"), insofar as they applied to LBIE's administration.

5. Those provisions are largely contained in Chapter 10 of the Rules, which applies to all distributing administrations (Rule 2.68(1)). The rules which govern the proving of debts in such an administration are set out from Rule 2.72 onwards. In accordance with Rule 2.86, debts which are denominated in a foreign currency must be converted to sterling on the date of the administration for the purposes of proof:

> "(1) For the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company entered administration or, if the administration was immediately preceded by a winding up, on the date that the company went into liquidation."

6. Rule 2.88, around which the issues arising on this appeal are centred, provides for the payment of statutory interest on debts in the event of a company's administration. It is convenient to set out in full the provision as it was in force on the date of LBIE's administration:

> "(1) Where a debt proved in the administration bears interest, that interest is provable as part of the debt except in so far as it is payable in respect of any period after the company entered administration or, if the administration was immediately preceded by a winding up, any period after the date that the company went into liquidation.
>
> (2) In the following circumstances the creditor's claim may include interest on the debt for periods before the company entered administration, although not previously reserved or agreed.
>
> (3) If the debt is due by virtue of a written instrument, and payable at a certain time, interest may be claimed for the period from that time to the date when the company entered administration.
>
> (4) If the debt is due otherwise, interest may only be claimed if, before that date, a demand or payment of the debt was made in writing by or on behalf of the creditor, and notice given that interest would be payable from the date of the demand to the date of payment.
>
> (5) Interest under paragraph (4) may only be claimed for the period from the date of the demand to that of the company's entering administration and for all the purposes of the Act and the Rules shall be chargeable at a rate not exceeding that mentioned in paragraph (6).
>
> (6) The rate of interest to be claimed under paragraphs (3) and (4) is the rate specified in section 17 of the Judgments Act 1838 on the date when the company entered administration.
>
> (7) 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.
>
> (8) All interest payable under paragraph (7) ranks equally whether or not the debts on which it is payable rank equally.
>
> (9) 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."

The scope of this appeal

7. As with the rest of the *Waterfall* litigation, this appeal is concerned with the proper application of the LBIE surplus. In particular, it requires the court to determine the extent of creditors' entitlements to interest on their debts for periods after the

commencement of the administration, and the correct approach to calculating those entitlements. The potential scope of those entitlements has been considerably reduced by the course charted by the previous *Waterfall* litigation, in particular by the Supreme Court's decision in *Waterfall I*. In order properly to understand the terrain to be covered it is first necessary to sketch a brief history of the procedural background to this appeal.

The litigation thus far

8. In February 2013 the joint administrators of LBIE applied to the court for directions on a number of issues relating to the proper distribution of the surplus. Amongst them were two issues with a direct bearing on the scope of the present appeal. The first arose from the fact that the statutory insolvency regime requires creditors whose unsecured debts are denominated in a foreign currency to convert their claims into sterling for the purposes of proof, at the rate of exchange prevailing at the date LBIE went into administration, and to be paid dividends on those proofs in sterling. The question was whether those foreign currency creditors could bring a "currency conversion claim" for any shortfall arising as a result of a depreciation in the value of sterling between that date and the date of payment of the dividend. The second directly relevant issue concerned whether, if creditors did not receive their full entitlement to statutory interest during an administration, such interest could nevertheless be claimed during a subsequent liquidation. The February 2013 application also raised a number of other important, albeit not immediately pertinent, issues concerning the proper ranking of subordinated debt in the statutory waterfall and the scope of members' obligations to make contributions to meet LBIE's liabilities in liquidation under s74 of the Insolvency Act 1986. The proceedings arising out of the February 2013 application are known collectively as the *Waterfall I* litigation.

9. In June 2014, the joint administrators LBIE made a second application for directions. In November 2014, David Richards J directed that the issues raised by the June 2014 application be sub-divided into three more manageable groups. The first of these groups, which has become known as *Waterfall IIA*, concerned the entitlements of creditors to post-administration interest including, but not limited to, the existence of claims to interest on foreign currency and other non-provable claims. The second group of issues related to the effect of certain post-administration contracts made with creditors on their claims for currency conversion losses and post-administration interest (*Waterfall IIB*). Originally, this appeal encompassed the issues raised in both *Waterfall IIA* and *Waterfall IIB* although, as we will shortly describe, the majority of the former, and the totality of the latter, have now fallen away. The third group of issues was to do with the construction and effect of various standardised pre-administration agreements on creditors' entitlements to interest (*Waterfall IIC*). One of the issues decided by Hildyard J in his Order made on 12th December 2016 has been argued on this appeal, and remains live.

10. Although closely linked in subject matter, the proceedings in *Waterfall I* and *Waterfall II* have progressed independently of each other. First in time came the first instance decision of David Richards J (as he then was) in *Waterfall I* [2014] EWHC 704 (Ch). Most relevantly for our purposes, David Richards J held that in the event of a surplus, foreign currency creditors were entitled to make a non-provable claim for losses suffered as a result of a decline in the value of sterling between the date of the

administration and the date of payment. Such claims were only payable once all proved debts, and statutory interest on those debts, had been paid in full.

11. On appeal, the majority of the Court of Appeal (including Briggs LJ) agreed with the judge as to the existence of non-provable claims to foreign currency shortfalls. The key plank of the Court of Appeal's reasoning in this regard was a "reversion to contract" analysis, according to which there was nothing in the 1986 Act or accompanying 1986 Rules which prevented a creditor reverting to his contractual rights once the statutory scheme for proof and payment of interest had run its course and resulted in a surplus (at [136]-[137]). The unacceptable alternative, it was said, would be to violate a cardinal principle of insolvency law by having too much of the surplus returned to shareholders. The Court of Appeal's decision in *Waterfall I* was subsequently successfully appealed to the Supreme Court although, as we shall see, not before considerable progress, including a full hearing in this court, had been made with *Waterfall II*.

