Neutral Citation Number: [2005] EWHC 2170 (Ch)

Case No: 002816 OF 2005
Case No: 007084 of 2003

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 09/09/2005

Before :

THE HONOURABLE MR JUSTICE WARREN

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Between :

(1) SISU CAPITAL FUND LTD **(2) SISU CAPITAL FUND LTD II LTD** **(3) SISUCAPITAL FUND LIMITED PARTNERSHIP** **(4) AVRO MASTER FUND LIMITED PARTNERSHIP** **(5) PROVIDENT LIFE AND ACCIDENT INSURANCE COMPANY** **(6) THE PAUL REVERE LIFE INSURANCE COMPANY** **UNUM LIFE INSURANCE COMPANY**	**Applicants**
- and -	
(1) JAMES TUCKER **(2) JEREMY SPRATT (the joint liquidators of Energy Holdings (No3) Ltd (in liquidation))** **and** **(1) PHILIP WALLACE** **(2) FINBARR O'CONNELL (the joint administrators of Energy Group Overseas BV(in administration)**	**Respondents**

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Mr S Davies QC, Mr P Gillyon, Mr D Wolfson, & Mr E Davies(instructed by **Bingham McCutchen LLP**) for the Applicants
Mr M Crystal QC, Mr R Dicker QC, Mr M Arnold & Mr D Allison (instructed by **Allen & Overy**) for Mr Wallace & Mr Tucker (the Respondents)

Mr M Briggs QC Mr J Machell & Mr D Drake (instructed by **Fladgate Fielder**)
for Mr Spratt & Mr O'Connell (the Respondents)

Hearing dates: Hearing dates: 8th ,9th ,10th, 11th, 12th,15th, 16th, 17th, 18th & 19th August 2005

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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THE HONOURABLE MR JUSTICE WARREN

Mr Justice Warren

Introductory Observations

A. This application has come on in the Long Vacation as a matter of urgency. I have needed to digest a mass of written material, including case summaries and written opening and closing cases running to several hundred pages, as well as witness statements (excluding exhibits running to some 30 ring-binders) of over 1000 pages. It is impossible for me, in the time available to write this judgment, to review the evidence in the detail which I would ordinarily wish to do in arriving at, and expressing, my conclusions. The fact that I do not do so does not mean that I have ignored it – although it would be a pretence at perfection to say that I had not overlooked anything. I should say that, in order to speed production, I have taken large parts of the narrative virtually verbatim variously from an agreed statements of facts and from the witness statements of Mr Wallace and Mr Roome where I am able to accept what they say as correct.

B. Accordingly, except in relation to a very few events, I state my conclusions of fact without setting out the detail of the competing stories. Statements of fact are to be taken, except where otherwise expressly qualified, as my findings. My findings necessarily entail acceptance or rejection of one or other of the inconsistent evidence from different witnesses.

C. Similarly, it has been impossible to deal with a substantial number of submissions made. I have read, and re-read, opening and closing written submissions from all parties. The fact that I have not expressly dealt with a point, and I am afraid there are very many of them which I have not dealt with, does not, again, mean that I have ignored it although it would, again, be a pretence at perfection to say that I had not overlooked any. I hope, however, that I have covered all the major submissions.

D. I shall start with a very brief review of the nature of the application and of the background and the major events so that the reader coming afresh to the case can see in broad terms what it is about. I shall then address the areas of law which have been debated before me, then set out in detail the facts and my findings, before expressing my conclusions.

Introduction

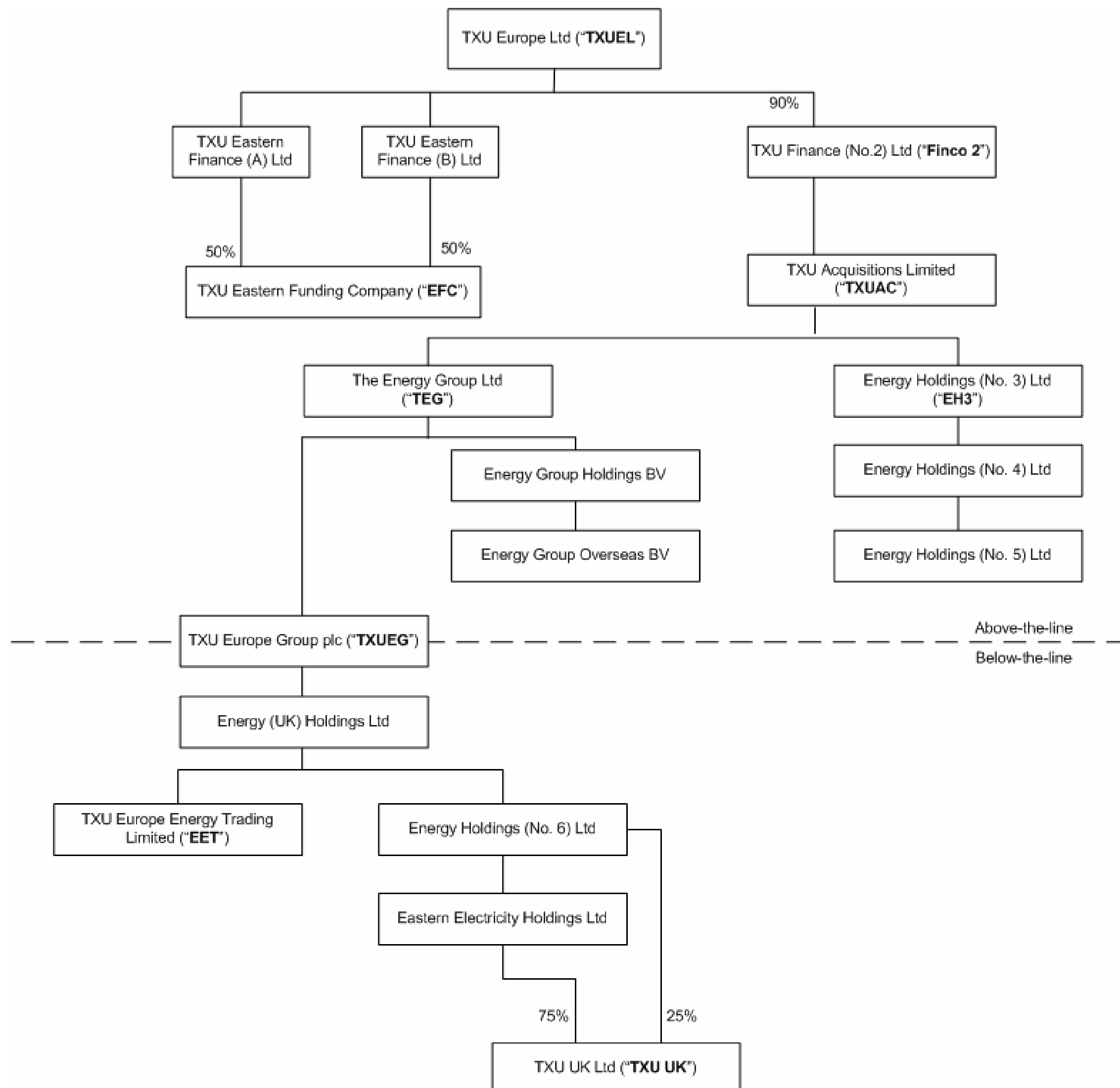
1. I have before me applications by the Applicants who seek the following relief:

   a. Pursuant to section 6 IA 1986, the revocation or suspension on such terms as the court thinks fit of the approval given by creditors' meetings held on 31 March 2005 of the CVAs in respect of EGO BV and EH3 on the grounds that those CVAs are unfairly prejudicial to the interests of the Applicants and that there were material irregularities at or in relation to the meetings approving the CVAs.

   b. Pursuant to paragraphs 74 and/or 88 of Schedule B1 to IA 1986, the removal of Mr Wallace and Mr O'Connell as the joint administrators of EGO BV and, under paragraphs 90 and 91 of Schedule B1 to IA 1986, the appointment of new administrators of EGO BV.

c. Pursuant to sections 108 and 171 of IA 1986, the removal of Mr Tucker and Mr Spratt as the joint liquidators of EH3 and, under section 108 of IA 1986, the appointment of new liquidators of EH3.

2. EGO BV and EH3 are part of a large group of companies, the ultimate parent of which is TXU Corp, a Texan corporation. For the purposes of the present case, I am concerned with the TXUEL Europe group, the structure of which appears from the following diagram:



3. It will be seen that there is a line passing through TXUEG. The expressions (which I adopt) for above the line and below the line are ATL and BTL. TXUEG itself is included as a BTL company. Broadly speaking, the BTL companies are the operating companies (carrying out the electricity and other power generation, retailing, trading, marketing, delivery and other energy related activities conducted by the group) whereas the ATL companies are holding companies (whose principal activity was the provision of finance to the operating companies). The BTL companies have, in the evidence, sometimes been referred to as the Operating Companies and the ATL companies have sometimes been referred to as the Holding Companies. On occasions I use those expressions too.

4. The Respondents are, and have at all material times been, partners in the well-known firm KPMG. Mr Wallace and Mr Tucker are joint administrators of TXUEL, TEG and TXUAC. They are joint administrators of TXUEG together with Mr Bloom and Mr Bailey of the equally well-known firm E&Y. Mr Bloom and Mr Bailey are also joint administrators of TXU UK together with Mr Chris Hughes of THM. The appointments of these individuals other than Mr Hughes took place on 19 November 2002; Mr Hughes was appointed on 11 March 2004. Mr Tucker is also, together with Mr Spratt, a joint liquidator of EH3 both having been appointed at a creditors' meeting on 8 January 2003. Mr Wallace is also, together with Mr O'Connell, a joint administrator of EGO BV both having been appointed on 20 November 2003. I will turn in due course in more detail to the making of those appointments.

5. The financial structure of the group is complex. At this stage, I simply note the principal creditors of the group in November 2002.

External creditors

6. First, the main external group facilities/creditors were as follows:

    a. The bank lenders:

        i. a £900 million Revolving Credit Facility for TXUEL arranged by Barclays, JPMorgan plc, Salomon Brothers International Limited and RBS dated 19 November 2001 (the "**RCF Facility**" giving rise to the "**RCF Debt**" owed to "the **RCF Banks**");

        ii. a £126 million Credit Facility for TXUEG arranged by RBS and Bayerische Landesbank Girozentrale, London Branch dated 20 June 2001;

        iii. a US$174.4 million Credit Facility for Eastern Group Finance Limited arranged by Bayerische Hypo-und Vereinsbank Aktiengesellschaft, London Branch, and Bayerische Landesbank Girozentrale, London Branch dated 13 March 2002. This facility was guaranteed by TXUEL; and

        iv. a US$220 million Letter of Credit and Reimbursement Agreement between Eastern Group Finance Limited (as accounts party), TXUEG (as guarantor) and Bayerische Landesbank Girozentrale, New York Branch as issuing bank, Bayerische Landesbank Girozentrale, London Branch and KBC Bank NV, London Branch as arrangers and KBC Bank NV as agent dated 16 June 2002 (together with (c), the "**Lilo Banks** ").

    the lenders together being called the "**Lending Bank Syndicates**".

    b. Bondholders ("EFC Bondholders") of approximately £1.3 billion of bonds ("EFC Bonds") issued by EFC (about £1.377 billion outstanding at 19 November 2002). The EFC Bonds were guaranteed by TXUEL. Further, the proceeds of the EFC Bonds were lent to TXUEL. Accordingly, the EFC Bonds give rise to several rights – the EFC Bondholders having direct claims against EFC (primary liability)

and TXUEL (guarantee liability) with EFC itself having a debt owing by TXUEL equal to the proceeds of the bonds on-lent to TXUEL.

c. Bondholders ("EGO BV Bondholders") of US$500 million of bonds ("EGO BV Bonds") issued by EGO BV (about £330 million outstanding at 19 November 2002). The EGO BV bonds too were guaranteed by TXUEL. They were also guaranteed by EH3. TXUEL also gave an indemnity to EH3 in respect of EH3's own guarantee. The Applicants held between them about 17.4% of the EGO Bonds, the majority being held by holders of RCF Debts and EFC Bonds.

7. I should say something more about these different creditors. It is central to the Applicants' case that they stand in a unique position, their only interest being as EGO BV Bondholders excluding what Mr Roome describes as a nominal holding by Unum of EFC Bonds. In contrast, they say, other creditors all have significant interests as creditors of other companies and that it is in their interests to see as much value as possible finding its way to TXUEL rather than to EGO BV. They say that the way in which various issues have been determined in the various CVAs has shifted value from EGO BV and is unfairly prejudicial to them. I make two observations at this stage. First, the assertion is not correct in relation to AEGON, whose economic interests in respect of certain of its funds were aligned with those of the Applicants. Secondly, it is not correct to assume that it is in the economic interests of all other financial creditors to see value shifted to TXUEL. It is true that EGO BV's estate may be increased if TXUEL receives less; but that increase only arises because of larger payments up the line from TXUEG. Those payments do <u>not</u> go to EGO BV but are shared between all of TXUEG's creditors above the line. It is in fact the case that it is in the economic interests of some other financial creditors to increase the amounts flowing from TXUEG to the Conduit Companies rather than to TXUEL.

8. Secondly, as to the main external BTL creditors, EET traded electricity and gas in the UK and had entered into a number of long-term structured power purchase agreements with third party companies that owned generating facilities in the UK. Under these arrangements EET received the output of those facilities. These deals were mostly guaranteed in part by TXUEG and are referred to as "PPAs". The PPAs were entered into at a time when the industry was forecasting increased demand. In fact, they had become a considerable burden such that EET had several significant third party contracts which required EET to purchase electricity at up to double the open market price, severely affecting the profits and cash flow of the TXU Europe Group. The PPA Creditors' claims were in excess of £2 billion, although, as will be seen, those claims were settled for a sum in the region of £1.2 billion.

9. The majority of the TXU Europe group's assets were held below the line in the BTL companies. It can be seen from the group structure diagram that TXUEG was the holding company for all the other BTL companies. There was also a complex web of inter-company indebtedness. The vast majority of the value of the BTL companies to the ATL companies was dependent on (a) the equity investment in TXUEG and (b) the indebtedness of TXUEG to three ATL companies – TEG, TXUAC and EH3 whose respective debts in November 2002 were in the order of £82 million, £161 million and £177 million. A fourth, smaller, inter-company creditor known as the TEG Head Office was also a creditor of TXUEG but can, for all practical purposes, be ignored. TEG, TXUAC and EH3 are together referred to as "the Conduit Companies".

Committee Creditors

10. Following the commencement of the administrations, the meetings of the creditors of TXUEL, TXUAC and TEG pursuant to section 23 of IA 1986 were convened to take place on 8 January 2003. One of the purposes of each of the meetings was to elect creditors' committees and, in the preceding days, KPMG had been discussing their composition with the Bondholder Committee, Barclays and JPMorgan. It is to be noted that the powers of a creditors' committee are very limited; it has no power to veto actions by the administrators and there is no requirement for its consent to the exercise by the administrators of their powers.

11. Creditors' committees are required to have from three to five members. KPMG had a number of candidates for each of the committees (each of the members of the Bondholder Committee, Barclays and JPMorgan), and some additional candidates (TXUAC loan noteholders) for the TXUAC committee. KPMG made it clear that they intended to treat all of these candidates equally in terms of provision of information and permission to attend creditors' committee meetings. Given numerical constraints on formal membership, this would require that those who could not be members of the committees would be "observers".

12. Mr Wallace does not recall the composition of the committees being an issue amongst the candidates at this stage. It did, however, become an issue subsequently, when EGO BV went into administration, as I explain later.

13. The committees were proposed and formally constituted as follows:

    a. TXUEL: Unum, SISU, Appaloosa, JPMorgan and Barclays as members, with AEGON and Citigroup as observers.

    b. TXUAC (whose creditors were largely other group companies in respect of inter-company balances): John Pattisson (a retired executive director of Hanson plc and a TXUAC loan note holder) ("**Mr Pattisson**"), Finco No. 2 (represented by Unum), Global Energy Finance LLC (represented by SISU) and EH4 (represented by Appaloosa) as members, with no observers. It may be that JPMorgan was an observer to this committee but nothing turns on that.

    c. TEG (whose creditors were also largely other group companies in respect of inter-company balances): EH5 (represented by Unum), Energy Resources Limited (represented by SISU) and EGO BV (represented by Appaloosa) as members. It may also be that AEGON and Citigroup were observers to this committee but again nothing turns on that.

    The creditors on these committees (and subsequently the liquidation committee of EH3) have been referred to by the Respondents as Committee Creditors and I will adopt the same phrase.

Outline of relevant major events

14. By October 2002, it had become apparent that the TXU Europe group was facing serious financial problems. The directors of the TXU Europe group had been sufficiently

concerned that they retained E&Y and solicitors, Herbert Smith, to advise them on their options and duties. In early October 2002, the credit rating of TXUEL was downgraded by various agencies to the lowest category of investment grade and placed on credit watch.

15. The financial concerns were brought to a head when, on 14 October 2002, TXU Corp publicly announced that it had resolved not to make any further capital contributions to the TXU Europe group. In light of this announcement, the credit ratings of TXUEL and its subsidiaries were downgraded by Moody's Investors Service and Standard & Poor's to below investment grade. Maintaining an investment grade credit rating was critical to the TXU Europe group, as many of its major contracts and financing agreements contained "ratings trigger" clauses which required (or gave counterparties or creditors the option to require) the posting of credit or cash collateral, or the repayment of indebtedness, if TXUEL's rating descended below investment grade. Such contingent obligations totalled many hundreds of millions of pounds. TXU Corp's failure to provide capital and the resulting credit rating downgrade therefore exacerbated the TXU Europe group's liquidity crisis.

16. At or around the same time, many of the Financial Creditors of the TXU Europe group retained their own advisers to advise them as to their options and to liaise with the companies and their advisers to obtain the information they required in order to determine whether they could continue to support the group. Andrew Wilkinson of Cadwalader and Houlihan Lokey were retained as legal and financial advisers respectively to advise a committee of bondholders (the "**Bondholder Committee**"). Mr. Segal, together with Mr Florent, of A&O and KPMG (principally Mr Wallace and Mr. Tucker) were retained by an informal steering committee of lending banks (the "**Bank Steering Committee**"), the assignment coming to be called "Project Lundy".

17. The Bondholder Committee consisted of representatives of AEGON, Appaloosa, Citigroup, M&G, SISU and Unum. They were all either or both EFC Bondholders and EGO BV Bondholders.

18. The Bank Steering Committee consisted of Barclays, JPMorgan, RBS, KBC Bank NV and Bayerische Landesbank, representing four lending syndicates with claims at various companies in the TXU Europe group.

19. The parties for whom KPMG and A&O acted prior to the administrations had, it is therefore apparent, interests throughout the TXU Europe group, including TXUEG. Their interests were not simply those as creditors of TXUEL. Although the Bank Steering Committee included the RCF Banks, it also included other institutions.

The £67 million payments

20. At this point, I wish to identify the background to one of the issues about which the Applicants complain and which is referred to as "**the £67 million**" issue.

21. Between 11 and 18 October 2002, certain currency swaps belonging to TXUEL, which were "in the money" to the tune of approximately £67 million, were cashed in. There were three encashments: Credit Lyonnais swaps of £45,500,000 on 11 October 2002;

Merrill Lynch and UBS swaps of £17,032,620 on 16 October 2002; and UBS swaps of £5,359,865 on 18 October 2002.

22. However, instead of being held at TXUEL or its subsidiary for the benefit of TXUEL's creditors, these Swap Proceeds fell prey to cash sweeping arrangements that operated throughout the TXU Europe group. Pursuant to these arrangements, all group companies' credit balances (or at least those of many group companies including TXUEL) were regularly swept (via the accounts of intermediary group companies) pursuant to standing instructions to one or more bank accounts in the name of TXUEG, one of the functions of which was to act as the group's treasury company. The transfers of the three encashments (less a deduction of about £360,000 from the first encashment) took place respectively on 14 October, 17 October and 22 October 2002. They were transferred to accounts of TXUEG *via* intermediate subsidiaries (Finco 2 and TXUAC) to support the liquidity of the BTL companies.

23. The bank creditors of TXUEL were, unsurprisingly, very concerned about the transfer of these funds from TXUEL to TXUEG and onward to other BTL companies at a time when the impending administration of TXUEL must have been recognised by its directors. The banks insisted on their return to TXUEL. Part of the actual monies involved were not, however, identifiable by this stage, having passed through overdrawn accounts, equivalent sums finding their way in large part to EET and TXU UK.

24. However, before the final payment had been made by TXUEL, it appears that an agreement may have been made under which further monies were to be lent by TXUEG to EET and TXU UK to stabilise their businesses. It seems that TXUEL consented to such loans but that it was agreed between TXUEL, TXUEG, TXU UK and EET that the monies would be repaid, effectively back up the chain, out of the proceeds of the sale of the TXU UK business.

25. The relevant sale was a sale to Powergen, which took place on 21 October 2002. It appears that the £67m was about to be paid up to TXUEL when the solicitors, Herbert Smith, acting for TXUEG and TXU UK and their respective boards of directors, advised that such payment should not be made. On 19 November 2002, £67m out of the proceeds of the sale to Powergen was placed in escrow in Herbert Smith's client account pending determination of the ownership of the £67m swaps proceeds.

26. Returning to the brief narrative, the directors of TXUEL and other companies decided that certain members of the TXU Europe group should be put into administration. Although the financial creditors did not wish this to happen, administration orders were made on 19 November 2002 in relation to TXUEL, TEG, TXUAC, TXUEG, EET and TXU UK, with the appointment of joint administrators as set out at [4] above. The purposes for which the Administration Order dated 19 November 2002 of TXUEG was made were to achieve the approval of a voluntary arrangement under Part 1 of IA 1986 or the sanctioning of a scheme of arrangement under section 425 of the Companies Act 1985 and/or a more advantageous realisation of TXUEG's assets than would be effected on a winding up. I shall deal in more detail later with the appointments and the conflicts involved. I do note, however, that the companies which were subject to these first administrations included, above the line, what have been described as "spine" companies – in other words, the chain of companies down from TXUEL to TXUEG. Neither EH3 nor EGO BV were part of that spine and fell to be dealt with later.

27. It was envisaged that there would be a Memorandum of Understanding dealing with the respective roles of the KPMG and E&Y administrators in TXUEG. This was, in the event, signed by Messrs Wallace, Tucker, Bloom and Bailey and approved by the Court (Blackburne J) on 27 November 2002 without a hearing.

28. In relation to EH3, it had become clear that some sort of insolvency process would be necessary, be it administration or liquidation combined with a scheme of arrangement or a CVA. Liquidation was decided upon for tax reasons, which I will in due course explain. A members' resolution to wind up EH3 was duly passed on 30 December 2002.

29. At the 30 December 2002 meeting when it was resolved to wind up EH3, Mr Spratt and Mr Treharne, partners in KPMG, were appointed joint liquidators.

30. On 8 January 2003, there was a creditors' meeting of EH3. Mr Spratt and Mr Tucker were appointed joint liquidators (Mr Tucker replacing, rather than being appointed in addition to, Mr Treharne).

31. On 28 March 2003, the Court approved certain solicitor protocols by the erection of information barriers within A&O and Cadwalader: both of these firms were acting for Messrs Wallace and Tucker in relation to various aspects of their administrations but also acted for certain external creditors of the TXU Europe group. These barriers were clearly considered by the court to be adequate to deal with the conflicts of interest which existed. Although they are not directly relevant to the issues before me, they indicate a willingness to accept that some, at least, of the conflicts in the present case were capable of <u>management</u> rather than elimination.

32. Eventually, it was decided that EGO BV would need to go into some sort of insolvency process. Notwithstanding their continuing protestations about conflict of interest, Bingham reluctantly, and on the basis of what was then known to and understood by them and their clients, agreed to the appointment of KPMG partners as administrators but only on the basis that the issue might need to be revisited later due to conflicts, communicating that agreement by an email dated 30 September 2003. On 20 November 2003, Mr Wallace and Mr O'Connell were appointed joint administrators. They remained, and remain, the only joint administrators notwithstanding the Applicants' subsequent complaints.

33. On 18 February 2004, the creditors' committee was appointed to EGO BV. Bingham and their clients had been greatly exercised by the constitution of this committee. It eventually comprised representatives of SISU, Unum, Citigroup and AEGON. This gave SISU and Unum together power to block any decision of the committee. I comment here, however, that the only significant formal power which the committee had was the setting of the remuneration of the administrators. However, it is part of the Applicants' case that they were assured by Mr Wallace that allocation of assets between the various groups of creditors above the line would be a consensual process and would require the approval of the liquidation committee of EH3 and the creditors' committee of EGO BV.

34. On 11 March 2004, Chris Hughes of THM was appointed an additional administrator of TXU UK. This was to provide an independent individual able to represent the interests of TXU UK where its interests conflicted with other companies of which Mr Bloom and/or

Mr Bailey were officeholders, in particular TXUEG and EET. This is another example of conflicts management rather than elimination.

35. Without at this stage going into detail, I need to describe the major issues facing the officeholders of both BTL and ATL companies and also to record the timing of the events leading to the BTL CVAs and the ATL CVAs.

36. I have already described briefly the £67 million issue.

37. The next major issue to mention is the PPA issue. Large amounts of money – over £2bn - were claimed by the PPA counterparties ("the **PPA Creditors**") under the PPAs, principally from EET (whose liabilities under the PPAs were, in many cases, guaranteed by TXUEG). A compromise was reached with them – at about £1.2bn – by the administrators of the BTL companies which became embedded in the eventual proposal for the BTL CVAs and the actual CVAs eventually approved by the creditors of the BTL companies. Certain of the ATL creditors subsequently, in entirely separate negotiations, achieved an agreement from three of the PPA Creditors to pay a total sum of £11.5m ("the **PPA Payments**") directly to TXUEL. The Applicants say that that money should never have gone directly to TXUEL but was money which should have been dealt with in the BTL CVAs: if that had happened, the value would have passed through to the Conduit Companies and thus enured, in part, for the benefit of the EGO BV Bondholders.

38. The next issue is known as the "Net v Gross" issue. The officeholders of many of the TXU Europe group companies found the financial records concerning inter-company indebtedness of their respective companies in an appalling state. It was often difficult, if not impossible, to reconcile accounting entries in one company with those in another in relation to the same transaction. A particular difficulty in the BTL companies (especially between EET and TXU UK) was whether substantial inter-company transactions had been netted off, leaving a balance owing one way or the other, or whether the many transactions which could have been netted off had not in fact been. The two different treatments would lead to totally different financial results in an insolvency and would have significantly affected the amounts available to different creditors (including the Conduit Companies) at different levels of the BTL group of companies.

39. The next issue is known as the Double Dip issue. This issue concerned the merits of a "double dip" claim asserted by the EFC Bondholders. The EFC Bonds had been issued by EFC, a finance company and subsidiary of TXUEL, with the benefit of a guarantee from TXUEL. As a finance company, EFC's only liabilities were the EFC Bonds and its only asset was an inter-company debt from TXUEL resulting from the advance of the bond proceeds to TXUEL. The effect was to give EFC Bondholders, effectively, the right to claim twice in the TXUEL insolvent estate: first under their guarantee and second by virtue of EFC's claim in TXUEL. The double dip question was whether the second claim, through EFC, was subordinated to TXUEL's other debts.

40. The next issue is known as the Multiple Dip or GFA issue. This issue concerned the potential existence of a further claim by EGO BV against EH3 under the terms of a Group Financing Agreement dated 21 November 1997 ("the **GFA**"). The issue is whether, under the GFA, there was a subsisting valid guarantee by EH3 of any receivables due to EGO BV from other TXU Europe group companies. In practice, the only relevant receivable was a debt owed by TEG to EGO BV of some £430 million. This was the issue which

would have the most financial impact on the recoveries which the EGO BV Bondholders would make. The two key questions were whether the GFA was an immediate guarantee or a contingent guarantee which would come into force only upon EGO BV making a demand under it. There was also a question, as a result of an internal reorganisation of the TXU Europe group in 1998, whether repayment of the amounts owed by TEG to EGO BV was in fact guaranteed by EH3 under the GFA.

41. The next issue is the Valuation Date issue. This concerned the appropriate date to be used in the CVAs for the valuation of claims in currencies other than sterling and the calculation of interest. The appropriate date was disputed by various parties primarily because of the fluctuation of US dollar exchange rates since the start of the insolvency proceedings, and the different currencies of the TXU Europe group debt.

42. The last issues relates to claims against TXU Corp. I shall call it the "**TXU Corp Claims**" issue. It became apparent, following investigation by the officeholders and the creditors, that there might be substantial litigation claims against TXU Corp and the former directors of certain ATL companies (who were indemnified by TXU Corp against such claims). There were two classes of claim: first, claims by TXU Europe group companies for the benefit of their estates and secondly direct claims by external creditors ("**Direct Claim*s***"). I do not need, at the moment, to say anything more than that a global settlement of all claims was reached with TXU Corp under which it is to pay about $220m to the ATL Companies and their creditors. The level of the global settlement with TXU Corp is not something about which the Applicants complain. The Respondents clearly believe that it was a considerable achievement, a sentiment with which I fully agree. The negotiation of it is fully described in Mr Wallace's first witness statement at paragraphs 530-605, the contents of which I accept.

43. The TXU Corp Claims issues relate firstly to the allocation of the $220m recovery between the claims on behalf of the estates and the direct claims of creditors, and secondly to the allocation between the various ATL estates of that part of the recovery allocated to the estates. The Applicants say that the allocation in fact effected as a result of the BTL and ATL CVAs is unfairly prejudicial to them.

44. I add at this point that the obligation of TXU Corp to make payment under the global settlement is conditional on the ATL CVAs becoming unconditional and not subject to any subsisting challenge, by 30 November 2005. It is the commercial imperative (from the perspective of the vast majority in value of external creditors and from the perspective of the officeholders) of achieving finality by that date which makes the applications in this case a matter of urgency.

45. After that brief explanation of the major issues facing the officeholders, I return to the timing of events leading to the BTL and ATL CVAs (although there was, of course, a huge amount of activity going on between these events, some of which I will need to deal with later).

46. On 5 April 2004, E&Y put forward proposals for an overall settlement of the issues concerning the BTL companies. The administrators of the BTL companies had to wrestle with the issues which I have identified other than the GFA issue (since that was really a matter between EH3 and EGO BV) and the Double Dip issue, although the TXU Corp Claims issues were of less concern below the line than above the line.

47. The proposal was unacceptable to Mr Wallace who regarded it as unfair to the creditors of TXUEG as well as to the creditors of the ATL companies. Some, at least, of the Committee Creditors also considered the proposal to be unacceptable. After discussing alternatives with the Committee Creditors, it was decided that the Committee Creditors should themselves submit a counterproposal with the benefit of input from KPMG.

48. On 21 May 2004, the counter-proposal to E&Y's proposal of 5 April 2003 was sent to E&Y by Andrew Wilkinson of Cadwalader on behalf of the Committee Creditors. It included these key terms:

    a. Net v Gross was to be settled at 75:25 in favour of net.

    b. The £67 million held by Herbert Smith was to be paid to TXUEL.

    c. Investigation proceeds (*ie* the proceeds of the claims against TXU Corp and directors) were to be split 5% to creditors of EET, 5% to creditors of TXUEG who were not creditors of the ATL companies and 90% to the creditors of the ATL companies.

    d. TXU UK was to receive for no consideration the benefit of the tax losses used to set off against its gain on the sale of its operating business.

49. In the event, the creditors of the BTL companies regarded the counterproposal as unfair and rejected it.

50. Mr Wallace and Mr Bloom decided to convene a meeting of the BTL companies creditors' committees and the Committee Creditors (*ie* creditors of the ATL companies) and their advisers in the hope of progressing a consensual solution. That meeting took place on 16 June 2004. It did not result in any agreement, the various creditor groups remaining polarised.

51. Mr Wallace and Mr Bloom then decided that, the creditors having failed to agree among themselves, they should put forward proposals which they considered to be fair and reasonable. Following negotiations between them, Joint Heads of Terms ("the **Joint Proposal**") were agreed on 29 July 2004. This contained a complete interlocking package of compromises dealing with each of the issues in contention.

52. It was not until 25 November 2004 that the lock-up agreements to the BTL settlement were completed. I note here that Bingham were very concerned, in relation to the £67 million issue, that the BTL settlement would be detrimental to their clients' interests unless the terms on which the £67 million was to pass to TXUEL were carefully spelt out to enable claims on behalf of the Conduit Companies to be asserted. They attempted to procure a suitable "reservation of rights" document. They failed in their attempt. That is a matter which I will have to deal with in detail later.

53. The BTL CVA proposals were circulated on 10 January 2005 and the BTL CVAs were approved at a creditors' meetings on 28 January 2005.

54. It had originally been envisaged by the officeholders of companies both below and above the line that the BTL and ATL CVAs would be synchronised. There is, in fact, an issue which I will deal with in due course about whether the BTL and ATL CVAs were ever intended to be mutually conditional and what the Applicants and Bingham were led to believe. In the event, it was not possible to bring them forward together. Instead, creditors above the line were not willing to turn their minds seriously to reaching an agreement to settle all issues above the line until the BTL lock-up agreement had been signed. Eventually, ATL lock-up agreements were signed on 26 January 2005 by a majority of creditors in order to provide the necessary percentage (60%) which TXU Corp required to see before it was prepared to enter into the TXU Corp settlement which was made on 27 January 2005.

55. On 3 March 2005, draft proposals were circulated by A&O for the ATL CVAs. After comments from Bingham, which were rejected, the final CVA proposals were circulated on 11 March 2005 and the creditors' meetings approving the CVAs took place on 31 March 2005.

LAW

Arrangement

56. Section 1(1) IA 1986 provides by the making by an administrator of a company in administration or for a liquidator of company which is being wound up of a "proposal to the company and its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs" referred to in the Act as a "voluntary arrangement". The decision whether to accept the proposal is that of the creditors and the members in accordance with section 4 and 4A IA 1986 and the Insolvency Rules.

57. If the proposal is accepted by the requisite majorities of creditors and members, then, under section 5 IA 1986, the voluntary arrangement takes effect as though made by the company at the creditors' meeting, thus binding the company, and becomes binding on every creditor who voted or was entitled to vote at that meeting as if he were a party to the voluntary arrangement. In other words, the section treats the company and the creditors as though they had made a contract giving effect to the terms of the voluntary arrangement.

Powers of liquidator

58. A liquidator has power to compromise claims by or against the company under section 165 IA 1986 but he requires the consent of the liquidation committee, or of the court, to an exercise of the powers specified in Part 1 Schedule 4 IA 1986, which include powers to compromise with creditors or claimants against the company and to compromise debts and claims by the company and to compromise "all questions in any way relating to or affecting the assets or the winding up of the company".

59. Where a liquidator proposes a CVA, he is not acting as an agent of the company, the creditors or the members. He is operating pursuant to a statutory provision with a view to the creditors and the members voting on the proposal. He clearly has power to make proposals and to take actions ancillary to that (*eg* taking advice on the strength of claims by and against the company); equally clearly, he does not, simply by making proposals,

enter into any compromise for which sanction is required under section 165 IA 1986. The voluntary arrangement itself may include compromises not only between the company and creditors but also between creditors. Thus, in a simple case, if company A has two creditors C1 (at £X) and C2 (at £Y) whose debts are both open to some challenge, the liquidator might consider that a fair compromise of each claim would be to reduce the first by 50% and the second by 10%. He could put forward proposals under which the claims of C1 and C2 are compromised at 50%x£X and 90%x£Y and under which each shares *pro-rata* to those amounts in the assets made available for the purposes of the arrangement. If the necessary majorities of creditors and members vote in favour of those proposals, the arrangement becomes binding on the company and on A and B. But there is no requirement for the liquidator to obtain the sanction of the liquidation committee or of the court.

60. A liquidator might consider that the proposal which he is to put forward should be conditional for some good commercial reason. I see no reason why he should not put forward a conditional proposal which, if voted on, will become binding on the company and the creditors so that, if the condition is duly satisfied, the voluntary arrangement will then take effect according to its terms.

61. Whether a liquidator of one company (company A) can vote in the CVA of another company (company B) of which his company is a creditor without sanction is a nice question. The answer may depend on the precise nature of what he is voting for. If he simply votes in relation to an unconditional CVA as a result of which company A's (disputed) claim against company B is settled for some smaller figure, I can see that it can be said that he is compromising the claim and that sanction is required (although if company B's CVA would have gone through anyway without company A's vote, the absence of sanction has no consequence unless the resulting CVA is unfairly prejudicial).

62. However, on different facts a different result may obtain. Take, for instance, a case where the liquidator of company A votes in relation to a CVA of company B where, contemporaneously, he is putting forward proposals for a CVA for company A. Let us suppose, in this example (as is so on the facts of the present case) that the CVA of company A is conditional on approval of the CVA of company B and *vice versa*. Unless and until the CVA of company A is approved, the liquidator has not bound company A to any final compromise even if company B's CVA is, in the event, approved before that of company A (conditionally, again, on the approval of company A's CVA): there is, at most, a conditional compromise of company A's claim against company B.

63. However, this conditional compromise is an unusual one. Unlike a conditional contract where the condition is in the control of a third party (*eg* a contract for sale of land subject to obtaining a suitable planning permission within a specified period of time) the condition in the example given cannot be fulfilled unless company A's own CVA is approved. But if that CVA is approved, then, pursuant to section 5, it takes effect as if made by the company itself at the creditors meeting and its terms are binding on the creditors. It ceases, in my judgment, to be of any consequence whether the liquidator of company A should have obtained the sanction of the creditors' committee or of the court. The effect of the CVA is to ratify on behalf of the company and all of the creditors voting or eligible to vote so that none of those creditors can complain about the manner in which the liquidator voted in relation to company B's CVA.

64. The position is *a fortiori* where the vote of the liquidator of company A would have made no difference at all to the result of the vote in relation to company B's CVA. It then becomes a matter of no substance (unless company B's CVA is in fact unfairly prejudicial to company A) whether or not the liquidator had the consent of his creditors' committee or of the courts, since even if he had voted against company B's CVA, it would have gone through.

65. Continuing with the example, suppose that the liquidator of company A has bound himself in advance of the putting forward of company B's CVA to vote in favour of it (*eg* by entering into a lock-up agreement such as was entered into by the liquidators of EH3 in relation to TXUEG's CVA). Is that something which requires sanction where both CVAs are conditional on the approval of each CVA? My conclusion is that it is not, my reasoning being precisely the same as just explained in relation to a vote by the liquidator of company A on company B's CVA at a time before company A's own CVA is approved.

Powers of administrator

66. An administrator has very wide powers under paragraph 59 Schedule B1 and Schedule 1 IA 1986, including powers to compromise. Mr Davies refers me to *Re C E King Ltd* [2000] 2 BCLC 297, where Neuberger J commented (at 306b) upon the importance of the committee:

> "However, it is right to say that the court does, in appropriate circumstances, have power to authorise the administrator to take a course, despite the fact that the creditors' committee have voted by a majority against it, but that is a course which the court would only take in very exceptional circumstances."

67. But those comments were made in the context of the court authorising the administrators to depart from the decision of the committee when voting on proposals put by the administrator in accordance with sections 23 and 24 IA 1986. I do not find them of assistance in relation to the exercise by the administrator of his powers of compromise let alone in carrying out his functions in proposing the terms of a voluntary arrangement.

Unfair prejudice

68. It is for an applicant for relief under section 6 IA 1986 to show that the voluntary arrangement which he challenges unfairly prejudices his interests.

69. To constitute a good ground of challenge, any unfair prejudice must have been caused by the terms of the arrangement itself: *IRC v Wimbledon Football Club Ltd* [2005] 1 BCLC 66. That proposition (and some other useful conclusions) appear in the passage from the judgment of Lightman J at para 18:

> "Section 6 provides that a creditor may apply to the court for an order to revoke or suspend a decision approving a voluntary arrangement on the ground that the 'voluntary arrangement unfairly prejudices the interest of [the] creditor'. The authorities establish that: (1) to constitute a good ground of challenge the unfair prejudice complained of must be caused by the terms of the arrangement itself; (2) the existence of unequal or differential treatment of creditors of the same class will not of itself constitute unfairness, but may give

cause to inquire and require an explanation; (3) in determining whether or not there is unfairness, it is necessary to consider all the circumstances including, as alternatives to the arrangement proposed, not only liquidation but the possibility of a different fairer scheme; (4) depending on the circumstances, differential treatment may be necessary to ensure fairness (see *Cazaly Irving Holdings Ltd v Cancol Ltd* [1996] BPIR 252 at 269–270 and *Sea Voyager Maritime Inc v Bielecki* [1999] 1 BCLC 133 at 148 - 154, and (I would add) (5) differential treatment may be necessary to secure the continuation of the company's business which underlies the arrangement: (consider *Re Business City Express Ltd* [1997] 2 BCLC 510).

70. See also to the same effect, *Doorbar v Alltime Securities Ltd (No. 2)* [1995] 2 BCLC 513 at 517c; and *Re a debtor (No 259 of 1990)* [1992] 1 WLR 226 at 228-229. It is probably worth mentioning what is probably implicit but which was made explicit by Mr Richard McCombe QC sitting as a deputy judge of this division in *Sea Voyager Maritime Inc v Bielecki (t/a Hughes Hooker & Co)* [1999] 1 All ER 628 that the prejudice to the applicant must be prejudice as a creditor of the debtor and not in some other capacity: see at p 642. The only occasion on which the Court of Appeal appears to have considered this test is in *Cadbury Schweppes plc v Somji* [2001] 1 WLR 615 where Robert Walker LJ identified the "fairly strong line of first-instance authority" which is "uniformly in favour of limiting the effect of the provisions to unfairness brought about by the terms of the [CVA] itself". I propose to follow the same line.

71. In determining whether or not there is unfairness, it is necessary to consider all the circumstances and, in particular, the alternatives available and the practical consequences of a decision to confirm or reject the arrangement: *IRC v Wimbledon* (supra) per Lightman J at para 23:

> "The question of fairness of the arrangement requires consideration of all the circumstances and in particular the alternatives available and the practical consequences of a decision to confirm or reject the arrangement. In my judgment the only practicable course available to the administrators was to enter into the agreement and proceed with the scheme. The alternative advocated by the Revenue, in their single minded pursuit of their principled objection to the payment in full of the priority debts, can only bring down the whole edifice and secure a nil return for all concerned."

72. Where the Court's approval is sought to a proposed compromise by a liquidator, the Court must consider how the interests of creditors will be best served. As Chadwick LJ said in *Re Greenhaven Motors Ltd* [1999] 1 BCLC 635 at 643d-e:

> "In deciding whether or not to sanction a proposed compromise the court must consider whether the interests of those, whether creditors or contributories, who have a real interest in the assets of a company in liquidation are likely to be best served (i) by permitting the company to enter into that compromise with all the terms that it contains; or (ii) by not permitting the company to enter into that compromise. It is not for the court to speculate whether the terms of the proposed compromise were the best that could have been obtained; or whether the proposed compromise would have been better if it did not contain all the terms that it does contain. Unless it is satisfied that, if the

> company is not permitted to enter into the compromise on the terms which the liquidator has negotiated, there will then be better terms or some other compromise on offer, the decision is between the proposed compromise and no compromise at all."

73. Similarly, in my judgment, it is not for the Court to speculate whether the terms of a proposed CVA which were put forward by an officeholder were the best that could have been obtained, or whether it would have been better if it had not contained all of the terms which it did contain. Unless the court is satisfied that better terms or some other compromise would have been on offer, the comparison must be between the proposed compromise and no compromise at all judging matters as of the date of the vote on the CVA. If an administrator or liquidator puts forward a proposal which he considers to be fair then, unless it is established that he acted other than in good faith or that he is partisan to the interests of some only of the creditors, the court should not speculate about what other proposals might have gained acceptance and been capable of implementation (an essential element, since there is not much point in gaining approval unless the resulting arrangement can be implemented).

74. The statutory scheme envisages that different creditors might have different views on whether an arrangement should be approved and provides for the minority to be bound by the majority, subject to protection of the minority in cases of "unfair prejudice". This concept, as was said by Knox J in *Doorbar v Alltime Securities Ltd (No. 2)* (*supra*), at 518F-519A, is aimed at disproportionate prejudice on one side or the other.

