Michaelmas Term
[2009] UKSC 2
On appeal from: **[2008] EWCA Civ 1303**

JUDGMENT

In Re Sigma Finance Corporation (in administrative receivership) *and* In Re The Insolvency Act 1986 (Conjoined Appeals)

before

Lord Hope, Deputy President
Lord Scott
Lord Walker
Lord Mance
Lord Collins

JUDGMENT GIVEN ON

29 October 2009

Heard on 1 and 2 July 2009

Appellant: B
Richard Sheldon QC
Felicity Toube
(Instructed by Dechert LLP)

Respondent: A
Mark Howard QC
Jonathan Dawid
(Instructed by Mayer Brown (International) LLP)

Appellant: C
Simon Mortimore QC
Daniel Bayfield
(Instructed by Jones Day LLP)

Security Trustee
James Potts
(Instructed by Allen & Overy LLP)

Appellant: D
Sue Prevezer QC
Edmund King
(Instructed by Quinn Emanuel Urquhart Oliver and Hedges LLP)

Administrative Receiver
Gabriel Moss QC
Barry Isaacs
(Instructed by Lovells LLP)

LORD MANCE (with whom Lords Hope, Scott and Collins concur)

Introduction

1. Sigma Finance Corporation ("Sigma") and those who invested in it are victims of the current financial crisis. Sigma is a structured investment vehicle, whose business involved acquiring asset-backed securities and other instruments, using funds raised by issuing or guaranteeing US dollar and Euro medium term notes (MTNs) as well as liquidity from other sources, such as facilities, derivatives, repurchase (or "repo") contracts and capital notes (the last two categories representing its unsecured creditors). All of Sigma's assets are secured in favour of its secured creditors upon the terms of a Security Trust Deed (STD), dated 27 March 2003, made between Sigma as issuer and Deutsche Trustee Company Limited ("Deutsche Trustee") as security trustee and governed by English law.

2. The financial crisis affected the value and liquidity of Sigma's assets, as well as its ability to issue notes and raise funds to cover its obligations under previously issued notes and instruments as they matured from time to time. As a result, it began to resort to selling assets, either outright or under repo agreements. The latter involved Sigma in further potential liability to meet margin calls, if and when the value of the assets sold and agreed to be repurchased at some future date fell below a certain level. In September 2008, Sigma received margin calls which it did not honour. On 30 September 2008, its board resolved that it could no longer continue in business, and on 1 October 2008 Sigma wrote informing Deutsche Trustee as security trustee that it had resolved that there was "no reasonable likelihood of Sigma avoiding an insolvent liquidation" and that there had been non-payment of interest due on 30 September 2008 constituting a "Potential Enforcement Event" for the purposes of the Security Trust Deed. On 2 October 2008 one of Sigma's liquidity providers gave notice of an event of default under its facility agreement. In consequence, an actual "Enforcement Event" occurred and the floating charge created under clause 4.1 of the Security Trust Deed crystallised on that date, and the liquidity facility was also cancelled. On 6 October 2008 the Security Trustee appointed Receivers under clause 14.1 of the Deed, and directed them to comply with clauses 7.6 to 7.9 of the Deed as if references in those clauses to the Security Trustee were references to the Receivers.

3. Under the Security Trust Deed, the occurrence of an Enforcement Event started a 60-day "Realisation Period", and triggered an obligation on the Trustee to use its reasonable endeavours to establish by the end of that period a Short Term Pool (for Short Term Liabilities, defined by clause 1 to cover "outstanding payment obligations … which are due

and payable or which have scheduled maturity or payment dates falling less than 365 days from the Enforcement Date"), as well as a number of Long Term Pools (for "any liabilities …. which are not Short Term Liabilities") and a Residual Equity Pool. Following realisation of its remaining portfolio in December 2008 after the Court of Appeal had given judgment and refused a further stay, Sigma's assets consist of cash of no more than around US$450m.

4. Sigma's unpaid secured liabilities are estimated to total around US$6.2bn. They include (a) about US$900,000, representing coupon payments on notes which fell due on 30 September and 1 October 2008, (b) about US$1.350bn, representing principal and coupon payments on notes which fell due during the Realisation Period, (c) about US$3.134bn, representing principal on notes constituting Short Term Liabilities falling due between 30 November (i.e. after the end of the Realisation Period) and 1 October 2009 and (d) about US$1.511bn, representing principal on notes constituting Long Term Liabilities falling due after 2 October 2009. As is evident, Sigma's remaining assets fall far short of the liabilities included in (a) and (b), or in (b) alone.

5. The issue on these appeals is how Sigma's remaining assets are to be distributed. This is an issue of construction of the Security Trust Deed. Secured creditors are under the terms of their notes precluded from seeking to wind up Sigma, and the Security Trust Deed defines their contractual rights against Sigma and in respect of its assets. Four interested creditors have advanced various possibilities. Interested parties A and B submit that the assets fall to be distributed preferentially to the creditors in respect of the debts identified in (b), or in (a) and (b). Assuming that to be right, they differ between themselves as to priority. Mr Howard QC representing interested party A submits that the assets are to be distributed according to the dates when the relevant debts became due, while Mr Sheldon QC representing interested party B submits that all debts falling due in (or prior to) the Realisation Period are part of a single pool, within which Sigma's remaining assets fall to be distributed *pari passu*. Mr Mortimore QC representing interested party C and Miss Prevezer QC representing interested party D maintain, first, that Sigma's remaining assets fall to be allocated equitably as between Short and Long Term Liabilities, and, secondly, that, having been so allocated, its Short Term Liabilities identified in (a), (b) and (c) fall in effect to be distributed *pari passu* in relation to each other, and that its Long Term Liabilities identified in (d) fall to be treated likewise in relation to each other.

6. Sales J and, by a majority, the Court of Appeal accepted the case advanced by Mr Howard for interested party A. Lord Neuberger

dissented, concluding that the case advanced by interested parties C and D was generally correct, but with the refinement that creditors with debts falling due in the Realisation Period were entitled to be paid within that period such amount as the Trustee was confident would ultimately be paid to them out of the Short Term Pool, with any balance due being paid later from that Pool. Against the decision of the majority, these appeals are brought by leave of the House of Lords.