12. Many of the issues arising for determination in the *Waterfall II* litigation therefore proceeded on the assumption that the 1986 Act and Rules, in general, permitted non-provable claims aimed at ensuring that creditors received the full amounts to which they would otherwise have been contractually entitled, and in particular, entitled foreign currency creditors to claim for shortfalls resulting from sterling depreciation. In *Waterfall IIA*, these issues included: a) whether a creditor who received less in statutory interest than that to which he would otherwise have been entitled under his contract could have a non-provable claim for the difference, and b) a number of issues relating to the scope of non-provable claims, and in particular foreign currency claims, including whether such claims should be reduced to take into account statutory interest already paid, and whether interest was payable on the non-provable claims themselves. Also fuelled by the reversion to contract analysis was the issue whether a creditor was entitled to have his statutory interest calculated by reference to the rule in *Bower v Marris* (1841) Cr&P 351, 41 ER, under which dividends would be allocated first to the payment of statutory interest, and only then to the dividend (i.e. the proved debt) or vice versa, by paying down principal first. *Waterfall IIB* was exclusively concerned with whether creditors could effectively release their claims to foreign currency shortfalls, or to non-provable interest, by way of a number of variants of standardised contract.

13. Once again, the first-instance judge in both *Waterfall IIA* and *B* was David Richards J ([2015] EWHC 2269 (Ch) and [2015] EWHC 2270 (Ch) respectively). He held that Rule 2.88 was to be treated as a complete code for the payment of statutory interest, which prescribed the entirety of a creditor's right to interest in the administration. Accordingly, it was not possible to bring a non-provable claim for post-insolvency interest, whether on ordinary debts or in relation to currency conversion claims. The same analysis applied to prevent the application of *Bower v Marris*, for which likewise no provision was made in the 1986 Rules. As a matter of contractual construction, the judge found that the agreements in issue in *Waterfall IIB* variously operated to release some, or none, of the creditors' claims. The decision of David Richards J was subsequently appealed to the Court of Appeal, which heard submissions on the same basis as the case had been dealt with by the judge, namely that the insolvency regime did not extinguish creditors' contractual rights, but merely

suspended them, so that they could be revived to determine creditors' entitlements in the event of a surplus.

14. Following the Supreme Court's decision in *Waterfall I,* it is clear that the concept of foreign currency claims in particular, and the reversion to contract analysis in general, no longer prevail in the way they had previously done in this court. Giving the judgment of the majority of the Supreme Court (Lord Clarke dissenting), Lord Neuberger held that the effect of Rule 2.86 was to exclude currency conversion claims, and accordingly upheld Lewison LJ's dissent in the Court of Appeal on that basis. His Lordship's reasoning can fairly be summarised as follows. First, whilst there existed judicial dicta both for and against the recognition of currency conversion claims, those dicta related to the pre-1986 insolvency regime, and it was accordingly dangerous to rely on them when seeking to interpret the 1986 provisions, which were intended to operate as a completely new code. Second, relevant background documentation to the 1986 legislation, including the Law Commission's reports on foreign money liabilities, and the Cork Report, strongly suggested that the new insolvency code was not intended to provide for currency conversion claims. Third, the legislative purpose underpinning the 1986 regime was to simplify the insolvency regime, which told against the recognition of claims not expressly provided for in the legislation. Fourth, recognising currency converclaims would have an unacceptably discriminatory effect, in that they would entail application of a later conversion date in a case where currency fluctuations were advantageous to the foreign currency creditor, but protect him by applying the conversion rate at the date of proof where they were not. Finally, the absence of any express provision for currency conversion claims was particularly telling, given that the 1986 Rules made explicit provision for the revaluation of claims in other circumstances, for example where there occurred a variation in the contingency underlying a contingent debt (Rule 2.81) (at [83]-[94]). To this list, Lord Sumption added the observation that, in circumstances in which a debt was provable, but the limited character of the relevant insolvency provisions left part of it unsatisfied, it was not open to the court to read into the legislation a non-provable claim to the unsatisfied balance (at [194]).

15. Although it was not necessary to decide the point, given his conclusions as set out above, Lord Neuberger also made a number of broader *obiter* observations to the effect that, in his view, the effect of payment in full of a proved claim in an insolvency was to extinguish a creditor's underlying contractual debt, replacing it with a set of statutory rights (at [98]-[112]). For his part Lord Sumption would have found that the effect of insolvency was administrative, rather than substantive (at [197]-[200]). However, as the majority of the Supreme Court agreed with Lord Neuberger, it appears that the reversion to contract analysis must be taken to be, for now at least, almost completely dead and buried.

16. This conclusion is supported by Lord Neuberger's observations on the issue of whether the contractual right to interest for the post-administration period revived in favour of a creditor who had proved for his debt and been paid out on his proof in a distributing administration. In a section of his judgment with which all other members of the Supreme Court agreed, Lord Neuberger held that it did not. Rules 2.88 and 4.93, along with s.189 of the Act, provided a complete statutory code for the recovery of interest on proved debts in administrations and liquidations. There was accordingly no room for the previous judge-made law that the creditor was remitted to his

contractual rights in the event of a surplus. As with a currency conversion claim, the contractual right (whether to recover interest or to be paid at a particular rate) had been replaced by legislative rules. A contractual right could not revive simply because those rules contained a *casus omissus* or because they resulted in a worse outcome for a creditor than he would have enjoyed under his contract (at [202]-[222]).

