IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2015-404-1274
[2016] NZHC 2119

BETWEEN	ADVICEWISE PEOPLE LTD AND ORS Plaintiffs
AND	TRENDS PUBLISHING INTERNATIONAL LTD Defendant

Hearing: 11, 12 and 14 July 2016

Counsel: S M Bisley and O Gascoigne for Plaintiffs
J S Langston and W D Buckham for Defendant

Judgment: 7 September 2016

JUDGMENT OF HEATH J

This judgment was delivered by me on 7 September 2016 at 2.30pm pursuant to Rule 11.5 of the High Court Rules

Registrar/Deputy Registrar

Solicitors:
Buddle Findlay, Wellington
Shieff Angland, Auckland

CONTENTS

The application

[1] On 12 May 2015, the directors of Trends Publishing International Ltd (Trends) made a proposal, under Part 14 of the Companies Act 1993 (the Act),[1] to compromise the company's debts. The compromise was approved, by a majority in number and 75 percent in value,[2] at a meeting of affected creditors[3] held on 22 May 2016. Although the Part 14 procedure is primarily contractual in nature, a proposal approved by those majorities binds all affected creditors to whom notice is given.[4]

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1 The scheme and purpose of Part 14 is discussed at paras [48]–[54] below.

2 Companies Act 1993, s 230 and Schedule 5, cl 5(2).

3 I have adopted the term "affected creditors" from s 229(1) of the Companies Act 1993, which provides that notice of the meeting shall be given to all "who would be affected by the proposed compromise". Section 229(1) is set out at para [61] below.

4 Companies Act 1993, ss 230(2) and (3) and Schedule 5, cl 5(2).

The harshness of that rule may be ameliorated if this Court exercises a residual discretion to grant relief on an application by an affected creditor.[5]

[2] Unlike its predecessors and other statutory schemes dealing with corporate business rehabilitation, a compromise of debt entered into under Part 14 of the Act does not require the sanction of the Court before it becomes operative.[6] Under Part 14, the Court's role is limited. It may, on the application of the proponent or the company, give directions in relation to any procedural requirement imposed;[7] order that proceedings be stayed or that a creditor refrain from taking action against the company;[8] and grant relief in favour of an individual creditor, in specified circumstances.[9] While the Court's discretion to grant relief, if either a qualifying procedural irregularity or unfair prejudice to a creditor were established, is broad, the primary focus of the inquiry is into whether the applicant creditor should be bound by the compromise.[10]

[3] In this case, four of the creditors that voted against the proposal, Advicewise People Ltd (Advicewise), Callaghan Innovation (Callaghan), Mediaworks Radio Ltd (Mediaworks) and Blue Star Group (New Zealand) Ltd (Webstar)[11] (the challenging creditors), apply for orders that the adoption of the proposal was not valid and the resulting compromise is not binding on the affected creditors. Alternatively, an order is sought that the compromise is not binding on any of the challenging creditors. As a fall-back position, the challenging creditors seek "such other orders as the Court thinks fit". Another creditor, Times Printers Pte Ltd (Times Printers), a Singaporean company, supports the application but has not joined in it as a party. Trends opposes the application.

[4] In broad terms, the issues in this proceeding are:

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5 Ibid, s 232(3).

6 In New Zealand, Court sanction is still required by Part 15 of the Companies Act 1993; cf Companies Act 1955, s 205.

7 Companies Act 1993, s 232(1)(a).

8 Ibid, s 232(1)(b).

9 Ibid, s 232(3), set out at para [54] below.

10 Ibid, s 232(3), set out at para [54] below. See also, paras [48]–[51] below.

11 I refer to Blue Star Group (New Zealand) Ltd as "Webstar" because that is the name of its trading division through which the debt was incurred.

(a) Has the Part 14 procedure miscarried in a material respect?

(b) Is the compromise that was approved by the requisite majorities at the meeting of creditors, unfairly prejudicial to (one or more of) the challenging creditors?

(c) If either of those grounds were established, what (if any) relief should be granted to (one or more of) the challenging creditors?

Background

[5] Trends is part of a wider group of companies that trades in Australia, the United States of America, Hong Kong and Singapore, as well as New Zealand. In this country, it carries on business as a provider of print and digital media solutions.

[6] The proposal to compromise was put to 62 unsecured creditors, whose debts totalled $4,343,843.23 (the affected creditors).[12] Of that sum, a total of $3,230,391.80 was owed to an associated company, Thecircle.co.nz Ltd (Thecircle), Trends' General Manager, Ms Messer, and one of its directors, Mr Taylor, (the insider creditors). The debt owing to Thecircle ($3,080,361.80) represented unpaid rent.[13] The balance of the listed debts appear to have been incurred at arm's length and in the ordinary course of business.

[7] The debts owed to Advicewise, Mediaworks and Webstar totalled $50,791.63, made up as follows:

(a) $19,285.50 to Advicewise: this debt represented unpaid fees for advice and other services rendered to Trends, to enable it to defend a personal grievance claim brought against it by an employee.

(b) $18,291.48 to Mediaworks: this debt arose out of a contract whereby Mediaworks was to play television advertising at Trends' instigation.