75. In *Re T&N Ltd* [2004] EWHC 2361 (Ch) David Richards J gave a most helpful summary, essentially for the benefit of the Courts of the United States, of voluntary arrangements and schemes of arrangement. In relation to fairness, he said this at para 81:

> "There is no statutory guidance on the criteria for judging fairness either for a scheme of arrangement under section 425 of the Companies Act 1985 or for a CVA under section 6 of the 1986 Act. There is a difference in the onus. Under section 425, it is for the proponents to satisfy the court that it should be sanctioned, whereas under section 6 it is the objector who must establish unfair prejudice. I do not, however, consider that there is any difference in the substance of the underlying test of fairness which must be applied. It is deliberately a broad test to be applied on a case by case basis, and courts have struggled to do better than the approach adopted by the Court of Appeal in Re Alabama, New Orleans, Texas and Pacific Junction Railway Co [1891] Ch 213 and summarised in the often-cited passage from a leading textbook, Buckley on the Companies Acts:
>
>> 'In exercising its power of sanction the court will see, first, that the provisions of the statute have been complied with, second that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.

> The court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting, but, at the same time, the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found in the scheme.'

That paragraph is directed to schemes of arrangement. The crucial difference with a CVA is that there is just one meeting of creditors, so that necessarily means that there may be sub-groups who would constitute separate classes for a scheme. In considering unfair prejudice, the court will have regard to the different position of different groups of creditor. This, too, will be the case with a scheme of arrangement where groups of creditors with different interests or even rights nonetheless have been included in the same class for the purpose of considering and voting on the scheme."

76. The citation of the passage from *Buckley on the Companies Acts* of the decision of the Court of Appeal of *Alabama etc Railway Co* shows the reasonable and honest man to be a welcome guest also at the home of the CVA. Ultimately, if I judge that this reasonable and honest man in the same position as the Applicants might reasonably have approved the CVAs which are challenged, the Applicants fail.

77. The application of this test can be seen in operation in the context of schemes of arrangement in the decision of Lewison J in *Re British Aviation Insurance Company Limited* [2005] EWHC 1621. Mr Crystal (for Mr Wallace and Mr Tucker) relies on paragraph 75 where, after reading from *Buckley*, Lewison J says this:

> "Thus stated, the test is not whether the opposing creditors have reasonable objections to the scheme. A creditor may be equally reasonable in voting for or against the scheme. In such a case Mr Moss submitted that creditor democracy should prevail. Where, as here, those who voted in favour of the scheme are large and sophisticated corporations, the rigid application of this test as the sole criterion would rarely, I think, enable the court to refuse to sanction a scheme. It is also not entirely clear to me how the rigid application of this test sits with statements that the court has an unfettered discretion"

78. Mr Crystal submits that, considering the terms of any CVA, the Court proceeds on the basis that in commercial matters creditors are usually much better judges of their own interests than the Courts. The Court will, therefore, be slow to differ from the views expressed by creditors at the meeting. I agree with that, of course, as a general proposition. But where a creditor or group of creditors are looking at their wider interests (*ie* not simply as creditors of the company under consideration) they may judge it to be in their interests to vote in favour of a proposal which is favourable to them notwithstanding that, as creditors of that company only, they would have voted against it. If such a course results in unfair prejudice to another creditor, section 6 is there to provide a remedy.

Material irregularity

79. It is again for an applicant to show that there were material irregularities at or in relation to the meetings voting in favour of proposals for a voluntary arrangement.

80. The words of section 6(1)(b) of IA 1986 make clear, in my judgment, that it is necessary for an applicant to demonstrate that (i) there was an irregularity at or in relation to the CVA meeting and (ii) that irregularity was material.

81. Mr Crystal submits that, if the irregularity relates to the information provided to creditors, the correct approach to materiality is to ask the following question, which must be answered objectively: Whether, had the truth been told, it would be likely to have made a material difference to the way in which the creditors would have considered and assessed the terms of the proposed arrangement, adopting the words of Robert Walker LJ in *Cadbury Schweppes plc v Somji* (supra) at para 25, cited with approval by Lewison J in *Re Trident Fashions (No. 2)* [2004] 2 BCLC 35 (see at paras 38, 45-6). I accept Mr Crystal's submission and note (only to agree with) what Lewison J says at para 46 after citing the test approved in *Cadbury Schweppes plc:*

> "I do not consider that is the same as asking: would the meeting have been adjourned? It seems to me the real question is: would the revelation of the truth have made a material difference to the way in which the creditors would have considered the terms of the CVA itself? The word "likely" is used in a variety of different ways. It does not necessarily mean that there is more than a 50% chance. It seems to mean, therefore, that the right test is whether there was a substantial chance that the creditors would not have approved the CVA in the form in which it was presented."

Removal of officeholders

82. The applications for removal are made, in relation to EGO BV, pursuant to paragraphs 74 and/or 88 of Schedule B1 to the 1986 Act and, in relation to EH3, pursuant to sections 108 and 171 of the 1986 Act.

83. Under section 108, the applicant must show "cause" as to why a liquidator should be removed from office. The burden under section 108 is on an applicant to show cause: *Re Keypack Homecare Ltd* [1987] BCLC 409 per Millett J at 415E. That is not the same thing, according to Millett J, as providing for removal "if the court thinks fit" but nor does it require anything amounting to misconduct or personal unfitness.

84. The test for due cause remains that set out in *Re Adam Eyton Ltd ex parte Charlesworth* (1887) 36 Ch D 229 per Bowen LJ at 306.

> "The due cause is to be measured by reference to the real, substantial, honest interests of the liquidation, and to the purpose for which the liquidator is appointed."

most recently followed by Etherton J in *Re Buildlead Ltd (In Liq) (No.2)* [2005] BCC 138 at paragraphs 168-9 following citation from a number of authorities at paragraphs 154-168.

85. There is a, sometimes difficult, balance to be held. On the one hand, the court expects any liquidator to be efficient, vigorous and unbiased in his conduct of the liquidation and should have no hesitation in removing him if satisfied that he has failed to live up to those standards unless it can reasonably confidently be said that he will live up to those

requirements in the future. On the other hand, the court must think carefully before removing him, otherwise similar applications by disgruntled creditors in other cases would be encouraged; and there would, of course, be likely to be cost implications: see *AMP Music Box Enterprises Ltd v Hoffman* [2003] 1 BCLC 319 per Neuberger J at 325F-326G:

> "[23] In an application such as this, the court may have to carry out a difficult balancing exercise. On the one hand the court expects any liquidator, whether in a compulsory winding up or a voluntary winding up, to be efficient and vigorous and unbiased in his conduct of the liquidation, and it should have no hesitation in removing a liquidator if satisfied that he has failed to live up to those standards at least unless it can be reasonably confident that he will live up to those requirements in the future.
>
> [24] Support for this approach is not only to be found in *Keypack*, but also in some cases where the court has compulsorily wound up the company and appointed a new liquidator in circumstances where there is already a voluntary liquidator in place – see for instance, *Re Zirceram Ltd* [2000] 1 BCLC 751, especially at para 25(5). Also where the liquidator could not be seen as independent – see, for instance, *Re Lowerstoft Traffic Services Ltd* [1986] BCLC 81 (where the liquidator concerned seems to have been the same liquidator as in *Keypack*).
>
> [25] It may also be right to remove a liquidator where the circumstances are such that, through no fault of his own, he is perceived to be – even though he may not be – biased in favour of, say, one or more of the creditors – see per Robert Walker J in *Re Gordon & Breach Science Publishers Ltd* [1995] 2 BCLC 189, another case concerned with a compulsory winding-up order in circumstances where there was already a voluntary liquidator in place.
>
> [26] While the removal of the liquidator is not necessarily based on any fault on his part, most such cases will involve a degree of criticism. Although in *Keypack* Millett J emphasised there was no criticism of the general ability, experience and professionalism of the liquidator, and that, even in relation to the particular case, there was no evidence of his being biased or dishonest, it is nonetheless clear that he was removed because the judge took a dim view of the way in which he had conducted the particular liquidation. As the judge said, the fact that this may to some extent resound to the discredit of the liquidator, does not mean that the court should shy away from making the order. On the contrary, in an appropriate case it is the duty of the court to make such an order, not merely on the merits of the particular case, but also because it sends out a clear message to liquidators that they have an important function which they should conduct in a vigorous, effective and independent manner.
>
> [27] On the other hand, if a liquidator has been generally effective and honest, the court must think carefully before deciding to remove him and replace him. It should not be seen to be easy to remove a liquidator merely because it can be shown that in one, or possibly more than one, respect his conduct has fallen short of ideal. Otherwise, it would encourage applications

> under s 108(2) by creditors who have not had their preferred liquidator appointed, or who are for some other reason disgruntled. Once a liquidation has been conducted for a time, no doubt there can almost always be criticism of the conduct, in the sense that one can identify things that could have been done better, or things that could have been done earlier. It is all too easy for an insolvency practitioner, who has not been involved in a particular liquidation, to say, with the benefit of the wisdom of hindsight, how he could have done better. It would plainly be undesirable to encourage an application to remove a liquidator on such grounds. It would mean that any liquidator who was appointed, in circumstances where there was support for another possible liquidator, would spend much of his time looking over his shoulder, and there would be a risk of the court being flooded with applications of this sort. Further, the court has to bear in mind that in almost any case where it orders a liquidator to stand down, and replaces him with another liquidator, there will be undesirable consequences in terms of costs and in terms of delay."

Perhaps one can say that this is another area of the law where one's flexible friend, proportionality, is to be found at work and the matter should simply be approached on a proportionate basis.

86. In considering the interests of the insolvency proceedings, the Court may well be concerned only with the future and not with the past as was the case in *AMP Music Box Enterprises Ltd v Hoffman*: see *per* Neuberger J at 328F. It will have regard to (but will certainly not be bound by) the wishes of the majority of those interested in deciding whether to remove an office-holder. It should not lightly remove its own officer and must pay due regard to the impact of any removal on his professional standing and reputation: see *Re Edennote Ltd* [1996] 2 BCLC 389 (CA) per Nourse LJ at 398F.

87. The cases I have referred to relate to removal under section 108(2) (or its predecessors). The same approach applies to removal under section 172(2): see *Re Edennote Ltd* at 397h-i, Nourse LJ saying that the difference in language between section 108(2) and section 172(2) is immaterial, adding that "it is not easy to think of any circumstances in which the court would remove a liquidator without cause being shown". I see no reason to apply a different approach in relation to section 171(2).

88. Paragraph 74 Schedule B1 IA 1986 permits the Court to make an order which provides for the appointment of an administrator to cease to have effect. Such an order can be made pursuant to an application under paragraphs 74(1) or (2). If the court decided that removal was the appropriate remedy based on the underlying facts justifying the complaint, no doubt "cause" (in the same sense as in section 108) is shown for the removal. The free-standing power under paragraph 88 appears to be unlimited. However, like Nourse LJ in *Re Edennote Ltd* when addressing section 172(2), I consider that it is not easy to think of any circumstances (that is to say, I cannot at present think of any circumstances) in which the court would remove a liquidator under paragraph 88 without cause being shown.

89. The last case to which I want to refer under this heading is *Shepheard v Lamey* [2001] BPIR 939 which the Applicants rely on. I do not think it adds much, if anything, to the approach which the cases I have already cited display although it is a case, like *Buildlead*

Ltd, which shows that if there is a possibility of misfeasance proceedings against a liquidator, he should, ordinarily speaking, be removed. In Jacob J's pithy words

> "….The fact is that these documents alone indicate a case for removal. After all, all that one has to find is some good cause why a person should not continue as liquidator. You do not have to prove everything in sight; you do not have to prove, for example, misfeasance as such; you do not have to show more than there may well be a case for misfeasance or, indeed, incompetence."

90. And as Etherton J reasoned in *Buildlead* (see at paragraph 243):

> "..a new liquidator would be able to exercise an independent professional judgment about the liquidator's conduct, having investigated all the circumstances, and to decide not only whether [certain allegations are made out] due to culpable conduct on the part of the liquidators".

Conflicts of duty and interest

91. Mr Crystal and Mr Briggs submit that I should not waste, to use their word, much time on considering conflicts. They say that it is not really relevant to the question of unfair prejudice under section 6 IA 1986 whether any of the officeholders were subject to conflicts which made their tasks difficult (or as Mr Davies would say, impossible) of performance. It is for the court to judge whether the result – even if one arrived at by persons in positions of conflict – is or is not unfairly prejudicial to the Applicants; it is irrelevant how that result is reached. I will deal with that submission later, pausing only to observe that, in my view, the conflicts are not, on any reasonable view, irrelevant. If, as the Applicants say, decisions have been made by persons in positions of serious conflict which have resulted in CVAs which are unfairly prejudicial to them, the conflict makes it even more important that the court is sure that there is no such prejudice if it is to refuse the Applicants a remedy. The conflicts cannot, I consider, simply be ignored.

92. It is, indeed, part of Mr Davies' submissions that these officeholders could not, as a matter of law and because of their conflicted positions, have taken some of the actions which they did including entering into lock-up agreements and proposing the two sets of interlocking CVAs which they did and from which it is said to follow that the CVAs are either altogether invalid or necessarily unfairly prejudicial to the Applicants. Accordingly, I propose to address some, at least, of the submissions made by the parties in relation to conflicts and then to make some observations on the relevance of conflicts as I see the position.

93. Mr Davies' Opening Written Submissions contain a long and learned exegesis about the different types of conflict which can arise for professionals, such as the officeholders in the TXU Europe group insolvencies, where they or their partners have previously advised interested parties or companies (or their directors) within the group or where they or their partners are officeholders in more than one company. These submissions also address the applicable ICAEW Guidance. I have found it very difficult to decide how to deal with his submissions (which, so far as concerns general principles, are to be found in his written opening submissions in part of the section under the heading "Conflicts of interest" running from paragraph 181 to 276) in the light of (a) their length (as to which I would like to make clear I intend no criticism at all) and (b) the time available to me to

extract the important elements for the purpose of this judgment. Much of what he says about the law is not contentious. And some, at least, of the conflicts he identifies certainly existed. What I propose to do, therefore, is not to deal with most of his submissions in this section of my judgment (on the law) but to bear in mind the conflicts which he identifies when dealing with the particular aspects of the CVAs of which complaint is made (the four main issues – the £67 million, the GFA, the TXU Corp settlement and the PPA Payments – and the releases of the officeholders).

94. There is, however, one general observation Mr Davies makes in relation to conflicts issues for insolvency practitioners. He says that there is a natural tendency for an insolvency practitioner affected by conflicts of interest to trivialise them or to assert that they can or have been managed and that they will not affect (or have not in fact affected) the officeholder's impartiality or independence. He then refers to *Re Barings plc* [2001] 1 BCLC 159, where there was concern expressed about the position of conflict of E&Y (who were eventually replaced). Sir Andrew Morritt VC said (emphasis added):

> "The fact that the present liquidators may face conflicts of interest comparable to those which would face the partners of KPMG if appointed liquidators in their place is no consolation to those such as the perpetual trustee or the FSA claimants who have not been informed of the reasons why the 1986 trustee requisitioned a meeting at the time it did. <u>Indeed the time may be approaching when, to deal with the conflicts faced by all the major firms of insolvency practitioners in liquidations such as this, serious consideration will have to be given to leaving the Official Receiver as a liquidator and authorising him to employ his agents and insolvency practitioners of his choice and to requiring him to monitor their costs and expenses."</u>

95. As to that case, the background is that certain bondholders wanted there to be a meeting at which they could vote out the existing Court officers and appoint new Court officers. The existing officers were E&Y partners and the proposed new officers were KPMG partners. The conflict that KPMG were facing was that they were the auditors of ING, so it was being said that ING wanted to put its own auditors in as officers of the Court. The judge was not dealing with conflicts management or addressing conflicts between estates in a group situation at all and none of the cases which I am about to consider in relation to that were drawn to his attention.

96. Rather, he was being asked to order a meeting which would have the result of the Court's officers being removed in favour of other highly experienced and reputable accountants who had conflicts. It was in that context that the Judge said what he did. It is interesting to note, I think, that the Judge recognised that conflicts within large insolvencies were common - and I might add almost inevitable given the small number of large practices competent to deal with them.

97. Mr Crystal comments that the passage which I have quoted was not the subject of any argument before the judge and that his suggestions are, in practice, unworkable, because the theory underlying the insolvency legislation would not enable the Official Receiver effectively to delegate the whole of the management of a major insolvency to a firm of accountants. That is not a problem with which I am concerned but there clearly are difficulties with the Vice-Chancellor's approach.

98. Mr Davies submits that what he terms existing client conflicts can arise for insolvency practitioners where the same officeholders, or officeholders from the same firm, are appointed in respect of two companies with competing interests. He says that, in accordance with normal principles relating to existing client conflicts, the officeholders should obtain the informed consent of both companies (and their respective creditors) before accepting both appointments. Nonetheless, the officeholder still has a duty to act impartially: he will still be subject to the no inhibition principle (inhibition from performing his duty to each client as if his only client even where both clients consent to his acting) and will also have to resign one or both appointments if an actual conflict arises. Further, the acceptance of multiple appointments will, he says, often give rise to at least the appearance of bias or partiality, which is itself a sufficient ground for removal.

99. He refers to *Re City & County Investment Company Ltd* (1877) 25 WLR 342 where the same person was appointed liquidator of two companies which had conflicting interests. Malins VC said that he:

> "would never have appointed the same person as liquidator of both [companies which had an antagonistic interest] for no man should ever be placed in a position in which his duty and his interest conflicted."

This was a case of actual conflict. The refrain "a position where his duty and interest conflict" is, I note, one which runs consistently through the many cases in the field of trusts relating to conflicts: see for example the cases cited by Mr EG Nugee QC in *Re Wallace Smith & Co Ltd* [1992] BCLC 970 at page 987.

100. Mr Davies also refers to *Re Britton & Millard Ltd* (1957) 107 Law Jo 601 where the same person was appointed liquidator of two associated companies in circumstances where it was not apparent from the books which debts were owed by which company. In a passage on which Mr Davies relies Roxburgh J said this:

> "It appeared that the liquidator could not from the books of the two companies say whose debts they were; he was thus going to exercise a quasi-judicial position but, as he represented each of the two companies, he would be appearing for conflicting interests. If there was an apparent conflict then the liquidator could not act for both conflicting interests."

101. However, in referring to a quasi-judicial function, Roxburgh J was clearly referring to the decision of the liquidator to admit, for the purposes of voting, a disputed debt in relation to which, as liquidator of two companies, he was in a position of conflict. Since I will need to deal with it at some stage, I say at this point that, in my judgment, an officeholder making proposals for a voluntary arrangement is not in a similar quasi-judicial (whatever that may mean) position as has been submitted to me. He is not adjudicating on the claims of creditors when putting forward proposals. True it is that he may, in the course of doing so, need to make some sort of assessment of the strength of competing claims in order to present a proposal which he considers to be fair. But it is for the creditors to vote on those proposals (so that, if anyone is making an assessment, it is the creditors) subject to the protection afforded by section 6 to a minority creditor.

102. Mr Crystal says that the Applicants' complaints about conflicts of duty/interest ignore the well established approach of the Courts to conflicts, actual or potential, in the context

of large group insolvencies in England. As he says, large group insolvencies inevitably raise the potential for conflicts of interest. He makes these perfectly correct assertions

> "These can relate to a myriad of matters including, for example, inter-company balances, competing claims to assets, allocation of liabilities, guarantee and indemnity claims, issues of set-off or double proof, the validity of security, tax and avoidance or recovery actions. Often, at the stage at which office-holders are appointed and for some considerable time afterwards, it may not be clear what conflicts exist or how they should be managed."

103. In the context of large group insolvencies, the appointment of a common office-holder is *prima facie* likely to be in the interests of the general body of creditors of each company. The conduct of the insolvencies by a common officeholder will be more efficient and less costly than having a plethora of appointments. Having regard to considerations such as cost and efficiency, especially in relation to the sharing of resources, the English Courts, Mr Crystal submits, have for many years approached the issue of conflicts in relation to large group insolvencies in a common sense and pragmatic way. In particular, he says that the general approach of the Courts has consistently been that:

   a. Licensed insolvency practitioners are professional men who are well accustomed to dealing with conflicts.

   b. In general it is in the interests of creditors, at least in the first instance, to appoint a single officeholder and any conflicts are usually best left to be managed if and when that becomes necessary.

   c. If and when it becomes clear that any conflict is sufficiently material to require to be managed, one of a variety of different approaches may be appropriate depending on all the circumstances.

   d. Such different approaches may include, for example, obtaining legal advice, the appointment of an additional partner from the same firm or the appointment of an independent partner from a different firm.

104. These submissions certainly find some support in the authorities. Starting with *Re British National Life Assurance Association* (1872) LR 14 Eq. 492 one finds Malins VC referring, at page 498-499, to "the great inconvenience which would arise from having a number of separate liquidators mixed up with these affairs" and to the fact that "everybody must see what the consequences would be of having separate sets of liquidators of each of the thirty-nine companies going about the same offices, looking over the same books, searching through the same papers, and substantially engaged about the same business"; and one sees reference (at the foot of page 498) to the case of *In re Western Life Assurance Society* LR 5 Ch 396, where, in relation to a potential conflict on any question of law, it was said that a separate solicitor could be appointed.

105. More recently, in *Re Esal (Commodities) Ltd* [1989] BCLC 59, Dillon LJ referred to the conflicts capable of arising between the interests of group companies with different creditors. He pointed out that insolvency practitioners are well-accustomed to dealing with such conflicts. The following passage is instructive (see p65c-d):

> "…..Of course there are possible conflicts of interest. It is unnecessary to go into them in detail, but one of the more obvious is that in an insolvency situation the subsidiary will have its own creditors whose claims will have to be met. Sometimes the creditors will include the parent company or the subsidiary next up the line. Sometimes the interest of the parent company or subsidiary next up the line will merely be an interest as shareholder which ranks behind the creditors of the subsidiary. But these sort of potential conflicts do not in practice give rise to any serious difficulty because they are well known to the experienced insolvency practitioners."

106. In *Re Arrows Ltd* [1992] BCC 121, Hoffmann J. had to deal with an application for the removal of certain provisional liquidators. Partners in E&Y were appointed provisional liquidators of a company and receivers of another 80 companies with which the company was connected. There were potential conflicts of interest arising out of the receivers' entitlement to forfeit certain reversionary leases, the provisional liquidators' right to trace the company's moneys in the properties owned by the receivers and debtor/creditor cross-claims. The company applied for an order for the replacement of the provisional liquidators, who had by that time spent a considerable amount of time, money and effort in unravelling the company's affairs. It was held that it would not be right to order the replacement of the provisional liquidators on account of a potential conflict of interest which had yet to materialise. There was little prospect of a conflict arising between the receivers and the provisional liquidators as in most cases the lenders had appointed Law of Property Act 1925 receivers to the properties owned by the receivership companies. Those companies which did not fall into that category could be adequately protected by ensuring the receivers received separate legal advice from the provisional liquidators from different solicitors. There was no useful purpose in replacing the provisional liquidators in the light of the work undertaken by them to date which would otherwise be wasted and the necessity to produce a report from the provisional liquidators.

107. Hoffmann J. noted that: (1) the potential conflicts could be adequately addressed by the provision of independent legal advice or by the appointment of independent members of the same firm to act against their partners in case of conflict (at page 123F); and (2) the efficient conduct of investigation work could be hampered by the appointment of more than one firm to act (at page 123G-H). With those considerations in mind, he stressed that the Court's approach was to manage conflict on behalf of creditors as and when it arose:

> "... the course taken by Knox J in appointing the same firm to be both provisional liquidators and receivers of the property holding companies was, if I may say so with respect, eminently sensible. In fact, it is very difficult to see how the necessary process of investigation would have been efficiently conducted if there were separate firms representing all, or worse still some of the receivership companies, and another firm representing the provisional liquidators. It is by no means uncommon in the case of the insolvency of a substantial group of companies for cross-claims and conflicts of interest to arise between companies within the group. That does not usually deflect the court from appointing a single firm of insolvency practitioners in the first

> instance to deal with the whole insolvency of the group, leaving the question of potential conflict of interests to be dealt with if and when it arises."

108. That, it is to be noted, is a decision concerning potential conflicts. The Applicants in the present case complain that KPMG were from the outset acting under actual conflicts and should never have taken office as liquidators of EH3 or administrators of EGO BV, the informed consent of the Applicants not having been obtained. That is certainly a difference. However, if the correct approach is to allow the same individuals to act where there is potential conflict but to ensure that the conflict is managed if and when it becomes an actual conflict, I do not see why an existing actual conflict should preclude an appointment rather than providing for it to be managed – assuming of course that it is capable of being effectively managed.

109. Mr Davies contrasts the decision in *Re Arrows* with *Re Wallace Smith & Co Ltd* [1992] BCLC 970, in which joint liquidators of an English company applied to wind up a Canadian company in circumstances where the joint liquidators (from KPMG) expected to be appointed liquidators of that Canadian company if the order were made. Mr Davies refers me to what Mr EG Nugee QC said namely that if appointed to both companies, the liquidators

> "would be subject to an acute conflict of duties, and the conflict would be hardly less acute for anyone else who was a member of KPMG…. or any firm associated with it."

110. However, that passage should be read in the context of the facts of that case and it should be remembered that what Mr Nugee said about conflicts of interest was in the context of refusing to make a winding-up order, in relation to which conflicts were but one factor. However, he does say this, in distinguishing *Re Arrows Ltd* and *Re Esal (Commodities) Ltd*:

> "The present case is very different from those two cases. Here there is not merely a potential conflict of interest but substantial litigation on foot between WSTC and WS & Co, and it would in my judgment be quite wrong to make a winding-up order in this jurisdiction which would be very likely to have the consequence that the liquidators of WSTC, or persons closely associated with them, would be appointed liquidators of WS & Co….."

111. The next case to consider is *Re Maxwell Communications Corporation plc* [1992] BCLC 465 another decision of Hoffmann J. It was another case of potential, rather than actual, conflict where the conflict was, as described by the judge, distant (although it would, if it arose, be serious since it involved criticism of the proposed administrators in carrying out audits of a subsidiary of the company). Nobody, however, was proposing exclusively wholly independent administrators; the question was whether an additional administrator should be appointed, as Morritt J had done in *Re Polly Peck International plc* (unreported). In the course of his judgment, Hoffmann J said this:

> "The disadvantage of appointing an additional administrator is as Morritt J. observed in the Polly Peck case, the further expense and delay which is caused by having to have co-operation between two different firms of accountants and in this case by having to introduce a new firm which has no previous

> knowledge of the circumstances of this company to join Price Waterhouse, who have a head start in the matter.
>
> There are other ways of dealing with a potential conflict of interest. One of them is to leave the matter to be dealt with if and when it arises. It seems to me that any provision which I make to deal with it today could equally be made at some future date either here or in the US. If such a conflict should surface there should be no difficulty for the administrators, if they find themselves faced with any difficulty in the matter, in securing the appointment of the necessary independent persons by the court in New York or by the court here to relieve them of any embarrassment which they might feel."

112. In other words, the Judge is again saying that conflicts of this nature can be managed rather than there being a rigid requirement to avoid them. Whether, and if so how, a conflict can be managed is a matter for decision when a potential conflict materialised. Where there is already an existing conflict, the management must be put in place immediately, if it can be, or if it cannot be, then the administrator will have to relinquish one, if not both (or more), of his conflicting positions. But even then, the circumstances may be such that the officeholder could not responsibly resign, for instance if some commercial compromise were about to take place against the background of an immovable and urgent timetable which simply would not allow for a new officeholder to become sufficiently familiar with the full facts of the case in time to make an informed decision on the deal.

113. Mr Crystal referred to *Re Bank of Credit & Commerce International S.A. (No. 2)* [1992] BCLC 579 which he describes as a good illustration of the Court's attitude to the appointment of a single firm to a complex international group insolvency. Partners in Touche Ross were appointed as provisional liquidators of BCCI. Certain depositors sought the appointment of an additional provisional liquidator to BCCI from a firm other than Touche Ross. The majority shareholders of BCCI were discussing a possible rescue operation and regarded the appointment of an additional provisional liquidator as unhelpful and unlikely to assist their negotiations. Sir Nicolas Browne-Wilkinson VC, in commenting on the delicate aspects of the application, rather than regarding the appointment of a single firm as undesirable, said this:

> "Hitherto in virtually all jurisdictions where court proceedings have been taken the court officers appointed to preserve on an interim basis the assets of the BCCI group have either been members of Touche Ross or associates of Touche Ross. Thereby the accountancy profession has managed to achieve, at least in part, a worldwide system for regulating international insolvency which the civilised countries of the world have failed to achieve so far as the law is concerned. For this court to contemplate on the existing state of affairs that there could be imported into that machinery somebody who was not part of the otherwise co-ordinated system of administration would be to send out an entirely erroneous message about what were the intentions and likely intentions of this court."

Now, there is nothing said about conflicts in this judgment. But it can be seen from further proceedings in the BCCI saga - *Re Bank of Credit and Commerce International*

SA (No.3) [1993] BCLC 106 per Nicholls VC and 1490 (CA) – that Touche Ross (subsequently Deloitte & Touche) became and remained liquidators of such companies. During the course of those liquidations, amongst other things, they negotiated and agreed a pooling agreement between the relevant BCCI companies (which had claims against each other) and a settlement agreement with the Government of Abu Dhabi, on behalf of, amongst others, both BCCI SA and BCCI Overseas, the two main companies in the group. Touche Ross continued to act at all times as liquidators in spite of the obvious potential conflicts amongst the various companies in the group.

114. I do not think that it is disputed that it is not unusual in England for accountants who have previously been advising a group of creditors to be appointed as office-holders. Mr Wallace, who has enormous experience in this field, says that it is commonplace. Whether or not that is strictly expert evidence (which he was not called to give) I do not pause to consider. In any event, one sees it occurring from reported cases: see again *Re Maxwell Communications Corporation plc* [1992] BCLC 465, where Hoffmann J did not regard the fact that Price Waterhouse had acted for the banks in investigating the company's affairs as precluding them from becoming officeholders, adding for good measure this:

> "There is in my mind nothing to choose so far as competence, integrity and independence are concerned between these two eminent firms. I have no doubt that each of them would act independently as office holders appointed by the court and that Price Waterhouse would in no way act in a way which favoured the banks at the expense of other creditors or…..that Messrs Touche Ross would cast themselves in the role of the management's nominees and favour them."

115. Mr Davies also referred to *Re Exchange Travel (Holdings) Ltd (in liq) (No 3)* [1997] 2 BCLC 579 where the same three office-holders were appointed as joint administrators and subsequently as joint liquidators of two companies, Holdings and its wholly-owned subsidiary Agency. When the appointments were made the affairs of the two companies were confusingly intermeshed. Mr and Mrs McNally were directors of both Holdings and Agency. Holdings did not trade in its own right, but incurred costs on behalf of its subsidiaries. Holdings used Agency's bank accounts to fund its expenditure. It was unclear whether the repayments which were the subject of the section 239 IA 1986 proceedings had been made by Agency or Holdings, and those proceedings had initially been brought in relation to both Agency and Holdings. By early 1994 it had become apparent (i) that Agency was the major creditor in the Holdings liquidation and (ii) that the repayments which were the subject of the section 239 proceedings had been made by Holdings. The amount owed by Holdings to Agency represented 98.8% of Holdings' indebtedness. On those facts (which Mr Davies, at least, describes as "exceptional"), Phillips LJ concluded:

> "In the light of these facts I cannot see any conflict of interest between the creditors of Agency and the creditors of Holdings, nor anything improper in the same office holders acting in respect of the liquidations of each company."

So that is a case where the court perceived there to be no conflict and, accordingly, had no problem with the appointment of the same liquidators to each company. It is not authority for the converse proposition that, in all cases, it is inappropriate to appoint

individuals as officeholders to two or more companies even where there are existing conflicts but where conflicts can be satisfactorily managed, for instance, in cases where this is adequate, by the appointment of an additional independent officeholder.

116. Apart from these authorities, it should be noted that officeholders, in putting forward proposals for a CVA, are not negotiating or agreeing anything. It is not for the officeholders to advocate the interests of one group of creditors as against another group, nor to engage in brinkmanship, or attempt to extract ransom payments, on their behalf by refusing to put forward what he, the officeholder, regards as a fair proposal in order to extract a better proposal for the first group. They simply put forward proposals (which, if they are acting properly are ones which they must consider to be fair to all the creditors of the company and to the company itself). It is for the creditors to decide, by voting on the proposal, whether a voluntary arrangement under IA 1986 should come into effect. Nor are they negotiating on behalf of creditors in negotiating compromises of claims by or against third parties (although when they are negotiating compromises, they should, of course, be concerned to achieve the most for the estate of the company as they can).

117. It is helpful to consider further what it is that an officeholder ought to be doing when he is appointed for the purpose of achieving the purpose of proposing a CVA or a scheme of arrangement for his company. In the case of a group of companies, it may (as in the present case) be perceived that the most satisfactory way – perhaps the only way – of achieving a CVA is as part of a wider raft of arrangements and compromises, including CVAs for other group companies; and this can be so whether the officeholder is an officeholder only of the company under consideration or of other companies in the group as well.

118. His responsibility, in attempting to fulfil the purpose for which he is appointed, is therefore to try to structure an arrangement that will be capable of achieving the necessary statutory majorities and will not be unfairly prejudicial to any creditor. There will, inevitably, be a range of proposals which he could put to creditors: as already pointed out, what one creditor regards as satisfactory, another may regard as unsatisfactory and it is precisely to resolve that problem that a minority creditor can be bound by a vote provided that he is not unfairly prejudiced. To achieve a proposal which falls within the permissible range, the officeholder will often need to adopt a variety of approaches, including in particular acting as a mediator or broker between various groups of creditors in an attempt to see if sufficient common ground can be found. If the officeholder can broker an agreement between all creditors, his task in putting forward proposals is an easy one. If, after attempting to broker a deal, he can establish consensus among a majority, he can put the consensus forward as a proposal for a voluntary arrangement – but only if he considers that it is not unfairly prejudicial to the minority.

119. If he cannot even find a consensus among majority creditors (as in the present case), he can, and should if he possibly can, nonetheless formulate proposals for a voluntary arrangement to put forward for approval. Again, he should only do so if he considers that the proposals are not unfairly prejudicial to any creditor constituency. Moreover, he should not, in my judgment, put forward proposals unless he considers that there is a reasonable prospect of their being adopted. If he knows that a minority sufficient to block the proposals is adamantly opposed to them, he would be wasting time, effort and money in formulating such proposals in detail and ought not to do so. In those circumstances, he may have to accept, however reluctantly, that he simply cannot formulate a voluntary

arrangement which has any prospect of being accepted, in which case a winding-up is inevitable.

120. This approach is correct, in my view, whether one is looking at the officeholders of a single company who are proposing a CVA or scheme of arrangement for that company or at the officeholders of several companies who are jointly attempting to formulate proposals for a complicated and inter-locking set of CVAs or schemes of arrangement in relation to a group of companies.

Relevance of conflicts and ICAEW Guidance and its status

121. The two issues before me are whether the CVAs for EH3 and EGO BV are unfairly prejudicial to the Applicants and whether the officeholders of those companies should be replaced. The Applicants say in their opening written submissions that the Respondents wrongly proceed on the basis that this application stands or falls on the section 6 IA 1986 point and that their Case Summaries do not address the Applicants' conflicts case at all (although they do, however, deal with it in their subsequent submissions). What the Applicants say is that the Applicants have a separate and serious case based on the Respondents' conflicts of interest. I have to say that that is not how I see this case in relation to the CVAs although I can see that these aspects may be important in relation to the removal of officeholders from office.

122. So far as concerns the CVAs, section 6 is the beginning and end of the case before me. The issues of conflicts and breach of ICAEW Guidance come into the picture only insofar as (if at all) they are relevant to establishing unfair prejudice. In relation to that, they may be factors but I do not consider that the facts that an officeholder is in a position of conflict, even serious conflict, and that he is in breach of his professional rules are enough, by themselves, to establish unfair prejudice; to the extent that Mr Davies submitted to the contrary, I reject his submission.

123. Indeed, I treat the whole issue of conflicts with some circumspection. The question for me in relation to the CVAs is, ultimately, whether they unfairly prejudice the Applicants, not whether the process by which the CVAs were arrived at was fair. There are, of course, cases where conflicts can result in a transaction being set aside, for instance by application of what have become known as the self dealing and the fair dealing rules (as to which see *Snell's Equity* (31st ed) at 7-37 to 7-46). There is nothing of that sort in the present case – nor could there be since the CVAs are given effect to by statute and do not, in any event, give rise to any sort of statutory "contract" to which the officeholder is a party.

124. In any event, even if the facts of the present case are sufficient to invoke the conflicts rules which Mr Davies has identified those (judge-made) rules must give way to the statutory provisions of IA 1986 and the Insolvency Rules. The fact of the matter is that the officeholders in all the companies in the present case have been validly appointed: at least, there is no application to establish to the contrary, the Applicants seeking only to have them removed from office in EH3 and EGO BV. As such officeholders, they have duties to perform pursuant to the statute: they are not precluded from performing those duties by reason of any conflicts which they are under.

125. As I have already said, in voting on a proposal, the creditors decide whether to accept it or to reject it, a minority being given only limited protection against the will of the

relevant majority *ie* the protection of being able to challenge the CVA but only where it is unfairly prejudicial. Parliament recognises the possibility that reasonable persons can take different, reasonable, views of a proposal.

126. Just as there is a range of reasonable views among creditors about a proposal, there is likely, in many cases, to be a range within which a CVA could be approved without giving rise to unfair prejudice to any creditor. Off each end of that scale, where one or more creditors would suffer unfair prejudice, the CVA would be open to challenge under section 6. But within that range, no successful challenge can be mounted.

127. However, it is for the officeholder to present proposals for approval. In doing so, he too has a range within which he can act. He should, no doubt, present only a proposal which he himself thinks does not unfairly prejudice any creditor and which is one which he considers is likely to gain the necessary majority of acceptance among the creditors as a whole. Suppose then that a particular proposal, Proposal 1, presented by an officeholder is within the range of proposals which a wholly independent officeholder could properly put to creditors. Now suppose that the officeholder is in fact in a significantly conflicted position but that he nonetheless puts forward Proposal 1, in his own mind putting aside his conflicts and making what he regards as a fair assessment. The question then arises: Can a creditor who would do better under an alternative proposal, Proposal 2, say that he is unfairly prejudiced (for the purposes of section 6) by the CVA resulting from Proposal 1 because an independent officeholder might have put Proposal 2?

128. The answer to that must clearly, in my judgment, be No unless the creditor can at least show that Proposal 2 would have been accepted <u>and would have been capable of implementation</u>. I add, and emphasise, those last words, because it is absurd to suggest that even an independent officeholder would, or should, put forward a proposal which was not capable of implementation (*eg* because it requires co-operation/agreement from a third party who will afford that co-operation in relation to Proposal 1 but not in relation to Proposal 2). This may give rise to difficult questions about the degree of certainty which the court must have but, as a minimum, the creditor would need to show, in my judgment, that on a balance of probabilities, Proposal 2 would have been accepted.

129. Further, one should not lose sight of the substance of an application under section 6. The substance is that one creditor or group of creditors is challenging a voluntary arrangement binding on the company and all its creditors – effectively there is an issue between different groups of creditor. In form, the application under section 6 is an application to which the officeholders, and not the other creditors, are parties. Where relief is sought against a fiduciary – such as a trustee in a self-dealing or fair-dealing situation – it is entirely unsurprising that the fiduciary must suffer the consequences of failing to eliminate, or properly to manage, his conflict. But where the relief sought is, in substance, against other creditors (*ie* to upset the binding voluntary arrangement between them all) the position is very different. The other creditors have to accept, of course, that if the voluntary arrangement which they have entered into is, objectively, unfairly prejudicial to an applicant creditor, it is vulnerable; but what they might find difficult to understand is why, if the voluntary arrangement is within the range of proposals which an officeholder could properly have put forward for approval, it should be open to challenge simply because a different officeholder might have put a different proposal.

130. Similar considerations apply in relation to breach of professional guidance/standards. There is, in my judgment a distinction to be drawn between the interests of the insolvency administration and any guidance given by a relevant professional body. This aspect was present in *Re Polly Peck International plc* in an application which came before Millett J on 3 February 1992. There had been criticisms in the accountancy press of Mr Jordan and Mr Stone, partners in Coopers & Lybrand, for having accepted appointments as administrators in spite of a conflict of interest (the firm having acted for Mr Nadir). This passage appears in the Judgment of Millett J (at p 2C-E):

> "Mr Jordan and Mr Stone have made full and detailed disclosure to the Institute, which is still considering the matter. The Institute is, of course, concerned with the integrity and objectivity of its members and has laid down guidelines for the conduct of their professional duties. I am concerned with the interests of the administration. It is, of course, of paramount concern that administrators who are officers of the court, possess integrity and objectivity. No possible criticism can be made of the applicants in the present case."

131. Millett J also referred to the costs consequences of displacing the administrators, and the protection afforded by the appointment of an office-holder from another firm (see at page 3A-C):

> "To displace the administrators, a year into office, without a very strong reason for doing so would be very damaging. I can see no reason for doing so and, indeed I would have no hesitation, as Morritt J. in appointing the three administrators even if the question arose at the very outset of the administration, instead of a year into it".

In fact, Mr Crystal tells me, the two administrators subsequently remained in office, notwithstanding that they were later fined as a result of disciplinary proceedings actually brought against them by the ICAEW.

132. Further, since the alleged breaches of the ICAEW Guidelines in the present case relate, in effect, to conflicts of interest, I do not consider that consideration of those Guidelines really adds anything to the Applicants' case save for the forensic point that, not only have the Respondents acted when suffering from allegedly irreconcilable conflicts but those conflicts are ones specifically to be avoided in accordance with professional rules. My approach is consistent with that of Popplewell J in *Huxford v. Stoy Hayward & Co.* [1989] BCC 421. In that case, a partner in the defendant firm had acted as the receiver of a company. The claimants (guarantors of the company's debts) alleged that the firm had given the company negligent advice pre-receivership. They alleged, amongst other things, that the firm had been in a position of conflict, since it had advised both the company and the appointing debenture holder. At trial, the parties' expert witnesses canvassed the guidance on conflicts of interest published by the ICAEW and the Insolvency Practitioners Association. Popplewell J. said this, at p 435F-454B:

> "2.100 Although the matter was canvassed at considerable length with [the claimants' expert], it seemed to me at the end of his evidence, as indeed it does now, that as an allegation it did not found a cause of action on its own. If as a result of the conflict of interest the defendants were negligent in the advice they gave to the plaintiffs then the plaintiffs have a cause of action as a

> result of the negligence. The conflict of interest would historically be the reason for the negligent advice ...
>
> 2.104... I approach this case not in any semantic way but by looking to see whether as a matter of fact Stoy Hayward acted properly or not in relation to the plaintiffs. If in fact there was a conflict of interest which resulted in their giving improper advice I shall say so; but it is the quality of the advice and not the reason behind it which is the question I have to resolve"

Scheme of arrangement

133. Mr Davies points out that the liquidators and administrators of EH3 and EGO BV could have proceeded, in the present case, by way of a scheme of arrangement under section 425 Companies Act 1985 rather than a CVA in which case, he says, if I understand him correctly, that the Applicants together with any other EGO BV only bondholders would have formed a separate class for voting purposes. He seems to suggest that this was the only way in which the liquidators/administrators could properly have proceeded. In my judgment, it was perfectly proper to proceed by way of CVAs rather than schemes of arrangement. Parliament has provided these alternative routes and afforded different types of protection in relation to each route (albeit that the test of fairness in each case is effectively the same). Mr Davies has cited various authorities in relation to the identification of classes in the context of a scheme of arrangement. I do not consider that I need to decide whether, had the proposals proceeded by way of schemes of arrangement rather than CVAs, the Applicants and those in a like position formed a separate class and decline to do so.