Live issues

17. It will we hope be clear from the above brief summary that the issues initially arising for determination in the present appeal have been considerably narrowed by the Supreme Court's judgment in *Waterfall I*. All of the issues relating to currency conversion claims fall away, as do those relating to creditors' entitlements to interest on non-provable claims, and the effect of release agreements on either type of claim. We are grateful for the parties' efforts to agree a list of the remaining, relatively compact, issues and for the efforts of their counsel in making themselves available for a short supplemental hearing late last term at which submissions were heard on the impact of *Waterfall I* on those issues.

18. The issues which remain live and require determination by this court are:

    a. **Item 1:** Whether, on the true construction of Rule 2.88(7), statutory interest is to be calculated on a *Bower v Marris* basis, namely with dividends being first allocated to the reduction of statutory interest and then to the payment of principal (i.e. the proved debt), or vice versa, by paying down principal first (declaration (iii)).

    b. **Item 2:** Whether, where the relevant interest rate to be applied under Rule 2.88(9) is the *"rate applicable to the debt apart from the administration"*, and such rate is a compounding rate, accrued statutory interest continues to compound following the payment in full of the principal amount through dividends (declaration (viii)).

    c. **Item 4:** Whether a creditor is entitled to further interest, damages, or any other form of compensation in respect of the time taken for statutory interest to be paid (declaration (iv)).

    d. **Item 5:** Whether statutory interest payable in respect of an admitted provable debt which was a contingent debt as at the date of administration is payable from that date, or from the later date (if any) when the debt ceased to be contingent (declaration (xiv))

    e. **Item 11:** Whether the *"rate applicable to the debt apart from the administration"* in Rule 2.88(9) can include: (a) a foreign judgment rate of interest applicable to a foreign judgment obtained after the date of administration, or; (b) a foreign judgment rate of interest which would have become applicable to the debt if the creditor had obtained a foreign judgment, when it did not in fact do so (declaration (x)).

    f. **Item 12:** Whether the words "the rate applicable to the debt apart from the administration" in Rule 2.88(9) of the Rules include, in the case of a provable debt that is a close-out sum under a contract, a contractual rate of interest that began to accrue only after the close-out sum became due and payable due to action taken

by the creditor after the date of the commencement of LBIE's administration (declaration (xxvii)).

19. All declaration numbers refer to the relevant paragraphs of the order made by David Richards J. save for the last, which refers to a declaration made by Hildyard J in *Waterfall II C.*

Item 1: *Bower v Marris*

20. This issue is concerned with the correct approach to the calculation of statutory interest payable in an administration pursuant to Rule 2.88(7) where, after payment in full of the proved debts, there remains a surplus. It will be borne in mind that interest payable for periods prior to the cut-off date will have been the subject of proof, so that Rule 2.88(7) relates only to interest accruing during any period or periods thereafter, and that the expression "proved debts" therefore includes both contractual principal and interest down to the cut-off date.

21. This item (then called issue 2) was presented to the judge in the following terms:

> "Whether on the true construction of Rule 2.88(7) of the Rules, Statutory Interest is calculated on the basis of allocating dividends:
>
> (i) first to the payment of accrued Statutory Interest at the date of the relevant dividends and then in reduction of the principal;
>
> (ii) first to reduction of the principal and then to the payment of accrued Statutory Interest; or
>
> (iii) on the basis of some other sequencing."

22. The issue has, as the judge noted at paragraph 31, been treated from first to last as a question of statutory interpretation, as to the meaning of and effect of Rule 2.88(7), in its textual and historical context. He recorded that, at the time of the hearing before him in early 2015, the issue had a price tag of £1.3 billion. It is therefore no surprise that the interpretation of this short sub-rule has, both at first instance and on appeal, generated the most intense submissions, backed by historical legal research into the treatment of post cut-off date interest in both bankruptcy and insolvency, from the eighteenth century in relation to bankruptcy and from the origins of corporate insolvency in the mid-nineteenth century. Of the two alternatives presented to the judge, the SCG and York supported (i) (allocation first to interest) while Wentworth and the Administrators supported (ii) (allocation first to principal).

23. The judge preferred alternative (ii). His main grounds for doing so were as follows:

a) Alternative (i) (allocation first to interest) was incompatible with the statutory scheme for proof of debts and payment of statutory interest.

b) By contrast, alternative (ii) (allocation first to principal) reflected the ordinary meaning of the language of Rule 2.88(7) in its context.

c) Alternative (ii) appeared also to reflect more closely than its rival the recommendations of the Cork Committee.

24. In this court, the submissions supportive of the contrary conclusion were advanced primarily by Mr Robin Dicker QC for SCG, supported by Mr Tom Smith QC for York. A bare but sufficient summary is as follows:

a) Attributing incoming payments to outstanding interest before principal is the ordinary commercial conduct of any creditor at liberty to do so, and is reflected in typical commercial contracts made between persons at arm's length.

b) The same approach underlies the court's historic judge-made attitude towards the award of interest from a surplus in the administration of estates.

c) The *Bower v Marris* approach (i.e. attribution of payments received to interest before principal) was applied by the courts in bankruptcy, at least until the Bankruptcy Act 1883, and probably thereafter.

d) The *Bower v Marris* approach was also used in the exercise of a judge-made jurisdiction to award interest in cases of corporate insolvency, in the event of a surplus, from its origins in the mid-nineteenth century until 1986.

e) Nothing in the *travaux preparatoires* preceding the 1986 insolvency legislation indicate an intention to abolish that long-standing application of commercial and equitable principle.

f) Nothing in the language used in Rule 2.88 prevents the equitable principle from continuing to be applied.

g) Attribution of dividends first to outstanding interest better ensures that contributories do not receive that which, apart from the insolvency, would have been paid to creditors, than the application of dividends to principal.

h) *Bower v Marris* has been widely applied in other common law jurisdictions, including the Republic of Ireland, Scotland, Canada and the USA.

i) The judgment of the Supreme Court in *Waterfall I* affirmed the vitality of judge-made rules within the insolvency code, where consistent with the terms and underlying principles of current legislation, and where reasonably necessary to achieve justice.

