Neutral Citation Number: [2009] EWCA Civ 1161

Case No: A2/2009/1994

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE, CHANCERY DIVISION, COMPANIES COURT
BLACKBURNE J
CASE NO: 7942 of 2008 and CASE NO: 16389 of 2009

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 6th November 2009

Before :

THE MASTER OF THE ROLLS
LORD JUSTICE LONGMORE
and
LORD JUSTICE PATTEN

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IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

AND IN THE MATTER OF THE COMPANIES ACT 2006

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William Trower QC and **Daniel Bayfield** (instructed by **Linklaters LLP**) for **the Administrators**
Richard Snowden QC and **Andrew Thornton** (instructed by **Freshfields Bruckhaus Deringer LLP**) for the **London Investment Banking Association**
Anthony Zacaroli QC (instructed by **Allen & Overy LLP**) **for GLG Partners LP**

Hearing date : 26th October 2009

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Approved Judgment

Lord Justice Patten :

Introduction

1. Lehman Brothers International (Europe) ("LBIE") entered administration on 15th September 2008. Until then one of its major business areas was the provision of what are described in the evidence as prime services to various institutional clients. Most of these were hedge funds. The services in question included the execution, clearing and settlement of securities and derivative trades and the custody and valuation of the clients' portfolios.

2. Hedge funds do not have substantial back office functions of their own. They therefore require a third party to deal with the trades themselves and thereafter to provide custodial and reporting services. As part of these transactional arrangements, prime brokers such as LBIE lent cash and securities to the hedge funds and provided foreign exchange services. Any finance was usually secured against the assets of the hedge fund held by or through the prime broker.

3. These services were provided under a variety of standard form agreements which I will come to in a little more detail later in this judgment. The principal contracts under consideration in these proceedings are International Prime Brokerage Agreements, Master Custody Agreements, Margin Lending Agreements and what is referred to as the Credit Support Annex to the ISDA Master Agreement. As the names suggest, LBIE's prime service clients ranged from hedge funds who used the company to provide the full range of services described above to clients who placed securities with LBIE for safe custody.

4. It is common ground that a key feature of all these transactions was that the counterparty client obtained (or, in the case of pure custody agreements, retained) proprietary interests in the assets held by or on behalf of LBIE. LBIE held the assets through various depositories, exchanges, clearing systems and sub-custodians depending on the type of asset and the systems through which they were traded. But none of these arrangements is said to have effected any material change in beneficial ownership.

5. The administrators have therefore recognised that the contracts described above give many of the counterparties specific claims over the cash and securities transferred to LBIE. But they are faced with the serious difficulty that, as things stand, they cannot be certain who is entitled to the trust property in their hands. Therefore any distribution of the assets without the protection of some kind of approval from the court is likely to give rise to claims against LBIE and the administrators for breach of trust by those who claim to be entitled to the property adversely to the counterparties to whom it is in fact distributed. For the same reasons, the recipients of the assets are also at risk. Conversely, if no distribution takes place or delays in distributions continue, the administrators are likely to face proceedings for the return of the assets from those who claim to be entitled to them. In relation to some classes of asset, these may exceed the quantity of the relevant securities which remain available for distribution.

6. The uncertainties involved in dealing with the trust assets have three primary causes: a lack of response from clients to enquiries made about the transactions in which they

were involved; the inability of the administrators to rely on LBIE's books and records; and the failure of custodians, depositories and affiliates to provide information about the assets held on behalf of LBIE.

7. These difficulties have been recognised for some time. On 7th October 2008, at an early stage in the administration, directions were obtained from Blackburne J as the designated judge under which the administrators were to take appropriate steps to identify whether money or securities might be subject to trust or proprietary claims. This order envisaged requests for information being sent to counterparties and for Linklaters (the administrators' solicitors) to devise and set up a programme for identifying the legal issues which needed to be determined before a proposal for the distribution of trust property could be prepared.

8. The administrators have written to 1,707 account holders who are thought to have potential claims against LBIE for the return of trust property. The letters ask for details of any such claims, rights or other interests in the assets in question; confirmation of the positions and balances held with LBIE immediately prior to the making of the administration order on 15th September 2008; copies of all relevant documentation; and details of any positions which have been terminated or closed since the making of the administration order. Similar requests for information have been added to the administrators' website.

9. As of 29th May 2009, 950 responses have been received, some of which are incomplete. In the same period the administrators have received some 1,214 claims for the return of trust assets. A number of these have been identified as priority claims by a Hardship and Prioritisation Committee set up by the administrators in accordance with the prioritisation principles referred to in the order of Blackburne J dated 7th October 2008.

10. Aside from issues of priority, the administrators have had to expend considerable resources on making requests for information from clients and locating documents within LBIE's records in order to conduct a line-by-line reconciliation of the clients' positions. Where assets have been distributed, the clients have been required to enter into deeds of undertaking which give the administrators a right to recover the assets or their value where they subsequently turn out to be subject to competing claims. It goes without saying that these measures add to the cost and uncertainties involved in the distribution process.

11. In order to produce some finality for the clients and for the process of administration in respect of these claims, permission was sought from Blackburne J that the administrators should be at liberty to propose a scheme of arrangement under Part 26 of the Companies Act 2006 between LBIE and the persons who are its creditors in relation to Trust Property as defined in paragraph 9 of what is referred to as the Pearson Statement. This is a witness statement made by Mr Steven Pearson, one of the administrators, on 25th February 2009 which explains the steps taken to process the proprietary claims and the reasons for seeking to promote a scheme. Mr Pearson says in paragraph 9:

> "As set out in my First Statement, made in relation to the application for the Trust Property Order, a redacted version of which has been placed on the Court file and is available on the

> section of the PwC website dedicated to the administration of LBIE, the Administrators wished to adopt a system for dealing with all property of, or held in the name of, or otherwise to the order of, LBIE which is subject to trust or proprietary claims, whether comprising monies under the FSA's Client Money Rules ("Client Money") or other monies or assets ("Trust Assets") (together with "Trust Property") in an orderly and efficient manner and one which balanced the importance of dealing with the potential proprietary claims and the achievement of the statutory purpose for which we have been appointed."

12. On 16th March 2009 Blackburne J gave the administrators liberty to propose a scheme of arrangement of the type sought. Section 899 of the Companies Act 2006 empowers the court to sanction a compromise or arrangement proposed between a company and its creditors or any class of creditors when it has previously been agreed to in class meetings by a majority in number representing 75% in value of the creditors or class of creditors in question.

13. There is no statutory definition of "creditor", "compromise" or "arrangement" but a Scheme has been prepared under which (subject to certain exceptions which I will come to in more detail later) "Scheme Creditors" (as defined) who can establish proprietary claims to the assets held by LBIE at the time of administration will release those claims and any associated pecuniary claims for damages or equitable compensation and will receive, in return, what are described as New Claims. They will give to each Scheme Creditor a right to receive, on a pooled basis, securities or other assets of the type claimed and (when it occurs) will leave the counterparty to recover as an unsecured creditor the value of any shortfall in its proprietary claim caused by the shortage of the relevant assets.

14. Scheme Creditors will therefore be required under the Scheme to release proprietary rights in assets which are held for their benefit by LBIE as trustee and the combination of the necessary majorities in suitably constituted class meetings and the court's sanction of the Scheme will be effective to enforce those provisions against any dissenting minority of creditors who would be otherwise unwilling to give up their property rights. A question arose as to whether a scheme which has this effect falls within the provisions of Part 26. The administrators therefore applied, pursuant to paragraphs 63 and 68(2) of Schedule B1 to the Insolvency Act 1986, for a determination of this question by the court in advance of any further directions being given for the preparation of the Scheme and the constitution of the class meetings. After hearing argument from the administrators and a representative of some hedge funds (GLG Partners LP) who support the Scheme and from the London Investment Banking Association ("LIBA"), a trade association for firms in the investment banking and securities industry, who oppose the Scheme on jurisdictional grounds, Blackburne J decided that, insofar as the proposed Scheme of Arrangement is concerned with the distribution by LBIE of property held or controlled by it on trust for any of its creditors and to the extent that it varies or extinguishes those property rights, the court has no jurisdiction under Part 26 to sanction the Scheme. The administrators now appeal from that decision with the leave of the Judge.

