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ARTICLE

Proving for Foreign Currency Debts in an Insolvency

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Lehman Brothers International (Europe) ('Lehman Brothers') was an unlimited company, with two members, Lehman Brothers Holdings Intermediate 2 Ltd ('LBHI2') and Lehman Brothers Ltd ('LBL'), both of which were unsecured creditors of Lehman Brothers. In 2008 Lehman Brothers went into administration, as did LBHI2 and LBL. LBHI2 had made subordinated loans to Lehman Brothers, repayment of which was conditional on Lehman Brothers being able to pay its 'liabilities'. Obligations which were 'not payable or capable of being established in the insolvency [of Lehman Brothers]' were to be disregarded. Lehman Brothers also had many other creditors owed unsecured debts payable in foreign currencies. Although, rather unexpectedly, Lehman Brothers had a surplus in its administration, LBHI2 and LBL were unlikely to be able to repay their creditors. The Court was required to determine certain issues concerning the validity and ranking of various claims on the surplus for the purposes of the distribution to creditors in the administration. The Supreme Court[1] allowed a number of appeals and cross-appeals from the decision of the Court of Appeal[2] (which had for the most part upheld the decisions of David Richards J at first instance[3]).

The Supreme Court held:

(1) That LBHI2's claim as holder of subordinated loans was subordinate (a) to statutory interest and (b) to non-provable liabilities.

(2) If statutory interest was not paid during an administration, it could not be claimed in a subsequent liquidation.

(3) Lehman Brothers were entitled to seek contributions from members under section 74(1) of the Insolvency Act 1986 for non-provable liabilities but not for statutory interest.

(4) Lehman Brothers could not prove in the administrations of its members for a potential contribution claim under section 150 of the Insolvency Act 1986.

(5) Likewise, the members' potential liabilities under section 150 as contributories could not be set off against their claims as subordinated creditors.

(6) Lehman Brothers could rely on the contributory rule to resist paying the members on their proofs until they met their liabilities as contributories.

(7) Creditors who had suffered a loss due to the depreciation of sterling between the administration date and the payment date were not entitled to claim it as a non-provable debt.

This note is concerned only with the last of these holdings. It involves consideration of the way in which foreign currency debts are to be treated, both in the case of existing debts and in the case of debts which would accrue in the future. The Court of Appeal, by a majority, had upheld the decision of David Richards J that exchange losses were recoverable on foreign currency debts arising out of the conversion of the debt into sterling at the rate prevailing at the date of the order for administration. The Supreme Court, Lord Clarke of Stone-cum-Ebony dissenting, reversed the decision of the lower courts on this point.

Currency conversion claims

Rule 2.86 of the Insolvency Rules 1986 deals with the case of the company which goes into administration. It provides that:

> 'For the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company entered administration ...'[4]

This is so even if the company subsequently goes into liquidation, though if the liquidation is not preceded by a period of administration, the relevant date is the date on which the company goes into liquidation.[5] The

Notes

1 [2017] 2 W.L.R. 1497.
2 [2016] Ch 50.
3 [2015] Ch 1.
4 The equivalent rule for liquidations is Rule 4.91 and is in identical terms, *mutatis mutandis*.
5 Insolvency Rules, r 4.91. Conversely if the administration is preceded by a liquidation, the date of the liquidation governs.

issue in *re Lehman Brothers*[6] was whether creditors who had suffered a loss due to the depreciation of sterling between the administration date and the payment date were entitled to claim that loss as a non-provable debt. The majority of the Supreme Court held that no such recovery was possible. The leading judgment was given by Lord Neuberger of Abbotsbury PSC, with whose judgment Lord Kerr of Tonaghmore and Lord Reed JJSC agreed. Lord Clarke dissented and Lord Sumption expressed certain reservations considered below.

