IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO. FSD 27 OF 2013 – (IKJ)

IN THE MATTER OF THE COMPANIES LAW (2018 REVISION)
AND IN THE MATTER OF HERALD FUND SPC (IN OFFICIAL LIQUIDATION)

Appearances:

Mr Stephen Atherton QC, Mr Matthew Goucke and Ms Amy McLeish of Walkers for the Additional Liquidator of Herald Fund SPC (in Official Liquidation) ("**Liquidator**")

Mr Tom Smith QC, Mr Nicholas Fox, Mr Rocco Cecere and Mr Christopher Levers of Mourant Ozannes on behalf of the December Redeemers and the KYC Redeemers ("**the Redemption Creditors**"), represented by Primeo Fund (in Official Liquidation) ("**Primeo**")

Before:	**The Hon. Justice Kawaley**
Heard:	**24 July 2018**
Date of Decision:	**20 August 2018**
Draft Reasons circulated:	**20 August 2018**
Reasons delivered:	**27 August 2018**

HEADNOTE

Solvent winding-up proceeding-claim by redemption creditors for statutory interest-whether redemption creditors entitled to receive statutory interest on their admitted claims-Companies Law section 149-Companies Winding Up Rules Order 16 rule 12

Introductory

1. "*There is nothing new under the sun*" is an adage which, the present application reveals, has only limited resonance for Cayman Islands insolvency law. By a Summons dated April 6, 2018, the Liquidator sought this Court's determination of a commercially significant legal question which was not directly illuminated by binding or persuasive authority. The relevant issue was whether or not the Redemption Creditors were entitled to recover statutory interest on their claims under section 149(2) of the Companies Law. If the Redemption Creditors were entitled to statutory interest, the distribution made to the members or contributories of Herald Fund SPC (in Official Liquidation) (the "Company") would be substantially diminished. If the Redemption Creditors were not entitled to claim statutory interest, the distributions made to the members would be substantially enlarged.

Consent Order for Directions-June 21, 2018

The Statutory Interest Issue

2. The issue was defined as follows in the Consent Order:

> "*1. The Court direct a hearing on the issue of whether interest is payable pursuant to section 149(2) of the Companies Law (2018 Revision) (the '**Companies Law**') on the claims of:*
>
> *(a) former shareholders of the Company arising from redemption requests submitted to the Company for the Redemption Day 1 December 2008 and which were redeemed on 1 December 2008 but in respect of which redemption monies were not paid prior to the commencement of the Company's liquidation (the '**December Redeemers**'); and/or*
>
> *(b) former shareholders of the Company who redeemed their shares before 1 December 2008 but in respect of which redemption monies were not paid prior to the commencement of the liquidation because the Company was awaiting proof of*

*entitlement (the '**KYC Redeemers**' and together with the December Redeemers, the '**Redemption Creditors**'),*

*(the '**Statutory Interest Issue**').*"

Representation

3. The main directions given (in addition to dealing with costs and updating represented parties) were the following:

> "*2. The Statutory Interest Issue shall be adjudicated as an inter partes proceeding pursuant to Order 11, rule 3 of the Companies Winding Up Rules, 2018.*
>
> *3. The following parties shall be appointed as representatives of the classes of investors in the Company in respect of the Statutory Interest Issue, the Court being satisfied that the respective classes of investors have a sufficient communality of interest:*
>
> *(a) The Additional Liquidator shall be appointed as representative of all contributories who are not Redemption Creditors; and*
>
> *(b) Primeo Fund (in Official Liquidation) ('**Primeo**') shall be appointed as representatives of the Redemption Creditors,*
>
> *(together the '**Statutory Interest Representative Parties**').*"

Determination of the Statutory Interest Issue

4. The following simple directions were given as to which party would argue which position:

"6. The Additional Liquidator shall argue that statutory interest is not payable to the Redemption Creditors pursuant to section 149(2) of the Companies Law.

7. Primeo shall argue that statutory interest is payable to the Redemption Creditors pursuant to section 149(2) of the Companies Law."

Agreed Facts

5. The Company was incorporated in the Cayman Islands on March 24, 2004 as an exempt segregated portfolio company and was also registered as a regulated mutual fund. Its custodian and administrator was HSBC Securities Services (Luxembourg) SA ("HSSL"). Through HSSL, the Company invested funds with Bernard L Madoff Investment Securities LLC ("BLMIS") in New York. The Redemption Creditors acquired Participating Non-Voting Shares in the Company.

6. Redemption requests were received by HSSL from the KYC Redeemers requesting the redemption of Participating Non-Voting Shares (the "KYC Redeemer Shares") on various Redemption Days prior to December 1, 2008 (the "KYC Redeemer Redemption Requests"). All or substantially all of the KYC Redeemer Redemption Requests were accepted by the Company so that the KYC Redeemer Shares were redeemed before December 1, 2008 and removed from the Company's share register prior to the commencement of the Company's winding-up. Payment of the relevant redemption proceeds was deferred by the Company pending receipt of what it regarded as the requisite "Know Your Client" documentation. Redemption requests were received by HSSL from the December Redeemers requesting the redemption of Participating Non-Voting Shares (the "December Redeemer Shares") for a Redemption Day of 1 December 2008 (the "December Redeemer Redemption Requests"). All or substantially all of the December Redeemer Redemption Requests were accepted for the Redemption Day December 1, 2008. The December Redeemer Shares were removed from the Company's share register as of that date. (In light of the next part of the agreed narrative, the timing of these Redemption Requests would prove to be fortuitous).

7. The Redemption Creditors' right to receive their redemption proceeds as soon as practicable under the Company's Articles of Association was subject to the Company's right to suspend payment. On December 11, 2008 Bernard Madoff admitted that BLMIS was a fraud. The following day, the Company's Directors resolved to suspend the

calculation of the Net Asset Value of Participating Non-Voting Shares and their redemption with immediate effect (the "Suspension"). On December 24, 2008, the Directors passed a circular resolution which clarified for the avoidance of doubt that "*the payment of redemption proceeds to investors.... is hereby suspended with immediate effect and until further notice*".

8. Primeo petitioned to wind-up the Company on February 14, 2013. On July 16, 2013 the Company was wound-up. On July 23, 2013, Russell Smith and Niall Goodsir-Cullen of BDO CRI (Cayman) Limited were appointed as Joint Official Liquidators (the "Principal Liquidators"). Michael Pearson was appointed as Additional Liquidator on the same date. On August 12, 2013, the Principal Liquidators filed a Certificate confirming that the Company should be treated as being of doubtful solvency for the purposes of section 110(4) of the Companies Law and Orders 8 and 9 of the Companies Winding Up Rules ("CWR").

9. On August 14, 2013, the Liquidators gave notice of a Concurrent Meeting of Creditors and Contributories on September 17, 2013 for the "*primary purpose of electing a Liquidation Committee*". Primeo submitted a proof of debt which claimed, *inter alia* (1) unpaid redemption proceeds, and (2) certain performance fee rebates.

10. On January 28, 2014, Jones J directed the Principal Liquidators to reconsider their determination of doubtful solvency, under Order 8 rule 1(2) of the CWR. On February 6, 2014 they filed a Revised Certificate confirming that the Company should be treated as solvent for the purposes of section 110(4) of the Companies Law and Orders 8 and 9 of the CWR.

11. On October 13, 2014 Primeo filed a Summons (the "Primeo Summons") seeking the following material relief:

    (a) a declaration that section 37(7)(a) of the Companies Law did not apply in relation to certain Participating Non-Voting Shares (the "Primeo Shares") which had been redeemed prior to the commencement of the Company's winding-up; and

    (b) a declaration that Primeo had a claim against the Company for (i) payment of monies due in respect of unpaid redemption proceeds which was admissible to proof and ranked *pari passu* in the Company's liquidation with other ordinary

unsecured creditors' claims, and (ii) in the event of a surplus, interest on the said claim pursuant to Order 16, rule 12 of the CWR.