The contractual arrangements

15. As mentioned earlier, the administrators have identified four principal contracts under which the counterparties will retain proprietary interests in the cash or securities held by LBIE. The issue of jurisdiction raised before the Judge and on this appeal can be determined as a matter of principle without any detailed consideration of the provisions of the particular contracts which give rise to the proprietary interests. But it is useful to have in mind the various types of agreement and some of their key provisions when considering Mr Trower's submissions about the proper approach to be applied to commercial arrangements which utilise a trust mechanism in relation to the assets involved. I can therefore deal with the individual contracts quite shortly by commenting on two of the agreements which illustrate the point.

(1) International Prime Brokerage Agreement ("IPBA")

16. This governed all acquisitions and disposals of securities by LBIE as prime broker together with the provision of any related advances of cash and securities. Under the agreement LBIE acted as the counterparty's agent in settling the transactions and delivering the securities. Cash Accounts were opened into which all advances of cash made to the counterparty were entered as credits. Securities delivered by the counterparty to LBIE as prime broker or received by LBIE in settlement of third party transactions were entered as debits in a Securities Account.

17. Clause 5.2 of the IPBA provides that:

> "5.2 The parties acknowledge and agree that any cash held by us for you is received by us as collateral with full ownership under a collateral arrangement and is subject to the security interest contained in the Agreement. Accordingly, such cash will not be client money pursuant to the Rules (or any successor provisions thereto) and will not be subject to the protections conferred by the Rules. Such cash held by the Prime Broker will not be segregated from the money of the Prime Broker or any other counterparty of the Prime Broker and will be held free and clear of all trusts. The parties further agree that the Prime Broker will use such cash in the course of its business and the Counterparty will, therefore, rank as a general creditor of the Prime Broker in respect of such cash."

18. This is in contrast to the position in relation to securities. Clause 17.1 provides that:

> "With the exception of any assets transferred to the Prime Broker pursuant to Clause 11, any securities debited to the Securities Accounts shall be held by the Prime Broker as custodian, and the Counterparty hereby appoints the Prime Broker, and the Prime Broker agrees to act, as its custodian, in accordance with the terms of Schedule 2."

19. Paragraph 2 of Schedule 2 requires LBIE to segregate assets by identifying in its books and records that the securities belong to a particular counterparty and not to LBIE and requiring any sub-custodians to do the same. But, subject to this, LBIE is

authorised by paragraph 9 of Schedule 2 to hold securities in fungible accounts with the securities of other customers designated as customer accounts. The reference in clause 17.1 to clause 11 is to the right of use granted by the client to LBIE as prime broker to borrow, lend, charge or dispose of any securities charged to it under the provisions of clause 10 of the agreement. Where this right of use is exercised, the securities become the absolute property of LBIE: see clause 11.2(a). The charge granted by clause 10 in respect of the liabilities of the counterparty to LBIE includes securities debited to the Securities Account subject to a number of specific exceptions including securities where the certificates of title are deposited with a Lehman company and all cash credited to any Cash Account.

20. These provisions were recently considered in some detail by Briggs J in his judgment in *Re Lehman Brothers International (Europe)* [2009] EWHC 2545 (Ch) where he rejected an argument that the existence of a trustee/beneficiary relationship subsisting between LBIE and the counterparty in respect of securities held by LBIE was inconsistent with the right of use provisions and the permission to hold the counterparty's assets in a fungible account. The Judge also decided that the provisions of clause 5.2 had no application to cash derived from securities and received by LBIE or any of its sub-custodians on or after the making of the administration order on 15th September 2008. These monies would include the proceeds of any redemptions together with receipts in the forms of dividends or coupons. Those monies therefore remain trust assets in the administrators' hands.

21. Clause 13 of the IPBA entitles a counterparty to terminate the agreement in the event of a failure by LBIE to provide the prime services contracted for. But the exercise of this power has the effect of making any outstanding loans from LBIE immediately repayable and of converting the obligations of the company under clause 7 to deliver the securities in specie to the counterparty on request into an unsecured obligation to pay a net cash balance arrived at by setting off against the value of the securities and any other assets held by LBIE for the client on closure of the client's liabilities to LBIE.

<u>(2) Master Custody Agreement ("MCA")</u>

22. The MCA covers holdings of both securities and cash on behalf of the client. It was used when only custody services were provided by LBIE and in investment banking transactions where such services were provided to the client as part of a larger transaction.

23. In earlier versions of the agreement, LBIE is granted a general lien over the property until satisfaction of all liabilities of the client to it or to any other Lehman Brothers entity. But, subject to this, all versions of the agreement contain provisions requiring LBIE to separately identify property of the client in its records and to provide the client with an annual statement of the property held to the client's account. Subject to this, LBIE was entitled, in appropriate cases, to pool the property with that of other clients.

<u>The Scheme</u>

24. The key provisions of the proposed scheme ("the Scheme") are conveniently summarised in the judgment of Blackburne J as follows:

22. The scheme is intended to deal with persons who are described as "Scheme Creditors". These are persons who have claims against LBIE at the time it was placed in administration (the "Time of Administration") for or in respect of what are described as "Segregated Assets". The claims must be capable of being satisfied by the delivery, in whole or in part, of the Segregated Assets. Segregated Assets are defined as "any Security which at the Time of Administration was held on a segregated basis" meaning that the asset "was recorded as being held separately from LBIE's own Securities in both the Books and Records of LBIE and also at LBIE's custodian or depository (the Intermediary)..." "Security" is defined as any financial instrument, including any share, instrument creating or acknowledging indebtedness, instrument creating or acknowledging entitlements to investments, warrant and unit in a collective investment scheme..." It excludes money. I was told that there are approximately 28,000 different categories of security to be dealt with.

23. A Scheme Creditor is expressly described as excluding anyone whose claims "are not proprietary but are only unsecured". Equally, as Mr Trower explained in the course of argument, a Scheme Creditor will not include anyone who has no kind of pecuniary claim, however contingent, against LBIE. Thus, a client with a claim to a particular security but who renounces any pecuniary claim (for example, for damages for late delivery of the security) and confines his claim to its return will not be included. In short, a person is only a Scheme Creditor if that person (1) has a pecuniary claim against LBIE and (2) has a proprietary claim to a security which was held on a segregated basis at the Time of Administration.

24. The scheme explains, in what is described as "Key Concept 2", that "the subject matter of the Scheme is Trust Property". Trust Property is wider than "Segregated Assets" because it includes assets, referred to as "Derived Assets", which are derived from Segregated Assets, and "Recovered Assets". Recovered Assets are assets received by LBIE from a source which has an obligation to redeliver to LBIE a security which had been delivered by LBIE to that source after the Time of Administration but prior to the date ("the Effective Date") when a copy of the court's order sanctioning the scheme under Part 26 (assuming such an order is made) is delivered to the Registrar of Companies.

25. The scheme is intended to deal with all of a Scheme Creditor's proprietary claims against LBIE for the return of Trust Property. It extends to property which LBIE should have held even if in fact it does not. This is subject only to the requirement that LBIE must hold some property of the Scheme

Creditor and means therefore that if the claim is confined to an unsecured pecuniary claim against LBIE, the claim will not be dealt with under the scheme.

26. The key provision of the scheme, set out in Part 2 of Section 4 of the proposal, is that Scheme Creditors release all claims (save for certain "Excluded Claims") against LBIE, the scheme supervisors, the administrators and other Scheme Creditors, including all claims for or in respect of (1) any "Asset Claim" (meaning, put shortly, a claim against LBIE in respect of any Trust Property), (2) any payment for or on account of any asset which is or was at any time the subject of an Asset Claim, (3) damages, indemnity or contribution in respect of any loss, cost or expense in connection with any asset which is or was at any time the subject of an Asset Claim, (4) all liabilities for breach of contract, loss or damage, indemnity or contribution of any nature, (5) all rights to seek or enforce judgment, exercise any remedy or apply any set-off, netting, withholding, combination of accounts or retention or similar rights against LBIE in respect of any claim or liability, and (6) all rights in respect of any financial contract. These are defined as "Released Claims".