134. There is, in any case, a material difference between the two processes. In relation to a scheme of arrangement, there needs to be approval from each voting class. Accordingly, a separate class can block a scheme of which it does not approve even though the overall scheme may fall within the range of reasonable proposals which that class could adopt without unfairness to any particular member of that class. In contrast, a CVA is determined by a single vote of all creditors. A group of creditors forming a separate class who would be able to block a scheme of arrangement may well not have sufficient voting power to block a CVA. Their only remedy, if they do not like the result of the vote, is to challenge it on the grounds of unfair prejudice under section 6. The mere fact that they would be able to block it as a separate class were the matter proceeding by way of a scheme of arrangement does not entail that they are necessarily unfairly prejudiced when the vote of the CVA goes against them.

The Witnesses

135. I have no doubt that all of the witnesses who gave oral evidence are honest people, none of whom is deliberately lying or attempting to mislead the court except that I do have some reservation in the case of Ms Seppala which I come to in a moment. They do, however, have different recollections of certain events and have very different perceptions of the events as they unfolded. If one starts with suspicion and conspiracy theory, then the actions of the KPMG administrators/liquidators can be seen as confirmation of the Applicants' fears that the conflicts of interest of the KPMG administrators/liquidators have led them inevitably to treat the Applicants unfairly and, indeed, in a deliberately prejudicial way. If, in contrast, one starts with a view of them as honest men attempting to achieve the best outcome for all concerned, their actions can, at

least on one view, be seen as achieving a successful outcome which has treated everyone fairly, the conflicts having been managed appropriately.

136. On behalf of the Applicants I heard from Mr Roome, Ms Seppala and Mr Olin. From the Respondents I heard from Mr Wallace, Mr Tucker, Mr Spratt and Mr O'Connell. I also heard from Mr Bloom who was called by the Applicants but had not produced a witness statement.

137. Mr Roome's evidence was, in the end, largely uncontentious. He does, if I may say so, seem to have identified very closely with his clients and their case and in his enthusiasm has, I fear, lost a full sense of objectivity. Large parts of his witness statement are advocacy rather than evidence of fact – but nonetheless of assistance in identifying the issues – and he seemed unwilling to accept that views which differed from his own might nonetheless be reasonable. He made some serious allegations of bias and misconduct, including professional misconduct which, as will be seen, I totally reject but which he declined unequivocally to withdraw.

138. Ms Seppala was the least satisfactory of all the witnesses. In making my general comments above, I said that no-one was deliberately lying. But I fear Ms Seppala has a distorted recollection of some events – particularly about what happened at the meetings in New York in January 2005 – and, with the benefit of hindsight, has introduced a "spin" (I am sorry not to be able to find a better word) which suits the Applicants' case. She is also prone to exaggerate – the Respondents would characterise it as lying, but I give her the benefit of the doubt on that – for instance her suggestion (eventually withdrawn by her) that Mr Wallace had "continually" represented to the Applicants that the RCF Banks had a strong direct claim against TXU Corp when in fact he never said that at all. She also recollects (and she may well have believed what she was saying) events which did not, as I conclude, take place (namely a conversation with Mr Wallace "in a small room" and Mr Olin reading and explaining a position paper in New York on 11 January 2005). She is, I am quite sure, an astute and effective business woman. I totally reject her description of herself as naïve. I am quite sure that she was closely involved in developments as the representative of SISU as a Committee Creditor. But she had many other business matters on her mind and when it came to producing her witness statement and giving her oral evidence, her recollection was not, I think, as accurate as she would like to make out.

139. Mr Olin's evidence did not, in the end, assist me much. He, like Ms Seppala, gave evidence in his written statements about the Material Facts (as to which see [215] below) and the state of Unum's knowledge about them when agreeing to the appointment of KPMG liquidators of EH3. His responses in cross-examination were not supportive of what he had said. My own conclusion on that issue appears later.

140. Mr Bloom was an important and helpful witness. He was clearly entirely honest and attempted to assist as best be could. It is important to take his evidence as a whole because some of his answers taken in isolation give a misleading impression of what he is really saying.

141. In addition to these witnesses, the Applicants relied on the evidence of Mr Terry whom the Respondents did not seek to cross-examine. His evidence was largely confirmatory of Mr Roome's evidence although any other matters raised by him were dealt with in cross-examination of the other witnesses.

142. Mr Wallace was also, to my mind, a transparently honest witness. His mastery of both the broad picture and the detail of negotiations was impressive. I accept his evidence on matters of fact; in particular, where there is an inconsistency between his evidence and that of Mr Roome, I prefer that of Mr Wallace. As with Mr Roome, Mr Wallace's witness statements contain some argument rather than being restricted to matters of fact. In saying that I accept Mr Wallace's evidence, I am not saying that I accept his arguments. My own conclusions on those appear later.

143. Mr Tucker, too, was a transparently honest witness and I accept his evidence too.

144. Mr Spratt did not have anything like the involvement of Mr Wallace and Mr Tucker in the events leading up to the BTL and ATL CVAs. He was, however, clearly honest and trying to assist the court. He was perfectly frank about his lack of involvement until quite a late stage in relation to each settlement, both above and below the line. The dispute concerning Mr Spratt is, or should be, not whether what he says he did and thought was true (as to which I accept his evidence) but whether his actions were adequate, whether he was capable of representing the interests of EH3 against Mr Wallace (to whom the Applicants say he was subservient and deferred) and whether they resulted in unfair prejudice to the Applicants.

145. Finally, Mr O'Connell was, again, to my mind an honest witness who was perfectly frank, again, about his lack of involvement until a late stage. As with Mr Spratt, I accept the truth of what he says. Mr O'Connell is described by the Applicants as glib. That he brought humour – I do not accept, as the Applicants say, that he was glib - to his oral evidence is true, but that is not to say that he was not on top of the issues.

146. Mr Hassenstab and Mr Hearn provided witnesses statements. They were not cross-examined and their evidence stands uncontradicted.

Bias and deliberate bias

147. It is appropriate that I deal at this stage with the allegation that KPMG were biased in the sense that their conflicts in having acted for the RCF Banks – but only, I remind myself, as part of a larger syndicate whose interests did not all lie at TXUEL – and their conflicts as officeholders in companies whose interests diverged on some important issues, made it impossible for them to act objectively and also with the related, and far more serious, allegation, that those conflicts led them them <u>deliberately</u> to prefer the interests of the RCF Banks over the Applicants. I totally reject that second allegation. I have no doubt whatsoever that both Mr Wallace and Mr Tucker (and indeed Mr Spratt and Mr O'Connell) were at all times attempting to be fair; they were certainly acting honestly; they were certainly <u>not</u> making decisions with a view to preferring the RCF Banks over any other creditors, including the Applicants. I quite understand the argument that they were not capable of acting objectively so as to be fair because of the conflicts which I have just mentioned. But I do not consider that there is adequate material on which the more serious allegation, which may on one view amount to dishonesty and certainly one of serious professional impropriety, can properly be made.

148. Nor do I accept, although I do not say the argument should not have been made, that any of the KPMG officeholders were driven by an imperative to achieve settlements,

whether below or above the line "at any cost". Of course, Mr Wallace and Mr Tucker had, and have continued to this day, to put in an enormous amount of effort into achieving an overall settlement. They regard what they have in fact done as a considerable achievement. They believe that what they have achieved is fair (in particular, is not unfairly prejudicial to the Applicants) and have always believed that to be the case. Even if the Applicants are correct in saying that they have been unfairly prejudiced, I do not consider that it is correct to categorise what the officeholders have achieved as being driven by "agreement at any cost" let alone, in relation to one of the most significant complaints, "£67 million to the banks at any cost". The purpose of their appointments at TXUEL, TXUEG, TXUAC and TEG was, after all, to achieve (if they could properly and fairly do so) CVAs or schemes of arrangement precisely to avoid liquidations. They have put all their energies into achieving settlements and CVAs to give effect to them. I reject the notion that, in doing so, they have abandoned the interests of certain creditors, the Applicants, who had become a nuisance and whose interests could safely be disregarded. In short, I consider that all of the officeholders have carried out their duties in a conscientious manner. Whether that has nonetheless resulted in unfair prejudice to the Applicants is what I have to decide.

A more detailed statement of the relevant events and issues

149. **October to mid November 2002:** There were, at least in theory, essentially two courses open to the TXU Europe group in dealing with its financial problems: a financial restructuring of the group or an asset sale coupled with some sort of insolvency proceedings. Since the approach of various interested parties (including the group companies, the major financial creditors and the other major creditors, in particular the PPA Creditors, and their respective advisers) developed, and one might say became, in certain respects, entrenched, during October and the first half of November 2002, it is helpful to set out the developing dynamics. I take this from Mr Wallace's first witness statement which, in these respects, I accept.

150. On 17 October 2002, the companies in the TXU Europe group invited the financial creditors and their advisers to a meeting at the offices of their own solicitors, Herbert Smith, for a presentation about the group's financial position and the options for the future. All the Lending Bank Syndicates (including the Bank Steering Committee) were invited. Mr Wallace attended this presentation in his role as adviser to the Bank Steering Committee.

151. The presentation was delivered by Paul Marsh, the COO of the TXU Europe group, although representatives of the group's advisers (including E&Y and Herbert Smith) and other directors also participated in the presentation. At the presentation it was explained that TXU Corp had withdrawn its financial support to the TXU Europe group, that as a result of this, the group had been downgraded by the ratings agencies to sub investment grade with a negative outlook and that the downgrade had triggered a number of cross default clauses in the TXU Europe group's financing and trading contracts, with the result that the group was in a bad and quickly worsening financial position. Mr. Marsh then explained that the directors of the TXU Europe group companies were considering two plans to deal with the crisis:

a. a work out over the next 6-9 months based on short term cash preservation, a renegotiation of the PPAs and a rescheduling of the group's long term debt. This was referred to as "Plan A"; and

b. an immediate sale of the core UK business (*ie* the retail business located in TXU UK), followed by administration of the remainder of the business. This was known as "Plan B".

152. Of the two plans outlined, the Lending Bank Syndicates (and possibly some other financial creditors) clearly preferred Plan A. Whilst they realised that they had little prospect of ever being paid out in full, they believed that their best chance of maximising their recoveries was for the group to be restructured and allowed to trade out of its difficulties. Their preference for Plan A was clearly communicated both by them and by their advisers to the TXU Europe group.

153. **The Sale of the Retail Business to Powergen**. On 18 October 2002, however, the financial creditors were told that a substantial bid for the group's retail business had been received from the Powergen group of companies and within 24 hours of this bid being received, it became clear that the TXU Europe group had no further interest in a "Plan A" restructuring but now favoured a "Plan B" sale of the group's principal business.

154. On 21 October 2002, various companies in the TXU Europe group entered into a sale and purchase agreement by which the vast majority of the group's assets, of both its retail and other businesses, were sold to the Powergen group of companies for a cash consideration of approximately £1.37 billion. With this sale, the financial creditors lost what some of them at least perceived to be their best chance of maximising their recoveries. This was a frustrating development for them. Not only had they clearly stated their preference for a financial restructuring, the sale was completed by the group without seeking or obtaining the consent of the RCF Banks or other Lending Bank Syndicates despite the fact that the relevant loan documentation contained express non-disposal provisions. I would, however, add that Mr Wallace believed at the time and remains of the view that the sale of the retail business was for a consideration which represented fair market value for the assets sold.

155. Another relevant factor in the unfolding events was the regulatory regime within which the group operated. The industry regulator, The Office of Gas and Electricity Markets ("Ofgem"), had the power to step in (in its capacity as "supplier of last resort") and, if it was felt that the supply of electricity to the customer might be interrupted, effectively appropriate without consideration the group's entire retail business for re-distribution amongst other suppliers. Ofgem was in constant touch with the directors of the TXU Europe group throughout this period and was actively threatening to exercise its powers. Consequently, the group was under the threat of losing its only substantial asset for no consideration. It is reasonable to assume that this risk must have played an important part in the thinking and actions of the group and its directors and advisers. Nevertheless, the financial creditors, at least some of whom had themselves held discussions with the regulator, felt that the group's actions in selling the retail business had been unnecessarily precipitous and that more time and energy should have been devoted to what was described as "Plan A".

156. At the 17 October 2002 presentation to the financial creditors, Plan B had been presented as a sale of the retail business followed by administration of the rest of the business. Over the course of the next few days, however, and certainly by completion of the sale, the TXU Europe group had decided not to petition for immediate administration but to pursue a strategy that was described as an "orderly wind down" over a period of several months.

157. It was at or around the time of the sale to Powergen that the directors of the TXU Europe group and their advisers decided that separate legal representation was required for certain companies in the group. On or around 20 October 2002, Lovells were appointed to act for TXUEL, Finco 2, TXUAC and TEG whilst Herbert Smith continued to act for TXUEG and its subsidiaries. E&Y continued to advise all companies in the TXU Europe group.

158. It was with the appointment of Lovells that the "above-the-line" and "below-the-line" expressions were coined, with the former being used to describe the Holding Companies down to but excluding TXUEG and the latter being used to describe TXUEG and its subsidiaries (*ie* the Operating Companies).

159. **The £67 million Swap Proceeds.** I have already identified the £67 million issue and the timing of the relevant payments. It is to be noted that neither the financial creditors nor their advisers, including KPMG and A&O, knew about the relevant encashments or how they had been dealt with until the next week, on about 22 October 2002, and after the sale to Powergen had taken place.

160. This is what Mr Wallace has to say in his first witness statement about the events in question at the time (which I accept):

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> 49. The directors [of TXUEL] and their advisers became aware of at least the first of these transfers (albeit after it had taken place) before 18 October 2002 (and in all likelihood, some time prior to that). ……. We were told that the group's total cash balance would be down to £47 million by the following Monday morning (21 October 2002), but that £45 million of this was somehow restricted. I had no knowledge at the time where this £45 million had come from or why it was restricted.
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> 50. Two days later, at noon on 20 October 2002, I participated in a conference call in which a further update was given by, I believe, Mr. Gale [of Herbert Smith, TXUEL's then advisers]. …….I note that Mr. Florent's [of A&O, acting for the Bank Steering Committee] note states that "*We have worked out a way to introduce £45 million into our cash-flow. It is not now blocked*". At this point, I still had no knowledge where this £45 million had come from, why it had been restricted or what way had been found to release it.
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> 51. It was not until the following week, on Tuesday 22 or Wednesday 23 October 2002………that I (or indeed to my knowledge any of the Financial Creditors or their advisers) was told of the genesis of the "restricted" £45 million.

52. Mr. Gale told me that the £45 million was the proceeds of various in the money swap transactions with TXUEL which had been encashed. These proceeds had then been transferred to TXUEG. He further informed me that he had deliberately decided not to tell the Financial Creditors during the various calls and meetings over the previous weekend why the £45 million had been restricted (or "ring-fenced" as I believe he put it) or that the £45 million of the swap proceeds had been assets of TXUEL. He told me that the reason for withholding this information from the Financial Creditors was that he feared that they would have used this information to seek to freeze the money in the hands of TXUEG, on the basis that those funds belonged to TXUEL. If the Financial Creditors had been successful, these monies would not have been available to support the business until the sale of the retail business had been effected.

53. Mr. Gale apologised for not explaining the position fully at the weekend but explained that the £45 million had been released into cash flow on the basis that it would be repaid to TXUEL from the proceeds of the sale of the retail business. He told me that the release had benefited the creditors since it had removed the danger that the regulator might exercise his powers to appoint a supplier of last resort and left the way open for the business to be sold and value released for the benefit of all creditors.

54. Mr. Gale went on to tell me that he had previously understood there to be approximately £45 million of swap proceeds but that he now thought that there may be more. Herbert Smith and the TXU Europe group companies were in the process of clarifying the position. I subsequently learned that the amount of the swap proceeds was approximately £67 million.

55. Accordingly, it was only at this stage that I, the Financial Creditors and their advisers (including Mr. Segal and Mr. Florent) became aware of the existence of swap transactions with TXUEL, their encashment, and the subsequent transfer of the proceeds to TXUEG and their ultimate release into general cash-flow to facilitate the sale of the retail business to Powergen.

56. I duly reported these matters to the Financial Creditors and their advisers. This information caused considerable consternation on the part of the Financial Creditors. They blamed the directors of TXUEL for allowing substantial assets to be removed at a time when TXUEL was, on any view, hopelessly insolvent and, rightly or wrongly, also blamed the company's advisers, Ernst & Young and Herbert Smith, whom they perceived to be inextricably tied up with the events in question. These events came to light within days of the sale of the retail business to Powergen which the Financial Creditors had opposed on the basis that it removed their last chance of maximising their recoveries on their very substantial investments.

57. Once the information concerning the Swap Proceeds had come to light, the Financial Creditors of TXUEL and their advisers pressed for the Swap Proceeds to be returned to TXUEL. By 4 November 2002, the directors of TXU UK had agreed to make the repayment from the proceeds of the sale to Powergen but, just before the payment instructions could be given, White & Case LLP, who then acted for the Lilo Banks which had lent funds to TXUEG, objected to the transfer

taking place. Accordingly, it was agreed that £67 million of the proceeds received by TXU UK from the sale of its retail business (a sum equivalent to the Swap Proceeds) would be placed in escrow pending agreement of its rightful ownership.

58. As a result of these events, a key inter-company dispute emerged. The Swap Proceeds were originally an asset of TXUEL but each of TXUEL, TXUEG and TXU UK had a possible claim to the equivalent amount which had been taken from the proceeds of the sale of the retail business and placed in escrow."

161. I record this evidence in such length because it is important to understand the reasons behind the strength of feeling which was generated within the Lending Bank Syndicates that monies should be returned to TXUEL. As we shall see, it was an issue of principle in relation to the ATL settlement which led to the ATL CVAs.

162. **The inter-company balances:** Meanwhile, E&Y were spending a considerable amount of time trying to unravel the TXU Europe group's inter-company position. From this exercise emerged another of the main issues requiring resolution. This issue was whether certain key inter-company balances had been left to accrue unsettled or whether they had been settled by netting them against the balances which each company had with the group's treasury company, TXUEG, as a result of sweeping and funding processes. In the case of the ATL companies, there were large historical inter-company balances resulting from the transfer of the Eastern Electricity business from EH3 to TEG in 1998 and the funding arrangements for the acquisition of the TXU Europe group.

163. The group was comprised of numerous subsidiaries, some of which traded heavily with each other, giving rise to substantial liabilities and therefore inter-company balances. Further significant inter-company balances arose as a result of TXUEG's role as banker to the group, pursuant to which it received credit balances from other group companies and made funds available to subsidiaries when required. It emerged that the most important inter-company relationships for these purposes were those among TXUEG, TXU UK and EET.

164. From March 2001, EET supplied electricity to the group's retail business. The volumes and values were considerable and between approximately March 2001 and November 2002, electricity (as well as gas and some coal) worth approximately £1.8 billion was supplied by EET to TXU UK.

165. At the same time, positive cash balances in TXU UK's bank accounts resulting from its customers settling their electricity bills were transferred or "swept" up to TXUEG (in that company's capacity as group banker) giving rise to a debt obligation from TXUEG to TXU UK and TXUEG made funds available to EET (again in the same capacity) so that EET could settle its liability to the outside market, in turn giving rise to a debt obligation from EET to TXUEG.

166. The group's financial records were in a state of considerable disarray and it was impossible to determine conclusively from these whether or not various obligations were still outstanding (the "gross" argument) or had been discharged (the "net" argument) (the "**Net v Gross**" issue).

167. The Net v Gross issue came to light gradually during October and early November 2002. Whether or not the liability between TXU UK and EET had been discharged was of crucial importance to all the financial creditors (whether their financial interests lay primarily at TXUEL or TXUEG). Indeed, if the liability between TXU EG and EET had not been netted off, the "Gross" approach, significant funds would flow to EET in satisfaction of TXU UK's debt to EET and then on to own EET's creditors (principally the PPA Creditors). The total flow of funds to TXUEG and its creditors, however, would be reduced, as TXUEG would only receive a distribution in its capacity as a creditor of EET. On the other hand, if the "Net" approach were adopted, TXU UK would in all likelihood be solvent and funds would be available to flow to TXUEG by way of equity distributions and from there to travel further up the group through other inter-company balances or equity distributions.

168. A significant impact of the Net v Gross debate was on the relationship between the financial creditors and the TXU Europe group's other largest creditor constituency, the PPA Creditors. All of the creditors knew that the most substantial asset of the group was the proceeds of the sale of the retail business to Powergen which resided almost entirely at TXU UK and their ultimate destination would, to a very large extent, determine the level of any dividend to creditors. All creditors believed at the time that Net v Gross would be the single most important issue in any restructuring or insolvency process. The interests of the financial creditors and the PPA Creditors were directly opposed in relation to this issue.

169. Another inter-company balance of considerable importance was the balance between TXUEG and TXUAC. The directors and advisers to the TXU Europe group had stated in a presentation on 17 October 2002 that a substantial inter-company balance was owing from TXUEG to TXUAC (not, it is to be noted, to the Conduit Companies collectively). In the event that TXUEG was insolvent (which appeared likely and would certainly be the case if the Gross argument prevailed), this was the principal route through which funds would flow from the Operating Companies to the Holding Companies. During the course of the following days and weeks, complete confusion surrounded the amount of this inter-company balance. Soon after the sale of the retail business to Powergen, the financial creditors were informed that the amount of the balance owing from TXUEG to TXUAC was a fraction of what they had previously been told. Rightly or wrongly, the financial creditors associated the group's advisers with a failure to give them proper, accurate or timely information.

170. It can be seen therefore that the position was unclear at the beginning and for some time thereafter, although it can now be said, with the benefit of hindsight, that the only material inter-company creditors of TXUEG above the line were the Conduit Companies with EH3 at £176.5 million, TEG at £82.4 million and TXUAC at £161.4 million. This means that funds flowing from the BTL companies to the ATL companies go *via* TXUEG to the Conduit Companies before passing to other ATL creditors.

171. **PPA negotiations**: I have already mentioned the PPAs in [8] above. The PPA Creditors were the largest creditor constituency after the financial creditors. Because they were, for the most part, creditors of EET with guarantees from TXUEG, the PPA Creditors were considerably more likely to benefit from the group's principal asset located at TXU UK than were the financial creditors.

172. Following the sale of its retail business, the TXU Europe group decided not to petition for immediate administration but to pursue an "orderly wind down" strategy over a period of several months. This strategy required the negotiation of settlements with the PPA Creditors. Each of the PPAs contained provisions for determining termination payments that would be triggered by TXUEG's or EET's insolvency. The quantum of such payments in most cases depended heavily upon an assessment of future power prices and their implications for the ability of each PPA Creditor to mitigate its loss in the period between early termination and the scheduled termination of the PPAs (which in most cases was several years in the future), although in the case of Drax, there was a liquidated damages provision. It was felt by the directors that quick negotiated settlements of termination payment liabilities would be attractive both to the TXU Europe group and to the PPA Creditors, saving expense for the group, on the one hand, and resulting in early payments for the PPA Creditors (at least some of whom were in financial difficulties themselves) on the other.

173. The TXU Europe group's strategy in this respect was outlined to the financial creditors at a presentation on 7 November 2002. Mr Wallace exhibits to his witness statement some slides used at that presentation which show the group's intention to achieve a negotiated settlement of the PPA Creditors' claims, the probable range of settlement being specified to be £0.7 billion to £1.4 billion with the probable duration of the orderly wind down being 6-9 months.

174. Neither KPMG nor the Lending Bank Syndicates were parties to the related negotiations with the PPA Creditors which took place prior to administration.

175. By about 18 November 2002, the financial creditors were being told that agreement in principle had been reached or was close to being reached with four of the main PPA Creditors and that Herbert Smith were proceeding to document these agreements. Whilst that work was proceeding, however, Drax (one of the largest PPA Creditors) served a termination notice pursuant to the terms of its PPA. As a result of this termination, the directors of the TXU Europe group reconsidered their approach to the remaining PPAs and, late in the evening of 18 November, decided that it would be inappropriate to continue to settle out any of the remaining PPAs or to continue with the orderly wind down of the group. Herbert Smith sent an email to KPMG to that effect on 19 November 2002.

176. The financial creditors were opposed to such a hasty end to the orderly wind down. Despite this opposition, however, TXUEL, TEG, TXUAC, TXUEG, TXU UK and EET (but not EGO BV or EH3) all petitioned for administration on 19 November 2002.

177. **The Choice of Officeholder**: In the period leading up to the administration, considerable planning was carried out, not only by the TXU Europe group companies and their advisers, but also by the various creditor constituencies and their advisers, for the contingency that the group could not continue trading and would have to be put into an insolvency process. Much of this contingency planning revolved around which companies would be placed into a process and who should be appointed as the officeholders in respect of each such company.

178. It might have been thought that the obvious choice would have been for partners in E&Y to be appointed as administrators. However, there were these factors to take into

account. The period during which E&Y had already acted as financial adviser to the TXU Europe group had already lasted approximately two and a half months. During this period, E&Y had become very closely involved in the running of the group, advising (with Herbert Smith) on individual payments and transactions. Many of the financial creditors had lost confidence in the group's advisers (including E&Y) because, rightly or wrongly, they came to associate those advisers with the various controversial events and issues during the "orderly wind down" phase particularly the payment of £67 million Swap Proceeds downstream and the changing information in relation to the inter-company balances.

179. Some, at least, of the financial creditors including the Lending Bank Syndicates, were opposed to E&Y taking appointments over any company in the group. The directors of the TXU Europe group companies, however, were keen to see their advisers appointed. The directors had been working very closely with them over an extended period of time and they could see considerable savings in costs in appointing individuals who already had a good working knowledge of the business and of the key issues that would have to be resolved in any insolvency process.

180. At a meeting held on 6 November 2002 there had been discussion about contingency planning to meet the possibility that administrations might in the end be necessary. Those attending that meeting included Mr. Segal (of A&O), Mr. Gale (of Herbert Smith) and Mr Wallace. Mr Segal stated the position of the financial creditors to be that if, contrary to their wishes, administration was to take place, it would not be appropriate for E&Y to be appointed as officeholders to both TXUEG on the one hand and TXU UK and EET, on the other. This was because of the clear conflict that existed between TXUEG and EET concerning the ultimate destination of the proceeds from the sale of the retail business as a result of the Net v. Gross issue. Mr Gale was not, at that stage, willing to enter into a debate.

181. On 16 November 2002, Mr. Segal wrote to Mr. Gale of Herbert Smith setting out the financial creditors' concerns in writing. By that time, general agreement had been reached that insolvency practitioners from KPMG should, in the event of insolvency, take appointments at TXUEL and at any financing subsidiaries of TXUEL down to but not including TXUEG and that insolvency practitioners from E&Y should take appointments at EET. No agreement, however, had been reached on the positions at TXUEG and TXU UK. The key points made by Mr. Segal in his letter in relation to this issue were that:

a. The Bank Steering Committee considered it inappropriate for administrators from the same firm to be appointed both at TXUEG and EET in view of the Net v Gross issue.

b. Both E&Y and KPMG had acquired considerable knowledge of the affairs of the group during the "orderly wind down" period and it would be an undesirable expense to bring in yet another firm and that a degree of pragmatism was required in resolving the problems to which conflicts gave rise.

c. Partners of KPMG should be appointed as administrators of TXUEG.

d. Partners from E&Y should be appointed at EET.

e. Joint officeholders should be appointed at TXU UK. The rationale for this was that this was where the group's principal asset resided and this would ensure that these assets were not distributed without the agreement of both sets of administrators.

182. Mr. Gale responded to this letter on 18 November 2002. He agreed that adding a third accountancy firm as administrator would give rise to unnecessary expense and that the Net v Gross issue gave rise to a conflict but stated that in his view, there was an inherent conflict between partners of KPMG acting as sole administrators of both TXUEL and TXUEG. Mr. Gale therefore suggested that KPMG be appointed at TXUEL, E&Y be appointed at EET, E&Y and KPMG be jointly appointed at TXUEG and E&Y be appointed at TXU UK, subject to agreed restrictions on distributing the sale proceeds from the sale of the retail business.

183. When the companies petitioned for administration the next day, on 19 November 2002, it was essentially on the basis set out in Mr. Gale's letter. This arrangement was supported by all the key creditor constituencies on the basis of what was known to them at that stage of the process. Orders were made on that date and joint administrators appointed as set out at [4] above.

184. The existence of the Memorandum of Understanding was made clear in a telephone conference which Mr Wallace had with members of the Bondholder Committee (including Mr Olin) on 20 November 2002. The agenda for that meeting was set out in an email from Cadwalader to members of the Bondholder Committee, including the Applicants. It included "the relationship between KPMG/Ernst & Young outlining the breakdown of work streams between them (which will be documented in the Memorandum of Understanding)". It is not clear whether the responsibilities under the MoU of the KPMG and E&Y officeholders in relation to conflict issues, and in particular the £67 million issue, were discussed.

185. The appointments of joint administrators were effected, at least in part, to manage the conflicts which were then perceived. The Applicants now complain that the conflicts were so deep and inherently incapable of management, that KPMG officeholders should not have accepted appointment at all or should, at a later stage when the full extent of the conflicts became further apparent, have resigned.

186. The purposes for which the orders were made were to achieve the approval of a voluntary arrangement under Part I IA 1986 or the sanctioning of a scheme of arrangement under section 425 of the Companies Act 1985 and/or a more advantageous realisation of assets than would be effected on a winding up.

187. **The Memorandum of Understanding:** Given the obligation (at least as perceived by KPMG and E&Y) of the joint administrators to manage the conflicts which their joint appointment was designed to manage (that is to say the conflicts which might arise between TXUEG/TXU UK and other group companies), steps were taken to allocate their respective responsibilities. The Administration Order made by Blackburne J on 19 November 2002 in relation to TXUEG had itself made provision for the agreement of a memorandum of understanding ("**MoU**") between the KPMG and E&Y administrators setting out the respective roles and responsibilities of each set of administrators. The

MoU was, in the event, agreed between the KPMG and E&Y administrators and its terms were approved by the Court (without a hearing) on 27 November 2002.

188. Mr Wallace states that the purpose of the MoU was to ensure that TXUEG's interests were properly protected whenever there was a conflict between the position of TXUEG on the one hand and that of any of the Holding or Operating Companies on the other, and that the KPMG and E&Y administrators agreed that whenever such a conflict arose at TXUEG the unconflicted administrators would represent the interests of TXUEG. Since there seems to be some disagreement about the effect of the MoU, I deal with its terms at this stage.

189. The relevant provisions for present purposes are as follows:

i) "1.1.6 '**E&Y Reserved Matters**' means, in relation to the Administration:…

a) (B) (1) the long term Power Purchase Agreements entered into between [TXUEG] and various counter-parties;

(a) ………..

(ii) (7) any litigation on behalf of [TXUEG] against [TXUEL] arising in connection with the encashment of certain swaps by [TXUEL] and the subsequent utilisation of the proceeds of encashment (totalling approximately £67,000,000);

b) (C) the initiation, continuance, settlement or compromise of any legal or other proceedings against any company or persons whatsoever or wheresoever situate (sic) arising from the investigations carried out under paragraph […] (B); and

c) (D) all KPMG Conflict Matters...

d)

1.1.9 '**KPMG Conflict Matters**' means any matter on which KPMG have a conflict either as a result of work undertaken for any person by KPMG or as a result of a conflict between the interests of [TXUEG] and its creditors and the interests of any other company within the TXU Group for whom KPMG act as administrators or liquidators."

Clause 2 gave exclusive conduct of the E&Y Reserved Matters to the E&Y Administrators.

190. KPMG were, therefore, expressly precluded by the MoU from representing the interests of TXUEG in relation to any aspect of the £67 million issue. It was the E&Y administrators who would act in the interests of the estates of TXUEG and TXU UK. As will become apparent, the real claim below the line rested in TXU UK: it is extremely difficult to see what claim TXUEG would have had to the £67 million ring-fenced at TXU UK other than as the recipient of monies as an indirect creditor or indirect shareholder in TXU UK. However, TXUEG did assert such a claim and the inevitable

conflict between it and TXU UK was managed by the E&Y administrators arranging for the appointment of a conflict administrator, Chris Hughes of THM, to ensure that that company's claim (and therefore those of its creditors) in relation to the £67 million issue was fully and properly represented. From this, it can be seen that the MoU provided for the principal conflicts of interests which were then known about including the Net v Gross issue and the £67 million issue.

191. Accordingly, in relation to any dispute in relation to the £67 million issue between TXUEL (above the line) on the one hand and TXUEG or TXU UK (below the line) on the other hand, Mr Wallace and Mr Tucker would fight for the interests of TXUEL whereas Mr Bloom and Mr Bailey would fight for the interests of TXUEG or TXU UK. In relation to the £67m, the only companies which had any claim were those three companies.

Events leading up to liquidation of EH3:

192. As I have said, a members' resolution to wind up EH3 was duly passed on 30 December 2002. The decision to have a liquidation was tax driven. In selling its operating business, TXU UK had triggered substantial capital gains which would, unless losses (whether capital losses or revenue losses) within the TXU Europe group were available to offset against it, give rise to a large assessment to corporation tax on capital gains. The joint administrators of TXU UK together with those of other TXU Europe group companies both above and below the line therefore sought to identify a company or companies with available losses. To the extent that it was necessary to realise losses which had not yet been triggered, that had to be done by the end of the relevant accounting period – in this case by 31 December 2002.

193. Bingham and their clients perceived that a liquidation would be less beneficial to them than an administration and sought to persuade the joint administrators of companies already in administration of their case. Although some losses were available in BTL companies, notably EET, it was not, however, clear at that stage that they would be sufficient. In any event, the various administrators of those companies would require a substantial consideration to be paid for the surrender of those losses to enable them to be offset against TXU UK's gain.

194. The joint administrators of the ATL companies, in particular of TXUEL and TXUAC, did not want payment to be made by TXU UK to any BTL company for these losses since it would result in more assets being available to external creditors of BTL companies. Further, they perceived that, if losses were made available in ATL companies, there would be competition on the price which the joint administrators of TXU UK would need to pay to obtain a surrender of the losses. Now, below the line, it may have been the case that significant trading losses would be available to off-set the gain. But that was not clear at the time (and history has proved the concerns to be real) and the position so far as concerned the Inland Revenue was therefore uncertain. The way in which the joint administrators could be certain that a loss would be available would be for TXUAC to trigger a disposal, for the purpose of corporation tax on capital gains, of its shares in EH3 which had become worthless; and the most certain way of doing that was to put EH3 into liquidation. That is what it was decided to do.

195. It seems to me that that was a perfectly rational and sensible decision to have made. In any event, it is something that was (a) a matter for the decision of the shareholders and

directors of EH3 who were able to put EH3 into voluntary liquidation (b) clearly in the interests of TXUAC (the sole shareholder of EH3) and (c) not something that EH3's creditors could have prevented. Accordingly, in my judgment, no conceivable issue of conflict of interest in relation to the decision to put EH3 into liquidation arises from the fact that Mr Wallace and Mr Tucker were liquidators/administrators of both EH3 and TXUAC. I do not consider that the Applicants have any ground whatsoever for complaining that EH3 was put into liquidation rather than some other process having been adopted. The matter is dealt with at much greater length in Mr Wallace's witness statements. I accept and agree with everything he has to say on this topic (see paragraph 147 to 161 of his first witness statement).

196. In the period leading up to the decision to liquidate EH3, the first contact was made by Bingham with Mr Wallace. Mr Roome contacted Mr Wallace and Mr Tucker sometime in the period 20 to 22 December 2002 and explained that he had been retained to act for the Applicants. Mr Roome says that his clients were concerned about conflicts under which KPMG were labouring, having been advisers to the banks prior to taking appointments as administrators. He says that it is important to understand that the Applicants were largely in the dark and dependent upon KPMG to make full disclosure of all facts material to their decision whether to agree to allow KPMG to become office-holders in EH3. He says that, because of the perceived conflicts and the consequent risk of a transfer of value to TXUEL (where the banks had their principal exposure), the Applicants were pre-disposed against KPMG taking the appointments.

197. The alleged conflict arising from the fact that KPMG had previously advised the Bank Steering Committee is not one which, in my judgment, should, at least by itself, have led KPMG to refuse to accept office as liquidators of EH3 (or, indeed, later accepting office as administrators of EGO BV). It would be an overly strict application of the principles which Mr Davies has dealt with in his submissions on conflicts to say that a professional who has previously advised a group of creditors about their position is thereby precluded from becoming an officeholder in any of the group of companies of which the debtor company forms part. The authorities show, in my judgment, that there is no such rigid rule and that there is a balance to be struck between the risk of bias and the advantages of having someone in office who is already familiar with the case, thus enabling a more efficient and less costly exercise to be carried out.

198. A conference call with the Bondholder Committee was due to take place on 23 December 2002. One purpose was to discuss some fairly complex arrangements (which were not, in the event implemented) concerned with establishing tax losses, the final proposals being circulated in a paper by Mr Porter of KPMG.

199. Before the conference call, KPMG received a letter (the first letter dated 23 December 2002) from Bingham setting out some concerns which the Applicants had. Their first concern was that there was insufficient time and information available for them properly to consider Mr Porter's proposal; their second arose out of what they termed the potential conflicts of interest. As to those, they wrote:

> "We think it is incumbent on you as administrators to give the holders of BV Notes (and especially our clients) sufficient information to make an informed decision, particularly given the potential conflicts of interest arising from this unusual group structure. These potential conflicts of interest arise from: first,

> your role as administrators not only of TXU Acquisitions Ltd, but also of other companies within the TXU Group; second, from the *de facto* control that you have over other key TXU companies and, third, by virtue of the fact that you, and your legal advisers Allen & Overy, acted as advisors to certain creditors within the TXU Group prior to commencement of the various TXU administrations. These potential conflicts make it critical that there be transparent and comprehensible explanations of the impact of any steps you might take to maximise recoveries for the TXU Group as a whole, on the recoveries for the creditors of individual TXU entities."

Bingham claimed that their clients needed to be given funds and the opportunity to obtain urgent independent advice in relation to the tax proposals and that KPMG should provide them with full access to all the information they had, including KPMG's working papers.

200. Mr Wallace says this (and I have no doubt that these were his honestly held views):

> He thought that Bingham were overstating the issue. Nevertheless, it was KPMG's objective to achieve a consensual resolution of the numerous complex issues if that were possible, and considered that it was important in that regard to ensure that the various creditor constituencies, including the Applicants, had confidence in the transparency and fairness of the insolvency process. He took the view that a consensual resolution would be reached only if everyone had the resources they felt were necessary in order to deal with the issues. In this context, KPMG were working with a large number of US-based organisations, including Unum, who are used to consulting their own legal advisers, and without consulting whom they would be reluctant to agree to any proposals.

201. Mr Wallace, on 23 December 2002, therefore telephoned Mr. Terry of Bingham and agreed to consider his firm's engagement at the expense of the estates to advise the Applicants. He also said that Mr. Tucker and he would make themselves available to "brief" Bingham on the background facts relating to the matter generally. For the reasons just set out, Mr Wallace agreed that the Applicants should be advised by Bingham at the expense of the TXUEL and TEG estates, the primary focus being on issues where a conflict might arise between different groups of creditors (there being concern that there should not be duplication of work being carried out by Cadwalader on behalf of bondholders representatives as a whole). For similar reasons, he subsequently also agreed that the Applicants should be advised by Moore Stephens at the expense of the estates, given SISU's particular concern with the inter-company balances work and tax issues.

202. In seeking funds to obtain advice, the Applicants really had a choice between three options for dealing with the work required to pursue their interests as creditors of EH3 and EGO BV:

a. They could have the relevant work done by Bingham, funded by the estates, with Bingham arguing the Applicants' position on an inter-creditor basis.

b. They could, at least in relation to the £67 million issue, join with the teams fighting the corners respectively of TXUEG and TXUUK (which was indeed one suggestion which KPMG made later, in May 2004).

c. They could turn to Mr Spratt and Mr O'Connell, insisting that they involve themselves; they would undertake the necessary work at the expense of their estates.

203. The issue of cost duplication was significant. Between December 2002 and February 2005, when Mr Wallace terminated the fee agreements, Bingham and Moore Stephens incurred fees amounting to well over £1m. Nobody, including the Applicants, was expecting Mr O'Connell and Mr Spratt to take an active role at that stage (December 2002), thus duplicating work, but Bingham and the Applicants knew that they could ask them to become involved if the need arose. Mr Roome accepted this in his cross-examination and I think that the contemporary correspondence and emails are to the same effect.

204. Following the telephone call between Mr Wallace and Mr Terry, Mr Wallace received a second letter dated 23 December 2002 from Bingham in which they wrote:

> "Since we sent our first letter of today, our clients (and we) have learned from you that that (sic) the proposal for offsetting the capital gain realised by TXU UK Limited at this stage now simply involves placing No. 3 into creditors' voluntary liquidation".

205. Bingham also re-iterated their concerns about conflict saying this:

> "In principle, our clients do not object to a straightforward liquidation of [EH3] at this stage. However, our clients maintain their concerns regarding your potential conflicts (as set out in our first letter of today) in relation to your proposal that you now also act as liquidators of [EH3]. As it stands, our clients believe that [EH3]'s liquidators should be entirely independent office-holders, who are neither partners in KPMG nor Ernst & Young."

They also said that the proposed "briefing" meeting would provide an opportunity to discuss the issue of who should act as liquidators of EH3 prior to the section 98 meeting. I am not clear whether such a briefing meeting took place prior to the section 98 meeting which took place on 8 January 2003.

206. The identity of the EH3 liquidators was raised again in a meeting on 27 December 2002 held with Mr Terry. Mr Tucker said that the KPMG officeholders' intention was for the insolvency proceedings to operate on a consensual basis with a view to achieving a scheme of arrangement and that key decisions would be put to the Creditors' Committees and, if there was a dispute, a means would be found to resolve it. Mr Tucker's view, however, was that there would be substantial negotiations in the insolvency proceedings and the fewer firms of insolvency practitioners that were involved, the better. Mr Tucker considered that it would complicate matters to bring in an independent person to take a joint appointment with KPMG as liquidator of EH3. His proposal was to appoint, as the liquidators of EH3, Mr Steve Treharne and Mr Spratt, two partners from KPMG's liquidation team who did not have appointments elsewhere in the TXU Europe group.

207. There was, in the event, no further opposition to the proposal to liquidate EH3. The shareholders passed the necessary resolution on 30 December 2002. Mr Spratt and Mr

Treharne were appointed joint liquidators. The section 98 meeting was convened to take place on 8 January 2003.

208. Mr Wallace's decision to permit the Applicants to be advised by Bingham and Moore Stephens at the expense of the ATL estates was not universally welcomed by other Holding Companies' creditors, either then or subsequently. Ms Denise Duffee of Citigroup, even at that time, wanted Bingham's role either to be terminated or limited to very specific areas with a view to avoiding unnecessary costs. However, Mr Wallace's concern was that sufficient support for a consensual resolution of the issues would not be obtained unless major creditors had an opportunity to make a careful and informed assessment of the issues.

209. **The Appointment of Mr. Tucker**: The Section 98 meeting in EH3's liquidation was scheduled to take place on 8 January 2003 in London. In advance of those formal meetings, an informal meeting took place between Bingham and KPMG on 6 January 2003. Mr Roome says this:

> "At that meeting, Mr Wallace was evidently keen to overcome the Applicants' objections to the appointment of KPMG partners as liquidators of EH3. He questioned why the Applicants would want independent liquidators at EH3. He accepted that the Applicants would want the liquidators to fight their corner but said that, in reality, independent liquidators would have limited access to information from the KPMG office-holders and would therefore have less say in the process. Mr Wallace offered to procure that the liquidation committees of EH3 and TEG (which was a large debtor of EGO BV and EH5) would be controlled by the Applicants. Mr Wallace also agreed that the Applicants should have independent accountants to undertake due diligence on their behalf in relation to the accounting work undertaken by KPMG; whilst he did not think this last measure was necessary, he said that he wished the Applicants to have confidence in the Insolvency Proceedings, the outcome of which for the various creditor groups would, to some extent, be determined by the settlement of the ATL inter-company balances."

