Friday, 20 February 2015

(10.30 am)

MR JUSTICE DAVID RICHARDS: Mr Zacaroli, just before you start your submissions, can I raise a logistical issue as regards Monday. As you may know, there is the Global Law Summit taking place in London, I think it's Monday, Tuesday, Wednesday, and on Monday afternoon there is a session here in the Rolls Building, not only here in the Rolls Building but on this floor. They are not, I think, going to be using this court but there are going to be quite a lot of -- upwards of about 200 delegates outside and they are going to have a session outside before going into various courts. I have been wondering how best we can cope with that. It occurs to me there are two alternatives. One is to press on with usual court hours, as if they weren't there, which is possible, I think, given we have double doors and so on. I would hope that the noise outside would be kept to a minimum, but one doesn't know and there is the difficulty you have 200 people out there and quite a lot in here and so on.

The alternative, which on balance I think may be preferable, would be to sit at, let's say, 9.30 on Monday go and on with a break at some point to 1.30 or 2 o'clock. I mean, I'm quite -- I would welcome your

views on that. You might want to just have a word about it in the mid-morning break and come back to me. I have a slight inclination in favour of sitting early and just finishing before they all arrive, but if you could give some thought to that, the precise hours, I would have thought if we started at 9.30, I think we would need certainly -- certainly I think our transcribers would need some -- a half hour break or something in the middle and what time we finish, you just might like to think about. But perhaps I can leave that with you all. It would be helpful if you can tell me after the mid-morning break what your views are about it.

Opening submissions by MR ZACAROLI

MR ZACAROLI: My Lord, we will do. Thank you.

MR JUSTICE DAVID RICHARDS: Thank you very much.

MR ZACAROLI: My Lord, I propose to deal with issue 2 under three broad topics. First of all, the construction of the rule itself as a matter of construction.

Secondly, to explain why Bower v Marris is irrelevant to that question of construction.

Thirdly, to deal with the fact that Bower v Marris, even where it does apply, can only apply in respect of interest-bearing debts and the impact that has on the second topic.

To unpack those three broad points by way of

overview for a moment, so far as construction is concerned, broadly we say that the rule, 2.88(7), requires interest to be paid at a defined rate on a defined sum for a defined period. Those words neither permit nor require that interest is calculated on the basis that the proved debt has not in fact been paid or that interest will be payable long after the proved debt has been paid, or that what is being paid is actually principal, not interest, all of which are characteristics of the Bower v Marris rule.

I will develop those points shortly.

So far as the second point is concerned, why Bower v Marris is irrelevant, and, again, just to summarise what we'll be dealing with in some detail when we go to the cases, but the proposition for which Bower v Marris stands as authority is that payments made under a process of law, such as dividends under the Bankruptcy Act, but also other examples, are not appropriated towards discharge of principal or interest, they're not appropriated at all. They are treated as being payments on account in the event that any surplus arises, such that the creditors' right, which is a right under the general law, to appropriate payments when the debtor has not appropriated them, survives and is exercisable.

The ordinary rule of appropriation as between solvent debtors and creditors therefore applies and operated on a presumption that the creditor would wish to satisfy interest first, but it's a presumption and is not always so.

Now, that proposition, for which Bower v Marris is authority, has relevance when one is considering a creditor's entitlement once there is a surplus to pursue whatever pre-existing claim it had on the assumption that the debtor is now solvent. That was the basis on which interest from an insolvency surplus was payable under every English case, every Australian case that my Lord has had to consider, that has ever considered the point. It was not the case in two examples, re Hibernian in Ireland and the Confederation Trust case in Canada. We distinguish those cases on the basis they were wrongly decided, there was no proper analysis and the arguments weren't put. So I'll always exclude those two cases in my general propositions about the cases that have considered this idea.

But the proposition is simply irrelevant to 2.88(7) because the legislation in 1986 proceeded on a different basis. It's no longer a question of allowing pre-existing claims to be reasserted once the debtor is

solvent, whether company or individual. Instead there's a direction as to how to apply the surplus, i.e. paying interest at a defined rate on a defined sum for a defined period.

Turning to the third topic, just by way of overview. If and where the Bower v Marris calculation applies, it can only logically apply to creditors with interest-bearing debts. There are two reasons for that. The first one is a technical reason: because for a creditor to be able to appropriate a payment to one payment or -- one liability or another, both those liabilities must exist at the time the payment is made. In the case of a non-interest-bearing debt, there is no interest accrued at the date that dividends are paid in the bankruptcy.

The second reason is a broader reason and really goes back to the rationale underlying Bower v Marris and Bromley v Goodere, which is that creditors' contractual rights should be satisfied before the bankrupt gets anything. So the whole rationale for the rule, as applied in bankruptcy, in the early part of the 19th century, was it was based upon satisfying creditors' rights.

Now, that is both a freestanding point, that whatever else may be the case, it can't apply to

creditors with non-interest-bearing debts, but it also reinforces the point we make that the draughtsmen can't have intended that this Bower v Marris-type of calculation would have any application under rule 2.88(7) because it creates unworkable difficulties. I will develop those when we get to the third topic, but that's our broad proposition there.

Now, by way of perhaps footnote at this stage, if my Lord is ultimately persuaded by an argument that creditors who would have had some right under the general law to appropriate payments towards interest as opposed to principal first, had the debtor been solvent, if those creditors' rights have been prejudiced by the insolvency regime as a whole, and that my Lord is concerned about that, the only way logically that that can be addressed is through a non-provable claim that comes after 2.88(7). I'm not submitting that my Lord should find that. Of course we say there shouldn't be one for a variety of reasons, but logically the only way out of this is that it comes in afterwards and only in respect of interest-bearing debts.

One of the slightly odd features of the submissions of both parties or both sides in this so far as -- I think we agree there's an element of common ground that actually there are good reasons why there shouldn't

be such a non-provable claim in relation to interest, but we say that the only way out of the dilemma, if my Lord sees that as a dilemma or some sort of prejudice being suffered, the only way out of it is by a further round of claims, non-provable claims for those with interest-bearing debts.

Now, there are, as my Lord will see, many areas of disagreement, but two main areas of disagreement with the Senior Creditor Group about the application of Bower v Marris. First of all, we disagree fundamentally with their description of the so-called rule in Bower v Marris. They refer to it as essentially a rule which dictates the calculation of interest payable in an insolvent estate. We disagree with that fundamentally. We say it is as I have already stated and I will come back to develop it in due course.

Secondly, and it follows from that, we disagree with the repeated assertion that our case involves the abolition of the rule in Bower v Marris, whether in 1883 in bankruptcy or in 1986 for companies. The point is that Bower v Marris is simply a facet of a creditor's rights in relation to interest against a solvent debtor, and where the rules, as they did in 1883 with bankruptcy and 1986 for companies and bankruptcy, do not proceed on the basis of remitting creditors to their contractual

rights, it simply has no part to play. It's not abolished, it's just irrelevant.

The rest of my submissions will fall into the following parts. First of all, I'll take each of those three broad topics in turn. That will take a considerable amount of time. We'll have to go through many of the cases that my Lord has seen and many that my Lord has not seen.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: Secondly, I'll pick up on the point that the word "rate" in rule 2.88(9) incorporates Bower v Marris into the calculation process. I'll deal, I think, at the same time with the sub-issue about interest on a compound basis, continuing to compound and accrue on a compound basis after the debt has been paid.

The third thing is I'm going to respond briefly to my learned friend's three basic propositions from Wednesday about how the rule works -- about how the construction works, how the construction of the present rule works.

Fourthly, I'll deal with some point of principle and policy and then, fifthly, I'm going to take issue 39 which really follows on from those point of policy and principle.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: So then, turning to the first topic, which is construction. All parties agree that question 2 in the application is actually a question of construction of the rule. Before I get to looking at the words themselves, the specific words themselves, I want to place the rule in context, which requires seeing what the existing regime was that Parliament was faced with when enacting the 1986 Insolvency Act and rules.

This is familiar ground so I can take it quickly, although I do want to go back over the Bankruptcy Act in a little detail to correct what we says a misconception as to how they worked.

First of all, as my Lord well knows, in winding up there was no statutory regime for payment of interest if a company turned out to be solvent at all. There was a judge-made rule from Humber Ironworks that interest stop running at the date of winding up, but, if there was a surplus, creditors were remitted to their contractual rights.

On the other hand, in bankruptcy there was already a long history of statutory provision of one kind or another for post-bankruptcy interest, it's actually 1824 but the Act was replaced within a year by the 1825 Act, which is the one we're going to look at.

Can I my Lord to take up the bundle 3A, just to go

quickly back to the statutory provisions. Tab 10 is the 1825 Act. Section 132 is in the last page of the tab, I think.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The section that's following features. They won't be unsurprising to my Lord. First of all, the surplus is to paid to the bankrupt after all creditors who have proved have been paid. That's the first aspect of the rule. Secondly, it requires, before that happens, that interest to be paid on those debts with -- which bear interest at such rate as they carry, but only if there's anything left after that, so on a subordinated basis there's a right of 4 per cent interest for all non-interest-bearing debts.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Turning on then to the 1883 Bankruptcy Act. That provision remained in substantially the same form in the interim Acts, and we needn't look at those, but there was a substantial change in 1883.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: Tab 27 of the bundle.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The two relevant sections are section 40, sub-section 5, on page 302.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: If there's any surplus, it shall be applied in payment of interest from the date of the receiving order at the rate of £4 per centum per annum.

Then section 65 over the page:

"The bankrupt shall be entitled to any surplus remaining after payment in full ...(reading to the words)... as by this Act provided and of the costs, charges ...", et cetera.

Now, at this point we suggest there's a misconception in my learned friend Mr Dicker's analysis of the rules here or the sections here. He submitted that in section 65 what Parliament was doing was preserving the rights of creditors who might have a higher contractual rate of interest to be paid before it goes back to the bankrupt. My Lord, first of all, as a matter of construction of the section, that ignores the crucial words "as by this Act provided". The only interest as by this Act provided for the post-bankruptcy period is section 40, sub-section 5. There is no other provision.

My learned friend's reading would have the slightly -- well, we would say very -- odd intention to be imputed to Parliament that, having the started with an Act which gave creditors a contractual right of interest as a priority over everybody else,

subordinate -- altered that priority by subordinating them to the creditors but said nothing about it.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Mr Dicker referred to no authority to support his construction of the rule in that way. In a moment I'll show my Lord a case which is inconsistent with that construction, but, before I do that, I want to deal with the other aspect of interest which comes in in the 1914 Act.

So if my Lord turn on to tab 36. We first of all have the same provisions as in the 1883 Act but this time section 338, which is the only provision providing for interest for the post-bankruptcy period. It's the 4 per cent flat rate for all.

Then section 69 is the mirror of section 35 of the 1883 Act and refers to the surplus going to the bankrupt after payment in full of his creditors with interest as by this Act provided. The same words appear.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The other provision, which is new --

MR JUSTICE DAVID RICHARDS: Sorry, that's in section 69?

MR ZACAROLI: 69.

MR JUSTICE DAVID RICHARDS: Yes, absolutely.

MR ZACAROLI: So then there's another provision which is new. It in fact came in in the Bankruptcy Act 1890 and

is then incorporated into this consolidated statute in 1914 and that's section 66(1). My Lord was shown the section.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: "Where a debt has been proved and the debt includes interest ...(reading to the words)... have been paid in full."

Now, no submission was made about that but lest it be thought that that section somehow continues to apply to interest in the post-bankruptcy period, it does not. It is dealing with proof. It's dealing with an excess over the proved debt.

MR JUSTICE DAVID RICHARDS: I see.

MR ZACAROLI: Excess in the proved debt over 5 per cent.

To make one obvious point: a creditor with, let's say, 4.5 per cent rate of interest would not fall within section 66(1) but would be being done out, as it were, of 0.5 per cent per annum per interest. No way section 66 can deal with that possibility.

Now, there is authority that makes good both these propositions. First of all, that the surplus after payment of the 4 per cent statutory and secondly that section 66(1) is dealing only win the pre-bankruptcy interest period.

The case is re Baughan, in bundle 1B, at tab 74.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: In fact this was two different cases that came on together. In the headnote, at page 313, the second paragraph, it is said:

"in two bankruptcy cases the official receiver as trustee ...(reading to the words)... valuable consideration had been satisfied."

So those are the two cases.

The decision, as noted in the "Held" below:

"The money lenders were creditors for their excess interest as a debt provable in bankruptcy and though postponed to other debts it took precedence over the payment of statutory interest under section 33(8)8."

Then so far as settlement trustee's claim was concerned:

"They were not a creditor whose proof for trustee in bankruptcy was bound ...(reading to the words)... to the creditor's claim to statutory interest."

Now, looking at the facts briefly, on page 314, towards the bottom of the page, the learned judge, Mr Justice Romer, deals with the first case, the money lender's case. Reading from the bottom, six lines up:

"Four proofs by money lenders were admitted for sums totalling £2,000-odd. Of this sum, the amount of ...(reading to the words)... pursuant to section 9(1) of

the Moneylenders Act."

We will see that section but it's in the same in material terms as section 66(1) of the Bankruptcy Act.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: There then at page 315, paragraph 8 in this -- about seven lines down, there's a number 8 in brackets, it then falls to be considered how the balance of approximately £692 shall be applied. That's the surplus -- the surplus in the hands of the trustee:

"The possible claimants to this fund are the four money ...(reading to the words)... under section 33(8)."

Then reading down a few lines, just above the break, six lines above the break:

"The precise direction which the official receiver required and which was argued before his Lordship was an order directing him to what person or persons he should paid the sum of £692 then in his possession being the surplus remaining in his hands."

Now, taking up briefly the second case, which is dealt with -- summarised at page 317, the top half of the page, about eight lines down, there's a reference to "the said Alfred Harvey Bennett".

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: He was the trustee of the marriage settlement. So the question for the opinion of the court on this

matter is.

"... whether the official receiver should apply the surplus ...(reading to the words)... to the creditors who have proved."

If we can pick up the judgment at page 320 and deal with case 1, the money lenders first, and then I'll come back to the judgment and deal with case 2. The so the money lenders' claim is dealt with at page 320, the second paragraph of the judgment. Mr Justice Romer says:

"The claim by the money lenders on the first application to interest in excess of 5 per cent under section 9(1) ... analogous provisions are contained in section 66(1) of the Bankruptcy Act 1914."

You will see the Moneylenders Act section 9 is there in the footnote and it's materially the same, postponing the right to proof.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: For the excess.

"It is, I think, clear that the amount due to a money lender ...(reading to the words) ... is whether the excess interest is subordinated further to the statutory interest."

The question of subordination is not so important. The important point is it is quite clear that this is

talking only about interest due at the date of the adjudication of bankruptcy, or the receiving order.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: In fact, at the bottom of the page, he decides, page 321, the bottom two lines:
"The result of that is that no creditors are entitled to ...(reading to the words)... for the payment of statutory interest."
Therefore, at page 327, he concludes, at the bottom the page, the fourth line from the end:
"As I have said earlier in this judgment, excess interest due on money lenders' loan is a debt, and a provable debt. As was stated by the present Master of the Rolls In re A Debtor, Section 9(1) ...(reading to the words)... postponed under section 42(2) of the Bankruptcy Act."
That's the matrimonial causes matter.
Picking up then case 2, the matrimonial case, this is the aspect which deals with all -- the only interest available to creditors under the Bankruptcy Act is 4 per cent -- in relation to post-bankruptcy period is the 4 per cent as provided.
MR JUSTICE DAVID RICHARDS: Right, yes.
MR ZACAROLI: So case 2 is described, first of all, at page 322 of the judgment. In the middle of the middle

paragraph, Mr Justice Romer says:
"These provisions and authorities conveniently took consideration ...(reading to the words)... or money or money's worth have been satisfied."
And it's that phrase "have been satisfied" which is picked up in the judgment later on.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: I'll come to the consideration of Mr Justice Romer on page 327 in a moment, but, first of all, he cites a case at page 325, a decision of Mr Justice Clauson In re Howes from 1934. He notes at the top of that paragraph:
"He, Mr Justice Clauson, there held where the assets of a bankrupt are sufficient to satisfy in full ...(reading to the words)... debts proved in the bankruptcy."
Then the principle which he's applying he cites at the bottom of the page, seven lines up:
"The principle appears to be well-established by the older cases and the ...(reading to the words)... to meet the claim of Sir Charles Cottier's executors."
Although it's not dealing with the surplus being remitted to the bankrupt there, the partner is essentially in the of the bankrupt, in the same position.

MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Clearly indicating that only -- the statute is only requiring 4 per cent in order to satisfy claims of creditors in full.
So with the help of, among other things, that authority, Mr Justice Romer at page 327, says, in the middle paragraph:
" I have accordingly come to the following conclusions as to the position of ...(reading to the words)... next in paying dividends to him."
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Now, it's evident from the report of the Cork Committee that they took the same view as to the operation of the Bankruptcy Act in both respects. If I can ask my Lord to turn that up. It's in bundle 4.
MR JUSTICE DAVID RICHARDS: The position therefore is that after 1883 the bankruptcy legislation did not make provision for the payment of post-bankruptcy interest, except to the extent of the statutory 4 per cent?
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: So that was clearly a change from the 1825 section?
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: Yes, I see. Right.
MR ZACAROLI: There's no possibility --

MR JUSTICE DAVID RICHARDS: Do we know why?
MR ZACAROLI: Well, we don't know why. I'm not sure if it's available.
MR JUSTICE DAVID RICHARDS: No, I just wondered. Anyway ...
MR ZACAROLI: I will, when I come to policy and principle arguments, suggest some reasons why.
MR JUSTICE DAVID RICHARDS: Sometimes this is referred into a judgment but it's not here.
MR ZACAROLI: We haven't found anything which explains it, but that undoubtedly was the position.
MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: The Cork Report extracts are in volume 4 at tab 3. First of all, to pick up a quick reference at paragraph 1364 on page 310, my Lord has seen this paragraph. I'm just reminding my Lord of the last sentence at 1364. This is dealing with section 66(1). You will see as described in the last sentence:
"The interest in excess of 5 per cent is postponed and ranks for dividend only after all the debts which have been proved have been paid in full."
So it picks up the point I made that that's only dealing with pre-bankruptcy interest, provable interest.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Then, more importantly, paragraph 1383, section 33(8) of the Act of 1914 provided that:

"If, after all the proving creditors have been paid in full, the bankrupt's estate still has a surplus, it is to be applied first in paying interest from after the date of the receiving order at the rate of 4 per cent per annum on all debts proved in the bankruptcy. Any balance then belongs to the bankrupt."

Now, it's important to remember, and I'll come back to this again when I'm dealing with policy and principle, that in bankruptcy there is no possibility of the creditor claiming against the bankrupt after he has had his discharge because the debt has been discharged, which includes the interest payable on it.

MR JUSTICE DAVID RICHARDS: I see. Right.

MR ZACAROLI: So one of the things you might want say is in the bankruptcy context non-provable debts just re-asserted against the bankrupt once he has his discharge, and that's true of many of them.

MR JUSTICE DAVID RICHARDS: But not true of interest on a debt which is discharged in the course of the bankruptcy.