Analysis

25. The appellants' submissions on this issue were supported by a wealth of authority and scholarship. Some of them, in particular the point summarised at (g) above, had real force. Nonetheless we have concluded, with less difficulty after the Supreme Court's decision in *Waterfall I* than before it, that they all founder on the rock identified by the judge himself, namely that they advance an approach to the award of statutory interest which is incompatible with Rule 2.88, read in its context. It is both clear in its meaning and leaves no lacuna which needs to be filled by a judge-made rule.

26. The starting point is to be found in the simple words of Rule 2.88(7):

> "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."

When aggregated with the provision as to the interest rate in Rule 2.88(9) and the provision for equal ranking between creditors in Rule 2.88(8) this simple formula constitutes, in our view, a complete and clear code for the award of statutory interest on provable debts. As Mr Zacaroli QC for Wentworth put it, it contains all you need to know.

27. The quoted words 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 relevant surplus. Reference back to the earlier provisions of Rule 2.88 showS that it is also to be assumed that, in addition to the whole of the principal, contractual interest due until the commencement of the administration will also, in the stated circumstances, have been proved for and paid. Thus the "debts proved" referred to in Rule 2.88(7) will include the whole of the principal and, probably in most cases, all outstanding pre-administration interest. The aggregate of those amounts will constitute the "debt" upon which statutory interest for the period since the onset of the administration is payable. The requirement that there should be a surplus out of which statutory interest is paid means that the aggregate of principal and pre-administration interest will for each creditor be a specific, known figure, ascertained during the course of the administration, prior to the calculation and payment of any statutory interest.

28. It would in our view run entirely counter to that simple structure for the calculation of statutory interest to require that aggregate sum to be re-opened, to the intent that dividends are re-allocated first to interest and only then to principal, for the purpose of distributing a surplus which, on that re-allocation for all proving creditors, might leave all or many of them with a shortfall in payment of principal, so that on the re-analysis there was not even a surplus after payment of "the debts proved" within the meaning of Rule 2.88(7).

29. Further, if the re-allocation was to be done on purely contractual principles, it would require a departure from the express provisions in Rule 2.88(1) to (6) which regulate the extent to which a creditor may prove for pre-administration interest, as part of his debt.

30. In short, Rule 2.88(7) and (9) identify, 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.

31. Mr Dicker tried hard to persuade us that this fundamental re-opening of the accounts between creditors and the company necessitated by a *Bower v Marris* approach did no violence to the necessary starting point, that principal and pre-administration interest (to the extent permissible) was to be treated as having been paid in full. All it did, he said, was to inform the application of an already identified surplus for the purpose of

paying interest to proving creditors, by reference to equitable principles which had been in use for well over a century and which would be readily understood by commercial creditors. We disagree, for the reasons which follow.

32. First, the rule in *Bower v Marris* was originally devised, and used throughout corporate insolvency until 1986, to fill a vacuum or lacuna. So far as concerns corporate insolvency, that much is common ground since, prior to 1986, the statutory insolvency code made no express provision for interest on proved debts at all. In relation to bankruptcy, the position is less clear. *Bower v Marris* was, although decided in 1841, a case about a bankruptcy which occurred prior to the passing of the Bankruptcy Act 1825, which was the first to make any provision for statutory interest on debts.

33. Mr Dicker may be right to say that, nonetheless, a *Bower v Marris* approach may have been applied to personal bankruptcy between 1825 and the passing of the Bankruptcy Act 1883, but we regard the question whether a *Bower v Marris* approach to the award of interest continued to be applied thereafter as entirely unclear. Although therefore Section 40(5) of the Bankruptcy Act 1883 made provision for statutory interest in terms having some similarity with Rule 2.88, there is in our view no persuasive basis for interpreting Rule 2.88 as incorporating a *Bower v Marris* approach to the computation of statutory interest merely because of a speculation that this might have been done in the personal bankruptcy context since 1883.

34. Likewise, we have not been persuaded that authorities which suggest that *Bower v Marris* may well have been applied for the computation of interest payable in the context of the administration in bankruptcy of deceased persons' estates (or other estates) has any persuasive carry-over by way of affecting the construction of Rule 2.88, in the context of a modern corporate insolvency. Again, it seems to us that this would be to misuse judge-made law designed to fill a lacuna, contrary to the Supreme Court's judgment in *Waterfall I*.

35. The appellants' best point was, in our view, that a *Bower v Marris* approach to the computation of interest would better avoid the distribution to the company's contributories of any part of a surplus which might otherwise find its way into the hands of the company's creditors (by comparison with the full vindication of creditors' contractual rights) than would the application of the apparently clear statutory scheme to be found in Rule 2.88. This is likely to be generally, but not invariably, true although creditors' contractual rights to interest may entitle them to a rate lower than that provided for in Rule 2.88(9), and creditors with a right to compound interest would be much less benefited by a *Bower v Marris* approach than creditors entitled only to simple interest, as Mr Dicker fairly acknowledged.

36. Prior to the Supreme Court's decision in *Waterfall I*, this consideration might have been of real weight. But the same underlying principle (about preventing contributories from receiving any part of that which would otherwise have been payable to creditors in accordance with their contractual rights) did not persuade the Supreme Court to recognise currency conversion claims, as a means of achieving the same objective, and it cannot in our view prevail if the outcome would be to require an approach to the computation of interest which is, as we have said, clearly inconsistent with the simple and complete statutory code set out in Rule 2.88.