The Security Trust Deed

7. The appeals turn ultimately on the meaning given to the final sentence of clause 7.6 of the Deed. But this needs to be set in its context. Clause 7 is long and detailed, and provides inter alia:

"**7. ENFORCEMENT**

7.1 The Security Trustee shall be entitled to enforce the Security on and from the Enforcement Date only in accordance with this Clause notwithstanding any contrary instruction or direction from any Beneficiary or any other person. The Security Trustee shall not exercise any of its powers under this Clause until the Enforcement Date.

7.2 Without prejudice to any rule of law which may have a similar effect, the floating charge constituted by Clause 4.1.2 shall on the Enforcement Date automatically be converted with immediate effect into a fixed charge as regards the assets subject to such floating charge and without notice from the Security Trustee to the Issuer.

7.3 On the Enforcement Date or as soon thereafter as can practicably be arranged the Security Trustee shall (to the extent that the relevant Liquidity Facility has not been cancelled by the relevant Liquidity Provider) on behalf of, and as attorney for, the Issuer draw Advances under each Liquidity Facility up to the Available Amount and shall specify repayment dates (except in the case of Swing-line Advances) for such Advances falling after the Realisation Period. If the Issuer has Committed Liquidity (as defined in the IMC) and more than one Liquidity Facility, the Security Trustee shall ensure that, as between Liquidity Facilities, any drawings are made *pro rata* to the aggregate available commitments under such Liquidity Facilities. Advances drawn shall be used in order (i) to discharge the Issuer's obligations to pay sums due and owing to Beneficiaries in accordance with the relevant Beneficiaries' Documents and (ii) to effect replaying of any Advance made

under a Liquidity Facility. If and to the extent that all or any part of the Advances drawn down are not immediately required by the Security Trustee for the purposes of (i) or (ii) above, the Security Trustee shall deposit the unutilised portion(s) of such Advances on a call basis with any bank or financial institution whose short-term unsecured, unguaranteed and unsubordinated debt is rated A-1 by S&P, P-1 by Moody's and F1 by Fitch or shall invest such portion(s) in certificates of deposit, United States or United Kingdom government securities or commercial paper rated A-1 + by S&P and P-1 by Moody's.

7.4 If the Security Trustee applies an Advance (or part thereof) to discharge any of the Issuer's Short Term Liabilities because of the default, late payment or non-performance of any Asset in the Short Term Pool (a "non-performing asset") any monies subsequently recovered or received in respect of such non-performing asset shall be applied by the Security Trustee in repayment (or part payment) of such Advance before being applied pursuant to the trust declared in Clause 7.11.2.

….

7.6 The Security Trustee shall use its reasonable endeavours (and in doing so may rely upon the advice of any investment or other advisers as it shall in its absolute discretion consider appropriate and shall not be responsible for any loss which results from such reliance) to establish by the end of the Realisation Period a Short Term Pool, a number of Long Term Pools (one in relation to each Series of EMTNs each Series of ADMTNs and each Series of USMTNs, and one in relation to each other group of Long Term Liabilities having the same payment and/or maturity dates), and a Residual Equity Pool. In order to establish such Pools, the Security Trustee shall during Realisation Period (but not thereafter) realise, dispose of or otherwise deal with the Assets in such manner as, in its absolute discretion, it deems appropriate. During the Realisation Period the Security Trustee shall so far as possible discharge on the due dates therefor any Short Term Liabilities falling due for payment during such period, using cash or other realisable or maturing Assets of the Issuer.

7.7 The Security Trustee shall use its reasonable endeavours (and in doing so may rely upon the advice of any investment or other advisers as it shall in its absolute discretion consider appropriate and shall not be responsible for any loss which results from such reliance) to ensure that at the time the Short Term Pool and each Long Term Pool is established (1)

the aggregate principal amount of the Assets allocated to each such Pool is equal to the aggregate principal amount of the liabilities to which such Pool has been allocated, (2) the Assets allocated to each such Pool have maturity and payment dates corresponding to the relevant liabilities and (3) payments, recoveries and receipts in respect of the Assets allocated to each such Pool are scheduled to be made or received in the currency in which the relevant liabilities are denominated and (4) the aggregate principal value of Assets rated AA/Aa or lower (or if the Asset has a short-term rating, A-1 + or lower) issued or guaranteed by any one single body corporate or sovereign or by separate bodies corporate which are members of the same group does not exceed an amount equal to 50% of the Residual Equity Pool Stake attributable to such Short Term Pool or, as the case may be, Long Term Pool and (5) the aggregate principal value of Assets rated A (or if the Asset has a short term rating, A-1/P-1) issued or guaranteed by any one single body corporate or sovereign or by separate bodies corporate which are members of the same group does not exceed an amount equal to 50% of the Residual Equity Pool Stake attributable to the Issuer's Short Term Liabilities or, as the case may be, those of its Long Term Liabilities in relation to which a Long Term Pool is established. The Security Trustee shall also use its reasonable endeavours to ensure that the credit quality by rating category and percentage of Assets comprising the Short Term Pool and each Long Term Pool is the same or better than the following:

Long Term Rating Principal	**Short Term Rating**	**Percentage by Value of Short Term/ Long Term Pool**
AAA (S&P)/Aaa	-	Minimum 20%
AA (S&P)/Aa	A-1 + (S&P)	Minimum 50%
A	A-1/P-1	Maximum 30%

7.8 Subject to Clause 7.7, it is a matter for the Security Trustee's absolute discretion which Assets are allocated to

which Pool and no liability shall attach to the Security Trustee if its allocation of Assets between Pools proves to be unfavourable or disadvantageous to any person. *Provided that* the Security Trustee uses its reasonable endeavours as provided in Clause 7.7, no liability shall attach to the Security Trustee if the purpose for which such endeavours were to be made fails to be realised and the Security Trustee shall be under no liability to any Beneficiary if the Assets allocated to any Pool are insufficient to meet the liabilities of the Issuer to which such Pool related in full or in a timely manner, notwithstanding that the claim of any other Beneficiary shall have been discharged in full. For the avoidance of doubt, the Security Trustee shall not be obliged to ensure that each Pool complies with the criteria set out in the Second Schedule to the IMC. Subject to the above and to Clause 7.7, the Security Trustee (i) shall have no regard to the credit quality of each Asset when establishing the Short Term and Long Term Pools and when determining which Assets should be allocated to which Pool and (ii) shall not be concerned with the ultimate composition of each of the Short Term Pool and Long Term Pools with regard to the concentration of assets by rating category nor to the spread across the Pools of Assets of any given rating category.