210. Accordingly, by the time of this meeting, the Applicants had accepted the position that KPMG liquidators should be appointed. The circumstances in which Mr Spratt and Mr Tucker came to be appointed are as follows. During the course of this meeting, according to the Minutes which were in evidence, Mr Spratt stated that he and Mr Treharne had been appointed liquidators on 30 December 2002, and asked if there were any other nominations. Mr Olin nominated Mr Tucker as an additional liquidator. After discussion, according to the Minutes, it was decided that Mr Tucker would be appointed in place of rather than in addition to Mr Treharne. Mr Olin did not recall the detail of the meeting, but he accepted in his evidence that the Minutes suggest (i) that he decided that it was in best interests of his company to have Mr Tucker appointed and (ii) that there was then a discussion, following which Mr Tucker was appointed. I accept the accuracy of the Minutes. Notwithstanding the complaints – based on conflict of interest - which the Applicants now have about partners in KPMG becoming office-holders in various TXU Europe group companies, there was, on what was then known and understood by the Applicants and their advisers, no objection, let alone opposition, on 8 January 2003, to the appointment of Mr Spratt and Mr Tucker as liquidators of EH3.

211. This is entirely in accordance with what Mr Tucker says namely that he recalls Mr. Roome suggesting that he or Mr Wallace should at least act as one of the liquidators of EH3 on the basis that their involvement as "main officeholders" of the Holding Companies would benefit the EH3 estate and those interested in it because they were more familiar with the background than either Mr. Spratt or Mr. Treharne.

212. It is also entirely consistent with a file note dated 8 January 2003 made by Mr Spratt. It states that, following the appointment of himself and Mr Treharne as joint liquidators, Bingham requested that one of the joint administrators (*ie* Mr Wallace or Mr Tucker) should replace one of the existing liquidators or be appointed as an additional liquidator.

213. The Applicants' position, as stated in Bingham's second letter dated 23 December 2002, had previously been that independent liquidators should be appointed. Mr Roome himself, or perhaps Mr Terry, appears (see the file note just mentioned) to have considered that it would be preferable that the liquidators should include a KPMG liquidator who was already an officeholder in other companies rather than have two liquidators (Mr Spratt and Mr Treharne) neither of whom would have had as great a knowledge as Mr Tucker or Mr Wallace. Whatever reservations that the Applicants and Bingham had on 8 January 2003, they were not expressed at the creditors' meeting.

214. Mr Roome says in his second witness statement that, in relation to the liquidation of EH3 and the appointment of KPMG liquidators, "we" (which in the context can only be read as Bingham, not the Applicants as well, whom he refers to consistently as "our clients") were unaware of a number of facts which he calls "the Material Facts" (a phrase I adopt) and which he says would (whether taken together or separately) have caused the Applicants to refuse outright to agree to KPMG taking appointments in EH3 (or, later, in EGO BV). The allegation concerning absence of knowledge of the Material Facts was a central part of the Applicants' case in relation to the appointment of KPMG liquidators of EH3 and confirmed by both Ms Seppala and Mr Olin in their second witness statements and repeated frequently by Mr Roome in his witness statements. It was repeated in the Applicants' written opening and closing. The Material Facts are, according to Mr Roome:

a. That, prior to Mr Wallace's appointment as an officeholder at TXUEG and TXUEL, he and Mr Florent of A&O, on behalf of creditors of TXUEL, had been involved in a contest over the destination of £67 million held in TXU UK and had adopted a position which was contrary to the interests of the Applicants as creditors of EH3 and EGO BV.

b. That, prior to his appointment as an officeholder at TXUEG and TXUEL, Mr Wallace and Mr Florent had been informed by various creditors of TXUEL that the £67 million had to be returned to TXUEL at all costs and should not under any circumstances be allowed to remain in TXU UK or go to TXUEG (and thence to the Conduit Companies) and that they remained immovable in respect of this conviction.

c. As a result of differences between E&Y and KPMG leading up to their respective appointments, they had agreed that KPMG could not deal with any matter where there was a conflict between the interests of TXUEG and TXUEL respectively and that a Memorandum of Understanding had been agreed and approved by the

court to that effect (although Unum and SISU had become aware of the existence of such a document, no details had been released and none were volunteered or disclosed by KPMG).

d. That Mr Wallace and Mr Tucker were acting for TXUEL alone in respect of the dispute between TXUEG and TXUEL over the £67m.

e. That they could not therefore act for EH3 or EGO BV on that issue.

215. It is, of course, true (as Mr Wallace acknowledges and indeed asserts) that during the pre-administration period the financial creditors of TXUEL had pressed for the £67 million swap proceeds to be paid to TXUEL and that these financial creditors included members of the Bank Steering Committee. KPMG and A&O represented the Bank Steering Committee in this respect. The Applicants were aware of the £67 million issue. For instance, on 30 October 2002 they were sent a draft letter for review by Cadwalader which mentioned it (referring then to only £45 million) and notes of various phone calls (in which either the Applicants took part or of which they had knowledge) during November 2002 refer to it. Mr Olin made a note of the telephone call for the bondholders' committee at which Mr Wallace reported on 2 November 2002 on which he has written "Need to see the MoU": there is no record of his having subsequently asked for it let alone that he was refused it. There was also a letter sent on 13 November 2002 from the ad hoc Bondholders' Committee demanding the return of the £67 million. The Applicants were members of that Committee and it is to my mind highly unlikely that they did not know the contents of that letter.

216. Ms Seppala accepted that that anyone involved with the ad hoc Bondholders Committee who participated in the update calls and received the same e-mails as Mr Hassenstab (as the Applicants did) would have known that KPMG and A&O were working for the banks, and that Cadwalader on behalf of the ad hoc Bondholders Committee was working with Mr Wallace and the Banks' legal advisors to have the £67 million returned to TXUEL. It was one of many topics being discussed. I think that the cross-examinations of both Ms Seppala and Mr Olin established that they were fully aware of the £67 million issue, of the RCF Banks' interest in obtaining repayment of that to TXUEL and of KPMG's position on behalf of TXUEL on that issue. I also think that Ms Seppala for certain, and possibly Mr Olin too, regarded the £67 million issue as of nowhere near the importance of some other issues and concluded that the Material Facts, even if they had not been fully understood, would have been unlikely to have made any difference to their attitude about the appointment of KPMG liquidators.

217. It is, in any event, accepted that Bingham received a copy of the MoU on 20 January 2003. That Mr Terry and Mr Roome may not have read it or understood its effect is neither here nor there it seems to me. The fact is that its provisions, if one does read it, in relation to the £67 million are, to my mind at least, perfectly clear.

218. Having said that, I would mention some other detail. In their discussions on this issue with the TXU Europe group companies and their advisers, Mr. Segal (of A&O) and Mr Wallace co-operated closely with Mr. Wilkinson of Cadwalader, who represented the Bondholder Committee. Throughout the pre-administration period, from the time that the issue arose, Mr. Wilkinson's vigorous and unequivocal position on behalf of the Bondholder Committee was that the £67 million should be returned to TXUEL. The

Applicants were members of the Bondholder Committee for all or part of this period. There is no suggestion that the Applicants took a different view on this issue from the other members of the Bondholder Committee. That, of course, is not to say that the Applicants were precluded from later asserting a different view. But what they cannot say is that they were any less informed than other members of the Committee in acting as they did in relation to the appointment of officeholders at EH3.

219. The section 23 report dated 8 January 2003 for TXUEL, TXUAC and TEG (*ie* all ATL companies) identifies the £67 million issue under the heading "£67 million swap encashment" within the section headed "Investigations". It explains that swaps were encashed and that the funds were eventually transferred to TXUEG. It goes on:

> "Following the sale to Powergen, the creditors of TXUEL, together with their advisers, made repeated requests for the reimbursement of TXUEL/Eastern Funding. The directors ultimately received legal advice that it would be inappropriate to do so. "

and goes on:

> "We have instructed solicitors to obtain witness statements from the directors, their legal advisers, and appropriate TXUEL senior management, in order that the facts leading up to the transfer of the £67 million can be properly established. This process is ongoing".

220. Mr. Tucker handed drafts of that report to the members of the Bondholder Committee, including the Applicants, at a meeting on 6 or 7 January 2003. The final report was made available to Committee Creditors (including the Applicants) early on the morning of 8 January 2003, prior to the series of creditor meetings held that day. Its contents were addressed in a lengthy presentation which Mr Wallace made at the creditors' meetings for TXUEL, TXUAL and TEG, which took place prior to the creditors' meeting for EH3. For completeness, I mention here that the report identified the Double Dip issue in connection with the EFC Bonds.

221. It is apparent from all of the above that the Applicants were provided with material from which they would, if they had read it, have known of KPMG's and A&O's involvement in, and partisan position concerning, the £67 million and that they had been involved in pressing for the return of that money to TXUEL prior to its administration.

222. The Applicants also had information, not least from their involvement with the Bondholders Committee, from which they knew, or should have known, that there were bank and bondholder creditors of TXUEL who strongly believed that the £67 million should be returned to TXUEL, and had pressed the companies and their advisers in that respect (although whether the Applicants told Bingham about any of this is another matter and not one with which I am concerned). If there were any doubt about that, the section 23 report for TXUEL, TXUAC and TEG made clear that there was an issue about the £67 million in which Mr Wallace and Mr Tucker were concerned as administrators of those companies.

223. Further, the existence and nature of the MoU were publicly disclosed in the section 23 report for TXUEG dated 19 December 2002 and the section 23 reports for TXUEL, TXUAC and TEG dated 8 January 2003.

224. As to the section 23 report for TXUEG, the MoU is referred to in paragraph 1.22 of the Summary and in paragraph 1.25 it is stated that E&Y are solely responsible for various matters stated in language which accurately reflects that of the MoU itself which I have already quoted at [189] above.

225. As to the section 23 reports for TXUEL, TXUAC and TEG, Appendix 3 deals with the MoU, giving a one page summary of its effect. The MoU is described as setting out "the respective responsibilities and duties of the administrators [of TXUEG] in respect of TXUEG's interest in the following"; and there then appears in the column containing E&Y's responsibilities "Any action to retain for TXUEG the £67 million swap proceeds downstreamed from TXUEL in the period leading to the administration".

226. During the pre-administration period, Mr Wallace acknowledges that KPMG made no assessment of whether the return of the £67 million to TXUEL would be contrary to the specific interests of creditors of EH3 or EGO BV. An assessment of this issue was, however, made when KPMG were preparing their 27 February 2003 report to Committee Creditors in which it was observed that a key inter-creditor issue was likely to be "whether the £67 million swaps cash stays below the line". The summary of the analysis giving rise to this conclusion showed the EGO BV Bonds receiving between £3 million and £7 million more if the £67 million were not returned to TXUEL and stayed instead at TXU UK.

227. My conclusion is that the Applicants had, through their involvement with the Bondholders Committee and the provision of the reports to them which I have mentioned above, the material from which they knew, or would have known if they had read it, of the Material Facts a, c and d (although whether Bingham were told of the relevant material, I do not decide). Bingham were, in any case, provided with MoU in January 2003. As to Material Fact b, it may well be that the Applicants were not informed by Mr Wallace and Mr Tucker that the £67 million had to be returned to TXUEL "at all costs" although they must have had some idea of the strength of feeling. But that, in my judgment, is not to the point: if the Applicants knew (or are to be treated as knowing having been provided with informative material) that TXUEL was claiming payment and that KPMG was acting for it in that regard, it matters not whether the creditors of TXUEL required this result to be achieved "at all costs" or whether they were simply using it as a bargaining chip. KPMG's conflict, such as it was, was the same in either event.

228. As to Material Fact e, this is a conclusion which Mr Roome draws from the earlier Material Facts and does not require separate consideration <u>as a fact</u>.

229. Having said all that, I acknowledge that nothing was said expressly by Mr Wallace to Bingham (or to the Applicants) in the correspondence about KPMG's involvement as advisers to the banks or their active pursuit of the £67 million claim on behalf of TXUEL. It is submitted on behalf of the Applicants that the conflicts which KPMG faced were, especially in the light of the ICAEW Guidance, such that KPMG could not properly accept office as liquidators of EH3. Further, it is submitted that, if they are to rely on the absence of opposition from the Applicants' to such an appointment, they must show that

such acceptance was on the basis of informed consent and that whatever consent the Applicants did give, it was certainly not informed consent. However, the fact is that Mr Tucker and Mr Spratt were appointed liquidators and the only question is whether they should now be removed. It is not relevant to know whether, had objection been taken at the time in the light of then known conflicts or had an application been made shortly after their appointment to remove them, their appointment would have not taken place or they would have been removed. Whether they should now be removed is a question which I will address much later in this judgment.

230. In those circumstances I do not propose to address further the question whether the KPMG liquidators would have been appointed if, contrary to my findings of fact, the Applicants knew nothing of the Material Facts.

231. **The EH3 Liquidation Committee**: The section 23 meetings for the creditors of the companies placed into administration had been set for 8 January 2003. Since creditors would be in London, the section 98 meeting for EH3 was also convened to take place that day. As far as EH3 was concerned, the Applicants were willing to act on its liquidation committee. Indeed, Mr Roome says that the Applicants' control of the committee was a matter of great importance to them and that Mr Wallace had agreed, at the meeting on 6 January 2003, to procure their appointment to the committee. I think Mr Wallace probably did agree to do so, but I think that for him it was not a matter of any great significance who was on that committee which had very few formal powers. With a third creditor required, Appaloosa also agreed to act. Mr Wallace does not recall that any conscious decision was made to give the Applicants a controlling vote on the EH3 Committee but accepts that it was perceived as important by them at the time

232. So far as concerns the creditors' committees of TXUEL, TXUAC and TEG, the constitutions adopted were as follows:

a. TXUEL: Unum, SISU, Appaloosa, JPMorgan and Barclays as members, with AEGON and Citigroup as observers.

b. TXUAC (whose creditors were largely other group companies in respect of inter-company balances): John Pattisson (a retired executive director of Hanson plc and a TXUAC loan note holder), Finco2 (represented by Unum), Global Energy Finance LLC (represented by SISU) and EH4 (represented by Appaloosa) as members.

c. TEG (whose creditors were also largely other group companies in respect of inter-company balances): EH5 (represented by Unum), Energy Resources Limited (represented by SISU) and EGO BV (represented by Appaloosa) as members.

233. **March 2003 Correspondence with KPMG**: Meetings of the Committee Creditors of TXUEL, TXUAC and TEG took place on 27 February 2003, during which KPMG addressed a number of complex issues to keep Committee Creditors up to date with developments. A detailed report was prepared and circulated to the Committee Creditors, including the Applicants.

234. That report referred to evidence of cash flowing between TXU Europe group entities in a different way to that shown in the accounting records. This raised the possibility of a

different accounting treatment being adopted and the possible implications of this were set out. The analysis was at a preliminary stage, and further investigation was required before any firm conclusions could be reached. The following day, Peter Norris of KPMG held what Mr Wallace describes as a constructive four-hour meeting with Peter Coleman of SISU and Mark Shaw of Moore Stephens, at which this and other issues were discussed.

235. Given the preliminary stage of these investigations and what he regarded as the constructive meeting on 28 February 2003, Mr Wallace says that he was surprised to receive a letter dated 4 March 2003 from Bingham (described by him as "contentious") addressed to him and Mr. Tucker as administrators of TXUEL, TXUAC, TEG and TXUEG (not, it should be noted, to the officeholders of EH3). In their letter, Bingham stated that KPMG had "glossed over" the issue at the meeting. They also said that this and the other matters to which they referred raised further questions on the part of the Applicants that the administration process was unfairly prejudicial to them. Mr Wallace and Mr Tucker strongly disagreed and responded to the concerns Bingham had expressed in a letter dated 7 March 2003.

236. In particular, in response to their comments to the effect that it was inappropriate for KPMG to seek advice from A&O in relation to these issues, it was made clear that Mr Wallace and Mr Tucker were satisfied that A&O had appropriate procedures and processes in place to manage any potential conflicts of interest. Nevertheless, they had no reason to object to the Applicants' request, and so decided to instruct Cadwalader on these issues.

237. As a result of the further investigations and the advice taken, Mr Wallace and Mr Tucker concluded in late 2003 that no adjustments were necessary and that the accounting treatment should remain as it was.

238. All of this seems to have been perceived, according to Ms Seppala's evidence, as a further attempt "to shift value" within the TXU Europe group. She had also stated that it was a "re-occurrence of the tax issue" raised before EH3 went into liquidation and asserted that Mr Wallace was demonstrating a tendency to align himself with the interests of the RCF Banks and that he "rapidly backtracked on the proposal" in the face of Bingham's letter dated 4 March 2003.

239. I do not consider that that is a fair representation of what Mr Wallace was doing. In saying that, I do not overlook Mr Roome's evidence in his first witness statement at paragraphs 106 to 109.

240. First, there was no attempt to "shift value". At this stage, there was no proposal of any kind. Rather, KPMG had identified an issue which they considered warranted further investigation. Secondly, the issue had nothing whatsoever, so far as I can see, to do with the proposals to crystallise tax losses at TXUAC which led to the liquidation of EH3. Thirdly, there was never any question of "rapidly backtracking". The issues were investigated fully over a period of several months prior to reaching the conclusions reached. In any event, this issue is not one on which the Applicants rely to establish unfair prejudice

241. Mr Wallace was concerned at what he regarded as the Applicants' over-reaction to his merely informing creditors in February 2003 that this was an issue which KPMG were looking into. He saw the Applicants' position as being that there should be consultation with them first on any matter before bringing it to the attention of other creditors and that they seemed concerned to ensure that KPMG would resolve issues with them before informing other creditors who might take a different position. Mr Wallace thought this was wholly inappropriate. If that was what the Applicants were saying, then I wholly agree with Mr Wallace.

Administration of EGO BV:

242. On 20 November 2003, the court made an administration order in respect of EGO BV. Mr O'Connell and Mr Wallace were appointed joint administrators. Although its formal insolvency had been under discussion since March 2003, its implementation had been delayed pending discussion as to the selection of the appropriate insolvency process (*ie* under English or Dutch law) and the resolution of the claims of the Dutch tax authorities. Ultimately, all concerned considered that administration in England was a preferable route for reasons which I do not need to go into.

243. Initially, the Applicants' position was that independent officeholders (that is non-KPMG officeholders) should be appointed as administrators of EGO BV. It was suggested that Mr Shaw of Moore Stephens (who were acting as financial advisers to the Applicants) might be appointed. The KPMG officeholders did not oppose this proposal. Mr Wallace says, and I accept, that he had no particular reason to object to the appointment of someone other than a KPMG partner: EGO BV was a relatively self-contained entity and the only potentially contentious issue of which he was aware at that time was the GFA issue.

244. However, Ms Duffee of Citigroup took a contrary view and argued for the appointment of partners of KPMG principally on the grounds of cost. Moreover, Ms Seppala said in her first witness statement that she herself became uncomfortable with a Moore Stephens appointment as it would threaten their continued ability to act for the Applicants.

245. On 30 September 2003 the Applicants indicated that they would support the appointment of KPMG office-holders to EGO BV on the basis that Bingham and Moore Stephens would continue to be retained to represent the interests of the Applicants for the remainder of the restructuring process and that the appointments could be revisited if issues of conflict of interests arose which meant that it was no longer appropriate for the KPMG administrators to remain in office. Ultimately it was agreed that Mr Wallace and Mr O'Connell should be appointed administrators of EGO BV.

246. The first meeting of creditors was held on 11 February 2004. The constitution of the EGO BV creditors' committee was disputed between the Applicants, on the one hand, and Appaloosa, Citigroup and AEGON, on the other. The last three creditors all wanted to be on the committee and, given their voting strengths, believed they could compel this. The Applicants argued that, as they were the only "unconflicted" EGO BV creditors, they should be the only members of the committee. An impasse was reached at the original meeting. Mr Wallace was reluctant to determine matters by a vote, which he thought would have led to a breakdown in any consensual process. Accordingly, he adjourned the meeting for a week and eventually persuaded both sides to accept a "hung" committee,

with two representatives from each side. The result was that Unum, SISU, Citigroup and AEGON were appointed to the creditors' committee of EGO BV.

247. In his first witness statement, Mr. Roome says that it was envisaged that Mr. O'Connell would have principal conduct of the administration and that he understood Mr. O'Connell's appointment to be an attempt by KPMG to manage conflicts issues. Mr Wallace acknowledges that KPMG were aware of the GFA Claim by the time of their appointment and considered that Mr. O'Connell would be able to consider the issue independently if the need to do so were to arise. He says that the approach adopted was that Mr. O'Connell would deal with the day-to-day affairs of the administration as well as any potential conflict issues (such as the GFA), while Mr Wallace would focus on seeking, if possible, the consensual resolution of issues between the Holding Companies and the Operating Companies, and among the Holding Companies themselves. That is how Mr O'Connell says he perceived his involvement. I accept Mr Wallace's evidence on that (which I do not perceive, in any case, to be inconsistent with what Mr Roome says).

Events leading to the BTL CVAs and the CVAs themselves

248. **Background**: The principal business of the Holding Companies was the provision of finance to the Operating Companies and the principal significant assets of the Holding Companies as a group were (directly or indirectly) (i) the claims of the Conduit Companies against TXUEG; (ii) potential litigation claims against the directors of the Holding Companies, TXU Corp or other third parties and (iii) the disputed £67 million. The outcome of the Operating Company settlement negotiations with external creditors was therefore of crucial importance to all Holding Company creditors. Mr Wallace also observes, correctly I think, that it made sense, at the same time as attempting to achieve a settlement below the line, for the officeholders of the Holding Companies to aim to synchronise proposals for Operating and Holding Company CVAs in order to provide certainty of outcome and so that distributions could be made as soon as possible.

249. In November 2003, KPMG hosted a meeting of the Committee Creditors and the creditors' committees of all the Operating Companies, for the purposes of which the key issues were summarised on a single sheet of paper. It identified the key issues as Net v Gross, PPA quantification, Investigations [*ie* claims against TXU Corp and directors], Intercompanies; it identified the "Next tier of issues" as "Tax shelter, £67 million, EET BV…". The parties have agreed before me that the principal issues affecting the Operating Companies were as follows:

a. Compromise of PPAs.

b. The Net v Gross Issue.

c. The estates' claims against TXU Corp.

d. The inter-company balances owed by TXUEG to the Conduit Companies.

e. £67m held in escrow.

f. The valuation date for BTL creditor claims and the entitlement to interest.

250. In the absence of significant progress in resolving various inter-creditor issues and to break the deadlock, Mr. Bloom prepared draft heads of terms for settlement of the BTL issues which he put forward on 5 April 2004 (the "**E&Y Proposal**").

251. The E&Y Proposal was premised on a number of assumptions, including the assumption that the PPA Creditors' claims would be allowed at approximately £1.32 billion, with the total value of PPA guarantees at £1.1 billion. The E&Y Proposal can be summarised as follows:

   a. Creditors who would receive 100% in any event, would be paid in full but without any payment of interest.

   b. All creditors who would not receive 100% would compromise the Net v. Gross issue at 50:50 initially.

   c. All creditors, excluding the Conduit Companies and the two largest PPA Creditors (namely, Drax Holdings Limited and Drax Power Limited ("**Drax**"), and Scottish and Southern Energy plc ("**SSE**")), would receive a dividend based on the Net v Gross dispute being settled at 70:30 in their favour (ie 70:30 net for those preferring net and 70:30 gross for those preferring gross); a shortfall would arise under these proposals which would initially be borne mostly by the Holding Companies but also in part by Drax and SSE.

   d. The £67 million would be split 50:50 above the line and below the line.

   e. Any proceeds of investigations would first be distributed to any creditors who had suffered the initial shortfall under the Net v. Gross compromise, in order to top up their distribution to revert to 50:50.

   f. Any further proceeds would then be used to top up those creditors still receiving 50:50 to their preferred outcome (i.e. 70:30) on Net v. Gross.

   g. Any surplus proceeds of investigations would then be allocated to all creditors who had not received a 100% dividend, in a compromise formula to be agreed.

252. Mr Wallace regarded the E&Y Proposal as unfair to the creditors of TXUEG as well as the Holding Company creditors and could not support it. He identified a number of difficulties which were communicated in a report dated 26 April 2004 entitled "TXU Europe Limited, TXU Acquisitions Limited, The Energy Group Limited (in administration) – Counterproposal analysis (Draft for discussion at meeting on 27 April 2004)". The difficulties identified can be summarised as follows:

   a. There had been no disclosure to either the Operating Companies' creditors' committees or the Committee Creditors of the work performed by the E&Y and the KPMG officeholders and their advisers (including National Economics Research Association Inc. ("**NERA**") and Ilex Energy Consulting Limited ("**ILEX**") on PPA valuation and the associated valuation methodology. By 2004 the PPA negotiations had come to a standstill. On the one hand, the Holding

Company creditors were demanding full disclosure of all PPA related documents and wanted to be engaged in the negotiations of the claims. On the other hand, the PPA Creditors saw no reason why the Committee Creditors should have any involvement in the PPA valuation process or have sight of any PPA related documents.

b. The assumed value of the PPA Creditors' claims was towards the top end of Mr Wallace's expectations and significantly in excess of the expectations of the Committee Creditors.

c. The costs of funding the proposed Net v. Gross settlement and of buying out "smaller" creditors would have been borne disproportionately by the Holding Companies.

d. The Net v Gross settlement proposal did not reflect the merits of the arguments made through the Net v Gross position papers which had been exchanged between the parties as part of the negotiation process.

e. The proposed allocation of investigation proceeds did not take into account the merits of the different claims.

253. The Committee Creditors considered the E&Y Proposal to be wholly unacceptable. There were a number of ways in which they could respond to the E&Y Proposal. After discussing the alternatives with the Committee Creditors, it was decided that the Committee Creditors should themselves submit a counterproposal (the "**Counterproposal**"), with the benefit of input from KPMG.

254. **The Counterproposal**: The Counterproposal was sent to Ernst & Young by Mr Bickle of Cadwalader (on behalf of the Committee Creditors) on 21 May 2004. The key terms of the Counterproposal were as follows:

a. Net v Gross was to be settled at 75:25 in favour of net.

b. The £67 million was to be returned to TXUEL.

c. Investigation proceeds were to be split 5% to the creditors of EET, 5% to the creditors of TXUEG who were not Holding Company creditors, and 90% to the Holding Company creditors.

d. TXU UK was to receive tax losses for no consideration.

255. There was specifically no counterproposal in respect of the PPA Creditor claims valuation. This is because there had been no disclosure to the Holding Company creditors of the PPAs and related documents and only limited disclosure in relation to the PPA valuation methodology and associated issues for quantifying the PPA claims. The Counterproposal was therefore expressly stated to be conditional on, amongst other things, PPA due diligence being completed and agreement being reached in relation to the PPAs.

256. In the event, the BTL creditors rejected the Counterproposal.

257. It will be noted that it was proposed that the £67 million should be returned to TXUEL. I will need, in due course, to deal with this issue in some detail, as well as with the attempt by Bingham to obtain a "reservation of rights" letter from KPMG. I simply note for the present that, as Mr. Roome says in his first witness statement, in the discussions which took place between the Committee Creditors while the Counterproposal was being drafted, the Applicants reserved their position as to the £67 million and the litigation proceeds.

258. Bingham agreed, however, that the reservation of their position should not be communicated to E&Y, no doubt thinking that, if Mr Bloom got wind of a possible dispute about the £67 million above the line, he might backtrack on his apparent acceptance of that amount going above the line as part of the BTL settlement. In relation to this, a draft of the Counterproposal was sent on 18 May 2004 to various legal advisers (including both Mr Roome and Mr Terry) and to the various Committee Creditors by Mr Bickle of Cadwalader (who was acting for the bondholders), for their comments with a view to finalising a draft to send to Mr Bloom. Mr. Terry returned to Mr. Bickle a mark up of the document, making a number of comments, in relation to the £67 million. Mr. Bickle's draft contained the following term in square brackets: "Returned in full from TXU UK to TXUEL". Mr. Terry's mark up deleted the square brackets and added a footnote stating that:

> "This is accepted by Unum Provident and SISU Capital for the purposes only of negotiation with the below-the-line creditors, on the condition that the position of EGO BV bondholders is reserved with regard to the allocation of the £67m Swap Proceeds as between the above the line finance creditors, and on the basis that a process for addressing the above-the-line inter-creditor issues is put in place in short order. This footnote is addressed to the above-the-line finance creditors only and may therefore be removed from this term sheet when it is sent to EY."

259. In its final form, therefore, the Counterproposal provided for the £67 million to be returned from TXU UK to TXUEL, the qualification having been removed in accordance with Mr. Terry's mark-up.

260. I pause here to remind myself that the only parties with any possible legal claim to the £67 million were TXUEL, TXUEG and TXU UK and, in that regard, I find TXUEG's claim very difficult indeed to formulate. None of the Conduit Companies (including EH3) had any claim to the £67 million: at most they could hope to receive more by way of distribution from TXUEG if the £67 million remained at TXU UK (or at TXUEG). The only claim above the line was TXUEL's claim; the other claims (of TXU UK and TXUEG) were below the line claims.

261. As the creditors remained entrenched in their positions, Mr. Bloom and Mr Wallace decided that a consensual resolution of all the remaining issues between the ATL and the BTL Companies might be assisted by holding a meeting of the creditors' committees at which the ATL Companies' officeholders' advisers would address the BTL Companies' creditors and *vice-versa*, in relation to those issues.

262. **16 June Meeting:** It was therefore agreed that an all-parties creditors' meeting should be held on 16 June 2004.

263. The following presentations were given at this meeting:

a. Net v Gross: Mr. Florent (of A & O) presented TXUEG's case and Mr. Lloyd and Mr. Milner-Moore (both of Herbert Smith) presented EET's case;

b. £67 million: Mr. Florent presented TXUEL's case, while Mr. Lloyd opposed it, arguing that the £67 million should either remain at TXU UK or be paid to TXUEG; and

c. Litigation: Mr. Douglas (of Cadwalader) presented on the merits of the potential claims available to the Holding Companies and TXUEG against third parties including TXU Corp, while Mr. Milner-Moore presented on comparable claims available to the Operating Companies (excluding TXUEG).

264. For several key creditors, including at least Appaloosa and Citigroup, the £67m issue was non-negotiable. From the outset and repeatedly throughout the insolvency proceedings, these creditors had signalled (and continued to do so) to KPMG that they would not support any consensual process for the distribution of the group's assets that did not include the return to TXUEL of the £67 million which had been paid away at a time when the company was already insolvent. My conclusion on the totality of the evidence is that several key creditors, including at least Appaloosa and Citigroup, would not have supported an overall settlement or an ATL settlement in which the £67m did not pass to TXUEL. Mr Goldstein of Appaloosa stated in extremely forceful terms – clearly recollected by Ms Seppala and Mr Olin – that, as far as Appaloosa was concerned, no settlement would be agreed unless the £67 million held in escrow by TXU UK was paid to TXUEL. This sentiment was further echoed by Ms Duffee of Citigroup. Notwithstanding that, and consistently with their general approach, the Applicants see KPMG's – and in particular Mr Wallace's – subsequent conduct in progressing the BTL and ATL settlements on terms which included the £67 million going to TXUEL as, at best, a craven submission to pressure which unfairly prejudices the Applicants and, at worst, a deliberate decision to prefer creditors other than themselves. Others, however, might view that subsequent conduct as a recognition of the reality that there would be no deals at all without this term, and that to lose the BTL deal would be madness: the decision was, on this view, a "no-brainer" as Mr Wallace would describe it.

265. Although Mr. Bloom, Mr. Tucker and Mr Wallace had hoped that this meeting would bring the creditors closer together, it did not do so. The creditors' positions remained as polarised as ever.

266. Following this meeting, and in spite of the absence of agreement, the Committee Creditors remained concerned about the level of the PPA Creditors' claims and considered it important to respond in some way. It was agreed that the Committee Creditors should send an addendum to the Counterproposal (the "Addendum") by way of a response. Mr. Wilkinson of Cadwalader agreed to prepare the Addendum in consultation with the Committee Creditors. The Addendum was finalised on 1 July 2004 and sent to E&Y under cover of an email of the same date from Mr. Smith. It indicated that the Committee Creditors would, in principle, be prepared to support the figure of

£1.150 billion in respect of the PPA Creditors' claims in a scheme of arrangement or CVA, subject to disclosure of the PPAs and of all matters relating to mitigation. E & Y rejected the Addendum.

Negotiations concerning the £67 million

267. In the meantime, the proper destination of the £67 million had, since April, been debated and continued to be debated through to July 2004 in the course of the negotiations regarding the settlement between the ATL and BTL companies.

268. In order to understand the debate about the destination of the £67 million, it is necessary to go back in time. Upon TXUEL going into administration on 19 November 2002, Mr Wallace in his capacity as administrator of TXUEL instructed A&O to investigate TXUEL's claim to the £67 million and to advise on possible action to recover those monies on behalf of TXUEL. A&O instructed counsel (Mr Crystal QC) to advise. Mr Wallace says, and I accept, that in giving these instructions, he was not asking A&O and counsel to advocate TXUEL's position (which is not to say that he would not, when it came to negotiations, push hard for TXUEL's position). He required objective advice to assist him in fulfilling his duties as an officeholder and an officer of the Court.

269. It should be noted immediately that the Applicants say that they did not realise that Mr Wallace was acting on behalf of TXUEL in obtaining advice in this way until much much later, at the beginning of June 2004 and that they thought that Mr Wallace was acting for the ATL companies collectively. Mr Roome says this:

> "This disclosure was a shocking revelation to the Applicants and my firm. It appeared that the KPMG office-holders, Allen & Overy, Mr Crystal QC and Mr Oditah QC had from the outset been representing just TXUEL on this issue but had never seen fit to disclose this fact to us or our clients, although it must have been obvious to them that we understood them to be acting for all of the ATL Companies - as they had in relation to the Double Dip, the Multiple Dip and, indeed, all of the other ATL issues. This disclosure also put in a very different light the prior statements of the office-holders and their advisers at Allen & Overy concerning the availability of Mr Crystal QC's original opinion. It also explained why the position paper and Counsel's opinion we had been given in early May 2004 were one-sided and lacking in any depth of reasoning. We then understood that the position paper and new opinion were anything but advice to the Creditors' Committees. This disclosure very substantially raised the level of the Applicants' concerns about the conflicts of interest faced by the KPMG office-holders and their advisers."

270. Returning to late 2002, the interests of the creditors of TXUEG and TXU UK were in fact, at that time, being represented by the E&Y officeholders and Herbert Smith. Even if the Applicants had not realised this, Mr Bloom certainly did and, in relation to the £67 million issue, had a duty to act in the best interests of the general body of creditors of each of the Operating Companies where he was an officeholder.

271. In a consultation on 11 February 2003, Mr. Crystal QC and Dr. Oditah advised the KPMG Officeholders that TXUEL had good prospects of recovering the £67 million. Their advice was preliminary and subject to further investigation. Dr. Oditah recorded

this advice, including in particular the conclusion that TXUEL had "good prospects of recovering the £67 million [swap] proceeds", in a note dated 27 February 2003. These views were communicated to the Committee Creditors in the report dated 27 February 2003. I do not find it at all surprising that, in that report, KPMG did not emphasise their different roles or that Mr Crystal's advice was obtained on behalf of TXUEL. At that time, long before the BTL settlement was anything like well developed, the main consideration from the point of view of all ATL creditors was to (a) negotiate down as far as possible the claims of the PPA Creditors and (b) so far as proper maximise the ATL assets at the expense of the BTL assets in order to minimise what would actually pass to the PPA Creditors.

272. After further investigations, a further report (the title page referring to TXUEL, TXUAC, TEG and TXUEG only) was given to creditors on 29 July 2003, in which it was stated that "Leading Counsel['s] … preliminary advice continues to be that TXUEL has a strong claim to the £67 million held in escrow". Attached to this report was also a much more detailed document setting out many of the background facts to the Swap Proceeds dispute, together with relevant accounting analysis.

273. At or around the same time as A&O were carrying out their investigation, Herbert Smith conducted a similar exercise. As already mentioned, E&Y and Herbert Smith initially represented the interests of both TXU UK and TXUEG. By early March 2004, however, Mr Bloom sought the appointment of Chris Hughes of THM to act as conflict administrator at TXU UK (originally primarily in relation to the Net v Gross issue but subsequently taking on responsibility for TXUEG/TXU UK conflicts over the £67 million issue).

274. Mr. Hughes was duly appointed as conflict administrator of TXU UK on 4 March 2004; he in turn instructed CMS Cameron McKenna to advise him in relation to the £67 million issue.

275. From 5 April 2004, therefore, each company capable of asserting a claim in relation to the £67 million was separately represented by its own administrators and legal advisers.

276. Although the Applicants now complain that the £67 million went to TXUEL under the BTL settlement, it is not immediately apparent to me that, at that time, it would have been to their advantage to have the £67 million remain at TXU UK as part of that settlement. Had that occurred, the PPA Creditors might, one can well suppose, have had a different view about the amount at which they were prepared to settle their claims as part of the BTL CVAs.

277. In any case, the £67 million swaps proceeds which found their way down to TXUEG were not paid onward to TXU UK but were made available to the Operating Companies generally (mostly EET). There was not, on any footing, a £67 million debt owing by TXU UK to TXUEG.

278. Mr Wallace was not satisfied that the 50:50 split proposed by E&Y in the E&Y Proposal reflected the merits of TXUEL's claim; it did not conform with the legal advice which he had received and he knew that the creditors of TXUEL would find such a split to be unacceptable. As a result of discussions between them, Mr Bloom and Mr Wallace agreed that there should be an exchange of "position papers" between the various

interested parties - TXUEL, TXUEG and TXU UK (rather than the creditors who seemed to be getting nowhere towards resolving matters) – setting out each side's claim.

279. Position papers were duly prepared and exchanged and a series of "without prejudice" meetings ensued between the KPMG administrators of TXUEL, the E&Y administrators of TXUEG and the THM Administrator of TXU UK and their respective advisers.

280. Details of the position papers and meetings (both before and after the 16 June 2004 meeting) are set out below:

7 May 2004	TXUEL position paper
25 May 2004	TXUEG position paper
26 May 2004	Without prejudice meeting between the officeholders of TXUEL, TXUEG and TXU UK and their respective legal advisers
29 June 2004	TXUEL supplementary position paper
1 July 2004	Without prejudice meeting between the officeholders of TXUEL and TXU UK and their respective legal advisers
2 July 2004	TXUEG supplementary position paper
5 July 2004	Without prejudice meeting between the officeholders of TXUEL and TXUEG and their respective legal advisers

281. All of the position papers were provided to the Committee Creditors.

282. The E&Y administrators, pursuant to the MoU, were, or should have been, concerned to protect the interests of TXUEG in the £67 million (and thus indirectly to protect the interests of its creditors, principally the Conduit Companies but not, of course, the Applicants who had only an indirect commercial interest in seeing that TXUEG's assets were maximised nor TXUEL other than as a result of its claim to the £67 million) and I have no doubt that Mr Bloom recognised this. Similarly, Mr Hughes had a duty to assert the claim of TXU UK to retain the £67 million (as part of the proceeds of sale of its business to Powergen). From all the evidence which I have seen and heard, I am sure that both the E&Y administrators and Mr Hughes were aware of their duties and properly pushed for their respective positions in the tri-partite negotiations concerning the £67 million.

283. During the course of all this, on 7 June 2004, A&O informed Bingham that the advice originally given to the KPMG officeholders by Mr Crystal QC regarding the £67m would not be supplied to them on the grounds that it was privileged advice prepared solely for TXUEL, which led to the letter from Bingham from which I have quoted at [269] above.

284. As a result Bingham requested that the Applicants should be funded to obtain separate and independent advice from leading Counsel. Mr Wallace approved this step and Mr Paul Girolami QC was instructed. It cannot, I consider, have been thought by anyone, least of all Bingham and the Applicants, that this funding was provided other than to enable the Applicants to be able to put forward forcefully, and with the benefit of the best of legal advice, their position in subsequent consideration of the £67 million issue; nor can anyone have thought that the further investigations being carried out by Bingham would also be carried out – at significant duplication of cost – by the KPMG officeholders in EGO BV or EH3. It was precisely because Bingham perceived a conflict

which they (but not KPMG) considered could not be properly managed that they insisted on funding at the expense of the estates.

The Joint Proposal

285. With a view to breaking the deadlock between the ATL creditors and the BTL creditors, Mr Wallace and Mr Bloom decided that they would jointly put forward a proposal. They spent a week putting together such a joint proposal. The Joint Proposal was agreed in principle on 29 July 2004. This constituted a draft settlement comprising a complete inter-locking package of compromises dealing with each of the BTL issues. The main elements of the Joint Proposal can be summarised as follows:

    a. Interlocking CVAs would be proposed for the five most important BTL companies (namely TXUEG, TXU UK, EET, TXU Europe Power Limited and EGFL) but would not take effect unless at least 75% by value of the PPA Creditors agreed the value of their claims for both voting and dividend purposes at the values set out in the Joint Proposal.

    b. The PPA Creditors' claims were to be compromised at £1.2 billion (compared with claims in excess of £2 billion).

    c. The Net v Gross issue was to be compromised on a 50:50 basis.

    d. All existing and future claims of the BTL companies against TXU Corp, the directors, auditors and certain other third parties were to be pursued by the KPMG officeholders for the exclusive benefit of the ATL companies,

    e. The inter-company balances owed by TXUEG to TEG, EH3, TXUAC and TEG Head Office (a minor creditor of TXUEG) were to be fixed at a total of £429 million.

    f. The "non-compete" claims of two PPA Creditors against TXUEG would be settled for approximately £29 million instead of being litigated.

    g. The £67m was to be repaid from the escrow account to TXUEL, together with interest.

    h. All unsecured claims were to be valued as at 19 November 2002 and no interest was to be paid by BTL companies to their creditors, even in the event that it transpired that they were solvent, unless all BTL companies became solvent.

    i. TXU UK was to acquire tax losses to shelter its 2002 tax year gain by paying £70 million to EET and £35 million to certain ATL companies. However, an adjusting payment would be made (either by the ATL companies or by the BTL companies) such that the effect of the tax loss payments would be neutral for the ATL companies.

    j. The ATL companies would pay an aggregate amount of £7.5 million to various BTL company creditors.

286. Mr Wallace says that he was "satisfied that the Joint Proposal achieved a fair and reasonable balance which was in the interests of each of the companies of which I am an officeholder and the general body of creditors of each of those companies". He includes in that the ATL companies whose economic interests would be affected by any BTL settlement. I have no doubt that in saying that, he is expressing the view which he honestly held at the time and that that is a view which he honestly maintains to this day. I am also satisfied that Mr Tucker and Mr Spratt held, then and now, the same views in respect of the companies of which they are officeholders and that those views were honestly held. The fact that those views were and are honestly held does not, of course, answer the questions whether the BTL CVA for TXUEG was fair to the Conduit Companies or whether the ATL settlement and ATL CVAs for EH3 and EGO BV which later followed were unfairly prejudicial to the Applicants.

287. Mr Bloom (who I take as speaking also for his co-E&Y officeholder, Mr Bailey, from whom I did not receive evidence) was clearly of the view – and as with Mr Wallace, this was a view which Mr Bloom quite clearly honestly held at the time and which remained his view at the hearing – that the Joint Proposal was fair to each of the companies of which he was an officeholder and to each of their creditors, in particular each of the Conduit Companies as creditors of TXUEG. He expressly stated, in answer to a question from me, that he regarded the Joint Proposals as fair overall <u>even if</u> the entirety of the £67 million went to TXUEL beneficially and was not dealt with differently in any ATL settlement (and thus so that none of it went to the Conduit Companies). He did not regard it as his duty to consider the interests of the creditors of the Conduit Companies: that was a perfectly correct attitude because the overall interests of a creditor of the Conduit Companies might lie in <u>reducing</u> the amount which the Conduit Companies recover.