37. We recognise, as did the judge, that the Appellants may derive some support from cases about the administration of estates, such as *Whittingstall v Grover* (1886) 55 LT 213, and from first instance decisions about insolvency in Ireland and Canada, specifically *Re Hibernian Transport Companies Ltd* [1991] 1 IR 263 and *AG of Canada v Confederation Trust Company* (2003) 65 OR (3d) 519, for the proposition that the *Bower v Marris* approach has been applied to statutory provisions for interest, some in similar form to Rule 2.88. But they cannot in our view, particularly in the light of the decision of the Supreme Court in *Waterfall I,* justify the application of that approach to the clear and simple code for statutory interest established by Rule 2.88 if, as both we and the judge have concluded, it is clearly inconsistent with it.

38. For those reasons we would dismiss the appeal on Item 1.

Item 2: Compounding under Rule 2.88(9)

39. The judge decided, and so declared that, where the "rate applicable to the debt apart from the administration" under Rule 2.88(9) is a compounding rate, accrued statutory interest does not continue to compound following the payment in full of the principal amount by way of dividends. His reasoning was that Rule 2.88(7) made it clear that statutory interest was only payable in respect of periods (following the commencement of the administration) during which the relevant debts were outstanding: see paragraph 26 of his judgment.

40. This is a short point, and argument about it did not occupy a large part of any of counsel's submissions. In our view, for the reasons which follow, the judge was clearly right about it.

41. While it is not an abuse of language to describe a provision for compounding as forming part of a "rate of interest", and common ground that it may apply in relation to the periods before payment of relevant dividends, the essence of compounding is that interest in arrears at the end of a particular period is added to the amount upon which interest is then payable in the subsequent period. Leaving aside the fact that (as is common ground) the "debt" upon which interest is payable under Rule 2.88 includes pre-administration interest, to the extent permitted by sub-rules (1) to (6), the concept of arrears of interest arising after payment of dividends, as the basis for compounding, sits uneasily with the basis upon which statutory interest is payable. That is, under Rule 2.88(7), that proved debts have been paid in full by a series of dividends, and a surplus has then arisen. While it is true that interest is then payable in respect of the period between the commencement of the administration and the payment of the last dividend necessary to achieve payment in full, there is no room for the concept of interest, let alone compound interest, being payable in respect of any later period.

42. We would therefore also dismiss the appeal on Item 2.

Item 4: Compensation for Late Payment of Statutory Interest

43. This ground of appeal (which replicates submissions made, unsuccessfully, to the judge) arises from the fact that Rule 2.88(7) requires interest on proved debts to be paid once there is a surplus after payment of those debts in full whereas, in many

cases, and the present is no exception, payment of interest may ultimately be made some time later.

44. The Appellants do not suggest that express provision for payment of such compensation (whether or not itself labelled interest) is to be found in Rule 2.88, or elsewhere in the statutory code. Rather, they submit that the court should recognise a common law entitlement to compensation for the late payment of a statutory entitlement, making the telling point that the surplus out of which interest is to be paid will itself have been invested by the administrators and that the intermediate income on that investment would unjustly fall to be paid to contributories if not used to pay compensation for late payment to creditors.

45. The judge dealt with this submission in two short paragraphs of his judgment, upon which we have found it impossible to improve:

> "166. In my judgment, this submission faces two obstacles. First, while statutory interest is payable out of the surplus remaining after the payment in full of proved debts, rule 2.88 does not stipulate the time at which such payment is to be made. The reason it does not do so is that, while administrators are obliged to proceed with the administration with all reasonable speed, there may, as in the present case, be very good reasons why they cannot immediately proceed to the payment of statutory interest. The SCG have gone out of their way to say that there has been no breach by the administrators of their duties or any unreasonable or culpable delay on their part. If there had been, creditors have their remedies against the administrators under the provisions of schedule B1 to the Insolvency Act 1986. It cannot in the present case be said that there has been any breach of the obligation to pay statutory interest or that the due date for payment has yet arrived. There is therefore no basis on which creditors could either seek an order for the payment of statutory interest or damages for any loss said to be suffered as a result of delay.
>
> 167. The second obstacle is that the legislation makes no provision for the payment of interest on statutory interest. In the absence of a breach of an obligation to pay the statutory interest, no jurisdiction exists to award interest or damages in respect of the time taken to pay the statutory interest. If it had been intended that a further sum by way of interest should be paid, on the amount of statutory interest due under rule 2.88 from the date on which all proved debts were paid or provided for in full or from some other date to the date of payment of the interest, a provision to that effect would have been included in the Rules."

46. Mr Dicker relied upon the general right to compensation for late payment of a debt recognised by the House of Lords in *Sempra Metals Limited v IRC* [2008] 1 AC 561, and in particular in Lord Nicholls' leading speech at paragraphs 94 to 99. But the analysis in that case pre-supposed a cause of action of some kind for payment of money: i.e. that there had been some legal wrong committed by its non-payment earlier than it was in fact paid. The difficulty in applying the *Sempra Metals* analysis to the present case is, as explained in the first of the judge's reasons for rejecting this

claim, that Rule 2.88 specifies no time at which a payment of statutory interest must be made. Rule 2.88(7) is concerned with identifying the condition for the making of such a payment, namely the existence of a surplus after payment in full of all proved debts. But the timing of the payment of interest will be subject to the usual exigencies arising in an administration including, as in the present case, legal or forensic uncertainty as to the existence or the amount of the surplus, uncertainty as to the persons entitled to receive interest, or the amounts of interest to which each person is entitled. As the judge put it, creditors with a right to receive statutory interest under Rule 2.88 are entitled to have that aspect of the administration undertaken with all reasonable speed, and to call the administrators to account in the event of any unreasonable or culpable delay on their part.

