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DEBT SUBORDINATION

This article examines a method of debt financing which is relatively new in Singapore although it has been used in the United States since the 1930s and in England from the 1960s. Part of the reason for this may be attributed to the uncertainty over whether arrangements for subordinated debt will survive the insolvency of the debtor. This article will, therefore, focus primarily on the enforceability of debt subordination agreements in the context of, certain rules in the law of insolvency.

I. INTRODUCTION[1]

DEBT subordination is a transaction whereby one unsecured creditor (the junior creditor) of a debtor agrees not to be paid until another unsecured creditor (the senior creditor) of the debtor is paid in full. In other words, as between the senior and junior creditors, there is an agreement between them which governs the priority in which the debts payable to them by their common debtor are to be paid.

There are a number of reasons why a debtor may find it advantageous to issue subordinated debt, and why a creditor may agree to be subordinated to other creditors. In certain jurisdictions (such as England),[2] subordinated debt is in many contexts treated for accountancy purposes as if it were part of the company's capital. Therefore, in such jurisdictions, where a debtor wishes to increase its capital base, perhaps for regulatory purposes (*eg,* in the case of banks, because of central bank supervision of their capital adequacy), it may choose to issue subordinated debt.

The debtor may also wish to raise money without infringing borrowing restrictions imposed by its loan agreements or constitutional documents.[3] For instance, its loan agreements may provide that its debt should not exceed a multiple of its equity and reserves. Borrowing through subordinated debt may take place without contravening this restriction if equity is defined

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[1] For useful readings on the subject, see Johnston, "Debt Subordination: The Australian Perspective" (1987) Australian BLR 80, and Wood, *The Law of Subordinated Debt* (1990). Since writing this article, my attention was drawn to an article by Powell, "Rethinking Subordinated Debt" [1993] LMCLQ 357.

[2] See *Re Maxwell Communications Corporation Plc,* Suit No 0014001 of 1991, 26 March 1993.

[3] Wood, *supra,* note 1, at 2-3.

as including subordinated debt. Such a definition is not unlikely. As subordinated debt will only fall to be paid after debts owed to senior creditors are met, the debtor's existing creditors may be prepared to allow the debtor to incur further debt on a subordinated basis.

Where a company is in financial difficulties, "insiders" such as directors and substantial shareholders may agree to their debts being subordinated to creditors who agree to advance new money to the company. As the company may not be able to grant security, or security of the requisite value, the provider of new money may only be prepared to advance money if some of the company's existing creditors, particularly the insiders who may have advanced large sums to the company, agree to subordinate their debts to the new advances. In this way the provider of new money will be able to obtain a measure of priority in the event that the company is unable to trade out of its difficulties. From the viewpoint of the existing creditors of the company, subordination may be desirable because they stand to lose a great deal if the company goes into insolvency. A new credit facility, or an extension of an existing credit facility, may allow the company to prevent such a result.

Even where a company is not in financial difficulties, the major shareholders of the company may agree to subordinate their debts to a bank in consideration of the bank granting a loan facility to the company. Thus a parent company may agree that the loan facility to its subsidiary shall be repaid first before the subsidiary can make any repayments of money owing to its parent company. Such an agreement may arise because the subsidiary does not wish to encumber its assets, and the bank feels that there is little prospect of the subsidiary going into insolvency during the period of the loan facility. This type of subordination agreement has been entered into by Singapore companies.

Where a company is in a healthy financial state, lenders may be prepared to advance money on a subordinated basis because the rate of interest may be higher than the prevailing market rate. In England, convertible subordinated bonds have also been issued.[4] Presumably, the ability to convert the bonds to equity may make the bonds more attractive to investors.

There are two basic types of subordination. The first is inchoate subordination where the debtor can make payments to the junior creditor until the occurrence of an event, usually the commencement of winding-up proceedings against the debtor. The second type of subordination is complete subordination where no payments may be made to the junior creditor until the senior debt has been paid. This form is commonly used to subordinate the debts owing to insiders such as directors and shareholders.

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[4] See *In re British & Commonwealth Holdings Plc, (No 3)* [1992] 1 WLR 672.

II. The Problem of Insolvency

So long as the debtor is solvent and can pay its debts, all will be well. The difficulties with subordinated debt arise upon insolvency. The question which arises upon the insolvency of a company is whether the subordination agreement can be enforced in the light of the insolvency provisions in the Companies Act[5] and the Bankruptcy Act.[6] There are two major areas of difficulty, namely, set-off and the pan passu principle of insolvency law. Both will be considered in turn.