288. Now, the Applicants rely on the answer which Mr Bloom gave to the question which he was asked, in relation to the BTL settlement, about which officeholders were responsible for assessing whether the BTL settlement was in the interests of the Conduit Companies. He replied that it was the KPMG officeholders. Of course, he was obviously correct in saying that in the sense that it was for the officeholders of the Conduit Companies to decide whether to enter into the lock-up and to approve the settlement, and those officeholders were KPMG officeholders. There were no E&Y officeholders at any of the Conduit Companies. But there is a separate question which is who, <u>in putting forward</u> the BTL settlement and proposing the TXUEG CVA, was looking after the interests of the Conduit Companies. That question was not expressly asked of Mr Bloom. The only answer he could have given consistently with the terms of the MoU would have been the E&Y officeholders at TXUEG; and that is the only answer which is consistent with his clear answer that he regarded the BTL settlement as fair to the Conduit Companies even if the £67 million went to TXUEL beneficially.

The Decision to Implement the Joint Proposal

289. Mr. Wallace says that he and Mr Bloom knew (something I find entirely unsurprising) that no creditor was going to be entirely happy with the proposed terms. The PPA valuations were a particular concern, given the lack of trust born from the failure to disclose the PPAs and work relating to them to the Committee Creditors. At the end of July 2004, an email was sent to Committee Creditors convening a conference call to discuss the Joint Proposal and to seek to resolve inter-creditor issues among the Holding Company creditors in order to allow heads of terms for a Holding Company settlement to be considered at the same time, a draft of which had been prepared by then. The e-mail

noted specifically that, failing resolution of Holding Company issues, consideration would have to be given to whether the Holding and Operating Company settlements could be de-linked, hitherto the officeholders having been proceeding on the basis that it would be possible to bring the two settlements forward at the same time.

290. That conference call took place on 2 August 2004. None of the creditors was happy with the Joint Proposal. The reaction from all of the Holding Company creditors, according to Mr Wallace, was that the PPA valuations were far too generous to the PPA Creditors. Mr. Bloom, meanwhile, was consulting with the Operating Company creditors none of whom were happy with the Joint Proposal either. In particular, the reaction of the PPA Creditors was that the PPA valuations were far too low.

291. Comments were made by several BTL and ATL creditors about the Joint Proposal; but none of these comments altered the KPMG or the E&Y officeholders' view that it achieved a fair and reasonable balance for all of the creditors of each of the companies of which they were officeholders.

292. On 8 August 2004, a report dated 6 August 2004 produced by KPMG on the benefits of the Joint Proposal on the principal creditor groups of the Holding Companies was sent to the Committee Creditors. The report stated that:

> "if we cannot reach agreement on these [*ie* the Holding Company] issues the Creditors Committees will need to consider de-linking the Holding Company and Operating Company CVAs."

293. On 13 August 2004 Mr Bloom wrote to Mr Wallace informing him that the EET creditors' committee had voted in favour of the administrators pursuing the CVAs in accordance with the Joint Proposal (although individual creditors had not committed to voting in favour of any CVA). The letter explained that although most of the PPA Creditors were extremely uncomfortable about the PPA valuations included in the Joint Proposal, the certainty that CVAs would provide and the timing of dividends were critical to them. The EET creditors' committee approval was subject to, amongst other things, similar approvals being received from the creditors' committees by close of business on 26 August 2004.

294. It is extremely important to note this discomfort of the PPA Creditors since they, quite clearly, considered that their claims were worth more than the Joint Proposal gave them but, because of their own commercial imperatives – in particular their own need for cash – were willing to settle. An immediate BTL settlement would give them something they needed; but if there were no settlement (or at least not one in the short term) one of the main advantages to them (or some of them) would be lost and one can reasonably think that they would have held out for more. Certainly, there is no dissent from anyone appearing before me that the BTL settlement represented a good deal so far as concerns disposal of the PPA Creditors' claims.

295. At a meeting of the Creditors' Committees on 20 August 2004, there was a discussion of Mr Bloom's letter, and it was agreed that the administrators of the BTL companies (including TXUEG) should commence the preparation of the CVA documents required to implement the Joint Proposal, subject to two conditions. First, the TXUEG administrators should be able to complete their review of the PPA valuation process. Secondly, although

Mr Bloom had already recommended this, the appropriate PPA information should be provided in a dataroom in order that the ATL creditors and their advisers could carry out their own review of the documentation. As with the BTL company approvals, the ATL company approvals did not commit individual creditors to voting in favour of any CVA. The agreement and the conditions were set out in a letter to Mr Bloom dated 24 August 2004.

296. I can then jump to 1 October 2004 when Mr Tucker circulated a memorandum containing a timetable for finalising the BTL and ATL settlements.

297. A slightly revised version of the Joint Proposal was circulated on 17 November 2004. The most significant change referred to in this document related to the PPA valuations. Further work by E&Y on PPA valuations had revealed an error in the Barking Power and the Lakeland Power Limited figures, as a result of which KPMG and E&Y sought reductions in the amounts of their claims.

298. The PPA Creditors had made it a condition of entering into a settlement that, within the deadline imposed, lock-ups were received from each of the Conduit Companies. This condition was strictly unnecessary in the sense that the Conduit Companies were never in practice in a position to block a CVA at TXUEG holding, as they did, only a small percentage of claims. However, there was grave mistrust between the PPA Creditors and the Holding Company creditors and this condition was required by the PPA Creditors as they perceived it as a way of giving them comfort that the creditors of the ATL companies supported the proposal.

The decision to de-couple

299. The agreed facts are as follows:

a. It was originally intended to synchronise an ATL settlement with the BTL settlement.

b. In their report to creditors on 8 August 2004, the Respondents had indicated that de-coupling might be necessary in the absence of progress on the resolution of issues between the ATL companies.

c. On 16 November 2004 Mr Tucker emailed the members of the Creditors' Committees and advisers. Mr Tucker proposed that the BTL and ATL CVAs be de-coupled. The e-mail contained a revised timetable for finalising the BTL and ATL settlements, and proposed that lock-up agreements be entered into by the material BTL company creditors by 25 November 2004.

d. During a conference call on 24 November 2004 Mr Wallace stated that the KPMG officeholders intended to enter into lock-up agreements to the BTL company settlement at TXUAC, TEG and EH3 if they had majority creditor support.

300. Those bare facts hide rather a lot. The Applicants in the written submissions before trial and in their evidence, have made a great deal of the fact, as they allege it, that the BTL and ATL settlement were linked, not only in the sense that everyone was moving forward with the intention that the two should happen at, or about, the same time but also in the sense that one could not happen without the other. In other words, there was some

sort of binding obligation which prevented the officeholders of the various BTL and ATL companies from entering into agreements of CVAs in respect of BTL companies separately from ATL companies. As Mr Roome puts it in his first witness statement, "the office-holders and the Creditors' Committees were proceeding on the express basis that all parties would seek to achieve contemporaneous **and, crucially, inter-conditional**, settlements of the BTL and ATL issues" asserting that this "had always provided the Applicants with a considerable level of comfort". However, I have no doubt, on the totality of the evidence which I have seen and heard, that there was never any such interdependence (and, indeed, I remark that it is difficult to see how the officeholders of the companies concerned could have bound themselves to such a course). What was in the contemplation of all those involved was that the two sets of CVAs would be synchronised if that could be achieved; but as will become apparent, that objective could not be achieved. Accordingly, I reject what Mr Roome says about how the officeholders were proceeding and accordingly also reject his assertion that this provided the Applicants with some comfort. Such, if any, comfort they had can have derived only from the (genuinely held) intention (not an obligation) on the part of the officeholders to bring the two settlements forward synchronistically. That was an intention which they were entitled to alter when the changing circumstances led, as they did, to that being the course they considered appropriate.

301. The reasons for this change can be summarised:

a. The timetable for implementing the Joint Proposal was extremely aggressive. The PPA Creditors felt that the process had already taken far too long and were adamant that unless the process was confined to a tight timetable, their interests would be better served by causing EET to go into liquidation. Threats were made to liquidate EET at various times throughout the process. A final deadline was set on 16 November 2004 when Mr Bloom sent an email to Mr Wallace and Mr Tucker setting out a timetable which included:

    i. Lock-up and compromise agreements to be signed and delivered to Herbert Smith in escrow by 25 November 2004.

    ii. Lock-up agreements to be released from escrow and to become unconditional on 29 November 2004.

    iii. A formal Operating Company CVA Proposal to be posted to creditors on 7 January, 2005.

    iv. CVA meetings to be held on 28 January 2005.

302. Mr Wallace says this:

> "It was an absolute requirement of EET creditors that the creditors' meetings to consider the Operating Company CVA Proposals be held before the end of January 2005. Mr. Bloom stated in the e-mail that the timetable had no room for slippage. In view of the time that had elapsed since the first proposal, with the support of the Operating Company Creditors, Mr. Bloom indicated that if the lock up agreements were not lodged by 25 November in escrow and released from escrow on 29 November, the CVA process would be terminated.

> The likely effect of this termination would be the commencement of liquidation at EET and litigation in respect of all those matters which were sought to be dealt with through the CVAs.
>
> Although Allen & Overy were able to find one or two extra days in the timetable, thus extending this lock up period, which still allowed for creditors' meetings to be held before the end of January 2005, I believed that the written threat of termination of the CVA process if the timetable was not adhered to was genuine and serious. This was reinforced in my discussions with key Operating Company creditors and in an e-mail dated 26 November 2004 in which the EET only creditors, represented by David Buchler……., also threatened to take steps which were likely to result in EET being put into liquidation.
>
> By the end of October at the latest it was clear to me that it would not be possible to resolve Holding Company inter-creditor issues with a view to putting forward proposals for Holding Company CVAs within the same timetable as that contemplated in relation to the Operating Company CVAs. The response from some Committee Creditors was that they were unwilling even to begin to discuss the means by which inter-creditor issues could be resolved amongst themselves until they had completed their due diligence on the PPAs, or separately from a deal with TXU Corp.
>
> On 16 November 2004, therefore, Mr. Smith circulated on behalf of Mr. Tucker a detailed e-mail to the Committee Creditors (including the Applicants) explaining our concerns and recommending that the Holding Company CVAs and the Operating Company CVAs be de-coupled. We also recommended that the Committee Creditors should sign off on the Operating Company deal by 25 November 2004."

303. I accept what Mr Wallace says in those passages. I do not think that any fair criticism can be levelled against him or Mr Tucker for deciding that the interests of creditors of both BTL and ATL companies were best served by de-coupling the two settlements and groups of CVAs. Whether or not the Applicants were surprised by this decision – and I am surprised to be told by Mr Roome that they were surprised – the de-coupling was, in my judgment, perfectly proper and, indeed, it is not easy to see how the Applicants were disadvantaged by it. What they <u>might</u> have been disadvantaged by is the absence of a "reservation of rights" letter in relation to the £67 million issue, which is a matter which I will consider in due course.

Lock-up Agreements and reservation of rights

304. The BTL lock-up agreements (under which certain creditors of BTL companies (including the Conduit Companies as creditors of TXUEG) bound themselves to the terms of the Joint Proposals (as amended on 17 November 2004)) and the "reservation of rights" proposal (under which Bingham sought to obtain a letter reserving the Applicants' position in relation to a number of allocation issues arising out of the Joint Proposal) are, for the purposes of the matters before me, closely connected. I take the lock-up agreements first.

305. **Lock-up agreements**: As should by now be apparent, the approach of Mr Wallace and Mr Tucker to the entire insolvency process was to seek consensus from creditors. This they saw as the most likely way to achieve the purpose of the administrations, namely to achieve CVAs or schemes of arrangements for all of the group companies concerned. Mr Wallace saw no point at all in promoting a CVA unless he thought it stood a good chance of being accepted. His approach therefore, was to promote the BTL CVAs and the lock-up agreement with the consent of the Committee Creditors. There is a dispute about precisely what Mr Wallace or Mr Tucker may have said to Mr Roome or Mr Terry. Mr Roome says that he was told that Mr Wallace and Mr Tucker would only support the BTL CVAs and the BTL lock-ups if they had approval from the Creditors' Committees of TXUAC, TEG and EH3. Mr Wallace says that he does not recall saying such a thing at any time; and Mr. Tucker takes the same position. I think it is very unlikely that Mr Wallace or Mr Tucker did say anything of the sort, rather than that they hoped to get such support. If they did, then they were being deliberately dishonest and I simply do not believe that they were doing anything other than acting, as they saw it, in the interests of creditors overall.

306. Mr Wallace says this:

> "Up until late November 2004 we had received unanimous approval from all of the Committee Creditors for all key decisions put to them. Given the close involvement of all the Committee Creditors in the negotiation of the Operating Company CVA Proposal and the progress of those negotiations in the preceding months, particularly as the PPA information became available in the dataroom, in mid to late November I expected that we would receive unanimous approval from all of the Committee Creditors for us to sign lock up agreements with respect to the Operating Company CVAs on behalf of the Conduit Companies. This situation changed on 24 November 2004, when the Applicants indicated that they would not support the course we proposed."

307. Mr Wallace was challenged about this. It is said that, by 24 November, he knew that he would not obtain the support of the Applicants and therefore not of the liquidation committee of EH3. He therefore turned to "majority rule" to disable the Applicants from challenging the lock-up which EH3 was about to enter into. However, I accept that Mr Wallace did honestly believe up until 24 November 2004 that there would be unanimous approval for KPMG to enter into the BTL lock-ups.

308. Accordingly, on 24 November 2004, Mr Wallace and Mr Tucker say that they faced the following situation:

   a. They considered the Joint Proposal (as amended) to be the best settlement reasonably obtainable for each of the Conduit Companies and their creditors as well as in the best interests of each of the other ATL companies of which they were officeholders and their creditors.

   b. If the BTL company lock-up agreements had not been deposited into escrow on 25 November 2004, or become unconditional on 2 December 2004, then the entire BTL CVA process would have been likely to collapse. The Operating Company CVAs gave the Conduit Companies and all the other ATL companies the prospect of certainty. If the process had collapsed it was likely that the main Operating

Companies would have been placed into liquidation. All ATL creditors would have faced massive uncertainties and the prospect of having to wait 18 months to 2 years to receive any distributions. They also considered it likely that each of the Conduit Companies would face substantially reduced recoveries in a liquidation, compared to the recoveries which they could expect through the Operating Company CVAs.

c. In contrast, they estimated that if the £67 million were treated as the Applicants wanted, that would result in an increase of approximately 2p in the £ in the dividend payable on the EGO BV Bonds.

d. They believed that a large majority of the Committee Creditors wanted the BTL CVAs to proceed.

e. The Applicants held approximately 17% of EGO BV Bonds. The other Committee Creditors held approximately 57% of the EGO BV Bonds.

f. The sole reason given by the Applicants for not endorsing the Operating Company CVAs was that they wanted the terms of a "reservation of rights" letter to be agreed for the purpose of preserving their rights for the allocation discussion between the ATL creditors (as to which see below).

309. They formed the very clear view that the commencement of the Operating Company CVA process was in the best interests of each of the Conduit Companies, their creditors and the other Holding Companies and their creditors. They therefore decided that the lock-up agreements should be executed and deposited in escrow if a majority (in value) of EFC bondholders and the majority (in value) of EGO BV Bondholders and a majority (in value) of holders of debt under the RCF Facility who were in each case Committee Creditors approved such action.

310. They point out, correctly, that none of the Committee Creditors were actually <u>against</u> the execution of lock up agreements on behalf of the Conduit Companies in relation to the BTL CVAs. Of the RCF Banks, JPMorgan, Barclays, Appaloosa and Davidson Kempner were in favour. Of the EFC Bondholders, AEGON, Citigroup, Appaloosa, Varde and Davidson Kempner were in favour. Of the EGO BV Bondholders, AEGON, Citigroup, Appaloosa, Varde and Davidson Kempner were in favour, while the Applicants abstained from support pending agreement on the terms of a reservation of rights letter. Accordingly, on 25 November 2004, lock-up agreements were executed on behalf of the Conduit Companies and delivered into escrow.

311. According to their terms, the lock up agreements could be withdrawn from escrow at any time before 2 December 2004. On 1 December 2004, there was a further conference call with the Committee Creditors (and their advisers) – including the Applicants and Bingham – during which creditors were asked whether any of them wished the executed lock-up agreements to be withdrawn. None of the creditors, including the Applicants, asked that this should be done. After the conference call, Mr. Roome sent an email stating that the Applicants reserved their rights. The lock-up agreements executed on behalf of the Conduit Companies therefore became unconditional the following day.

312. I turn now to the involvement of Mr Spratt and Mr O'Connell. Mr Spratt's involvement was far the more important since he was an officeholder of EH3 which was a Conduit Company and had claims against TXUEG whereas EGO BV had no claims against TXUEG or BTL companies. The Applicants, who describe the events I have just related as very troubling, decided that they should themselves press for the active involvement of Mr Spratt and Mr O'Connell as conflicts officeholders at EH3 and EGO BV respectively; Mr Roome says that the Applicants felt that real value-shifting was now being allowed to occur to the detriment of the creditors of EH3 and EGO BV (a feeling which, however, I do not agree with).

313. Mr Roome, in his first witness statement, says this:

"

242. My colleague, Mr Terry, therefore contacted the conflicts office-holders on 26 November 2004 ………requesting that they become involved with the issues raised in our letter to Messrs Wallace and Tucker of 25 November 2004.

243. Mr Wallace and Mr Tucker had aligned themselves with the interests of TXUEL in relation to the £67 million ring-fenced at TXU UK and, despite the conflicts they faced as joint office-holders of TXUEL, TXUEG, TEG, EH3 and EGO BV, they were not ensuring that the conflicting interests in these monies were being resolved or even effectively managed.

244. The disclosures relating to the PPA counter-party payments and the move to "majority voting" increasingly caused the Applicants to believe during early December 2004 that Mr Wallace was willing simply to ignore the difficulties caused by the conflicting interests in favour of the wishes of his majority creditors at TXUEL.

245. It was unclear to us what involvement or knowledge the conflicts office-holders had until this point. As the Applicants had now largely lost confidence in Mr Wallace and Mr Tucker's willingness to treat them fairly, I felt it was incumbent on us at least to try and engage with the conflicts office-holders. Unfortunately, the Applicants' subsequent experience only confirmed their initial views that the conflicts office-holders would be incapable of taking an independent view.

246. At a meeting with Messrs Spratt and O'Connell on 1 December 2004, I explained the background to the £67 million ring-fenced at TXU UK, the £11.5 million PPA cash-backs and the assignment of the BTL litigation proceeds, and the reasons why it was essential to preserve the rights and interests of those office-holders' estates by a reservation of rights letter. I urged Mr Spratt, as joint liquidator of EH3, to withdraw EH3's executed BTL lock-up agreement (which had been placed in escrow until the following day), at least until a proper mechanism had been put in place to preserve the rights of TXUEG's creditors. I also urged that, as a creditor of TXUEG, EH3

should approach the joint administrators of TXUEG to assert that EH3 was being materially prejudiced by the BTL settlement. Mr Spratt refused to agree to withdraw the BTL lock-up agreement, but he did say he would seek to agree suitable wording with Mr Wallace to preserve these rights.

247. Despite the concerns expressed by my firm on behalf of the Applicants, and their refusal to support the BTL settlement, Mr Tucker agreed to the release of the EH3 BTL lock-up agreement from escrow on 2 December 2004. Mr Spratt's lawyers have since asserted in their letter dated 3 February 2005 that Mr Tucker signed the BTL lock-up agreements after consulting Mr Spratt…….".

314. In the light of the basis on which the estates were funding Bingham, it is not surprising to me that Mr Spratt and Mr O'Connell had not become actively involved in the negotiations before this and I do not think that Bingham or the Applicants should be in the least surprised or, indeed, harbour any criticism for that. Mr Spratt's response to Mr Roome comes to this:

a. His detailed involvement in the BTL and ATL settlements commenced on Monday 29 November 2004.

b. In relation to Mr Terry's contact with him he refers to the email exhibited by Mr Roome dated 26 November 2004. He says, and I accept this, that he in fact never saw this email and it was sent to an incorrect address for Mr O'Connell.

c. He makes observations on Mr Roome's comments on his and Mr O'Connell's involvement, noting, I think correctly, that Bingham knew that they were not actively involved in the BTL settlement negotiations and (as Mr Roome would have seen) they had not been copied in on any of the voluminous emails.

315. From the passages just quoted from Mr Roome, it can be seen that he says that he asked Mr Spratt to withdraw EH3's executed BTL lock-up. Mr Spratt says that he does not believe that he was asked to do so, either at that meeting or subsequently. There is no note of the meeting, either from Mr Roome or from Mr Spratt, to indicate what actually happened. However, Mr Spratt exhibited an email (sent by Mr Spratt to himself by way of a file note) dated 9 December 2004, in which it is recorded that "…at no time did he [Mr Roome] or any other EGO BV bondholder, request that I take steps to withdraw the EH3 lock-up letter". There is no doubt that that is contemporaneous. I decline to conclude that Mr Spratt dishonestly manufactured this note at the time. I can only think that if Mr Roome did ask Mr Spratt to withdraw the lock-up, he did not do so in terms which Mr Spratt understood. One explanation may be that there were discussions about using the <u>threat</u> to withdraw as a negotiating lever. But it is hard to believe that even Mr Roome and his clients would have wanted to lose the BTL settlement on the basis of the allocation of the £67 million at that stage. Indeed, the Applicants did not, in the course of the conference call of Committee Creditors generally on the same day, ask for the lock-up agreement to be withdrawn when all attending had been asked if they wished such agreements to be withdrawn.

316. It has been suggested that Mr Spratt did not properly consider the BTL proposals once he had become involved. Mr Spratt vigorously disputes that, although he acknowledges that he did not consider the need for any liquidation committee sanction. He formed the view that the Applicants did not want to scupper, to use his word, the BTL settlement, but wanted to ensure that their position was preserved in relation to certain aspects, in particular the £67 million issue. To that end, he sought, together with Mr O'Connell, to broker a suitable reservation of rights letter. Clearly, at no time in this process, prior to 1 December 2004, did the Applicants or Bingham ask him to withdraw the lock-up. There is no doubt that Mr Spratt spent a considerable amount of time in the short period from 29 November to 1 December 2004 attempting to get on top of the issues including meeting with Mr Wallace and Mr Tucker and separately with Mr Florent of A&O, as well as with Mr Roome. For his part, Mr Spratt had formed the view that the BTL settlement was a good deal. Mr Bloom was of the same view: he regarded the lock-ups simply as comfort. And even Mr Roome eventually agreed in cross-examination that the BTL settlement was beneficial even if the £67 million did not go to the Conduit Companies (which is not, I accept, to acknowledge that it is not, nonetheless, unfair).

317. **Reservation of rights**: The execution of the lock-up agreements on behalf of the Conduit Companies was effected even though a reservation of rights letter had not been agreed with Bingham. Such a letter was not agreed after the execution of the lock-up agreements either. The Applicants and Bingham see the failure to agree such a letter as procrastination and a deliberate attempt to thwart the Applicants in protecting their economic interests. Mr Wallace denies those allegations. It is therefore necessary to look in a little detail at what happened.

318. There are three issues relating to the BTL settlement and the BTL CVAs which give rise to what have been termed "allocation issues", that is to say how certain sums are to be dealt with as between the different ATL companies:

    a. The £67 million which, it will be remembered, belonged either to TXUEL or to TXU UK (with a somewhat spectral alternative claim by TXUEG) but with no direct claim by any Conduit Company.

    b. The proceeds of any claims that the BTL companies, including TXUEG, might have against TXU Corp and TXU Europe group company directors.

    c. Payments agreed to be made by the PPA Creditors to certain of the ATL companies.

319. There has been some argument about the effect of the Joint Proposal and the BTL CVAs on these allocation issues. In particular, the Applicants say that the effect of them is to render the £67 million beyond the reach of EH3 and EGO BV and the EGO BV Bondholders. As part of an overall settlement of the below the line issues, Mr Bloom, as the non-conflicted officeholder of TXUEG was concerned to see that the BTL settlement and the BTL CVAs were fair to all of its creditors; otherwise, as he recognises, he should not (and says he would not) have put forward the Joint Proposal as amended. He says that he was comforted by the lock-up agreements, since they showed that the creditors (including the Conduit Companies) concerned were also content to proceed with the proposed settlement but he did not regard that as a beginning and end of his responsibilities.

320. It is fair to say, however, that Mr Bloom was not particularly concerned about allocation issues above the line in the sense that it was open to the ATL creditors to agree among themselves how the allocation issues should be dealt with. But he was aware, as any experienced officeholder would have been aware, that there was no certainty that an ATL settlement would come to pass. Accordingly, he was not unaware that the BTL CVAs could in practice be not just the starting point but also the end point for discovering entitlement to the monies subject to the allocation issues just identified. The position in relation to the £67 million was that, absent any different agreement in an ATL settlement, the £67 million went to TXUEL beneficially; he was content with that and considered it a fair outcome for each and every creditor in the overall scheme which comprised the BTL CVAs.

321. Mr Bloom, it should be remembered, was fully involved in the three-cornered dispute over the destination of the £67 million as between TXUEL, TXUEG and TXU UK. As an officeholder of each of TXUEG and TXU UK, he was fully aware of the arguments in favour of each claimant. He, like Mr Wallace, was fully cognisant of the whole picture, in particular of the commercial factors which were driving the PPA Creditors to settle on the terms which they were willing to settle. He regarded the overall terms of the BTL settlement to be very beneficial to all of the financial creditors in the light of the settlement achieved with the PPA Creditors.

322. Mr Wallace (and I think Mr Tucker had no separate view on this) was content that the ultimate destination of the £67 million should be open for discussion in any ATL settlement negotiations. They were of the view, and so informed the Applicants, that the rights of the ATL company creditors amongst themselves could be reserved so that none of them was prejudiced by the BTL CVAs. The same applied to the PPA Payments and any other allocation issues. Mr Wallace states clearly in his first witness statement that, contrary to what the Applicants have from time to time said, he was supportive of the idea of a reservation of rights letter.

323. Mr. Roome requested that it be expressly recognised by the officeholders and Committee Creditors as part of the BTL CVAs lock-up process that they (and other ATL creditors) should remain free to argue allocation issues on all matters, including the £67 million issue and any PPA Payments to be made

324. Notwithstanding the execution of the BTL lock-up, correspondence seeking to agree a reservation of rights letter continued into January 2005, but no reservation of rights letter acceptable to the parties could be agreed. I do not propose to rehearse that correspondence, save to say that Mr Wallace and Mr Tucker consistently took the position that the allocation of the PPA Payments and the £67 million was not pre-determined. Indeed, Mr Wallace indicated to Mr Spratt and Mr O'Connell on 13 December 2004 that it was consistent with his intentions that the £67 million should be held by TXUEL on behalf of the Holding Companies. By 14 December 2004, Mr Spratt was able to report to Mr Roome that he was hopeful that a letter agreeing that the £67 million would be held "on behalf of the Holding Companies" would be accepted by Mr Wallace. Some wording was produced leading up to a draft on 22 December 2004. The wording of that was unacceptable to Mr Roome.

325. The problem was that Bingham wanted to go further than Mr Wallace was prepared to accept. Bingham wanted it to be provided that the Conduit Companies should receive in full all of the benefits of the BTL settlement unless someone else could show a superior claim. In practice, this meant that proprietary claims would have to be shown. This went further than Mr Wallace and Mr Tucker considered reasonable (as to which I agree with them). It would be to create new rights in the Conduit Companies whereas Mr Wallace was only prepared to see their existing rights preserved. In the end, nothing was agreed. I do not accept, however, that Mr Spratt was procrastinating. He was genuinely attempting to broker a suitable reservation of rights letter, but was unable to produce a solution acceptable to both Mr Wallace and Mr Roome.

326. Perhaps jumping ahead, but it seems sensible to deal with this aspect of the £67 million at this stage, it has been argued by the Applicants that there should have been "carve-outs" of issues (effectively leaving the BTL settlement to depend on the result of the carve-out). In particular, it is said that, in the period leading up to the lock-up agreements for the BTL settlement, the £67 million issue should have been carved out, that is to say, to be resolved by some dispute resolution procedure be that mediation, litigation or some other process. Mr Wallace did not support this because:

    a. Other major creditors were making clear that they would not be willing to agree an ATL settlement unless it involved the resolution of all ATL issues. It was also Mr Wallace's own view that it was more desirable, and more practicable, to try and resolve all outstanding issues at once through a "package deal".

    b. There was a limited window of opportunity to seek to agree the terms of an ATL settlement if the prospect of a valuable settlement with TXU Corp was to be preserved. Resolution of the £67 million issue could not realistically have been achieved in that time-scale.

    c. To have resolved the £67 million would have meant adducing evidence from partners in Herbert Smith and from TXUEL directors. The inability to compel them to give evidence in an out-of-court process would have impeded TXUEL in asserting its claim since there must be doubt whether the individuals concerned would be willing to expose themselves to criticism and possible liability.

327. The Applicants say that, because each of the Conduit Companies was, but TXUEL was not, a company which was required to enter into BTL lock-ups, the Conduit Companies had particular leverage in the BTL negotiations. This ignores totally the point that the there could be no CVA unless the statutory majority was achieved so that the officeholders also required conditional compromises from 75% of the financial creditors by the terms of which those PPA Creditors would agree to compromise their claims at an agreed value conditionally on implementation of the CVAs. Further, TXUEL could, but the Conduit Companies could not, sue for the £67 million. It seems to me, therefore, that it makes no difference at all to the Conduit Companies' negotiating position that TXUEL was not required to enter into a lock-up.

The Approval of the BTL CVAs

328. On 30 December 2004, the Drax bondholders consented to Drax supporting the CVAs for EET and TXUEG. Formal proposals for the BTL companies' CVAs were sent out to creditors dated 10 January 2005. The CVA meetings took place on 28 January 2005.

Each of the BTL company CVAs was approved by the requisite majorities of creditors and became unconditional in accordance with their terms on 1 March 2005. It is thought that about £450 million will be received by the Conduit Companies as a result.

329. Under the BTL CVAs, amongst other things, the £67 million ring-fenced at TXU UK was released to TXUEL and the potential claims of BTL companies against TXU Corp and directors of TXU Europe group companies were assigned to a nominee company on the basis that the allocation of the proceeds of any such claims would be dealt with subsequently.

330. On 21 February 2005, Bingham asked Mr Spratt to challenge the TXUEG CVA. He declined to do so.

Material change of position

331. In the light of the above discussion concerning the process leading to the BTL settlement, and in particular why and how the BTL and ATL settlements became decoupled, I reject the complaints which the Applicants make to the effect (a) that the decoupling was a material change of circumstance which led to unfair prejudice to the Applicants and (b) the decision to execute the BTL lock-up by EH3 was a fundamental change designed, improperly, I infer, to circumvent the creditors committees of TXUAC and TEG and the liquidation committee of EH3: indeed, that is essentially another allegation of bad faith or bias which I totally reject.

Sanction

332. I need to deal with the submissions concerning the absence of sanction by the liquidation committee to the BTL lock-up and the TXUEG CVA. I have dealt with the law on this aspect at [59 - 64] above. Applying that law to the present case, my conclusion is that the consent of the liquidation committee for the liquidators of EH3 to sign up to the lock-up was not required. But even if that is wrong, the absence of consent appears to me to have no consequence. The fact is that the TXUEG CVA proposals were subsequently put to the creditors and were approved by their vote with the statutory majority. The lock-up was then, by its own terms, at an end. The CVA itself cannot, in my judgment, be invalidated by the fact the EH3 liquidators had previously entered into the lock-up which obliged them to vote in favour of those proposals; the CVA is invalidated only if a successful application is made under section 6 IA 1986. Further, in the present case, the TXUEG CVA did not depend on the vote of the EH3 liquidators. Even if they had voted against, the TXUEG CVA would have been approved.

Above the Line issues and the ATL settlement

333. Following the BTL lock-up agreements, attention became focused on above the line issues, negotiations taking place through December 2004 and January 2005. At the same time, negotiations were being held with TXU Corp in relation to claims against it and against directors of various TXUEL group companies, in respect of whose liabilities TXU Corp had given indemnities/guarantees.

334. The principal issues affecting the ATL companies were as follows:

a. The Double Dip.

b. The allocation of any settlement payment made by TXU Corp.

c. The GFA Claim.

d. The inter-company balances.

e. £67m swaps proceeds held in escrow.

f. The allocation of £11.5m of payments to be made by certain PPA creditors upon the implementation of the BTL CVAs.

g. The valuation date for the ATL creditor claims for the purpose of any CVA and their entitlement to interest.

335. Mr Wallace says, and I accept, that there were good reasons to seek to compromise those issues through a series of inter-related CVAs:

a. The officeholders' goal was to make distributions of assets to Holding Company creditors. In this context, it plainly made sense to seek a consensual compromise of those matters that might impede or delay such distributions, rather than to litigate them.

b. Timing in this respect was critical. There was a real prospect of agreeing a valuable early settlement with TXU Corp, but the officeholders believed that they needed to do so by 15 January 2005 at the latest as a result of a deadline imposed by TXU Corp which they considered to be genuine. However, major creditors such as the RCF Banks had made clear that they would not be willing to endorse a settlement with TXU Corp unless they knew how other Holding Company issues would be resolved. I would add here that TXU Corp had also informed Mr Wallace and Mr Tucker that unless direct claims by creditors, as well as claims by TXUEL group companies, were resolved as part of one package, there could be no substantial settlement of the claims of the estates alone. Further, TXU Corp's original date for settlement had been the year end *ie* 31 December 2004, and that, failing agreement, the matter would be turned over to their D&O insurers.

c. The majority of the principal Holding Companies were in pre-Enterprise Act administration proceedings. Putting those companies into liquidation (the alternative to CVAs or schemes of arrangement) in order to make distributions would have entailed material disadvantages in terms of adverse tax consequences and the need to maintain higher reserves.

336. There had, by the time negotiations on the ATL issues began in earnest, been a large amount of information provided by the officeholders to all financial creditors including the Applicants; they conducted as open a policy as possible with a view to achieving an agreed settlement of all issues, including an exchange of position papers on a number of topics. Mr Wallace impressed upon creditors his views that TXU Corp was already offering a sizeable sum for a combined, all-party settlement; that the deadlines in TXU

Corp's settlement timetable were likely to be genuine; and that calling their bluff would risk the loss of an opportunity to agree a valuable settlement.

337. Bingham discussed with Cadwalader (acting for the EFC Holders) and A&O (acting for the RCF Banks) the outstanding ATL company allocation issues that remained to be resolved. This led to the preparation of a combined list of information to be requested from the KPMG officeholders in order to progress the ATL Company CVA discussions, dated 8 December 2004.

338. On 10 December 2004, Mr Douglas of Cadwalader (representing the officeholders) addressed a meeting of the advisers to the members of the creditors' committees in order to provide them with the outstanding information items identified in the list of 8 December 2004. Mr Douglas suggested that a fair way to divide the proceeds of the estates' recoveries from any payment by TXU Corp in respect of the litigation claims would be 50:50 as between TXUEL and TXUEG. He summarised the main heads of claim.

339. On 14 December 2004, in advance of the meetings, KPMG had circulated another detailed report to relevant creditors setting out potential financial outcomes for them based on differing resolutions of the open ATL issues. The modelling for creditors contained in this report, as indeed in reports throughout the negotiations, illustrated financial outcomes based on various different allocations among the ATL companies. I should add here that, in the light of the complex web of intercompany indebtedness and the different interests of the various creditors in different ATL companies, the model is the only satisfactory way of seeing what results different allocations have; for my part, I have found some of the results surprising and even counter-intuitive.

340. The first proper negotiations took place in meetings involving the officeholders and the Committee Creditors and their respective advisers at A&O's offices in London on 15 and 16 December 2004. TXU Corp was also involved in these meetings. These meetings, which stretched through the day into the late evening, consisted of a plenary session at which the creditors were updated on the settlement discussions with TXU Corp, related tax matters and the merits of the estate claims and the recommendations of the advisers in that respect. This plenary session was punctuated by break-out meetings in which the RCF Banks and the two bondholder groups met separately with their advisers and, from time to time, with Mr Wallace, Mr Tucker and their advisers.

341. On 16 December 2004, various further meetings were held. Again, these meetings focussed on the allocation of the proceeds of any settlement with TXU Corp and the tax aspects of the settlement.

342. Immediately prior to Christmas 2004, it was clear to Mr Wallace that the Committee Creditors would not be in a position to commit their support to heads of terms for an ATL settlement before the end of the year. First, there were material disagreements among the creditors on a number of ATL issues, including but not limited to the allocation of settlement proceeds. Second, a number of major creditors in the RCF Bank syndicate, who were not Committee Creditors, were only just starting to receive information on relevant issues.

343. Nevertheless, Mr Wallace believed that there was still the opportunity to agree the terms of a settlement with TXU Corp prior to 31 December 2004, on the basis that everyone would then work to try to secure the support of creditors to heads of terms enshrining that settlement in the first half of January 2005. In that way, the TXU Corp deadline of 15 January 2005 could still be met.

344. Indeed, on 29 December 2004 the Committee Creditors, including the Applicants, agreed that the officeholders should seek to conclude a settlement with TXU Corp on the terms proposed by TXU Corp that day, on the basis that agreement on the terms of an ATL settlement, including the manner of allocation of settlement proceeds from TXU Corp, would need to be reached by 15 January 2005. They did so having been provided with further analysis of the economic significance for them of differing resolutions of ATL issues.

345. Discussions as to allocation of the TXU Corp settlement were revived in early January, in an attempt to conclude a deal. During this period, JPMorgan insisted that a settlement could not be reached without concurrent agreement on the allocation issues. Early in January 2005, it was agreed that further negotiations should take place in New York on 11 and 12 January, with a view to finalising the TXU Corp settlement, the allocation of the proceeds of that settlement and, if possible, all of the other ATL company issues.

346. To this end, further meetings of the Committee Creditors were convened at A&O's office in New York on 11 and 12 January 2005. Prior to or at the commencement of the meetings, the following papers were distributed:

    a. On 5 January 2005, KPMG distributed update reports on their analyses of the Double Dip Claim and the GFA Claim.

    b. On 6 January 2005, a number of papers and opinions were distributed with respect to the Valuation Date issue (and a related issue that had arisen with respect to currency indemnity provisions). These included papers and opinions prepared on the respective instructions of the officeholders, the RCF Banks and the EFC Bondholders.

    c. On the morning of 11 January 2005, the creditors were provided with the papers on the direct claims of the RCF Banks and the EFC Bondholders against TXU Corp and certain directors of TXU Europe group companies.

347. Mr Spratt and Mr O'Connell had not involved themselves in the TXU Corp negotiations which were being carried on by Mr Wallace. Mr Spratt's understanding was that Mr Roome was representing the interests of the Applicants. Again, this is not surprising in the light of the fee arrangement with Bingham and the need to avoid duplication of costs. He and Mr O'Connell could, of course, be brought into the process at any time. That is not to say that Mr Spratt was taking no interest: he was, but given the advice he had received that EH3 had no direct claim against TXU Corp he did not see the need for his active involvement in those negotiations.

348. Mr Roome and the Applicants learned that Mr Spratt and Mr O'Connell were not intending to attend the New York meetings. They say that they were astonished to learn this. On Friday 7 January 2005 Mr Roome telephoned Mr Spratt and said that he would

be sending separate letters to Mr Spratt and Mr O'Connell later that day urging their involvement in the ATL company allocation discussions and suggesting that they should attend the proposed meeting in New York. Astonishment or not, it seems to me that one here sees Bingham again operating on the understanding that Mr Spratt and Mr O'Connell could be called upon if Bingham considered that that was desirable. Mr Spratt and Mr O'Connell retained Mr Connell of Fladgate Fielder on Sunday 9 January 2005 and asked him whether he could accompany them to New York to which he replied the next morning that he could. Following that, as one would expect, there were discussions between Mr Spratt, Mr O'Connell and Mr Connell about the ATL process.

349. They travelled to Heathrow with Mr Wallace on 10 January 2005. He updated them on developments including allocation issues (although this was not the first occasion on which Mr Spratt and Mr O'Connell had addressed their minds to such allocation issues) and discussed what was proposed for the New York meetings. The Applicants, however, in their mission to demonstrate the incompetence and bias of the KPMG officeholders, have asserted consistently that Mr Spratt and Mr O'Connell came to New York unprepared, not even having read the position papers. Ms Seppala professed to be shocked to discover, at the first meeting on 11 January 2005, that they had not read the position papers and had no real knowledge of the facts and Mr Olin took a similar line. In the light of all the evidence which I have heard, I have no doubt at all that both Mr Spratt and Mr O'Connell had read all the relevant position papers by the time they arrived in New York, having read the most recent ones on the plane from Heathrow. Ironically, it appears that it may well have been Ms Seppala and Mr Olin who were the persons at that meeting who had <u>not</u> read all the position papers, the latest ones coming into their personal possession only that morning. And Ms Seppala's clear recollection of Mr Olin reading <u>and explaining</u> the documents to her and others, when Mr Olin's own evidence and that of Mr Roome was that they had not read the relevant papers (the RCF Banks' position papers) is, as Mr Briggs describes it, bizarre.

350. Attending the meetings on 11 and 12 January 2005 were the officeholders (Mr Wallace, Mr Tucker, Mr Spratt and Mr O'Connell), the members of the Creditors' Committees and their respective advisers. The meetings were scheduled to start at 10.00 a.m. on 11 January. At about 9:30 a.m. on 11 January, Mr Spratt and Mr O'Connell had a preliminary meeting with Mr Roome and Ms Guthrie of Bingham, Mr Olin and Ms Seppala and other representatives of the Applicants.

351. At the New York meeting, there was a large room in which the creditors could all come together to meet, and there were breakout rooms for each constituency, including separate breakout rooms for the officeholders and their advisers. Negotiations commenced with a plenary session focusing on tax. Mr Wallace and Mr Tucker circulated and talked through a one-page summary of illustrative financial outcomes based on a range of differing compromises on the various ATL issues. Finally, Mr. Douglas gave a brief update on relevant legal issues and the position papers that had been circulated in that respect, before the Committee Creditors moved to break-out sessions.

352. From time to time representatives of various constituencies – and in particular the officeholders – moved between groups to discuss progress or particular issues, and KPMG assisted the creditors in modelling the economic effects of differing resolutions of issues.

353. The respective positions, taking this from Mr Wallace's first witness statement which I accept, adopted at these meetings were as follows:

  a. There was disagreement both between and within the EFC Bondholder and RCF Bank groups on the resolution of the Valuation Date issue. This issue affected different members of the EFC Bondholder group in different ways, as there were EFC Bonds denominated in dollars, sterling and euros, and the EGO BV Bonds were denominated in dollars. The RCF Debt was largely denominated in Euros, but the position of Barclays differed from the other RCF Banks, because it also had a claim denominated in sterling at EH3. The Applicants were contending that a 19 November 2002 date should be used.

  b. The EFC Bondholder group appeared less willing than the RCF Banks to support the allocation of some of the proceeds of the PPA Payments to the Conduit Companies. The Applicants considered that all of the proceeds of the PPA Payments should go to the Conduit Companies.

  c. The EFC Bondholder and RCF Bank groups each appeared to accept that no value should be attributed to EFC's Double Dip Claim or EGO BV's GFA Claim. The Applicants agreed with the former proposal, but not the latter.

  d. The EFC Bondholder and RCF Bank groups each took the position that TXUEL should retain all of the £67 million Swap Proceeds. The Applicants' position remained that the proceeds should be allocated to the Conduit Companies unless TXUEL could establish a proprietary claim. I note here that Mr Wallace was, as he said he would, be perfectly prepared to consider the allocation issues held over, as it were, from the BTL settlement, including the £67 million issue. He did not say to the Applicants that there was no point in their making suggestions because the issue had been finally resolved by the BTL settlement.

  e. Mr Wallace believes that the EFC Bondholder group eventually agreed certain proposals among themselves and put them to the RCF Bank group, but that they were rejected. No agreements were reached with the Applicants.

  f. Accordingly, the New York meetings appear not to have moved matters forward and there remained material disagreements.