47. In the present case the appellants have very properly abjured any suggestion that the administrators have acted unreasonably, still less culpably, in delaying payment of statutory interest, while major legal uncertainties affecting any such distribution have been referred to the court for determination.

48. There was some debate at the resumed hearing (following the Supreme Court's judgments in *Waterfall I*) whether that decision affected the judge's analysis of this point, whether by strengthening or weakening it. Certainly the Supreme Court concluded, as is now common ground, that Rule 2.88 constituted a complete code for the payment of statutory interest. But we accept Mr Dicker's submission that this does not of itself resolve his argument based upon the existence of a supposed common law liability. Nonetheless, for the reasons given above, no common law liability can arise in the absence of a cause of action constituted by the late payment amounting to some form of legal wrong, and no such cause of action has arisen in the present case.

49. Accordingly we would dismiss the appeal on this issue as well.

Item 5: Interest on Contingent Debts

50. A contingent debt is provable in an administration even though the contingency upon which it becomes payable has not occurred at the date of the administration. Dividends are payable in respect of it regardless whether the contingency has occurred by the time of dividend. The issue raised by this Item is whether the phrase in Rule 2.88(7) "the periods during which they have been outstanding since the company entered administration" does or does not include any period between the date of the administration and the date (if any) before payment of dividends when the relevant contingency occurred. Put more generally the question is whether statutory interest is payable in respect of a period when the debt remained contingent.

51. The judge decided in the affirmative. There follows a summary of his reasons:

  a) Distribution in administration is made to creditors *pari passu* in discharge of their proved debts, not their underlying claims;

  b) Creditors are compensated by the payment of statutory interest for the delay in payment of their proved debts from the date of administration, not their underlying claims;

c) Although some parts of Rule 2.88 use the word "debts" to refer to the underlying claims, the reference to the periods when debts have been outstanding in Rule 2.88(7) is clearly a reference to proved debts;

d) This construction was consistent with the treatment of statutory interest on future debts (which is not subject to appeal), and with the insolvency code as a whole, in which the *pari passu* principle is applied as far as possible from a single common date, here the date of the administration.

52. The appeal against the judge's declaration to this effect was advanced by Wentworth. It was opposed by both the SCG and York, who supported the judge's reasoning. The essence of Mr Zacaroli's argument for Wentworth may be summarised as follows:

a) Although there is provision for the discounting of a contingent debt for the purposes of proof by reference to a judgment about the likelihood of the contingency occurring, where the contingency occurs before dividend the debt may be proved for and is admitted in full.

b) In such a case, for example when the contingency occurred in the last month of a period of several years between the date of administration and the date of payment of dividend, the creditor would be paid interest in relation to a long period when the debt was neither interest-bearing nor outstanding in the ordinary sense of the word.

c) By paying statutory interest to a creditor for a period when his debt remained only contingent, the scheme would fail to apply *pari passu* treatment, by comparison with ordinary creditors with debts payable as at the date of administration, or even future creditors with debts bearing interest (as is common) in the meantime.

53. This is at first sight an attractive and persuasive argument but we have not, upon reflection, been persuaded by it. The main difficulty seems to us to be that Rule 2.88(7) provides the same regime for statutory interest for all provable debts, whether due at the date of administration, due then only in the future, or subject then to a contingency which may, in fact, never occur. All the "periods" in respect of which statutory interest is payable start on the date of administration, and end on each dividend date (in respect of the part of the provable debt then paid). This is of course the case for a debt due at that date, but it is also true of a future debt, as the judge determined, and as to which there is no appeal.

54. Critically, it is also true of a contingent debt, where the contingency has not occurred as at the date of dividend. It is submitted that this causes no unfairness because debts which are still contingent at the dividend date are discounted. That may be so, but to treat a contingent debt where the contingency has not occurred at the dividend date as "outstanding" when a debt where the contingency occurs just before dividend as not "outstanding", in both cases at the date of the administration, would require using a very different and counter-intuitive pair of meanings of the same word in a provision plainly designed to work in the same way for all provable debts. If Wentworth were correct that a contingent debt was not outstanding until the contingency occured, then

a contingent creditor whose contingency occurred after the dividend date would suffer both discounting and a total deprivation of statutory interest.

55. The same difficulty arises in relation to future debts. Where a future debt has not fallen due at the dividend date, it is discounted for futurity at 5% per annum from the date of administration. But if it falls due (however shortly) before the dividend date, it is provable in full. Again there can only be one meaning of "outstanding" in Rule 2.88(7) for such debts, and the judge has determined without appeal that this begins with the date of administration.

56. If there is arguable unfairness in the way in which contingent and future debtors are treated under the statutory scheme, it lies in our view more in the provisions for discounting than in the regime for statutory interest. Discounting is not an issue on this appeal.

57. More fundamentally, we agree with the principled basis for the judge's analysis, which treats the debt as the provable debt rather than the underlying claim, and the application of the *pari passu* principle to all debts as from a single cut-off date. Statutory interest is compensation for dividends on account of provable debts having to be paid after (sometimes long after) that cut-off date, and does not depend upon there being any right to interest under the underlying claim, even though the rate of interest may do: see below under Item 12.

58. Although the Supreme Court's decision in *Waterfall I* was not prayed in aid on this Item, we derive some comfort from the view of the majority, to which we have already referred, that the statutory process of proof entirely replaces and discharges the previous contractual liability.