III. Insolvency Set-Off

Set-off has been defined as "the discharge of reciprocal obligations to the extent of the smaller obligation."[7] The exercise of a right of set-off amounts to a mode of effecting payment.

The right of set-off is capable of affecting a subordination agreement because it enables the junior creditor to obtain payment by setting-off what he owes the company against what the company owes him (the subordinated debt). The effect of this is that the subordinated creditor obtains payment of the subordinated debt to the extent of the junior creditor's own obligations to the company. Without the right of set-off, the junior creditor would not only be subordinated to the senior creditor, he would also have to make payment of his debt to the company thereby increasing the pool of assets available for distribution to the creditors of the company. The right of set-off allows him to avoid this consequence.

It is possible to exclude set-off contractually while a company is still solvent. Upon insolvency, however, the insolvency set-off provisions in the Bankruptcy Act are mandatory and cannot be contracted out of. Insolvency set-off in Singapore is governed by section 327(2) of the Companies Act read with section 41 of the Bankruptcy Act. Section 41(1) provides as follows:

> Where there have been mutual credits, mutual debts, or other mutual dealings between a debtor against whom a receiving order is made under this Act and any other person proving or claiming to prove a debt under the order, an account shall be taken of what is due from the one party to the other in respect of such mutual dealings, and the sum due from the one party shall be set-off against any sum due from the other party, and the balance of the account and no more shall be claimed or paid on either side respectively.

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5 Cap 50, 1990 Rev Ed.

6 Cap 20, 1985 Rev Ed.

7 Wood, *English and International Set-Off* (1989), at 5.

In *National Westminster Bank* v *Halesowen Presswork Ltd*[8] the House of Lords held, in relation to the English equivalent of section 41, that the section was mandatory because it did not merely introduce a private right. Instead, it was designed to lay down statutory directives to ensure that bankrupts' estates and insolvent companies were administered in an orderly way. This was a matter in which the commercial community generally had an interest. Accordingly, the principle that a person may at his pleasure renounce the benefit of a stipulation or other right introduced entirely in his own favour did not apply. As such, the right of set-off upon insolvency could not be renounced by either party.

There are two possible ways of getting around this difficulty. The first is for the junior creditor to declare that the junior debt is to be held on trust for the senior creditor.[9] Where the junior debt is to be held on trust for the senior creditor, set-off between the debtor company and the junior creditor would not be possible for want of mutuality. The second is for the junior creditor to assign the benefit of the junior debt to the senior creditor. Such an assignment will be subject to equities, including rights of set-off, available by the debtor company against the junior creditor before notice of the assignment is given to the debtor company.[10] To avoid this problem, the senior creditor should ensure that the junior creditor and the debtor company enter into an agreement providing that any assignment of the junior debt shall be free of equities.[11] Such an agreement will allow the senior creditor to prevent a set-off being enforced against him. One danger with subordination by way of assignment, however, is that the assignment may be construed as one by way of security which may require registration under section 131 of the Companies Act.[12]

IV. The Pari Passu Principle

Winding up proceedings give rise to a collective regime for the enforcement of claims against the insolvent company. The effect of the pan passu principle in insolvency is to ensure that all creditors participate in the common pool in proportion to the size of their admitted claims. It also ensures that agreements which have as their object or result the preference of a particular creditor over other creditors are struck down.

Section 300 of the Companies Act which applies to voluntary windings up provides as follows:

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8 [1972] AC 785.

9 *In re British & Commonwealth Holdings Plc, (No 3), supra,* note 4.

10 See Derham, *Set-Off* (1987), at 309-318.

11 *In re Agra and Masterman's Bank* (1867) LR 2 Ch App 391; *Higgs* v *The Northern Assam Tea Company, Ltd* (1869) LR 4 Ex 387; *In re Gay & Co Ltd* [1900] 2 Ch 149.