MR ZACAROLI: Precisely.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: Can we keep the Cork Report open because I want to move now to having summarised the position that the legislature was faced with, namely a remission

to contractual rights in winding up and a flat rate of interest but no more for all creditors in bankruptcy, that was the starting point before 1986; what then did the Cork Report and the White Paper which followed it recommend? I know my Lord has been taken through the entirety of the paragraphs that I'm going to refer to so I'm not going to ask my Lord to read them again but pick up highlighted points.

The first is, as my learned friend pointed out, there's a lot of dissatisfaction with the generally confused position under the 1914 Bankruptcy Act, in particular section 66(1) and sub-section 2 which deal with what has happened if you have been paid interest in the period prior to bankruptcy at the greater rate; that sort of thing.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: That's undoubtedly true, but other matters which were of concern to the committee, first of all, is the inequality of the position in winding up, that creditors with contractual rights got interest as if there was no winding up at all and others got nothing. That's paragraph 1384. They pick up on this just after halfway through paragraph in the middle of the line:

"This means that the creditor who was entitled to interest on the debt for which he has proved may recover

the interest after the presentation of the winding up petition as if there had been no winding up at all. On the other hand, the creditor who is not entitled has no means of recovering interest, even if later there is a surplus."

Thirdly, the committee picked up on the anomalous position that there was a distinction or different approach in bankruptcy and winding up. That paragraph 1386. They refer to it as the anomaly that has been drawn to their attention by many different bodies.

Fourthly, they note, in 1385, citing the decision of the Vice Chancellor Pennycuick in Rolls-Royce that the purpose of interest post-bankruptcy, post-liquidation is to compensate creditors for being kept out of their money during the period of the administration of the estate.

My Lord found exactly the same in the Waterfall 1 judgment. You needn't look at it but the reference, if you want it, is paragraph 86 of the Waterfall 1 judgment. It's the compensation for being kept out of money during the period of administration of the estate.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Now, one major consideration in formulating proposals was to keep matters simple and certain. You

see that from paragraph 1392 under the subheading, "Our proposals".

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: "We have taken the following matters into consideration. We consider there should be one set of rules relating to the interest on debts in all forms of insolvency proceedings. In preparing the rules simplicity and certainty are essential."

The conclusion, therefore, the recommendation, was to take the current bankruptcy position and extend it across the board. You see that in recommendations at 1395, (c):

"During the insolvency, in the event of there being a surplus after ...(reading to the words)... at the commencement of the insolvency."

So you will see the recommendation then did change. The recommendation then was just the Judgments Act rate, so exactly the position that had applied in bankruptcy.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The other point to note is a clear intention in that very paragraph that the interest should run until a final dividend is declared.

Finally, one point to just go on. In the middle of paragraph 1392 on this same page, one of the other problems they identified is the unequal treatment of

different classes of creditors and they are trying to address that as well.
MR JUSTICE DAVID RICHARDS: What is that actually a reference to?
MR ZACAROLI: I assume that's talking about the fact that creditors with a right of interest get interest, but those without don't. Maybe not. I thought that's what it was referring to.
MR JUSTICE DAVID RICHARDS: That's not -- no, that's not right, is it, in bankruptcy? Sorry, is this bankruptcy or winding up?
MR ZACAROLI: This is just generally formulating proposals.
MR JUSTICE DAVID RICHARDS: I suppose it could be -- so you think -- hold on. Yes, I think it must be a reference -- it probably is a reference to the winding-up petition, yes.
MR ZACAROLI: But point is that inequality of treatment amongst creditors is an important factor.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Then turning to the White Paper, because the White Paper did move on from that recommendation in one very important respect. That's at tab 1. First of all, just to pick up a reference in paragraph 85, the review committee identified numerous instances where the present law in relation to the payment of interest is

unsatisfactory. Particular areas of concern were the provision of section 66 of the Bankruptcy Act and then -- and interest payable out of a surplus on claims for the period between the commencement of proceedings and the winding up and the date of payment in full. So they think they're considering the issue of interest payable until the date of payment in full.
MR JUSTICE DAVID RICHARDS: I see, yes.
MR ZACAROLI: Then the important paragraph is 88. The proposal now is that the judgments rate should be a minimum rate and that if there's a higher contractual rate, then that rate should be applied instead.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: We say it's important to note that all that is being incorporated here, from what was the position in relation to companies, is the rate of interest, if provided by a contract, was being enhanced. So a higher contractual rate was being substituted for the Judgments Act rate, nothing more.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: I'll come back to that when dealing with the question whether rule 2.88(9) somehow incorporates Bower v Marris because it uses the word "rate".
Now, if I can finally go to rule 2.88(7) itself. As my Lord knows, this is in the same form as the rule in

bankruptcy and winding up. It's exactly the same formulation.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So the first point to note is it follows the Cork Committee's recommendation in not adopting the old Companies Act regime but taking the bankruptcy regime of a rate of interest payable to all, with the uplift if there was a contractual rate of that rate. So it does not leave creditors to claim as if there had been no winding up at all.
It spells out how the payments from the surplus are to be made:
"In so doing, we say that it provides new rights that are substantially different to creditors' pre-existing contractual or other rights to interest as against the solvent company."
We summarise some of these in paragraph 17 of our initial skeleton, but just to run through them quickly. The most obvious one is that provides a rate of interest at the judgments rate to all creditors, even those who had no right of interest before.
The second is, and linked to that, if the creditors had a rate of, say, 4 per cent under his contract, it gave that creditor an uplift if the judgments rate was higher.

The third point is this, and we do say this is new in 1986: there is, for the first time, form of one-off compounding because what interest is being paid upon is the proved debt and the proved debt includes principal and interest up to the date of the winding up.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: That was not the case in companies -- under companies liquidation before. It was simply a remission to your contractual rights. On a proper analysis it wasn't the case in bankruptcy prior to 1883 either. Of course these particular changes had already happened in bankruptcy some 100 years previously.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: But what I'm detailing here is the differences from creditors' contractual rights.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: There are other respects in which the rights here are potentially different from contractual rights. Whether these are good points or not will depend upon my Lord's answer to subsequent questions.
MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: But, for example, in relation to future debts, it is common ground amongst all parties in relation to issue 8 that where a dividend is payable on a future debt after the time at which that debt has fallen due

for payment there is no discounting back on the value of that debt to the date of administration for the purposes of dividend. So a £100 debt due in three years' time, if there's a first and final dividend paid three years and one day after the administration, the creditor receives £100. If the answer to question 8 is as the administrators and we say it is, interest is payable from the date of administration. That could never have been the position absent an administration.

Sorry, it is us and them.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Similarly, on question 7, depending on my Lord's answer to that question -- which is, when does interest begin to run in relation to a contingent debt? -- if on this one we are wrong and on this we side with the administrators, if we're wrong on that, then interest is payable from the date of administration, even though, under -- absent the insolvency, that could never have been the case. You couldn't get interest until the debt has fallen due. So two other potential ways in which creditors' contractual rights have changed.

Lest it be said that some of these benefits could have been obtained by creditors going off and getting a judgment, not true necessarily. It depends.

A creditor with a debt denominated in a foreign currency, for example, would not get Judgments Act rate of interest on that debt. They would get a commercial rate, and not true of course in relation to future or contingent debts. You can't get a judgment with interest before the date that the debt's fallen due.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: So the overall point we make here is that there is a bundle of rights given by rule 2.88 which substantially alter, for better, and potentially worse, the pre-existing rights of creditors against the solvent debtor. The only concession to the contractual rights is the rate point, which I've already dealt with, although we say this as well: the fact that the draughtsman has identified one particular facet of contractual rights, namely the rate, and decided to incorporate that, but otherwise not adopt a remission to the contractual rights, would support our view that actually that's all that comes in from the contractual world from the non-insolvency world; you look at this rule alone to determine what's payable.

Just in passing, one question posed: does the rate in 2.88(9) incorporate the right to appropriate on Bower v Marris basis? I'll deal with that later, but we say "no".

MR JUSTICE DAVID RICHARDS: Very well.

MR ZACAROLI: It's easier to understand some of our points there once I have been through the rest of the submissions.

So now looking at what the rule actually requires to be done, and I've made these points briefly in opening and actually making them more extensively doesn't take much longer. We say as a matter of construction the rule does not permit interest to be paid to creditors on the basis that prior dividends are treated as having discharged interest before principal. What the rule does is it directs the surplus to be applied first only when all the proved debts have been paid in full; secondly, at a defined rate, minimum 8 per cent, on a defined sum. The defined sum is the amount of the proved debt on the basis that's now been paid.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Then for a defined period. The defined period, leaving aside any wrinkles about contingent and future debts for a moment, leading that aside, the defined period is the date between the date of administration and the date or dates on which the debt was in fact paid in whole or part. We get that from the word "periods", periods of the debts outstanding. That caters for the fact that there will be in many cases

interim dividends, so the debt will cease to be outstanding in part before it ceases to be outstanding in whole.

The phrase "for the period during which they have been outstanding" must mean up until the date the dividend is finally paid because the relevant surplus is that remaining after payment of the debts proved. What has to have been outstanding is those debts proved. I don't think there's disagreement about this. I think everyone accepts that's what the word must mean there.

Now, to apply the Bower v Marris approach to calculating interest, if that's what it is, would require the following. It requires an assumption to be made that what has been paid to date is statutory interest already, not the proved debt, or at least not just the proved debt.

Secondly, it requires the proved debt to be treated as if it hasn't been paid in full.

Thirdly, it permits interest to be paid long after the proved debt has in fact been paid in full.

Fourthly, it requires that what is being paid pursuant to the rule is in fact the proved debt itself and not interest.

We say these are all simply incompatible with the rule as we have noted.

Just to take a very simple example, to put that -- give that some colour. Imagine a proved debt of £100. It's outstanding for five years after the date of administration. After five years there will be £40 interest owing at 8 per cent a year. The proved debt is then paid in full, so £100 is paid after five years. There is then a further delay of two years before there's sufficient surplus to pay any interest. Interest now amounts -- well, on the other side's case, the Senior Creditor Group's case, the £100 is taken to have discharged £40 of interest and £60 of principal, leaving £40 principal unpaid and further interest of £6.40. So the £20 which is then payable -- of that £20, £6.40 is paid in relation to interest accruing since the date that the dividend was actually paid and the remainder, £13.60, is used to discharge such part of the outstanding proved debt itself.

So, first of all, one is paying interest for a lot longer after the date the dividend was finally paid and you're paying something which isn't interest, you're paying the proved debt.

Now, it really is that simple, my Lord, in terms of construction. We haven't really, with respect, heard a response to that on the meaning of the words. The other side's cases, York's and Senior Creditor Group's

cases, we say are remarkably thin in responding to this argument. Their case on construction starts we say from a peculiar position and involves three basic propositions. These are set out by my learned friend Mr Dicker in the first day's transcript, page 63 for my Lord's note.

The three points they make are, first of all, that features of rule 2.88 on which we rely were also features of the previous regimes. Secondly, the arguments we make were advanced and rejected under the previous regimes. Thirdly, under the prior regimes the courts construed the statutory scheme as providing a mode of calculation for interest which proceeded on the basis that dividends were treated as notionally discharging interest before principal.

Now, again, it will be more helpful, I submit, to deal with the answer to those fully once I've been through all the cases, but, in short, we say all three propositions are wrong. The previous regimes were fundamentally different and, as I pointed out in my overview at the beginning, SCG and York's case misconstrues what the rule in Bower v Marris was all about.

So far as the principles of statutory construction are concerned, the administrators in their skeleton have

included a quite lengthy passage on the appropriate rules.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: I'm not going to take my Lord through those. To the extent that it's necessary, Mr Trower will do that. I just make the following very short point, that no case has construed the rule we are considering or anything substantially like it. Thus, there is no authority which has any bearing on the interpretation of rule 2.88(7) for that reason. In fact, as I will hope to make good in going through the authorities, none of the cases are in fact construing a statutory rule as to how interest from a surplus should be calculated at all. They are all concerned with something else, which is this rule of appropriation.

There is not a single case and not a single writer that anyone has found writing on the regime since 1986, which is now nearly 30 years, that has suggested rule 2.88(7) works in this way, in the Bower v Marris way. Equally, no one has suggested it works the other way. It hasn't been considered; I accept that, but it is telling that no one has considered this point before.

My learned friend was taken to a sentence in a footnote in Gore-Browne. It's worth just looking at that again. It is in bundle 2, I believe. It's tab 7.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The relevant passage is on page -- the numbers are obscured but it's the page after 59-26.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Paragraph 18F and the sentence that the footnote relates to is that beginning five lines down or six lines down:

"Such interest is itself provable as part of the debt to the extent that it is payable in respect of a period preceding the commencement of the liquidation."

So the text is dealing with pre-administration or liquidation interest.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The footnote refers to insolvency rule 4.93(1) which is indeed dealing with pre-insolvency interest.

MR JUSTICE DAVID RICHARDS: Yes, I see.

MR ZACAROLI: So it's the prohibition -- sorry, it's allowing the proof in relation to pre-administration interest.

MR JUSTICE DAVID RICHARDS: So the equivalent of 2.88 --

MR ZACAROLI: -- is 2.88(1).

MR JUSTICE DAVID RICHARDS: Sorry, can you just repeat that?

MR ZACAROLI: The equivalent for administration is rule 2.88(1).

MR JUSTICE DAVID RICHARDS: What is the equivalent of -- for

the statutory interest?
MR ZACAROLI: I see. Ah, that's section 189, I believe.
MR JUSTICE DAVID RICHARDS: Is it?
MR ZACAROLI: Yes. That's in the Act.
MR JUSTICE DAVID RICHARDS: Thank you.
MR ZACAROLI: Yes, 189, sub-paragraph 2 and then 4 is the rate.
MR JUSTICE DAVID RICHARDS: I see. In Gore-Browne they dea with further down the page.
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: Yes, I see.
MR ZACAROLI: So we would suggest that the authorities of the sentence in the footnote is somewhat diminished by the understanding of its author that it was dealing with provable interest.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: In a sense, it's irrelevant for provable interest because we know interest stops running at the date of the bankruptcy or winding up or administration, so the only relevance of knowing to which part interest or principal was the dividend first payable will be for the benefit of a creditor who has some tax interest in that. That's likely the only circumstances because interest doesn't keep running so it's irrelevant -- the proved debt can't increase in value because dividends

are appropriated towards interest first because interest must stop running at the date of bankruptcy.
MR JUSTICE DAVID RICHARDS: It could be relevant to a claim against a co-obligor.
MR ZACAROLI: Indeed could be, yes. Yes, as we say, none of this deals --
MR JUSTICE DAVID RICHARDS: Was Joint Stock Discount Company, I forget, concerned with co-obligors, or not?
MR ZACAROLI: I just have to remember which one it was. One of them was.
MR JUSTICE DAVID RICHARDS: The reference is to number 2. (Pause)
MR ZACAROLI: Yes, this is the two estates one.
MR JUSTICE DAVID RICHARDS: It is. So, actually, understood in that context, the point made in the footnote is a perfectly sensible point.
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: But it's not actually concerned with post-liquidation interest.
MR ZACAROLI: Correct, yes.
My learned friend Mr Dicker yesterday then referred to the fact that there are a number of authorities since 1986 which have cited Humber Ironworks or Lines Brothers, although he frankly conceded to my Lord that none of those cases considered this point on the

Humber Ironworks.
MR JUSTICE DAVID RICHARDS: Quite.
MR ZACAROLI: He took my Lord to Wight v Eckhardt. It's worth looking at that briefly again. That can be found in bundle 1D at tab 132. He read to you the passage at paragraph 27 that Lord Hoffmann referred to Humber Ironworks and Lines Brothers in paragraphs 23 through 26. Perhaps my Lord will just remind yourself of paragraphs 23 to 26.
MR JUSTICE DAVID RICHARDS: Certainly. (Pause) Yes.
MR ZACAROLI: So Humber Ironworks, the "different" point, is the different Lines Brothers case altogether.
My Lord, my final point on construction is this, that we saw that one of the aims of the Cork Committee was simplicity and certainty. I am going to come back to deal with complications that arise if Bower v Marris is included only for some creditors within 2.88(7) and the problems that creates, but actually there's a wider point to be made about the lack of certainty and simplicity which is created if Bower v Marris is applicable at all. This arises because the essence of the Bower v Marris approach is that interest remains outstanding after the date the final dividend has been paid, potentially indefinitely.

Now, before -- well, in describing the problems that gives rise to, it is helpful to look at a very clear exposition in one of the Australian cases as to why it is that back in the 19th century the judges adopted a rule that interest stopped running at the date of bankruptcy or winding up. It's because it creates complications, if you're trying to make a pari passu distribution thereafter, if you don't know when interest stops running. I will be taking my Lord to the case in more detail later on but can I for the moment pick up a passage in it.
It's MacKenzie v Rees, bundle 1B, tab 71. It's a case from 1941. It's in the High Court of Australia and much of the case is taken up with a debate as to whether the relevant debts were interest-bearing or not. The case is authority -- all the judges in the case agreed -- for the proposition that interest stops running at the date of the winding up or the bankruptcy, as in England. It's not a Bower v Marris case at all, but it does deal with that basic rule.
Page 9 in the judgment of Mr Justice Dixon, just the second paragraph, a third of the way down the page, he says:
"The principal rule, namely that excluding intermediate interest ...(reading to the words)... might

lead to many difficulties."

He then cites Browne v Wingrove.

Then he says:

"The principle is accepted in the United States of America and the principle upon ...(reading to the words)... of the estate would be seriously complicated."

One must not forget that 2.88(7) doesn't operate only where -- I suggest rarely where -- there is so much surplus that everyone gets paid in full, certainly in one go. Indeed, sub-rule 8 recognises that by saying that all interest payable under paragraph 7 ranks equally whether or not the debts on which it's payable rank equally. So there is another form of pari passu distribution of statutory interest. So all the arguments that led to the interest stopping at the date of bankruptcy apply with equal force to requiring interest to stop accruing at the date of final dividend being paid because only then do you have fixed and ascertained claims to interest which can be distributed on a pari passu basis.

Precisely the same argument works to stop interest at a compound rate compounding beyond that date.

My Lord, I'm about to move on to the second topic, that is the rule in Bower v Marris, so it might be a convenient moment.

MR JUSTICE DAVID RICHARDS: I think that would be a convenient moment. I'll rise now for five minutes.

(11.43 am)

(Short break)

(11.48 am)

MR ZACAROLI: My Lord, I believe the consensus in relation to Monday is that we start at 9.30 and continue until 2.00 with a half hour break after two hours.

MR JUSTICE DAVID RICHARDS: Yes. Fine. Let's do that. The only thing I was just thinking about in the break was at 2 o'clock they are going to be setting up chairs and things outside. We will say at the moment we'll do exactly that, but it may be that we'll have to rise a bit earlier than 2 o'clock because I know they are going to be setting things up out there. Fine. Good. Thank you very much indeed.

MR ZACAROLI: My Lord, turning to the second topic which will be the largest of them, Bower v Marris and its application throughout the English-speaking world.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Our core propositions, just to remind my Lord very quickly, are that the Bower v Marris rule is merely that payments which are required to be made by law from an estate, such as a bankruptcy estate, are not thereby appropriated either way. That is an aspect of the law

of appropriation because it mean the creditor's right to appropriate remains.