7.9 If the principal amount of the Assets is less than the principal amount of the Issuer's Total Indebtedness, the Security Trustee shall calculate the proportion borne by the deficit to the Issuer's Total Indebtedness and shall reduce the principal amount of the Assets allocable to the Short Term Pool and each Long Term Pool accordingly.

….

7.11 Subject to Clause 7.4, all payments, recoveries or receipts in respect of Assets in the Short Term Pool shall be held by the Security Trustee on trust and shall be applied in accordance with the following priority of payments:

7.11.1 *first*, to pay the Relevant Proportion of the remuneration payable to the Security Trustee pursuant to this Deed and of any amount due in respect of costs, charges, liabilities and expenses incurred by the Security Trustee or a Receiver appointed by it

(and for the purposes of this sub-clause the "Relevant Proportion" shall be the principal amount of the Issuer's Short Term Liabilities divided by the Issuer's Total Indebtedness,

both such amounts to be determined on the last day of the Realisation Period);

7.11.2 *second*, to pay when due or as soon thereafter as can practicably be arranged all principal, interest or other amounts in respect of the Issuer's Short Term Liabilities to Beneficiaries (*pro rata* to the respective amounts of the Short Term Liabilities due, owing or incurred to each Beneficiary); and

7.11.3 *third*, in accordance with the provisions of Clause 7.13

Provided that (in respect of 7.11.2 above):

(a) if at any time after the Realisation Period the Security Trustee reasonably believes that payments, recoveries and receipts in respect of Assets allocated to the Short Term Pool will be insufficient to meet the Issuer's Short Term Liabilities, the Security Trustee shall calculate the proportion of the Short Term Liabilities which, in its reasonable opinion, can be met and shall pay only that proportion of any amounts due in respect of the Issuer's Short Term Liabilities to any Beneficiary; and

(b) if at the time a payment is proposed to be made to a Beneficiary pursuant to this Clause such Beneficiary is in default under any of its obligations to make a payment to the Issuer pursuant to any Beneficiaries' Document (the "**defaulted payment**") the amount of the payment which shall be made to such Beneficiary shall be reduced by an amount equal to the amount of the defaulted payment. Any amount so withheld shall be paid to the relevant Beneficiary as and when (and *pro rata* to the extent that) the defaulted payment is duly paid by that Beneficiary.

7.12 Subject to Clause 7.5, all payments, recoveries or receipts in respect of Assets in the Long Term Pool shall be held by the Security Trustee on trust and shall be applied in accordance with the following priority of payments: *[There follow provisions largely similar to those of clause 7.11, relating to the Short Term Pool]*

Clause 17 further provides:

…..

17 **GENERAL SECURITY TRUSTEE PROVISIONS**.

…

> 17.3 The Security Trustee (save as expressly provided otherwise herein) as regards all the trusts, powers, authorities and discretions vested in it by these presents or by operation of law, have absolute and uncontrolled discretion as to the exercise or non-exercise thereof …..
> …..
> 17.5 The Security Trustee as between itself and the other Beneficiaries shall have full power to determine all questions and doubts arising in relation to any of the provisions of these presents and every such determination, whether made upon a question actually raised or implied in the acts or proceedings of the Security Trustee, shall be conclusive and shall bind the Security Trustee and the other Beneficiaries."

8. The scheme of the Security Trust Deed is thus that, upon the occurrence of an Enforcement Event, there will be a Realisation Period of up to 60 days, to enable the Security Trustee to establish the relevant Pools using Sigma's Assets. "Assets" are defined in clause 1 in the widest possible terms, including, in a final sub-clause, "all other rights, benefits, property, assets and undertaking … whatsoever and wheresoever situate". The Short and Long Term Pools are under clauses 7.7 and 7.8 to be structured with a view to matching the principal amount of Sigma's short and long term liabilities with high quality rated assets in corresponding principal amounts and with corresponding maturity and payment dates. If that is not possible, because the principal amount of Sigma's Assets is less than that of its Total Indebtedness, then, under clause 7.9, the Trustee is to calculate the proportionate deficit, and reduce the principal amount of Assets allocable to each Pool accordingly. Once the Pools have been set up, then, under clauses 7.11 and 7.12, each Pool is to operate separately, but within each Pool, if it later appears that the Assets allocated to that Pool will be insufficient to meet the Pool's liabilities, the Trustee is to calculate and pay to any creditor only that proportion which can, in its reasonable opinion, be met. Under clause 17.3 and 17.5, the Trustee is given the broadest discretion and powers. It is in the context of this scheme that it is necessary to read and understand the provision in the third and last sentence of clause 7.6, that

> "During the Realisation Period the Security Trustee shall so far as possible discharge on the due dates therefor any Short Term Liabilities falling due for payment during such period, using cash or other realisable or maturing Assets of the Issuer."