354. The Applicants complain that they were excluded from negotiations in New York. True they attended A&O's New York offices, but had no meaningful discussions. Their participation was limited to the briefest of statements made by Mr Roome to a meeting of some of the creditors in which he summarised the Applicants' position but had no opportunity for debate. The Applicants were sidelined and ignored. They complain also that Mr Spratt and Mr O'Connell failed to fight for EH3 and EGO BV in relation to these allocation issues regarding them as ill-informed, weak and incompetent. So far as concerns the Applicants' exclusion from negotiations between creditor groups, that is not, I think, something about which complaint can be levelled against the officeholders. There were significant differences not only between, but also within, the other creditor groups, which differences those groups focused their energies on, the discussions being ones which, rightly or wrongly, those creditors wished to hold in the absence of the Applicants. It is not difficult to see that those discussions are likely to have gone much

wider than the issues with which the Applicants were concerned and to give rise to matters of commercial sensitivity which the other groups did not wish to share with the Applicants. It is difficult, however, in the light of those differences to see how Mr Spratt and Mr O'Connell could have fared any better than the Applicants in achieving a consensus had they taken a more interventionist approach.

355. The Applicants did, however, take part in plenary sessions at both the London and New York meetings (albeit that those sessions were not really negotiation sessions but rather information provision sessions). They were able to, and did, discuss matters with the officeholders with whom they met separately at both meetings. They were kept updated and informed of the developing positions of the other creditor groups.

356. Further, it was the perception of others that the Applicants were not seriously interested in negotiating but were interested only in reaching a final position under which their own interests prevailed. Even if what Mr Wallace has to say about this (see paragraphs 312-3 of his first witness statement) is to be discounted as self-serving, Mr Hassenstab's evidence is not. I accept what he has to say about the matter:

> "The approach adopted by the Applicants to the restructuring proposals appeared to us to amount to a pursuit of every argument available, regardless of the legal and economic merits, in order to provide them with a lever in the negotiations in the restructuring. This was apparent during the negotiations; the position taken by the Applicants on these issues was always an extreme one. AEGON were not and are not prepared to conduct business in that way. We were not prepared to pursue claims to a point that exceeded a fair reflection of their legal merits in an attempt to increase recoveries by threatening to block or impede the restructuring. Nor do I consider that such a strategy would have yielded a more favourable outcome for EGO BV holders, for the reasons I have given. AEGON have been involved in numerous restructurings and take the view that while parties with different interests are to be expected to push their position in respect of their claims, achieving a restructuring ultimately involves the various competing interests taking a realistic approach resulting inevitably in compromise."

357. The Applicants take exception to this of course and say that they were always willing to compromise. However, considerable reliance is placed on what Ms Seppala had to say in her oral examination but I found much of what she had to say on the issue confusing and unhelpful. This is all, in any event, peripheral since whether or not the CVAs for EH3 and EGO BV are unfairly prejudicial to the Applicants is not to be determined by whether or not the Applicants were given an opportunity to negotiate in New York. The fact is that the New York meetings were not productive and the failure or inability of the Applicants and Mr Spratt and Mr O'Connell to argue their cases to the other creditors did not result in an agreement contrary to their interests.

The ATL heads of terms and lock-up agreements

358. Time was by now, 12 January 2005, running out for the completion of a settlement with TXU Corp. Although 15 January had been TXU Corp's original deadline, Mr Wallace was told that there were a few extra days available the new deadline being in time for approval of any agreement at the TXU Corp board meeting fixed for 26 January 2005.

Mr Wallace was also told by TXU Corp that it required prior evidence of contractual support from 60% of the creditors (by value) of the ATL companies before agreeing a settlement.

359. Mr Wallace considered that it was incumbent on the officeholders to put forward a proposal that might be capable of attracting sufficient support to enable a settlement with TXU Corp to be concluded, and to give creditors a final opportunity to decide whether they would support it. Mr Wallace clearly regarded the proposed settlement as a good one from the point of view of creditors generally: there were advantages to both sides in effecting a compromise at that time, advantages which would not be available if the compromise were not effected in the short term. He is of the view, and I think he is obviously correct in this, that it would not be possible to achieve a similar deal with TXU Corp today if the existing TXU Corp settlement were to fall away, not least because of tax implications.

360. In the course of the week of 17 January 2005, Mr Wallace and Mr Tucker had various communications with representatives of the EFC Bondholders, the RCF Banks and the Applicants about the terms of a CVA proposal that the officeholders were considering putting forward. On 19 January 2005, a draft form of lock-up agreement was circulated binding assenting creditors to heads of terms set out in the agreement and to vote in favour of the relevant proposals.

361. In a letter dated 19 January 2005 Bingham wrote to TXU Corp's legal advisers, Lovells, indicating their concern over allocation issues relating to the settlement, and formally reserving the Applicants' rights. As to this letter see [534] below.

362. On 21 January 2005, draft heads of terms for the CVAs and a revised form of lock-up agreement was sent to the Committee Creditors (and other creditors who had indicated that they would be willing to lock up) including to Bingham.

363. Following further comments from advisers to the EFC Bondholders and the RCF Banks, a final draft of the lock-up agreement, attaching the final form of the CVA heads of terms, was circulated to Committee Creditors (and others willing to lock-up) on 25 January 2005 including to Bingham.

364. In a conference call that day, convened for the Committee Creditors that held EGO BV Bonds, the Applicants informed Mr Wallace that they would not be signing lock up agreements. Mr. Roome explained, as he had done previously, that he believed the proposals were unfair to the Applicants in respect of the £67 million, the PPA Payments and the allocation of the TXU Corp settlement proceeds, although he made no reference to the GFA Claim issue.

365. Following that conference call, Mr Spratt late in the afternoon of 25 January 2005 authorised Mr Tucker to sign the EH3 ATL CVA lock-up. Mr O'Connell indicated his agreement as officeholder of EGO BV the next morning

366. Signed lock-up agreements for 63% of the Holding Company creditors were received before expiry of an extended deadline imposed by TXU Corp (3:00 p.m. on 26 January 2005). Six of the creditors who had participated in discussions did not sign. These were

the Applicants and also four of the RCF Banks (RBS, JPMorgan, Bear, Stearns & Co. Inc. and Citibank).

367. I should add one other fact to all of this. Mr Spratt and Mr O'Connell were involved in the process leading up to the proposal by all of the officeholders for an ATL settlement which they believed was fair and stood a reasonable prospect of sufficient creditor support. The Applicants were invited, during the course of a meeting on 20 January 2005, to suggest an alternative deal to be considered and if appropriate, pursued in negotiation but they never did so.

Termination of Bingham's retainer

368. On 8 February 2005, Mr Wallace wrote to Bingham terminating the fee agreement, under which the estates were meeting their fees, 15 days from the date of that letter. The reasons for the termination of the arrangement, which are set out in the letter, were as follows:

  a. The BTL CVAs had been approved by overwhelming majorities at the creditors meetings.

  b. The heads of terms for the ATL CVAs had been approved by a majority in value of the creditors of each of the relevant companies.

  c. The Applicants were refusing to support either the BTL CVAs or the ATL heads of terms.

  d. Mr. O'Connell and Mr. Spratt had retained independent legal advisers.

The ATL CVAs and CVA Meetings

369. Following the execution of the ATL lock-up agreements, the terms of the CVAs and associated documents were prepared giving effect to the terms of the deal. On 7 February 2005, a letter was sent by KPMG to all creditors of the ATL companies, outlining the heads of terms and indicative timetable for the ATL CVAs. On 3 March 2005, draft terms of the ATL CVAs and related documents were circulated by A&O, on behalf of the ATL companies to all advisers of creditors of the ATL companies for their comment.

370. Bingham wrote to A&O on 8 March 2005 stating that they considered the ATL company CVA proposals contained insufficient information to enable creditors to reach an informed decision when deciding how to vote.

371. On 11 March 2005, A&O replied to Bingham's letter dated 8 March 2005 rejecting each of the points concerning the form and content of the ATL company CVA proposal, but at the same time stated that copies of both letters would be appended to the final CVA proposal.

372. The documentation containing the proposal for CVAs for the Holding Companies was issued on 11 March 2005. The proposed documentation included:

  a. The proposal (including the notices of meetings).

b. A letter from the officeholders dated 11 March 2005.

c. The letter from Bingham to A&O dated 8 March 2005.

d. The letter from A&O to Bingham dated 11 March 2005.

373. The CVA proposals provided that the ATL issues identified above should be resolved as follows:

a. EFC's claim against TXUEL would be treated as subordinated (*ie* there would be no Double Dip).

b. The US$175m litigation recoveries from TXU Corp settlement would be split 60:40 between estate and direct claims. The US$105m (*ie* 60% of the TXU Corp Settlement) going to the estates would be split (after certain specified deductions) 50:50 between TXUEL and TXUEG. The remaining US$70 million (*ie* 40% of the TXU Corp settlement) would be split between the RCF Banks and the EFC Holders in respect of their direct claims against TXU Corp, with US$1.5 million of this sum going to the EGO BV Bondholders as a whole.

c. EGO BV's claim against EH3 under the GFA would be released.

d. In relation to the inter-company balances (i) the claim of TEG against TXUEG was recognised; (ii) the triangle of liabilities were not treated as having been netted-off; (iii) EH3 was treated as having back-to-back recourse to TXUAC with respect to EH3's liability to Barclays under the currency swaps; and (iv) EH3's indemnity claim against TXUEL was allowed.

e. The £67 million plus interest previously ring-fenced at TXU UK would be paid to TXUEL to form part of TXUEL's assets.

f. The £11.5 million PPA Payments would be split 50:50 between TXUEL and the Conduit Companies.

374. Bingham's letter dated 8 March 2005 raised a number of issues in response to the draft ATL CVA proposal. Mr Wallace and Mr Tucker considered that the draft ATL CVA proposal contained all the information which was appropriate to enable creditors to come to an informed decision on it but that the proper course was to reply to their letter and to include copies of both their letter and a reply from A&O with the proposal documentation. I deal with the Applicants' complaints concerning the inadequacy of information later in this judgment.

375. The meetings to consider the proposals were held on 31 March 2005. Apart from the formal business of the meetings, all meetings were held concurrently to give all creditors the opportunity to hear what was said by any of the creditors. Mr Wallace gave the opening remarks for all the meetings.

376. Mr Wallace noted that copies of the letter from Bingham dated 8 March 2005 and the response from A&O dated 11 March 2005 were enclosed with the proposal issued on 11

March 2005. He explained that Bingham represented two holders of EGO BV Bonds (the Applicants). He noted that as creditors would be aware from their letter dated 8 March 2005, Bingham had stated that their clients were vehemently opposed to the CVAs and had raised a number of objections to them. He then reported that correspondence between EGO BV, EH3 and Bingham had continued and that, most recently on 29 March 2005, EGO BV and EH3 had received letters before action from Bingham indicating their view that their clients had proper grounds to make applications to Court to protect their interests.

377. He summarised Bingham's points as follows:

a. The liquidators of EH3 required (but did not have) the sanction of the liquidation committee or the Court for various matters involving the CVAs of the BTL and ATL Companies.

b. There were various claims relating to conflicts of interest.

c. The CVA proposals were unfairly prejudicial to their clients.

d. The proposal contained insufficient information to enable creditors to make an informed decision on the CVAs, that their clients had been denied access to other EGO BV Bondholders and that, accordingly, there had been material irregularities in the CVA process.

e. Certain members of the creditors' committees had indicated to the officeholders their dissatisfaction with certain aspects of the conduct of the administration and liquidation proceedings for the ATL companies.

378. Mr Wallace informed the meeting that the administrators of EGO BV and the liquidators of EH3 would be making a formal response to Bingham but that creditors should be aware that those officeholders considered that there was no substance to any of the points which had been made.

379. No questions were asked and nor were any modifications to any of the CVAs proposed at the meetings. Bingham and SISU attended the meetings but did not raise any points. Resolutions approving the CVAs for each of the ATL companies were approved. The table below sets out the voting at the meetings of EGO BV, EH3, TXUEL, TEG and TXUAC as filed with the Court.

	Unconnected creditors			**Connected creditors**	**Total % of claims voting in favour**	**Total % of claims voted against**
	Value of Claims voting for, £	**Value of Claims voting against, £**	**% value of unconnected claims voting in favour**	**Value of Claims for, £ (no votes against)**		
EGO BV	225,052,924.17	72,236,386.85	75.7%	99,400,000.00	81.79%	18.21%

EH3	264,128,640.90	71,271,237.78	78.75%	255,345,322.64	87.94%	12.06%
TXUEL	2,150,237,368.96	167,829,230.72	92.76%	2,513,738.00	92.77%	7.23%
TXUAC	10,238,732.30	67,315.00	96.9%	3,758,337,718.17	91.99%	0.01%
TEG	1,304,365.14	0	100%	3,062,096,817.76	100%	0

The allegations of unfairness

380. As I have already noted, the relief which the Applicants seek is for an appropriate order under section 6 IA 1986 based on unfair prejudice and separate orders for removal of the Respondents as officeholders of EH3 and EGO BV. A considerable part of the evidence and argument has focused on the four allocation issues about which the Applicants complain (the £67 million issues, the TXU Corp settlement allocation, the PPA Payments and the GFA issue) in the context of the ATL CVAs.

381. However, the Applicants also complain that the first three of those allocation issues were unfairly handled by the KPMG officeholders at an earlier stage in the context of the BTL settlement and BTL CVAs. The BTL CVAs are, of course, binding and have not been challenged within the time-limit imposed by section 6. The Applicants say, however, that by agreeing to the BTL lock-ups and voting in favour of the BTL CVAs, the officeholders were acting improperly as officeholders of EH3 and EGO BV. Accordingly, they say, independent officeholders should be appointed to investigate claims against the officeholders and to recover from them for the benefit of the creditors as a whole.

382. The Applicants also complain that Mr Wallace and Mr O'Connell as joint administrators of EGO BV acted improperly by agreeing to an ATL lock-up which gave a nil value to the GFA claim and again assert that they should be replaced by independent officeholders as a mechanism for seeking redress (on behalf of EGO BV).

383. Since the ATL CVAs contain wide releases in favour of the relevant officeholders, it may be that such claims, even if independent officeholders were appointed, would not be available. Accordingly, these releases are relied on by the Applicants as factors to establish that the ATL CVAs are themselves unfairly prejudicial to the Applicants.

384. Although the four allocation issues are the matters of complaint, it must also be borne in mind that the CVAs, both above and below the line, brought about a resolution of a number of other issues, none of which was straightforward. These included, as between group companies, Net v Gross, Double Dip, inter-company balances and valuation date and, as between group companies and outsiders, the TXU Corp claims and the PPA Creditors' claims. It is important, in my judgment, to consider not only the matters of

complaint but also the other issues (each of which was resolved in a manner favourable to the Applicants) in assessing whether there has been any unfair prejudice.

385. I propose, however, to consider in the first place each of the four matters complained of to see whether, in isolation, the manner in which each was dealt with was unfairly prejudicial to the Applicants since, if the answer in each case is that there was no unfair prejudice, it is unnecessary to examine separately whether, overall, the CVAs were unfairly prejudicial.

386. However, before I do so, I wish to return to the assertion by the Applicants that they are in a unique position as holding only EGO BV Bonds whereas all other financial creditors have an interest in shifting value to TXUEL. What is said to follow is that the Applicants alone are prejudiced by the allocation issues having been decided in the way that they were. As a matter of fact, it is incorrect to say that the economic interests of all other creditors were favoured by the resolution of the allocation issues in the way that they were in fact resolved.

387. For example, AEGON's position is interesting. AEGON manages a number of investment funds. Each fund is managed on a discrete basis. As Mr Hassenstab puts it "We do not compromise one legal entity to benefit another or "sum" outcomes to the AEGON group as a whole". Although AEGON held both EFC Bonds and EGO BV Bonds, a considerable holding of EGO BV Bonds was held as part of funds which comprised no EFC Bonds (or other TXU Europe group debt). Accordingly, the interest of AEGON, so far as concerns those funds, was identical to that of the Applicants.

388. Initially, the Applicants asserted in this application that AEGON's interests differed from their own. Even after receiving Mr Hassenstab's first witness statement, they maintained the position, Mr Roome asserting that Mr Hassenstab "was prepared to accept a considerably lower return than Aegon would have recovered on a liquidation in order to achieve consensus and avoid dispute". Mr Hassenstab responded to that as follows:

> "I disagree both with this assertion and with Mr Roome's and Mr Olin's assessment of me. As regards the assertion I note that Mr Roome does not provide any information as to what he believes AEGON would have recovered under a liquidation scenario. His assertion is unsupported by any facts, documents, or underlying assumptions. Further, his suggestion is inconsistent with the liquidation analysis I had received from KPMG which……estimated the expected recovery for the EGO BV holders in a liquidation scenario would be 62.4p on the pound, some 5p on the pound less than the distributions expected under the CVAs at the time of voting….."

389. In the end, the Applicants decided not to cross-examine Mr Hassenstab whose evidence I accept in its totality.

390. Barclays, represented by Mr Hearn, had interests as an RCF Bank and a claim against EH3 pursuant to an interest rate swap. Its interest on many issues was aligned with EH3.

391. Citigroup's economic interests, save on the Double Dip issue, were aligned with the Applicants in the sense that it would have fared better on each of the four matters complained of by the Applicants if the proposal had provided as the Applicants wish it

had. It nonetheless voted in favour of the CVAs. It is fair to say that the economic impact in percentage differences was not as significant for Citigroup as for the Applicants and it could, therefore, have thought that the certainty of a deal was not worth risking for the difference which holding out for the Applicants' proposals could achieve. But I do not place much weight on that, since Citigroup voted the holding of Primerica Life Assurance Company in favour notwithstanding its only interest was as an EGO BV Bondholder. Citigroup's representative, Ms Duffee, clearly took a close interest in the negotiations and took a considered and informed decision.

392. Varde too would have been better off with the adoption of all of the Applicants' suggested outcomes on the four issues of complaint although its position was broadly neutral on the £67 million and the PPA Payments. The same observation can be made as in relation to Citigroup concerning the risk of losing a deal compared with the increased return it might make. Its representative, Mr Hicks, regarded the proposal as fair, giving up his argument on the Double Dip (an argument contrary to the interests of the Applicants) in order to achieve a deal.

393. Quite apart from the economic interests of those creditors, I must also mention that Mr Hassenstab (AEGON) and Mr Hearn (Barclays) in their unchallenged evidence both state that they gave the most careful consideration to the terms of the CVAs and the separate allocation issues. Each of them (and contrary to the assertion of Ms Seppala in relation to Mr Hassenstab) were deeply involved in the various meetings and conference calls of Committee Creditors. Each of them gives cogent reasons not only for supporting the CVAs but also for considering that the allocation issues were dealt with fairly. This was particularly important for Mr Hassenstab because his company treated each of its funds separately and it held funds which comprised only EGO BV Bonds. Barclays' position, too, is important because, taking a responsible and reasonable attitude, it considered the CVA proposals to be fair whereas some of the other RCF Banks were dissatisfied, thinking that the proposals failed to give sufficient weight to their Direct Claims. Mr Hearn quite clearly considered the interests of EH3 in his deliberations – more so, in fact, than the Applicants themselves who I conclude, on the totality of the evidence, were concerned with maximising their recovery and thus looking at EH3 only in the context of using it to maximise recovery at EGO BV.

394. Mr Goldstein of Appaloosa (who, it is to be noted, had stated at the June 2004 meeting that there could be no deal unless the £67 million went to TXUEL) says that he looked at the terms of the proposals for EH3 and EGO BV and was satisfied that they represented a fair outcome and that if he had been an EGO BV only holder, he would have voted in favour. It is, of course, easy for him to say that now. However, the Applicants have accepted the honesty and integrity of all those creditors who have written letters opposing the Applicants' application, of which Mr Goldstein's was one. Although I attach little weight to Mr Goldstein's letter, it is confirmatory of the attitude of others. And I note that Appaloosa was in a position to block the CVAs.

395. Davidson Kempner also supported the CVAs. I do not attach any weight to the suggested alignment on some issues of its interests with those of the Applicants. But as with Mr Goldstein, here is another man of acknowledged honesty and integrity who voted for the CVAs believing they were fair to all creditor groups.

396. These were all men of honesty and integrity acting in good faith – Mr Roome, quite rightly, accepted that – and as such they made honest and reasonable decisions not only in supporting the proposals but also in considering them to be fair to all creditor groups including the Applicants. Of course, I am not bound to accept proposals as fair simply because certain creditors consider them to be reasonable any more than I am bound to accept that they are unfair because Mr Roome and the Applicants consider them to be unfair. But the test for unfair prejudice does require me to look at what intelligent and honest men acting as members of a class could consider fair. AEGON were in the same position as the Applicants in respect of certain of their funds and took the view that the proposals were fair. And whilst other creditors were not in the same interest, I do not simply ignore what other creditor representatives, Mr Hearn in particular, have to say about the process and the result.

The allocation of the £67m

397. This issue is the one on which the Applicants have focused most criticism. It needs to be considered at both the BTL and the ATL level since what happened in relation at the BTL level has an impact on what it was possible to achieve at the ATL level.

398. I have already considered much of the background and negotiations concerning the £67 million in paragraphs [267*ff*] above.

399. Shortly after the agreement of the Joint Proposal on 29 July 2004, Bingham sent (under cover of an e-mail from Mr Terry dated 11 August 2004) to Mr Wallace an opinion dated 10 August 2004 produced by Mr Girolami QC. Mr Girolami QC advised that TXUEL had no basis for asserting a proprietary claim to the £67m and that these monies should form part of the assets of TXU UK or TXUEG.

400. There then ensued an exchange of position papers and a meeting as follows:

10 August 2004	Opinion of Mr Girolami QC
18 August 2004	Meeting between KPMG, A&O and Bingham
1 September 2004	Response to Mr Girolami QC's opinion sent to Bingham by A&O
24 September 2004	Applicants' position paper
21 October 2004	TXUEL position paper

401. As I have already explained, the only companies with any claim to the £67 million were TXUEL, TXU UK and TXUEG. As to the last of those, I will repeat what I have already said which is that it is difficult to see what direct claim it could have to the £67 million. In reality, either TXUEL was entitled to receive £67 million from the Powergen proceeds of sale or the entirety of those proceeds remained with TXU UK. Further, in spite of the way that Bingham have from time to time stated the Applicants' case, it is clear that neither EH3 nor EGO BV have ever had any right or interest in the £67 million held in escrow by Herbert Smith but have only an economic interest in seeing TXUEG's assets maximised. Once the BTL CVAs had been approved and become binding, that economic interest dictated, of course, that the Applicants would assert that the £67 million should be paid to the Conduit Companies.

402. The proposition that the Conduit Companies should be entitled to the £67 million needs to be carefully examined. Had the beneficial ownership of the £67 million been determined (*eg* by litigation) prior to the BTL settlement and BTL CVAs, the real candidates were that it belonged to TXUEL or TXUEG, with an argument, apparently, but one I do not understand, that it belonged to TXUEG. If it had been established that it belonged to TXU UK, then that fact would have been known to the PPA Creditors whose primary claims lay against EET to which TXU UK owed large sums. To put it at its lowest, there would have been a possibility that the PPA Creditors would have been unwilling to agree to a settlement under which the £67 million went above the line. Even if the £67 million belonged to TXUEG, that company had guaranteed many of the PPA Creditors' claims so that, again, there would have been, at least, a possibility that the £67 million would have stayed below the line for the benefit of creditors of BTL companies.

403. In that last context, it must be remembered that the Conduit Companies were minority creditors of TXUEG, the vast majority of whose indebtedness was owed to trading creditors (particularly the PPA Creditors) and to some extent to the banks.

404. The arguments advanced by the Applicants through Mr. Girolami QC's opinion and Bingham's position paper can be summarised as follows:

a. TXUEL has no proprietary claim to the £67 million.

b. TXU UK and TXUEG agreed, by the BTL settlement and BTL CVAs, to give up their claims to the £67 million.

c. Accordingly, as Bingham put it in their position paper, "as among the above the line creditors, the £67 million represents funds advanced by and repayable to TXUEG, and it can only therefore be allocated to TXUEG from whence it came, so as to augment the assets of TXUEG available for distribution to TXUEG's above-the-line inter-company creditors". Or, as Mr Roome later put it "unless some person has some greater right to the assets being released by the below-the-line administrators, TXUEG's above-the-line creditors should receive the benefit of all amounts that the below-the-line administrators are prepared to release above the line in order to achieve this package deal – including the GBP 67 million".

405. Of course, that last proposition does not follow from the fact that the joint administrators of TXUEG and TXU UK had agreed, and the relevant BTL CVAs had provided, that the £67 million should go above the line. Viewing the BTL settlement and BTL CVAs overall, the E&Y administrators and the external creditors viewed as a whole must have considered that the settlement and CVAs reflected the strength of their own economic positions. On that basis, the fact that the £67 million was allowed to go above the line could be explained on one of two bases: First, that the administrators and BTL creditors thought that TXUEL's claim was extremely strong and were willing to cede the point in the context of a commercial settlement which had advantages for them; secondly, that there were countervailing and compensatory elements in the settlement which justified them in giving up what they regarded as a good (or at least well-arguable) claim that the £67 million belonged to TXU UK or TXUEG.

406. As to that second possibility, Mr Wallace says this:

> "[Mr Roome's comments] led me to believe that he was in fact alleging that the Ernst & Young administrators of TXUEG had conceded the Swap Proceeds issue in exchange for some other equivalent benefit under the Joint Proposal and that such benefit would inure only to the Operating Company creditors of TXUEG and that, consequently, the Holding Company creditors of TXUEG should receive equivalent compensation. Although not directly in response to Mr. Roome's e-mail, I did address this argument in an e-mail which I sent to Mr. Olin on 21 January 2005. In this e-mail, I stated: "*I acknowledge that it is possible to argue that Chris Hughes and the* [Ernst & Young] *Administrators gave up part or all of the £67 million in return for an equivalent value transfer from the Holding Companies on some other part of the Operating Companies' Settlement. However, no one has suggested to me areas or issues on which the Holding Companies have given up value that they ought not to have done*." I am certainly not aware of any benefit obtained by the Operating Company creditors as a quid pro quo for giving up the Swap Proceeds, nor has anyone (including the Applicants) ever identified any such benefit."

407. So what Mr Wallace is saying is that he, at least, was not aware of any compensatory element which would lead to the conclusion that the £67 million was given up for some other element which would otherwise have enured only for the benefit of TXUEG's creditors. I accept that evidence. Mr Bloom's evidence in chief and in cross examination gave no basis for reaching that conclusion either. I conclude, therefore, that the second possibility is to be rejected. So, without any compensatory element having been expressly identified, the E&Y administrators and the BTL external creditors were content that the BTL settlement and BTL CVAs as a package represented an appropriate deal reflecting the strength and weaknesses of the case.

408. Quite apart from that, the BTL administrators should have put forward proposals providing for the £67 million to go above the line only if they had regarded the proposals as fair and, in that context, that it was appropriate for the £67 million to go to TXUEL (albeit believing that the ultimate distribution would be in accordance with an ATL settlement of some sort). It must be remembered in that context that the interests of the Applicants were aligned with the interests of the general creditors of TXUEG and TXU UK; the BTL administrators could not simply concede any point about the £67 million unless they considered that the resulting position was in the interests of the company and its creditors.

409. Further, at the very least, TXUEL had a well-arguable case that it was entitled to the £67 million whatever Bingham and the Applicants (or indeed Mr Girolami QC) have to say about it. In that context, it is to be noted also that the E&Y Proposal was for the £67 million to be split 50:50 between TXUEL and TXU UK but this did not accord with the advice which Mr Wallace had received on behalf of TXUEL that it had a strong claim. However, suppose, for the sake of argument, that the rival cases (TXUEL v TXU UK) were assessed at 50:50 and assume that the BTL creditors were content to allow all of the £67 million to go above the line notwithstanding that assessment, then in any ATL settlement it would be entirely appropriate for 50% of the £67 million to go to TXUEL. A reservation of rights letter might have expressly preserved the right of any interested party to assert that the £67 million belonged to TXU UK rather than to TXUEL, but it would have been entirely unreasonable for the Applicants to have insisted on a

reservation of rights which removed from the officeholders of EH3 and EGO BV the power (subject to any necessary sanction) to compromise that issue.

410. For these reasons, I think that it is impossible for the Applicants sensibly to argue that the whole of the £67 million should have passed to the Conduit Companies.

411. As an aside, I note Mr Briggs' closing submission that, even taking Mr Bloom's opening suggestion of a 50:50 split between TXUEL and the Conduit Companies, the outcome for the EGO BV Bondholders is virtually unchanged from the actual recovery. This is shown in the bar-charts contained in the package circulated by KPMG on 6 August 2004 to ATL Creditors. I think that any assessment of the Conduit Companies' claims to the £67 million in excess of 50% would be wholly unrealistic, so it is difficult to see that there is any non-legal merit in the point which the Applicants raise.

412. So, what could the Applicants have done? They could have aligned themselves with the E&Y administrators in arguing to keep at least a share of the £67 million below the line (as had been the E&Y position under the original BTL Proposal) but they did not do that. Instead, they were willing to see the whole of the £67 million go above the line under a BTL settlement but sought to protect their economic interests by reference to a reservation of rights letter. But it was not possible to agree the terms of such a letter. The Joint Proposal, unfortunately from the perspective of the Applicants, provided for the £67 million to pass to TXUEL. Clearly, Mr Wallace, representing TXUEL, would not have agreed that the £67 million should pass to the Conduit Companies as part of the BTL settlement; nor would he have agreed to the creation of a trust pending resolution of any issues (because of the uncertain tax consequences).

413. The position when it came to the decisions by the joint liquidators of EH3 whether to enter into the BTL lock-up agreements and whether to withdraw them on 1 December 2004 was in reality a choice between rejecting the settlement and accepting the Joint Proposal lock stock and barrel including provision that the £67 million went to TXUEL. They faced a deadline imposed by the PPA Creditors – in the absence of lock-up agreements, liquidation of EET would follow and the opportunity for a consensual resolution would be lost. The joint liquidators cannot, in my judgment, be criticised for making the decision which they did which was to enter into the lock-up and to allow it to become effective. This is particularly so given Mr Wallace's stated position that the £67 million would be an issue for final resolution in any ATL settlement. Mr Roome says that he requested Mr Spratt, at the meeting on 1 December 2004, to withdraw the EH3 lock-up so that it would not become binding. There is a dispute about whether he did make that request. But even if he did, it seems to me that the decision made by Mr Spratt (together with Mr Tucker) to allow the lock-up agreement to take effect rather than to take the risk of the deal collapsing was a decision which fell well within the range of proper decisions which an officeholder could take. As to that, Mr Spratt says, and I accept, that he

> "believed that there was a significant risk that the BTL deal would collapse if EH3 had withdrawn its lock-up agreement. That was a risk which I was not prepared to take on behalf of EH3. In other words, I had formed the view that the BTL deal was fair and reasonable from EH3's perspective even without a reservation of rights letter".

414. As an aside, I note in that context that all concerned considered the BTL settlement to be a good one for the ATL companies (including the Conduit Companies) and this was so even if the £67 million went beneficially to TXUEL; I think that even the Applicants now accept that.

415. Having bound themselves by the lock-up agreement to vote in favour of the BTL CVA for TXUEG, the joint liquidators of EH3 did so. Even if they had they not been bound, a decision to vote in favour would have been entirely understandable.

416. It follows from the terms of the TXUEG CVA taken at face value that the £67 million issue was already decided once and for all and that in the ATL settlement negotiations there was no room for negotiation at all.

417. However, Mr Wallace, as I have said, had all along made clear that he was willing to consider the arguments at the ATL settlement stage. I have already dealt with the course of the negotiations in London and New York and their lack of success. That led Mr Wallace and Mr Tucker to propose heads of terms which were eventually adopted in the ATL CVAs. Those proposals contained, of course, provision for the £67 million to be retained by TXUEL. The overall ATL settlement required, however, that the officeholders of EH3 and EGO BV put forward proposals for CVAs for each of those companies. Accordingly, Mr Spratt and Mr O'Connell had to do more than simply consider whether to agree to Mr Wallace's proposals; they had actively to consider whether they were appropriate proposals to put forward for the approval of their respective company's creditors and, in so doing, should have satisfied themselves that the proposal treated all creditors fairly.

418. Although Mr Wallace had consistently indicated that the £67 million issue would be addressed in any ATL settlement, the Applicants and Bingham produced no <u>new</u> arguments in favour of their position. I do not say that in any critical sense; indeed, it is entirely unsurprising given the very full consideration which had already been given to that issue. But just as it had been impossible to persuade Mr Wallace to agree to a reservation of rights letter acceptable to the Applicants, so too Mr Wallace's position remained that the Applicants (or rather, the Conduit Companies) had no right to or interest in the £67 million. As I have already explained, the £67 million issue had, all along, been a point of principle for certain of the large financial creditors and, realistically, a proposal which did not include payment of that sum to TXUEL would not find favour with a significant body of creditors. Quite apart from the time pressure resulting from TXU Corp's requirements (which I will consider later) an overall compromise which did not include payment of the £67 million to TXUEL, and the necessary CVAs for all the ATL companies (including the Conduit Companies) to implement such a compromise, stood no realistic chance of being approved.

419. In those circumstances, the liquidators of EH3 would have been faced with a serious problem even if the £67 million issue had been the only problem facing them (and this problem would have faced even by wholly independent liquidators having no connection with KPMG). Mr Wallace and Mr Tucker, acting as they saw it in a way fair to all the creditor constituencies, and taking into account the legal arguments in relation to the £67 million, had formulated proposals which they considered both to be fair and to be ones in respect of which they could sensibly expect the necessary majority for approval. But the whole proposal was dependent upon the approval of CVAs for each and every ATL

company including EH3 and EGO BV. The serious problem is this: by the officeholders agreeing to put forward a proposal for each of EH3 and EGO BV reflecting the terms of Mr Wallace's proposal, the £67 million would be lost for all time if the CVAs were all approved; but if the officeholders refused to put forward such proposals unless amended to deal with the £67 million in some other way, the proposals would fall, in which case the £67 million would remain with TXUEL under the BTL CVAs. In either case, EH3 had no claim and the liquidators' only negotiating position would have been to hold out for a share of the £67 million by refusing to put forward proposals which did not so provide. But clearly, the overall settlement with TXU Corp was one which should not be lost: in those circumstances the liquidators would, I consider, have been acting irresponsibly if they had rejected the proposals.

420. I would add one short comment to the last paragraph. It is unlikely, in any event, that Mr Wallace himself would have been willing to put forward proposals for TXUEL which did not include its receipt of the entire £67 million. That is because creditors of TXUEL regarded the £67 issue as a matter of principle. And whatever the legal merits, one can have nothing but sympathy with their position. £67 million of swap proceeds had been utilised by the directors without the consent of the creditors at a time of insolvency which should not have been allowed; further, that had taken place in breach of express covenants in at least some of the financing agreements. The use of those proceeds, by staving off immediate insolvency process, may well have enabled TXU UK to effect a beneficial sale of its assets which otherwise might not have taken place and thus to increase the dividend to <u>all</u> creditors including the Applicants. The creditors of TXUEL would justifiably have felt aggrieved, whatever the legal position, if other group creditors should receive an increased dividend through the use of TXUEL's money and yet that TXUEL should not be entitled to recover the funding which had made that possible.

421. However, if my analysis of the BTL negotiations and the ensuing settlement and BTL CVAs is wrong and the BTL CVAs do not, contrary to my view, resolve the £67 million issue in the absence of any ATL settlement, it could not possibly be sensibly argued that the EH3 liquidators should have insisted on receipt by the Conduit Companies of the entire £67 million (which seems to be the Applicants' position) and should have refused an overall compromise on any other basis. But it could be argued that the Conduit Companies had a claim at least to a share of that amount and that any proposals should have reflected that claim. For instance, if the Conduit Companies could claim £X of the £67 million and that their chances of success were assessed at precisely 50%, a fair proposal would have been for EH3 to receive its share, *pro rata* with TEG and TXUAC, of 50% x £X. The liquidators would then have to choose whether to put forward Mr Wallace's proposals or to reject them and attempt to obtain a revision to them to obtain that *pro rata* share.

422. The choice would present the liquidators with a dilemma. They might take a position of brinkmanship, saying to themselves that a compromise is at least as valuable to the other ATL companies as to EH3 and refuse to put forward any proposal unless EH3 received a share of the £67 million (although it is difficult to see how any proposal could justifiably treat EH3 differently from TEG and TXUAC). Or they could take a view about their prospects of success in litigation and, if they regarded their position as not particularly strong, they could put forward the proposal (with the £67 million going to TXUEL) leaving it to the creditors to decide whether to accept the proposal according to the statutory procedure.

423. In my judgment, liquidators who took the second course would be acting well within the range of reasonable decisions. First, the exchange of position papers and legal opinions may well have persuaded the liquidators that they had a not particularly strong case. Secondly, and more importantly, the overall settlement with TXU Corp (which was subject to a fast-approaching deadline) was one which it would have been very unwise to lose. Thirdly, the return for EH3, were there to be no ATL CVAs and instead liquidations were to ensue, would be reduced. Fourthly, in relation to the decision facing them, the liquidators would have been entitled to take account of what the majority of their creditors wanted: faced with two possible courses of action (which, for the purposes of argument I assume were both within the range of decisions which could properly be made) I consider that the officeholders are entitled to take account of the views of their creditors and, other things being equal, to give effect to the majority wish.

424. Accordingly, the EH3 liquidators would have been acting properly in putting forward the proposals which they did if the £67 million had been the only issue left in contention. In those circumstances, I do not see how a CVA implementing those proposals could be open to challenge, by reference to the £67 million issue, as unfairly prejudicial to the Applicants.

425. I accept that it is not open to a majority creditor to insist on unequal treatment of himself and a minority creditor; he could not, for instance, insist that his debt should attract a larger *pro rata* recovery than the minority creditor's debt, threatening to block the CVA unless that were agreed. But that is not the present case: the present case, at the ATL level, is, to put it at its strongest from the Applicants' point of view, one where one claimant, EH3, to part of the fund of £67 million is in dispute with another claimant, TXUEL. TXUEL is putting forward proposals to compromise a whole raft of issues, including the £67 million issue, under which the £67 million passes to it. EH3 can take or leave that proposal: but if it takes it as the result of a vote on its own CVA, there can be no question, in my judgment, of that CVA being unfairly prejudicial to the Applicants by reference to the £67 million.

426. Mr Briggs, for Mr Spratt and Mr O'Connell, throws another factor into the equation. He points out that section 238 IA 1986 (which deals with transactions at an undervalue) may apply to the transfer of the swaps proceeds down the company chain to TXUEG and that at each stage, each paying company will have a claim under the section. Now, that is a point which no-one, prior to Mr Briggs' involvement, had identified or, at least, raised. It certainly formed no part of the negotiations in relation to the CVAs. It is, however, as near a certainty as can be that it would have been identified and relied on by TXUEL if the £67 million issue had ever been the subject of litigation or some other resolution process. I do not have the material before me to make any sort of assessment about whether the conditions of section 238(5) would be satisfied (in which case, no restitutionary order could be made) but it is at least possible that the section applies. It is another hurdle for the Applicants to jump in showing that the EH3 and EGO BV CVAs are unfairly prejudicial to them.

427. I have, thus far, drawn no distinction between the CVAs for EH3 and EGO BV. In principle, however, the £67 million issue is relevant only to the EH3 CVA. EGO BV has no claim to any part of the £67 million other than as a creditor of EH3 or TEG. If the BTL and ATL CVAs do not, so far as concerns the £67 million issue, result in unfair

prejudice to the Applicants in relation to the EH3 CVA, they cannot do so in relation to the EGO BV CVA.

428. My conclusion is that the resolution of the £67 million issue by the BTL and ATL CVAs was not unfair and that, taking that issue in isolation, there is no unfair prejudice to the Applicants for the purposes of section 6 IA 1986 in the EH3 and EGO BV CVAs.

The GFA Claim

429. This required the resolution of whether EGO BV was entitled to claim against EH3 as guarantor of TEG's borrowing of a sum equivalent to the proceeds of the EGO BV bonds. The recognition of this claim would increase the dividend payable to creditors of EGO BV, but reduce the dividend payable to creditors of EH3. To that extent, the Applicants themselves were in a position of conflict. The interests of the general creditors of EH3 (which included the Applicants) were in minimising its liabilities and thus arguing against the application of the GFA. As EGO BV Bondholders, their interests were precisely the opposite.

430. The Applicants say that they have been prejudiced by the officeholders' failure, in the ATL settlement and ATL CVAs, to achieve the attribution of any value at all to this claim. Although this prejudice has been said to relate to both EGO BV and EH3, there is no prejudice at all to EH3; this was eventually recognised by the Applicants (Mr Olin and Ms Seppala) and their advisers (Mr Roome – and Mr Davies did not press any point) during the course of the hearing. They say that this failure was unfair because, amongst other things, it is alleged that there were failures (i) to undertake a full and proper investigation of the GFA Claim (ii) to make sufficient enquiries for information and documentation and (iii) to obtain appropriate independent advice. They do not say that, had such failures not occurred, the GFA claim would have been established. Instead they say that the failures resulted in insufficient value being attributed to it in the CVAs. They also say that there could be no valid compromise between the office-holders of EGO BV and EH3.

431. Dealing with the second complaint first, there are two arguments. First, that it was not possible for the liquidators of EH3 to enter into any compromise without the sanction of the liquidation committee or of the court. Secondly, the conflicts which the office-holders faced made it impossible for them to reach any binding agreement.

432. **Sanction**: I have dealt with the law on this topic at 59 – 63 above. Applying that law, the requirement for sanction does not prevent the liquidators of EH3 from putting forward proposals for a voluntary arrangement under section 1 IA 1986. The proposal for the EH3 CVA was, in my view, in its entirety a "composition in satisfaction of its debts or a scheme of arrangement of its affairs". Accordingly, there was no need for the sanction of the liquidation committee to the putting forward of the proposal and there was not, of course, any need for the sanction of the liquidation committee to the CVA itself, a matter which is entirely subject to the vote of the creditors.

433. **Conflicts**: The Applicants correctly identify a conflict of interest between the liquidators of EH3 and the administrators of EGO BV all of whom were (non-overlapping) partners in KPMG. They also correctly identify a conflict between the officeholders of EGO BV and the officeholders of TXUEL, the former wishing to maximise the assets of EH3 in a competition with EGO BV. I take account of the helpful

submissions of the Applicants in relation to the law concerning conflicts. I do not attempt to summarise those submissions since, in doing so, significant points would inevitably be lost. My conclusion, as a matter of law, is that, in spite of those conflicts, there is nothing which would invalidate any proposal put by either set of officeholders for a CVA of the relevant company; nor, if there were, contrary to my view, a compromise between the two sets of officeholders, is there anything to render invalid any such compromise. The question seems to me to be whether the officeholders could properly put forward the proposals which they did. And, in relation to that question, if the proposals resulted in a CVA which was unfairly prejudicial to the Applicants, their remedy (which is the one they seek) lies in section 6 IA 1986; but if the proposals result in a CVA which is not unfairly prejudicial to them, they have no remedy under the section. In other words, the mere fact of conflicts does not necessarily result in unfair prejudice – indeed, if it did, any creditor would be able to block any CVA however reasonable it might be. I accept that, in deciding whether a CVA is or is not unfairly prejudicial to a creditor, conflicts of the type about which the Applicants complain are a factor to be taken into account and may tip the balance when the court is uncertain whether or not the proposals are, indeed, fair. And I take those conflicts into account in reaching my decision on that question.

434. Returning, then, to the merits of the proposals, as I understand the Applicants' case, they do not say that <u>on the material actually available</u> when the EH3 and EGO BV CVA proposals were made, or when they were voted on, that EGO BV had an arguable case that should have been reflected in the CVAs (Mr Roome taking an illustrative figure in his first witness statement of a value of 20%). Rather, they say two things: first, that Mr Wallace and Mr O'Connell (as administrators of EGO BV) should have negotiated with Mr Tucker and Mr Spratt (as liquidators of EH3) pointing out that further enquiries needed to be conducted and insisting on <u>some</u> recognition of the claim; and secondly, that Mr Wallace and Mr O'Connell should have taken the steps which they failed to take and which I have just listed, it presumably following that if they had done so, they would have been in a better negotiating position. I will return to these suggestions later.

435. This issue was not raised by or on behalf of the Applicants as one of prejudice to them prior to the approval of the ATL CVAs or even in the correspondence leading up to this application. It seems to be something of an afterthought.