The principles of appropriation are well-known. They are that where two or more liabilities are due from the debtor, first of all, the debtor can choose which one he is paying. The creditor may agree to accept that or not.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: But if the debtor does not appropriate, then it's up to the creditor to decide how to appropriate the payments. In the absence of appropriation by either, the law applies certain presumptions and always has done.

In the case of principal and interest, it has long been the case that if there's no appropriation the starting presumption is that it's appropriated towards interest first because that's in the creditor's best interest usually. That's a relevant question wherever the distribution of interest from an insolvency estate is by reference to the contractual rights of the creditors alone, but irrelevant under 2.88(7) for the reasons we've already given.

Although I said the principles of appropriation are well-known, it may be worth just looking at those for a moment to see how they have applied both in two

different debts cases and then in interest and principal cases, just a few references. We can start, my Lord, with Chitty which is in bundle 2, tab 2. If my Lord turns to page 1587 at the bottom of the pages, there's a subheading, "B. Appropriation of payments":

"Where several separate debts are due from the debtor to the creditor the debtor may, when making a payment, appropriate the money paid to a particular debt or debts and if the creditor accepts the payment so appropriated he must apply it in the manner directed by the debtor. If, however, the debtor makes no appropriation when making the payment, the creditor may do so."

Then paragraph 21068, one page on:

"Appropriation as between principal and interest. 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."

So clearly operating on a presumption.

A couple of authorities. One goes way back before Bower v Marris and that's Clayton's case. Clayton's case is a very long case. I am only going to take my Lord to one paragraph in it. I'm hoping that the

principles for which the case stands are well-known.
MR JUSTICE DAVID RICHARDS: I think so.
MR ZACAROLI: The part that we're concerned with -- it's in bundle 1A at tab 13A. It's one part of a very large case called Devaynes v Noble. It's a long report but Clayton's case begins being dealt with on page 781 of the English reports and the passage is at 791.
Of course the point here was about whether payment were to be appropriated on the basis of "first in first out" or some other basis. So that was what the case was about.
One sees that from what the Master of the Rolls says at 26 July, page 791; that the principles which are being applied are stated very shortly at page 792 in the first full paragraph:
"This state of the case has given rise to much discussion ...(reading to the words)... or the priority in which they were incurred."
In the case of a running account, the decision in the case was that the presumption is that each payment made in is appropriated to the first one out.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So from way before Bower v Marris, the general principle is one of relying on presumptions.
Then, skipping forward a few years to the Mecca in

the 1890s, I think. It's bundle 1A, tab 50.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: This is a decision of the House of Lords. The headnote reads:
"When a debtor pays money on account to his creditor and makes no ...(reading to the words)... the creditor expressed, implied or presumed."
That point is made good in the judgment of Lord Macnaghten at page 293, towards the bottom of the page:
"Now, my Lords, there can be no doubt what the law of England is on this subject ..."
It repeats the same principle there.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Then 294, seven lines down, at the end of the line:
"Where the election is with the creditor it is always his intention ...(reading to the words)... there are no circumstances pointing in the opposite direction."
The cases I've shown my Lord were not cases where the appropriation was between principal and interest, but the next case is. The next case is at bundle 1B, tab 66. It's Income Tax v Maharajadhiraja. It's a Privy Council appeal from India.

MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: My Lord was shown one of the -- a case on a similar line yesterday from India.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: It's a tax case about appropriation of principal or interest.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: You will see from the headnote:
"For the purpose of the Indian Income Tax Act the income derived ...(reading to the words)... has not credited as a receipt of interest."
The principles are discussed briefly in the judgment of Lord Macmillan at page 157. At the top of the page:
"Now where interest is outstanding on a principal sum due and the creditor ...(reading to the words)... it also applies where the income tax officer is concerned."
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: While we're in this bundle, there's one other case which shows that the presumption can be the other way in relation to principal and interest. My learned friend Mr Smith showed my Lord a debenture trust case.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: There's another debenture trust case which in fact was referred to in the one he looked at. This case is called Smith v Law Guarantee and Trust

Society Limited. It is at tab 54A of bundle 1B. The facts of this case were that the trust debenture by its terms required payments to be appropriated towards interest first before capital.
MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: Payments were made. They were made, however -- it was held, pursuant to an order of the court, but the subsequent court decided that those payments had not been appropriated by that order in any particular manner. The judge at first instance held, and I don't believe this was appealed but it's certainly common ground in the Court of Appeal, that although the contract required the payments to be appropriated towards interest first, that was a provision solely for the benefit of the debenture holders and they could therefore waive it. When it transpired that company was insolvent, it remained insolvent, it was in their interests to appropriate towards capital because an appropriation towards interest gave rise to a tax liability.
MR JUSTICE DAVID RICHARDS: I see.
MR ZACAROLI: So that was the point in the case.
MR JUSTICE DAVID RICHARDS: Yes, I see.
MR ZACAROLI: The Court of Appeal decided that notwithstanding that term in the contract, since there

hadn't been an appropriation because this was made by operation of law, it remained for the creditors to appropriate. They didn't bother to ask the debenture holders themselves because they took the view that they would only answer one way, namely it's in our interests to appropriate towards capital, so let's please do that.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: I needn't read the headnote. I've described the case, I hope, sufficiently.
Page 571 of the report is reciting what happened in front of the judge. At the bottom of the page, it says:
"Mr Justice Byrne held that the provisions in the trust deed for payment ...(reading to the words)... in their hands it would after be treated differently."
Then in the Court of Appeal Lord Justice Vaughan Williams, at page 574, middle paragraph, next to the second hole-punch:
"In this state of things these orders of 15 June 1896 and 21 July 1897 ...(reading to the words)... payments should not be immediately appropriated."
So the court was considering earlier orders which may or may not have amounted to an appropriation. But they decided they hadn't:
"If the payments had been made simply generally on account, it may well be ...(reading to the words)...

should now be attributed to capital."
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Now, I am turning to the application of this principle in the bankruptcy cases. We start with Bromley v Goodere.
Again, my Lord has seen this decision so I can take it, I hope, quite quickly. Just a couple of points about it. First of all, there is of course no discussion anywhere in the decision, the judgment of Bromley v Goodere about the appropriation of payments or and order in which payments should be dealt with. That's something which appears only in the order itself.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: In fact, there is no analysis in any case from the 19th century in relation to bankruptcy about how this works, other than in Bower v Marris. That is the only place one finds any analysis of the topic.
The other point to mention of course is that there was no statutory provision at all dealing with interest post-the date of bankruptcy at the time of Bromley v Goodere. So it's entirely judge-made law.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So whatever the rule is here, it cannot have been a rule as to the construction of a statutory provision dealing with the payment of interest from

a surplus.
MR JUSTICE DAVID RICHARDS: No.
MR ZACAROLI: There is also no doubt in this case that the entitlement to post-bankruptcy interest was based purely on such rights as the creditors had to interest against the debtor, assuming it to be solvent. It's all about contractual rights or similar.
There's a passage that my learned friend read to you but I want to highlight at page 50 which I'll come back to the point here later on in my submissions, but what he says at page 50, about four paragraphs up from the bottom:
"All bankrupts are considered in some degree as offenders ...(reading to the words)... is given for delay of payment."
I'll come back to that very important background context for these cases later on.
Then the actual decision in the case, I can highlight two passages which get to the crux of it. The judgment takes us through all of the old Bankruptcy Acts, but at page 51 he's dealing with the Act of Elizabeth 13 which is an Act prior to there being any discharge for the bankrupt. So there was no discharge for the bankrupt at this stage. Page 51, the first full paragraph:

"The Act goes on to take notice of the surplus ...(reading to the words)... from him again by the creditors."
Then over the page he deals with the Act of Ann 4th and 5th which introduced the concept of a discharge. At page 52, the first full paragraph, he says:
"Consider, therefore, the effect of the discharge; the certificate is not to operate as a discharge of the fund before vested in the assignees but to extend only to any remedy to be taken against the person of a bankrupt of his future effects."
In essence, therefore, it leaves -- the creditors are free to claim against the surplus, precisely what they would have claimed against the bankrupt before the discharge. That's the only difference it makes. On any view one is dealing here with a case where one requires full satisfaction of creditors before anything can go to the bankrupt.
You see that in fact from the order itself, at the top of page 53, just before the paragraph break:
"The requirement is pari passu all creditors until they receive full satisfaction."
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: As I mentioned, no other case contains any analysis of the point until you get to Bower v Marris.

So can we go then to Bower v Marris. I don't think I need to show my Lord the statutory provision again. My Lord is now well familiar with it.
MR JUSTICE DAVID RICHARDS: Hmm, hmm.
MR ZACAROLI: Bower v Marris is at tab 17 of this bundle
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: It's a small point but worth noting that the case is authority for the question of appropriation as between -- as it arose in the claim by the creditor against the solvent co-obligor. So everything else is technically obiter. And the headnote refers to it as (inaudible), but I'm not taking much of a point on that. It's clearly well-reasoned judgment, but it's worth noting it is actually obiter dicta.
Turning to the decision -- the judgment of the Lord Chancellor, Lord Cottenham. I am going to pick up a number of points on the way through this judgment so I'm not going to read all of it, but the first point to notice is that when he refers to the argument that there should be appropriation towards interest first, at the very beginning of the judgment, at the bottom of page 354, over to the top of page 355, where he says:
"... insist the amount is to be calculated by applying the amount ...(reading to the words)... discharge pro tanto of the principal."

discharge to part of the principal whilst any interest remained due."
It's an implicit recognition that it's for the creditor to decide that any creditor would do it that way.
The third point to note is what the argument advanced was, and this is very important for the next point, which is when the Lord Chancellor says:
"The doctrine of appropriation has nothing to do with it", he's not saying the doctrine of appropriation has nothing to do with this case. What it has nothing to do with is the argument that is being immediately presented to him. We'll see how that works.
The middle paragraph, page 355, he says:
"The question so far as it's a question of principle turns upon the accuracy ...(reading to the words)... was upon each payment discharged."
So that's the argument that he's faced with.
His response:
"In the first place as this mode of payment is regulated by Acts of Parliament, the doctrine of appropriation which is founded upon the intention expressed or implied of a debtor or creditor cannot have any place in the consideration of the present question."
The present question being have the payments so made

He says:
"This is no doubt the ordinary mode of calculation."
Now, it's clear, we submit, that what he's saying there is the ordinary mode of calculation in accordance with the general principles of law, not some ordinary mode of calculation in bankruptcy, because he has not yet referred to any authority and the whole of this part of the judgment is in fact argued or reasoned as a matter of principle because he doesn't turn to authority until the top of page 358, where he says:
"If there had been no decision on this subject, I should have thought these reasons conclusive in favour of the mode of calculation."
He then turns to look at cases like Bromley v Goodere.
He goes on to say that it is the general course of dealing in cases of mortgages, bonds and other securities; emphasising that he is talking here about a general principle of law applicable where a debtor owes money to his creditor.
The second point to note is that he clearly understands that this is -- the general law operates on the basis of a presumption as to the creditor's interest because he goes on to say immediately:
"No creditor would apply any payment to the

already been appropriated towards principal? No, because they're made in regulation of Acts of Parliament.
MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: As put later by Lord Justice Selwyn, in process of law. It's the same concept.
He then goes on to recognise that the question of appropriation is therefore a matter of entitlement for the creditor. So he says:
"The estate of the obligor under administration is liable to pay all the ...(reading to the words)... and he is entitled [that's the creditor] to apply all payments on account to the interest due before he would be bound to apply any part of it towards the discharge of the principal."
That is simply a classic statement of the state of law as it then existed under the general rules of appropriation.
He confirms or it can be confirmed that that is what he is talking about at page 357, when, about five lines down, at the end of the line, he asks rhetorically:
"Why should such payments [that is, made pursuant to the Act] have a different effect than they would have if made by a solvent obligor?"
If made by a solvent obligor, they could only have

had the effect of leaving the creditor with the option of appropriating.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Now, the next point to note from this decision is that it is essential to the reasoning of the case that the creditor had an existing interest-bearing debt. First of all, if you look at the top of page 356, the passage we have already looked at, where he talks about the entitlement of the creditor:
"... is to apply all payment on account to the interest due."
Secondly, when he's talking about the rule of convenience at the bottom of page 356, that interest stops at the date of commission, about eight lines from the bottom, there's a passage which begins:
"The trains stops at the date of the commission and though subsequent interest becomes due it is not provable under the commission."
Again, only talking about interest which is pursuant to a pre-existing right.
Then at the top of page 357 he makes it absolutely clear:
"The bankrupt continues indebted for the principal and interest accrued since the commission."
MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: He asks why should it be different with a solvent obligor? That can only be relevant to whether in relation to the solvent obligor there's an obligation to pay interest.
Then at the bottom of the page, 357, again, the middle of that paragraph, he talks about interest stopping at the date of the commission because it's supposed the estate will be deficient. So interest can only be stopped if it's already due or otherwise would have been due.
Then, finally, at the bottom of the page:
"The creditor in that case will not have received interest upon his debt to the same extent as he would if there had been no bankruptcy. If there had been no bankruptcy he would only receive interest if he was entitled to it."
So it is absolutely clear that the reasoning in this case is founded upon the fact the creditor has a right to interest and therefore in the background that interest is accruing and that creditor has a right of appropriation in relation to payments made to him at a time when both principal and interest are owing under his contract.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So, in short, we submit that the words at the

bottom of page 355, "the doctrine of appropriation cannot have any place in the consideration of the present question", have been taken out of context by York and the Senior Creditor Group, have been assumed to mean that the case itself has nothing to do with the doctrine of appropriation. And that is wrong. They are very clearly directed only at the argument that he's been presented with at that time.
My learned friend Mr Dicker referred to a sentence or a line on page 358, in the middle of page 358, where he refers to Bromley v Goodere and the order that was made in that case. So the reference to Bromley v Goodere is next to the first hole-punch.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: "The order appears to have been framed by himself ...(reading to the words)... justice of the case without the aid which the statute now affords."
My Lord, the only thing he can be referring to there is that the statute now provides that there is a right to interest payable once all the debts have been paid to creditors.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: That simply wasn't there at the time of Lord Hardwicke's decision. So he isn't saying, "I'm now construing this statute as giving this right to interest

in a way which must be calculated in this way". That's not what is happening here. He's simply saying the creditor remains entitled to his rights and in that context the general law give this right of appropriation and there has been no appropriation so far.
The final point that I want to pick up on from the case is at page 359, the second paragraph on that page:
"It is true that in certain cases the dividend has been considered ...(reading to the words)... in justice and defeat the contract between the parties."
Now, my learned friend Mr Dicker yesterday accepted that this rule in Bower v Marris is always subject to there being a contrary agreement between the parties. Now, that contrary agreement is not one which is an agreement reached after bankruptcy; it's a contrary indication in the agreement between the parties. So in a case where the debtor and creditor have previously agreed that all payments shall be appropriated pari passu towards interest on the principal outstanding at any time, that clearly governs.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Which emphasises that this is a question of general law. That's irrelevant unless one is actually saying that what one is doing is looking to see what the general law of appropriation is. It's only then that it

becomes relevant to the contract and creates a different outcome.

My Lord, on the first day, page 88 of the transcript, Mr Dicker said to my Lord that there are -- having looked at Bower v Marris, he said:

"There are a very large number of bankruptcy cases I could show your Lordship but I think that's all I need to".

Now, this chimes with a very eloquent way my learned friend expressed the case throughout, that there is this rule in Bower v Marris as if everyone has known about this rule all along and it's well understood and has always been applied, up until some change happened in 1986.

My Lord, the truth is very different.

The Bower v Marris judgment was delivered on 7 August 1841. It so happens it was a Saturday. They worked much harder in Victorian days. If I may be permitted a little colour, at this point, just a little; the infamous Marshalsea debtors' prison in which Charles Dickens' father had been imprisoned a mere 17 years before was still open for business.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: This is 28 years before bankruptcy becomes decriminalised in 1869.

Now, it's not irrelevant colour because there are two points that spring from this. First of all, as I'll come back to when looking at broader policy and principle arguments, it is very important to look at general statements in the old cases about everyone must be satisfied in full before the bankrupt gets anything in that context. The debtor was regarded as an offender, a criminal, who was deliberately not paying his debts, who was thrown into prison, therefore making it impossible for him to pay his creditors but, nevertheless, being punished for that. That's the context.

More important for the present moment, since judgment was given in Bower v Marris, on 7 August 1841, neither the case nor the principle of appropriation applied in it has been applied or even referred to in any bankruptcy case in England. You have not been shown one. The parties no doubt between us have been scrabbling around to find any reference to it. There is no bankruptcy case which has applied the principle or even referred to it.

In fact, leaving aside the Scottish decision of Gourlay v Watson, which wasn't a bankruptcy case but was something similar and was in Scotland anyway, there is no case at all, whether bankruptcy or company, in any

jurisdiction that my Lord has been shown that applies English law -- I'm leaving aside America -- any jurisdiction where the principle has been applied to the distribution of interest from a corporate or personal insolvent's estate, until Lines Brothers.

MR JUSTICE DAVID RICHARDS: Really?

MR ZACAROLI: So between Humber Ironworks and Lines Brothers -- I should have made that clear, a period of 100 years -- there is no case when the principle has been applied in the context of the distribution from an insolvent's estate.

There's a danger here of my Lord being shown a lot of authorities. Those that referred to the Bromley v Goodere, they are all Bower v Marris or prior. The rest of the cases my Lord has been shown are from Australia, Canada, Ireland, they are all post-1986. So in asking yourself what was the legislature in England faced with in 1986, was it faced with this long-standing rule that everyone knew about, that this was how you always distributed from a bankruptcy estate? We would suggest absolutely not.

Moreover, there's no reference to the Bower v Marris case at all or the principle of appropriation in it in any edition of Williams. Williams, the leading bankruptcy textbook for the whole of the 20th century;

not one of its editions contains any reference to it.

My learned friend Mr Smith refers to two textbooks, one Mr Robson from 1884 and one Mr Wace from 1904, I think it was. The second one is a rather tentative reference to, "It's conceived that this is the way you do it".

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: That book has never seen the light of day since. I'm not sure who Mr Wace was. It's certainly not of the calibre of Williams throughout the rest of the century.

Mr Robson, then, in 1884 -- my Lord was shown the passage. He says, "As to the old law, this was how it was done under Bower v Marris", I agree it's an ambiguous concept but at least on one view he's talking about what the "old law" was. There is another reason to question the authority of that statement anyway. It's worth just picking the book up at bundle 2, tab 12, page 291.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The footnote G is referable to the text, halfway down the page:

"The Act of 1883 also provides if there is any surplus it shall be ...(reading to the words)... on all debts proved in the bankruptcy."