12. By a Summons filed on November 7, 2014 (the "Additional Liquidator Summons"), the Additional Liquidator sought authority to reject the December Redeemer Redemption Requests and the KYC Redeemer Redemption Requests. The parties agreed that the issues raised by the Primeo Summons and the Additional Liquidator Summons should be dealt with by representative proceedings pursuant to Order 11 rule 3 of the CWR. On November 24, 2014, this Court gave directions for the determination of, inter alia, whether section 37(7)(a) of the Companies Law applied to the Participating Non-Voting Shares which formed the subject of the December Redeemer Redemption Requests and the KYC Redeemer Redemption Requests (the "December Redeemer Issue") (the "First Representative Order"). The December Redeemer Issue was then determined at three Court levels as follows:

- **June 12, 2015**: the Grand Court determined the December Redeemer Issue in favour of Primeo, holding that section 37(7)(a) of the Companies Law[1] did not apply to the Participating Non-Voting Shares which formed the subject of the December Redeemer Redemption Requests and the KYC Redeemer Redemption Requests;

- **July 19, 2016**: the Court of Appeal dismissed the Additional Liquidator's appeal, holding that the Redemption Creditors' contingent claims were provable in the Company's liquidation and ranked behind ordinary unsecured creditors but ahead of claims by the Company's members in their capacity as such;

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[1] Section 37(7)(a) provides as follows:

"*Where a company is being wound up and, at the commencement of the winding up, any of its shares which are or are liable to be redeemed have not been redeemed or which the company has agreed to purchase have not been purchased, the terms of redemption or purchase may be enforced against the company, and when shares are redeemed or purchased under this subsection they shall be treated as cancelled:*

Provided that this paragraph shall not apply if-

(i) the terms of redemption or purchase provided for the redemption or purchase to take place at a date later than the date of the commencement of the winding up; or

(ii) during the period beginning with the date on which the redemption or purchase was to have taken place and ending with the commencement of the winding up the company could not, at any time, have lawfully made a distribution equal in value to the price at which the shares were to have been redeemed or purchased.

- **July 6, 2017**: the Judicial Committee of the Privy Council dismissed the Additional Liquidator's appeal against the Court of Appeal's decision, which it upheld.

13. On November 3, 2017, the Liquidators sought authority to pay the principal amounts due to the Redemption Creditors in full without requiring them to submit formal proofs of debt, as contemplated by Order 16 rule 1(3) of the CWR. The supporting Affidavit of Russell Smith deposed that dispensing with the proof of debt requirement would save costs. By Order dated November 7, 2017, this Court directed that the Liquidators were at liberty to :

    (a) lift the Suspension; and

    (b) pay the principal amounts due to the Redemption Creditors in full without requiring them to submit formal proofs of debt.

14. In November 2017 the Liquidators made 43 payments to Redemption Creditors totalling in excess of €26 million and US$160 million, keeping a reserve of approximately US$21 million in respect of the statutory interest claims.

The key statutory provisions-preliminary overview

Companies Law

15. The most directly relevant provision is that which creates the right to statutory interest in a winding-up. Section 149 of the Companies Law provides as follows:

> "***149. INTEREST ON DEBTS***
>
> *(1) Subject to subsection (5), in a winding up interest is payable in accordance with this section on any debt proved in the winding up, including so much of any such debt as represents interest on the remainder of the debt.*
>
> *(2) Any surplus remaining after the payment of the debts proved in a winding up shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the period during which they have been outstanding since the company went into liquidation.*

(3) All interest under this section ranks equally, whether or not the debts on which it is payable ranked equally.

(4) The rate of interest payable under this section in respect of any debt is the greater of -

(a) the rate applicable to the currency of the liquidation prescribed from time to time by the Judgment Debts (Rates of Interest) Rules, 2012 made under section 34 of the Judicature Law (2017 Revision); and

(b) the rate applicable to that debt apart from the winding up.

(5) No interest shall be payable if the liquidation is concluded in less than six months or the accrued amount is less than five hundred dollars."

16. On the face of this provision, interest is payable out of the surplus (if any) remaining after all debts proved have been paid and, for these purposes, all claims rank equally. As regards what debts are provable, section 139 of the Companies Law provides as follows:

"(1)All debts payable on a contingency and all claims against the company whether present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company and the official liquidator shall make a just estimate so far as is possible of the value of all such debts or claims as may be subject to any contingency or sound only in damages or which for some other reason do not bear a certain value."

17. A question arose in the course of argument as to whether section 149 of the Companies Law only conferred an entitlement to interest on debts which had been formally proved. In the present case the Liquidators had sought this Court's approval to dispense with the requirement to require proofs of debts. It is noteworthy that section 139 of the Companies Law describes what debts may be proved without mandating or in any way prescribing how debts should be proved. How the CWR deal with the proof of debt process will be considered below. However, the following provisions of Part I of Schedule 3 to the Companies Law which (as read with section 110 of the Companies Law) set out those

powers liquidators enjoy subject to sanction of the Court, are indirectly relevant in this regard:

> "*6. Power to compromise on such terms as may be agreed all debts and liabilities capable of resulting in debts, and all claims (present or future, certain or contingent, ascertained or sounding only in damages) subsisting, or supposed to subsist between the company and a contributory or alleged contributory or other debtor or person apprehending liability to the company.*
>
> *7. Power to deal with all questions in any way relating to or affecting the assets or the winding up of the company, to take any security for the discharge of any such call, debt, liability or claim and to give a complete discharge in respect of it.*" [Emphasis added]

18. A fundamental rule of distribution is set out in section 140(1) of the Companies Law, which provides that "*the property of the company shall be applied in satisfaction of its liabilities pari passu and subject thereto shall be distributed amongst the members according to their rights and interests in the company.*" Section 141 of and Schedule 2 to the Companies Law prescribe the priorities of preferential debts.

19. The most significant single provision apart from section 149 of the Companies Law, for present purposes, is section 49 ("*LIABILITY OF PAST AND PRESENT MEMBERS*"):

> "*49. In the event of a company being wound up every present and past member of such company shall be liable to contribute to the assets of the company to an amount sufficient for payment of the debts and liabilities of the company, and the costs, charges and expenses of the winding up and for the payment of such sums as may be required for the adjustment of the rights of the contributories amongst themselves:*
>
> *Provided that -*
>
> > *(a) a past member shall not be liable to contribute to the assets of the company if he has ceased to be a member for a period of one year or upwards prior to the commencement of the winding up;*

(b) a past member shall not be liable to contribute in respect of any debt or liability of the company contracted after the time at which he ceased to be a member;

(c) a past member shall not be liable to contribute to the assets of the company unless it appears to the Court that the existing members are unable to satisfy the contributions required to be made by them under this Law;

(d) in case of a company limited by shares, no contribution shall be required from any member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member except where such member or past member holds or held shares of a class which are expressly stated in the memorandum of association to carry unlimited liability, as provided in section 8(2);

(e) in the case of a company limited by guarantee, no contribution shall be required from any member exceeding the amount of the undertaking entered into on his behalf by the memorandum of association, except where the amount of the undertaking of such member is unlimited, as provided in section 9(2);

(f) nothing in this Law shall invalidate any provisions contained in any policy of insurance or other contract whereby the liability of individual members upon any such policy or contract is restricted, or whereby the funds of the company are alone made liable in respect of such policy or contract; and

(g) no sum due to any member of a company in his character of a member by way of dividends, profits or otherwise, shall be deemed to be a debt of the company, payable to such member in a case of competition between himself and any other creditor not being a member of the company; but any such sum may be taken into account for the purposes of the final adjustment of the rights of the contribut[ories] *amongst themselves.*" [Emphasis added]

20. Section 49 (g) of the Companies Law derives from a provision in the English Companies Act 1948 which was carried over in England as section 74(2)(f) of the Insolvency Act 1986. The House of Lords considered this provision in *Soden and Another-v- British & Commonwealth Holdings Plc* [1998]AC 298. Lord Browne-Wilkinson (with whom all other panel members agreed) opined as follows (at page 3) in passages to which Mr Atherton QC referred:

> *"Section 74(2)(f) requires a distinction to be drawn between, on the one hand, sums due to a member in his character of a member by way of dividends, profits or otherwise and, on the other hand, sums due to a member otherwise than in his character as a member. In the absence of any other indication to the contrary, sums due in the character of a member must be sums falling due under and by virtue of the statutory contract between the members and the company and the members inter se constituted by section 14(1) of the Companies Act 1985*[2]*:*
>
> > *'14(1) Subject to the provisions of this Act, the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles.'*
>
> *Moreover, the construction of the section which I favour accords with principle. The principle is not 'members come last': a member having a cause of action independent of the statutory contract is in no worse a position than any other creditor. The relevant principle is that the rights of members as members come last, i.e. rights founded on the statutory contract are, as the price of limited liability, subordinated to the rights of creditors based on other legal causes of action. The rationale of the section is to ensure that the rights of members as such do not compete with the rights of the general body of creditors."*

21. Section 154 of the Companies Law provides for the establishment of the Insolvency Rules Committee. Section 155(1)(a) of the Companies Law empowers the Rules Committee to "*to make rules and prescribe forms for the purpose of giving effect to*", inter alia, Part V ("**Winding up of Companies and Associations**").