The Law

9. The principles upon which a court should interpret a document such as the present are not in doubt. They have been reviewed and restated by the House of Lords in a series of cases: *Charter Reinsurance Co. Ltd. v Fagan* [1997] AC 313, *Mannai Investment Co. Ltd. v Eagle Star Life Assurance Co. Ltd.* [1997] AC 749, *Investors Compensation Scheme Ltd. v West Bromwich Building Society* [1998] 1 WLR 896 and *Chartbrook Ltd. v Persimmon Homes Ltd.* [2009] UKHL 38. In *Charter Reinsurance* Lord Mustill underlined the danger of focusing too narrowly on a critical phrase (in that case, a phrase defining the term "net loss" as meaning "the sum actually paid by the Reinsured in settlement of claims"), saying (at p.384G-H) that:

> "This is …. an occasion when a first impression and simple answer no longer seem the best, for I recognise that the focus of the argument is too narrow. The words must be set in the landscape of the instrument as a whole. Once this is done the shape of the policy and the purpose of the terms … become quite clear"

Adopting that approach, the House concluded that the words "actually paid" were in context intended not to introduce a pre-condition of pre-payment by the insurer to the original insured, but to ensure that the reinsurers' liability was measured precisely by reference to any settlement of liability as between the insurer and insured. Later (at p.387D) Lord Mustill said that the principle that the liability of a reinsurer is wholly unaffected by whether the insurer has in fact satisfied the claim under the inward insurance is one which

> "can undoubtedly be changed by express provision, but clear words would be required; and it would to my mind be strange if a term changing so fundamentally the financial structure of the relationship were to be buried in a provision such as clause 2, concerned essentially with the measure of indemnity, rather than being given a prominent position on its own"

10. In *Investors Compensation Scheme* at pp.912G-913F, Lord Hoffmann summarised the development of the principles of contractual interpretation in this well-known passage:

“The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual baggage of "legal" interpretation has been discarded. The principles may be summarised as follows:

(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(2) The background was famously referred to by Lord Wilberforce as the "matrix of fact," but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the

> reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax. (see *Mannai Investments Co. Ltd. v. Eagle Star Life Assurance Co. Ltd.* [1997] AC 749).
>
> (5) The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *The Antaios Compania Neviera S.A. v. Salen Rederierna A.B.* [1985] A.C. 191, 201:
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> ". . . if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense."

In the present case the focus is on the general nature of the business involved – apparent from the document itself – and upon the scheme and wording of the Security Trust Deed read as a whole. As in *Miramar Maritime Corporation v Holborn Oil Trading Ltd* [1984] 1 AC 676 (per Lord Diplock at p 682A-F), so here the document is one which would be expected to have a consistent meaning as between all parties to whom it applied. I therefore also agree with Lord Collins' supplementary remarks on the approach to interpretation.

11. I pay tribute to the speed with which the courts below have addressed the issue, and the meticulous attention which they have given it. Ultimately, Sales J and the majority in the Court of Appeal were persuaded in favour of interested party A's case by the consideration that the last sentence of clause 7.6 had a clear natural meaning, and that there was nothing in its language (particularly in the phrase "so far as possible") to affect the operation of that meaning in the circumstances which arose. The Trustee's obligation during the Realisation Period was to continue to discharge Sigma's debts as and when they fell due, so

long and so far as such payment was possible using cash or other realisable or maturing Assets; and the reference to such debts being discharged "on the due dates therefor" was inconsistent with party B's argument in favour of pari passu distribution of available assets between creditors whose debts fell due during the Realisation Period.

Analysis

12. In my opinion, the conclusion reached below attaches too much weight to what the courts perceived as the natural meaning of the words of the third sentence of clause 7.6, and too little weight to the context in which that sentence appears and to the scheme of the Security Trust Deed as a whole. Lord Neuberger was right to observe that the resolution of an issue of interpretation in a case like the present is an iterative process, involving "checking each of the rival meanings against other provisions of the document and investigating its commercial consequences" (para. 98, and also 115 and 131). Like him, I also think that caution is appropriate about the weight capable of being placed on the consideration that this was a long and carefully drafted document, containing sentences or phrases which it can, with hindsight, be seen could have been made clearer, had the meaning now sought to be attached to them been specifically in mind (paras. 100-1). Even the most skilled drafters sometimes fail to see the wood for the trees, and the present document on any view contains certain infelicities, as those in the majority below acknowledged (Sales J, paras. 37-40, Lloyd LJ, paras. 44, 49-52 and 53, and Rimer LJ para. 90). Of much greater importance in my view, in the ascertainment of the meaning that the Deed would convey to a reasonable person with the relevant background knowledge, is an understanding of its overall scheme and a reading of its individual sentences and phrases which places them in the context of that overall scheme. Ultimately, that is where I differ from the conclusion reached by the courts below. In my opinion, their conclusion elevates a subsidiary provision for the interim discharge of debts "so far as possible" to a level of pre-dominance which it was not designed to have in a context where, if given that pre-dominance, it conflicts with the basic scheme of the Deed.

13. The starting point is that the occurrence of an Enforcement Event is not necessarily to be equated with insolvency, still less insufficiency of assets to meet all secured liabilities. On the contrary, and this is I think a point with a relevance which does not emerge from the judgments below, clauses 7.3 to 7.8 are all drafted on the assumption of a situation in which Sigma has enough assets to cover at least its secured creditors. The detailed provisions in clause 7.3 and 7.4 for drawing down on any relevant Liquidity Facility can have little or very limited

application in any situation where Sigma lacked funds to cover such creditors, since in such a situation any liquidity provider would be expected to cancel any relevant facility (as happened in this case: see para. 12 above). The provisions of clauses 7.7 and 7.8 contemplate that there will be sufficient assets to create matching Pools of assets of high rating quality and liabilities. Only in clause 7.9 does the Deed turn to and address the possibility of a shortfall in the principal amount of the Assets needed to cover Sigma's liabilities.

14. The provision by clause 7.6 for discharge of Short Term Liabilities as they fall due thus appears in a context where the underlying assumption is that all secured liabilities can be covered and no issue of priority can arise. To treat it, in the different context of insolvency, as creating effective priority for such Short Term Liabilities as may happen to fall due during the Realisation Period may, therefore, involve a similar risk to that identified by Lord Mustill in *Charter Re* - that of giving to a sentence, buried in a provision like clause 7.6 concerned essentially with a different situation, the effect of changing fundamentally the apparent financial structure of the relationship.

15. A second point is that the Short and Long Term Pools were under clauses 7.6, 7.9, 7.11 and 7.12 to be established to meet Sigma's total indebtedness, with the Short Term Pool covering all its Short Term Liabilities and the Long Term Pool covering all its Long Term Liabilities as defined by clause 1. Any suggestion that the final sentence of clause 7.6 was intended to extract, from the Short Term Liabilities, any which happened to fall due during the Realisation Period and to constitute them a separate pool or class with effective priority over other Short Term Liabilities is questionable on its face. Yet, the conclusion accepted in the courts below means that Realisation Period debts will not (or only in very rare circumstances) form part of the Short Term Liabilities to be met out of the Short Term Pool.