It refers to section 40, sub-section 5:
"This provision is altered by Bankruptcy Act 1890, section 23" --
MR JUSTICE DAVID RICHARDS: Sorry, where are we?
MR ZACAROLI: I am looking at footnote G, section 40, sub-section 5.
MR JUSTICE DAVID RICHARDS: Where does it say --
MR ZACAROLI: G is on the left-hand column.
MR JUSTICE DAVID RICHARDS: I have that, yes.
MR ZACAROLI: So he cites section 40 sub-section 5. He then says:
"This provision is altered by the Bankruptcy Act 1890, section 23, for the benefit of creditors whose debts carry higher interest that 4 per cent."
That's just plainly wrong.
MR JUSTICE DAVID RICHARDS: Oh dear.
MR ZACAROLI: It's worth -- what he's talking about is in fact the section of the Bankruptcy Act 1890 which became section 66(1) which is about the 5 per cent interest that's capped for proving creditors and then there's an uplift -- they are entitled to the excess as a matter of proof once everyone has been paid in full. I can show my Lord that section very quickly. It's bundle 2 -- bundle 3A, tab 29. Within the tab, it's page 628, section 23 is there set out. You'll see it's exactly

the same as what becomes section 66(1). I am sorry, it's page 623.
MR JUSTICE DAVID RICHARDS: I'm getting there gradually.
(Pause)
Oh, yes. You mentioned it had come in at this stage.
MR ZACAROLI: In re Baughan, the case we looked at, shows that's just about provable interest.
So when he goes on to say "as to the mode of calculating interest on the old law", it may be that he's again, rather like the editor of Gore-Browne, not necessarily wrong because he's talking about the provable interest, but, anyway, he's clearly wrong in the first sentence which undermines to some extent the rest.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Be that as it may, that and Mr Wace's reference are the only references you will see in any textbook to Bower v Marris throughout that entire period. That is 1880 through to 1986.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So when one comes to the question of what policy reason could there have been in 1986 for abolishing the rule in Bower v Marris, well, we question whether there was ever any such rule that was ever

applied in the way my learned friends contend, but any rule there may have been had been pretty much forgotten about, apart from Lines Brothers, for over 100 years.
MR JUSTICE DAVID RICHARDS: Was Lines Brothers decided before or after the Cork Committee reported?
MR ZACAROLI: Afterwards.
MR JUSTICE DAVID RICHARDS: Lines Brothers was after?
MR ZACAROLI: I'm pretty sure because 1982 is the Cork Report and Lines Brothers number 2 was -- it's reported in 1984 and I'm pretty sure it was decided in 1983 or 1984. I am reminded, December 1983, January 1984.
MR JUSTICE DAVID RICHARDS: That's Lines Brothers?
MR ZACAROLI: Lines Brothers number 2.
MR JUSTICE DAVID RICHARDS: And the Cork Report was ...?
MR ZACAROLI: June 1982.
MR JUSTICE DAVID RICHARDS: Because Mr Dicker made the point that David Graham QC was a member of the Cork Committee. If Lines Brothers had been decided before the report, it might have featured.
MR ZACAROLI: I see, yes. It is the wrong way round. It makes a very large assumption anyway, or a number of assumptions.
MR JUSTICE DAVID RICHARDS: Hmm, hmm.
MR ZACAROLI: I am reminded that Mr Graham was also the

editor of Williams.
MR JUSTICE DAVID RICHARDS: Was he? Right, along with Mr Muir Hunter, I think.
MR ZACAROLI: Yes.
Now, I have made the point about no references for 100 years, but of course the really important date for that purpose is 1883 because that's the date when there's a significant change in the law relating to bankruptcy in post-administration which -- I've already shown my Lord how that works.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Importantly, therefore, the premise of Bromley v Goodere, that creditors must be satisfied in full before surplus goes back to the bankrupt, and the underlying premise in Bower v Marris Bower v Marris, which is to the same effect, creditors' rights must be satisfied before anything goes back, those are completely -- substantially removed because the principle is now not creditors must get everything they could have got as a matter of contract before the surplus goes to the bankrupt. Now the principle is creditors must get what the statute requires them to get by way of statutory interest before the bankruptcy gets the surplus.
So, so much for the bankruptcy cases. Now the

company cases. The statutory framework here, as my Lord knows, that there is no provision until 1986 dealing with the payment of interest from a surplus once it arises so we're in the judge-made rule period. There's then the quartet of cases involving Humber Ironworks and the Joint Stock Discount Company. On proper analysis, we say that each of those cases supports the proposition we say you get out of Bower v Marris, namely that there is simply no appropriation when the payments are made pursuant to a statutory regime pursuant to law which leave the creditor free to exercise his contractual rights. That's a phrase which crops up more than once in the judgments in these four cases.

So if we start with 1A, tab 27, which is the first Humber Ironworks case.

MR JUSTICE DAVID RICHARDS: Just give me a moment. Yes, I have it. Tab 27.

MR ZACAROLI: The case is most often cited for the famous "the tree lies where it falls" quote, and the idea that interest stops running at the date of winding up, which is the first case in winding up where that was decided.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: It's also very clear that the basis upon which creditors could claim interest once the company was now surplus, is, as Lord Giffard put it, memorably by

remission to their contractual rights.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Lord Justice Selwyn alone deals with the Bower v Marris issue at page 645. So what he says there, at the bottom paragraph, where there's a surplus:

"Whatever manner the payments may have been made, whether originally made in respect of capital or in respect of interest, still in as much as they have all been paid in process of law [picking up the concept from Bower v Marris] and without any contract or agreement [so, again, subject to contrary intention amongst the parties] the account must, in the event of there being a surplus, be taken as between the company and creditors in the ordinary way. That is in the manner pointed out in Bower v Marris by treating the dividends as ordinary payments on account and applying each dividend in the first place to the payment of the interest due at the date of such dividend and the surplus, if any, to the reduction of principal."

So only relevant where there is interest due at the date of the dividend. Described as being in the ordinary way, a phrase used in Bower v Marris to describe the way in which it's been used for bonds, securities and debentures, et cetera, i.e. the general law principles.

So, properly read, entirely consistent with the way we say Bower v Marris should be read.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: There's nothing in Lord Justice Giffard's judgment which really touches on this point because he wasn't dealing with the appropriation of payments.

Just to pick up on one point. When Lord Justice Giffard says, at the end of his judgment -- he adds another reason, pages 647 to 648:

"I do not see with what justice interest can be computed in favour of creditors whose debts carry interest ...(reading to the words)... and so obtaining a right to interest."

That is a reason he's putting forward as to why all interest stops running at the date of winding up for the purposes of proof.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: Because that's what he's been talking about above.

MR JUSTICE DAVID RICHARDS: Yes, I see.

MR ZACAROLI: In the immediate preceding sentence he's made it clear --

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: He's made it clear in the preceding sentence, of course, there's no interest out of a surplus to

someone who had no right to it in the first place.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: My Lord, then turning to the next of the four cases, the Joint Stock Discount Company case, which is tab 28. This is the proof against two estates case.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: I can take this very shortly. At page 88, Lord Justice Giffard refers to Mr Jessel's argument about appropriation having already happened and says that's a mistake:

"The rule which has been made has no such effect ...(reading to the words)... or the particular winding up."

That's the rule about interest stopping at the date of winding up:

"But it is not meant at all to interfere with the rights of the creditor."

So here one falls back to it is the creditor's rights which are being respected:

"If he can get payment from other sources to combine and retain ...(reading to the words)... not only his principal but all his interest."

So the only principle he's applying is there is no appropriation because matters are paid in a process of law. There's no appropriation and therefore the

creditor's rights remain, as they did in Bower v Marris against the co-debtor.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Similarly, in the Humber Ironworks Shipbuilding number 2, tab 29. This is the security case. This is the creditor with rights of security, as well and provable rights.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: He refers, page 92, to the Joint Stock Discount Company number 2 which I think is the one we just looked at. Yes, it is.
MR JUSTICE DAVID RICHARDS: Hmm, hmm.
MR ZACAROLI: "The creditor proves in the winding up as in bankruptcy for whatever the amount of ...(reading to the words)... amount to an appropriation in any shape or form."
So that's the key point we get from Bower v Marris as well, no appropriation.
Then page 93, the way he puts it here is very important, the last four lines before the last little paragraph:
"Although the proof in terms is in respect of principal, that does not amount to any appropriation or preclude the party who has proved from appropriating the sum received for the payment of interest so long as the

train is due."
Very clearly the creditor's right to appropriate remains.
Then the last of the quartet is the re Joint Stock Discount Company number 2. Here the point is put most clearly by Sir Richard Baggallay QC, which is the successful counsel whose arguments were accepted, having responded yet again to Mr Jessel's arguments. Page 13 is the note of the argument. He refers again to the Joint Stock Discount Company case. He refers to the argument about appropriation, and then says:
"But that is an appropriation simply for the convenience of the court and not such as to deprive the creditor of his right to appropriate the payment in any way he thinks most beneficial, according to the principle laid down in Bower v Marris."
So there we have an extremely clear statement of the Bower v Marris principle, as one which simply preserved the creditor's right to appropriate.
MR JUSTICE DAVID RICHARDS: Yes, I see.
MR ZACAROLI: The judgment doesn't give us much help. It's a very short judgment of Lord Romer.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: My Lord, that's the English cases on the subject. Until Lines Brothers --

MR JUSTICE DAVID RICHARDS: That's it.
MR ZACAROLI: Yes. Which is a concession, as my Lord knows. There's no decision there at all.
MR JUSTICE DAVID RICHARDS: No.
MR ZACAROLI: I'm going to deal separately with cases in other fields, like the debenture actions and the testamentary cases, because there's a similar principle at play. Well, it's the same principle of appropriation at play, but I'll deal with those separately.
I'm now going to turn to the foreign cases. In all of them, except the two I've already mentioned, Hibernian and Confederation Trust, the conclusion is entirely consistent with our analysis of Bower v Marris. They don't contradict it whatsoever. In all of them, again excluding those two, the relevant statutory provision relating to post-liquidation interest or post-bankruptcy interest operated on the basis that the claims of the creditor against the now solvent debtor were to be satisfied before anything else happened.
So in all of them, to the extent that they considered Bower v Marris at all, which is not all of them by any means, but to the extent that they did, they were applying it as a principle of appropriation.
MR JUSTICE DAVID RICHARDS: Yes, all right.
MR ZACAROLI: In the two cases which don't fit with that

thesis, there was no argument and no analysis of any substance to the point.
Now, I'm afraid I will go to a number of these cases that my Lord has seen but it's important to make that point good. In a sense, I'm looking for a negative but I shall go through them hopefully quite quickly.
The first is one we saw briefly this morning, MacKenzie v Rees, bundle 1B, tab 71. The reason for showing my Lord this case, apart from the fact that it's cited in my learned friends' skeletons, is it's not a case which deals with Bower v Marris at all, but it's a very important case in Australia as the reasoning underlines what is happening when creditors are coming against the insolvent company under the Australian legislation to claim interest. What is happening is that they are essentially having another run. The claim that they had at the outset is suspended and they come back in with their claim once there's a surplus. So nothing like the current position in England. It's very much you have your contractual right which we're now going to respect.
As I mentioned this morning, earlier on, one of the main debates in the case was whether or not the relevant debts carried interest at all, but that's not a concern for us.

MR JUSTICE DAVID RICHARDS: No.
MR ZACAROLI: Picking up Mr Justice Dixon's judgment at pages 10 and 11. So page 10, he is referring here to the principle that interest stops running. We have seen that this morning, that passage about interest stops running at the date of bankruptcy.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: At the bottom of page 10, about four lines from the bottom, he says:
"It is possible, I think, to give effect both to the principle and to the form ...(reading to the words)... thus the wide language of section 81.1 [I will come back to that in a moment] may be taken as covering the intermediate interest [by which he means interest between the date of bankruptcy and the surplus arising, that intermediate period] so that it is not altogether excluded as a claim against the assets and, at the other end, section 118 may be regarded as conferring upon the debtor ...(reading to the words)... allowed only if and when a surplus is attained."
MR JUSTICE DAVID RICHARDS: I'm just going to re-read this passage to myself, sorry. (Pause)
Yes, thank you.
MR ZACAROLI: It is helpful to see the statutory background. I should perhaps have taken my Lord to it first.

MR JUSTICE DAVID RICHARDS: No, don't worry.
MR ZACAROLI: I have them. They're appended to our skeleton. I don't know if my Lord still has them there?
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: It's annex 2 to our skeleton. We're dealing here with the Commonwealth Bankruptcy Act of 1924 in Australia and the first page of the annex is section 81.
MR JUSTICE DAVID RICHARDS: Sorry, page --
MR ZACAROLI: It's annex 2.
MR JUSTICE DAVID RICHARDS: Just give me a moment. Right, yes, I see. Yes, I have it.
MR ZACAROLI: It should be the Australian Commonwealth Bankruptcy Act.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Section 81.1:
"All debts and liabilities, present and future, certain or contingent, to which the bankrupt is subject at the date of the ...(reading to the words)... deemed to be debts provable in bankruptcy."
That's the first of his termini, debts provable.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: But then the judge-made rule says that interest stops running for the purposes of proof.
Section 11.8 is the second of the two termini he's referred to over the page:

"The bankrupt shall be entitled to any surplus remaining after payment in full of his creditors and of the costs, charges and expenses of the bankruptcy."
The form of the legislation thereafter in Australia relevant to the later cases changes slightly and some of the cases considering whether the fact the legislation has changed in a particular respect has altered this rule and they all decide it hasn't, but that's the underlying basis of the jurisprudence in Australia.
MR JUSTICE DAVID RICHARDS: I see. So just remind me, under the Bankruptcy Act 1914 was there express provision -- yes, of course there was. There was a provision for the payment of interest. Sorry, yes. So there was nothing in the Commonwealth Bankruptcy Act?
MR ZACAROLI: That's right, yes.
The second decision, one I think my learned friend did take you to, is Midland Montagu v Harkness, in bundle 1C, at tab 119.
MR JUSTICE DAVID RICHARDS: I don't think I have seen this one.
MR ZACAROLI: I am sorry, I thought you had. I think it may have been mentioned in passing. I can be quite short then. It's not one that seems to be relied upon, but this is a case which did consider the rule in Bower v Marris and applied it in Australia, if

I remember rightly.
MR JUSTICE DAVID RICHARDS: In relation to a scheme, yes.
MR ZACAROLI: It was a scheme which applied -- let me get the facts right -- the position in companies to the scheme and the company law itself referred on to the bankruptcy law in relation to interest. In the headnote -- yes, there were a number of companies subject to schemes of arrangement.
MR JUSTICE DAVID RICHARDS: Perhaps I'll just read the headnote to myself to see what the context of this is.
MR ZACAROLI: Yes. (Pause)
MR JUSTICE DAVID RICHARDS: Yes, I see. I'm just reading headnote. (Pause)
Yes.
MR ZACAROLI: My Lord, the relevant statutory provision which at the end of that cross-referral process applied was 82.3(b) of the Bankruptcy Act 1966, which you can see copied out at page 330 of the report.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: What the learned judge says is that that sub-section does no more than enact in statutory form a principle as to the proof of liabilities carrying interest which has been part of the general rule of bankruptcy since 1789, citing MacKenzie v Rees.
MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: What he finds is that no change in the law was intended by the introduction of that statute.

So what the decision stands for is an application of the principle in Bower v Marris in the context of a statutory regime which mirrored very much that scheme applicable in England to companies pre-1986; that is, there is no provision for interest out of the surplus as such in the statute.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: I am not going to take my Lord to all the cases referred into the skeleton which my Lord hasn't been taken to. I will make that general proposition that in none of them is there anything which contradicts this basic principle.

MR JUSTICE DAVID RICHARDS: I'm with you.

MR ZACAROLI: The one case worth reminding my Lord of is Tahore Holdings, 1D, tab 135, which you were taken to.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: My learned friend Mr Dicker described this case as one which applied Bower v Marris to a case where the right to interest arose by way of a judgment. So it was a judgment of interest. That's not quite right. It is true that the interest in this case arose because of a judgment, not because of a contract, but actually the case doesn't apply Bower v Marris. It's merely dealing

with the principle of the right to interest coming back in once there's a surplus.

The judgment critically was a pre-insolvency judgment, so at the time of the insolvency the creditor had a right to interest --

MR JUSTICE DAVID RICHARDS: Yes, I'm with you.

MR ZACAROLI: The principle for which it was cited by my learned friend Mr Smith, I think, was that interest in these circumstances isn't limited to contractual interest and includes interest arising under, for example, a judgment. We don't disagree with that. The question is what right did the creditor have to interest at the date of the bankruptcy or winding up or administration. If he already had a Judgments Act judgment and therefore a Judgments Act interest in favour of him, he was like a creditor with a contractual right.

MR JUSTICE DAVID RICHARDS: I'm with you.

MR ZACAROLI: We don't draw a distinction.

My Lord, is that a convenient moment?

MR JUSTICE DAVID RICHARDS: Yes, certainly. 2 o'clock.

(1.00 pm)

(Luncheon Adjournment)

(2.00 pm)

MR JUSTICE DAVID RICHARDS: Yes, Mr Zacaroli.

MR ZACAROLI: My Lord, the next case to go to is the case of Gerah Imports v The Duke Group Limited.

MR JUSTICE DAVID RICHARDS: You just touched on re Tahore just before we rose. I had looked at that before, but a point you make about this case is that there's no discussion of Bower v Marris or the principle in Bower v Marris at all.

MR ZACAROLI: No.

MR JUSTICE DAVID RICHARDS: But consistently with your submissions, would Bower v Marris be applied in Tahore?

MR ZACAROLI: Yes, we accept that. We don't draw a distinction between a pre-existing right to interest, which is derived from the law, as opposed to derived from a contract.

MR JUSTICE DAVID RICHARDS: Yes, quite. I'll just make a note of that, yes. (Pause)

Just give me one moment.

MR ZACAROLI: The next case is Gerah Imports v The Duke Group Limited, bundle 1D at tab 137.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: My Lord was taken to this, again so if I can take this quite briefly.

MR JUSTICE DAVID RICHARDS: Yes, I was.

MR ZACAROLI: Paragraph 13 of the judgment is where you see the relevant section of the Companies Act, the amount of

the debt of a company including a debt that includes interest is to be computed for the purposes of the winding up as at the relevant date.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: One of the questions in this case was whether the previous law about allowing a second round of proofs once there was a surplus was somehow changed because of the statutory provision.

MR JUSTICE DAVID RICHARDS: Yes, I see.