The effect of a liquidation on foreign debts had been considered in *Miliangos v George Frank (Textiles) Ltd*,[7] in which English law for the first time accepted the possibility of foreign debts being recovered in foreign currencies. Lord Wilberforce (with whom Lord Cross of Chelsea agreed) expressed the view that the exchange of the foreign debt into sterling should be effected at the date when the claim was admitted to the liquidation. That case was concerned with a simple claim for the recovery of a contractual debt, and Lord Wilberforce's observations about insolvency were *obiter*. However, the matter arose for decision in two subsequent cases, *Re Dynamics Corp of America (In Liquidation) (No 2)*[8] and *Re Lines Bros (In Liquidation)*.[9] In those two cases, the courts refused to follow the guidance given by Lord Wilberforce and instead laid down a rule that the date for conversion was the one on which the order for liquidation or administration was made. The Supreme Court ignored the radical difference between the two approaches and ruled that the dicta in these cases did not provide any useful guidance. The reasoning was as follows. The provisions of the 1986 insolvency legislation and the rules made under it were a new scheme. These cases were concerned with an earlier insolvency code, and the legislation constituted a radical change in the law. The treatment of foreign currency creditors was expressly dealt with for the first time in the 1986 Rules. The new insolvency legislation and rules followed on the publication of the Cork Report[10] and two Law Commission working papers, *Private International Law: Foreign Money Matters*[11] and Final Report on Private International Law Foreign Money Liabilities,[12] all of which argued for the date of the order for administration as being the conversion date. Even so, one would have thought that the considered reasoning of eminent judges in the context of the law as it formerly stood should not have been simply ignored. They involved the consideration of the underlying problems with which the Rules were supposed to deal.

There were two principle arguments put forward to support the Supreme Court's conclusion that no recovery was possible.

The narrower issue. What the Supreme Court called 'the narrower issue' was whether the wording of the rules was such that the claim in respect of exchange losses was one which was barred by the wording of the rules. Lord Neuberger considered that it should be inferred that the new r.2.86 was intended to spell out the full extent of a foreign currency creditor's rights, especially as the purpose of the 1986 legislation was to simplify and clarify the law. He thought that if it were otherwise, r.2.86 would operate as a one-way option on the currency markets in a foreign currency creditor's favour. He noted[13] that the rules expressly provided for adjustments to a proof of a contingent debt and that there was no equivalent provision for a foreign currency debt. This approach is supported by *Mann on Money,*[14] broadly on the ground that it is necessary for there to be a single date taken for the ascertainment of claims but challenged by *Howard, Knott and Kimbell on Foreign Currency*[15] on the ground that Lord Wilberforce's approach still resulted in a single date being taken for the assessment but involved the deferment to the latest possible date for the conversion. (Neither of these works appears to have been cited to the Supreme Court.) The wording of the Rules is such as to require there to be a conversion where there are foreign currency debts.

The narrow argument is therefore that (a) on their true construction, the Rules provide for the payment to be limited to the sterling equivalent of the debt at the date of the order; (b) this construction is supported by contrasting the express provision for adjustment of contingent debts with the silence in relation to foreign currency debts; and (c) the foreign currency creditor would benefit if sterling appreciated after the date of administration but, on the other view, would not lose if sterling depreciated. The narrow view results in the claim of the creditor being satisfied if he receives payment in full of the proved sterling sum.

It is not possible therefore for a liquidation or administration to be carried out in a foreign currency, even though all the liabilities are properly expressed in the same foreign currency. Where any foreign debt is

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6 *Ante*, note 1.
7 [1976] AC 443 (HL).
8 [1976] 1 WLR 757
9 [1983] Ch 1 (CA).
10 Report of the Review Committee on Insolvency Law and Practice, 1982 Cmnd 8558.
11 (1981) Working Paper No. 80.
12 (1983) Law Com No 124 (Cmnd 9064).
13 Judgment, §93.
14 C. Proctor (ed.), *Mann, the Legal Aspect of Money* (7th edn, Oxford, Oxford University Press, 2012) §8.27.
15 Michael Howard QC, John Knott and John Kimbell QC, *Foreign Currency: Claims, Judgments, Damages* (Informa 2016) §§10.5-10.17.

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involved it seems that there must be a conversion as a result of the wording of the new rules. In this respect, the Rules must be taken to have overruled the decision of Harman J in *Re Scandinavian Group PLC*[16] where it had been held that liquidation could be carried on in a foreign currency. That would have been possible in practice only in the exceptional case where all the liabilities were in a single foreign currency,[17] which would be a very rare event in an English liquidation (and was not the situation in *Re Lehman Brothers*).