12 See Johnston, *supra,* note 1, at 115-116.

> Subject to the provisions of this Act as to preferential payments, the property of a company shall, on its winding up, be applied pari passu in satisfaction of its liabilities, and, subject to that application, shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company.[13]

Certain exceptions, however, must be kept in mind. First, secured creditors are not affected by the pari passu principle. Secured creditors, by virtue of their proprietary interests in the assets of the insolvent company, are entitled to look to those assets in priority to the claims of unsecured creditors.[14] In addition, secured creditors may also agree as between themselves what their respective priorities are. For instance, a fixed chargee may agree with a floating chargee that the floating charge shall have priority over the fixed charge.[15] Second, as section 300 itself provides, preferred creditors are also not affected.[16]

Like the insolvency set-off provisions, the pari passu rule cannot be excluded by contract. It is not open to a company and some of its unsecured creditors to agree that in the event of the company's insolvency, those creditors will obtain certain rights to the company's property which were not available prior to the onset of insolvency. In *Ex parte Mackay*[17] *A* sold a patent to *B* in consideration of *B* paying royalties to A. At the same time *B* lent *A* a sum of money. It was agreed between them that *B* should retain one-half of the royalties, as they became payable, towards satisfaction of the debt. It was also agreed that if *A* became bankrupt, *B* might retain the whole of the royalties in satisfaction of the debt. Upon *A's* bankruptcy, the Court of Appeal held that while *B* had a good charge on one-half of the royalties, the charge could not extend to the other half. As James LJ put it:[18]

> But, on the other hand, it is equally clear to me that the charge cannot extend to the other moiety. If it were to be permitted that one creditor should obtain a preference in this way by some particular security, I confess I do not see why it might not be done in every case – why, in fact, every article sold to a bankrupt should not be sold under the stipulation that the price should be doubled in the event of his becoming

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[13] Also see s 327(2) of the Companies Act read with s 43(6) of the Bankruptcy Act which provides: "Subject to this Act, all debts proved in the bankruptcy shall be paid pari passu."
[14] See *Bristol Airport Plc* v *Powdrill* [1990] Ch 744, at 760.
[15] See *In re Portbase Clothing Ltd* [1993] 3 WLR 14.
[16] See s 328 of the Companies Act.
[17] (1873) 8 Ch App 643.
[18] *Ibid,* at 647.

> bankrupt. It is contended that a creditor has a right to sell on these terms; but in my opinion a man is not allowed, by stipulation with a creditor, to provide for a different distribution of his effects in the event of bankruptcy from that which the law provides. It appears to me that this is a clear attempt to evade the operation of the bankruptcy laws."[19]

The leading case is now *British Eagle International Air Lines Ltd* v *Compagnie Nationale Air France*.[20] In that case the plaintiff and defendant companies, together with 74 other airline operators, were members of the International Air Transport Association (the "IATA"). The IATA set up a clearing house system by which sums due from member airlines to each other were settled through the clearing house with remittances being sent by IATA to airlines having a net credit balance and collected from airlines with a net debit balance. All the member airlines had agreed that they would not claim payment from one another and could only claim any sums due to them from the IATA. British Eagle went into liquidation owing money to a number of airlines but with a claim against Air France which the liquidator sought to recover. Air France pleaded that the liquidator could only look to the IATA for payment and then only such sum, if any, as was due to it after taking into account what British Eagle owed the other airlines. The liquidator contended that such an arrangement contravened the pari passu rule as it removed from British Eagle's estate for the benefit of other member airlines a sum due from Air France which would otherwise have been an asset available to the general body of creditors. By a bare majority, the House of Lords accepted the liquidator's contention.

Lord Cross of Chelsea, with whom Lords Diplock and Edmund-Davies agreed, held that the effect of the clearing house arrangements was to enable the contracting parties to contract out of the pari passu principle of insolvency law. Such a contracting out was against public policy. The court could go behind the agreement if it was satisfied that it had been created deliberately in order to provide for a different distribution of the insolvent's property on his bankruptcy from that prescribed by the law. He went on to state:[21]

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[19] Also see the judgment of Mellish LJ where he said that "a person cannot make it a part of his contract that, in the event of bankruptcy, he is then to get some additional advantage which prevents the property being distributed under the bankruptcy laws", *ibid,* at 648.

[20] [1975] 1 WLR 753.

[21] *Ibid,* at 780-781.

> In such a context it is to my mind irrelevant that the parties to the 'clearing house' arrangements had good business reasons for entering into them and did not direct their minds to the question how the arrangements might be affected by the insolvency of one or more of the parties. Such a 'contracting out' must, to my mind, be contrary to public policy. The question is, in essence, whether what was called in argument the 'mini-liquidation' flowing from the clearing house arrangements is to yield to or to prevail over the general liquidation. I cannot doubt that on principle the rules of the general liquidation should prevail.