[2] Section 12 of the Companies Law is expressed in similar terms.

The Cayman Companies Winding Up Rules 2018

22. The current version of the CWR came into force on February 1, 2018. The CWR clearly applies to the present application. Order 1 rule 2(1) of the CWR provides as follows:

> *"(1) These Rules shall apply to –*
>
> *(a) every winding up petition presented on or after the commencement date;*
>
> *(b) every other application made under Part V of the Law on or after the commencement date;*
>
> *(c) every application made on or after the commencement date in a winding up proceeding which was pending on that date;*
>
> *(d) any step taken or required to be taken after the commencement date in any winding up proceeding which was pending on that date; and*
>
> *(e) any step taken or required to be taken on or after the commencement date in any voluntary liquidation which was in progress on that date, except that a voluntary liquidator shall not be required to apply for a supervision order under section 124 of the Law in respect of a voluntary liquidation which commenced prior to the commencement date."* [Emphasis added]

23. Order 16 rule 1 of the CWR provides as follows:

> *"1. (1) Where a solvent company is being wound up by the Court, the official liquidator shall pay the debts owing to its creditors in the ordinary course and in the currency of the obligation as if the company were still carrying on business.*
>
> *(2) Where a company which is insolvent or of doubtful solvency is being wound up by the Court, a person claiming to be a creditor of the company and wishing to recover his debt must (subject to Rule 7)[3] submit his claim in writing to the official liquidator and is referred to as 'proving' for his debt and the document by which he seeks to establish his claim is referred to as his 'proof' or 'proof of debt'.*

[3] Order 16 rule 7 creates an exception for the winding-up of licensed banks.

(3) The official liquidator of a solvent company which is being wound up by the Court may require a creditor to submit a proof of debt if there is a doubt or dispute about the existence of the debt or the amount owing to the creditor.

(4) It is the duty of the official liquidator to adjudicate the creditors' claims, for which purpose he acts in a quasi-judicial capacity." [Emphasis added]

24. As the Company is now being wound-up on a solvent basis, there is no mandatory general or standard requirement under the CWR for the Liquidators to require creditors to formally prove their debts. However in my judgment even in the absence of an express power in the CWR to dispense with formal proofs in insolvent liquidations, the Court could sanction such a decision by a liquidator under paragraph 6 or more likely 7 of Part I of the Third Schedule to the Companies Law, the provisions of which are set out above.

25. The most pertinent provisions of the CWR as regards the statutory interest issue are the following provisions of Order 16 of the CWR:

"***Post-liquidation Interest on Debts (O. 16, r. 12)***

12. *(1) This Rule applies to every official liquidation of a company which lasts more than six months.*

(2) Any surplus remaining after payment of the debts proved in the liquidation shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the period during which they have been outstanding since the commencement of the liquidation pursuant to section 149 of the Law.

(3) The rate of interest payable under this Rule is the greater of –

(a) the contractual rate; or

(b) the prescribed rate under the Judgment Debts (Rates of Interest) Rules.

(4) The liquidator shall not pay interest under this Rule to any creditor whose claim to interest would amount to less than $500."

26. This rule does not at first blush appear to elucidate in any way the scope of the entitlement to post-liquidation statutory interest beyond the definition found in section 149 of the Companies Law itself.

The Additional Liquidator's submissions

The statutory waterfall

27. The Additional Liquidator submitted that the following order of priorities, relied upon by Primeo in its written case before the Privy Council, was agreed:

(1) fixed charge creditors (section 140(2));

(2) preferred creditors (section 140(2));

(3) floating charge creditors (sections 140(2), 141(1));

(4) liquidation expenses (section 109(1));

(5) provable debts of unsecured creditors (section 140(1));

(6) statutory interest on proved debts (section 149(2));

(7) non-provable liabilities;

(8) deferred debts;

(9) returning capital to shareholders.

The "fundamental issue"

28. In the Additional Liquidator's Written Submissions after the order of priority is addressed, the following argument is advanced:

> *"6...The fundamental issue is that the claims of the Redemption Creditors, though provable deferred/postponed claims, will not be proved claims at the time that statutory interest is to be paid pursuant to s.149 of the Companies Law. Moreover, there is no express provision or mechanism for two, or more, successive payments of statutory interest (i.e. payment of interest to ordinary unsecured creditors, payment of interest to ordinary unsecured creditors, payment of principal to deferred creditors, and then payment of interest to deferred creditors, who rank for payment subsequent to the payment of interest on ordinary unsecured debts in any event.). In other words, there is no provision of either the Companies Law or the CWR which expressly contemplates the payment of statutory interest on claims which rank in priority below statutory interest, including claims which have been deferred or postponed pursuant to s.49(g) of the Companies Law."*

29. At first blush this submission was not easy to digest. Seasoned by the typically flavourful oral arguments of Mr Atherton QC, the key points became more digestible and may be summarised as follows:

(a) section 149 of the Companies Law only creates an entitlement to statutory interest in respect of debts which have been formally proved and formal proofs have been dispensed with in the case of the Redemption Creditors;

(b) having regard to the low ranking of deferred claims in the distribution waterfall and the way statutory interest is required to be calculated and paid, it is incongruous to construe the provision as applying to deferred claims at all. Express words indicating such a legislative intention would be required to support such a construction.

The English authorities

30. It was submitted on behalf of the Additional Liquidator (without any dissent) that the English statutory framework was "*broadly analogous*": section 189 of the Insolvency Act

1986; rule 2.88 of the now replaced Insolvency Rules 1986. Two points of principle were extracted from judicial decisions on this statutory regime:

(a) the statutory provisions constituted "*a complete statutory code for the recovery of interest*"[4];

(b) the reference in the rule to "debts" meant debts that had been proved.

31. Reference was then made to the status of deferred debts under English law, with reference to section 74(2)(f) of the Insolvency Act 1986, which corresponds to section 49(g) of the Companies Law, the case of *Soden* (discussed briefly above) and various textbook authorities. It was argued in the Additional Liquidator's Written Submissions that the English law position was as follows:

(a) ordinary unsecured debts are provable in the ordinary way;

(b) statutory interest is payable on debts which have been proved in the ordinary way;

(c) "*Deferred/postponed debts are not provable, or at least not provable in the ordinary way, but are taken into account for the purpose of the adjustment of the rights of contributories and there is no mechanism...for the payment of statutory interest on such sums...*";

(d) "*The most recent iteration of the relevant principle in England is contained in Rule 14.2(4)(b) of the Insolvency Rules 2016 and provides that debts which are deferred...are not provable until after all the claims of creditors have been paid in full with interest under s.189(2) of the Insolvency Act.*"

[4] *Lehman Brothers International (Europe) (in Administration)* [2017] UKSC 38 at paragraph 125 (per Lord Neuberger), affirming David Richards J (as he then was) in *In Re Lehman Brothers International (Europe) (in Administration)*[2016] Bus. L.R. 17, [2015] EWHC 2269 (Ch), at paragraph 164.

32. It was conceded that the now repealed Insolvency Rules 1986, "*appeared to contemplate that creditors would /could be considered as having 'proved' for their debts, notwithstanding the absence of a written proof of debt.*" It was said to be arguable under the Insolvency Rules 2016 that, subject to a small debt exception, a creditor who has not submitted a proof of debt will not be considered to have "proved" their debt.

33. It was submitted that under Cayman Islands law, the statutory scheme did not contemplate a creditor having "proved their debt" otherwise than through a formal proof of debt process. It followed that the Redemption Creditors were not entitled to statutory interest because:

(a) their claims are not "proved debts" at the point at which statutory interest is paid on all prior ranking claims;

(b) their claims are not provable in the same way as ordinary unsecured debts.

Primeo's submissions

Introduction

34. In Primeo's Skeleton Argument, it was submitted that "[t]*here is no reason, as a matter of policy or indeed common sense*" why the Redemption Creditors should not be compensated "*for the loss of the time value of their money, before any sums are payable to shareholders*". It was also contended that the Additional Liquidator's arguments were "*convoluted, highly technical and unmeritorious*".

English law

35. It was argued with reference to UK Supreme Court authority that English law has always adopted a broad approach to what debts are provable in a liquidation[5].