16. Sigma's assets could normally be expected to consist of cash or other maturing or realisable Assets - even if, in the case of some "realisable" assets, their realisation prior to maturity would come at some cost, because of the element of "fire-sale" involved. Accordingly, on the approach taken by the courts below, Realisation Period debts will either have been paid during the Realisation Period before any Pools are established at all, or their payment will exhaust all the Assets with the result that there will never be any Pools at all.

17. In any case where there is an overall shortfall of Assets, the priority given by the courts below to Realisation Period debts would also skew the relationship of any Short and Long Term Pools which were created. Clause 7.9 requires an overall comparison of Total

Indebtedness and Assets, and a pro rata reduction of the amount of Assets allocated to each Pool. Realisation Period debts fall within the definition of Short Term Liabilities. However, they would on the approach of the courts below have been paid in full. This would further reduce the amount available for payment to other Short Term Liabilities, which would accordingly receive a lesser pro rata payment than Long Term Liabilities. The only alternative, to treat Realisation Period debts as an entirely separate pool, conflicts with the definition of Short Term Liabilities in clause 1 and with the express recognition of such debts as Short Term Liabilities in the third sentence of clause 7.6 itself, and gives the third sentence a significance which seems in context improbable.

18. There are further conceptual difficulties about drawing any clear-cut distinction between Realisation Period debts and other Short Term Liabilities. Three subsidiary points arise. First, the last sentence of clause 7.6 contemplates on any view that it may not always be possible to pay Realisation Period debts on their due dates during the Realisation Period. Some might as a result not even be paid within that Period. They would then fall within the general body of Short Term Liabilities where they would have no especial priority. That raises the question why Realisation Period debts should be given priority according to the happenstance that their payment was possible within the Realisation Period.

19. The second subsidiary point is that Pools were to be established "by the end of the Realisation Period". The processes of making realisations and establishing matching Assets envisaged by clauses 7.6 and 7.7 and of calculating whether any and if so what deficit adjustment was necessary under clause 7.9 were bound to take time and to be potentially complex. In a fully solvent situation, there would be little problem about continuing to discharge Realisation Period debts as they fell due. But, in an insolvent situation, with the risk that further indebtedness might arise during that Period from margin calls or the acceleration of other debts and a shortage of Assets overall, the Trustee would, on the approach accepted by the courts below, face conflicting pressures which it would be difficult to reconcile: on the one hand, the short-term duty to meet Realisation Period debts as they arose, if necessary by fire-sales; on the other the long-term duty to ensure balanced and equitable Pools for the benefit of Short and Long Term creditors.

20. The third subsidiary point is that the language of clause 7.6 indicates on its face that Pools might be established *before* the end of the Realisation Period, as Rimer LJ accepted (para. 89), though Sales J, as I read his judgment, did not (para. 28). It is true that clauses 7.11.1, 7.11.3(a) and 7.12.1 all operate by reference to the last day of the

Realisation Period, in a way which might be said to assume that the Pools will not have been established until then. This may well be no more than a drafting infelicity, since it would seem strange, if it were not open, as clause 7.6 suggests it is, to the Trustee to establish the Pools on a day prior to the 60th day after the Enforcement Event. Assuming this to be so, then, in a situation where clause 7.9 came into operation, the setting up of the Pools would be expected to exhaust Sigma's assets. Yet, on the approach of the courts below, clause 7.6 would, read literally, require the Trustee to continue to discharge Realisation Period debts in full, after the setting up of the Pools, in circumstances where Sigma's assets were now held on the express trusts established by clauses 7.11 and 7.12. The only alternative would be to treat the obligation under clause 7.6 as coming to an end, despite its terms, before the end of the Realisation Period. However, this third subsidiary point is a small one.

21. A third main point is the fortuitous effect of the interpretation placed on clause 7.6 by the courts below. Depending upon when an Enforcement Event occurred, those whose debts happened to fall due during the ensuing Realisation Period would gain priority. Creditors might be able to procure priority for themselves by making a margin call or giving notice advancing the payment date of their debts. Sales J treated this as representing a normal assumption of risk, under which every lender to Sigma "took a chance …. that it might be in the advantageous position in which Party A now finds itself" (para. 26). Rimer LJ was also influenced by the fact that the Deed was a "commercial bargain", intended to operate in insolvent and solvent situations, although he thought it improbable that the parties had foreseen "the possibility of the extraordinary, probably unprecedented, market events" that had actually unfolded (para. 92). Accepting what Rimer LJ says, it remains in my view improbable that commercial parties would contemplate that, after so important an occurrence as an Enforcement Event, priority would be conferred even to a modest extent and in the short-term on a particular group of creditors on the basis of the chance of their indebtedness falling due, or being capable of being made to fall due, during the Realisation Period.

22. The basic aim of clause 7.6 is to provide for the establishment of the Pools and the realisation of Assets, in such manner as the Trustee may in its absolute discretion deem appropriate, for that purpose. The Pools are under clauses 7.7 to 7.9 to contain Assets matching, or corresponding pro rata with, the payment and maturity dates of Sigma's Short and Long Term Liabilities. The third sentence of clause 7.6 has in this context the flavour of an ancillary provision designed to achieve a similar interim position during the Realisation Period. To my mind, it is unlikely that the Trustee's obligation under the third sentence was

intended to override the absolute discretion given to it under the second sentence. This may be part of the explanation for the use of the phrase "so far as possible". Whether that is so or not, the third sentence appears in a context and form which makes it, to my mind, an improbable vehicle for a duty to pay Realisation Period debts, regardless of any conclusion by the Trustee that clause 7.9 applies or will apply and that such payment will accordingly diminish the Assets capable of allocation to the Short Term Pool (or to the Short and Long Term Pools).