436. The relevant terms of the GFA provide that:

> "[EH3] hereby undertakes to guarantee any receivable (including interest) on [EH3] Group Companies, immediately upon receipt of EGO BV's first written demand, in relation to its indebtedness arising from Group Financing."

437. "Group Financing" is defined in the GFA as loans provided by EGO BV:

> "…to [EH3] group companies, of which [EH3] holds, whether directly or indirectly, at least 50% of the issued and outstanding shares, or on which [EH3] exercises ultimate control to a substantial extent."

438. There were two key questions with respect to the GFA claim:

a. Whether Clause 2 of the GFA was an immediate guarantee, or rather a contingent executory obligation to give a guarantee if and when a demand was made by EGO

BV (no such demand having been made prior to the commencement of EH3's liquidation).

b. Whether the provisions of the GFA were capable in any event of constituting a guarantee in respect of TEG's borrowing from EGO BV. This comes down to whether the indebtedness of TEG to EGO BV falls within the definition of "Group Financing" and is therefore covered by the provisions of the GFA.

439. KPMG had sought advice on the issue from Michael Crystal QC and Fidelis Oditah QC in May 2003. Following a consultation on 16 June 2003, the KPMG officeholders had been advised in July 2003 that:

a. Clause 2 gave rise to an executory obligation only and that, no demand having been made by the directors of EGO BV prior to the commencement of EH3's liquidation, it would be contrary to public policy to attempt to enforce EH3's obligation to give EGO BV a guarantee now, being in fraud of insolvency laws and the *pari passu* treatment of all creditors.

b. As a matter of construction, the terms of the GFA were not capable of constituting a guarantee in respect of TEG's borrowing from EGO BV as, given that EH3 did not either hold at least 50% of the shares in TEG or exercise ultimate control over it, that borrowing did not fall within the definition of "Group Financing" under the GFA.

440. In December 2003, after Mr Wallace and Mr O'Connell had been appointed as administrators of EGO BV, Cadwalader had sought advice from a Dutch law firm, Boekel de Neree, on the meaning of the GFA under Dutch law. Boekel de Neree had explained that the GFA was probably governed by English law (a view with which both Cadwalader and Bingham agreed).

441. Bingham subsequently sought advice at the expense of the estates on behalf of the Applicants from a Dutch law firm, Van Doorne, as to the purpose of the GFA in the context of Dutch tax law, and also from Mr Girolami QC, as to the proper construction of the GFA as a matter of English law in the light of Van Doorne's advice as to its purpose.

442. On the basis of advice received from Mr Girolami QC, the Applicants' case was set out in a position paper submitted by Bingham dated 24 September 2004, to the effect:

a. First, that clause 2 of the GFA constituted an immediate guarantee rather than an executory obligation to provide a guarantee on demand.

b. Secondly, that even if clause 2 only created an executory obligation, there is no rule of policy of insolvency law which would prevent EH3 from giving the guarantee now, pursuant to the executory obligation.

c. Thirdly, that although it was accepted that TEG's borrowing from EGO BV did not come within the definition of Group Financing, EH3 was or might be estopped from denying that the liabilities of TEG to EGO BV constituted "Group Financing" within the meaning of the GFA.

To succeed in its claim EGO BV would have needed to succeed on the third of these three points as well as on either the first or second points.

443. In the light of the arguments advanced by the Applicants, the Respondents sought further advice from Dr Oditah QC. He advised in writing on 18 December 2004 on the basis of information then available that the Applicants' contentions were wrong. As a matter of construction, clause 2 only created an executory obligation; even if the purpose of the GFA was that stated by the Applicants, that could not displace the clear meaning of clause 2. Further, EGO BV was now unable to compel EH3 to execute a guarantee in its favour by reason of fundamental principles and policies of English insolvency law, having gone into insolvent liquidation. Finally, he advised that the Applicants' estoppel argument was "*hopeless*", there being no evidence that could begin to establish an estoppel. I consider that the officeholders were entitled to rely on this advice provided that it is recognised that it was advice given on the basis of material then available.

444. Mr O'Connell too (as joint administrator of EGO BV) separately considered and subsequently took his own advice (from Stephenson Harwood, but not from Counsel) in relation to the GFA Claim and concluded that he could not regard it as anything other than weak. Cadwalader had made available all the necessary papers to Stephenson Harwood to enable them to consider the merits of the GFA Claim and to render advice to Mr. O'Connell in this respect. Subsequently, Mr. O'Connell confirmed that he supported his fellow KPMG Officeholders' proposal with respect to the GFA Claim. Bingham themselves seem to have agreed at the meeting on 1 December 2004 with Mr Spratt and Mr O'Connell that the conclusion reached by the Respondents that the GFA Claims had no value was the correct one.

445. I return to the two aspects of the Applicants' case on this issue. The first is that Mr Wallace and Mr O'Connell should have negotiated with Mr Tucker and Mr Spratt pointing out that further enquiries needed to be conducted and insisting on <u>some</u> recognition of the claim. This, in my view, is a hopeless argument. The advice which Mr Spratt had from Dr Oditah was that the estoppel claim was hopeless; Mr O'Connell knew of that advice. Even Mr Girolami's advice was only that an estoppel claim might be made out. Moreover, he recognised that further enquires would need to be made. Nothing further had come to light by the time of the ATL proposals and the ATL CVAs which would have enabled Mr Girolami to advise that an estoppel claim stood a reasonable prospect of success. Indeed, nothing further has come to light since then. Accordingly, Mr O'Connell was not in a position to insist on anything. He could, I suppose, have refused to put forward a CVA for EGO BV unless the proposals overall were modified to provide for such a claim. But he would in my judgment, have been perfectly justified in refusing to embark on such brinkmanship. Further, the recognition in any way of such a weak claim could well have led other creditors to revise their views in relation to weak issues which had been decided against them in the proposals (*eg* the Double Dip). Mr O'Connell says that he did try to extract something from Mr Spratt but was met by a drumming of fingers on the table and a response to the effect that EGO BV had no case at all. Even Mr Roome accepted, in cross-examination, that "there was not enough material available to make out the claim as it then stood".

446. The second aspect of the Applicants' case is, if I have understood it correctly, that Mr Wallace and Mr O'Connell should have taken the steps which they failed to take and which I have just listed. It is presumably said to follow that, if they had done so, they

would have been in a better negotiating position otherwise there is nothing in the argument. But that does not follow at all. Further investigations might have made it absolutely clear that Dr Oditah's view was absolutely correct. I cannot speculate on what might have resulted from enquiries which were never made and certainly cannot conclude that the EGO BV CVA is unfairly prejudicial to the Applicants in relation to the GFA.

447. What I can do is look at the enquiries and investigations which were made and see how full they were. Doing so, I conclude that the investigations were, by the end, really quite thorough – and their results were known to all parties – and that Dr Oditah's later views were based on reasonably full material. I can, and do, conclude that it is unlikely that further enquiries would have produced material – the topical smoking gun – which would demonstrate that there was any real strength in EGO BV's claim.

448. The actual investigations and advice obtained are dealt with fully in Mr Wallace's first witness statement at paragraphs 423 to 454 and his second witness statement at paragraphs 16 to 18. There was a very full consultation process involving Dutch lawyers and tax advisers; Bingham were kept fully informed about what was happening and were given the opportunity to comment and raise further questions. I cannot deal with all the matters he raises, but I do quote some selected passages:

> "440 Bingham McCutchen also instructed Mr. Girolami QC….He then concluded, as we had done, that the terms of the GFA did not on their face extend to EGO BV's lending to TEG. However, on the basis of an assertion that it seemed "*quite plain that the group [had] dealt with EGO BV's tax affairs on the basis that the liabilities of TEG to EGO BV were within the scope of the GFA*" (paragraph 18), he opined that further steps needed to be taken by us to satisfy themselves that they had fully investigated the factual matrix relevant to the creation of the GFA.
>
> 441. The matter apparently relied upon by Mr. Girolami QC in support of his assertion was EGO BV's successful extension of its tax ruling in 2001 (see paragraph 10 of his opinion). This was a matter that Boekel had already addressed in their advice of 25 May 2004. They concluded that Loyens had apparently failed to assess whether EGO BV remained compliant with the terms on which it originally obtained its tax ruling. They did not conclude that EH3 should therefore be deemed to have guaranteed the liabilities of TEG to EGO BV. To the contrary, their view was that, following the 1998 restructuring, it was EGO BV's new parent TXUEL, rather than EH3, that should have provided any necessary guarantees.
>
> 442. In any event, neither we nor our solicitors had located any evidence of action or conduct on EH3's part to support a conclusion that it had agreed to guarantee TEG's liability. Nevertheless, given the Applicants' continuing challenge of our conclusions, our solicitors were instructed to address additional questions directly with the directors of the EH3 and TXUEL companies and TXU Corp in respect of both the GFA and the 1998 TXU Europe group reorganisation. …. Questions were sent to former directors on 27 September 2004………
>
> 443. At the same time, Bingham McCutchen produced a position paper on behalf of the Applicants with respect to the GFA Claim. No new issues were raised in

the position paper. It was again accepted that the TEG receivable fell outside the definition of Group Financing under the GFA.

444. The former EH3 and TXUEL directors took many weeks to respond to the questions posed of them. Berwin Leighton Paisner responded on 10 November 2004 on behalf of Mr. Marsh, offering scant information concerning the 1998 group reorganisation, no information on the GFA, and providing no relevant documentation.

445. Pending receipt of answers from the other directors, we arranged for our solicitors to interview Mr. Buchanan on 29 November 2004. ….

446. Mr. Buchanan recalled that no-one had had any involvement with the GFA except himself, Mr. Murray, a former in-house legal counsel to the TXU Europe group, Loyens and The Equity Trust Company. He confirmed again that the GFA had not been considered in the context of the group reorganisation in 1998.

447. Our solicitors then sought to speak to Mr. Murray. However, I understand from Ms. Croucher of Cadwalader that Mr. Murray either declined to be interviewed or was uncontactable despite several requests through his advisers, Berwin Leighton Paisner."

Mr Wallace then goes on to explain, in an explanation I find wholly convincing, why nothing of assistance was found in the files of Norton Rose (who had at one time acted for EH3 and/or TXU Corp at the time of the reorganisation in 1998). He then says:

450. Given the further investigations that we had undertaken since counsel first opined in July 2003, including the advice that we and Bingham McCutchen had obtained from respective Dutch counsel and the opinion that Bingham McCutchen had obtained from Mr. Girolami QC, our solicitors instructed Dr. Oditah QC to reconsider his original joint advice. His further opinion dated 18 December 2004 confirmed the conclusions in his original advice, and dismissed any claim that EH3 might be estopped from denying liability in respect of the TEG receivable as "hopeless".

451. ……….

452. Lovells responded to us on 10 January 2005 on behalf of other directors of EH3 and TXUEL who were in office at the relevant time. The directors could not recollect the GFA, and could provide no relevant documentation. On 18 January 2005, the Applicants' advisers were informed that these answers were available for inspection at Cadwalader's offices.

449. What I derive from the totality of the evidence from both sides is that the officeholders had carried out full and proper investigations by the time that the ATL CVAs were proposed. They were entitled to rely on Dr Oditah's view expressed in his opinion of December 2004 and his assessment of the estoppel issue as "hopeless" (an assessment which I have no reason to doubt). I am not surprised that Mr Spratt refused to allow any value to be allocated to the claim. In saying this, I do not overlook that the amount of the

claim is large. The guarantee was for over $400 million and even though full recovery could never be expected in the light of EH3's insolvency, the claim would have been a valuable one.

450. The unchallenged evidence on behalf of other creditors of EH3 (Citigroup, Appaloosa, Davidson Kempner and AEGON) is that they considered the merits of the arguments in relation to the GFA Claims and concluded that what was proposed was fair and reasonable. I say "unchallenged": it was unchallenged in the sense that the truth of what the witnesses were saying is accepted, but it is not accepted that the subjective views of the witnesses are relevant. I consider that submission elsewhere in this judgment when dealing with this type of evidence generally in relation to all of the four contentious issues.

451. Even Mr Roome was constrained to accept, in his oral evidence, that KPMG "probably got it right". And in their own internal deliberations, Bingham suggested that the Applicants should drop the GFA claim on the basis that it would be difficult to litigate, something with which Mr Olin agreed in cross-examination. I do not take account of those points in reaching my own decision, but they are, perhaps, matters which the Applicants themselves might take on board when reflecting on this judgment. These views of Bingham and the Applicants may be an explanation for the fact that the GFA Claim was not raised as a complaint during the conference call on 25 January 2005 for restricted creditors of EH3 and EGO BV.

The allocation of £11.5m of payments made by certain PPA creditors

452. This required the resolution of which ATL company or companies (or their creditors) should receive the £11.5 million in payments made by three PPA counterparties.

453. There was at the outset and for a considerable time thereafter an unresolved tension between the PPA Creditors and the financial creditors. The former considered that the latter should not be involved in the negotiations about the PPA debts which were a matter between the PPA Creditors and EET/TXUEG and refused to provide them with documentation or information. The latter – or at least the Committee Creditors – took the position that they would not support any BTL settlement unless and until they were granted full and unrestricted access to the PPAs and related information.

454. From the early summer of 2003 Mr Tucker and Mr Wallace worked together with the E&Y officeholders to devise a process for quantifying and resolving the PPA Creditors' claims. The process can be seen recited in Part C, paragraph 2.3 of the BTL CVAs.

455. At the conclusion of this process, and as part of the BTL companies' settlement negotiations, the KPMG officeholders agreed values for each of the claims with the E&Y officeholders which they would each be prepared to agree with the PPA Creditors for the purposes of (and conditional upon) the BTL CVAs. Although the agreed values shifted during the negotiation process, the ultimate aggregate of the valuations was £1.2 billion. The joint administrators of course considered the result to be fair, but recognised that it was likely to be contentious.

456. Predictably, the PPA Creditors with unliquidated claims considered that the result was an undervalue. Indeed, when it came to voting on the BTL CVAs, two of the nine PPA Creditors refused to support the settlement for that reason. Some PPA Creditors

considered that there had been an overvaluation of the claims of others. Also predictably, several of the ATL creditors, including Appaloosa and Davidson Kempner, expressed concern that the PPA claims had been overvalued.

457. In an effort to find a way through this blockage Mr Bloom and Mr Wallace decided to put forward a proposal which included the following:

a. Their agreed valuations would be included in the Joint Proposal, intending that these valuations would stand as their proposal unless they could be persuaded that any of them had been reached on the basis of some manifest error.

b. A data room would be set up in which the PPA documentation would be made available to restricted Operating Company committees and Committee Creditors. This would provide Committee Creditors with the opportunity they required to test the officeholders' valuations (and PPA Creditors the opportunity to assess each other's claims).

458. The Committee Creditors decided to instruct energy industry and valuation experts at PA Consulting to review the contractual documentation and the work already undertaken by NERA and ILEX (who had been instructed by the officeholders for the purposes of drawing up their own proposals on valuations) and to produce their own valuation of PPA Creditors' claims. Cadwalader (acting for the EFC Bondholders) suggested that PA Consulting be instructed by each Committee Creditor and that its fees be met by the estates. Mr Wallace was reluctant to see another adviser involved, incurring cost and occasioning delay, but he recognised that the lack of transparency associated with the PPA valuation process to date would make it very difficult for him to persuade many of the Committee Creditors to accept the valuations in the absence of their own review. For that reason, he agreed in principle to support the appointment of PA Consulting. The Committee Creditors, including the Applicants, unanimously took the decision to instruct PA Consulting.

459. On 16 September 2004, Mr Wallace received an email from Mr. Bickle of Cadwalader attaching PA Consulting's draft engagement letter. The draft letter contained a clause precluding the KPMG officeholders from having access to the PA Consulting report without the prior written consent of all of the instructing creditors. This restriction had apparently been included in the draft engagement letter at the insistence of Bingham. It was, unsurprisingly, wholly unacceptable to Mr Wallace. He made clear that cooperation with the instruction of PA Consulting and its funding by the estates was on the basis that:

a. The officeholders were guaranteed access to the final report.

b. The officeholders would not re-visit the valuations contained in the Joint Proposal unless it could be shown that the work conducted by the officeholders' experts, NERA and ILEX, contained some manifest error. Neither Mr Wallace nor Mr. Bloom were prepared to re-open negotiations with the PPA Creditors simply on the basis of differing expert opinions on matters of a subjective nature. Both Mr Wallace and Mr Bloom were absolutely clear in their evidence that the figures in the Joint Proposal were, subject to that possible variation, sacrosanct.

460. On 7 September 2004, Mr. Tucker advised the Committee Creditors of PA Consulting's fee estimate and informed them that their fees would be borne by TXUEL. The RCF Banks had been content to endorse the instruction of PA Consulting, but they were not convinced that it was as essential as other Committee Creditors believed. In any event, they soon raised an objection to TXUEL bearing the entire cost of PA Consulting's fees, as this would affect them disproportionately. They pointed out that, if the PPA valuations contained in the Joint Proposal were revised as a result of PA Consulting's work, it would be the Conduit Companies that would directly benefit. Therefore, they proposed that the costs be borne by those companies. This approach was eventually adopted.

461. The PA Consulting report was supplied to Mr Wallace on 26 October 2004. Prior to that, two errors (in relation to Barking Power and Roosecote) had already been identified by E&Y and the need for downward revised valuations was recognised. Apart from that the PA Consulting report produced nothing to persuade Mr Wallace and Mr Bloom to revise their valuation figures for the proposal. There were differences between PA Consulting's figures (their aggregate being lower) and the officeholders' aggregate but, as this was due to subjective differences of expert opinion and not to manifest error, Mr Wallace and Mr Bloom proposed no changes.

462. I now need to summarise some further paragraphs (484 to 489) of Mr Wallace's first witness statement which I accept:

a. Not all of the Committee Creditors agreed with the officeholders' approach. Appaloosa and Davidson Kempner, in particular, remained intent on convincing them that their valuations should be reduced. To this end, they asked them both to attend a meeting with them in New York on 3 November 2004.

b. At the meeting, Mr. Bloom spent some time explaining why the officeholders were confident that they had arrived at fair valuations. He accepted that PA Consulting's views were defensible, and did not discourage the Committee Creditors from trying to persuade major PPA Creditors to reduce their claim, but expressed doubt that any would agree to do so.

c. The Committee Creditors agreed that, initially, they would approach Drax and SSE which they did. Rugeley Power was later added.

d. Although there was no scope for a dispute with Drax as to the expert valuation of their claim, there were three legal issues:

    i. Whether a particular clause in their contract prevented TXUEG from making a claim against the estate of EET unless and until Drax had been paid out in full (the so-called "non-compete" clause).

    ii. Whether Drax had acted prematurely in terminating its contract giving rise to repudiatory breach.

    iii. A minor issue as to the proper interpretation of a financial cap on TXUEG's liability as guarantor.

e. These issues had already been the subject of extensive consideration by the KPMG and E&Y officeholders. The Joint Proposal proposed that Drax be paid an additional £25 million in settlement of the first and third of these issues.

463. The officeholders considered that they had taken the negotiations with the PPA Creditors as far as they could without seriously jeopardising the BTL settlement process. They had formed their views on the right level of the claims, and did not think it was appropriate to negotiate them further. For this reason, their involvement in the Committee Creditors' own negotiations with the PPA Creditors was limited.

464. Negotiations by certain of the Committee Creditors with certain of the PPA Creditors proceeded, the detail of which I do not need to rehearse. The officeholders were brought up to date with progress, a memorandum of heads of understanding with Drax being provided on 18 November 2004 providing for payment of a sum of money to TXUEL and subject to what Mr Wallace regarded as some extremely complicated provisions.

465. On 23 November 2004, Mr. Roome and Mr. Terry met with Mr. Tucker and Mr. Douglas at KPMG's offices. The points raised by Bingham included who were to be the beneficiaries of the proposed payment by Drax. This was the first time that Bingham had raised any issue with the officeholders with respect to the PPA Payments. Mr. Roome made clear his view that the benefit of any payment by Drax should go to the Conduit Companies, relying on the fact that the PA Consulting work had been funded by them.

466. At that stage, however, the officeholders did not know the basis on which the negotiations with the PPA Creditors had proceeded and did not know the extent to which the payments by them were linked to the PA Consulting report, although they did know that, in the case of Drax, it was nothing to do with that report. Mr Wallace and Mr Tucker took the view that the allocation of payments made to TXUEL was an ATL issue that would need to be addressed in any ATL settlement. In other words, the PPA Payments were not an asset of the BTL administrations but was an asset to which TXUEL became entitled pursuant to an agreement between third parties (the PPA Creditors and the relevant members of the "Holding Companies Creditors Committees").

467. Mr Bloom's evidence was to the effect that negotiations between the PPA Creditors and the financial creditors were not his concern. He was putting forward a Joint Proposal which he regarded as fair so far as concerns the PPA Creditors' claims. If one or more of the financial creditors was able to negotiate a payment from a PPA Creditor, that was a matter between them and did not detract from the fairness, as he saw it, of the Joint Proposal. Both Mr Wallace and Mr Bloom regarded the valuations they were putting forward as sacrosanct, any deviation being likely to result in rejection of the Joint Proposals.

468. By letter dated 1 December 2004 addressed to Messrs Wallace and Tucker in their capacity as Joint Administrators of TXUEL, SSE confirmed its agreement to pay TXUEL a total of £6 million on the implementation of the proposed BTL CVAs.

469. Drax and International Power also confirmed their agreement to pay, respectively, £2.5 million and £3 million to TXUEL in consideration of the support of the necessary majorities of the ATL creditors' committees in respect of the proposed CVAs in

accordance with the Joint Proposal. The letters of confirmation dated 2 December 2004 refer to an agreement with certain members of "the Holding Companies Creditors' Committees" [not a defined term] to pay TXUEL a specified sum of money and are countersigned, respectively, by Mr Tucker and Mr Wallace as an acknowledgement of the terms of that agreement (but not so as to make TXUEL a party to that agreement).

470. Thus, as a result of negotiations conducted by representatives of the Committees Creditors, certain PPA Creditors, namely Drax, SSE and International Power plc, agreed to make payments to TXUEL totalling, in aggregate, £11.5 million.

471. The Conduit Companies clearly had no legal right to the £11.5 million PPA Payments any more than any other ATL creditor. Nor did the PPA Payments constitute an asset of the BTL administration; rather they were coming out of the dividends received by the PPA Creditors from the estate or their other assets.

472. The evidence of Mr Bloom and Mr Wallace (which I accept) was that the PPA Payments were the price the PPA Creditors were willing to pay in order to get the ATL creditors to support KPMG causing the Conduit Companies (and not just EH3) to vote in favour of the TXUEG CVA This is reflected in Clause 1 of the Drax and International Power letter already referred to. Further, under the terms of each of those letters, the relevant PPA Payments were to be paid to the administrators of TXUEL, for "the benefit of the external creditors of the Holding Companies".

473. It was confirmed to Bingham on 6 December 2004 (after the lock-up agreements had been entered into) on behalf of Mr Wallace and Mr Tucker that the PPA payments would be received by TXUEL "on behalf of the Holding Companies pending clarification of entitlement".

474. Given the manner in which the PPA Payments were negotiated *ie* by certain of the creditors and not by the officeholders, and given the firm and, in my view, reasonable attitude of both Mr Bloom and Mr Wallace that their valuations were sacrosanct for the purposes of their proposals, I do not consider that there is any unfairness in their putting forward proposals under which the PPA Payments were reserved to the ATL settlement. There was in practice no way in which the final destination of the PPA Payments could be resolved prior to the deadline for the BTL settlement. I do not consider that the conflicts of interest which existed for any of the officeholders, whether the KPMG or the E&Y officeholders, had any impact whatsoever on this aspect. Wholly independent liquidators of EH3 would not have been able to achieve any resolution of that issue prior to the deadline and nor, in my judgment, could they possibly be criticised had they gone ahead, as the actual liquidators did, with a proposal that left the allocation of the PPA Payments to another day.

475. Under the ATL settlement which was eventually given effect to by the ATL CVAs, the PPA Payments were divided 50:50 between the Conduit Companies and TXUEL. The Applicants complain that this was unfair and that the PPA Payments should have been allocated wholly to the Conduit Companies. The basis for this contention is, in effect, that the PPA Payments reflect the willingness of the relevant PPA creditors to reduce their claims under the PPAs by an aggregate of £11.5 million. Had that reduction been reflected, as the Applicants assert should have occurred, by a reduction in the amounts which they were to recover from EET or TXUEG, the effect would have been to increase

by the amount of the payments the assets available for distribution by TXUEG to the Conduit Companies. TXUEL and financial creditors generally have no claim to the money.

476. Attractive as that argument is, I do not, ultimately, think that it is correct. The allocation in the ATL settlement of the PPA Payments needed to be made against the manner in which, and by whom, those payments were negotiated and the terms of the agreements which were negotiated. Financial creditors were perfectly entitled to negotiate with certain of the PPA Creditors to obtain a payment from the latter as a condition of the former supporting the proposals as to valuation of the PPA Creditors' claims which Mr Bloom and Mr Wallace considered to be fair and which, for good reasons, they regarded as sacrosanct.

477. The PPA Payments were received by TXUEL for the benefit of the Holding Companies pending resolution of entitlement but, in the case of the Drax and International Power payments, expressly for the benefit of external creditors of the Holding Companies (which would not include the Conduit Companies). The Respondents were advised by Cadwalader that there was no clear legal answer as to whom the £11.5 million PPA Payments belonged.

478. A substantial majority of creditors were willing to approve a proposal that the PPA Payments be divided equally between (i) TXUEL and (ii) the Conduit Companies, but not that they be paid solely to the Conduit Companies.

479. As in the case of the £67 million payments, the officeholders of EH3 and EGO BV could have refused to put forward proposals for CVAs for their companies unless 100% (or some percentage larger than 50%) of the PPA Payments went to the Conduit Companies. But that would be to indulge in the kind of brinkmanship which it is not their duty to conduct. The Applicants complain that there was no real negotiation between Mr Spratt and Mr O'Connell on the one hand, and Mr Wallace and Mr Tucker on the other hand and that, once again, the inherent conflicts and the suggestion that Mr Spratt and Mr O'Connell would always defer to Mr Wallace made negotiation impossible. There was no-one independent to look after the interests of the Conduit Companies. But in my judgment, those aspects, even assuming that Mr Wallace as a dominant character was able to suborn his colleagues, do not necessarily result in the allocation being unfairly prejudicial. Those aspects mean that the court has to look closely at the merits of the proposal.

480. In doing so, I reach the conclusion that Mr Crystal is right in his submissions that it was fair and reasonable for the Respondents to propose that the PPA Payments be divided in the way set out in the proposal. It may be that a proposal which provided for 100% of the PPA Payments to go to the Conduit Companies might also have been within the range of proposals which could properly be put forward. But it was not one which the officeholders believed would be accepted since it could be blocked by the financial creditors who regarded it as unfair. In contrast, the Applicants could not block the proposal once the officeholders of EH3 and EGO BV had decided to put it forward, as to which I have concluded that they could properly do so.

481. Mr Crystal also submits that an alternative way in which the Respondents could reasonably have proposed the £11.5 million could be allocated – although they did not do

so – would have been to propose that it remain in its entirety at TXUEL to be treated as an asset of TXUEL and distributed amongst its creditors. Such a proposal would have been consistent with the requirement to benefit all Holding Company creditors in accordance with the terms upon which the payments were to be made, since all such creditors, including the Applicants, had claims against TXUEL. By proposing instead that the £11.5 million PPA Payments should be allocated equally between (i) TXUEL and (ii) the Conduit Companies, however, the Applicants' share (both as creditors of TXUEL and of EH3) is greater than it would have been had the alternative been adopted. I do not need to decide whether that is correct and do not do so.

The allocation of any settlement payment made by TXU Corp

482. Extensive investigations were carried out by the KPMG and E&Y officeholders of claims which TXU Europe group companies might have, with legal aspects being divided between A&O and Cadwalader. The description of the types of investigation is dealt with by Mr Wallace in paragraphs 516 to 523 of his first witness statement. As a result of these investigations it had been concluded by June 2004 that a number of potential claims existed which could be brought by various companies in the TXU Europe group against TXU Corp and/or the directors of certain TXU Europe group companies in respect of which TXU Corp had given guarantees or indemnities. These arose from:

   a. The continuation by TXUEL and TXUEG of trading from the first quarter of 2002 until October 2002, when it was arguable that the directors were obliged to have regard to the interests of the creditors of the companies, and had failed to do so sufficiently or at all (the "**Trading Claim**"). These included "loss of chance" claims one theory of loss was that TXUEL had lost an opportunity to restructure the business of its subsidiaries without break-up and outside formal insolvency proceedings; another theory of loss was that the continuation of trading had caused diminutions in net assets over the relevant period.

   b. Inter-company dividends paid by TXUEG in 1999 and 2000 and by TXU (UK) Holdings, TXUEG, TEG and TXUAC in 2001, when those dividends were or were arguably unlawful under Part VIII of the Companies Act (the "**Dividend Claims**"). It is to be noted that it was not only TXUEG which had Dividend Claims.

   c. TXUEG's need to compromise the Net v Gross issue, when it was arguable that the compromise was necessitated by the absence of proper books and records (the "**Books and Records Claim**").

   d. TXU Corp's withdrawal of promised financial support for TXUEL in late 2002, in circumstances which arguably constituted a breach of contract or breach of promise sufficient to give rise to estoppel under the laws of Texas (the "**Texas Claims**").

483. Mr Wallace has, at times, described the Dividend Claims at TXUEG as strong or even as the strongest of the TXU Corp Claims. It is fair to say, however, that his description was intended to indicate that TXUEG had clearly failed to comply with its obligations under the Companies Act 1985. It was not, however, entirely clear what the consequences of that failure would be or to what extent relief might be obtained under section 727 of the Act.

484. The officeholders knew that if they were to commence litigation against the directors and TXU Corp, it would be costly, complex and hard-fought but were, of course, and as responsible officeholders, willing to explore whether there was a basis on which the potential claims could be settled on attractive terms. In this context, it was clear that TXU Corp would play a central role.

485. Mr Wallace and Mr Tucker held an initial without prejudice meeting in December 2003 in Dallas with Mr Peterson, TXU Corp's general counsel, and two former directors of TXU Europe companies, Mr. McNally and Mr. Wooldridge. They considered, as a result, that there was a prospect of early settlement. But it was made clear by TXU Corp any settlement would have to involve the compromise of claims against both TXU Corp and former directors of TXU Europe group companies.

486. Negotiations moved forward in the spring of 2004, following the appointment by TXU Corp of a new CEO in early 2004, Mr. Wilder, who had been recruited externally and had had no involvement in the collapse of the TXU Europe group. From discussions with Mr. Peterson and his assistant general counsel, Mr. Poole, Mr Wallace and Mr Tucker understood that Mr. Wilder had been given a remit to try to resolve "legacy" issues, including litigation and potential litigation in the US and the UK, in the course of his first year in charge, being TXU Corp's 2004 financial year. On 18 May 2004, in a public conference call with financial analysts, Mr. Peterson confirmed that TXU Corp would consider participating in a short-term resolution of its exposure to any claims the TXU Europe companies might bring.

487. However, it was emphasised by TXU Corp that this "settlement window" was limited. TXU Corp's position was that, if no settlement could be reached in 2004, it would turn the defence of any ensuing proceedings over to its D&O insurers and "bunker down" for long-term litigation. This threat was repeated many times in the course of the negotiations with TXU Corp. Mr Wallace says that this stance no doubt reflected an element of negotiating strategy on their part but that the officeholders' dealings with Mr Peterson and Mr Poole led them to form the view that their position was genuine, or that the officeholders would be taking a considerable risk in assuming otherwise.

488. 31 December 2004 was significant in other respects. A separate issue for TXU Corp had arisen out of the ability of certain of the Holding Companies (TXUEL, EFC and Finco 2) to utilise valuable UK tax losses generated in 2002. Both the officeholders and TXU Corp were aware that, if the Holding Companies did so, it could oblige TXU Corp to repay hundreds of millions of dollars to the US Internal Revenue Service ("the **IRS**") which it had received by way of refund as a result of US tax losses crystallised by the write-off of its investments in the TXU Europe group.

489. TXU Corp had indicated that it was willing to make payments to the relevant Holding Companies to procure their agreement not to use tax losses available to them in the UK. By the summer of 2004, the officeholders believed that the Holding Companies had only until 31 December 2004 to use UK losses. Therefore, any agreement that they would not do so in exchange for compensation had to be resolved by then.

490. Against this background, the officeholders considered that there was a genuine opportunity to negotiate a combined settlement with TXU Corp of potential claims and

tax matters prior to 31 December 2004. However, it was also clear that TXU Corp did not intend to consummate a substantial settlement of the potential claims of the Holding Companies or TXUEG unless the claims of both the Operating Companies and the respective companies' creditors were, so far as possible, simultaneously settled and released. TXU Corp and the officeholders knew that various creditors (including the RCF Banks and the Applicants) had been considering whether they had Direct Claims against the directors of the TXU Europe companies or TXU Corp.

491. The officeholders accepted as genuine Mr Peterson's stated position that he was willing to settle all potential litigation exposures but not just some. He required that creditor claims should be settled at the same time as estate claims. TXU Corp's insistence on this requirement was maintained throughout the negotiations and is reflected in the terms eventually agreed.

492. By about autumn 2004, the RCF Banks and EFC Holders were raising direct claims with TXU Corp. The officeholders had expected that the Applicants would present position papers as the other creditors had done, or even commence proceedings in the light of the impending expiry of a relevant limitation period. But it became apparent that they were not going to do so, at least not at their own expense, and expressed doubt to Mr Wallace about the merits of some of their claims.

493. Settlement discussions with TXU Corp began in earnest in late September 2004, following the delivery of a letter dated 13 September 2004 from the officeholders setting out the estate claims.

494. As a result of advice taken prior to that time and of discussion with Committee Creditors, Mr Wallace had formed the view that receipt by the estates of a sum of £60-70 million in an all-party settlement of claims, when added to the amount of £30-40 million which KPMG estimated TXU Corp might be prepared pay in connection with tax matters, would be a good result.

495. After preliminary meetings, with which I do not need to deal, a meeting was held at the offices of Lovells (for TXU Corp and the directors) in London on 19 October 2004. Mr Wallace started the meeting by explaining that his own views were that an overall all-party settlement offer (including tax matters) which was worth less than £100 million would be unacceptable; that by contrast a settlement offer worth £150 million was likely to be acceptable; and that he was unsure what creditors' responses would be to any offer falling between those two numbers.

496. Mr. Peterson responded by offering $100 million. He made it clear that this sum would need to settle both estate and creditor claims; it was also intended to cover compensation for tax losses. In correspondence, TXU Corp nonetheless maintained a robust rejection of liability.

497. The next meeting was on 4 November 2004. TXU Corp then started increasing the pressure on the officeholders by requiring that an agreement in principle should be reached prior to its 19 November 2004 board meeting; that there should be a "sign-off" from the Committee Creditors by 15 December 2004; and a completed agreement by 15 January 2005 (to enable TXU Corp to announce the settlement in its 2004 earnings

announcement, scheduled for the third week of January 2005). Failure to meet that timetable would cause their settlement offer to "come off the table".

498. Mr Wallace reiterated his view that an all-party settlement of potential claims and tax matters was unlikely to be supported by the Committee Creditors unless it fell within a range of £100 million to £150 million, and probably towards the top of that range. After a break-out session, Mr. Peterson tabled an improved revised offer. KPMG's estimated assessment of the realistic total value of this revised offer was $150 million.

499. However, the parties remained far apart on the figures. Indeed, in a telephone conference on 12 November 2004, Mr. Peterson suggested that a settlement could not be achieved on the basis then being put forward by KPMG and that TXU Corp was calling negotiations off. Mr Wallace, correctly as it turned out, suspected that TXU Corp's withdrawal from negotiations was tactical and that they had not given up the possibility of agreeing a settlement within their timetable. Nevertheless, he was concerned that, even assuming that negotiations were to recommence in short order, meeting the timetable would be challenging.

500. Mr Wallace was in Arizona on 16 November 2004 and telephoned Mr. Peterson. He was concerned to head off any possibility that Mr Peterson would report the collapse of the negotiations to the TXU Corp board at their scheduled meeting on 19 November 2004. He expressed the view that $125 million, if attributed solely to an all-party settlement of litigation claims (*ie* excluding tax issues), would be "about the mark", but that their offer in respect of tax was particularly "mean", given that they were proposing to fund the majority of it from recoveries from the IRS. Mr Peterson agreed to consider this, and called back subsequently improving TXU Corp's offer. KPMG's estimated assessment of the realistic total value of this revised offer was $160 million, being $125 million for litigation claims and $35 million in total for the tax components of the offer. The tax aspects of the proposals contained contingent elements of some complexity. At prevailing exchange rates in November 2004, this still fell short of, but was getting closer to, £100 million.

501. In the course of a conference call on 3 December 2004, Mr Wallace updated creditors on TXU Corp's current offer. He expressed the view that it was unlikely that he or Mr. Tucker would, on their own, succeed in negotiating a further improvement in that offer. Although he sensed that TXU Corp might be willing to move from $125 million to a maximum of $150 million for claims, he thought there was little incentive for them to do so in negotiation with the officeholders alone, given that they also needed creditors' support for the terms of an all-party settlement, and given that creditors were asserting Direct Claims. He also impressed upon creditors his views that the deadlines in TXU Corp's settlement timetable were likely to be genuine and that calling their bluff in this respect would risk the loss of an opportunity to agree a valuable settlement.

502. At meetings on 15 December, Mr. Crystal QC and Mr. Douglas of Cadwalader updated the creditors on their analysis of the estate claims. Mr. Crystal concluded that, in view of the risks and costs of litigation, everyone would need to deliberate very carefully before rejecting a settlement proposal of the magnitude that TXU Corp were now proposing ($125 million). Mr. Douglas concluded, as he had done previously, that a 50:50 split of settlement proceeds received for estate claims between TXUEL and TXUEG would be

fair, in view of his analysis of the relative merits of the claims that could be brought by or for the benefit of those companies. Mr. Crystal QC endorsed that conclusion.

503. The officeholders also communicated to creditors an update from TXU Corp concerning their negotiations with the IRS. As a result of that update, KPMG's assessment of the value of TXU Corp's offer on tax matters had reduced to $30 million. Later the creditors told Mr Peterson that they would not lend their support to an all-party settlement unless £100 million was paid in settlement of the claims of both estates and creditors (at then current exchange rates, around $190 million).

504. By 27 December 2004, Mr. Peterson had accepted that he needed to increase TXU Corp's offer for settlement of claims to $175 million but that, in spite of a number of alternatives that had been put to him, he would not improve TXU Corp's offer on tax matters (which retained certain contingent elements).

505. On 29 December 2004, Mr Wallace suggested that Mr. Peterson consider improving the offer by adding a number of additional items, namely:

a. Waiver of a £62.2 million claim by TXU Corp against TXUAC (its only claim against any of the Holding Companies).

b. Reimbursement of certain insurance premiums to TXUEG (estimated to be $1.3 million but which subsequently became $2.9 million).

c. Reimbursement of £680,553 in pre-administration legal costs to TXUAC.

506. Mr Peterson eventually confirmed that TXU Corp would agree to these improvements but was adamant that there was no scope to improve TXU Corp's offer on tax matters. Mr. Peterson proposed to fly to London to sign agreements on tax matters and a memorandum of understanding on an all-party claims settlement on these terms by 31 December 2004.

507. KPMG estimated the realistic value of the waiver of TXU Corp's claim against TXUAC to be about £6 million (and Mr Wallace considers that currently it stands at about £8.1 million) in terms of the estimated dividend that TXUAC would not have to pay. On this basis, they estimated the overall value of this revised settlement offer to be approximately $220 million, *ie* $190 million for settlement of all-party claims (including the three additional items just listed) and $30 million for tax. At then prevailing exchange rates, this comfortably exceeded £100 million.

508. A conference call with the Committee Creditors was convened later that day (29 December 2004). All of the creditors participating, including the Applicants, agreed that the officeholders should seek to consummate a settlement with TXU Corp on these terms, on the basis that agreement on the terms of a Holding Companies settlement, including the manner of allocation of settlement proceeds from TXU Corp, would need to be reached by the deadline imposed by TXU Corp of 15 January 2005.

509. As matters turned out at the very end of 2004, the parties could not agree the terms of a tax-sharing agreement. Instead, a tax co-operation agreement was signed. It was agreed

that this would provide for a one-off up-front payment by TXU Corp in settlement of tax issues of $50 million to be paid on or before 12 January 2005.

510. This agreement had knock-on consequences for the all-party claims settlement. TXU Corp's position was that they would only pay a total of $205 million for a combination of claims and tax, so that if $50 million was paid in respect of tax, only $155 million would be left for litigation claims. Thus, TXU Corp refused to sign the memorandum of understanding that had been prepared with respect to a claims settlement at $175 million.

511. The officeholders, however, wanted to preserve the possibility that TXU Corp would agree to pay $175 million in respect of claims. This was the sum that had been approved by the Committee Creditors, including the Applicants, on 29 December 2004. They therefore agreed with TXU Corp, on a non-binding basis, that they would seek to negotiate a mutually acceptable form of Tax Sharing Agreement before 12 January 2005 and that, if this could be achieved, its agreement to pay $50 million under the Tax Cooperation Agreement would be varied or substituted with an obligation involving a smaller up-front payment.

512. Mr Wallace says, and this appears to be correct, that it was clear that creditors would not support a settlement which entailed the payment of only $205 million by TXU Corp in respect of both claims and tax matters. If a Tax Sharing Agreement could not be negotiated on satisfactory terms some creditors wanted the officeholders to pressure TXU Corp to pay $225 million ($50 million for tax and $175 million for claims). The Applicants' position was that, if this was not possible, the priority should be to preserve the prospect of a litigation settlement at $175 million, *ie*, less than $50 million should be taken for tax.

513. In a telephone call on 11 January 2005, Mr. Peterson indicated to Mr Wallace that TXU Corp might be willing to move to a one-off payment of $40 million for tax matters and pay $175 million in respect of an all-party settlement of claims. KPMG's ensuing consultations with major creditors led them to believe that, with the exception of Davidson Kempner, that proposal would be supported, subject to agreement on allocation between estate claims and Direct Claims.

514. Importantly, it was made clear by TXU Corp that a settlement on these terms had to be agreed in time for approval at a board meeting fixed for 26 January 2005 and that, in order to approve the settlement, TXU Corp's board would need prior evidence of contractual support for the settlement from 60% of all the creditors (by value) of the Holding Companies by close of business on 25 January 2005.

515. A day or two after returning to London on 13 January 2005, Mr Wallace persuaded Mr. Peterson to improve TXU Corp's offer on tax matters in two relatively minor respects concerning costs. Davidson Kempner agreed, subject to approval of allocation among estates and creditors, to support a settlement with TXU Corp on these terms.

516. There then followed a period of hectic activity to finalise the terms of a settlement agreement. Advanced drafts of the settlement documentation were sent to major creditors, including the Applicants, for review and comment on 19 and 22 January 2005. On 21 January, Mr. Terry of Bingham provided comments on the settlement documentation.

517. Further drafts of the settlement documents were circulated to creditors on 26 and 27 January 2005. Following a late request by TXU Corp, the officeholders agreed to draft the settlement documentation so that, of the total sum that had been agreed as payable in respect of tax matters and claims:

    a. $13 million would be paid under the Tax Cooperation Agreement.

    b. $205 million (as well as the reimbursement sums in respect of legal costs and insurance premiums) would be paid under the settlement agreement.

518. This was done expressly without prejudice to the officeholders' entitlement and intention to treat the sums paid in conformity with the basis on which they had been originally agreed, namely $175 million in respect of claims with the balance of $43 million in respect of tax matters.