British Eagle clearly goes much further than *Ex parte Mackay* because the clearing house arrangements were operational well before the insolvency of British Eagle and were not conditional upon the insolvency of any party to the arrangements. This formed part of the basis for the dissenting judgments of Lords Morris and Simon. In their view this was a bona fide commercial transaction and not a deliberate device to give a preference on liquidation. There was no provision which was designed to come into effect or to bring about a change in the event of liquidation.[22]

British Eagle has been followed by the High Court in Singapore in the case of *Joo Yee Construction Pte Ltd* v *Diethelm Industries Pte Ltd.*[23] In *Joo Yee* the plaintiff was the main contractor under a building contract entered into with the government of Singapore. The four defendants were the nominated sub-contractors selected by the government. Payments for work done were to be made to the main contractor who would in turn make payments to the sub-contractors in respect of the work done by them. Clause 20(e) of the building contract provided that the government was entitled to make a direct payment to the nominated sub-contractors of moneys due to them from the plaintiff if the plaintiff did not show reasonable proof that the nominated sub-contractors had been paid for work previously rendered by them (the first limb of clause 20(e)). The second limb of clause 20(e) provided the government with the right to make direct payment to the sub-contractors if a petition for winding up of the plaintiff was presented.

A winding-up order was made against the plaintiff in February 1989. The issue before LP Thean J (as he then was) was whether any direct payment made by the government to the nominated sub-contractors contravened the pan passu rule in insolvency law. His honour explained the pari passu principle in the following manner:

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[22] *Ibid,* at 769-771.
[23] [1990] 2 MLJ 66.

> Upon liquidation of an insolvent company (whether voluntary or compulsory)...its property must be applied in settlement of its liabilities pari pasu, and any contract made by the company which provides for a distribution of any of its property for the benefit of one or more of its unsecured creditors which runs counter to or seeks to vary this rule, *ie,* any 'contracting out', is contrary to public policy, and the law as regards distribution of the insolvent's property under the insolvency legislation must prevail.

He then went on to say that upon the insolvency of the plaintiff, if the government elected to make payment directly to the nominated sub-contractors pursuant to the first limb of clause 20(e), this would have the effect of distributing to the defendants sums of money which would otherwise be paid to the plaintiff and form part of the general assets of the plaintiff available for distribution among all its ceditors pari passu. This would be contrary to *British Eagle* and the liquidator was entitled to disregard this limb of clause 20(e).[24] As far as the second limb of clause 20(e) was concerned, the position was even clearer. The operation of this limb would clearly be a contravention of the pari passu rule on the authority of *Ex pane Mackay*.[25]

None of the above cases were directly concerned with subordination agreements. It has been stated, however, that:

> English courts...will almost certainly consider that priority agreements are governed by the same principles as agreements excluding set-off and that they are bound by the House of Lords decisions to rule that such agreements must be disregarded by a trustee or liquidator in distributing the assets.[26]

It is doubtful if this statement of the law is right. It is submitted that the decision of the majority in *British Eagle* does not support such a wide view of the pari passu principle. If the contractual arrangements in *British Eagle* and in *Joo Yee* were given effect to, an asset which would otherwise have been available for general distribution to the creditors of both insolvent companies would become available to certain creditors only. In other words, the arrangements would have the effect of prejudicing other creditors who were not parties to the arrangements.

Authority that this is the proper scope of the pari passu principle can be found in the judgment of Thean J in *Joo Yee* as well as in the Singapore

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[24] *Ibid,* at 72.
[25] *Ibid,* at 74.
[26] Goode, *Legal Problems of Credit and Security* (2nd ed, 1988), at 96-97.

High Court decision of *Low Gim Har* v *Low Gim Siah.*[27] In that case SK Chan J had to decide if a shareholders' agreement providing for the distribution of the surplus assets of the company was enforceable against the liquidator as a contract. Counsel, relying on *British Eagle* v *Air France,* argued that the agreement contravened section 300 of the Companies Act. Chan J, rejecting the argument, said:

> *British Eagle* was concerned with the case of an insolvent company where the private scheme had the effect of benefitting some members thereof to the disadvantage of other unsecured creditors. Section 300 is intended to protect the interests of creditors and shareholders. There is no reason why the persons so protected may not waive their rights if they so wish.... I can see no public policy consideration here against a protected person waiving protection.

Although in the end his Honour held that the agreement was unenforceable on another ground, his point is clear. The pari passu rule does not prevent a person from waiving his right to a rateable distribution of the company's assets if he chooses to do so. In his Honour's view, *British Eagle* does not stand for this proposition.[28] The agreement in *British Eagle* was against public policy only because the private arrangements had the effect of benefitting certain creditors at the expense of other creditors.