MR ZACAROLI: Paragraph 19, there's this quite helpful description of what goes on here as a second round of proofs. That's really based upon the judgment of Mr Justice Dixon in MacKenzie v Rees at paragraph 20, which he then cites.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: At paragraph 22, in particular, the key passage he cites is that one we saw before about the principle is really one about determining the order in which debts are to be discharged. So very clear in this case, which he did apply Bower v Marris in the sense that he approved a paragraph in the liquidator's affidavit which said, "Should I do it on this basis?" which included Bower v Marris reference. So he approved that. He did it in the circumstance that what was happening was a second round of proofs, the original

creditor's claim was re-admitted once the surplus arose.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So entirely consistent with the way we put our case. Entirely dependent upon there being some interest accruing by the contract in that case.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: There are a couple of other Australian cases referred to in --
MR JUSTICE DAVID RICHARDS: Just to interrupt you, again nothing expressly in the legislation providing for post-liquidation interest?
MR ZACAROLI: No. My Lord, that is clear in this case because you have paragraph 19 talking about the rule at common law and the question is whether section 439(1) has changed that.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: There were a couple of other cases cited in probably footnotes or in passing in my learned friends' skeletons. I'm not going to take my Lord to those. They weren't relied upon. They do not have a -- contradict the basic proposition. If my Lord is taken to them, then maybe I'll have to deal with it but we don't need to go there.
That deals with Australia.
My learned friend mentioned in passing the case of

Peregrine v Hong Kong. No need to take my Lord to that. There is nothing in it which takes us any further either way. There is no relevant statutory provision. It's simply an application of Bower v Marris. It was a double estate case so it was a question of proving against one and being entitled to prove against the other.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Then Ireland, and the one case we need to deal with is the case of Hibernian. This is in bundle 1C, tab 107. This is the second judgment of Ms Justice Carroll; the first judgment having determined that in the context of that case the approach taken in Rolls-Royce that the Bankruptcy Act was not incorporated was not to be followed. Her judgment was overturned and therefore --
MR JUSTICE DAVID RICHARDS: On that point?
MR ZACAROLI: On that point. What appears in this judgment was not dealt with at all by the Court of Appeal.
MR JUSTICE DAVID RICHARDS: No, right.
MR ZACAROLI: It was certainly not approved, not expressly overturned, but obviously rendered moot by the fact that the original judgment itself was overturned. So given that state of the authority already, one doesn't find in this decision any analysis of the rule in

Bower v Marris; what it entailed and why it would extend the situation which existed in this case, that the statute proceeded on the basis that all creditors were entitled to interest at the judgments rate, whether or not they had a contractual right.
Again, one is looking for a negative. There is nothing in here which analyses underlying rationale in Bower v Marris and purports to extend it to that case in any reasoned way.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: I don't need to show my Lord any particular passage because it's a negative. There is nothing in here which deals with that.
It appears that it was a fairly speedy decision, given the day after the argument, so not much time taken for consideration.
The short point is it's of no persuasive authority at all.
MR JUSTICE DAVID RICHARDS: No, I follow. Sorry to -- the statutory regime in Ireland at the time provided for post-liquidation interest.
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: Unlike, for example, in Lines Brothers.
MR ZACAROLI: Yes.

MR JUSTICE DAVID RICHARDS: And the relevant provision is --
MR ZACAROLI: It's at page 267, at the top of the page. The section is -- it's section 304 it looks like of the original 1857 Act but it's been amended by section 86 of the Bankruptcy Act 1988.
MR JUSTICE DAVID RICHARDS: So it's still the provision at the top of the page, is it?
MR ZACAROLI: That's correct, yes.
MR JUSTICE DAVID RICHARDS: With interest at the rate currently payable on judgment debt?
MR ZACAROLI: Yes, yes.
Now, we would say that must be wrong on the analysis of Bower v Marris as we put forward insofar as it relates to creditors who had no contractual right to interest, because there was no right to interest accruing at the time that dividends would have been paid prior to the surplus arising.
MR JUSTICE DAVID RICHARDS: Sorry, I'm just wondering where she deals with this. So you get -- so all creditors got interest at the judgment rate.
MR ZACAROLI: Yes. There doesn't appear to be a reference to entitlement to a higher contractual rate.
MR JUSTICE DAVID RICHARDS: No. But at page 269 she says that after payment of the statutory interest, the contractual creditors are entitled to be paid the

balance due for contractual interest giving credit for the statutory interest.
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: In that context, she applies Bower v Marris, as I read it.
MR ZACAROLI: My Lord, I am terribly sorry, I am looking at the wrong decision. It's my fault entirely.
MR JUSTICE DAVID RICHARDS: Ah, right.
MR ZACAROLI: It should be tab 108.
MR JUSTICE DAVID RICHARDS: This not the one that was overruled --
MR ZACAROLI: No, this is the judgment that was overruled.
MR JUSTICE DAVID RICHARDS: This is the judgment?
MR ZACAROLI: This is the judgment that said that the Rolls-Royce approach doesn't apply.
MR JUSTICE DAVID RICHARDS: So this is the second judgment?
MR ZACAROLI: No, the first judgment was the one which said Rolls-Royce didn't apply; that was overruled. The second judgment, which is tab 108 -- I am very sorry -- therefore becomes --
MR JUSTICE DAVID RICHARDS: That's where we are. What she's done here, at 107, is this right, is to say creditors in the event of a surplus after payment of proved debts get interest at the rate currently payable on judgment debts.

MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: Then, if contractual creditors still have an entitlement to interest, they're entitled to be paid that, applying Bower v Marris?
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: The reasoning for that may well be because although there is a statutory right to interest in 86, as we've just seen at page 267, which is everyone has the judgments rate, the surplus provision, which is -- I was going to say the surplus provision is different, but it's -- I'm not entirely sure at the moment why it is she thought that there was a contractual right to interest.
MR JUSTICE DAVID RICHARDS: Well, I suppose because -- no. Well --
MR ZACAROLI: It doesn't really matter because she's not construing any English Act.
MR JUSTICE DAVID RICHARDS: No.
MR ZACAROLI: The terms of the section are materially different to the English Bankruptcy Act, for example, which wouldn't have allowed such right for the reasons we went through this morning.
MR JUSTICE DAVID RICHARDS: Right. Okay. So 108.
MR ZACAROLI: 108 is the correct decision.

MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: This is a decision purely on the question of how interest was to be computed in relation to creditors whose debts did not carry interest, and her decision is -- her conclusion is at the end of the decision at page 273.
MR JUSTICE DAVID RICHARDS: Sorry to interrupt you again, but the decision on appeal from the case -- from the decision in 107 occurred after this?
MR ZACAROLI: Yes, that's right.
MR JUSTICE DAVID RICHARDS: So it sort of removed both these decisions in effect.
MR ZACAROLI: Yes. It removed the first one, so the premise for the second one just disappeared.
MR JUSTICE DAVID RICHARDS: I'm with you, yes.
MR ZACAROLI: That's 112, my Lord, if you want the reference.
MR JUSTICE DAVID RICHARDS: Thank you.
MR ZACAROLI: So this is the question about whether those not entitled to contractual interest would also be treated on the Bower v Marris basis, and the answer was "yes". But the reasoning is crisp, to say the least.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: She relies on page 272 on a report from the Bankruptcy Law Committee which says that they took the

view that in England interest was to be computed as running interest, referring to Bower v Marris, et cetera, and Bromley v Goodere. She says, at the bottom of page 273:
"If statutory interest is payable it seems to me it should be computed as running interest following Bower v Marris."
Therefore, you apply them to interest first.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: I make the same point I did before. It's of no persuasive value.
MR JUSTICE DAVID RICHARDS: The crisp reasoning -- well ...
(Pause)
MR ZACAROLI: The previous paragraph she just says the amendment to the Act, which we saw before, section 86, which gives interest at the judgments rate to all, she says that, at the bottom of page 273:
"The amendment removes the judicial discretion ...(reading to the words)... interest is payable it is payable on the running interest basis."
MR JUSTICE DAVID RICHARDS: Yes, I see.
MR ZACAROLI: Without having understood or analysed what it is that gives rise to this principle of appropriation in Bower v Marris, which clearly wouldn't work to interest which hadn't accrued --

MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: -- at the time of dividends.
MR JUSTICE DAVID RICHARDS: This Bankruptcy Law Committee, we don't know -- this was obviously some time in the 1980s, I take it.
MR ZACAROLI: One suspects, because the Act is dated -- is 1986 or 1988 -- the 1988 Act, yes.
MR JUSTICE DAVID RICHARDS: So it led to that, in other words?
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: It's interesting that they were on to Bower v Marris but the Cork Committee was not. Thank you.
MR ZACAROLI: That's Ireland.
Canada, the one decision which is inconsistent with our proposition is Confederation Trust which is at 1D, tab 133. Now, my Lord saw this but the question is summarised on page 2 of the report in the fifth line:
"The dispute was over whether the interest was to be paid in accordance with ...(reading to the words)... utilising an interest first or a principal first focus as a starting point."
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So the first question was whether section 95(2) applied at all because it came into effect after

the insolvency proceedings had started, but it was held to apply, even though the right to interest was a future contingent right. My Lord saw that paragraph yesterday.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: That didn't matter. It was -- the Act applied.
MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: The second question then is dealt with at page 9, paragraph 29 and following. Mr Justice Blair says:
"The traditional rule in insolvency situations is that dividends are to be applied first to the payment of interest and then to the payment of principal. This is said to prevent injustice, promote equity amongst the creditors and protect the contractual relationship between the parties."
Now, I should remind my Lord that section 95(2) provided a rate of interest at 5 per cent for all claims provable in the winding up, so there's -- some creditors would have had a right to interest before that, others not. So, like the Irish provision, it covers the ground.
Now, the first point to note about that sentence or those two sentences is that "the traditional rule in insolvency situations is that" is a very condensed and

inaccurate summary of the principle in Bower v Marris as applied in, for example, the quartet of cases about Humber Ironworks in 1870 for the reasons that I went through this morning. It is true that one ends up with a situation that generally interest under the English legislation prior to 1883 and bankruptcy and still in companies winding up until 1986, it is true that generally the interest was applied first -- the dividends were applied to interest before principal but not because that was the rule that had to be applied on distribution of assets from insolvency estate; it was because of the rule that the dividends themselves were not appropriated having been paid pursuant to law and therefore the creditor's right to appropriate remained with the presumption that that was the result. So that's a very condensed and inaccurate summary.
The second sentence doesn't make sense because -- at least the last part of it "to protect the contractual relationship between the parties" is only relevant to those who have a contractual right to interest.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So for those two reasons, those two sentences are equally of no persuasive authority before this court. Importantly, of course, the arguments that my Lord is hearing from this side of the court weren't

made in that case.
MR JUSTICE DAVID RICHARDS: But might you not say that insofar as he is condensing the sort of Bower v Marris history, that line of authority -- it was part of your point -- is to protect the contractual relationship between the parties?
MR ZACAROLI: True. The point is that it doesn't work. It doesn't lead to his conclusion.
MR JUSTICE DAVID RICHARDS: I follow that. I see.
MR ZACAROLI: That's all I meant. I am sorry, that is indeed the rationale underlying Bromley v Goodere and Bower v Marris.
MR JUSTICE DAVID RICHARDS: Quite.
MR ZACAROLI: It does not lead to the conclusion that those without a right to contractual right should get it.
MR JUSTICE DAVID RICHARDS: I follow that. I see that, yes. Right.
MR ZACAROLI: The rest of the judgment deals with points of more general principle. True enough you might say in paragraph 33, for example, that those policy considerations might be said to apply equally, although I'll come on to those arguments later and explain why, but I'm not saying that there's anything particularly wrong about how he construed the policy behind the Canadian legislation. The key point is in the technical

analysis part of this decision, which is just in paragraph 29, he's wrong. The analysis -- he doesn't deal with the analysis in Bower v Marris and he doesn't deal with the arguments we're presenting here and therefore my Lord gets nothing from this decision that helps in this case.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: My Lord, that's Canada. There was another case later on that my learned friend may have touched on. It's in their skeleton. It simply followed this case without any discussion, so nothing more to be got at of that.
That leaves us with Scotland.
The case of Gourlay v Watson. This is at bundle 1B, tab 51. This involved a sequestration. It appears, as my Lord noted with Mr Smith yesterday, it had the attributes -- some of the attributes of a bankruptcy although it doesn't appear to be a bankruptcy.
The relevant bankruptcy legislation which is -- seems to be applied by analogy is section 52 of the Bankruptcy (Scotland) Act 1856 which is copied at the bottom of page 765.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: That section, the relevant part of it is, is at end of the page:

"If there be any residue of the estate after discharging the debts ranked then he shall be entitled to a claim out of such residue, the full amount of the interest on his debt in terms of law."
He being the creditor.
So that pretty much mirrors the first part of the applicable rule in 1825 in England because it's simply remitting someone to the right he has at law to interest --
MR JUSTICE DAVID RICHARDS: What, this section is, is it?
MR ZACAROLI: The last words of that section. So the bit I've just read out. In Bower v Marris the creditors were entitled -- who had an interest-bearing debt were entitled to interest, and then there was the --
MR JUSTICE DAVID RICHARDS: I wasn't sure whether this -- I think Mr Smith took me -- gave me some explanation as to what was meant in Scotland by "legal interest".
I don't know whether interest on his debt in terms of law carries this rather more technical meaning.
MR ZACAROLI: My Lord, even what Mr Smith was showing you was, I think, legal interest being pursuant to some pre-sequestration.
MR JUSTICE DAVID RICHARDS: I see; is that right?
MR ZACAROLI: Yes. He wasn't, and I'm pretty sure he was not telling --

MR JUSTICE DAVID RICHARDS: The passage where it cropped up was in the judgment itself on page 765. So we've only got a relatively small part of the judgment as such there, I think. This is all judgment, is it, or is it?
No, I'm not sure it is.
MR ZACAROLI: The judgment starts at the bottom of page 766.
MR JUSTICE DAVID RICHARDS: So what is this that we're looking at here, I wonder?
MR ZACAROLI: This is just the --
MR JUSTICE DAVID RICHARDS: I see. At 765 this is the argument.
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: Sorry, yes, I see. Well, what Mr Smith showed me was if you see on 765, at the bottom of that bit, it says:
"The creditors were accordingly entitled, there being a surplus [then over the page] to principal and legal interest."
"Legal interest means allowed by law, not contractual", I have jotted down. I was just wondering -- you're reading in terms of law as meaning or at any rate including contractual interest and you may be right.
MR ZACAROLI: That's what I've assumed, but it would also include, as I understand it from Mr Smith's submissions

yesterday, what they call in Scotland legal interest, being something which is payable pursuant to -- I don't know exactly what it was -- it's a pre-bankruptcy right.
MR JUSTICE DAVID RICHARDS: It was explained by Lord Hodge. I think you're right, that it's a sort of judgment. I'm not sure.
MR ZACAROLI: Exactly, yes.
MR JUSTICE DAVID RICHARDS: It gets quite involved. I'm not sure I know the answer straight off.
MR ZACAROLI: I'm certainly not professing to explain to my Lord the law of Scotland.
MR JUSTICE DAVID RICHARDS: No. All right. Anyway, let's --
MR ZACAROLI: At the top of page 767 Lord Young is considering the case of interest with a contractual right. The first paragraph at the top of page 767.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: "It is not a matter of doubt that a creditor in any ...(reading to the words)... becomes due at the date of payment."
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Then at the bottom of that page:
"The doctrine of appropriation by payment of a debtor ...(reading to the words)... to pay certain interest-bearing debts."

So I have understood this case to be a case about interest-bearing debts.
MR JUSTICE DAVID RICHARDS: It may well be, yes.
MR ZACAROLI: As such, my Lord, it's not a bankruptcy case. It's an example of the principle of appropriation which we saw applied in Bower v Marris being applied in this Scottish sequestration, where creditors had accrued rights to interest from -- prior to the date of the sequestration.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: The reference to English bankruptcy law is very short, at page 770. It's the paragraph beginning in the middle of the page:
"The analogy of the law of bankruptcy, both here and in England, is in accordance ...(reading to the words)... the full amount of the interest on his debt in terms of law."
He cites the Warrant Finance Company case.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: I'm reminded this is a trust case. It's a trust deed which applies the principle of sequestration. That's how one gets there.
My learned friend Mr Smith said this case is notable because it's after 1883. It's true. It's in 1900. But the suggestion that the 1883 Bankruptcy Act and the

change that had made to English bankruptcy law was brought to the attention of the judges in Scotland is without any foundation. There's no reason why they would have been shown the 1883 Bankruptcy Act. It had nothing to do with the case.
The only reference into English law is in fact to the case involving companies, the Warrant Finance Company case. So the coincidence of the date being after 1883 is irrelevant.
MR JUSTICE DAVID RICHARDS: Yes, I see.
MR ZACAROLI: My Lord, we can keep that bundle. At the risk of straying into yet more remote areas of law, I'm going to turn to the testamentary cases. There are two types of -- two different categories of testamentary case to consider. One is where interest is payable on legacies; the other is where interest is payable on debts. There are three cases in the bundles dealing with legacies, one dealing with debts. The latter is Whittingstall v Grover.
So far as legacies are concerned, my Lord may know this. Interest is payable on legacies after the executor's year, so a year after the death, at a fixed rate to creditors, whether or not they had a right to interest -- there's no right to interest of course. It's a gift from the will so it's interest payable from

the will on the legacy.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: That right to interest accrues due before payments are then made under these cases to the relevant beneficiary. So all of these cases are examples of at the time a payment is made the legatee has, at the same time, the right to the legacy and interest accrued on it. The principle which the cases are authority for is that such payments made under a will do not constitute an appropriation towards principal or interest in the same way that payments made under bankruptcy legislation don't, because they're made not so much in compulsion of law but by someone other than the deceased, obviously, by the testator. They don't amount to an appropriation and therefore the creditor's right to appropriate one or the other remains. They are therefore perfectly consistent with the operation of the principle as applied in Bower v Marris itself.
The first case is called re Prince, Hardman and Willis. It's bundle 1B, tab 68. The headnote states simply that:
"Where there are insufficient funds to pay legacies when due ...(reading to the words)... due to them at the time of payment on account of such legacies."
The facts were that Mr Prince died in 1917. That's

the first paragraph on the left below the headnote.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: In the judgment of Mr Justice Clauson, he says towards the middle of the first paragraph:
"The executors made certain payments in the years 1933 and 1934 to the legatees without professing to appropriate between principal and interest."
Then in the last paragraph, he says:
"I have been referred to Bower v Marris, a decision of Lord Cottenham, and from that case I clearly infer that if the payer of a sum of money is a debtor and the payee is a creditor, the payee has the right to treat any sum paid to him without any appropriation in respect of the debt primarily as a payment of interest due."
We would say that's a perfectly respectable summary of the proposition one gets from Bower v Marris.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: He then says:
"I feel bound to hold that the principle laid down in Bower v Marris ...(reading to the words)... of the principle of the legacies."
The second case to look at is re Morley's Estate, the same bundle, tab 70.
MR JUSTICE DAVID RICHARDS: The right to interest on legacies, the source of that right is what?

MR ZACAROLI: My Lord, we've cited a case in our skeleton which I can take my Lord to. It is in our reply skeleton. My Lord, paragraph 36 of our reply skeleton. I think that's tab 6 of bundle --
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Paragraph 36, page 10.
MR JUSTICE DAVID RICHARDS: Yes, I see.
MR ZACAROLI: Perhaps my Lord could just read paragraphs 36 through to 39.
MR JUSTICE DAVID RICHARDS: I will. (Pause)
Is it a right to interest -- I mean, is the interest payable with the legacy or is it payable in the meantime or how does it work?
MR ZACAROLI: It's payable after a year.
MR JUSTICE DAVID RICHARDS: Yes. You have the year, so no interest runs then. Does it ... (Pause)
MR ZACAROLI: My Lord, I think it must be the case that it's payable along with. We can see that, I think, from re Morley's Estate.
MR JUSTICE DAVID RICHARDS: But it nonetheless you say it accrues due during the --
MR ZACAROLI: Yes. It accrues from after a year. Therefore it is clearly is accruing --
MR JUSTICE DAVID RICHARDS: Yes, I see.
MR ZACAROLI: -- thereafter, yes.