59. Accordingly we would dismiss Wentworth's appeal on this issue.

Item 11: Foreign Judgment Rates of Interest

60. The question here is whether the "rate applicable to the debt apart from the administration" in Rule 2.88(9) can include:

    a) A foreign judgment rate of interest applicable to a foreign judgment obtained after the date of administration, or;

    b) A foreign judgment rate of interest which would have become applicable to the debt if the creditor had obtained a foreign judgment, when it did not in fact do so.

61. The parties were agreed before the judge, and he so held, that where a creditor obtained a foreign judgment before the onset of the administration ("the cut-off date") then any interest rate applicable to that foreign judgment would fall within the phrase "the rate applicable to the debt apart from the administration" in Rule 2.88(9). But the judge ruled against both limbs (a) and (b) of this Item, as set out above, holding that neither an actual post cut-off date foreign judgment, or any foreign judgment which might have been obtained, fell within the statutory language.

62. It is convenient to begin with limb (b), which Mr Dicker put in the forefront of his argument before the judge, albeit not on appeal. The judge rejected limb (b) because,

in his view, the relevant phrase in Rule 2.88(9) related to actual rather than purely hypothetical rates of interest. He said (at paragraph 177):

> "The words "the rate applicable to the debt apart from the administration" cannot be read as including a hypothetical rate which would be applicable to a debt if the creditor took certain steps."

After giving certain examples, he concluded:

> "These examples do no more than demonstrate why the words "the rate applicable to the debt apart from the administration" should be given their obvious meaning of the rate in fact applicable to the debt."

63. We have, again, found it difficult to improve upon the judge's analysis. The submission that hypothetical judgment debts are intended to be included within the relevant phrase would in our view lead to such speculative uncertainty in what is otherwise a relatively simple and straightforward code for the payment of statutory interest that it should, and must, be rejected.

64. It was no surprise therefore that Mr Dicker concentrated, in his oral submissions, upon limb (a), where a creditor had in fact obtained a foreign judgment, conferring a relevant rate of interest on the judgment debt, after the cut-off date, but before the date of payment of statutory interest under Rule 2.88.

65. The judge rejected limb (a) mainly because, in his view, the payment of statutory interest, like the proof and payment of debts, needed to be regulated in a *pari passu* process of administration by reference to a single date, namely the cut-off date. He pointed out, in particular, that Rule 2.88(8) provided for all statutory interest to rank equally, and that Rules 2.88(6) and (9) provided that the alternative Judgments Act rate was that in force on the cut-off date i.e. at the commencement of the administration.

66. Mr Dicker's main submission in relation to limb (b) on appeal was that, by contrast with proof of debts, payment of interest did not of itself require a cut-off date as at the commencement of the administration, and could be done *pari passu* and with complete fairness if a cut-off date was chosen as at the commencement of payment of statutory interest, or as at the date of payment of the last dividend by which proved debts had been paid in full. Mr Zacaroli QC for Wentworth countered by pointing out that all the periods in respect of which statutory interest was to be payable under Rule 2.88(7) begin with the commencement of the administration, so that if some subsequent foreign judgment was taken into account, it would lead to differential rates being applied within a statutory period relevant to a particular creditor.

67. We did not find that the submissions made on appeal took the analysis of this issue significantly further than that set out by the judge in paragraphs 178 to 183 of his main judgment. It is true that contractual rates of interest which would clearly fall within Rule 2.88(9) might provide for different rates during the statutory period applicable to a particular creditor starting with the cut-off date and ending with the date of payment of his proved debt in full. We accept Mr Dicker's submission that the legislature might have chosen a different cut-off date for the payment of statutory

interest than that applicable for the proof of debts, but there is no indication in Rule 2.88 or elsewhere that it is intended to do so.

68. Accordingly, we are left with the same impression that drove the judge's conclusion on this issue, namely that it would be wrong to have regard under Rule 2.88(9) to a rate of interest applicable to a foreign judgment obtained only after the cut-off date constituted by the commencement of the administration, unsupported by or by reference to any pre-existing contractual right of the creditor as at the cut-off date. We would add that, but for the concession that pre-cut-off date foreign judgments could be relied upon as giving rise to a relevant statutory interest rate, we would have been in some doubt whether foreign judgments, and interest rates arising therefrom, were relevant at all. Foreign judgments would be likely (although perhaps not inevitably) to be given in a currency other than sterling, and interest rates applicable to such currencies, which might be more or less volatile than sterling, would not obviously be suitable for application to interest on a sterling amount, which would be the currency of the proved debt and of all relevant dividends upon it.

69. For those reasons, we would dismiss the appeal on this issue as well.

Item 12: Contractual Interest Rate due only after Close-out

70. This issue, namely whether a contractual rate of interest applicable only after a close-out triggered by a creditor after the date of the administration is to be taken into account under Rule 2.88(9), was answered in the affirmative by Hildyard J in *Waterfall IIC*. He did so notwithstanding the contrary decision of David Richards J in relation to post cut-off date foreign judgments which we have affirmed under Item 11 above. Both types of rate share this feature in common: that they are triggered by steps taken, after the cut-off date, by the creditor, without which the relevant rate would not have applied at all.

71. The typical example used in argument, both before Hildyard J and on appeal, is the default interest payable by the out-of-the-money party to an ISDA governed derivative, after close-out triggered by the counterparty gives rise to a close-out amount payable by the party in administration, which it fails to pay. Nothing turns on the precise example. This question of interpretation (or application) of Rule 2.88(9) will arise wherever, after the onset of administration, the creditor triggers a contractual right contained in a pre-administration contract giving rise to an interest entitlement at a particular rate, higher than the Judgments Act rate.