23. The fourth point is that, if the final sentence of clause 7.6 is intended to operate even in circumstances where this would give Realisation Period creditors priority over other Short and Long Term creditors, it fails notably to address the position of creditors whose unpaid debts fell due for payment prior to the Realisation Period, i.e. in this case the US$900,000 of debts representing coupon payments on notes which fell due on 30 September and 1 October 2008 (para. 4 above). Sales J thought that there was "no difficulty" about reading the words "falling due" as embracing debts already due, once it was borne in mind that a debt remains due on each day until it is satisfied (para. 36). Lloyd LJ (para. 51) and Rimer LJ (para. 90) thought that no specific thought can have been given to such liabilities when clause 7 was drafted (although they fall within the definition of Short Term Liabilities and so naturally within clause 7.11.2). Both thought that it would not be a "major qualification" to read the final sentence of clause 7.6 as if it referred to Short Term Liabilities "*already due or* falling due" (paras. 52 and 90). Elsewhere, Lloyd LJ laid some weight upon the Deed being "a commercial document prepared by skilled and specialist lawyers for use in relation to sophisticated financial transactions" (para. 67), and Rimer LJ upon it being "a 45-page document reflecting the considered input of (probably) a team of commercial lawyers" (para. 86). But it contains, as their judgments also accept (paras. 51-52 and 90) infelicities, which indicate, at the lowest, the importance of keeping an eye on and making sense of the overall picture.

24. I add that, on the view I take of the third sentence of clause 7.6, it is not surprising that it makes no reference to unpaid pre-enforcement debts; the sentence appears, as I have said, in a context where the assumption is one of solvency, in which context one would not expect any unpaid pre-enforcement debts. However, when the sentence is transposed and applied to a situation of insolvency, pre-enforcement debts are more easily and naturally catered for as part of the general body of Short Term Liabilities, on the construction advanced by parties C and D, with or without Lord Neuberger's refinement, for reasons pointed out by Lord Neuberger (para. 107).

25. A fifth point relates to the provisions for payment of the fees and expenses of the Security Trustee and any Receiver. Under clauses 7.11.1 and 7.12.1, these are, as one would expect, express prior charges on the relevant Pool Assets. In a solvent situation, there would be no problem about payment of such fees and expenses out of Sigma's Assets during the Realisation Period before any Pools or Pool Assets were established. But, if the final sentence of clause 7.6 applies to require payment out in insolvent situations, although discharge in full of the Realisation Period debts might (as here) exhaust the whole of the available Assets, there is nothing in clause 7.6 to give the Security Trustee or Receiver any priority or protection. Sales J (paras. 37-40), with whom Lloyd LJ agreed on the point (para. 53), regarded this as no more than infelicity of drafting. Sales J suggested that, in practice, the Receiver could be covered if the Trustee fixed his remuneration and directed that it be paid out of the Assets under clause 14.3.4 and if the Receiver, with the Trustee's permission, then, in order to cover his fees and expenses, borrowed money on the security of Sigma's Assets in priority to any secured creditor, as expressly permitted by clause 14.3.6. As to the Trustee, he thought the position "slightly less clear", but that the Trustee could cover itself in one or two ways. First, it could appoint a Receiver to act on its behalf, in which case the Receiver's fees and expenses would be recoverable as above. Second, clause 13.2 allowed the Trustee, out of the profits and income of the Assets and monies received by it in the exercise of any of its powers, to "pay and discharge all expenses and outgoings incurred in and about the exercise of any such powers", and the word "expenses" could be read as including "remuneration". These ingenious solutions do not overcome the basic problem, that, if the last sentence of clause 7.6 was ever envisaged as creating a continuing "pay as you go" regime, which would give effective priority to Realisation Period creditors, even though nothing would then remain for other creditors, it is remarkable that no special provision was made for the Trustee's or Receiver's fees and expenses. However remote the risk of non-payment, such priority would normally be standard form. The inference is that the Trustee's and Receiver's prior right under clauses 7.11.1 and 7.12.1 was thought to be all that could ever be required, and that it was never contemplated that payments could or would be made under clause 7.6 in circumstances which could conceivably affect their entitlement to such fees and expenses. That argues for considerable caution before concluding that it must nevertheless be interpreted and so taken to have been intended to have that effect.

26. Most if not all of the above points were identified by both Sales J and by the majority in the Court of Appeal and are summarised clearly and cogently, for example by Lloyd LJ (paras. 57 and 58) and Rimer LJ (para. 80). At the end of the day, other considerations persuaded them that the last sentence of clause 7.6 must be regarded as applying so as to

require payment in full of Realisation Period debts as they fell due, regardless of the effect on the creation of the Pools in general or on other Short Term creditors in particular.

27. In support of this approach, Mr Howard and Mr Sheldon submit that an important key to understanding the last sentence of clause 7.6 is to see it as no more than the agreed continuation for a short period of the "pay as you go" regime prevailing prior to the occurrence of the Enforcement Event. While realisations were being made, they submit, it would have been thought convenient to continue this regime and to be unlikely to have much if any effect on non-Realisation Period creditors. However, that in my opinion fails to give proper weight to the major significance attaching under the scheme of the Deed to an Enforcement Event. It may be (although the House understood it to be contentious) that Sigma was free to continue with a "pay as you go" system after it had become clear that this could affect later creditors, by realising assets and entering into repo agreements for the purpose. But the purpose of clause 7 is evidently to draw a line at a certain point. The crystallisation of powers and of the floating charge under clauses 7.1 and 7.2 and the definitions in clause 1 of Short and Long Term Liabilities and of the Pools to be established under clauses 7.6 to 7.9 strongly support a conclusion that that point was the Enforcement Date.

28. The argument remains, nevertheless, that the third sentence of clause 7.6 is an unequivocal short-term provision, and that nothing in its language or in the Deed as a whole limits, or entitles the court to limit, its application in a situation like the present. The majority in the Court of Appeal in rejecting the arguments advanced for parties C and D attached importance to the fact that the sentence used the words "so far as", rather than "if". Further, in rejecting Lord Neuberger's refinement of the argument, they noted the absence of any definition of the state of mind which the Trustee would have to have or of what it would have to do, as well as the absence of any definition of the scope of the Trustee's discretion, or judgment, if it was in whatever was the relevant state of mind as regards the prospects for payment in full, or only on account, of Sigma's various secured liabilities (paras.62-72, per Lloyd LJ). I think that a similar objection could however be made in relation to clause 7.9. Its operation must involve a substantial and time-consuming process of evaluation and judgment during the Realisation Period. Whether and how it applies must be potentially complex matters for the Trustee's judgment, having regard to the provisions of clause 7.7 regarding maturity and rating quality.