The wider issue. When the case was before the Court of Appeal,[18] Lewison LJ would have held that the foreign currency debt was in effect merged with the sterling sum proved in the administration, and the dividend established by reference to the date of the order for administration was substituted for the contractual liability, which thereupon ceased to exist.[19] This reasoning failed to find favour with the majority in the Court of Appeal. Briggs LJ (as he then was) expressly held that the contractual liability continued, and the assessment as at the date of the order of the sterling value of the debt was a matter merely of procedure.[20] The debt remained in being and unsatisfied, and if there turned out to be funds available to satisfy the balance of the debt, assessed by reference to exchange rates prevailing at the date of payment, there was no reason why the claimant should not recover the surplus over the sum for which he had proved. Moore-Bick LJ came to the same conclusion.[21] Essentially, he held that the words of the Insolvency Rules did not have the effect that the order for administration substituted a right to a sterling sum in the administration for the contractual right to a foreign currency debt.

Lewison LJ's approach was therefore consonant with the result reached in the Supreme Court; but was based on a conclusion about the wider issue. In essence, the difference between the two is that between substance and procedure. If as a matter of construction Rule 2.86 bars any inquiry as to the state of the debt after the date of the order for administration, the creditor has lost his right to pursue the debt, even though it may still exist. This is purely a matter of procedure. If, however, it is not merely that his remedy has been barred: the debt has become the sum fixed by the compulsory conversion and there has been a substantive change in the obligation.

In view of the Supreme Court's holding in relation to the construction of Rule 2.86, it was thought unnecessary for the Supreme Court to go on to decide the wider issue, but all the judges expressed their opinion about it. The majority view was that the conversion did indeed take place.[22] 'It would be inconsistent with the general thrust of Chapt.10 of Pt 2 ... of the 1986 Rules that a debt, which has been the subject of a proof which has been met in full, nonetheless includes a component which is somehow capable of resurrection.'[23] The point is so fully argued out that it has the general character of an alternative *ratio decidendi*. It seems however that it has been expressly left open, because Lord Neuberger states that his reasoning is the basis only for his 'current inclination';[24] and he expressly says that his 'Conclusion' is founded on 'the narrower contention'.[25]

The views of the minority are instructive. Lord Sumption supported the general rule which prevents upward variation of foreign currency debts to take account of currency fluctuations by reference to the argument (for which he cited the judgment of Brightman LJ in *re Lines Bros*[26]) that this was not consistent with a *pari passu* distribution. It is not clear that this is so, because the recovery of the exchange loss would simply mean that the correct figure was entered as the claim. The same would apply to contingent liabilities, for which, as Lord Neuberger pointed out, special provision is made in the Rules. There would be something to be said for the view that all future debts in foreign currencies (as opposed to debts in foreign currencies already accrued) should be treated as contingent debts, as the exact quantum of such debts in sterling terms cannot be known until after the date of the order for administration or liquidation. That would have been consistent with Lord Wilberforce's approach in *Miliangos v George Frank (Textiles) Ltd,*[27] though not, as mentioned earlier, with the later decisions in *Re Dynamics Corp of America (In Liquidation) (No 2)* and *Re Lines Bros (In Liquidation)*.[28] The wording of Rules 2.86 and 4.91 appear to prevent this conclusion because they refer to debts 'incurred *or payable*'. And it is for that reason that Lord Sumption agrees with the first ground of the decision, namely

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16 [1987] 1 Ch 87 at 107-8.
17 There may be room for argument about this, for example in the case where 90% of the debts are in US dollars and 10% in Euros. But this debate cannot take place while the Rules are as they are now.
18 [2016] Ch 50.
19 *Ibid.*, §§64-101.
20 *Ibid.*, §§142-166.
21 *Ibid.*, §§247-259.
22 The Courts reasoning is set out at §§97-112.
23 *Ibid.*, §94.
24 *Ibid.*, §98.
25 *Ibid.*, §112.
26 [1983] Ch 1 at 16.
27 [1976] AC 443 at 467.
28 *Supra.* See the discussion in *Howard, Knott and Kimbell* (n. 15) at §§10.5-10.17.

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that the words of the statutory scheme are clear and cannot be circumvented.

It is perhaps worth noting that Lord Sumption expresses some doubt as to the validity of the reasoning of the Committees whose recommendations led to the Rules being formulated so as to make the cut-off date for conversion that of the order for administration.[29] He went on to express a preference for the view of the courts below on the wider argument as to the effect of the winding up order, though, like Lord Neuberger's contrary opinion, his words were *obiter* only.[30] Lord Sumption's analysis was however underpinned by a substantial body of authority (to which David Richards J and the majority of the Court of Appeal had also referred). In particular in *Wight v Eckhardt Marine GmbH,*[31] Lord Hoffmann said that 'the winding up leaves the debts of the creditors untouched. It only affects the way in which they can be enforced' and that 'the winding up does not either create new substantive rights in the creditors or destroy the old ones'. Again, in *Parmalat Capital Finance Ltd v Food Holdings Ltd (in liquidation),*[32] he said that 'a winding up order does not affect the legal rights of the creditors or the company'. These are clear expressions of principle, stated well after the Insolvency Act 1996 and its associated Rules came into effect. It is thought, with respect, that Lord Neuberger's attempts to qualify or escape from these dicta are unconvincing.