A well drafted subordination agreement can avoid contravening the pari passu principle by limiting its application to the parties to the agreement. Support for the enforceability of such agreements can be found in several cases which have specifically dealt with the issue. One such case is *Home* v *Chester & Fein Property Developments Pte Ltd.*[29] *C* and *S* had entered into a contract to purchase a restaurant property. *F* entered into an agreement with C and *S* to create a unit trust for the purpose of operating a restaurant at the restaurant property. A company was incorporated to act as a trustee for the unit trust and F, *C* and *S* each held 25 units in the unit trust. Clause 4 of the unit holders agreement provided that all moneys advanced to the company shall rank equally in order of priority as to repayment provided that if any unit holder made an additional loan, such amounts should be repaid before any other repayment of loans to other unit holders. *C* and 5 made additional loans to the company. Southwell J accepted the principle in *British Eagle* but held that there was nothing in that case to prevent enforcement of the unit holders agreement In his view, to give effect to the agreement of the parties was not against public policy as it would not

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[27] [1992] 2 SLR 593, at 611-612.

[28] Contrast the approach in *Re Orion Sound* [1979] 2 NZLR 574.

[29] (1986) 11 ACLR 485.

cause any detriment to a creditor not a party to that agreement. All it would mean is that as between the three unit holders, the liquidator would pay the total amount payable to them in accordance with the agreement, and not pari passu. The entitlement of other creditors who were not parties to the agreement would not be affected.[30] On the facts, this led to *F* not receiving anything.

What emerges from the cases of *Low Gim Har* v *Low Gim Siah* and *Home* v *Chester & Fein* is that the pari passu rule is not concerned with the *destination* of the proceeds of the winding up. In other words, there is nothing against public policy to prevent certain creditors from agreeing, *as between themselves,* that what they are entitled to will be distributed amongst them in a manner other than pari passu. Provided other creditors who are not parties to such an agreement are unaffected by it the law will give effect to the agreement.

Such an approach is also commercially sensible. When a company is performing poorly, it may not be able to obtain new sources of financing or further supplies of goods unless the financier or supplier obtains priority over other unsecured creditors. While this can be done by taking security, a company in such a financial state will probably be unable to grant security. In such circumstances it may be advantageous to existing unsecured creditors, or some of them, to agree to be subordinated to the financier or supplier as this may enable the company to trade out of its difficulties. If other creditors not a party to the arrangement are not affected it is difficult to see why such an eminently sensible commercial arrangement should be against public policy.

Another case dealing with debt subordination which is instructive is the case of *Re Maxwell Communications Corporation Plc*.[31] Briefly, the facts are as follows.

Maxwell Finance Jersey ("MFJ") issued 5 and ½% convertible bonds 1989-94 in the nominal amount of SFrl25m. These bonds were unconditionally and irrevocably guaranteed on a subordinated basis under Swiss law by Maxwell Communication Corporation ("MCC"). The guarantee provided that in the case of any distribution of assets by MCC, creditors of unsubordinated indebtedness of MCC should be entitled to be paid in full before any payment shall be made to the bondholders. Both MCC and MFJ became insolvent and the adminstrators of MCC sought directions as to whether MCC was entitled to exclude from a scheme of arrangement the holders of the subordinated bonds which were guaranteed by MCC. The question therefore was whether liabilities to the bondholders under the

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[30] *Ibid,* at 491.

[31] *Supra,* at note 2.

guarantee were effectively subordinated to MCC's liabilities to other unsecured creditors. This in turn would depend on whether such a contractual provision for the subordination of a debt is effective under English law. If the bondholders' liabilities were effectively subordinated, the bondholders would receive nothing and would therefore not be entitled to attend and vote at the meeting where the scheme of arrangement was to be placed before the creditors.

Vinelott J took the view that a subordination agreement does not contravene English law. He said that after the commencement of a bankruptcy or winding up, a creditor must be entitled to waive his debt just as he is entitled to decline to submit a proof. Since a creditor can waive his right to payment, so too he can agree with the debtor that his debt will be subordinated in the event of a bankruptcy or winding up, save to the extent of any assets remaining after the debts of other unsecured creditors have been paid in full. Such agreements should be given effect to for other creditors might have given credit on the assumption that the agreement would be binding.