27. In exchange for their Released Claims, Scheme Creditors are given what are described as "New Claims". Broadly stated, these are (1) the right of each creditor to have its net contractual position (as earlier summarised) and what are described as "Allocations and Distributions" determined on the basis set out in the Scheme, (2) the right to have such part of the Trust Property as is available for distribution under the scheme allocated to and then delivered to the creditor, alternatively appropriated by LBIE in or towards discharge of the creditor's liabilities to LBIE (or certain affiliates or other third parties), (3) the right to claim against LBIE in accordance with the scheme for the amount of that creditor's net contractual position (assuming that the position has resulted in an amount owing by LBIE to that creditor) as a new obligation of LBIE and (4) the right to claim in LBIE's winding-up or any other distribution of LBIE's assets for such amount as is determined under the scheme. The New Claims are subject to an overriding proviso that no Scheme Creditor is entitled to recover more than once in respect of the same asset or claim.

28. The reference to "Allocations" is, shortly stated, to the right of LBIE to allocate Trust Property available for distribution under the scheme to a Scheme Creditor by reference to individual stock lines (for example the quantity of a particular quoted security) held as Trust Property. Paragraph 10.7 of "Key Concept 6" (concerned with "Allocations and shortfalls") provides in terms that "a Scheme Creditor's

entitlement to participate in an Allocation will be based on its Asset Claim". This in turn is to be determined by LBIE based on certain information available to it. The Scheme Creditor has the opportunity to challenge the determination through a dispute resolution mechanism. Paragraph 10.8 requires the Scheme Creditor when receiving anything in respect of its Asset Claim to account for any assets received from an Intermediary (rather than from LBIE direct) and paragraph 10.10 provides, in effect, that if the allocations made to a Scheme Creditor result in a shortfall then the value of that shortfall is to rank as an unsecured claim against LBIE.

29. The broad effect, although the drafting of the scheme is a little dense at this point, is that, subject to certain exceptions, LBIE will match a Scheme Creditor to a particular stock line where LBIE can be satisfied on the information available to it that the creditor has a proprietary claim (the so-called "Asset Claim") to assets answering the description of that stock line. This is on the basis that the creditor's claim will be satisfied (by means of the "Distribution") out of that stock line so far as is possible having regard (1) to the overall quantity of the stock line available for distribution and (2) to the competing claims of other creditors to the same stock line.

30. But there is an important qualification to this which is set out in Part 3 of Section 4. This is the provision of a cut-off date (the "Bar Date") for the submission of claims under the scheme. The date envisaged is either 31 December 2009 or, if later, the last business day of the second full calendar month following the Effective Date. Paragraph 21.1 provides that "[a]ny claim submitted after the Bar Date can be disregarded by LBIE". But this is subject to an exception: if by the Bar Date a Scheme Creditor has failed to submit a claim (by completing a pro forma claim form) LBIE will calculate that Scheme Creditor's entitlement under the scheme using "Relevant Information". This is information capable of ascertainment from LBIE's books and records, information contained in the Scheme Creditor's claim form (if one has been submitted) and also, shortly stated, information from various notices delivered under the scheme as well as information made available by intermediaries, affiliates and any relevant exchange. Once the Bar Date has passed LBIE will start allocating, appropriating and distributing on the basis of pre-Bar Date claim forms and other Relevant Information. This means that if a Secured Creditor fails to submit a claim form by the Bar Date and, by that date, LBIE is without any Relevant Information in relation to that Scheme Creditor's claim, the claim may be disregarded.

31. However, as Mr Trower explained in the course of argument, the imposition of a Bar Date is not intended to have

the consequence that the late claim is altogether barred. If the Scheme Creditor can substantiate its claim, then, notwithstanding that this is after the Bar Date, it may share in the particular stock line, but it may only do so if and to the extent that there is any surplus in that stock line. Thus, if there are no other claimants to a particular stock line (or the claims of those other claimants have been fully satisfied), the late claimant is unaffected by the Bar Date. Conversely, if there is insufficient in the stock line to satisfy the accepted claims of pre-Bar Date claimants, the later claimant will be left to claim as an unsecured creditor. In short, there is no "catch-up" concept for late claimants as regards any distribution: they must await the full satisfaction of the accepted claims of pre-Bar Date established claims.

32. For present purposes, the scheme may be summarised by saying that a client of LBIE who qualifies as a Scheme Creditor - in that the client has, or potentially has, a pecuniary claim against LBIE and is the owner of a particular asset held or controlled by LBIE (for example a quantity of a particular quoted security) - will have that asset claim satisfied on a pooled basis, ranking alongside (and in competition with) others who can establish ownership claims to the same asset, to the extent that the securities comprising that asset are available to meet the claims. The unrecovered value of the client's Asset Claims and any balance due to the client on computing the client's net contractual position with LBIE resulting from the closing out of all financial contracts between the client and LBIE are to rank as unsecured claims against LBIE. All other pecuniary claims of the client against LBIE are foregone."

25. As the Judge recognised, there will be cases where the claims of some of those counterparties are sufficiently well documented to establish a clear entitlement to particular securities ahead of any other potential claimants. In such cases the conversion of a counterparty's existing proprietary claims into New Claims as defined will inevitably involve a loss of priority in cases where the pool of assets of a particular type (e.g. a particular stock line) held by LBIE is insufficient to meet the claims of all clients who are able to establish a right to assets of that kind. Clients in that position have least to gain from the Scheme but are at risk of having their property rights compulsorily acquired in order to permit a speedy and effective distribution of available assets amongst the entire class of relevant claimants.

26. Likewise the Scheme Creditor who fails to submit a claim by the Bar Date in circumstances where the administrators have no Relevant Information as defined may find that it effectively forfeits its right over securities it once owned and is limited to recovering from any surplus of assets once the claims to that stock line by the pre-Bar Date claimants have been satisfied.

27. Blackburne J held that the court has no jurisdiction under Part 26 to sanction a scheme which interferes with the property rights of the clients of LBIE in this way. Although the potential effect of the Bar Date on some Scheme Creditors is perhaps the most

striking example of the way in which existing property rights could be removed, the issue of principle raised before the Judge and on this appeal does not turn on those particular provisions of the Scheme. LIBA's objection on jurisdictional grounds centres on the identity of the Scheme Creditors and the nature of the rights which the Scheme attempts to deal with. The Judge identified the key question as being whether the Scheme affects clients of LBIE in their capacity as creditors of the company. His view was that it did not insofar as it purported to deal with and discharge their proprietary rights over the securities and other assets held to their account by LBIE. There is, of course, no dispute that in respect of any pecuniary claims which they may have against the company for damages or equitable compensation for breach of trust, they are, to that extent, creditors. But the Judge held that this was insufficient to entitle the court in the exercise of its Part 26 jurisdiction to sanction a scheme insofar as it compromised or removed their rights over trust property.

Jurisdiction

28. The argument advanced by Mr Snowden on behalf of LIBA which the Judge accepted can be expressed quite shortly. Part 26 of the Companies Act 2006 confers on the court a jurisdiction to sanction compromises or arrangements between the company and its creditors which have been approved by a majority in value of creditors according to the conditions set out in s.899(1). Although the discretion to approve the Scheme is a general one to be exercised judicially having regard to the objects of the Scheme and its general fairness in relation to creditors, the jurisdiction is not an unlimited one. The "arrangement" must have the necessary features of give and take described by Brightman J in *Re NFU Development Trust Ltd* [1972] 1 WLR 1548 and it has to be an arrangement between a company and its creditors or members.