I think I showed you the passage from Prince which talks about interest being due.
MR JUSTICE DAVID RICHARDS: Where is that?
MR ZACAROLI: When he summarises the rule in Bower v Marris he talks about it being appropriation in respect of the debt primarily as a payment of interest due. We see the same thing from re Morley's Estate perhaps better expressed.
MR JUSTICE DAVID RICHARDS: Fine.
MR ZACAROLI: This is at tab 70:
"Where, owing to the nature of a testator's estate, it has been impossible to realise it ...(reading to the words)... previously made by the court in the matter to the contrary."
Then he deals with this question at page -- the judge does -- 496:
"The questions before me are really these: first, what is the rule of administration which ...(reading to the words)... precludes me from doing so", and refers to Thomas v Montgomery and re Prince.
He finds there's nothing in the will in that case to reach a contrary conclusion.
Two points to note. First of all it applies where both the payments are made when interest is due as well as the legacy.

MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Secondly, subject to any contrary indication in the will which mirrors the position under the general law in relation to contracts, subject to different agreement between the parties.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: My Lord, the only other reference in the legacy line is the other -- the third case which is an older case of Thomas v Montgomery, volume 1A, tab 15. It's a decision from 1828, so prior to Bower v Marris. The headnote, reads:
"In the progress of a suit for the administration of a testator's asset which are more ...(reading to the words)... in reduction of one fourth of the principal."
There's a passage I want to draw to my Lord's attention in the argument for the legatees, for the successful legatees, at page 820, which explains the rationale behind payments on account and how they are appropriated. In the left-hand -- at the bottom of the page on 820, the last paragraph in the middle of that paragraph:
"Now a payment on account deemed to be made in a case where principal and interest are due ...(reading to the words)... to compensate him for the delay which he has suffered."

So it's similarly adopting a presumption approach to this. That's what creditors generally would want to do because that's what's in their interests. The decision is very short. It's the Vice Chancellor, Sir Lawrence Shadwell at page 821. He notes the order the Master made and then the reasoning is pretty short at the end. He just says, in the last five lines of the judgment:
"And without entering into the question of law ...(reading to the words)... in this case should be confirmed."
Then there are the interest on debts -- there is the interest on debts case. There is only one case, Whittingstall v Grover. That's bundle 1A, tab 43.
My learned friend Mr Smith took my Lord to this at some length yesterday. The case deals principally with the issue of priority between the joint and separate estates because the deceased partner's partner subsequently went bankrupt.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Therefore it involves that horrendous complication of the interplay between estates and bankruptcy.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: We make the point in our skeleton that even by

the time this case was decided, the point had become irrelevant because from 1883 any deceased's estate which became insolvent had to be transferred to bankruptcy and the rules about interest and bankruptcy applied to the exclusion of anything else. So this is in fact the only case on the subject because it was decided just after that had happened or the bankruptcy related back some 30 years.

MR JUSTICE DAVID RICHARDS: I see, yes.

MR ZACAROLI: The first thing which happened then was that one partner, Mr Whittingstall, died. That was in 1856, in March 1856. His partner became bankrupt some months later, in August 1856. That was Mr Smith. If my Lord picks up the second page of the report where it's setting out -- reciting the facts, in the middle of the right-hand column, paragraph begins:

"By the decree made in the first of such actions [so administration actions in the estate] on 26 January 1857 the usual accounts and enquiries were directed to be taken and made."

So that's the second important date is that in 1857 a decree was issued in Chancery for accounts and enquiries.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: The important thing to understand about that

is that that decree operated as a judgment, treated in equity as a judgment against all creditors of the deceased, and giving them a right to interest because it's a judgment.

That's the rationale, and I'll make that good by reference to Mr Justice Chitty's judgment, but it's worth, first of all, picking up the rule which by this time gave interest. That can be found at 3D, tab 57. Mr Smith showed this to my Lord yesterday. These are the rules of the Supreme Court 1853, order 55, rules 62 and 63.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Rule 62:

"Where a judgment order is made directing the account of the debt to the ...(reading to the words)... 4 per cent per annum from the date of the judgment or order."

So there accrues a right to interest from the date of judgment. True it is that in certain cases -- it's not entirely clear what they are -- where a creditor comes in subsequently and establishes his debt before a judge in chambers, then there's an order of priority so that the right to interest conferred by rule 62 is postponed until after contractual interest has been paid.

MR JUSTICE DAVID RICHARDS: Right. Yes, I see. Thank you.

MR ZACAROLI: This is dealt with in the judgment of Mr Justice Chitty on page 217 on the left-hand side of the page. The question he is dealing with here is the priority as between the rights of creditors whose debts did not bear interest against the separate estate and the creditors of the joint estate. So it's the two estates priority issue he is determining, not at this point any question of appropriation. That's just at the end of the judgment. At this point he's dealing with the priority issue.

He refers just below halfway down the page, the sentence begins:

"Previously to the orders of 1841 ..."

Now, the orders of 1841 are what became --

MR JUSTICE DAVID RICHARDS: Sorry, where are you?

MR ZACAROLI: Page 217, left-hand side, just halfway down the page.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: He says:

"Previously to the orders of 1841 [those were the forerunner to rules 62 and 63] the court of Chancery did not give ...(reading to the words)... the existing rules of court merely give effect to such right."

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Before we deal with the rest of the judgment, I think we should skip to Lord Rommily's explanation in the Herefordshire Banking Company case which my Lord will find at the same bundle, tab 24. We'll come back to Mr Justice Chitty's judgment afterwards.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: This was a decision on rule 26 of the Companies (Winding-Up) Rules 1862. Those were similarly orders of court, i.e. they weren't statutory. They were rules made by the judges. My Lord will remember that rule 26, which gave a right of interest to creditors in a winding up at 4 per cent, was held to be ultra vires.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: This judgment explains why that was ultra vires but why the similar rule in equity was not.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: So the headnote reads shortly:

"Where a company is wound up under the Companies Act 1862 and calls have been made on the shareholders ...(reading to the words)... order of November 1862 is ultra vires and invalid."

On page 252, Lord Rommily, Master of the Rolls, says:

"I entertain no doubt about this case. It is impossible to get ...(reading to the words)... or

entitled to any interest in respect of it."

So it has very long been a key distinction between testamentary cases and bankruptcy and winding-up cases that in the case of deceased's estates, the decree ordering the account is a judgment against all creditors entitling them to interest from the date of the decree.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: So when one goes back to tab 57 and the judgment of Mr Justice Chitty -- sorry, 43, not 57 -- it was in fact the case, although it's not something which he relies upon, but it was in fact the case that by the time any dividends were paid, those were paid in respect of principal and interest which was already accruing as from 1857, the date of the decree.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: Mr Justice Chitty deals with the Bower v Marris point at the very end of his judgment on the right-hand side of page 217. He says, 12 lines from the end:

"The remaining question relates to the manner in which the dividends received ought to be accounted for in ascertaining the amount of interest due. All the dividends have been paid in process of law and the account ought to be taking the manner pointed out in Bower v Marris. It is by treating the dividends as

ordinary payments on account and applying each dividend in the first place to interest calculated to the day of such dividend and the surplus, if any, to the reduction of the principal."

So he does make it clear in fact that it's interest that's due at the date of the dividend.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: That's perfectly consistent with our interpretation of both Bower v Marris and the Humber Ironworks cases. Interest was due. Payment was made on account of it and principal from the deceased's estate, and therefore was appropriated towards interest first.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Just one more point to make on this judgment.

My learned friend Mr Smith, echoing a point made in my learned friend Mr Dicker's skeleton, drew attention to a passage on the right-hand side of the page in the middle of the page where the learned judge says:

"But where both sets of creditors have received their principal in full ...(reading to the words)... on which the general orders are founded."

The point being made was the judge didn't distinguish between interest-bearing debts and non-interest-bearing debts. That's true. But he was

dealing there with the question of priority between the two estates. He was certainly not addressing the calculation of interest on the Bower v Marris basis.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: So, properly analysed, Whittingstall v Grover is perfectly consistent with the case we advance on the true rule that one gets from Bower v Marris.

I think my learned friend Mr Smith made the point that this case was also after the Bankruptcy Act 1883. Irrelevant. It was dealing with a bankruptcy that started long before that, so the 1883 Act was irrelevant, and no suggestion that its terms were brought to the attention of the judge anyway. It wouldn't have needed to be.

The final category of cases where this principle has been applied, so far as cases before this court show, is the debenture holder actions. My Lord was taken to the Calgary and Medicine Hat Land Company, bundle 1B, tab 58. I think my Lord read the headnote. I don't know if my Lord wants to remind himself of it? It's a simple case of payment being made without appropriation. (Pause)

MR JUSTICE DAVID RICHARDS: Indeed, yes.

MR ZACAROLI: So far as I'm concerned, there is merely one passage I wish to show my Lord which shows how the rule

as applied here is entirely consistent with our case.

Page 663 in the judgment of Lord Justice Farwell.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: It's towards the end of the first paragraph, having cited Staniar v Evans and Preston Banking Co v Allsup. He says:

"It was in fact a payment on account of and by reference to the only sum of which the Master had taken an account. It was not a final payment destroying the creditor's rights but a payment on account without prejudice" --

MR JUSTICE DAVID RICHARDS: Sorry, where?

MR ZACAROLI: It's just above the break in the page.

MR JUSTICE DAVID RICHARDS: 663?

MR ZACAROLI: Yes.

MR JUSTICE DAVID RICHARDS: I see, yes.

MR ZACAROLI: After the reference to Preston Banking Co.

MR JUSTICE DAVID RICHARDS: I have it.

MR ZACAROLI: "It was in fact a payment on account of and by reference to the only sum ...(reading to the words)... right of adjustment which always exists in cases of this nature."

The way he expresses it is perfectly consistent with how it was put in the Humber Ironworks cases. There is no appropriation and therefore the creditor's rights are

unaffected.
I showed my Lord this morning the other case that dealt with debentures. That was the Smith v Law Guarantee case.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Where, as I pointed out this morning, the contract required interest to be discharged first but that was for the benefit of the debenture holders who weren't held to that and, in the circumstances, it was in their interest that it be the reverse.
We make a point in our reply skeleton, not for determination in this application, but just to show my Lord what happens -- or what might, as it were, follow on from Bower v Marris applying. It's quite clear that the appropriation towards interest first is subject to anything else being inconsistent with that, i.e. a term of the contract perhaps or conduct between the creditor and the debtor subsequent to the relevant bankruptcy or administration. The point in Smith v Law Guarantee Trust was that the creditors wanted the amounts to be appropriated towards principal because it was to their tax advantage.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: We refer, again not for determination today to the fact that in this the case administrators

consciously, expressly stated at the time of making each distribution that they were appropriating to principal as opposed to interest. And going on to mention the fact that they were -- the following sentence referred to the fact that they were not withholding tax where withholding tax would apply.
The point is this, simply, that one has to investigate therefore, when dividends are paid, whether the creditor, knowing that's the way in which it's being purportedly appropriated by the administrator, who would otherwise have received a smaller sum, because withholding tax would have been deducted, receives a large sum because it's been appropriated to principal, not interest. If that happens, there's a serious argument at least that there has been an appropriation. The creditor having said, "I'm taking this before principal for my tax purposes", can't then renege on that.
MR JUSTICE DAVID RICHARDS: But at the time the dividends were paid, if one applies this law, there was no appropriation.
MR ZACAROLI: Ah, sorry, correct.
MR JUSTICE DAVID RICHARDS: There was no appropriation.
MR ZACAROLI: Correct; there's no appropriation by operation of law.

MR JUSTICE DAVID RICHARDS: Correct. At the stage when you're making distributions in respect of principal -- of proved debts, it would be inappropriate to appropriate to interest.
MR ZACAROLI: My Lord, not if the debt carries interest. If the proved debt include interest --
MR JUSTICE DAVID RICHARDS: Pre-administration interest.
MR ZACAROLI: Exactly, yes.
MR JUSTICE DAVID RICHARDS: So when the distributions were made -- sorry, I missed the point. You're saying that the administrator said, "Well, we are paying this in respect of principal due at the date of administration, not interest accrued at the date of administration"?
MR ZACAROLI: They don't make that clear but that must have been what they meant because the only interest which would have been payable at that date is interest within the approved debt. So it only works where the creditor has an accrued right to interest. But if the creditor did, and chose not to receive that interest --
MR JUSTICE DAVID RICHARDS: Sorry, I'm getting a bit lost here. So the administrator said, "This is principal, not interest" or they said, "It's principal, not interest". So if some creditors had accrued interest as at the administration date for which they had proved, then presumably the last distribution did include

interest.
MR ZACAROLI: It must have done, yes.
MR JUSTICE DAVID RICHARDS: Yes, I see. What the relevance of that -- any of that to this?
MR ZACAROLI: Nothing -- that's why I say not for today's purposes, other than to recognise that that's one of the questions which arises if Bower v Marris as a -- on my learned friends' case that's one of the questions which arises because one needs to explore whether there has or has not in fact been an appropriation.
MR JUSTICE DAVID RICHARDS: Does it arise? Because the way Mr Dicker puts his case, I think -- and Mr Smith -- is that there is a notional adjustment or -- I forget the word; it doesn't really matter -- of the payments previously made?
MR ZACAROLI: Indeed.
MR JUSTICE DAVID RICHARDS: The adjustment is between principal and accrued interest at the date of administration and post-administration interest.
MR ZACAROLI: Yes.
MR JUSTICE DAVID RICHARDS: I mean, I accept that I'm not anxious to hear argument on this, but I'm just slightly puzzled by what its relevance could be, I must say, at the moment.
MR ZACAROLI: Its relevance could be this. I'm not

suggesting that the mere fact that the administrators state that is enough to make the appropriation one to principal as opposed to interest; that's not sufficient. The question is whether there has been any agreement, implicit or express, by the creditor to accept an appropriation on that basis. Take the case -- and there's no evidence of this, but these are hypothetical cases, but take the case where the administrators would, if they were paying interest, be required to withhold tax because it was regarded --

MR JUSTICE DAVID RICHARDS: But you must be here talking about pre-administration.

MR ZACAROLI: I am indeed talking about pre-administration interest.

MR JUSTICE DAVID RICHARDS: I, again, don't quite see what the relevance of that is to this.

MR ZACAROLI: Because if it so happens that the creditor for its own benefit, i.e. to get in the early distributions when it wouldn't know there's going to be a surplus of course, so it chooses to have a greater payment to be made to it, a gross payment rather than net, withholding tax, take the gross payment on the basis that that relates to principal --

MR JUSTICE DAVID RICHARDS: Well, I mean, what they're doing is effectively saying, aren't they, "Well, we will

postpone to later distributions, if there are any, the payment of accrued interest", always assuming this is possible? Assuming it is possible, that's all they're doing.

MR ZACAROLI: True, but once they have appropriated, let's say there's a dividend of 50p in the pound. They take that 50 per cent of their claim and appropriate that towards principal. Then that's --

MR JUSTICE DAVID RICHARDS: I see.

MR ZACAROLI: Once it is appropriated, it is appropriated they have now had that discharged. As I say, I'm not making too much of this because it's completely irrelevant to the decisions my Lord has to make, but it shows what there is -- as it were, if Bower v Marris were to apply, it gives rise to these further questions.

MR JUSTICE DAVID RICHARDS: Okay.

MR ZACAROLI: My Lord, is that a convenient moment to take a break?

MR JUSTICE DAVID RICHARDS: Yes. Five minutes.

(3.13 pm)

(Short break)

(3.18 pm)

MR ZACAROLI: My final point of this second topic, which is the Bower v Marris principle, is that this trawl through the different contexts in which a rule such as that has

been applied demonstrates that it is in fact a rule of the general law. It is not a principle about distribution from insolvency estates. It's a principle from the general law which is applied in the context of insolvency estates in the way that we've expressed.

The common feature between bankruptcy, testamentary cases, the debenture action cases is that the payments that were made of dividends, were made without an appropriation and therefore are treated as having been made on account. That's why the language in each of those different areas is expressed as "the creditor's right are unaffected", the right to appropriate, once the surplus arises, or in some cases even though there's no surplus it still retains the right to appropriate.

MR JUSTICE DAVID RICHARDS: That is in the context of the creditors receiving interest pursuant to their contractual rights or it might be with the benefit of a judgment or something of that sort?

MR ZACAROLI: Yes, a pre-existing right, i.e. an interest-bearing debt.

MR JUSTICE DAVID RICHARDS: That's what happened in Bower v Marris.

MR ZACAROLI: Yes.

MR JUSTICE DAVID RICHARDS: The odd thing about Bower v Marris, just thinking about section 132 of the

1825 Act, can I just get that? That's in 3A.

MR ZACAROLI: Tab 10. Which section are you after, section 132?

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Yes, tab 10.

MR JUSTICE DAVID RICHARDS: Just by way of passing, it's not completely clear to me at any rate -- you may know this one way or the other -- whether this Act applied to the bankruptcy in Bower v Marris because Thomas Marris was declared bankrupt in January 1812, the last dividend was paid in 1834. I make no comment at all, except to congratulate the administrators of Lehman Brothers. So whether or not it in fact actually applied, but of course we know that Lord Cottenham discussed the Act.

MR ZACAROLI: Yes.

MR JUSTICE DAVID RICHARDS: Now, under section -- have I got this right -- 132 we have this two-stage interest. First of all, we have those who have a rate of interest reserved or by law payable on their debts which is what -- that's the category into which the creditors in Bower v Marris would fall.

MR ZACAROLI: Yes.

MR JUSTICE DAVID RICHARDS: But then we have this second layer, all other creditors who have proved who are to receive interest at 4 per cent. So they are creditors

without any right to interest. So Bower v Marris establishes that its principle, if you call it that, applies when you're in the first of those categories, but what about the second category? You would say not applies?
MR ZACAROLI: No.
MR JUSTICE DAVID RICHARDS: The reason for that is because no interest has accrued?
MR ZACAROLI: Yes. Had we been there in 1832 and the point raised -- 1841 -- that's what we'd have been arguing; the same arguments that are running now would be run then on that point.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: This brings me, my Lord, on to the third topic which is indeed that rule only works where there is interest accruing. It only relates to interest-bearing debts.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: It may be worth keeping Bower v Marris open because --
MR JUSTICE DAVID RICHARDS: I have that here.
MR ZACAROLI: -- that is -- one of the submissions my learned friend made relates to it. As I said, the essential aspect of appropriation -- the essential requirement of appropriation is that there are two

debts, two liabilities, existing at the date when the payment is made. That simply does not apply in relation to a non-interest-bearing debt in a bankruptcy case. In opening I said there were two -- that was one of two reasons why the rule couldn't apply.
The other was the whole rationale of the reasoning in Bower v Marris is that you're respecting, giving effect to the full rights of the creditor which are its rights to interest.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: It is said against us that on page 357 of the report of Bower v Marris the Lord Chancellor recited section 132 or referred to section 132 without distinguishing between the contractual part of it and the non-contractual part of it.
MR JUSTICE DAVID RICHARDS: Page ...?
MR ZACAROLI: 357.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Just in the second paragraph there. So what is said is Bower v Marris is a case where the judge was considering and deciding in relation to the non-contractual creditors or the non-interest-bearing debts. My Lord, that is simply wrong. It's a very short reference to the Act. True, it doesn't there distinguish. One has to be careful with these reports

anyway because they were not -- these aren't transcriptions of judgments, these are people in court listening and writing it down.
MR JUSTICE DAVID RICHARDS: No.
MR ZACAROLI: Or sometimes not. I found a report the other day of a reporter who said, "I had a terrible case of the gout and therefore missed this case, but this is what I'm told the judge said".
The reason he can't possibly have been considering at all the last part of section 132 is because the context of this case was rights against a co-obligor.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Let's assume that there had been interest at 4 per cent for the creditor, where the debt did not bear interest. That could have no relevance against the co-obligor. The co-obligor could not take the advantage of the interest rate that is being paid from the bankruptcy and say, "Well, I'm owed interest as well. Therefore, as against me you're appropriating payments towards interest -- principal first rather than interest". So the whole promise of the case means it can't possibly have been considering the non-contractual rights creditor.
I showed my Lord, I think, probably five or six examples in the judgment where the reasoning is premised

on the fact that the creditor has a contractual right to interest.
MR JUSTICE DAVID RICHARDS: Yes, you did.
MR ZACAROLI: My learned friend Mr Dicker said yesterday that every case which has decided this point, i.e. whether it extends to non-interest-bearing debts, has concluded that the principle does apply. Well, there were four cases.
The first is Bower v Marris itself. Wrong for the reasons I've just given. The next two are to the Attorney General of Canada v Confederation Trust, and Hibernian. Yes, I accept that those cases did apply the principle or what they thought was the principle in Bower v Marris to the case where there were debts which were not interest-bearing debts. Those cases are wrong for the reasons we have been through. I'm not going to repeat those.
MR JUSTICE DAVID RICHARDS: No.
MR ZACAROLI: The fourth was Whittingstall v Grover.
As I hope I have explained to my Lord today, Whittingstall v Grover is a case where there was in fact interest accruing from the date of a judgment in equity which was a judgment against all creditors giving them a right to interest from that date.
MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: We said in opening that that's a freestanding point; that whatever else my Lord may decide in this application my Lord should not decide that any creditor without a right to interest pre-administration can reap the benefit of the principle in Bower v Marris. But it goes further because if it doesn't apply to those creditors, then it can't apply to anyone with 2.88(7) without creating the source of complications which the Cork Committee were set against. Indeed it makes part of the rule unworkable.