72. Those contending for a negative answer to the question (before the judge and on appeal) prayed in aid David Richards J's view that the interest rate applicable to a post cut-off date foreign judgment would not qualify under Rule 2.88(9), and his reasoning (with which we agree) that statutory interest needed to be regulated by reference to a single date, as part of a *pari passu* process of distribution. Mr Smith QC for York, who undertook the argument for the appeal on this issue, submitted that on this analysis there was nothing more than a purely formalistic difference between the two, so that David Richards and Hildyard JJ. could not both be right. Hildyard J said that the principal issue argued before him was whether the existence of a pre-existing contingent contractual right to interest at that higher rate made all the difference, if the contingency upon which it depended later occurred. He held that it did.

73. This issue needs to be addressed in the light of the further rulings of David Richards J in his supplemental judgment handed down on 24th August 2016 on what was labelled Supplementary Issue 1(c). This dealt with a situation where, under a pre-existing contract, no interest was due on the date of administration but a rate (higher than the Judgments Act rate) was provided for, absolutely or contingently, on a later date, before the dividend date. The judge concluded (and this has not been appealed) that for the period between the date of administration and the contractual start-date for the payment of interest, the alternative rate under Rule 2.88(9) was nil, rather than a back-dated application of the contractual rate to a period when it was not contractually payable. The two rates for those periods had then to be combined, not just to produce a numerical average, but to ascertain whether, in combination, they yielded more interest than did the Judgments Act rate for the whole period.

74. Finally by way of background, David Richards J recorded and accepted a submission from Wentworth (at paragraphs 179-181 of his main judgment) that where a pre-existing contract provided for a floating rate of interest, then Rule 2.88(9) required the interest payable to be ascertained by applying the variable rate from time to time throughout the relevant period (administration date to dividend date) in order to ascertain whether it was in aggregate higher than the Judgments Act rate, rather than just the floating rate in force on the administration date itself.

75. There is in our view no irreconcilability, or even significant tension, between the approaches of David Richards and Hildyard JJ. to this composite set of related issues. Taking them together, their approach to Rule 2.88(9) is as follows:

   a) The starting point is to examine what contractual or other rights to interest existed between the parties as at the administration date, which operates as a cut-off date for that purpose. Those rights might include a then current right to interest at a particular rate, a right to a variation in that rate in the future (as in a floating rate), a contingent right to a higher rate (such as a default rate), or a right for the first time to interest (as on a close-out triggered either automatically, or by the creditor). They would also include a right to interest under a pre-existing foreign judgment.

   b) This process of cut-off date examination will exclude foreign judgments not yet obtained, but include every interest entitlement, actual, future or contingent, in the pre-existing contract between the parties.

   c) A calculation then falls to be made whether, applying those various pre-existing contractual (or other) rights to the periods when they would have applied apart from the administration, they produce a higher rate for the proved debt than the Judgments Act rate. If they do, then that higher rate is the applicable rate under Rule 2.88(9).

   d) This does not mean that, where a contractual rate is only applicable for part of the period from the administration date, statutory interest at the Judgments Act rate is not recoverable for the whole period: see Item 5 above. The calculations called for under Rule 2.88(9) are still directed to identifying the higher statutory rate for the whole period.

76. The fact that a consistent approach to these problems emerges from the judgments of David Richards and Hildyard JJ. does not of itself mean that it is correct, although it does take the steam out of the submissions which relied upon a supposed irreconcilable difference between the two. But we consider that it is correct, for the reasons which follow.

77. Rule 2.88(9) constitutes a clear but limited departure from the emerging principle (fortified by the majority of the Supreme Court in *Waterfall I*) that the process of proof of debt and dividend in insolvency, including administration, replaces and extinguishes creditors' previous contractual rights. So far as concerns interest, the statutory regime permits regard to be had to those rights to enable it to be seen whether, under their contractual (or other) pre-existing rights against the insolvent debtor, creditors would have achieved a higher level of compensation for the delay in distribution after the cut-off date than they would, if compensated at the Judgments Act rate. This is not by way of specific enforcement of those contractual rights. They have been extinguished. Rather it is an examination of the parties' contractual relationship as at the cut-off date, to ascertain what is the appropriate statutory rate of interest payable thereafter. To that limited extent creditors are not treated equally, although compensation at the Judgments Act rate is an irreducible minimum to which they are all entitled, out of any available proceeds of the administration.

78. The yardstick for that examination is by reference to the contractual rate of interest which each creditor would have enjoyed, applied to the proved debt, during the period or periods between the cut-off date and the date or dates of distribution of dividend. For that purpose we can see no good reason why that rate should not be ascertained by reference to all the creditor's contractual rights to interest, whether current, future or contingent, when viewed from the cut-off date, but having regard to the benefit of hindsight to see what rate of interest those rights would in fact have generated if they had not been extinguished by the administration.

79. There is in our view nothing in York's submission that, apart from the administration, there would have been no event of default triggering a close-out under the relevant ISDA governed derivative contracts. The phrase "apart from the administration" at the end of Rule 2.88(9) is not designed to introduce an artificial pretense that the administration never occurred, but simply to set aside for the purposes of the comparative examination of pre-existing contractual (or other) rights the effect of the administration in extinguishing them.

80. To exclude having regard to pre-existing contractual right to interest for this purpose, simply because they are contingent or lie in the future, as York contends, would run counter to the inclusion of future and contingent debts for the purpose of proof. Furthermore there is no sensible reason to include changes in rate brought about by the application of a contractual floating rate, while excluding changes brought about, as here, by the exercise of a contractual right by the creditor.

81. Beyond those reasons, we simply agree with the analysis of these issues by David Richards and Hildyard JJ. We would therefore dismiss York's appeal under Item 12.

Conclusion

82. It follows from what we have said that we would dismiss the whole of this appeal, truncated as its ambit has been by the Supreme Court's decision in *Waterfall I*, and the parties' sensible acknowledgment of its consequences.