29. There is no statutory definition of "creditor" or "arrangement" for the purposes of Part 26 and, in relation to "arrangement", the courts have been careful not to attempt to provide one beyond the limited criteria described in *Re NFU Development Trust Ltd.* But Mr Snowden contends that, in order to be a creditor of the company, it is necessary to be owed money either immediately or in the future pursuant to a present obligation or to have a contingent claim for a sum against the company which depends upon the happening of a future event such as the successful outcome of some litigation. Although a creditor for the purposes of Part 26 is not therefore limited to someone with an immediately provable debt in a liquidation, it does require that person to have a pecuniary claim against the company which (once payable) would be satisfied out of the assets as a debt due from the company.

30. As support for this, we were referred to the decision of the Court of Appeal in *Re Midland Coal, Coke & Iron Company* [1895] 1 Ch 267 in which it was accepted that a person with a contingent claim against the company qualified as a creditor under a scheme of arrangement made under the Joint Stock Companies Arrangement Act 1870. Lindley LJ (at page 277) said that he agreed that:

> "... the word "creditor" is used in the Act of 1870 in the widest sense, and that it includes all persons having any pecuniary claims against the company. Any other construction would render the Act practically useless."

31. Based on this decision, David Richards J concluded in *Re T&N Ltd* [2005] EWHC 2870 Ch that persons with contingent claims for damages against a company were creditors within what is now Part 26:

> "[40] In my judgment, "creditors" in s 425 is not limited to those persons who would have a provable claim in the winding-up of the company, although it clearly includes all those who would have such a claim. As was submitted by Mr Snowden and other counsel, one of the recognised purposes of s 425 is to encourage arrangements with creditors which avoid liquidation and facilitate the financial rehabilitation of the company: see, for example, *Sea Assets Ltd v PT Garuda Indonesia* [2001] EWCA Civ 1696 at para 2. This suggests that as wide a meaning as possible should be given to "creditors" in the section. Having said that, it is important to bear in mind that s 425 is designed as a mechanism whereby an arrangement may be imposed on dissenting or non-participating members of the class and such a power is not to be construed as extending so as to bind persons who cannot properly be described as "creditors"."

32. These cases were not, of course, concerned with the status of claimants who were asserting proprietary interests over the assets held by the company. But LIBA fastens on the reference in Lindley LJ's judgment to the widest use of the words being capable of extending to contingent creditors as at least an indication that the concept of a creditor does not extend further to include those whose relationship is not that of a debtor/creditor at all.

33. The foundation of Mr Snowden's argument is that a beneficiary under a trust is not ipso facto a creditor of the trustee. Although the trust relationship may give rise to unsecured claims against the trustee for breach of trust or even negligence and may sometimes exist in a wider contractual framework, it remains at its core a different legal relationship. Subject to the terms of the trust instrument, the trustee holds the trust property for the benefit of those beneficially entitled to it and has a primary obligation to maintain those particular assets (or any which replace them) to the exclusion of all other claims. The trust property does not form part of the trustee's estate in the event of insolvency so as to be available to meet the claims of general creditors and the beneficiary is entitled to the property in specie free of any such claims.

34. If authority is needed to make good the distinction between a creditor and a beneficiary then Mr Snowden relies, by way of example, on the decision of Sir John Romilly MR in *Sinclair v Wilson* (1855) 20 Beav. 324 that the restoration of trust property from the estate of a bankrupt to a beneficiary did not amount to a fraudulent preference in favour of a creditor.

35. He therefore submits that the definition of a Scheme Creditor so as to include only counterparties who have both a proprietary claim and an unsecured pecuniary claim against the company is not sufficient to enable the court to exercise the Part 26 scheme jurisdiction so as to encompass the property rights of those involved. The proposed scheme is, in that respect, not an arrangement between LBIE and the

counterparties in their capacity as creditors. The court may therefore only sanction it (if at all) so far as it compromises the ancillary money claims.

36. In response to this argument Mr Trower submits that the Judge focused too much on the removal or variation of existing property rights under the Scheme and failed to apply the correct statutory test which is simply whether the Scheme constitutes an arrangement between the company and its creditors. The wording of s.895(1) does not impose, he says, a jurisdictional requirement that a scheme of arrangement should be made with creditors only in their capacity as creditors and if the Judge based his decision to that effect on the word "arrangement" then he was wrong to do so. The courts have steadfastly refused to attach a narrow definition to that term.

37. Mr Trower submits that once a person qualifies as a creditor in the sense accepted by LIBA, the scheme jurisdiction is engaged and extends to all of his rights against the company and not merely to those which give rise to a claim in debt. If this is right then the court could only refuse to sanction the Scheme as an exercise of discretion under s.899.

38. Mr Trower is clearly right to say that the Scheme Creditors are, on any view, creditors of the company, at least insofar as they have monetary claims against LBIE either for the net balance due on their Cash Accounts or because LBIE has committed breaches of contract or trust in connection with the management of the cash and securities it held. Most of these claims would be provable in a liquidation under the provisions of rule 13.12 of the Insolvency Rules but, as mentioned above, it is accepted that this is not a pre-condition to the claimant being a creditor for the purposes of Part 26.

39. What is said to follow from this is that the existence of a trust relationship is not inimical to the existence of a debtor/creditor relationship and may be the source of it. A claim for damages or equitable compensation for breach of trust arises out of the trust relationship. To that extent, a beneficiary will be a creditor of the trustee. The duty of the trustee to account to the beneficiary for trust property and to make restitution for any such property which has been lost is carried out in substitution for the trustee's core duty to preserve and disburse the trust fund in accordance with the terms of the trust instrument. It is artificial, Mr Trower contends, in the context of a Scheme to distinguish between the enforcement of this duty which gives rise to a monetary award in favour of the beneficiary (and thereby makes him a creditor) and the right of a beneficiary to the trust asset itself. They are simply opposite sides of the same coin.

40. He also emphasises that the fact that a creditor may have proprietary rights relating to his claim against the relevant company is not in itself a bar to the exercise of the Scheme jurisdiction. The most obvious examples are debenture-holders and other secured creditors who are undoubtedly creditors of the company but commonly have their security removed or modified under a scheme of arrangement.

41. So in *Re Empire Mining Company* (1890) 44 Ch D 402 North J sanctioned a scheme under the 1870 Act between the company and its debenture-holders on the basis that they were creditors. At p. 409 the Judge said that:

> "The Act gives the Court power to bind "creditors," and debenture-holders are creditors. The word "creditor" in the Act

> is general. No distinction is made between different kinds of creditors; there is nothing to except any particular class of creditors from the jurisdiction of the Court."

42. In *Re Alabama, New Orleans, Texas and Pacific Junction Railway Company* [1891] 1 Ch 213 the Court of Appeal rejected an argument that a scheme which deprived debenture-holders of their security fell outside the scope of the 1870 Act. The decision of North J that debenture-holders were creditors was affirmed. In relation to whether the removal of a security could be included in a scheme, Fry LJ (at p.246) said this:

> "But again, what kind of compromise or arrangement is the most common? Surely the most common kind of compromise or arrangement is one in which secured creditors diminish or alter the amount of their security. I repeat, that the Legislature having used the largest language, such as "any compromise or any arrangement between a company and any class of its creditors", I think, if we were to exclude from that class of creditors the secured creditors, or if we were to exclude from the arrangements or compromises to be made an arrangement or compromise which affected the security, we should be putting a most unwarrantable restriction on the generality of the language used in the Act, and therefore I have no hesitation in saying that in my judgment the court has jurisdiction in this matter."