I have already made my general submission based on the passages from Mr Justice Dixon in MacKenzie v Rees that applying it at all creates problems. These are additional problems.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The first thing that it does is that it creates differential treatment amongst creditors within 2.88(7) because it treats some creditors as entitled to interest for a lot longer than others, because the essence of Bower v Marris is it keeps interest rolling on, even though the principal debt has been paid.

So the period for which the debt is outstanding means something different for judgments rate creditors and Bower v Marris creditors.

The second point is it creates complications where

creditors have a contractual rate but it's less than 8 per cent. It does seems to us bizarre that a creditor should benefit from the greater rate of interest which the Judgments Act gives it but nevertheless be able to say, "Ah, but I have a contractual rate to interest at", let's say, "2 per cent, and I can apply dividends to that part of my interest first".

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The third problem is that -- it follows on from the fact that the period for which the debt is outstanding will be different between judgment rate creditors and Bower v Marris creditors. That means that the total amount of interest to which a Bower v Marris creditor is entitled cannot be known until there is a sufficient surplus to pay the very last amount of principal and interest. Until that point in time, by definition, every payment is going to discharge interest first leaving a rump of principal upon which interest still accrues.

So take the case of a distribution under 2.88(7), when you don't have enough to pay everyone everything in full, at that point in time you will not know what the ultimate claim of the Bower v Marris creditor is against that surplus. It entirely depends how long it is before you are able to pay more distributions, if any. It may

be that they have an indefinite right to interest that rolls forever, so the quantum of their claim is impossible to calculate.

MR JUSTICE DAVID RICHARDS: Was that a problem in Bower v Marris it self?

MR ZACAROLI: Well, it could have been. One doesn't know on the facts whether there was sufficient to pay everyone in full.

MR JUSTICE DAVID RICHARDS: No.

MR ZACAROLI: But it is -- it's not just a theoretical problem. It's a practical problem in any case where you have to distribute amongst a number of creditors, but it creates this particular problem where you have some -- only some creditors who are entitled to it because it makes reserving for their claims very difficult. You have -- let's say half your creditors have judgment rates interest. You know exactly the amount they're entitled to so you have £50 to distribute amongst everybody. You know what percentage of that they are entitled to. You don't know what percentage the rest are entitled to. So you have to reserve for those claims, and in reserving for those claims you can't pay out the other claims unless you know there's a maximum amount above which that interest can't extend.

MR JUSTICE DAVID RICHARDS: Just go through that. I mean,

the problems your contending with is where -- is particularly acute when you don't have enough clearly to pay everybody off.

MR ZACAROLI: Yes.

MR JUSTICE DAVID RICHARDS: You could reach a point where you say, "We clearly have enough to pay everyone off".

MR ZACAROLI: Yes.

MR JUSTICE DAVID RICHARDS: So you -- so we're in the position where we don't know. So, as you say, it may be that interest is continuing to run, but every time -- I appreciate there's going to be a gap between the date of calculating the distribution and the distribution, but you can draw the line then, can't you?

MR ZACAROLI: You could do but that means --

MR JUSTICE DAVID RICHARDS: It may still run on to the next distribution.

MR ZACAROLI: That means -- that assumes that the interest you're paying, when you make an interim distribution you're only paying interest up to a certain date. That's one way out of it; that you say, "Okay, we will pay interest only up to this date". That's a number you can calculate, whether you have a Bower v Marris calculation or not. The rule says you pay the interest out of the surplus pari passu which means you're looking at the total claims against this surplus because if you

waited a bit longer and got -- there was more surplus to pay, then there would be more interest payable to the Bower v Marris creditors. So it's the same problem wherever you have an -- it's a similar problem to wherever you have a distribution pari passu to be made: there's not enough, and you know the size of some claims but not the size of others.

MR JUSTICE DAVID RICHARDS: I suppose it's that latter bit I'm not quite clear about. Why don't you know the size of the claims at any particular moment?

MR ZACAROLI: Because you only know the size of the claims for interest up to that moment in time but they're still entitled to the interest from that surplus even after the moment you're paying this particular dividend out.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: You have to -- you can --

MR JUSTICE DAVID RICHARDS: While there is -- applying Bower v Marris, while there is any principal outstanding interest continues to run.

MR ZACAROLI: Yes. As I say, there is a way out of it but that would not then be strictly sharing the surplus amongst those who are ultimately entitled to it pari passu, because those who have interest running on have nothing to claim that interest against. They're not being paid out of the same surplus because you have

paid it to those who have a fixed rate.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Where this leads, the fourth proposition, is that for 2.88(9), you need to know which is the higher of the Judgments Act rate or the contractual rate.

If the contractual rate carries an entitlement to Bower v Marris, this is the, as it were, the last complication to which it gives rise, because the only way in which you can measure which is the higher of, the fixed judgment rate or the rate of 4 per cent, say, with the right of Bower v Marris, is by knowing what period of interest you're going to be paying the Bower v Marris creditor for because over the course of a year it may well be that 4 per cent, even with Bower v Marris, doesn't get you above an 8 per cent comparison. So you don't -- in many cases you will know that you've already got a higher number. You don't know what it's ultimately going to be, but it's a higher number already. But some cases you won't know whether the Judgments Act rate is or is not higher than the contractual rate if you were to apply Bower v Marris to it. So it renders in least some cases 2.88(9) unworkable.

MR JUSTICE DAVID RICHARDS: I see.

MR ZACAROLI: Now, linked to that I'm going to come head-on

to the question: do the words "rate applicable apart from the administration" in 2.88(9) encompass the Bower v Marris calculation? As I mentioned earlier, we say the answer to that is very clearly "no".

First of all, we don't necessarily align ourselves with the wording of the administrators' concession in their skeleton. We have made our concession clear here. This is issue 3. We have made our concession clear here that "rate" as a matter of English language is a word which is capable of covering both a simple rate and a compound rate; otherwise there's an umbrella term "rate of interest" within which you can have two possibilities, a simple rate or a compound rate.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: We're all familiar with the concept of APR. There's always a way of analysing a compound rate as a simple rate on an annualised basis.

I showed my Lord paragraph 88 of the White Paper that followed the Cork Report --

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: -- very clearly indicating that they were extending the amount of interest payable beyond the judgments rate to include a contractual rate of interest that one might have. I suggest the draughtsman was undoubtedly thinking along these lines, namely "it's

rate, nothing more".

The next point is that "rate" is a fundamentally different concept to the Bower v Marris calculation. Bower v Marris is not the same as compounding in economic effect. Indeed, it has no impact on the rate. Bower v Marris is simply about the order in which you treat dividends as having been paid, whether towards principal or interest. In order to make the choice you would need to know what interest was outstanding according to the rate. So the rate is a necessary pre-existing factor before you can apply Bower v Marris

The third point is this, that the use of the word "rate" has to be considered in the context of its place in the rules and the purpose of that rule. The purpose of 2.88(9) is simply to work out whether the rate apart from administration was higher than the Judgments Act rate. It was to preserve the right of those who have an entitlement to a rate greater than the Judgments Act rate to recover statutory interest at that rate. There is no basis for incorporating Bower v Marris into the Judgments Act rate, the rate with which that comparison is to be made. So even if they were right about the use of the word "rate" in 2.88(9), it couldn't possibly incorporate the concept of Bower v Marris into the Judgments Act rate as well.

The fourth point is it can only apply where the relevant rate was higher than 8 per cent because, if not, then it's irrelevant because the Judgments Act rate would apply. So, again, the rule is about determining which is the higher and only then does the contractual rate apply, so a 2 per cent right of interest, if with Bower v Marris it's not higher than 8 per cent, would not win the battle and the Judgments Act rate remains.

Which leads to the last point I have already made: how do you determine that? In some cases you will know, but in many cases you will not know at any particular point in time which is the higher of the two rates if you take Bower v Marris into account.

Now, just one final point on this. My learned friend Mr Smith argued that compounding is not a rate at all. It's interest on interest which logically lead -- well, logically that submission would lead to the conclusion that compound interest is not within 2.88(9) because if it's not a rate, then it can't be within the rule at all. Of course he's not arguing that. Everyone accepts that compound interest is within 2.88(9), but that's because it is in fact a rate.

That leaves just the sub-issue within, I think, issue 3: does compounding continue after the relevant -- after the final dividend payment? So if you have

a compound rate, do you carry on compounding that rate and accruing interest at that compound rate after the date the final dividend is paid. The answer is "no". First of all, as a matter of statutory construction, interest is payable for the period between the date of administration and the date the dividend is paid and therefore it's contrary to the statute.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Secondly, it creates all of the same problems I've just referred you to relation to Bower v Marris, in particular it means you don't know which is the higher of the rates for the same reason; it's continuing, so you just don't know.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: How that works, my Lord, is because the period -- interest is payable for the periods the debt is outstanding, so that if you have a debt that's paid by way of interim dividends, let's say one interim dividend after six months, the rest after a year, what that means is you treat the debt that was paid after six months as a slice of the debt upon which compound interest accrues during the period up until which that was paid, and the remainder of the debt, the other £50, has been outstanding for the whole year and therefore compounds for the whole year. It's very simply done.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: I am going to return now to my learned friend Mr Dicker's three core propositions, having been through all the cases, and answer them very shortly.

His first proposition, and this was as to the construction of rule 2.88(7), his first proposition was that the features of rule 2.88 which we rely upon were also features of the previous regimes. My Lord, we disagree. Critically the right to interest under rule 2.88 is not calculated as whatever claim could have been asserted against the debtor once solvent. So cases considering regimes where that was the position have no relevance at all to the construction of 2.88 which must be undertaken on the words in the context of the statute.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: His second proposition was in substance the arguments that we are making were made and rejected in relation to the previous regime. Again, we say "no". The arguments we are advancing could not have been made in relation to all of the English and Australian and Scottish cases because the regime was fundamentally different. The two regimes where there was sufficient similarity for the argument to have been run, i.e. in Canada and in Ireland, in the two cases we've looked at,

the arguments were not advanced and therefore not rejected.

MR JUSTICE DAVID RICHARDS: Right.

MR ZACAROLI: The third -- his third proposition was that the courts under the old regimes construed statutory -- the statutory scheme as providing a mode of calculation for interest which proceeded on the basis that dividends were treated as notionally discharging interest before principal. We say, again, wrong. They proceeded on the basis that they were not construing any statutory scheme about paying interest. The extent to which they construe the statutory scheme was to conclude that creditors were remitted to their contractual rights once the surplus arose, and determining that payments made to date were not appropriations at all and therefore it left the creditor free to exercise his right of appropriation.

So, in short order, that's our answer to the three basic propositions.

MR JUSTICE DAVID RICHARDS: Thank you.

MR ZACAROLI: I now turn to the last of the points I was going to raise under issue 2 which is questions of principle and policy.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: We were challenged, I think, to say that there

is no -- or by the proposition that there's no policy reason why the long-standing rule in Bower v Marris should have been abolished in 1986. Now, we first of all say that the premise behind that challenge is flawed because there's no question of us seeking Bower v Marris to be abolished. We simply say it has no application to the way that legislature chose to address the issue of post-insolvency interest in 1986, it's just irrelevant to the question.

We also say the premise is flawed insofar as it suggests there was a long-standing and, thus, I assume well-known rule of Bower v Marris. I have made submissions before about the length of time, about a century, in which no reference to Bower v Marris was made in the context of distributions from an insolvency estate, whether corporate or personal, and whether in this jurisdiction or abroad.

We also disagree with the premise because it is not the case that any such principle in any event was -- ceased to be relevant in 1986 in bankruptcy. It had already been irrelevant well over 100 years, since 1883, since which time there is no case and no textbook, other than one small reference in 1904, which has even cited the case in a bankruptcy context.

True it is the rule of appropriation that where

payments are made by a solvent debtor to a creditor on account the creditor has the right to appropriate -- and the presumption is the appropriation will be to interest before principal -- is a long-standing rule and no doubt well-known.

And in the only English cases that have considered the proposition -- the Humber Ironworks quartet and Lines Brothers, a century apart -- that was indeed the relevant principle because the statute simply left creditors to pursue their contractual rights against the company for post-liquidation interest once there was a surplus and the company was now treated as solvent.

So we disagree fundamentally with the premise behind the challenge, but addressing the question why is it that it might have been thought that the right of a solvent -- the right of a creditor as against a solvent debtor to appropriate was not applicable in winding up or bankruptcy from 1883 or 1986, as the case may be, the fact is that both those regimes, bankruptcy in 1883, companies in 1986, create for creditors a bundle of new rights which in many cases enhance the pre-existing rights of the creditors. In some cases they didn't, I accept that. In some cases, if we're right on Bower v Marris, it did deprive a creditor of the right against a solvent debtor to the appropriation

on Bower v Marris basis, but in many cases creditors' rights are enhanced.

Equally importantly, that bundle of rights constituted a bundle of obligations imposed on the insolvent estate that were new and different from the obligations the company had had before liquidation or administration.

Now, there was a deliberate choice in 1986, as we saw from the Cork Report -- the Cork Committee Report, taken up by the legislature, a deliberate choice to adopt the bankruptcy model, not the remission to rights against the solvent debtor model which had been the feature of company law for the last 150 years. It is simply a consequence of the fact the legislature chose an option which gave these creditors -- gave creditors a bundle of new rights, imposed on the company new obligations, and did not revert to contractual rights -- that the right of a creditor against a solvent debtor to appropriate, which is part of the general law, did not get carried along with it.

The third point is this, that what lies behind the Senior Creditor Group's challenge is the assumption that whatever contractual rights to interest a proving creditor had against a solvent debtor must be fully satisfied before anything is left for anyone behind them

in the queue. That undoubtedly was the premise behind the decision in Bromley v Goodere and in Bower v Marris too and therefore many of the cases around that time that did the same thing.

I go back here to the colour I gave earlier about the context at that time, namely debtors -- bankrupts were considered offenders who should be made to pay for the delay caused to their creditors in getting payment.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The comments therefore and the decisions even in those cases must be seen in that context.

The world today is very different.

Going back to 1883 for a moment, the world in 1883 was different because that -- it wasn't coterminous with the abolition of criminality in bankruptcy but it followed shortly after that. So a bankrupt was no longer a criminal in 1883.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: What Parliament did in 1883, we would say beyond any doubt, is took away the contractual rights of creditors if they were in excess of 4 per cent and left everyone with a 4 per cent claim for post-bankruptcy interest. We don't know what the policy of the legislators was. We simply don't know at this distance.

One possible and I submit tenable reason for that

decision was that there is a qualitative distinction between a debtor who is refusing to pay and a debtor who is insolvent, such that the administration of its estate by third parties takes time before its debts can be paid. In the first category, the creditor's contractual rights, whatever they may be, should be asserted because the debtor is simply refusing to comply with those rights. In the second -- and the debtor can seriously and correctly be seen as at fault in not repaying. In the latter, there is no fault or at least there may well be no fault on the debtor at all for the time taken to distribute assets -- to get in assets, to realise them, to deal with issues between creditors and end up paying dividends. So one tenable reason for the distinction is that when you look at a bankruptcy and take away the idea of the debtor being an offender, all creditors are suffering equally by the delay which follows from the date of bankruptcy and they're all suffering because of whatever it is within the administration of that estate which is taking time.

The same point can be made in relation to companies, but there's an additional point in relation to companies post-1986, and that is that it isn't just a debate or a dispute between the creditors and the debtor which is the case in bankruptcy. There are only two interested

parties. In a company you have the creditors, on the one hand, in this dispute and you have everyone else who is entitled to recover their investment from the debtor, the corporate debtor, that falls below them in the priority waterfall on the other hand.

There is no way in which it would be right to equate, for example, a subordinated creditor with the debtor as offender under the old bankruptcy regime. They're simply someone who is entitled to be paid from the estate. Similarly, shareholders. You can have all sorts of different layers of equity, preferential, ordinary and various layers in between. They are all people who have invested in this corporate personality and who are entitled to be paid what they are owed or entitled to in the case of an ordinary shareholder once the statutory scheme has been completed. None of them can properly be equated with the debtor whose fault it was that creditors were not being paid timely -- in a timely fashion under the Bromley v Goodere-type situation.

So the delay affects all of them equally, which leads to the conclusion they should all have the same nature of rights against the insolvent debtor. That perfectly explains, we say, the decision in 1883 to give all creditors the same rate of interest and nothing more

against the insolvent debtor and the reason why Bower v Marris would simply be irrelevant thereafter.

Those that -- that delay affects all creditors equally, even though creditors would have had a right to interest beforehand and others don't. There is that distinction between them, but they're all being prejudiced in the same way by the delay in the administration of the estate.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Now, hand-in-hand with this, to develop a point I made a moment ago, it's wrong to assume that the delay in payment of the dividend is down either to the company or the debtor in bankruptcy. The delay, for example, might easily be caused by creditors fighting over priority issues or one creditor or some creditors disputing the quantum of their claims, meaning there can't be distribution to anyone until those are sorted out, or it may just be delay because third parties are taking advantage of the insolvency to refuse to pay up and therefore time is taken to realise the assets. There's a whole plethora or reasons why administration of an insolvent estate takes time and none of those can be equated with the fault of the debtor or the company or, certainly not, the fault of those other people entitled to the priority waterfall below unsecured

ordinary creditors.

One reference, my Lord, if I may. My learned friend Mr Dicker referred you to it, but I'm not sure he went to the case. It's Danka Business Systems.