29. Ultimately, in Lloyd LJ's view, the position was that "the sentence is on the face of it, clear and unequivocal as to the Trustee's obligation to discharge the Short-Term Liabilities falling due during the

Realisation Period" (para. 63), in a commercial document prepared by skilled and specialist lawyers, "the clear and natural meaning of the words should prevail" (para. 67) and, especially bearing in mind the "elaborate and careful" provisos to clauses 7.11 and 7.12 whereby an obligation to pay pro rata was introduced, "the argument for pari passu distribution involves placing on the words "so far as possible" a weight and significance that they cannot bear" (para. 69). Rimer LJ adopted similar reasoning, considering that, if the approaches advanced by parties C and D or adopted by Lord Neuberger had been intended, that could and would have been said (paras. 86-88).

30. Both Lloyd and Rimer LJJ recognised that the parties would, when subscribing to notes on the terms of the Deed, not have had in contemplation the extraordinary market events which have occurred, or what, they recognised, might be regarded on their approach as leading to an "unfair result" (paras. 69 and 92). But they noted (paras.30-31, 85 and 92) that the Deed foresaw that an Enforcement Event might result from insolvency as from solvency. In those circumstances, and in the absence of any appropriate limitation, they saw the last sentence of clause 7.6 as equally applicable in both situations. At one point in his judgment (para. 59), Lloyd LJ also said that "The sentence does not say "if possible", but "so far as possible"; the latter phrase seems clearly to indicate that partial payment may be possible". However, if he was here suggesting that the sentence was expressly addressing a situation of insolvency in which Realisation Period debts would exhaust all Sigma's assets, the suggestion is in conflict with what was said elsewhere about the improbability of the parties foreseeing any such situation, and with the probable reality.

31. I return to my starting point. The last sentence of clause 7.6 appears in and was drafted in contemplation of the situation where no question of insolvency arose. It is not until clause 7.9 that any such possibility is addressed. In practice, no doubt, an Enforcement Event would be more likely than not to result from some financial difficulty on Sigma's part. But that is not the situation which clauses 7.6 to 7.8 are drafted to address. The last sentence of clause 7.6 has therefore now to be interpreted in a quite different context to that in which it appears and for which it was designed. This is not an unusual phenomenon, as Sales J and the majority in the Court of Appeal recognised, when they found it necessary to expand or to qualify or read words into certain of the Deed's provisions in the light of the "infelicities" of drafting which on their approach emerged.

32. In the present situation, the reasonable man's task in understanding the meaning and application of the last sentence of clause 7.6 is in my opinion greatly facilitated by the existence of a clear basic

scheme, from which it is improbable that the parties would have wished to depart. That basic scheme involved the creation of a Short and of Long Term Pools, each with sufficient nominal assets of sufficient rating quality to meet, or meet pro rata, the Pool's liabilities as and when they matured. The basic purpose of the Realisation Period was to give time for the creation of such Pools. Realisation Period debts were to be part of the Short Term Pool. Seen in the context in which the third sentence of clause 7.6 appears, its aim was to put Realisation Period debts in the same position as other Short Term Liabilities. They were to be paid so far as possible on their maturity and payment dates. Seen in a context where the Trustee concludes that clause 7.9 applies, the approach of the courts below achieves the opposite result. It elevates Realisation Period creditors to a special status, extracts them from the Pool to which the Deed assigns them, distorts the apparent aim to achieve equity between all creditors by the creation of Short and Long Term Pools, and probably also distorts the relationship between the Short and the Long Term Pools. These considerations are sufficient to persuade me, as they persuaded Lord Neuberger, that the parties to the Deed cannot have contemplated the approach adopted by the courts below, even in a less extreme situation of insolvency than the present, such as they might have foreseen.

33. The phrase "so far as possible" was used in a context where what were in mind were no doubt relatively minor discrepancies (during the Realisation Period when the Trustee's main concern would be the creation of appropriate Pools) between available cash or other realisable or maturing Assets and liabilities, which could delay or prevent payment of all or some Realisation Period debts. That alone would explain why the word "if" was not used instead of "so far as". But, when the sentence is transposed and applied to a situation in which clause 7.9 applies, those words are apposite to enable the Trustee to determine that no further payments can appropriately be made, having regard to the overall aim of achieving equitable Pools and an equitable allocation of Assets between the two (or more) main Pools. I would, in this context and so far as necessary, be prepared to read the words "so far as" as equating with "if". I find it difficult in any event to attach as much weight as the Court of Appeal did to the difference. But it seems to me, as it did to Lord Neuberger, that it would also be open to the Trustee to make on account payments during the Realisation Period in respect of Realisation Period debts as they fell due. The calculation made or being made under clause 7.9 would indicate what proportion of such debts could safely be paid. The Trustee's extensive and absolute discretions and powers under clauses 17.3 and 17.5 would avoid any argument. It is however unnecessary on the facts to reach any concluded decision on the correctness of Lord Neuberger's refinement to the case advanced by

parties C and D. It is not, in my opinion, critical to the outcome of these appeals whether or not that refinement be accepted.

Conclusion

34. I would therefore allow the appeals of interested parties C and D and dismiss the appeal of interested party B, set aside the decisions of the courts below and declare that, on the true construction of clause 7.6 of the Security Trust Deed, and in the events that have happened, the Receivers were not obliged to use cash or other realisable or maturing assets of Sigma to pay Short Term Liabilities falling due for payment during the Realisation Period after 6 October 2008 either in the order in which they fell due or pari passu with other Short Term Liabilities due for payment during the Realisation Period. I would further declare that such Liabilities are to be treated along with all other Short Term Liabilities in respect of which payments fall to be made under clause 7.11 out of the Short Term Pool to be established under clauses 7.6 to 7.10.