43. We were also taken to a number of authorities in which, in other contexts, beneficiaries under a trust have been treated as creditors of the trustee. In *Webb v Stenton* (1883) 11 QBD 518 an application was made to garnishee the money payable to a judgment debtor by way of income as a life tenant under a trust. Before the order could be made the money had in fact been paid to the debtor but Lindley LJ (at p.526) expressed the view that a liquidated sum payable in equity by the trustee to the life tenant constituted an "equitable debt" which was capable of being attached. Similarly in *Sharp v Jackson* [1899] AC 419 the House of Lords (following earlier decisions in the Court of Appeal) held that transfers of property to beneficiaries under a trust made by an insolvent trustee in order to make good previous breaches of trust did not amount to a fraudulent preference. The decision was based on there being no intention to prefer in the circumstances, but Mr Trower referred us to a passage in the speech of the Earl of Halsbury LC (at p.426) about whether the beneficiary in that case could be a creditor:

> "It has been suggested that there was a proposition which could be maintained, as to which I confess I entertain grave doubts whether any decision goes to that extent, namely, that the relation between a cestui que trust and a trustee who has misappropriated the trust fund is not that of debtor and creditor. That it may be something more than that is true, but that it is that of debtor and creditor I can entertain no doubt. As that question has been mooted and brought before your Lordships' House as one question for decision here, I certainly have no hesitation in saying that in my opinion no such proposition can

> properly be maintained, and that although there are other and peculiar elements in the relation between a cestui que trust and a trustee, undoubtedly the relation of debtor and creditor can and does exist."

44. I find these cases of very limited assistance in relation to what we have to decide. The interpretation of the rules of court governing the making of garnishee orders is far removed from the issues which arise in relation to Part 26. *Sharp v Jackson* is closer in context but the beneficiary in that case had a claim against the insolvent trustee for breach of trust which it is common ground would have made him a creditor for the purposes of a scheme. The issue in this case is whether the clients of LBIE are to be treated as creditors in respect of the rights in rem which they enjoy over the property held by the company. These are the elements of the trustee/beneficiary relationship which Lord Halsbury described as "other and peculiar". If anything, this reference is helpful to Mr Snowden's argument. But it certainly does not indicate that the Lord Chancellor thought that beneficiaries ought to be regarded as creditors in respect of their proprietary claims.

45. Mr Trower's principal submission that a scheme of arrangement can legitimately alter the property rights of creditors begins with the unrestricted meaning to be given to the word "arrangement" in the context of Part 26. This is, of course, common ground. As mentioned earlier, judges have deliberately avoided giving the word a narrow meaning beyond indicating that it cannot amount simply to a surrender or confiscation. Subject to that, however, the judges of the Companies Court frequently sanction arrangements where the rights of creditors not only against the company but also inter se are varied or where creditors are required to give up rights against third parties such as under guarantees. The use of the scheme jurisdiction in relation to takeovers makes this almost essential.

46. A particular illustration of this relied upon by Mr Trower is the scheme of arrangement considered by David Richards J in *Re T&N Ltd (No 3)* [2006] EWHC 1447 (Ch). The proposed scheme in that case was between T&N Ltd and various associate companies and employees and former employees who had claims for personal injuries arising out of their exposure to asbestos. The claims included in the scheme were restricted to those covered by employers' liability insurance. The insurers had disputed liability but agreed to pay the sum of £36.74 million to the administrators of the T&N companies on terms that a binding scheme of arrangement was put into place and approved by the court under which actual and potential claimants would agree not to bring claims against the insurers in return for being paid a dividend out of that fund.

47. One complication in the scheme was the effect of s.1 of the Third Parties (Rights Against Insurers) Act 1930. On entering administration, the rights of T&N and the other companies under the policies (in respect of liabilities which had by then been incurred) were transferred to those claimants. These rights had to be compromised as a term of the scheme. One of the arguments addressed to the Judge was that the scheme did not constitute an "arrangement" under what was then s.425 of the Companies Act 1985 because it only affected the rights between the employee claimants and the insurers and was not therefore a compromise or arrangement made between T&N and its creditors.

48. David Richards J dismissed this objection on the grounds that the rights which the claimants had against the insurers were sufficiently connected with the claimants' rights against T&N to bring the proposed arrangement within the scope of s.425:

> "45. The first and obvious point to make is that, whatever the precise meaning of a compromise or arrangement, it must be proposed with creditors or members of a company. It is implicit that it must be made with them in their capacity as creditors or members and that it must at least concern their position as creditors or members of the company. For the reasons already given, even those EL Claimants to whom T&N's rights against the EL Insurers have been transferred by operation of the 1930 Act remain creditors of T&N. The extent to which certain other persons with EL Claims are creditors for the purposes of section 425 is considered later in this judgment.
>
> .....
>
> 52. The settlement of the litigation is therefore in substance and form a tripartite matter, involving T&N, insurers and claimants. That is reflected in the proposed scheme, with T&N and the claimants as parties and with the EL Insurers appearing before the court to consent to the scheme and to undertake to be bound by its terms. It is true that the scheme has no effect on the present rights of EL Claimants against T&N. The right of claimants to assert their claims against T&N, and the right of T&N to defend those claims, are unaffected, and claimants are not obliged to proceed first against the trust to be established by the scheme. However, if a claimant establishes a claim under the trust distribution procedures and receives a payment, it will diminish the amount which T&N would otherwise be required to pay in respect of the claim, if the EL Insurers succeeded in avoiding the policies or in limiting the cover. Although not immediately affecting rights against T&N, the scheme is likely therefore to have an impact on those rights. Mr Chivers objected that these effects resulted not from the scheme but from the settlement agreement and arrangements constituted by the trust deed and trust distribution procedures which took effect outside the scheme. In my view, it is not possible to divorce the arrangements in this way. The scheme of arrangement is an integral part of a single proposal affecting all the parties, which includes also the trust and the trust distribution procedures to be established pursuant to the scheme.
>
> 53. In my judgment it is not a necessary element of an arrangement for the purposes of section 425 that it should alter the rights existing between the company and the creditors or members with whom it is made. No doubt in most cases it will alter those rights. But, provided that the context and content of the scheme are such as properly to constitute an arrangement

> between the company and the members or creditors concerned, it will fall within section 425. It is, as Nourse J observed, neither necessary nor desirable to attempt a definition of arrangement. The legislature has not done so. To insist on an alteration of rights, or a termination of rights as in the case of schemes to effect takeovers or mergers, is to impose a restriction which is neither warranted by the statutory language nor justified by the courts' approach over many years to give the term its widest meaning. Nor is an arrangement necessarily outside the section, because its effect is to alter the rights of creditors against another party or because such alteration could be achieved by a scheme of arrangement with that other party."

49. Mr Trower relies on the Judge's reasoning as including an acceptance that the Scheme jurisdiction can extend to rights held by the creditors that are connected to the subject matter of their claims against the company but are not rights as creditors against the company. Claims against third party sureties under a guarantee would fall into the same category. If an arrangement under Part 26 can extend this far then there is no reason in principle, he says, why it should not embrace other claims which the creditor does have against the company, although of a proprietary nature. The abandonment of claims against third parties is as much a release of property rights as any variation of the property claims which the counterparties have against LBIE. There is nothing in the language of Part 26 to exclude such claims from an arrangement between the company and its creditors and any objections to their inclusion as a term of the Scheme should be addressed, if at all, on the merits at the sanction hearing.

50. The question whether the Scheme jurisdiction can be used to require creditors to release rights against third parties has been considered in Australia in two recent decisions of the Federal Court of Australia. In *Re Opes Prime Stockbroking Ltd* [2009] FCAFC 125 a scheme of arrangement under s.411 of the Corporations Act 2001 (which closely resembles the provisions of Part 26) included machinery under which creditors of the scheme companies were required to release claims against third party financiers (ANZ and Merrill Lynch) who had provided the scheme companies with cash and other securities in return for the securities which the scheme companies had received from their own clients. As part of an overall settlement of claims by the creditors against the scheme companies, ANZ and Merrill Lynch, a fund was created for the benefit of creditors into which the two finance companies paid some $226 million in cash and released cash and assets of the scheme companies valued at a further $27 million. It was a term of the scheme of arrangement that, in return for being able to prove against the fund, ANZ and Merrill Lynch would be released from any claims by either the scheme creditors or the scheme companies. The circumstances were therefore very similar to those considered by David Richards J in *Re T&N Ltd (No 3).*

51. The Judge at first instance rejected a submission by a creditor that he had no jurisdiction under s.411 to sanction an arrangement which required the release of the creditor's third party claims against ANZ and Merrill Lynch. He approved the scheme. A Full Federal Court dismissed the creditor's appeal.