36. It was then pointed out that it was clear that section 74(2)(f) of the Insolvency Act 1986 did not make postponed debts unprovable because rule 12.3(2A)(c) (of the Insolvency

[5] *In re Lehman Brothers International (Europe)(No.4)* [2017] 2 WLR 1497 (paragraph 33); *Bloom-v-Pension Regulator* [2014] AC 209 (paragraph 92).

Rules 1986) expressly applies to postponed debts (requiring a postponement of the proof of such debts). The English statutory scheme explicitly contemplates more than one round of proofs.

37. After referring to the explanation of the function and operation of the statutory interest rules provided by David Richards J in *Re Lehman Brothers International (Europe)* [2016] BCC 239[6], Primeo argued as follows:

> *"21. It is submitted that the position in relation to statutory interest under English law in relation to the claims of unsecured creditors is therefore straightforward:*
>
> *(1) First , any assets remaining after the discharge of the claims of secured and preferential creditors and the payment of liquidation expenses are applied in discharge of the claims of ordinary unsecured creditors (comprising principal and any accrued but unpaid interest to the date of the winding up);*
>
> *(2) Secondly ,once those claims have been paid, statutory interest is then payable on the claims from the date of commencement of the liquidation;*
>
> *(3) Thirdly, once these claims and interest have been paid, the creditors with Postponed Debts are then permitted to prove and to have their claims paid (comprising principal and any accrued but unpaid interest to the date of the commencement of the winding up). Such claims are provable as late proofs;*
>
> *(4) Fourthly, once the Postponed Debts have been paid, statutory interest is then payable on the Postponed Debts from the date of the commencement of the liquidation;*
>
> (5) *Fifthly, only at this point, is any remaining surplus then available for shareholders."*

[6] At paragraphs 134, 207 and 208.

Cayman Islands Law

38. Primeo submitted (concurring with the Additional Liquidator on this broad point) that the position under Cayman Islands law was essentially the same as under English law. A notable divergence was the absence of any prohibition on proving before unsubordinated debts were paid in full under Cayman Islands law. However, the CWR clearly contemplated multiple rounds of proofs: late proofs are permitted under Order 18 rule 4(2) of the CWR. More than one round of proofs would probably be required to enable contractually subordinated debts (recognised by Order 16 rule 9(1) of the CWR) to be proved.

39. The five stages set out above in relation to the English statutory interest regime were said to apply under Cayman Islands law with the following modification at the third stage:

> "*(3) Thirdly, once these claims and interest have been paid, the creditors with Postponed Debts are then entitled to have their claims paid (comprising principal and any accrued but unpaid interest to the date of the commencement of the winding up). Under the Cayman legislation, such claims are provable at the same time as the claims of ordinary unsecured creditors but not payable until the claims of ordinary unsecured creditors have been paid with interest thereon.*"

40. It was submitted that there was in any event no basis in the legislative scheme for concluding that statutory interest can only be paid at one time, before postponed debts could be proved. Mr Smith QC emphasised in oral argument that it made no sense for either an ordinary unsecured creditor who happened to prove late or a postponed creditor generally to be deprived of statutory interest out of an available surplus.

41. As regards the argument that the debts were not "proved", Primeo submitted:

(a) Order 16 rule 1(1) of the CWR was clearly not engaged simply because the liquidation was a solvent one. The debts had not been paid in the ordinary course of business;

(b) the dispensation from requiring formal proofs did not result in the entire proof of debt process being disengaged;

(c) the Redemption Creditors had proved their debts in the requisite section 149(1) of the Companies Law sense because the Liquidators had admitted their claims.

42. Alternatively, it was argued, if the Liquidators' decision to dispense with proofs of debt achieved the legal result that Redemption Creditors lost statutory interest rights they would otherwise have enjoyed, this was fundamentally unfair. The Liquidators ought not to be permitted to rely on the ex parte sanction they obtained dispensing with proofs of debt on costs savings grounds. Reliance was placed on the principle in *Ex Parte James*[7] as explained in *In Re Lehman Brothers International (Europe)* [2015] EWHC 2270 (Ch), at paragraph 183.

43. In any event, Primeo had itself submitted a proof of debt on September 13, 2013 and the CWR do not distinguish between the filing of proofs for voting and distribution purposes. The "not proved" point did not accordingly apply to Primeo on any proper analysis, it was submitted.

Findings: the object and purpose of the statutory interest scheme in the wider insolvency law framework

44. It was common ground that the Cayman Islands statutory interest provisions were a complete code. David Richards J (as he then was) stated in *In Re Lehman Brothers International (Europe)* [2015] EWHC 2269 (Ch), at paragraph 164:

> "*164. In my judgment, Wentworth and the administrators are right in their submission that rule 2.88 represents a complete code for the payment of post-administration interest.*"

45. This reasoning was approved by the United Kingdom Supreme Court in *In re Lehman Brothers International (Europe) (in Administration)* [2017] UKSC 38 when Lord Neuberger opined as follows:

[7] (1874) LR 9 Ch App 609.

"125... I consider that the legislative provisions discussed above, namely rules 2.88 and 4.93 and section 189 provide a complete statutory code for the recovery of interest on proved debts in administrations and liquidations, and there is now no room for the Judge-made law which was invoked by Giffard LJ. It seems to me that this view is consistent with what David Richards J said in In re Lehman Brothers International (Europe) (in administration) [2016] Bus LR 17, para 164, although the point which was there being considered was more limited."

46. As already alluded to above, there are two directly applicable statutory provisions, one in the Companies Law and the other in the CWR. The right to statutory interest is defined in essentially unqualified terms in the core provisions of section 149 of the Companies Law:

"(1) Subject to subsection (5)[8], in a winding up interest is payable in accordance with this section on any debt proved in the winding up, including so much of any such debt as represents interest on the remainder of the debt.

(2) Any surplus remaining after the payment of the debts proved in a winding up shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the period during which they have been outstanding since the company went into liquidation.

(3) All interest under this section ranks equally, whether or not the debts on which it is payable ranked equally...."

47. The primary legislation does not in my judgment speak to procedural matters at all. Order 16 rule 12 of the CWR repeats the limitations imposed by section 149 of the Companies Law in terms of the minimum duration of the liquidation and amount of the interest claim. It also prescribes the rate of interest (the higher of the contractual interest rate and the judgment interest rate). However, it otherwise simply mirrors section 149 of the Companies Law in terms of defining who is eligible to claim statutory interest:

[8] The liquidation must last for longer than six months and the amount of interest claimed must be at least $500.

> *"(2) Any surplus remaining after payment of the debts proved in the liquidation shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the period during which they have been outstanding since the commencement of the liquidation pursuant to section 149 of the Law."*

48. However, both section 149 of the Companies Law and Order 16 rule 12 of the CWR do on their face appear to contemplate a certain timeframe as regards when interest will be paid, with the payment of principal amounts clearly expressed as preceding payment of interest. To my mind, although nothing perhaps turns on this point in the present case, the statutory language does not come close to mandating the actual payment of principal before interest. Read purposively, the section is most significantly specifying that interest is only payable at all if there is a surplus left after the principal amounts payable to creditors who have proved their debts have been both (1) quantified and (2) identified as being available for distribution.

49. By extension, it is difficult to see how these statutory provisions may fairly be read as imposing a mandatory requirement that debts must be proved by way of a formal proof of debt process (that is unless the term "proved" in the relevant statutory context connotes formal proof alone and does not embrace other forms of proof). This assumption provides the central underpinning of the Additional Liquidator's submissions.

50. Mr Smith QC rightly submitted at the outset that the purpose of statutory interest is to compensate creditors who cannot claim interest after a winding-up order has been made on a contractual basis for the delay in gaining access to their money. I agree that it is on superficial analysis far easier to identify policy reasons for postponed creditors being beneficiaries of the statutory interest entitlement than it is to identify reasons why they should not. They are admitted creditors who have been deprived of their money for several years by virtue of the Company's winding-up. The commercial prejudice which they suffer, in this regard, is indistinguishable from that sustained by ordinary unrelated creditors. Mr Atherton QC was unable to identify any clear-cut or coherent policy rationale as to why section 149 of the Companies Law should be construed as excluding deferred or postponed creditors.