Lord Clarke dissented on both points. He agreed with Lord Sumption and the courts below that the effect of making a winding up order had a purely procedural effect, so that the contractual debt survived. But he went on to hold that, as that was so, in the case where there was a surplus, there was no need to confine the creditor's recovery to the sum which was identified at the time of the order. In effect he held that the Rules governed the amount recoverable only in so far as there was a distribution to the creditors on an insolvency. Insofar as there was no insolvency, there was nothing on which the rules could bite so far as the funds exceeded those claims which were crystallised at the time of the order. As the underlying contractual right survived, there was no reason why the creditor should not make a full recovery as at the date of payment. There is, with respect, much to be said for this view. First, as Lord Clarke pointed out, the other conclusion would mean that the shareholders of the company would benefit at the expense of the general creditors.[33] Lord Neuberger took in effect the converse point.[34] He was concerned at the possibility that the foreign currency claimants would have a one-way bet if recovery for exchange losses were permissible. Creditors would be able to claim for losses if sterling depreciated against the currency of the claim, while they would not suffer any diminution in their recovery if sterling appreciated. It is thought, with respect, that this is to confuse recovery for exchange losses and recovery for losses crystallised at a date when a different exchange rate prevails.

Secondly, the reasons behind the Rules are not very satisfactory. The Committees on whose recommendations the Rules were based were considering the problems of foreign currency insolvency at a time when the decision in the *Miliangos* case[35] was still quite recent and its ramifications had not been explored fully in practice. And their remit was an extremely wide one, so that particular areas of insolvency practice could not of necessity have the intensive focus which would have been present had they been the only topic under consideration, rather than a small corner of a huge canvas which was to be painted in reforming legislation. Thirdly, while it is possible to agree that the construction of rules 2.86 and 4.91 leads inexorably to certain results in the distribution of funds which are insufficient to satisfy all the debts of a particular insolvent company, that does not dispose of the question. If it is decided, in accordance with the arguments which found favour with the trial judge and Lords Sumption and Clarke (for what are, with respect, good reasons), that the status of the debt was not necessarily touched by the Rules because they were to be regarded as governing a matter of procedure only, it is difficult to see how that procedure can affect the underlying rights of the parties except to the extent that the execution of that procedure is relevant. That being so, it is respectfully submitted that Lord Clarke's view makes better practical sense and does not violate the terms of the Rules.

It might be thought that the decision of the Supreme Court proceeds on the assumption that there is a potential cause of action for exchange losses. This would be a large assumption to make without argument.[36] In reality, however, the courts never became involved in this question. Their concern was whether the original

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29 See [2017] 2 WLR 1497 at §194. Lord Clarke agreed: see *ibid.* §222. I respectfully agree with those doubts.
30 *Ibid.*, §§195-6.
31 [2004] 1 AC 147 (PC), §§26, 27.
32 [2008] BCC 371 (PC), §8.
33 Judgment §§218-9.
34 Judgment §91, and see §§84-87.
35 *Ante.*
36 It is a question on which the authors of *Howard, Knott and Kimbell* (n. 15) are divided. See Chapter 13 where the majority view is embodied in the first part of the chapter, treated as representing the Orthodox View (§§13.1-13.43) and the minority view in a Note of Dissent (§§13.44-13.55). Reviewers of this book have been greatly interested by the conflict of views among the authors, but none has actually offered an opinion as to which set of arguments is the more persuasive.

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debt survived the order for administration and, if so whether it was enforceable. No new cause of action was involved. If there had been, there would have been a good argument that the cause of action arose *after* the order for administration, so that Rule 2.86 was never engaged. Nonetheless, the fact that none of the courts gave any consideration to the possibility that there was a separate cause of action for a reduction of recovery due to fluctuations in exchange rates gives some support for the view that there is no general right to claim for such losses.[37]

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37 Thus supporting the Note of Dissent in *Howard, Knott and Kimbell* (n. 15).

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