519. The Settlement Agreement and an amendment to the Tax Cooperation Agreement were finally agreed and executed on 27 January 2005. Bingham and the Applicants were advised of this by email on 27 January 2005. TXU Corp had required at least 60% of the external creditors of the ATL companies to enter into lock-ups as a condition of TXU Corp's execution of the settlement (which was achieved). Furthermore, the TXU Corp settlement is subject to the satisfaction or waiver of certain conditions including, amongst other things, the absence or final dismissal of any challenge under Section 6(1) of the Insolvency Act 1986 in relation to any Core CVA prior to 30 November 2005. The CVAs for EH3 and EGO BV are both Core CVAs.

520. Mr Wallace and Mr Tucker in their capacity as officeholders of each of the ATL companies obtained advice from Mr Crystal and Cadwalader on the merits of the adequacy for settlement purposes of a proposed sum of US$105 million to be allocated and shared equally by TXUEL and TXUEG as part of the wider settlement package to be agreed with TXU Corp. Mr Crystal and Cadwalader advised Mr Wallace and Mr Tucker that they should accept TXU Corp's offer. Further, (see paragraph 574 of Mr Wallace's first witness statement) Mr Crystal had, at the 15 December 2004 meeting, endorsed Mr Douglas' advice that a 50:50 split of the money going to the estates between TXUEL and TXUEG was fair.

521. I am not clear whether, at the end of the day, the Applicants say that the settlement with TXU Corp was a good one or not. For my part, on the totality of what I have seen, it was. What is more, and this may be of relevance later, the time limits which were imposed by TXU Corp for agreeing the settlement were real: there were advantages to both sides in a quick and speedy settlement and, if the opportunity had been lost, the overwhelming probability, I think, is that there would have been no settlement, at least not for a considerable period of time and then probably only on a claim by claim basis. Insofar as one can assess the position, it seems highly likely to me that recoveries from TXU Corp would have been less, and later, than under the settlement and that the Applicants themselves would receive less than they actually stand to receive under the CVAs which they now say are unfairly prejudicial to them. There can be no doubt, in my judgment, that, as between TXU Corp on the one hand, and the TXU Europe group companies on the other hand, the settlement was a proper one to have entered into. It is justifiably, I consider, described by Mr Crystal as "on any basis a considerable achievement".

522. The claims held by the BTL companies had, by the time of the TXU Corp settlement, been assigned above the line as part of the BTL CVAs. Further, in parallel with the TXU Corp settlement negotiations, negotiations had been proceeding over the ATL settlement. In that context, the RCF Banks and the EFC Bondholders were pressing their Direct Claims. The officeholders took advice, including advice from New York and Texas lawyers, in relation to the different Direct Claims. The advice received was that there were likely to be significant hurdles to the viability and success of the Direct Claims. Mr Wallace deals, at paragraphs 606 to 630 of his first witness statement, with the history of discussions between the various groups through the meetings of 15 and 16 December 2004 in London and of 11 and 12 January 2005 in New York. It would be fair to say that the various creditor groups were far apart, each insisting on a sum of money which would have left an inadequate amount for the estates. Mr Wallace's position, on the basis of his legal advice, was that the estates should not take less than 60% of the claims settlement monies; and it appears that, by 12 January 2005, the RCF Banks and the EFC Bondholders had agreed between them that a 40% attribution to Direct Claims would be acceptable.

523. However, at the December meetings Barclays had put forward a proposal under which 40% of the litigation recoveries would be allocated to Direct Claims provided that two thirds went to the RCF Banks and one third to the EFC Bondholders, the Applicants' position then being that $130 million should go the estates and only the balance to Direct Claims. Mr Wallace says that he would have been happy with the Applicants' proposal but he viewed it as clearly not the case that it would be capable of implementation through CVAs because it would attract insufficient creditor support. There was little movement at the December meetings, although the EFC Bondholders indicated that they might be prepared to move to the Barclays proposal. The RCF Bank syndicate was holding out for 85% of the 40%.

524. The Applicants' position had been, as I mentioned, that the estates should receive at least $130 million. However, on 12 January 2005, they put forward an alternative proposal based on reallocation of the 40% of the claims settlement proceeds which the RCF Banks and EFC Bondholders were now agreed should be allocated to Direct Claims. They said that, given the doubtful merits of the Direct Claims that had been asserted by the RCF Banks and the EFC Bondholders, any direct payments to creditors should in substance be characterised as payments for the general releases which TXU Corp required from all claims whatsoever, rather than for the settlement of specific claims. Mr. Roome told Mr Wallace that the Applicants would support a 40% allocation to Direct Claims if the EGO BV Bondholders received a share that was acceptable to the Applicants. He suggested that splitting the 40% three ways, so that one-third would be allocated to the EGO BV Bondholders, one-third to the EFC Bondholders and one-third to the RCF Banks, might be acceptable.

525. The eventual CVA proposal was in accordance with the Barclays proposal save that $1.5 million of the sum that Barclays proposed should go to the EFC Bondholders would instead be paid to the EGO BV Bondholders. Broadly speaking it provides:

   a. $43 million is allocated between TXUEL, EFC and Finco 2 in respect of tax matters.

b. $105 million (less certain deductions) is allocated equally between (i) TXUEL and (ii) the Conduit Companies *pro rata* to their claims as creditors of TXUEG. The deductions are designed to reimburse TXUAC in respect of certain costs and much of the benefit will flow to EH3 and EGO BV as indirect creditors of TXUAC.

c. US$70 million is allocated to Direct Claims

526. The Applicants have three complaints:

a. That the allocation of $43 million to TXUEL, EFC and Finco 2 of a portion of the settlement proceeds prejudices the interests of the Conduit Companies.

b. That the allocation of as much as $70 million to Direct Claims prejudices the interests of the Conduit Companies.

c. That the 50:50 split of the $105 million allocated to estate claims prejudices the Conduit Companies.

In each case the alleged prejudice to the Conduit Companies entails prejudice to the Applicants.

527. As to the $43 million, I quote from paragraphs 561(a) and (b) of Mr Wallace's first witness statement:

> "(a) Pursuant to the terms of the Tax Cooperation Agreement we had originally entered into……, TXUEL, Finco 2 and EFC had the right to compel a payment of $50 million from TXU Corp in respect of the use of (or agreement not to use) tax losses. Such right would have been retained and enforced if the overall settlement with TXU Corp was not consummated. At TXU Corp's request, we agreed to amend the Tax Cooperation Agreement in conjunction with the settlement to provide that only $13 million would be paid under its terms on the basis that, in exchange, TXU Corp would pay a further $30 million under the Settlement Agreement.
>
> (b) In these circumstances, and as described at Part C, paragraphs 7.5, 7.17 and 7.18 of the Holding Company CVA Proposal, we believed that the allocation of $43 million of the proceeds of the settlement to TXUEL, Finco 2 and EFC was fair……"

528. Accordingly, all that the ATL settlement did was to reflect the basis on which the $43 million had been negotiated with TXU Corp in the first place. It seems wholly appropriate to me that the entire sum should be allocated among those three companies as it was. I can see no prejudice to the Conduit Companies and do not consider that the EH3 or EGO BV CVAs are unfairly prejudicial to the Applicants in respect of the $43 million allocation.

529. As to the $70 million, the Respondents were advised by their solicitors and by leading counsel that the receipt of $105 million by the estates was a reasonable sum to accept in settlement of their claims and that they would be prudent in accepting it. The TXU Corp

settlement itself did not, of course, settle the estate claims at that figure: rather it settled all claims at an overall figure, leaving allocation to be dealt with in the ATL settlement. In putting their proposals for the ATL settlement, the Respondents were entitled, indeed bound, to take account of the legal advice which they had received. They were also entitled to take account of what they knew about the attitude of the creditors asserting Direct Claims and whether they would accept the allocation which was being put forward. Given that the allocation of $105 million was reasonably considered by the Respondents to reflect a fair settlement of their claims against TXU Corp and the directors in the context of the total settlement amount, there is no prejudice, in my judgment, to the Conduit Companies.

530. The Applicants seem to suggest that the conflicts inherent in the position of the Respondents mean that they could not effectively have agreed this allocation. However, in a dispute between the estates collectively and the creditors asserting Direct Claims, there was no conflict. Further, even if, as the Applicants suggest, Mr Wallace was driven by the desire to get a deal at all costs, it is difficult to see how such a desire has any impact on the complaint under consideration. Once it is accepted that the TXU Corp deal was a good one and that the $105 million represented a fair settlement of the estate claims, Mr Wallace has got in place one element of his overall deal. He has not needed to get that element in place "at any cost" *ie* by allocating to the estates less than a fair settlement of their claims in the light of the overall settlement.

531. Moreover, there was no better deal available for the Conduit Companies than the TXU Corp settlement. The negotiations between the estates and the Direct Claims (which were reflected in the eventual allocation in the proposal) were hard fought over a long period. There was a real risk of litigation if a deal could not be done and everyone, including the Applicants, was aware of the TXU Corp-imposed deadline. Litigation would take possibly years and it was not to be expected that such litigation would produce more than $175 million (and, for what it is worth, I mention that that was something which Mr Roome accepted in his evidence). Neither EH3 nor EGO BV had claims and there was a risk that they would receive less than that which they obtained under the allocation. There could be no TXU Corp settlement without releases from the creditors with Direct Claims. The RCF Banks were demanding a substantial share of the recoveries. It should be noted that some of the RCF Banks were dissatisfied with the $70 million allocation, saying that they should have more, and were not prepared to support it. The acceptance of the ATL CVA proposals as eventually put forward by the Respondents was not a foregone conclusion and was, in the event, only just achieved.

532. It should also be noted that it was in the interests of Committee Creditors other than the RCF Banks to increase the estates' share but a better share than 60% could not be negotiated in the light of the RCF Banks' hard-line position.

533. Various complaints have been made by the Applicants about the settlement process. I am satisfied that the process was fair and transparent. I am also satisfied that certain allegations made by the Applicants were unfounded. For instance:

   a. The Applicants, at one stage, complained that Mr Wallace had stated to Ms Seppala that the RCF Banks had strong claims; that was used to suggest that Mr Wallace was weak in conceding claims which he should not have done, to the detriment of the estates. In fact, what he had said was that the RCF Banks

themselves were saying that they had strong claims so that there was no foundation for the suggestion of weakness.

b. It was suggested that position papers had been deliberately withheld, but that was not maintained.

c. It was suggested by the Applicants that TXU Corp offered to settle the claims of the estates alone at $125 million but there never was such an offer.

d. It was suggested that the Applicants were not represented in negotiations with TXU Corp. They were not unrepresented and agreed how those negotiations should progress.

534. The Applicants' own conduct in relation to the negotiations was surprising. A direct approach was made by Bingham to TXU Corp in an attempt to obtain a payment for the releases which TXU Corp was requiring. The attempt made in a letter dated 19 January 2005 to Lovells shortly before the deadline. That letter appears to me, in spite of the unconvincing evidence given by Ms Seppala that the claim was being made on behalf of EGO BV and EH3, to be an attempt by the Applicants to obtain payment to themselves at a time when they were not making, and did not intend to make, any Direct Claims. Indeed, it seems to be recognised by Mr Roome that the Applicants had no such claims. To put it at its lowest, a unilateral approach of that sort was not designed to support an overall settlement with TXU Corp which it was in everyone's interests to achieve. The Applicants now say that the letter was sent at the suggestion of Mr O'Connell, a suggestion made by him in New York. However, Mr O'Connell never saw a draft of the letter and can hardly have had in mind in suggesting a direct approach to TXU Corp (if indeed he did) a threat of this sort.

535. In any event, the EGO BV Bondholders were allocated $1.5 million out of the $70 million total allocation. It is comparable compensation to the $21.8 million paid to the EFC Bondholders taking their respective shortfalls (as estimated by Mr Tucker) at £100 million and £1,200 million.

536. The Applicants say that Mr Spratt and Mr O'Connell had failed in their duties by not involving themselves earlier (whilst continuing to maintain that, even if they had done so, they were incapable of effective fulfilment of their duties because of their conflicts and subservient positions to Mr Wallace). I have dealt elsewhere with the involvement which the Applicants could reasonably have expected of Mr Spratt and Mr O'Connell in the light of Bingham's own involvement at the expense of the estates. But for my part, I think all this is really beside the point because I do not see how even totally independent officeholders in the Conduit Companies would have been in a position to obtain a better deal either *vis a vis* TXU Corp or *vis a vis* the creditors with Direct Claims than did Mr Wallace in his hard fought negotiations.

537. My conclusions are (a) that the negotiation process was fair and transparent and (b) that the Applicants are not unfairly prejudiced by the allocation of $70 million to Direct Claims.

538. In relation to the 50:50 split of the $105 million allocated to the estates, this was not a complaint raised until this application. It was not raised at the time of the ATL settlement

and ATL CVAs; indeed, it was the only point according to Mr Wallace, on which all the Committee Creditors had agreed. That is not, of course, to say that the complaint is a bad one or cannot be raised now. Indeed, I have found it the most difficult of the allocation issues to deal with in isolation.

539. Mr Wallace deals with the 50:50 allocation in paragraph 653 of his first witness statement:

"We considered the following matters:

(a) The Books and Records Claim belonged solely to TXUEG.

(b) The strongest of the Dividend Claims was likely to be the claim in respect of the £99 million dividend paid by TXUEG in 2001. Because TXUEG was a public company with significant external creditors, it was plain that the relevant dividend was illegal and there was an arguable basis for resisting relief under section 727 of the Companies Act.

(c) The other Dividend Claims of TXUEG, TXU (UK) Holdings Limited, TEG and TXUAC were weaker, because they were paid by private companies without significant external creditors and/or because it was difficult to identify a factual basis for resisting relief under section 727 of the Companies Act.

(d) The Trading Claim might be pleaded on behalf of both TXUEL and TXUEG, as the two most important companies in the TXU Europe group (both with significant bodies of external creditors). However, the claim appeared stronger at TXUEL, because the directors of TXUEL had a significantly greater opportunity to preserve the chance of avoiding the substantial losses that would result from the break-up of the business, whether through securing equity, restructuring TXUEL's balance sheet and/or effecting a sale of its subsidiaries or their businesses as a going concern. There was comparatively little that the directors of TXUEG could have done to avoid such loss, given TXUEG's inability to raise equity and its dependence on TXUEL's investment grade rating. In addition, the relative size of the shortfall to creditors at TXUEL enabled that company to formulate a significantly greater claim, running to many hundreds of millions (or even billions) of pounds.

(e) TXUEL had potential Texas Claims against TXU Corp arising out of TXU Corp's withdrawal of financial support for TXUEL in October 2002.

540. As can be seen from the history which I have given, matters were moving at a pace in the period leading up to the deadline for settlement with TXU Corp. As I have said, the Respondents took advice on the split and concluded that 50:50 was fair. That advice came from Mr Crystal and Cadwalader. It was, or was intended to be, neutral advice given to the officeholders across the board. Mr Wallace says, and I accept this, that it was not practical to obtain independent opinions for each company. Mr Spratt did not have separate independent advice but, in reliance on the advice of Mr Crystal and Cadwalader, decided to go along with the settlement by entering into the ATL lock-up on behalf of EH3 and later proposing CVAs for EH3. Although the Applicants and Bingham were of the view, strongly asserted to Mr Wallace, that the proposals were not fair in the way they allocated assets between Direct Claims and estate claims, there was no suggestion that the

50:50 split was, by itself, unfair in any way. Indeed, that allegation was not made until the written opening submissions on behalf of the Applicants were produced.

541. It is not my task, and is in any event an impossible task on this application, to assess the relative merits of the various claims which gave rise to the $105 million allocation. However, what I do conclude is that although Mr Wallace and Mr Tucker themselves were under a time constraint in formulating the proposal, a constraint imposed by TXU Corp in agreeing the TXU Corp settlement, they nonetheless gave detailed consideration to each and every claim. They carried out a careful balancing exercise with the benefit of legal advice from Mr Crystal and Cadwalader. They concluded that a 50:50 split was fair from the point of view of the two competing claimants – TXUEL and the Conduit Companies. I consider that that is a conclusion to which they could reasonably have come. I reject the Applicants' suggestions that there was no material on which to assess the fairness of the 50:50 split. In any event, given the desirability of achieving the TXU Corp settlement, it was incumbent on Mr Wallace to present <u>some</u> division of the $105 million as part of his proposals. In all the circumstances, it is impossible, I consider, to say that his 50:50 proposal should not have been made. In reaching that conclusion I do not overlook the Applicants' submissions in relation to the £99 million dividend claim at TXUEG.

542. The question then is whether the joint liquidators of EH3 should have gone along with the proposal. I do not overlook Mr Tucker's position of conflict as a joint liquidator of EH3 and as a joint administrator of TXUEL. However, that conflict would not, even if there had been a complete overlap between the two sets of officeholders, mean that they were incapable of putting forward a proposal which was fair to both TXUEL and the Conduit Companies, although the court would look at any resulting agreement carefully. But there was not a complete overlap and one cannot ignore the role of Mr Spratt.

543. Presented with the resulting proposal, Mr Spratt decided to enter into the ATL lock-up. In my judgment, Mr Spratt was acting sensibly and reasonably in entering into the lock-up; I think it highly likely that any wholly independent officeholder coming to the matter for the first time at the New York meetings on 11 and 12 January 2005 would also have come to the same conclusion. Such an officeholder would have found it difficult to take any other course: he would have been faced with a potential settlement with TXU Corp which had been hard fought and would be in no position at all to re-open negotiations with the other creditors at that late stage. He would also be faced with a potential lock-up agreement which bound EH3 to the proposals (subject to subsequent approval of its own CVA). Realistically, he, like Mr Spratt, would have had no time to get his own legal advice but would have needed to rely on Mr Crystal and Cadwalader. He would have the comfort of knowing that the proposals would only become binding if the creditors of his own company, EH3, eventually voted in favour of its own CVA. There would be no reason for him not to sign the lock-up when the alternative could have meant losing the TXU Corp settlement.

544. The Applicants, however, say that Mr Spratt was in an impossible position. He was conflicted by virtue of his position as a partner of Mr Wallace and Mr Tucker and was, in any event, subservient to Mr Wallace. As I have already said, conflicts of this sort do not, my view, make it impossible for settlement to be made. Nor is the fact, if it be a fact, that Mr Spratt would always defer to Mr Wallace, one which prevents a deal put forward by Mr Wallace being a fair deal for EH3 and one which Mr Spratt could accept. On the

facts, the proposal of the 50:50 split was one which was in the range which Mr Spratt could properly accept on the material available to him on 25/26 January 2005 when the lock-up was entered into.

545. The Applicants also say that, because Mr Spratt and Mr O'Connell came on the scene actively so late in the day (shortly before the New York meetings on 11 and 12 January 2005), they were totally ineffectual. The Applicants say that if they had acted properly as officeholders of EH3 and EGO BV, they would have been fully up-to-speed long before the New York meetings. They would have fought the corners of EH3 and EGO BV not only in relation to the allocation between estate claims and Direct Claims (a matter I have already dealt with) but also the 50:50 allocation of the $105 million between TXUEL and the Conduit Companies. That assumes, of course, that they would have had any cause to take any view other than that 50:50 was a fair apportionment. They would have had Mr Crystal and Cadwalder's advice as to the fairness of that allocation, advice which went back to December 2004 and might have considered that it was not necessary to commission their own separate legal advice on this aspect. They might have thought that there was no point to take – and after all, the Applicants and Bingham did not raise the point either before the ATL settlement or between then and the ATL CVAs or thereafter until after this application was commenced.

546. Now, I can see that Mr Spratt and Mr O'Connell might be criticised for not taking a more active role earlier and that their connection as partners of Mr Wallace and Mr Tucker made them unsuitable officeholders giving rise to conflicts of interest; and I can see the argument that they should therefore be removed as officeholders. What I do not accept is that, assuming they, or wholly independent officeholders, should have become involved earlier, the 50:50 split is unfair. At the very least, it could only be said to be unfair if some fairer, and justifiable, division could be shown.

547. As to that, I am not persuaded, on the material presently available, by the submissions on behalf of the Applicants that the 50:50 split was unfair. In particular, their reliance on the £99 million dividend claim at TXUEG does not persuade me that the allocation is unfair. It seems to me that the proposals were well within the range which Mr Spratt could properly have concluded formed the basis of a sensible compromise and within the range of proposals which a responsible officeholder could present for approval as a CVA. The Applicants have produced nothing, so far as I am aware, which was not available to the Respondents when they made the decision to put forward the proposals for the ATL settlement.

548. In any event, as with the £67 million claim, the joint liquidators would be faced with a dilemma even if they considered that some better deal for EH3 would be fairer than the actual proposal. As with the £67 million, they might take a position of brinkmanship, saying to themselves that a compromise is at least as valuable to the other ATL companies as to EH3 and refuse to put forward any proposal to their creditors unless the Conduit Companies received a larger share of the $105 million. Or they could take a view about their prospects of success in litigation and, if they regarded the 50:50 split as preferable to litigation and losing the TXU Corp settlement, they could put forward the proposal (with the 50:50 split) leaving it to the creditors to decide whether to accept the proposal according to the statutory procedure. In my judgment, liquidators who took the second course would be acting well within the range of reasonable decisions, for some of the same reasons as I have given in relation to the £67 million: First, the overall

settlement with TXU Corp (which was subject to a fast-approaching deadline) was one which it would have been very unwise to lose. Secondly, the return for EH3, were there to be no ATL CVAs and instead liquidations were to ensue, would be reduced. Thirdly, in relation to the decision facing them, the liquidators would have been entitled to take account of what the majority of their creditors wanted.

549. Accordingly, I do not consider that the Applicants have been unfairly prejudiced by the terms of the ATL CVAs in respect of the allocation of the proceeds of the TXU Corp settlement.

550. My conclusion, therefore, is that the EH3 and EGO BV CVAs are not unfairly prejudicial to the Applicants in respect of the TXU Corp settlement.

551. Since I have decided, in relation to each of the four complaints of unfair prejudice, that the EH3 and EGO BV CVAs are not unfairly prejudicial to the Applicants, it follows that the CVAs as a whole are not unfairly prejudicial. It is therefore strictly unnecessary to look at those CVAs in the round. However, I should say that, even if the various conflicts of interest of which the Applicants complain, and the conduct of the administrations/liquidations and of the officeholders (in particular, alleged deficiencies in the conduct of Mr Spratt and Mr O'Connell) give rise to doubt about the fairness of these four elements taken separately, the terms of the CVAs taken as a whole reinforce the conclusion which I have reached.

552. In considering the terms of the CVAs taken as a whole, there are three other elements which required settling: the Double Dip, the Valuation Date and the Inter-company balances.

The Double Dip

553. This required the resolution of whether EFC's claim against TXUEL in respect of the proceeds of the EFC bonds was subordinated.

554. The Double Dip was a claim that was advanced by the EFC Holders and its eventual resolution required investigation, legal advice and settlement as part of the ATL CVAs.

555. The officeholders obtained advice in writing from Leading Counsel dated 10 July 2003 in relation to the Double Dip claim (which fell to be considered in three parts) that, on the basis of the evidence available to them, (i) the proceeds of the Yankee Bonds and the Junior Subordinated Debentures were on-lent by EFC to TXUEL on a subordinated basis; and (ii) it was likely that the proceeds of the EMTN Notes were on-lent to TXUEL on a subordinated basis.

556. During August 2004 there were discussions about the production of position papers on the Double Dip issue from the various creditors. Cadwalader, on behalf of the EFC Holders, provided the office-holders with detailed questions which they wanted to be raised with the former directors of the TXU Europe group in relation to the Double Dip issue.

557. A position paper was subsequently produced by Cadwalader on behalf of the EFC Holders and circulated on 6 October 2004. It concluded by saying that the EFC Holders expected to receive due credit for the fact that all or part of the inter-company balance between EFC and TXUEL was not subordinated.

558. I have no doubt that there were real arguments in favour of the EFC Bondholders. The issue remained live and needed to be compromised. Mr Roome accepted in cross-examination that the description of the issue in the CVA proposal was fair and neutral and that on no basis was it being recommended for disposal as being "hopeless". However, in the event the ATL settlement allocated no value to the claim at all, which was a benefit to the EGO BV Bondholders.

The valuation date for ATL creditor claims for the purpose of any CVA and the entitlement to interest

559. This required the resolution of the date or dates by reference to which claims should be valued and distributions calculated in any CVA. The choice of date would affect the relative value of different creditors' claims due to foreign exchange movements between the relevant currencies during the relevant period and differential interest rates. The two dates for which various groups of creditors contended were either 19 November 2002, being the date on which many of the TXU Europe group companies had originally gone into administration, or the date of or as close as possible to the date of the proposed meetings to approve the CVAs.

560. There was a fairly complex resolution of this issue which is explained in the CVA proposals the detail of which I do not need to deal with.

561. Mr Roome accepts that was a complicated issue, not only because there appeared to be no right or wrong answer at law as to the basis of allocation, but also because it had a different impact on different creditors depending on the currency of their claims. He has stated his own view that "a half-way house compromise on this issue was reasonable" and now accepts that the compromise proposed by the Respondents was fair. In contrast, the position previously taken by the Applicants proceeded on the basis that a fair settlement should have used a valuation date of 19 November 2002. Although there were allegations that the approach taken in the CVAs to the valuation date involved a transfer of value from the EGO BV Bondholders, the adoption of the 19 November 2002 date would have in fact achieved a greater return for some of the EGO BV Bondholders.

562. Mr Roome also disagreed with Mr Olin's witness statement to the effect that the CVAs stripped the EGO BV Bondholders of the legal rights, a suggestion which Mr Olin withdrew in correcting his witness statement at the commencement of his oral testimony.

The inter-company balances

563. Given the poor state of the accounts and records, the Respondents had been required to conduct detailed investigations as to the inter-company balances in the course of the insolvency proceedings. This included resolving:

   a. Whether TEG had a claim against TXUEG, or whether the liability giving rise to that claim was instead owed by TXUEG to TXUAC. The Respondents concluded that TEG's claim should be recognised. If it had not been, the EGO BV Bondholders' receipts would have been reduced by £13 million.

b. Whether a triangle of liabilities shown in the accounting records as owed (i) by EH3 to TXUAC; (ii) by TXUAC to TXUEG; and (iii) by TXUEG to EH3 had in fact been netted off and no longer existed. The Respondents concluded that such liabilities had not been netted off. Had they been netted off, the EGO BV Bondholders' receipts would have been reduced by £56 million.

c. Whether EH3 had back to back recourse to TXUAC with respect to EH3's liability to Barclays under certain currency swaps. The Respondents concluded that it did. Had the claim not been recognised, the EGO BV Bondholders' receipts would have been reduced by £4.5 million.

d. Whether EH3's indemnity claim against TXUEL would be rejected in a liquidation of TXUEL as a consequence of the rule against double proof. The Respondents concluded that it would not. Had they concluded otherwise, the EGO BV Bondholders' receipts would have been reduced by £14 million.

564. It will be noted that none of these issues was resolved somewhere in the middle. Rather, each one of them was resolved conclusively in favour of one view or the other. In each case, the EGO BV Bondholders benefited from the resolution making available to the EGO BV Bondholders £112 million more than if each issue had been resolved in the other way.

565. There can be no doubt that none of these issues was straightforward. Of course, a proposal by an officeholder for compromise of one doubtful issue in favour of one party does not entitle him to propose a compromise of another issue against that party when that party's claim in relation to the latter issue is clear; nor even to propose a compromise of a second doubtful issue against that party simply because he has proposed the compromise of the first doubtful issue in favour of that party. But what I do consider an officeholder is entitled to do is pray in aid the way he has acted in relation to different doubtful issues in response to suggestions (as were made in the present case by the Applicants) that he has deliberately favoured one party (the RCF Banks) against another party (the Applicants themselves). And in assessing the overall fairness of the CVA proposal, the officeholder – and the court – is entitled to see how the whole raft of doubtful issues has been compromised. The manner in which the Respondents have dealt with the issues overall confirms the conclusion that there has been nothing unfairly prejudicial to the Applicants.

566. It is also necessary to look at the alternatives to the CVAs to see whether there is any unfair prejudice. One alternative is liquidation and, if liquidation can be shown to give more to a creditor than a proposed CVA, it is highly likely that the CVA will be regarded as unfairly prejudicial. But that is not the present case, where the liquidation alternative would have been highly likely at the time of the CVAs in March 2004 to result in a smaller recovery. If the TXU Corp settlement were to fall as the result of uncontested CVAs not being in place by the November 2005 deadline contained in the TXU Corp settlement, then I have no doubt that all creditors, including the Applicants, would be likely to fare less well than under the current CVAs. Thus it is necessary (see Lightman J in *IRC v Wimbledon Football Club Ltd IRC v Wimbledon Football Club Ltd*) to look at all the circumstances including the alternatives available and the practical consequences of a decision to confirm or reject the CVAs.

567. The package of compromises which were put forward by the ATL CVAs was the only package which the Respondents believed was reasonably capable of commanding the approval of the necessary majority of creditors. I am satisfied on the evidence which I have seen that they were entitled to take that view and act on it. No alternative proposal has been put forward which is both capable of achieving a better result for EH3 and EGO BV (or, as the Applicants would put it a fairer result) and at the same time commanding the approval of the necessary majority. Mr Roome seemed to accept this when he said that "if you replayed it, I guess you would get to the same result". There is one qualification to this: Mr Davies submits that, as a minimum, I should decide that the releases of the officeholders contained in the CVAs are unfairly prejudicial and that I should direct new proposals to be presented (which, in the light of my decision would, he says, be bound to omit the releases but would otherwise be the same as the existing proposals). I will deal with that submission later.

568. Accordingly, the only real alternative is that one or both of the EH3 and EGO BV CVAs are set aside, with the result that the whole inter-locking scheme of ATL CVAs will collapse. All the underlying issues will then become the subject of litigation, with uncertainty, delay and expense. As I have said, I consider it almost inevitable that all creditors, including the Applicants, would be worse off under that scenario than under the CVAs. Although the Applicants maintained otherwise in their written evidence, Mr Roome recognised the real risk of a smaller recovery in his oral evidence.

569. Consider then what difference it would have made to the Applicants if each of the four issues about which they complain had been resolved differently. According to the figures produced by KPMG for the purposes of Mr Wallace's first witness statement, the increased recoveries (over and above the amounts of £22.18 million for SISU and £21.17 million for Unum which they stand to receive under the CVAs) for the Applicants are as follows:

   a. GFA Claim on the basis of admitting the claim at 20% of value (the percentage adopted by the Applicants, as they now say, for illustrative purposes): £620,000 (or 2.08p/£) for SISU and £570,000 (or 1.88p/£) for Unum.

   b. PPA payments on basis of 100% rather than 50% going to the Conduit Companies: £160,000 (or 0.53p/£) for SISU and £150,000 (or 0.48p/£) for Unum.

   c. £67 million issue with 100% going to the Conduit Companies: £540,000 (or 1.81p/£) for SISU and £500,000 (or 1.64p/£) for Unum.

   d. TXU Corp settlement with TXUEL and the Conduit Companies sharing $140 million, instead of $105 million, as the Applicants propose: £490,000 (or 1.66p/£) for SISU and £460,000 (or 1.53p/£) for Unum.

570. These figures take each issue separately. If all issues go the way just suggested the total increase in value is not simply the sum of the four amounts because the claims have inter-actions with each other. The totals work out at £1.8 million for SISU (or 6.08 p/£) and £1.67 million (or 5.53 p/£) for Unum. If the GFA is left out of account, the totals are £1.15 million and £1.07 million respectively.

571. Mr Roome's third witness statement produced different figures based on a slightly different methodology which produced higher improvement figures for SISU and Unum. But I do not consider that the analysis undermines what I have said about the positions of the various creditors which I have addressed in [387 –396] above.

572. There has been a lot of paper generated in submissions dealing with what the Applicants variously call the loss or prejudice to them. Those words seem to me to beg the very question in issue. Of course, one set of allocations will give a better result for a particular creditor than another set. But I do not see why it is correct to describe the difference as a loss or as a prejudice. One might just as well say that the EEC Holders or RCF Banks were prejudiced by the way in which the Double Dip or Valuation Date issues were decided. Still less can a difference in the results be described as unfairly prejudicial unless it is judged against some other result which is manifestly and objectively fairer. What I have to examine is whether the Applicants are unfairly prejudiced and I do not gain much assistance from the mere fact that different allocations produce different results.

573. Now, the figures set out by Mr Wallace are the sort of differences which could have been expected at the time of the ATL lock-up, since KPMG's figures would have been relied on, at that time. I have already acknowledged that a majority creditor of a company cannot, without causing unfair prejudice, insist on receiving *qua* creditor of that company more than his *pro rata* share of assets as a condition of approving a CVA: the officeholder should not, in the first place, present such a proposal. But equally, if a person, whether or not a person who is himself a creditor of the company, has some bargaining position (as did the Football Association in the *Wimbledon FC Ltd* case) he is not prevented from using it. In that respect, TXUEL had a strong bargaining position in relation to recovery of the entire £67 million as a condition of its approval of the ATL CVAs and in relation to the PPA Payments, the use of which bargaining positions would not create unfair prejudice in the EH3 or EGO BV CVAs. The final position was that CVAs were achieved for EH3 and EGO BV which reflected the negotiating strengths of the interested creditor groups and which were better than liquidation. This all confirms, to my mind, that the Applicants are not unfairly prejudiced by the terms of the CVAs.

Releases

574. I have not so far considered one other aspect of the EH3 and EGO BV CVAs which the Applicants say renders them unfair; that is to say, the inclusion of releases to the officeholders in relation to the manner in which they have carried out their functions. The Applicants say that the serious conflicts of interest, both potential and actual, between the roles of the officeholders of different companies, in particular TXUEL on the one hand and variously TXUEG and TXU UK and the Conduit Companies on the other hand, made it inappropriate for Mr Wallace and Mr Tucker to be officeholders in EH3 and EGO BV; and inappropriate for Mr Spratt and Mr O'Connell to have accepted their offices. Alternatively, they should have resigned from office at EH3 and EGO BV by November 2004 by which time at latest the actual conflicts had become impossible of management. They also pray in aid in relation to that submission the allegation that the officeholders have also been in breach of the ICAEW Guidance.

575. The Applicants then say that, because of those conflicts of interest and in breach of professional guidance, the officeholders acted in a way which was detrimental to the

interests of EH3 and EGO BV. They may wish claims to be asserted against the officeholders: that, in practice, would require their replacement at EH3 and EGO BV by independent officeholders who could then bring the appropriate claims which would, of course, be claims for the benefit of the companies rather than the Applicants alone. They say that the releases would prevent such claims being brought. Accordingly, they submit that the EH3 and EGO BV CVAs are unfairly prejudicial by preventing the bringing of claims against the officeholders for breach of their duties in carrying out their functions.

576. During the course of the hearing, I could see that the position could, in theory, turn out to be this: (i) the officeholders had acted in breach of their duty *eg* Mr Tucker and Mr Spratt had failed to look after the interests of EH3 at the BTL settlement stage causing it loss and had failed to challenge the BTL CVAs which formalised the agreement which gave rise to that loss (ii) starting with a position where the BTL CVAs were in place, it was too late for the joint liquidators to negotiate a fair deal: the EH3 CVA was itself fair (apart from the releases); so that (iii) the Applicants had been treated unfairly at the BTL level and can only recover for the ensuing loss by persuading an independent officeholder of EH3 to bring proceedings against Mr Tucker and Mr Spratt. In a similar way, they may wish to seek to persuade an independent officeholder of EGO BV to bring a claim against Mr Wallace and Mr O'Connell.

577. However, in the light of my analysis of the four areas of substantive complaint which the Applicants make, there is, in my judgment, no reasonable prospect of a successful claim being brought against the officeholders in respect of their actions in agreeing the BTL lock-ups and the BTL CVAs, nor in agreeing the ATL lock-ups and the EH3 and EGO BV CVAs.

578. But even if I am wrong in that, it seems to me that such claims would be fraught with difficulty. It would not, in my view, be right to take any substantial risk of losing the inter-locking raft of ATL CVAs in order to allow officeholders of EH3 and EGO BV to bring speculative claims against the officeholders. But, in order to reach a position where new officeholders could bring such a claim – and assuming for the moment that the release would prevent such a claim – I would need to make an order under section 6 to enable revised proposals to be put to creditors of EH3 and EGO BV. There would be a knock on effect for the TXU Corp settlement and ATL CVAs of all the other companies, since that settlement and the ATL CVAs of all the other companies are conditional on approval of CVAs for the Core Companies. Mr Davies says that there is no reason why creditors should not be willing to vote in favour of a new proposal identical to the present ones but omitting the releases. But that is, I think, mere speculation. The CVAs did not meet universal approval in the first place and I can well imagine that creditors would want to renegotiate financial aspects if new proposals are put for approval. In other words, there is a risk of losing the overall financial deal if I take the course which Mr Davies urges; it is a risk which I do not consider it appropriate to take in the light of my view of the merits of any underlying claim and the amount which the Applicants could hope to recover.

579. In any event, it is unrealistic to think that the necessary process could be completed by the deadline imposed by the TXU Corp settlement for it to become unconditional. At the very least, there would be a very real risk that it could not be completed in time.

580. Taking these elements together, I would decline to make any order under section 6 IA 1986 even if, contrary to my view, the releases constitute unfair prejudice to the Applicants.

Material Irregularity

581. There are four areas of complaint by the Applicants.

582. First, the failure by the liquidators of EH3 to obtain sanction to the lock-ups and to the CVAs. I have already dealt with this separately in relation to both the BTL lock-ups and CVAs and the ATL lock-ups and CVAs.

583. Secondly, the approval of the EH3 and EGO BV CVAs by the use of the votes of what the Applicants term "conflicted bondholders". In my judgment, for reasons already given, conflict does not result in the disenfranchisement of conflicted creditors (and if it did, the Applicants themselves were in the same position of conflict in voting on the EH3 CVA). The protection afforded to a dissatisfied creditor is to apply, as the Applicants have done, under section 6.

584. Thirdly, the failure to provide adequate information to creditors to enable them to consider properly and in an informed way the ATL CVA proposals in particular by failing to explain adequately the Applicants' opposition and their reasons for it. On the totality of the evidence before me (some of which I have rehearsed above), including that of representatives of some of the creditors, I am perfectly satisfied that creditors were kept properly informed and had more than simply adequate information on which to base their decisions. Further, that information included Bingham's letter dated 8 March 2005 in which the Applicants' opposition was fully articulated. The ATL CVA proposal itself contained full details of the attitude which the Applicants were taking to the various issues about which they now complain.

585. Fourthly, the ability of the officeholders to canvass the views of bondholders and then to seek to persuade them to approve the CVAs, whilst at the same time denying the Applicants access to those same creditors. There is no evidence at all that the officeholders blocked contact by the Applicants with other bondholders. There were some bondholders the identity of whom the officeholders obtained through Bondcom Communications Group which specialises in identifying and communicating with account holders, brokerage firms and beneficial owners of bonds. With Bondcom's help, the officeholders were able to identify over 90% by value of the bonds issued by companies in the TXU Europe group. However, such information was provided on a confidential basis.

586. It was apparent from documentation supplied to all bondholders that Bingham were representing EGO BV Bondholders who opposed the CVA proposals. Any bondholder who wished to do so was able to contact Bingham for further information. The Applicants themselves did approach at least two EGO BV Bondholders, Stonehill and Northwestern Mutual and were well aware of how to contact other EGO BV Bondholders, AEGON, Citigroup, Varde, Appaloosa and Davidson Kempner. The Applicants were unable to persuade Stonehill to vote against the proposals, although they did abstain. The votes of others who did not vote would have been insufficient to change the outcome even if they had voted against. In these circumstances, I do not consider that

the assertion that the Respondents denied the Applicants the opportunity to discuss and explain their objections with other creditors is made out.

587. I doubt that, as a matter of law, it matters in any event. Provided that full information is given to creditors, I do not consider that there is any obligation on an officeholder to provide details to one creditor about another creditor in order to allow them to communicate.

588. I have been unable to detect any material irregularity in the manner in which the meetings to approve the EH3 and EGO BV CVA proposals were convened or conducted. No modifications were proposed by any person and the meetings were conducted fairly.

589. Accordingly, the Applicants' case on material irregularity fails.

Removal of officeholders

590. In the light of my conclusions on unfair prejudice in relation to the four matters of complaint, no question of removing the officeholders in order for independent office holders to put forward new proposals arises.

591. Further, in the light of my conclusions on unfair prejudice in relation to the releases of the officeholders contained in the ATL CVAs there is no point in removing them from office at EH3 and EGO BV. The majority of creditors do not want them removed – indeed, on the evidence before me, it is only the Applicants who do want them removed. As a result of my decision, the releases contained in the CVAs will be binding. To the extent that the releases prevent claims being brought against the officeholders by any person, they remain effective. To the extent that any claims are not released (and are not subject to any indemnity such as that found in Clause 17.4 of the CVAs), the Applicants can bring an action pursuant to section 212 (liquidators) or paragraph 75 (administrators) Schedule B1 IA 1986. Accordingly, I would consider that the KPMG officeholders should be left in office and the Applicants should be left to assert whatever rights they have pursuant to the statute.

Miscellaneous

592. As I have said, Mr Davies' opening submissions contained a long, learned and interesting exegesis on the law concerning conflicts of duty and interest. The closing written submissions of Mr Crystal and his team, too, are learned and interesting. That I do not deal at length with them means no disrespect for their respective efforts. Rather, I am severely time-limited in what I can address and, for the reasons which I hope are apparent from this judgment, I do not consider the conflicts issue to be central to the case.

Conclusion

593. The EH3 and EGO BV CVAs are not unfairly prejudicial to the Applicants either because of the four complaints which they make or because of the releases contained in them. However, even if I am wrong in that, this is not a case where it would be appropriate to grant any relief under section 6 for the reasons which I have given. Accordingly, these applications are dismissed.

GLOSSARY OF TERMS

A&O	Allen & Overy LLP
AEGON	Aegon USA Investment Management
Appaloosa	Appaloosa Management L.P.
ATL	above-the-line
Bank Steering Committee	The informal steering committee of lending banks formed in October 2002
Barclays	Barclays Bank plc
Bingham	Bingham McCutchen LLP
Bondholder Committee	The ad hoc committee of bondholders formed in October 2002, including the Applicants
BTL	below-the-line
Citigroup	Citigroup Investments Inc
Committee Creditors	Members and observers of creditors' and liquidation committees of TXUEL, TXUEG, TXUAC, TEG, EGO BV and EH3
Conduit Companies	EH3, TEG and TXUAC
CVAs	Company Voluntary Arrangements under Part I of the Insolvency Act 1986
E&Y	Ernst & Young LLP
EET	TXU Europe Energy Trading Limited (in administration)
EFC	TXU Eastern Funding Company (in administration)
EGFL	Eastern Group Finance Limited (in liquidation)
EGO BV	Energy Group Overseas BV (in administration)
EH3	Energy Holdings (No.3) Limited (in liquidation)
EH5	Energy Holdings (No.5) Limited (in administration)
Financial Creditors	Banks, bondholders and loan noteholders with debt claims against the Holding Companies or TXUEG

Finco No 2	TXU Finance (No. 2) Limited (in administration)
Holding Companies	TXUEL and its subsidiaries, excluding TXUEG and its subsidiaries
IA 1986	Insolvency Act 1986
JP Morgan	JPMorgan Chase Bank
Lending Bank Syndicates	Four lending syndicates with claims at different companies in the TXU Europe group
M&G	M&G Investment Management Limited
Operating Companies	TXUEG and its subsidiaries
PPA Creditors	Creditors under the PPAs
PPAs	Power purchase agreements. Long term power supply contracts.
SISU	Collectively, SISU Capital Fund Limited, SISU Capital Fund II Limited, SISU Capital Fund Limited Partnership and ARVO Master Fund Limited, acting by their investment manager SISU Capital Limited.
TEG	The Energy Group Limited
THM	Talbot Hughes McKillop LLP
TXU Europe group	TXU Europe Limited and its subsidiaries
TXU UK	TXU UK Limited
TXUAC or TXUAL	TXU Acquisitions Limited
TXUEG	TXU Europe Group plc
TXUEL	TXU Europe Limited
Unum	Collectively, Provident Life and Accident Insurance Company, The Paul Revere Life Insurance Company and Unum Life Insurance Company of America, acting by their investment manager Provident Investment Management, LLC