51. However, I also accept the more important legislative policy imperative which Primeo's counsel contended for. Namely, a broad and inclusive approach should be adopted in

relation to the question of what debts may be proved. In *In re Lehman Brothers International (Europe) (in Administration)* [2017] UKSC 38, Lord Neuberger stated:

> *"32. Rule 12.3(1) provides:*
>
> > *'Subject as follows, in administration, winding up and bankruptcy, all claims by creditors are provable as debts against the company or, as the case may be, the bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages.'*
>
> *33. There are certain specified exceptions to this definition, but rule 12.3(3) makes it clear that they are not exhaustive. However, as is clear from the strikingly wide words of rules 13.12(1) and (3) and 12.3(1), the statutory policy, which Briggs J rightly identified at first instance in In re Nortel GmbH [2011] Bus LR 766, paras 102-103, and which is supported by the Supreme Court in the same case at [2014] AC 209, paras 92-93, is that claims should, if at all possible, be admitted to proof rather than being excluded from proof..."*

52. Lord Neuberger had previously waxed eloquently on the same theme in *In re Nortel Gmbh* [2014] AC 209 when he opined as follows:

> *"92. The Report of the Review Committee on Insolvency Law and Practice ("the Cork Report", 1982, Cmnd 8558), para 1289, described it as a "basic principle of the law of insolvency" that "every debt or liability capable of being expressed in money terms should be eligible for proof" so that "the insolvency administration should deal comprehensively with, and in one way or another discharge, all such debts and liabilities".*
>
> *93. The notion that all possible liabilities within reason should be provable helps achieve equal justice to all creditors and potential creditors in any insolvency, and, in bankruptcy proceedings, helps ensure that the former bankrupt can in due course start afresh. Indeed, that seems to have been the approach of the courts in the 19th century before the somewhat aberrant decisions referred to in para 88 above...."*

53. In short, I find that cogent grounds are required to justify the conclusion that the claims of the Redemption Creditors are not provable claims for statutory interest purposes. Having regard to the policy underpinning section 149 of the Companies Law, I find that a clear case must be made out for construing the provision as only conferring statutory interest rights on some creditors but not others. The starting assumption must be that all creditors qualify, including deferred or postponed creditors. Primeo starts the 'race' at the front of the grid as far as this point is concerned, not least because the Privy Council has recently determined that the relevant claims are in general terms provable debts.

54. The logical order for dealing with the two main points seems to me to be as follows. The first and broader question is whether or not as a matter of construction of section 149 of the Companies Law deferred creditor claims asserted by past or present members do not qualify for statutory interest at all as a matter of general legal principle. The second more practical and narrower point is, assuming deferred claims do in fact potentially qualify for statutory interest, whether section 149 of the Companies Law only envisages that such claims should actually qualify if formal proofs of debt have been filed. The second point is more practical because it calls for an analysis of the practical function of the proof of debt process. It is narrower than the first point because it would only arise for consideration where formal proofs have not in fact been filed.

Findings: do the claims of deferred or postponed creditors qualify for statutory interest?

55. The relevant provisions of section 149 of the Companies Law state as follows:

> "*(1)... in a winding up interest is payable in accordance with this section on any debt proved in the winding up, including so much of any such debt as represents interest on the remainder of the debt.*
>
> *(2) Any surplus remaining after the payment of the debts proved in a winding up shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the period during which they have been outstanding since the company went into liquidation.*
>
> *(3) All interest under this section ranks equally, whether or not the debts on which it is payable ranked equally...*" [Emphasis added]

56. In my judgment the application of this provision to the Redemption Creditors is not as straightforward as Mr Smith QC implied. It is true that the language is broad and inclusive and that subsection (3) explicitly seeks to cut through whatever priorities might exist between different classes of creditors. But it was conceded that section 49(g) of the Companies Law impacted on section 149 of the Companies Law with the result that subsection (3) did not apply to confer equal ranking on the Redemption Creditors' claims:

> "*29....Thus, so far as section 149 itself is concerned, there is a pari passu right to interest–of course those rights conferred by section 149 are capable of being subordinated or postponed by a different contractual or statutory obligation (such as section 49(g)).*"

57. This concession was seized upon by the Additional Liquidator to argue, plausibly, that the intercession of section 49(g) of the Companies Law signifies that the qualifying proved debts referred to in section 149(1) of the Companies Law do not include redemption claims (or similar shareholder-derived claims) at all. Primeo's quoted submission was a very compressed one which left unexpressed a number of basic insolvency law principles. Initially, however, I found it less than obvious on superficial analysis that section 49(g) of the Companies Law could be said to operate by necessary implication to modify section 149(3) of the Companies Law as regards the entitlement to statutory interest. However, on further analysis, the Primeo submission was a sound one.

58. Is there a bright dividing line drawn by section 49(g) of the Companies Law between ordinary creditor claims (of whatever rank) and, "*sum*[s] *due to any member of a company in his character of a member by way of dividends, profits or otherwise*"? If there is, this can only be on the basis that section 49 (g) of the Companies Law states a fundamental distribution principle of general application under the Companies Law. A principle so fundamental that the draftsman would be expected to have used express language to manifest an intention to depart from it elsewhere in the statute. In my judgment section 49(g) of the Companies Law, in asserting the priority of ordinary creditors' claims over shareholder claims (in the event of any competition between them) does indeed reflect a principle of fundamental character. This provision forms one of the statutory terms upon which shares are issued, transferred and/or redeemed under Cayman Islands companies law. A closely connected and equally fundamental principle is the requirement that all

debts be fully paid before shareholders receive any distribution. Section 140 of the Companies Law provides:

> *"(1) Subject to subsection (2), the property of the company shall be applied in satisfaction of its liabilities pari passu and subject thereto shall be distributed amongst the members according to their rights and interests in the company."*

59. In one sense section 49(g) of the Companies Law is not truly engaged on the agreed facts of the present case at all. There is no competition between the Redemption Creditors and ordinary creditors here. The real competition is between past and present members. The past members are creditors asserting claims which derive from their former status as members. The present members are solely concerned with their distribution rights as members. All creditors can clearly in financial accounting terms be paid interest in full and as if all claims ranked equally as contemplated by section 149(3) of the Companies Law. However, it is appropriate to test the logic of the construction contended for by Primeo to imagine a scenario where such competition did exist. Section 149 of the Companies Law must be given a coherent meaning which is sustainable beyond the factual parameters of the present case. It seems self-evident that in any insolvent liquidation where it was possible for both ordinary and deferred creditors to be paid their principal but not their statutory interest in full, a competition between former and present members would arise in relation to the surplus.

60. It might be said that if the draftsman was aware of section 49(g) of the Companies Law and the fact that it stated a fundamental principle, that section 149(3) of the Companies Law might have been expressly qualified. Words such as "subject to section 49(g)" could have been used to qualify the equal ranking principle applied to statutory interest. On the other hand, the same point might be made in relation to section 140(1) of the Companies Law. In mandating that the assets of a company being wound-up should be, "*applied in satisfaction of its liabilities pari passu*", no mention is made about the various qualifications of this broadly expressed distribution principle, amongst them the rule expressed in section 49(g) of the Companies Law. No one would sensibly doubt that the fundamental general distribution principle adumbrated by section 140(1) of the Companies Law must be read together with allied principles expressed in other sections (such as section 141 of the Companies Law, preferred debts and section 142 of the Companies Law, secured creditors) as well as section 49(g) of the Companies Law. I accordingly find that

section 149 of the Companies Law may properly be construed in a similar manner to section 140(1) of the Companies Law.

61. It is ultimately clear that section 149 of the Companies Law creates an entitlement to statutory interest which potentially applies to shareholder claims for this simple reason. It is section 49(g) of the Companies Law which ultimately provides the answer to whether or not shareholder claims are provable for the purposes of an entitlement to statutory interest. It provides:

> *"(g) no sum due to any member of a company in his character of a member by way of dividends, profits or otherwise, shall be deemed to be a debt of the company, payable to such member in a case of competition between himself and any other creditor not being a member of the company; but any such sum may be taken into account for the purposes of the final adjustment of the rights of the contribut*[ories] *amongst themselves."*

62. Carefully read in light of its wider statutory context, section 49 of the Companies Law articulates the following legislative principles:

(a) as a general rule, debts due to a member (or former member) in his character as such <u>are debts</u> like any other debts capable of being proved;

(b) in the event of competition between a member or former member and an ordinary creditor (e.g. in any insolvent liquidation), the debt due to the member or former member shall (as between the shareholder claimant and the ordinary claimant, and to the extent of any competition and solely for these purposes) be deemed <u>not to be</u> a debt capable of being proved.