LORD COLLINS (with whom Lords Hope and Mance concur)

35. I agree with Lord Mance that the appeals of interested parties C and D should be allowed for the reasons he gives, and I add only a few remarks of my own on the approach to interpretation. In complex documents of the kind in issue there are bound to be ambiguities, infelicities and inconsistencies. An over-literal interpretation of one provision without regard to the whole may distort or frustrate the commercial purpose. This is one of those too frequent cases where a document has been subjected to the type of textual analysis more appropriate to the interpretation of tax legislation which has been the subject of detailed scrutiny at all committee stages than to an instrument securing commercial obligations: *cf Satyam Computer Services Ltd v Upaid Systems Ltd* [2008] EWCA Civ 487, [2008] 2 CLC 864, at [2].

36. Sigma financed its investments over a 13 year period by debt securities issued or guaranteed by it. It entered into liquidity facilities intended to hedge against market liquidity risks. It entered into financial instruments intended to hedge against currency and interest rate risk. Others provided liquidity facilities, or entered into financial hedging instruments. The Security Trust Deed secures a variety of creditors, who hold different instruments, issued at different times, and in different circumstances.

37. Consequently this is not the type of case where the background or matrix of fact is or ought to be relevant, except in the most generalised

way. I do not consider, therefore, that there is much assistance to be derived from the principles of interpretation re-stated by Lord Hoffmann in the familiar passage in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912-913. Where a security document secures a number of creditors who have advanced funds over a long period it would be quite wrong to take account of circumstances which are not known to all of them. In this type of case it is the wording of the instrument which is paramount. The instrument must be interpreted as a whole in the light of the commercial intention which may be inferred from the face of the instrument and from the nature of the debtor's business. Detailed semantic analysis must give way to business common sense: *The Antaios* [1985] AC 191, 201.

38. Once clause 7.6 of the Security Trust Deed is seen in context, the conclusion that the Receivers were not obliged to give priority to the first maturing Short Term Liabilities is consistent with the wording of the clause in the context of the Trust Deed as a whole and with the commercial purpose of the instrument.

LORD WALKER (dissenting)

39. These appeals will determine how the enormous loss incurred by Sigma Finance Corporation is to be borne as between the anonymous investment banks, hedge funds and other entities which are its secured creditors. Lord Mance refers to them as victims of the current financial crisis. An alternative view would be that they are among the authors of the crisis. But that is not an issue for the Court.

40. Although I was one of those who gave permission for a further appeal (as it then was, to the Appellate Committee of the House of Lords) I find, on closer consideration, that the case involves no issue of general public importance. There is no doubt as to the principles of construction to be applied. They are clearly summarised (under the heading "the law") in Lord Mance's judgment. The only issue is as to the interpretation of the security trust deed in the light of those principles. Sales J and the majority of the Court of Appeal (Lloyd and Rimer LJJ) took one view but Lord Neuberger (sitting in the Court of Appeal) took a different view.

41. In respectful dissent from the majority of this Court I prefer the view taken by the judge and the majority of the Court of Appeal. Since no issue of principle is involved it would be quite inappropriate to give any lengthy explanation of my reasons. I will limit myself to three fairly general points.

42. First, I completely agree that it is necessary to construe the language of clause 7.6 of the deed "in the landscape of the instrument as a whole" (in the words of Lord Mustill in *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, 384H). One of the most striking features of the landscape of the deed, to my mind, is that clause 7 does not provide for the immediate winding-up of Sigma on the occurrence of a default which amounts to an enforcement event. On the contrary, secured creditors are prohibited from taking steps to wind up the company. It is therefore necessary to repress any instinctive feeling (and it is, I acknowledge, a strong instinctive feeling) that *pari passu* distribution at the earliest practicable date is the most natural (one might almost say the only rational) solution.

43. Instead, the assets were to be retained and marshalled (in accordance with the detailed provisions of clauses 7.6 to 7.10) in order to match the company's short-term and long-term liabilities, as defined, all of which were to be paid (under clause 7.11 or 7.12) as they fell due. The procedure envisaged was comparable to that of a funded occupational pension scheme which is closed to new entrants but not wound up. In such a case the trustees would adjust the way in which the fund was invested in order to match its predictable short-term, medium-term and long-term liabilities. Scheme members would still have to wait for the payment of their respective pensions to fall due, and as each became entitled to a pension he or she would (in the typical case) then be entitled to preference, as against those whose pensions had not fallen due, if and when there was eventually a winding-up.

44. Second, the need to exclude any instinctive feeling about insolvent winding-up is reinforced by the fact, to which Lord Mance rightly attaches importance, that the parties cannot have contemplated that Sigma would have insufficient assets to meet its liabilities even to secured creditors – especially not on the scale of the extraordinary loss that has actually occurred. These skilled and sophisticated investors expected to make money, not to lose it. The fact that the effect of the deed, in a situation which the parties never contemplated, may appear fortuitous or arbitrary does not therefore carry much weight. It is not for the Court to make a new contract for experienced commercial operators advised by expert lawyers.

45. Third, clause 7.6 (the crucial provision which has to be fitted into the landscape of the deed as a whole) is concerned with what is to happen during the 60-day realisation period. In setting up the pools the trustee was to perform what might well be a difficult exercise, but it was essentially an exercise of an administrative nature. The references to the trustee's "absolute discretion" are to my mind explained by the trustee's

wish to protect itself from possible criticism, rather than to any power for the trustee to prefer one secured creditor to another. The direction for payment of liabilities falling due for payment during the realisation period was no doubt expected to be more or less ancillary (as Lord Mance puts it) but it has, in the wholly unexpected events which have occurred, assumed unexpected importance. Reference was made to the direction applying "so far as possible" (rather than "if and so far as possible") and to the fact that those words are not immediately adjacent to the words "on the due dates therefore". I would not attach any importance to those details of language. The words are wide enough to cover both the possibility that a payment might for practical reasons have to be delayed by a few days, and the much more remote possibility (as it would have appeared to the parties at the time) that there would be a permanent deficiency of assets.

46. I would therefore dismiss these appeals.