52. The submission made to the Federal Court was that a scheme of arrangement could not affect interests other than those of a creditor qua creditor of the company and that s.411 did not authorise the court to approve an arrangement between the company and its creditors which extinguished rights belonging to the creditor in some other capacity: in that case as a creditor of ANZ and Merrill Lynch. The Federal Court rejected that argument for the following reasons:

> "66 Doubtless there are limitations on the extent to which a scheme of arrangement purporting to be between a company and its creditors or a class of its creditors can purport to affect property of the creditor that has no connection with the company or the relationship of creditor and debtor between the creditor and the company. The mere fact that a person or entity is a creditor of a company would not, of itself, justify an arrangement between that person or entity on the one hand and the company on the other whereby property of the person or entity were confiscated without any benefit to the person or entity. Such an arrangement would not be approved by the Court pursuant to s 411(4)(b).
>
> 67 A purported scheme of arrangement must involve some arrangement in a sense that is to be construed liberally. No narrow interpretation should be given to the expressions "compromise" or "arrangement". An arrangement within the meaning of s 411 connotes some element of give and take. A proposal that conferred no benefit on creditors and constituted the mere confiscation of interests would not be an arrangement within the meaning of s 411. An arrangement must involve some bargain giving benefit to both sides. However, there is no reason to construe the term in s 411 as restricting in any way the nature of the bargain that might be made between company and creditors (*Re Sonodyne International Ltd* (1994) 15 ASCR 494 at 497-8), subject only to the additional requirement that the arrangement must be within the power of the company and not in contravention of the Corporations Act.
>
> 68 A scheme of arrangement between a company and its creditors or a class of creditors is no more than a proposal to vary or modify the company's obligations in relation to its debts and liabilities owed to the creditors or class of creditors. There is nothing to prevent the company from posing, as part of the arrangement, a term to the effect that, in consideration of what the company has provided under the scheme, the creditors will discharge not only the debts and liabilities of the company, but also the liabilities of, for example, sureties for the same debts and liabilities of the company.
>
> 69 It is permissible to incorporate in a scheme of arrangement an involvement or participation by an outsider, being a person or entity who is not a party to the scheme as a company or creditor (see *Re Glendale Land Development Ltd*

> *(In liquidation)* (1982) 1 ACLA 540. Such arrangements are commonplace in relation to schemes involving takeovers. A scheme of arrangement made between a company and its creditors under s 411 binds only the company and the creditors. Nevertheless, there is no reason why a bargain might not be struck between a company and creditors whereby the creditors are bound to enter into an arrangement with third parties. So long as there is some element of give and take, such that the creditors receive something in return for the benefit conferred on a third party, there is no reason in principle why that term could not be part of a scheme of arrangement as contemplated by s 411"

53. This decision is consistent with the reasoning of David Richards J in *Re T&N Ltd (No 3)* but it has not met with universal approval in Australia. In a subsequent decision of the Federal Court in *City of Swan v Lehman Bros Australia Ltd* [2009] FCAFC 130 which was concerned not with the approval of a scheme of arrangement under s.411 but with a deed of company arrangement made pursuant to s.444D(1) of the Corporations Act, another Full Court held that a deed of company arrangement did not have the effect of releasing creditor claims against a third party but only those against the company.

54. The relevant statutory language in s.444D(1) is that:

> "(1) a deed of company arrangement binds all creditors of the company, so far as concerns claims arising on or before the day specified in the deed under paragraph 444A(4)(i)".

55. The judgments in *City of Swan* distinguish between these provisions and those of s.411 on the grounds that the deed of company arrangement procedure is unsupervised and therefore more restricted in what it is intended to achieve. But, in some of the judgments, the members of the Full Court are careful not to endorse the correctness of the decision in *Opes* and even go so far as to suggest that it is inconsistent with earlier Australian authorities.

Conclusions

56. So that there should be no doubt about it, I accept (as the Judge did) that the proposed Scheme represents a considered attempt to overcome the difficulties faced by the administrators in reconciling the entries in the company's books and records with the claims made against the assets held. I also accept that although the Scheme, if implemented, will undoubtedly remove any existing proprietary rights over the assets in question, it will do so with a view to substituting for them a distribution of the securities amongst the relevant clients which is designed to secure for them the return of their property so far as that is possible consistently with a fair apportionment of available assets. But we are not concerned on this appeal with the fairness or reasonableness of the proposal. Whether the removal of vested and provable rights in this way is fair and reasonable as between the various classes of creditors is a matter to be addressed (if at all) at a sanction hearing. It is not necessary for this court to express any view about that.

57. The question whether the court's power to sanction a scheme of arrangement under Part 26 can extend to the release of rights over property held by the company under a trust is one of statutory construction. Considerations of expediency and convenience are only relevant if and so far as they can be assumed to have influenced the legislature when the statutory provisions were formulated. We have not been asked to treat the Companies Act 2006 as a consolidation measure for the purposes of Part 26 but it is evident that the current provisions have remained essentially unchanged since they first appeared in the 1870 Act and there is nothing to suggest that Parliament has recently intended to give them any different or wider meaning.

58. Conceptually no statutory power can be unlimited and, in this case, the court's jurisdiction is circumscribed by the requirement that the Scheme should be an arrangement between the company and its creditors. When the constituent parts of this formula are looked at in isolation there is a considerable measure of agreement as to what they can include. As mentioned earlier, a "creditor" will consist of anyone who has a monetary claim against the company which, when payable, will constitute a debt. Contingent claims are included for this purpose. A claim (e.g.) for damages in tort is still a legal liability of the company which will ultimately result in either an agreed payment or a judgment debt. The Scheme has been drafted so as to exclude anyone whose only claim against the company will be one in rem. To be a Scheme Creditor one has to have a current or contingent claim for damages or equitable compensation against the company, either of which is sufficient to render the claimant a creditor at least in that respect.

59. Mr Snowden, of course, relies upon this as an implicit acceptance by the administrators that a purely proprietary claimant does not qualify as a creditor. The requirement that all Scheme Creditors should have both an unsecured monetary claim as well as their proprietary claims is criticised as a device to enable, as he put it, the tail to wag the dog. But the resolution of these issues does not depend on a resort to canine metaphors. It is obvious that someone with a purely proprietary claim against the company is not its creditor in any conventional sense of that word. As a matter of ordinary language, a creditor is someone to whom money is owed. The use of this word with that meaning is a long-established and essential part of English company law. The Companies Act (and now the Insolvency Act) regime for the administration of insolvent companies and their assets depends upon being able to identify creditors and not to confuse them with those whose property rights do not fall into the insolvent estate: see, for example, *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567. Given that "creditor" is not defined in the legislation, it is inconceivable that Parliament should have used the word in the 2006 Act in any but its literal sense.

60. For these reasons, one gets no real assistance from the cases on secured creditors. No one can dispute that a creditor with security for what is owed remains a creditor of the company. Their security exists and is only enforceable to the extent and for so long as the underlying indebtedness continues. All that *Empire Trading* and *Alabama* establish is that a creditor with security is nonetheless a creditor for the purposes of the Scheme jurisdiction. That conclusion is hardly surprising given the absence from the legislation of any restriction of what is now Part 26 to unsecured creditors. Nor is it to the point that under a scheme of arrangement a debenture-holder or other secured creditor may be required to give up the whole or part of his security. The charges in question will have been granted by the company over its own property. The interests

granted to secured creditors (which, in the case of real property, amount to a legal estate) are only ever held as security interests subject to the debtor's equity of redemption. An arrangement under which that indebtedness is re-organised will therefore necessarily impact on any security held in respect of it and may involve the repatriation of the debtor's property free from the charge. When this occurs the secured creditor is simply returning to the debtor property which the creditor never owned beneficially and was only ever held as security for the debt. Blackburne J was quite right to regard this as wholly different from the converse case of property which has never formed part of the company's assets but is held by it only as trustee.