63. In an insolvent liquidation, therefore, section 149 of the Companies Law as read with section 49(g) of the Companies Law operates in this way. To the extent that ordinary creditors are not able to be paid their principal and interest in full, the claims of past or present members (regardless of whether they have <u>in fact</u> been admitted or proved) are not <u>in law</u> deemed to be debts either (a) upon which statutory interest can be paid, and/or (b) for any other purpose. In a solvent liquidation such as the present one (at this stage), the general rule that all proved debts qualify for statutory interest is not displaced because, in

the absence of any actual competition between member (or shareholder) debts and ordinary debts, the deeming provisions of section 49(g) of the Companies Law are not engaged.

64. Having regard to constructs such as "waterfalls", which were useful in the factual circumstances of other cases, in my judgment obscures rather than elucidates the true terms and effects of the statutory interest provisions for the purposes of the present case. What the order of priorities is between various classes of creditors who (I assume for the purposes of disposing of the present point) are entitled to prove sheds no light on who is entitled to claim statutory interest. Section 149 of the Companies Law unambiguously provides that interest is payable on "*any debt proved in the winding up*". Nor is it relevant to consider the time when interest may have to be calculated or paid and how many rounds of proof will occur. These are practical matters on which section 149 of the Companies Law is deafeningly silent. Mr Atherton QC conjured up a scenario in which the award of interest to shareholder claimants would reverse the statutory order of priorities, contending that a salmon could not go back up the waterfall. This seemed to me to be a false analogy which in no way undermined the coherence of the straightforward construction of section 149 of the Companies Law contended for by Primeo. It assumed a single point at which interest had to be paid, without demonstrating any support for the single point assumption, either in the statutory language or by reference to the realities of liquidation practice.

65. In fairness, Mr Atherton QC did identify a judicial statement which supported the proposition that the entitlement to statutory interest only crystallizes at a particular point in time, namely after dividends have been paid when a surplus actually exists. This to my mind did not undermine the cogency of the contention that deferred or postponed claims potentially qualified for interest. David Richards J (as he then was) stated in *In Re Lehman Brothers International (Europe)* [2015] EWHC 2269 (Ch):

> "149. *The right to interest out of a surplus under rule 2.88 is not a right to the payment of interest accruing due from time to time during the period between the commencement of the administration and the payment of the dividend or dividends on the proved debts. The dividends cannot be appropriated between the proved debts and interest accruing due under rule 2.88, because at the date of the dividends no interest was payable at that time pursuant to rule 2.88. The entitlement under rule 2.88 to interest is a purely statutory entitlement, arising once there is a surplus and payable only out of that surplus. The entitlement under rule 2.88 does not involve any remission to contractual or other rights existing apart from the*

administration. It is a fundamental feature of rule 2.88, and a primary recommendation of the Cork Committee that all creditors should be entitled to receive interest out of surplus in respect of the periods before payment of dividends on their proved debts, irrespective of whether, apart from the insolvency process, those debts would carry interest." [Emphasis added]

66. These sorts of judicial statements should not be read in a rigid or formulaic way. In any event, the quoted observations do not to my mind state more than what is obvious. Statutory interest is a right which only crystallizes when a surplus may be said to exist and cannot be paid before then. Circumstances may differ. A liquidator might in an uncontroversial solvent liquidation pay the final dividend and interest at the same time. The critical point is that statutory interest entitlements only arise when the final amount of principal to be distributed is known and it has been determined that there is a surplus out of which interest can be paid. These timing issues are entirely beside the point in terms of determining whether or not deferred or postponed claims qualify for statutory interest payments if a surplus occurs.

67. Mr Atherton QC correctly submitted that subordinated debt is analogous to deferred or postponed debt. In *In re Lehman Brothers International (Europe) (in Administration)* [2017] UKSC 38, the UK Supreme Court held that subordinated debt ranked after non-provable liabilities and statutory interest. Lord Neuberger made certain observations about when the subordinated creditor could file a proof, but this was not in the context of considering whether or not statutory interest could be claimed by that creditor:

"*69. In my judgment, David Richards J's view on this point is to be preferred. The Court of Appeal's view appears to me to raise a logical problem. If, at the time such a proof was lodged, there was a chance that the Senior Liabilities would be paid in full, then, as with any other debt which rests on a contingency that may occur, a valuation of that proof would not be nil: it would have to be a figure which discounted the sum due, in order to allow for the contingency not occurring. However, if the proof is ascribed a valuation greater than nil, it would have to be paid out on any distribution made prior to the satisfaction in full of other proved claims (unless there was one payment of 100%). As David Richards J said, that would appear to fall foul of clause 7. Further, any dividend would be paid out before any statutory interest or any non-provable liabilities had been paid off, which would be inconsistent with the conclusions I have just expressed.*

70. It therefore follows that, in my view, it would not be open to LBHI2 to lodge a proof in respect of the subordinated debt until the non-provable liabilities have been paid in full, or at least until it is clear that, after meeting that proof in full and paying any statutory interest due on it, the non-provable liabilities could be met in full. As soon as that has happened, there would, subject to what I say in the next paragraph, be nothing to stop LBHI2 lodging a late proof.

71. On the face of it at any rate, it seems a little strange that a proof can be, or has to be, lodged for a debt which ranks after statutory interest (which can only be paid out of a "surplus") and non-provable liabilities. It may be that the proper analysis is that the subordinated debt is a non-provable debt which ranks after all other non-provable liabilities. It is unnecessary to decide that point, and, as it was not argued, I say no more about it."

68. These observations do not assist the Additional Liquidator for two main reasons. Firstly, the *obiter dicta* about the logical incoherence of filing late proofs have no persuasive force under Cayman Islands law. There is no statutory provision postponing the right to prove corresponding to the relevant English law rule. Secondly, to the extent that doubt might have been expressed about whether a subordinated claim was provable at all, that question has now (on November 23, 2017) been finally decided in relation to the present liquidation in favour of Primeo: *Pearson-v-Primeo Fund* [2017] UKPC 19.

69. In large and complex insolvent liquidations there will often be a potential risk that distributions will be made before some creditors' claims are even known, let alone proved. Liquidators hedge against such risks by undertaking broad brush calculations as to the total number and value of claims and, if an interim distribution is to be made, ensuring that an appropriate reserve is kept for claims which have not yet been proved. Order 18 of the CWR expressly contemplates such a process. Such an exercise is, of course, an imprecise science. This is why, as Primeo's counsel pointed out, Order 18 rule 4 of the CWR provides:

"*(2) A creditor who has not proved his debt before the declaration of any dividend is not entitled to disturb, by reason that he has not participated in it, the distribution of that dividend or any other dividend declared before his debt was proved, but when he has proved that debt, he is entitled to be paid out of any money available for the payment of any further dividend.*"

70. In light of the agreed order of priorities, however, in an insolvent liquidation administered by a professional liquidator, the shareholder creditors would in practice receive no principal (let alone interest). Section 49(g) of the Companies Law would operate to prevent them receiving any distribution in competition with ordinary unsecured creditors. No practical problem is likely to arise as regards reserving funds for potential late claims in solvent liquidations involving a fund, it seems to me. The main stakeholders are likely to be definitively known past or present members. The ordinary creditors are also likely to be a small group of definitively known service providers. Be that as it may, I reject the Additional Liquidator's submission that there are inherent practical or logistical reasons for concluding that section 149 of the Companies Law should not be construed as applying to the claims of the Redemption Creditors.

71. Two such points which were made were plainly unsupportable. It was submitted (Additional Liquidator's Written Submissions, paragraph 20):

(a) if statutory interest was paid on redemption claims, this would reverse the order of priorities because such interest would be paid before the principal. According to the Amended Agreed Statement of Facts, the principal amounts have already been paid so any interest which is actually paid would be paid after the principal. It is true that one aspect of Primeo's claim is unresolved on its merits, but there is no evidence that this will have any practical effect in terms of eliminating the surplus and disrupting the order of priorities in real world as opposed to merely abstract and conjectural terms;

(b) statutory interest would be paid to redemption creditors before non-provable debts, contrary to the governing order of priority. As Mr Smith QC pointed out, there is no evidential basis for this assertion. And, in any event, in my judgment it matters not the order in which payments are administratively effected when, as between the various creditor classes, all claimants have been paid their principal in full and can be paid their statutory interest in full.