MR JUSTICE DAVID RICHARDS: He mentioned it.

MR ZACAROLI: Acknowledging that this is a different context, the judgment is in volume 1E, tab 162.

My Lord may remember this is a case about the valuation of contingent plans and, in particular, whether, where there's a surplus to return to members, the liquidator should make a reserve for the possibility of a contingency which hasn't yet fallen in, later falling in, before paying every available asset back to the members. The court of appeal held that he shouldn't.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: There is just one short passage that I would ask my Lord to look at which is in the judgment of Lord Justice Patten at paragraph 36. Perhaps my Lord can read 36 and 37.

MR JUSTICE DAVID RICHARDS: I will, certainly. (Pause) Yes.

MR ZACAROLI: The key sentence is the last one in paragraph 37, the reference to the company's liabilities in section 107 must be to the liabilities as determined

in accordance with the 1986 rules, otherwise they serve no useful purpose. Section 107 of course is the section which tells us to distribute the company's property in a voluntary winding up and in a satisfaction of the company's liabilities pari passu and, subject to that, distribution to the members.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: There's an echo there, we suggest, with the 1883 Bankruptcy Act in relation to interest and the way that's been construed subsequently in the Baughan case and by the Cork Committee themselves, that once you pay what the statute requires to be paid, the bankrupt gets it next; there's no gap for anyone else to come in at that point.
MR JUSTICE DAVID RICHARDS: No.
MR ZACAROLI: Similarly, here, you construe what is payable pursuant to the statutory regime and, once you have done that, it goes back to the bankrupt -- sorry, it goes to the next person entitled, which would be the members ultimately in the company case.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: The question as to what rights exist in the statutory scheme is a question of construction of the statute and the rules. Of course my Lord has decided in the Waterfall 1 judgment that one of the rights which is

left outstanding to be satisfied before a return to members is the currency conversion.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: The real point we'll come on to in issue 39 then is whether this interest claims can fall within the same category as currency conversion claims or whether there is some distinction between them. We'll come on to that.
MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: But, taking that statement from Danka, looking at the way the Bankruptcy Act was construed and dealt with in relation to post-bankruptcy interest, we say it's really unhelpful and distracting to try to construe the statutes by reference to broad statements, such as those of Lord Hardwicke in Bromley v Goodere, about everyone must be satisfied in full before the rubbed gets anything. That doesn't really help in construing the statute today.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Finally, on this topic, on this subject, if it's right, which we say it is, that Parliament since 1883 has seen fit to provide creditors with a fixed rate of interest without allowing them to pursue their claims for a higher rate by way of contract against the debtor and thus taking away the right that a solvent --

a creditor would have against a solvent debtor to apply payments on a Bower v Marris basis, if Parliament felt that was right to do that in bankruptcy and provide that immediately after satisfaction of creditors' proved debts and that statutory interest in full the surplus was returned to the bankrupt, we ask what possible policy would there be in reversing that in relation to companies?
One starts the history with the bankrupt being the debtor, the offender, someone who must be made to pay for delaying payment of his creditors. But in a corporate context, for the reasons I've been through, you can't equate any of the people in the queue, in the priority waterfall below unsecured creditors, as being in any sense at fault or offenders themselves. So what would be the purpose in Parliament in 1986 somehow meaning to introduce or allow in the corporate context the creditors to have that right; more importantly, perhaps, to burden those in the queue below the unsecured creditors with that additional burden when the bankrupt himself is not burdened with that?
My last task in relation to issue 2 is to deal with some miscellaneous point on this issue of policy and principle raised in the SCG's skeleton at paragraph 120. I will have dealt with quite a bit of these points

generally on the way through so I'm going to pick up a few additional matters.
Sub-paragraph 1, they say:
"The rule in Bower v Marris is consistent with fundamental policies and principles ... it ensures that all creditors, whether those with a right to interest apart from the administration (whether contractual or statutory) or those with a right arising under the statutory scheme are compensated for being kept out of their money."
My Lord, the fact is that the right given by the statute to all creditors to be paid interest for the delay caused by the distribution of dividends is what compensates them for the time value of money during the administration. So that point of principle has been answered in 1986 for companies but long ago in relation to bankruptcy to by allowing a statutory interest to everybody.
The complaint that creditors don't get compensation for delay in paying interest -- in the payment of interest is simply because the statute does not provide for interest upon statutory interest. It's not there. It's never been there. Therefore, it would be wrong, as it were, by a side-wind to say "because there's no interest on interest Bower v Marris must apply" reverses

the correct order here.
The correct order is the statute does not allow interest upon interest. It's a decision taken. There's no suggestion that the Cork -- the authors of the Cork Report ever recommended that there should be a third round of proofs for the delay caused in paying interest. Presumably a fourth round after that because of the delay on paying the interest on the interest. It would be never-ending.
Sub-paragraph 3, the point here is that Bower v Marris ensures equality of treatment, namely that creditors who have their provable claims admitted and paid early are not prejudiced by comparison with creditors who have their provable claims admitted and paid later. We submit this is a bad point. If you take this example, creditor A is paid £100 after one year. Creditor B is paid £100 after five years. Interest is only payable after five years when creditor B gets paid in full. It's true that creditor B gets five years' of interest. Creditor A doesn't get five years of interest, only one year. But the short answer to that supposed disadvantage is creditor A has had his money since the end of the first year. So both are affected equally. Both are delayed in getting interest payable on the relevant outstanding period. So for the first

year both creditor A and creditor B incur interest of £8 at 8 per cent.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: They both have to wait five years for that £8 to be paid.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So there's complete equality of treatment.
The next point is sub-paragraph 4. It ensures to the extent possible that creditors' existing rights to interest are given effect to and at sub-paragraph (a) they say:
"Creditors with a right to interest apart from the statutory scheme are treated in the same way that they would have been treated if the payment had been made outside of solvency."
My Lord, we certainly take issue with that. It's absolutely clear that the statute does not treat creditors with a right to interest apart from the statutory scheme in the same way. If you have a right to interest at 2 per cent you are given a right to 8 per cent under the statute. So there's no doubt that the statute alters the rights of creditors but for the scheme.
MR JUSTICE DAVID RICHARDS: Yes, I see.
MR ZACAROLI: Then sub-paragraph 7, the last point, it

avoids prejudice in other situations, including, for example, where a creditor with security or a claim against another person who was jointly and severally liable. As Lord Cottenham stated in Bower v Marris, it would be extraordinary if a co-obligor was able to benefit from prior payments having been attributed to principle. That's not a problem because, as we accept, the creditor's rights against a co-obligor would be unaffected. He has his rights of appropriation. He has his rights of appropriation in a sense against the company in liquidation. They're just irrelevant because that's not how you determine interest is payable from the statutory fund surplus. He has his rights against the co-debtor. It is clear law that a discharge of -- but from one co-debtor by operation of law does not discharge the co-debtor.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: We can provide authority if my Lord wants that. It was a point raised by Mr Smith in his submissions, that this creates problems when there is a discharge but there is clear law that discharge by operation of law does not discharge a co-debtor.
MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: My Lord, that is the end of my submissions on issue 2. I'm going to turn to issue 39.

MR JUSTICE DAVID RICHARDS: Right.
MR ZACAROLI: There are two different arguments that are advanced in relation to issue 39. The first is that creditors whose contractual rights were not fulfilled by payments from the statutory scheme so far should be entitled to payment from the surplus as non-provable debts. The second argument is that creditors are entitled to compensation because there's been a delay in distributing the surplus because there is a right to be paid statutory interest and when it's not paid after payment of proved debts, then there's a non-provable claim for damages based on the, I assume, Sempra Metals analysis.
Much of what I have said by way of general policy and principle applies equally here and I'm not going to repeat those comments. My Lord has them.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: But the same underlying reasons why the statute doesn't give these right is explainable by those principles.
So far as the first way of putting the case is concerned non-provable claims for -- non-provable liability for contractual claims. We rely on the submission that there is -- the way in which the statute provides for interest on post-insolvency period is

intended to be the compensation for interest -- for delay in payment for that period; in other words, as we put it perhaps colloquially, rule 2.88(7) in administration is intended to cover the ground. It is intended to be the way in which creditors are compensated for this prejudice identified by the Cork Committee, addressed by the Act.

So far as the construction of the rule is concerned, rule 2.88(7) requires that the surplus is applied in paying statutory interest and in the first line of the rule:

"Before being applied for any purpose."

That's the wording, "Before being applied for any purpose it shall be used to discharge interest on those debts in respect of the periods during which they have been outstanding".

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: So one point to make is that the logical reading of "purpose" there is any purpose other than the one that's just been identified, namely paying interest for the period the debts are outstanding.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Therefore, the draughtsman was not intending to include interest in any other purpose -- or any purpose. We submit more broadly that it would be an odd

statutory intention to impute in the legislature to try to deal with the problem that delay has caused in the distribution of an insolvent's estate by drafting a rule providing a right under this rule which gives interest because of that rule, but also intended that to the extent that a creditor could say, "Well, if the debtor had remained outside of an insolvency proceeding and was still refusing to pay me, I could have got more, I should have a second bite of the interest cherry". Interest is there to compensate for that delay and is intended to cover the ground.

Insofar as it helps at all, we say the Cork Report supports this view because the Cork Report was identifying the need to provide a remedy for creditors who suffer because of a delay caused by the distribution of the insolvent's estate and the remedy they have recommended, which Parliament adopted, was rule 2.88(7) and its equivalents.

If the draughtsman had intended that that was not everything but that interest for the same delay could be claimed on a higher basis by some other creditors, then it would be a very easy thing for the draughtsman to say, but the draughtsman has not done so.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Allied to that first point about statutory

construction is the broader point that there is a substantial change in creditors' rights and in the obligations of the company imposed by the 1986 regime. This is different to currency conversion claims because, as my Lord found in Waterfall 1, the currency conversion claim is simply the contractual entitlement which is left standing throughout, untouched by anything in the statutory process. And the loss is caused simply by the fact that there is a required conversion limited for the purposes of proof. That, as a matter of construction, left the currency conversion or the right to be paid in the foreign currency extant, therefore there could be a claim for the shortfall between distributions and the contractual right.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: I have been at length through the ways in which the creditors' rights and the company's obligations are changed substantively by the rules on interest.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Those changes, those alterations, take this outside of, therefore, the comment of Lord Hoffmann in Wight v Eckhardt, for example, that the statutory scheme has no effect on the creditors' contractual or other rights; it is undoubtedly the case here that the

statutory scheme does have an effect on those rights. A substantive effect not just a delaying effect, leaving them to come back in once the insolvency has run its course.

Now, parts of these submissions -- I think in particular the oddity of the draughtsman having sought to provide for interest under the rules but then thinking oh, well, there may be some more interest which people can claim, and that be a very odd construction -- it seems to be common ground, I think Mr Smith made a similar submission that it doesn't make sense for the draughtsman to have had that intention.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Of course the submissions lead us in very different directions but it's the same submission.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Now, the one argument of my learned friends which we say shows why it is or how it is that the statutory regime for interest covers the ground is the suggestion that actually all creditors who could have asserted a claim for late payment by way of damages can share in this right to come back in at the end of the process. That claim is premised upon the creditor having suffered because of a delay in payment. It's claiming damages for the loss caused to it by the delay

in the payment.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Just expressing the way that claim works shows that it's exactly the same thing which the statute is providing. The statute has provided a remedy where the delay is caused by an insolvency process which is intended to compensate the creditor for that very same loss. We suggest it would be bizarre if Parliament had intended that having provided that remedy, there was some other parallel claim for damages caused by the very same delay for the very same reason, namely an insolvency, that the creditor could assert on some different calculated basis to the amount of interest payable under the statute.
If that's right, then we also go on to say that, well, if that wasn't intended, why would the draughtsman have intended that creditors who had some other contractual basis for interest but for the insolvency should be able to assert those claims which are essentially, again, for the same loss but based on some other right that the statute has not respected?
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: My Lord, that, leaves just interest on interest which I can deal with now.
MR JUSTICE DAVID RICHARDS: How long will that take you?

MR ZACAROLI: Not long.
MR JUSTICE DAVID RICHARDS: All right.
MR ZACAROLI: Ten minutes.
MR JUSTICE DAVID RICHARDS: Okay.
MR ZACAROLI: I can deal with it hopefully shortly because I've made this submission before. The statute provides no right to interest for the delay in the payment of interest. It could have done so, it doesn't. There's no a priori reason to think that such a claim should exist because it's unfair in some way, it's unfair that they're suffering from this delay. This brings back into play some of my policy and principle points, that the delay is not the fault of the debtor any more, that's there's a qualitative difference between claims for delay interest because of delay against a defaulting debtor and one against someone who is now insolvent and the solvency regime is the thing that is causing the delay. Certainly the delay can't be laid at the door of those entitled in the queue behind ordinary creditors who get this statutory right to interest.
Important to realise that delay prejudices everyone equally. By that I just don't mean the creditors who are entitled to statutory interest. It actually prejudices those lower down the order of priority as well, obviously, because everyone is having to wait to

get back their debt or their investment. So the subordinated creditor is as much prejudiced by the delay as the ordinary creditors. The subordinated creditors will of course have a right to interest that will come into play at some point, assuming a sufficient surplus, but members don't.
Members who are entitled to the surplus as and when all debts have been paid are suffering just as much as creditors by the delay in being kept out of their investment, and there is no compensation for them by the statute at all. So combining those factors leads to the conclusion that there is no a priori reason why you should create a right of interest upon interest when the statute has not done so.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: Just by way of contrast, there is, of course, no compound interest on judgment debts so you don't gained interest on interest there.
If my Lord wants a reference to a short passage which makes that clear, it's in the Novoship case, bundle 1E, tab 168. I believe it's Lord Justice Longmore and paragraphs 139 to 141. It's hopefully a fairly obvious proposition.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: So one has to ask what is it then, where is

it -- what is it that gives the creditors a right to have this non-provable claim for interest on interest once the statutory scheme has run its course? We say that nothing of any substance has been identified. What is relied upon is a cause of action for breach of contract or breach of -- it must be breach of contract against the company which has failed to pay interest from the surplus after, as the rule says, after payment of the debts proved.
Now, the first point we make about that is that there is no date at which the company becomes under an obligation to make payment of statutory interest. All the rule does is identify a pre-condition, that the proved debts have to have been paid in full.
MR JUSTICE DAVID RICHARDS: Yes.
MR ZACAROLI: The timing of that payment is, like all of the administration of the insolvency estate, under the control of the administrator, subject to the directions of the court. As is rightly accepted by Mr Smith and Mr Dicker, there is no suggestion here that the administrators are in any way in default in not having paid statutory interest to date. So there could be no claim for any breach of duty by the administrators under whose control it is to pay statutory interest.
In those circumstances, we simply fail to understand

how it is that the company comes under some freestanding obligation to make this payment on any particular date that would give rise to a claim for not having paid on that date.

The essence of a Sempra Metals damages claim for late payment is that the payment is late, i.e. there is a date it should have been paid and it hasn't been. That is the essential foundation of a claim in Sempra Metals. That essential foundation is simply missing in this scenario. For the reasons I've given, there's no good reason to try and invent such a claim.

Finally, picking up on some points from my learned friend's skeleton for the Senior Creditor Group, paragraph 461. The first argument asserted, at 461, sub-paragraph 1, is that:

"This would defeat the intention of the legislature that all creditors should receive interest at the Judgments Act rate [if there wasn't interest upon interest]."

My Lord, the intention of the legislature is to pay statutory interest at the judgments rate for the period the proved debts were outstanding.

MR JUSTICE DAVID RICHARDS: Yes. I was just reading through it, yes.

MR ZACAROLI: The intention is to pay interest for that

period only, for very good reasons that we've been through.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: So that's the intention. That intention is indeed furthered, not prejudiced, by the fact that interest is paid for that period.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: The reverse could be said, equally, that if you allowed interest to accrue long after that or interest upon interest not provided for, then the total amount being paid to a creditor by way of interest would far exceed the Judgments Act rate for the period the debt was outstanding. So if you had the total interest paid over that period, it would be much more. So it would contradict the statutory purpose.

MR JUSTICE DAVID RICHARDS: Yes.

MR ZACAROLI: Then it's said, sub-paragraph 2 of that paragraph:

"This would also have the effect that interest would be paid to creditors otherwise than pari passu, and not in accordance with their entitlement after proved debts had been paid in full. The effect of the delay would be that all creditors with a non-provable right to compensation for such delay, whether as a result of a contractual or statutory right to interest or a claim

for damages, would be compensated for such delay, but creditors without such a right would not."

Well, first of all, there's no breach of the pari passu principle because, for reasons we've already been through, there is no such right to creditors with a contractual or other right to interest, but if we're wrong about that, there's still no problem with the pari passu principle. If there is differential treatment of creditors on the basis that some have a contractual right and some don't, that's explained purely by their different rights and pari passu treatment never has to come across existing rights of creditors.

Paragraph 465 draws a parallel with the Judgments Act rate and the fact that under a judgment they say:

"Further, whilst the company remains in administration creditors continue to be subject to the effect of the moratorium on proceedings. Given this, and in accordance with the rationale for the introduction of the right to interest at the Judgments Acts rate, the protection provided to creditors by the entitlement to interest at the Judgments Act rate should not stop when there is a delay in the distribution of the sums to which they are entitled."

The short answer to which I've already made, there's no interest on interest under the Judgments Act.

Finally, the incentive argument at paragraph 466:

"Such creditors should have a right to compensation in circumstances where there is sufficient cash to pay the claims of creditors in full, and where a failure to compensate creditors for delay in the payment of claims would benefit shareholders. If no such right exists, shareholders would have an incentive to extend the process of administration for as long as possible so at to ensure that they, rather than the creditors, received any interest earned on the company's assets ... it would be contrary to principle for creditors to be prejudiced by and for shareholders to benefit from delay in the distribution of a surplus."

A number of submissions I have made cover that but, frankly, that's quite a bizarre suggestion that the shareholders, who are also being kept out of their money, would (a) want to extend the process of administration to the sum increase on the fund when if they had the fund in their own hands they would be earning interest on it anyway or have the use of it and, (b), shareholders don't control the process, the administrator does.

MR JUSTICE DAVID RICHARDS: It's not in their hands, it's

the administrators.
MR ZACAROLI: Exactly.
If I can be forgiven for one perhaps slightly cheeky comment to finish with. The incentive in a case like this, although I accept my Lord can't decide this case on the basis that we happen to have a very high rate of Judgments Act interest, the incentive is the reverse here. The creditors will do better by arguing amongst themselves for as long as possible to avoid being paid. You wouldn't get that rate elsewhere.
My Lord, with that slightly cheeky comment, those are my submissions.
My Lord, it is the end of a long day. I think I have finished. If I think of a couple of points, with consultation with my colleagues, it may be I have five minutes on Monday, but I hope not.
MR JUSTICE DAVID RICHARDS: Very well. Thank you very much.
On Monday, therefore, we'll sit at 9.30. I'm not able to tell you now, but I will be able to tell you when we start on Monday, exactly what time we will finish, but I anticipate it being somewhere between 1.30 and 2 o'clock. Very good. Enjoy your weekend.
(4.30 pm)
(The court adjourned until
9.30 am on Monday, 23 February 2015)

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