61. What then of an "arrangement"? As described earlier, the court's approach has been to give this a relatively unrestricted meaning. Mr Trower relies on this to support his argument that there is nothing in the statutory language to restrict the content of an arrangement to the re-organisation of rights enjoyed by creditors qua creditors. But the question whether s.895 imposes that restriction has to be determined not by the meaning of "arrangement" alone, but by the use of the word in the phrase "an arrangement between a company and its creditors". Although "arrangement" is a wide expression, it is given content and meaning by the parties to it.

62. In terms of authority Mr Trower places some weight on the decisions in *Re T&N Ltd (No 3)* and *Opes* as indicating that the rights which can be released or re-organised under a scheme are not limited to those enjoyed by scheme creditors as creditors of the company. Both cases indicate that they can include rights against third parties related to and essential for the operation of the scheme. At first sight these authorities are helpful to the administrators in that they do establish that a scheme can extend beyond monetary claims by the creditors against the scheme company alone. But what they do not do is to suggest that claims which do lie against the company can be included if they are proprietary rather than contractual or tortious in nature.

63. Although the decision in *Re T&N Ltd (No 3)* has not been the subject of any judicial criticism in this country, the principle it establishes has proved controversial at least in Australia. It seems to me entirely logical to regard the court's jurisdiction as extending to approving a scheme which varies or releases creditors' claims against the company on terms which require them to bring into account and release rights of action against third parties designed to recover the same loss. The release of such third party claims is merely ancillary to the arrangement between the company and its own creditors. Mr Snowden has not invited us to overrule *T&N Ltd (No 3)* and it would not be appropriate for us to do so without hearing full argument on the point.

64. But when properly analysed, these cases do not, in my judgment, really assist Mr Trower in his argument. It seems to me tolerably clear from the judgments in both cases that the courts did not consider that they were changing the basic criteria for the approval of a scheme of arrangement. David Richards J (in the passage in paragraph 45 of his judgment quoted above) refers expressly to it being implicit in s.425 that the arrangement must be made with creditors in their capacity as creditors and must concern their position as creditors. In *Opes* (at paragraph 68) the Federal Court describes a scheme of arrangement as no more than a proposal to vary or modify the company's obligations in relation to its debts and liabilities owed to the creditors or class of creditors.

65. It seems to me that an arrangement between a company and its creditors must mean an arrangement which deals with their rights inter se as debtor and creditor. That formulation does not prevent the inclusion in the Scheme of the release of contractual rights or rights of action against related third parties necessary in order to give effect to the arrangement proposed for the disposition of the debts and liabilities of the company to its own creditors. But it does exclude from the jurisdiction rights of creditors over their own property which is held by the company for their benefit as opposed to their rights in the company's own property held by them merely as security.

66. I do not accept Mr Trower's submission that the reference to a creditor was intended to act as no more than a gateway to the inclusion of that person in the Scheme and that s.895 leaves the court with jurisdiction to sanction the compromise or removal of rights which the creditor does not hold as a creditor. That would, I think, be inconsistent with the expressed purpose of the legislation which must be to allow the company to re-arrange its contractual or similar liabilities with those who qualify as its creditors. A person is the creditor of a company only in respect of debts or similar liabilities due to him from the company. I am not persuaded that Parliament can have intended to allow creditors to be compelled (if necessary) to give up not merely those contractual rights but also their entitlement to their own property held by the company on their behalf.

67. A proprietary claim to trust property is not a claim in respect of a debt or liability of the company. The beneficiary is entitled in equity to the property in the company's hands and is asserting his own proprietary rights over it against the trustee. The failure by a trustee to preserve that property in accordance with the terms of the trust may give rise to a secondary liability to make financial restitution for the loss which results, but that is a consequence of the trust relationship and not a definition of it.

68. Part of Mr Trower's argument seeks to minimise these legal distinctions by treating agreements such as the IPBA as an overall commercial arrangement which should be looked at in the round for the purposes of Part 26. The commercial nature of these agreements is not in dispute but the trust mechanism has long been regarded as an important safeguard against insolvency and has been imported into commercial contracts for that very reason. In the case of pure custody agreements, it is, of course, paramount. I do not therefore accept that the trust element in these arrangements ought in some way to be merged into the general contractual framework and treated merely as ancillary when considering the limits of the Scheme jurisdiction or (which is more important) that Parliament ever intended to deal with it in that manner.

69. The language of s.895 ought therefore in my view to be read in the way that Blackburne J construed it. I would therefore dismiss this appeal.

Lord Justice Longmore :

70. I agree with the judgment of Patten LJ and with the judgment of the Master of the Rolls.

The Master of the Rolls:

71. I agree that this appeal must be dismissed. Despite the undoubted attraction of implementing the proposed scheme of arrangement in this case ("the Scheme"), it seems to me that Blackburne J was right to hold that he had no jurisdiction to approve the Scheme insofar as it was concerned with the distribution of property held or controlled by it on trust for any of its creditors. I entirely agree with the reasons given for this conclusion given by Patten LJ, and indeed by the Judge below. However, as the point is of some importance, I will briefly express my reasons in my own words.

72. The terms of the Scheme are long and complex, and the detailed provisions of the standard form "International Prime Brokerage Agreement" and "Master Custody Agreement" used by Lehman Brothers International (Europe) ("LBIE") are not simple. However, as Patten LJ has explained, the question thrown up by this appeal is one of principle, albeit that it can be expressed in more than one way. Mr William Trower QC, for the administrators of LBIE ("the administrators"), put it thus: can a scheme of arrangement be approved by the court under section 895 of the Companies Act 2006 if it varies proprietary rights? I prefer to express it rather more specifically, if more wordily: can a scheme be approved under section 895 if it extends to property which is held on trust by the company concerned (a) generally; or alternatively (b) where the persons for whose benefit the property is held on trust are also creditors of the company? The Judge held that the answer to the question was no.

73. Part 26 of the 2006 Act is concerned with "Arrangements and Reconstructions", and section 895, whose origins go back to section 2 of the Stock Companies Arrangement Act 1870, states, in subsection (1), that it applies "where a compromise or arrangement is proposed between a company and (a) its creditors,.... or (b) its members ...".

74. It has been held that the expression "creditors" in section 895 should be given a wide meaning (see *Re Alabama, New Orleans, Texas, and Pacific Junction Railway Co* [1891] 1 Ch 213, 236-237 and *Re Midland Coal, Coke and Iron Co* [1895] 1 Ch 267, 277), and the same principle seems to apply to the meaning of "arrangement" (*Re Savoy Hotel Ltd* [1981] Ch 351, 359 and 361). Bearing in mind the purpose of section 895, as discussed by David Richards J in *Re T&N Limited (Number 1)* [2006] 1 WLR 1728, paragraphs 32-40, and in *Re T&N Limited (Number 3)* [2007] 1 BCLC 563, paragraphs 43-55, it is plainly right that that is so.

75. It was argued by Mr Trower that, in the light of the very wide meaning which is to be accorded to the word "creditors" in section 895(1)(a), it is capable of extending to a beneficiary under a trust. However, I find it very hard to see how it could be said that a person ("a beneficiary") who has the beneficial interest in property ("trust property") held on trust by the company is thereby a "creditor" of the company, even bearing the wide meaning that word is to be given in section 895.

76. As Mr Richard Snowden QC, appearing for the London Investment Banking Association ("LIBA" who oppose the appeal because of what they regard as the unfortunate implications for London as a world financial centre should the administrators succeed on this appeal), says, in relation to such property, the beneficiary is "not a creditor of the [company] but ... the owner of certain specific property in the possession of the [company]" – to adapt an observation of Romilly

MR in *Sinclair v Wilson* (1855) 20 Beav 324, 331. The duty of a trustee is thus to account to the beneficiary for trust property. Although a breach of trust by the trustee will normally give rise to a claim which constitutes the beneficiary a creditor, the trustee-beneficiary relationship will not of itself give rise to the beneficiary having any "pecuniary claims" (to quote from the very passage relied on by the administrators in the judgment of Lindley LJ in *Midland Coal* [1895] 1 Ch 267, 277) against the trustee. It would also be surprising if a scheme under what is now section 895 could have been proposed and sanctioned in relation to trust property for over 100 years without anyone, including all the writers of the leading company law and trust law textbooks, apparently being aware of this important feature of the company law legislation. And it seems most unlikely that the legislature would have intended beneficiaries' rights to be capable of being altered by a scheme if the trustee was a company, when there would be no such possibility if the trustee was an individual.