In Vinelott J's view, *British Eagle* does not invalidate such a contractual arrangement. In *British Eagle the* majority of the judges in the House of Lords took the view that the clearance arrangements had had the effect of putting a party to the arrangements in a position which would have been better than the position of other unsecured creditors. Such arrangements would have infringed a fundamental principle of insolvency law, namely, that a creditor cannot validly contract with his debtor that he will enjoy some advantage in a bankruptcy or winding up which is denied to other creditors.

A subordination agreement would not have such an effect. All that a subordination agreement does is that the liquidator may distribute the assets of the company in accordance with the agreement between the parties. Other creditors not a party to the agreement are unaffected by such a distribution. If payment of the subordinated debt is subject to the assets of the company exceeding its liabilities, to the extent that the assets are less than its liabilities, the subordinated debt dies a natural death. The case of *Home* v *Chester & Fein* was cited with approval.

A third case which deals with debt subordination and which is instructive is *In re British & Commonwealth Holdings Plc (No 3).*[32] In 1987 the company and the trustee of various securities issued or guaranteed by the company entered into a trust deed governing the issue of some £320 million of convertible subordinated unsecured loan stock ("CULS"). Clause 5A of the trust deed provided that the claims of the holders of that stock were

[32] *Supra,* at note 4.

"in the event of the winding up of the company subordinated in right of payment to the claims of other creditors of the company (other than subordinated creditors) and any amounts payable to and received by the trustee in respect of the stock will be received by the trustee *on trust"* to pay first, the costs of the trustee, second, the claims of unsubordinated creditors, and third, the holders of CULS.

The immediate issue was whether the holders of CULS were entitled to attend and vote at a meeting convened to consider a scheme of arrangement. This depended on whether the holders of CULS had an interest in the company. If the assets of the company were insufficient to pay them, they would not have such an interest. The administrators argued that since the company had insufficient assets to pay the unsubordinated creditors in full, the subordinated creditors had no further interest in the company and were not entitled to attend and vote at the meeting to consider the scheme. This was accepted by Vinelott J.

Although there was little discussion of the legal nature of subordination, *In re British & Commonwealth Holdings Plc* suggests that subordination by means of a trust is legally enforceable.[33] In fact, a subordination trust poses less difficulties than contractual subordination as payments which would otherwise have been made to the junior creditor are regarded as the property of the senior creditor. It is open to a creditor to declare that the debt owing to him is to be held on trust for another person. By distributing the proceeds of the debt to the senior creditor, the liquidator will only be giving effect to the beneficial ownership of the senior creditor. Furthermore, as mentioned earlier, a subordination trust also avoids the mandatory set-off rule in insolvency because there would not be the requisite mutuality between the junior creditor and the company as the junior creditor is only holding the debt on trust for the senior creditor.

V. The Junior Creditor's Own Insolvency[34]

If, as a result of the insolvency of the debtor, the junior creditor also goes into insolvency, there will be a potential competition between the senior creditor and the creditors of the junior creditor as to whether the senior creditor is entitled to the subordinated debt. The answer to this question will largely depend on whether the senior creditor is itself to be regarded as a creditor of the junior creditor. If the senior creditor is also a creditor, the benefit of the junior debt must be distributed pan passu amongst all the creditors of the junior creditor.

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[33] This was also the view expressed by Vinelott J in *Re Maxwell Communications Corporation Plc, supra,* at note 2.

[34] Also see Johnston, *supra,* note 1, at 109-110.

Where the junior debt has been assigned to the senior creditor, or is held on trust for the senior creditor, the senior creditor will not be treated as an unsecured creditor of the junior creditor and will be entitled to be paid out of the junior debt in priority to the claims of the creditors of the junior creditor. In the absence of a trust or assignment the position is more uncertain. As between the parties to the subordination agreement, it is submitted that since payments are to be made in accordance with the agreement, the junior creditor is only entitled to receive such amounts as are payable to him pursuant to the agreement.[35] The creditors of the junior creditor cannot find themselves in a superior position to the junior creditor. Accordingly, only that part of the junior debt which is payable to the junior creditor is available for distribution to them.

VI. CONCLUSION

Debt subordination is another creative means of raising finance. Although no security is granted to the senior creditor, the senior creditor is effectively placed in a more advantageous position compared to other unsecured creditors. As between the senior creditor and the junior creditor, the senior creditor also has a measure of priority. Accordingly, debt subordination may properly be regarded as one of those legal creations which falls within the category of transactions collectively known as quasi-security interests.

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[35] *Home* v *Chester & Fein, supra,* note 29; *Re Maxwell Communications Corporation Plc, supra,* note 2.

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