72. The absence of authority directly addressing the issue of whether deferred or postponed creditors are entitled to claim statutory interest may largely be explained by the fact that the issue is unlikely to arise in an insolvent liquidation where there will be, by definition,

no surplus out of which any interest can be paid. If there was a surplus insufficient to meet the interest entitlements of ordinary creditors in full, section 49(g) of the Companies Law would, as already noted, come into play so as to disentitle the past or present shareholder claimants from asserting a statutory interest claim. Solvent liquidations are classically quick and quiet affairs in which the right to claim statutory interest would be equally unlikely to arise. Section 126 of the Companies Law requires a voluntary liquidator to convene a general meeting of the company where the liquidation lasts for longer than a year. As I observed in the course of the hearing, the local funds industry seems to have generated large and complex winding-up proceedings where the largest creditors are former shareholders. This distinctive commercial context may well have generated a unique set of insolvency law problems. The present liquidation is a case in point, where the liquidation began (as of August, 2013) as one of "*doubtful solvency*" but has largely (since February 6, 2014) been administered on a solvent basis. It was ultimately unremarkable that direct authority on the present statutory interest point could not be found.

73. Mr Atherton QC was forced to rely on very indirect authority indeed, such as the following passage in Roy Goode's '*Principles of Corporate Insolvency Law*' (at paragraph 8.26):

> "*Any surplus remaining after the payments of debts proved in a winding up must first be applied in payment of post-liquidation interest, all post-liquidation interest claims ranking pari passu. All such claims rank ahead of deferred debts.*"

74. As Mr Smith QC rightly responded, this passage is not concerned with the entitlement to statutory interest as it relates to deferred creditors at all. To the extent that the text is mainly (if not exclusively) concerned with insolvency law (as opposed to liquidation or winding-up law in the broader sense), in my judgment no need to consider a statutory interest claim on the part of the holders of deferred claims arises. The same applies to the list of priorities at paragraph 13-027 in '*McPherson's Law of Company Liquidation*', 4th Edition (which it was common ground was partially incorrect[9]). The fact that "*post-liquidation interest*" is correctly listed above "*deferred/postponed creditors*" comes nowhere near to an explicit or reasoned assertion that statutory interest cannot be claimed by such creditors. Rather, it represents the learned author's failure to deal with a point which was, understandably one might think, considered to be a non-issue.

[9] Postponed/deferred creditors were listed before rather than after "*non-provable liabilities*".

75. How one compiles a list of priorities in any event clearly depends on the circumstances of the case which will inform what classes of claim need to be identified and placed in appropriate order in the list. As Lord Neuberger observed in *In re Lehman Brothers International (Europe) (in Administration)* [2017] UKSC 38:

> "*17. I summarised the priorities in relation to such payments by a liquidator or a distributing administrator in the following terms in In re Nortel GmbH [2014] AC 209, para 39:*
>
> > *'In a liquidation of a company and in an administration (where there is no question of trying to save the company or its business), the effect of insolvency legislation ..., as interpreted and extended by the courts, is that the order of priority for payment out of the company's assets is, in summary terms, as follows:*
> >
> > *(1) Fixed charge creditors;*
> > *(2) Expenses of the insolvency proceedings;*
> > *(3) Preferential creditors;*
> > *(4) Floating charge creditors;*
> > *(5) Unsecured provable debts;*
> > *(6) Statutory interest;*
> > *(7) Non-provable liabilities; and*
> > *(8) Shareholders."*
>
> *This description of what is known as the waterfall is a generalised summary of the distribution priorities in an insolvency. It was not intended to be treated as some sort of quasi-statutory statement of immutable legal principle, and it would have been better if I had said so at the time.*" [Emphasis added]

76. In that case, unlike in this case, the question of whether or not a deferred creditor could claim statutory interest out of a surplus did not arise. That case involved an insolvent "*distributing administration*" (paragraph 4). The "waterfall" described in paragraph 17 of the judgment in *Lehman* was relevant to the question of the ranking of a subordinated lender, which had a claim which was competing against other creditor claims. In the present case it is agreed that deferred claims such as those asserted by the Redemption Creditors in effect fall into a new penultimate class 8 (or 7A). It is also agreed that each of classes

(1) to (7) in Lord Neuberger's priority list have been actually or notionally paid in full and that there is a surplus in the present case.

77. In my judgment that general list of priorities (informed by the context of an insolvent proceeding) can conveniently be collapsed for the purposes of the present case, there being no competition between the various creditor classes. There are in reality only two categories of claimants competing over the distribution of that surplus: (1) Redemption Creditors; and (2) shareholders. This is reflected in the terms of the First Representation Order and in the representation order which forms part of the June 21, 2018 Consent Order. The Additional Liquidator's contention that the Redemption Creditors should rank as ordinary members (and not as creditors) has already been rejected at two local Court levels and by the Privy Council. As Lord Mance crucially concluded in *Pearson-v-Primeo Fund* [2017] UKPC 19:

> "*22... Primeo and the December and KYC Redeemers have redeemed and are entitled to prove in respect of their claims to the redemption proceeds under section 139(1), though they are, as former members, subject to having their claims deferred under section 49(g) to those claims of other ordinary creditors.*"

78. The Privy Council's finding does not of course directly dispose of the present issue. But it indirectly becomes dispositive once one concludes that the right to claim statutory interest enures to the benefit of any creditor entitled to prove in the liquidation. For the above reasons I find that the Redemption Creditors' claims are potentially eligible for statutory interest under section 149 of the Companies Law, assuming they meet the requirement in subsection (1) that their claims should be "*proved in the winding up*".

Findings: have the Redemption Creditors' claims been "*proved in the winding up*"?

79. In the Written Submissions of the Additional Liquidator, the following secondary arguments were advanced in case the primary argument that section 149 of the Companies did not even potentially apply was rejected:

"21. Herald is in solvent liquidation and therefore the Joint Official Liquidators ("JOLs") may (but are not obliged to) require creditors to submit a proof of debt (see Order 16, rule 1(3) of the CWR).

22. If no proofs of debt are required (because there is no doubt or dispute as to the existence or amount of a debt (order 6, rule 1(3) of the CWR)) and the debts of the company are paid by the JOLs in the 'ordinary course', pursuant to Order 16, rule 1(1) of the CWR, there can be no basis upon which statutory interest can be applied to such claims, notwithstanding that the Privy Council characterised the claims of the Redeeming Creditors as being 'provable'. As noted above, in the present case (as set out in the Agreed Statement of Facts and as is apparent from the relevant documents), there has been no proof of debt submitted by the Redemption Creditors to prove their claim for the purposes of receiving a distribution)."

80. This argument focuses on the fact that section 149 of the Companies Law clearly only confers an entitlement to statutory interest in respect of, "*any debt proved in the winding up*" (subsection (1) as read with subsection (3)). The Additional Liquidator contended for a strict construction of this term while in Primeo's Skeleton Argument, a robust response to this argument was advanced (not forgetting that it was representing Redemption Creditors who may not (unlike Primeo itself) have filed formal proofs):

"53....the claims of Redemption creditors have been admitted or proved within the meaning of section 149(1). It is a point of utmost technicality and wholly devoid of merit to say that...where the Liquidators have sought to dispense with formal proofs because there is no need for proofs given the debts are already established, to deprive Redemption Creditors of statutory interest on the ostensible grounds that such debts have not been 'proved'."

81. Embedded in this concise but cogent submission was an important point which was given further weight by Mr Smith QC in oral argument. He noted that insolvency law has always adopted a practical approach. It made no sense to construe section 149 of the Companies Law as requiring formal proof of undisputed debts in order to qualify for statutory interest,

where such proof would serve no useful commercial purpose. This was an irresistible submission.

82. As a Cayman Islands insolvency law initiate, I draw succour from the fact that the local insolvency code is at its heart derived from now ancient English statutory insolvency law principles, principles which are recognised across the common law world. A fundamental goal of the statutory code, as noted above, is to minimize the costs of the liquidation process and maximize the returns to creditors and (if possible) shareholders as well. There is in substance no difference between an 'admitted' debt and a 'proved' debt. Although authority should not be needed for this proposition, the point is illustrated quite clearly by the language used by David Richards J (as he then was) in *In re Lehman Brothers International (Europe)* [2015] EWHC 2269 (Ch), in a passage upon which Primeo expressly relied:

> "*207. The purpose of rule 2.88(7), as earlier discussed in this judgment, is to provide for interest to be paid to all creditors, irrespective of whether they had any entitlement to interest apart from the administration. What they are being compensated for by the payment of interest under rule 2.88(7) is the delay since the commencement of the administration in the payment of their admitted 'debts', as ascertained or estimated in accordance with the legislation.*" [Emphasis added]

83. It is noteworthy that the judge used the term "*admitted 'debts'*" in discussing an English rule which, similar to section 149 of the Companies Law, confers a right to statutory interest on "*proved debts*". That suggests that the terms 'admitted' and 'proved' are synonymous in 'insolvency-speak'. More pertinently still, this is the language of the local rules, even though it finds expression only in the formal proof of debt context. Order 16 rule 6 of the CWR ("*Admission and Rejection of Proof*") as read with CWR Form 25 envisages that where a claim has been successfully proved, the liquidator will send the creditor a "*NOTICE OF ADMISSION OF PROOF OF DEBT FORM*". It is accordingly helpful to consider what proven or admitted debt actually means in a wider context.