77. As an alternative, Mr Trower has a more subtle argument. It is that, where a person has the beneficial proprietary interest in property held in the name of a company, a scheme in relation to that property can be validly approved under section 895 provided that the person concerned is also a creditor of the company. In other words, even though (on this alternative argument) such a person is not a creditor of the company qua beneficiary, and therefore a scheme could not extend to the trust property if he was not also a creditor, the argument is that, provided the beneficiary is also a creditor of the company, a scheme could extend to the trust property. So, on the administrators' case, once a person is, to any extent, a creditor of the company, a section 895 scheme in respect of the company can extend to any property or interest of that person.

78. In the absence of clear and binding authority to support that contention, I consider that this alternative submission should also be rejected. As a matter of ordinary language, section 895 appears quite clearly to be dealing with arrangements between a company and one or both of two groups of people – its members and its creditors. If a person's claim cannot be said to render him a creditor or a member, then it appears to me to follow that the subject matter of the claim could not be covered by the arrangement. The fact that he may, in connection with a different claim, be a creditor, does not justify him being treated as a creditor for the purpose of the first claim.

79. The practical consequences of the alternative contention would also be startling. Why should the mere fact that a beneficiary happens also to be a creditor of the company entitle the company, or its liquidators or administrators, to include his property in a scheme, when they could not otherwise do so? What commercial sense or logic is there in the notion, which would follow from the contention, that a beneficiary who is also a creditor could take the trust property out of the potential grasp of a scheme by waiving the debt, or by assigning the debt to another person? Equally, what commercial sense or logic is there in the notion that the company could engineer trust property being potentially brought within a scheme by breaching the trust, thereby creating a claim, and thus a debt, in favour of the beneficiary?

80. However, Mr Trower raised a number of arguments which, he contended, call into question the views I have expressed as to his arguments. First, he relied on the wide meaning of the term "arrangement" in section 895, to which I have already referred. That gets the administrators no further: however generous a meaning is given to the word, there is no getting away from the fact that, in order to be within section 895, an

arrangement must be made with the "creditors" (or members) of the company concerned.

81. Secondly, it was said that the court always has a discretion to refuse to sanction a scheme even when it satisfies the formal requirements of the section. This point, again, does not address the central problem faced by the administrators, namely that a beneficiary is not a creditor within section 895(1)(a). In any event, the relatively loose rein which the court normally adopts when approving a scheme which has been approved by the requisite majority of the various classes of creditors would scarcely be appropriate when it was sanctioning a scheme which extended to trust property.

82. Mr Trower's third point was that it has been authoritatively established more than 100 years ago, ever since the Court of Appeal decided *Alabama* [1891] 1 Ch 213, 236-237, that schemes can affect proprietary rights, and in particular creditors' rights in respect of the security they enjoy over the company's assets. In my view, that principle, which I accept unreservedly, does not assist the administrators here. In the case of a secured creditor, the security is an incident of the debt; to put the point another way, it is parasitic on the debt. If there is no longer any debt, there is no security (save that it can survive in some sort of inchoate form to underwrite future debts). Accordingly, as section 895 enables a scheme which varies the debt, then it must follow that the variation must, as it were, be followed through to the security. No such argument can be mounted in relation to trust property held in the name of the company, which also happens to have a debt to the beneficiary, even if the debt arises out of the trustee-beneficiary relationship. Further, as Mr Snowden said, a secured creditor merely has the right to look to his security to enable his debt to be repaid: unlike the beneficiary in relation to the trust property, he does not own the security. So, if the sale of the security realises more than he is owed, the rest of the proceeds of sale are available to other creditors.

83. Fourthly, Mr Trower relied on the fact that, in *T&N (No 3) Ltd* [2007] 1 BCLC 563, a scheme was held to be capable of extending to, and varying, claims which creditors of the company had against third parties. In *T&N (No 3)* [2007] 1 BCLC 563, paragraph 53, it was held that statutory rights which creditors of the company enjoyed against insurers could be varied as part of an arrangement under section 425 of the 1985 Act (the predecessor of section 895 of the 2006 Act) between those creditors and the company. However, unlike the rights of beneficiaries in respect of trust property, the creditors' rights against the insurers in *T&N (No 3) Ltd* [2007] 1 BCLC 563 (a) were closely connected with their rights against the company as creditors, (b) were personal, not proprietary, rights and (c) if exercised and leading to a payment by the insurers, would have resulted in a reduction of the creditors' claims against the company. Bearing in mind these three factors, it seems to me, as it does to Patten LJ, that the decision of David Richards J was correct, but is of no help to the administrators in this case. Indeed, like the security enjoyed by a secured creditor, the rights of the creditors against the insurers were effectively contingent on the existence of the creditors' claims against the company. It is right to add that, at least as presently advised, I am of the view that the decision in *T&N Ltd (No 3)* [2007] 1 BCLC 563 on this point was near the outer limits of the scope of section 895.

84. Fifthly, there is the argument (which was put to Mr Trower, rather than raised by him) that there could be said to be some support from the cases for the administrators' contention in the fact that money, such as sums received as dividends or rent paid in

respect of trust property, owed from the trust to the beneficiary, can be characterised as an "equitable debt" due from the trustee to the beneficiary: if money due from the trust is such a debt, then it can be said that it would render the beneficiary, at least to that extent, a creditor, and, on that basis, logic might suggest that he should be treated as a creditor in respect of the trust assets. In my view, however, there is nothing in that point for the purposes of this appeal. As Mr Trower realistically accepted, a beneficiary would not be a creditor of the company for the purpose of section 895, if the trust fund, of which the company was bare trustee, included money, whether or not it was received as income derived from trust property: the money would beneficially be his property just like any asset held in the trust. Cases such as *Webb v Stenton* (1883) 11 QBD 518 may support the proposition that in some contexts (in that case, for the purpose of an attachment order) an equitable debt arises when money is due and payable from a trust fund to a beneficiary (see, in ascending order of force, at (1883) 11 QBD 518, 522, 526-7 and 530). However, even if that is right, it cannot begin to justify the notion that, in the case of a bare trust, income, received by the trustee qua trustee and held in the trust, is a debt to the beneficiary such that he can be to that extent treated as a creditor of the company for the purpose of section 895.

85. Finally, it is worth noting that, far from there being any authority to support the administrators' contention, such judicial observation as there is on the point tends to support Blackburne J's approach. In *T&N Ltd (No 3) Ltd* [2007] 1 BCLC 563, paragraph 45 David Richards J, who has considerable experience of company law, described it as an "obvious point" and that it was "implicit" in the immediate statutory predecessor to section 895 (namely, as mentioned, section 425 of the Companies Act 1985) that a scheme of arrangement thereunder "must be made with [the creditors or members] in their capacity as creditors or members and that it must at least concern their position as creditors or members of the company".

86. Like Patten LJ and Blackburne J, I have some sympathy with the administrators' desire to have a scheme under section 895 which extends to trust property, in the light of the difficulties which would otherwise almost certainly arise in connection with seeking to satisfy the rights of beneficiaries in relation to trust property held in the name of LBIE. However, as Blackburne J held, the fact that such a Scheme might well represent a reasonable proposal in this case is plainly not enough to bring it within the ambit of section 895, and, as is evidenced by the opposition to the proposed Scheme mounted by LIBA, it may, viewed in the wider perspective, be positively undesirable that such a Scheme could be approved under section 895. I hope, indeed I would expect, that, if the administrators decide to make an application under the Trustee Acts or pursuant to the court's inherent equitable jurisdiction, in relation to dealing with beneficiaries' rights, the court will provide effective assistance, by arriving at a practical and fair outcome, while ensuring that delay and cost are kept to a minimum.

87. As it is, however, I, too, would dismiss this appeal.