84. A debt may be proved or admitted (or indeed established) in a variety of ways, only one of which is through a formal proof of debt. Another way is through litigation resulting in a judgment or a compromise, if the litigation stay is lifted (typically likely only in relation to proprietary claims). Yet another way is where it is clear on the face of the company's own records that valid claims exist which cannot sensibly be disputed and which accordingly

require no formal proof. In a solvent liquidation, the CWR expressly contemplate that a liquidator has the discretion as to whether or not to require formal proofs (Order 16 rule 1(1) of the CWR). That rule, somewhat narrowly expressed, perhaps primarily contemplates a standard solvent voluntary liquidation because it speaks of the payment of debts in the "ordinary course". The present liquidation was clearly not (to that extent) entirely an Order 16 rule 1(1) CWR case.

85. The Companies Law, which the CWR only purport to give effect to, not to supersede, is a flexible and practical beast. Even in an insolvent liquidation, or in a solvent liquidation where debts are not paid in the ordinary course of business, it must be possible for this Court to sanction the decision of liquidators to dispense with proofs of debt on the grounds of economy. As noted above, liquidators are empowered by Schedule 3 to the Companies Law "*to deal with all questions in any way relating to or affecting the assets or the winding up of the company*", with this Court's sanction. Pursuant to this statutory power the Liquidators in the present case dispensed with the requirement for proofs of debt to be filed. This was done, to my mind (Jones J having granted the dispensation), on the express basis that the debts had been sufficiently proved so that formal proofs were not required.

86. In my judgment the narrow construction contended for by the Additional Liquidator of the words "*proved in the winding up*" is wholly unsustainable having regard to the policy function of section 149 of the Companies Law and the technical meaning of the word "proved" in the statutory insolvency code as a whole. "Proved" essentially means established through whatever legally recognised process the liquidator (subject to this Court's supervision in doubtful cases) deems appropriate having regard to the nature and merits of the relevant claim, not forgetting the interests of the liquidation as a whole.

87. In summary, I find that the Redemption Creditors' admitted claims have been proved for the purposes of section 149 of the Companies Law.

Findings: Ex parte James

88. Primeo contends that the Additional Liquidator should be disentitled from relying on the point if, contrary to my above findings, the Order dispensing with the requirement for formal proofs extinguished the Redemption Creditors' statutory interest claims. The Additional Liquidator contends that the doctrine in *Ex parte James* does not apply to the present facts.

89. Primeo relied on the following passage from *In Re Lehman Brothers International (Europe)* [2015] EWHC 2270 (Ch), at paragraph 183:

> "*183. I take it that unfairness is a sufficient ground for the application of the principle in Ex parte James if the court thinks that, in all the circumstances, it is right to apply the principle. This is not a surprising development. While in some of the earlier cases the judges refer to the difficulty in applying the principle in Ex parte James because it involved moral rather than legal judgments, unfairness as a substantive legal concept is now well embedded in our law. It is directly applicable to the conduct of administrators, by virtue of paragraph 74 to which I refer below. What constitutes unfairness will, just like what constitutes dishonourable conduct, depend on the circumstances of the case.*"

90. David Richards J found that it was unfair for the administrators to pursue a certain construction of agreements after taking into account "[a]*ll of the background circumstances*" (paragraph 184). I have not been fully addressed on the precise circumstances in which the dispensation was obtained and would likely have to invite further written submissions (and possibly further evidence) on the issue. This would be wasteful of costs all round. The one point which it seems to me is common ground is that the November 7, 2017 Jones J Order was not consciously intended to abrogate the Redemption Creditors' statutory interest rights. In those circumstances Mr Atherton QC may well be right that, assuming the Additional Liquidator identified the point in preparing for the present hearing, relying on the point now would not amount to unfairness on the *Ex parte James* scale.

91. I decline to deal with this difficult issue which in the result only arises as a potential alternative finding. For case management reasons grounded in the goal of efficiency, I would deal with the matter on a more pragmatic basis.

92. If I was required by law to find that formal proofs were in fact required to enable the Redemption Creditors as a class to qualify for statutory interest under section 149 of the Companies Law, I would merely direct that the Liquidators and/or the Redemption Creditors have liberty to apply to vary the November 7, 2017 Order to set aside the dispensation aspects of the Order. It is difficult to imagine that any reasonable insolvency court properly directing itself would consciously deprive the Redemption Creditors of a

statutory right by an accidental procedural side-wind. If it were necessary to file formal proofs of debt, I would in the exercise of my discretionary case management powers afford the Redemption Creditors an opportunity to do so.

93. The scheme of the current CWR (Order 11) now requires express consideration to be given as to whether sanction applications should be heard on an *ex parte* or *inter partes* basis. If this is an entirely new rule, it is surely only making explicit pre-existing common law principles on how *ex parte* applications should be heard. Had the Liquidators adverted to this point before seeking the Court's sanction, whether or not these rules applied, whether or not the Court should deprive the Redemption Creditors of their right to interest should have been argued at a fully contested hearing.

94. I should add that it seems quite obvious to me that the Liquidators did not attempt to steal a march on the Redemption Creditors. They are officers of the Court. The "*not proved*" argument appeared to me to be a 'makeweight' argument which was added like a garnish to the main dish: the contention that postponed claims could not as a matter of principle qualify for statutory interest at all.

Findings: has Primeo proved?

95. If I was required to decide this issue, I would have summarily concluded that Primeo had formally proved its claim. It filed a proof of debt which has never been rejected and which has been substantially admitted. It is in my experience standard liquidation practice for liquidators to subsequently rely substantively on proofs of debts filed in the first instance for voting purposes only. Meeting reports typically record that proofs were accepted for voting purposes only. Whether fresh proofs or supplementary proofs are required will be determined by the liquidator on a claim by claim basis. But on the agreed facts of the present case it cannot credibly be suggested that, if a formal proof was required to qualify for statutory interest, Primeo has not filed a formal proof.

96. It is in any event wholly at odds with the practical and commercially-driven spirit of insolvency law to hold that a creditor who has filed a proof of debt which the liquidator has expressly admitted and paid (whether in whole or in part) has not "proved " the admitted debt. This finding could only be on the basis that, in effect, the Liquidators never sent a Notice of Admission of Proof of Debt Form. That is what the Additional Liquidator's residual argument against Primeo would amount to if the Additional

Liquidator succeeded in establishing that a formal proof was required to support a statutory interest claim.

Summary

97. The issue directed to be tried by the Consent Order dated June 21, 2018 which arose under the Additional Liquidator's April 6, 2018 Summons is resolved in the following way. Interest is payable pursuant to section 149(2) of the Companies Law (2018 Revision) on the claims of:

(a) former shareholders of the Company arising from redemption requests submitted to the Company for the Redemption Day 1 December 2008 and which were redeemed on 1 December 2008 but in respect of which redemption monies were not paid prior to the commencement of the Company's liquidation (the 'December Redeemers'); and/or

(b) former shareholders of the Company who redeemed their shares before 1 December 2008 but in respect of which redemption monies were not paid prior to the commencement of the liquidation because the Company was awaiting proof of entitlement (the 'KYC Redeemers' and together with the December Redeemers, the 'Redemption Creditors').

98. The right to statutory interest out of a surplus available under section 149 of the Companies Law in respect of proved claims potentially applies to all creditor claims, including those 'shareholder claims' which would in the event of competition be postponed in favour of ordinary creditor claims by section 49(g) of the Companies Law. The Redemption Creditors' claim to statutory interest is not defeated because the need to file proofs of debt has been dispensed with. The claims have in law been proved by virtue of their being admitted.

99. I will hear counsel if required as to costs.

IAN RC KAWALEY
JUDGE OF THE GRAND COURT

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