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12 Section 229(1) of the Companies Act 1993 puts an obligation on a proponent to identify creditors "who would be affected by the proposed compromise". Section 229(1) is set out at para [61] above.

13 See also, para [13] below.

(c) $13,214.65 to Webstar: this debt was for printing services.

[8] Trends owed $SGD272,103.17, to Times Printers.[14] This debt was incurred in 2014 and early 2015. Times Printers voted against the proposed compromise. It was represented at the meeting of creditors by a principal from the firm of solicitors who represent the challenging creditors.

[9] Opposition to the compromise was (and remains) led by Callaghan. It is a Crown entity established under a special statute, the Callaghan Innovation Act 2012. Among other things, Callaghan provides financial grants for worthy scientific and technology based innovation research. Under an agreement dated 2 April 2014, Callaghan provided funding to Trends in April and June 2014, in the sum of $313,536.70.

[10] As a result of investigations undertaken at its instigation in late 2014,[15] Callaghan formed the view that its advances had been induced by false representations as to Trends' financial position. Callaghan terminated its contract with Trends and demanded repayment of the moneys advanced.

[11] Although Callaghan was listed as an affected creditor for the purposes of the compromise, its claim is disputed by Trends and is the subject of a counterclaim in this proceeding. The counterclaim, which alleges breach of contract and defamation in consequence of Callaghan's termination of the 2 April 2016 agreement, was ordered to be heard separately[16] and is set down for hearing, over 10 days, starting on 21 November 2016. The counterclaim is for an unliquidated sum: an inquiry into damages is sought.

[12] Although reliance is placed on a number of other grounds, the core complaint of the challenging creditors is that the proponents of the compromise manipulated the voting procedures in order to manufacture statutory majorities to approve the

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14 In the "List of Compromise Creditors" annexed as Appendix 2 to the proposal, this debt was converted (for voting purposes) to NZD263,864.10.

15 This included instructions to Deloitte, chartered accountants, Wellington, to prepare a report on Trends' financial position: see paras [14] and [15] below.

16 *Accident Compensation Corporation v Trends Publishing International Ltd* [2015] NZHC 3316. Accident Compensation Corporation was previously a plaintiff in the compromise aspect of the proceeding, but subsequently discontinued its claim.

compromise. The challenging creditors claim that they were unfairly prejudiced, as a result. Their concerns revolve around the inclusion, *for voting purposes only*, of the insider creditors; particularly Thecircle, given the size of the debt owing to it.

[13] To exercise a vote in favour of the compromise, Thecircle waived a security that it held over Trends' undertaking, to the extent of $3,080,361.80. Waiver of the security interest was required in order for Thecircle to cast a vote as an unsecured creditor. Because the compromise was put on the basis that secured and preferential creditors would stand outside its scope, those creditors were not affected by the compromise. They each retained existing rights to enforce payout of their debts.

The compromise proposal

(a) Why was a compromise proposal made?

[14] Mr Johnson deposed that he and Mr Paul Taylor, the two directors of Trends, sought advice from Mr Khov, an experienced insolvency practitioner and a principal of Waterstone Insolvency, about the options available to it. They came to discuss the possibility of Trends entering into an arrangement to compromise its debts. Those discussions took place in the aftermath of an inquiry undertaken, at the behest of Callaghan, by a firm of forensic accountants, Deloitte, into the financial affairs of Trends.

[15] In evidence, Mr Johnson explained his reasons for seeking advice from Mr Khov. In summary:

(a) Trends was affected by "a severe downturn" in its market in the United States of America, where revenue was sourced from advertising and book sales. This occurred as a result of the Global Financial Crisis, in about 2009. In the period after that, Mr Johnson had to decide how Trends could continue in business. In early 2011, he saw acquisition by (or merger with) a larger media business or the development of an innovative new product as means by which Trends could restore its financial wellbeing.

(b) Mr Johnson decided "to leverage off the existing brand" and alter the revenue model for Trends. He sought to capture "an audience by using media to deliver stories that gave them products, ideas and solutions" in a way that would provide added value to customers, and enhance their ability to do business. This was to be done through the use of "algorithms and metrics" that Mr Johnson was developing. Mr Johnson estimates that the investment, to that date, in relation to this innovative idea, was something in the order of $5.8 million.

(c) In July 2012, Trends successfully applied for a project grant from Callaghan. A formal funding agreement was entered into on 2 April 2014, for a period of three years. It was to end on 31 December 2016.

(d) The total grant was for $17,250,000, including GST. Mr Johnson says that, when the contract was entered into on 2 April 2014, "Trends was profitable in its core operating activities as a print media business producing a range of publications within the home and design industry, and within digital media offering on-line content and digital marketing solutions".

(e) Trends lodged its claims for the first and second quarter of 2014. After "minor queries", they were paid. When the third quarter claim was lodged on 30 September 2014, the situation changed. On 31 October 2014, having made some initial inquiries, Callaghan advised Trends that it would be instituting a review by Deloitte of the claims made.[17]

(f) Deloitte commenced its inquiries on 6 November 2014. Before a report was made available, Mr Johnson was contacted, on 11 December 2014, by someone from the Serious Fraud Office. Documents were requested. Mr Johnson understood that the approach was, at that stage, confidential.

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[17] Mr Johnson uses the word "audit". Because of the technical nature of that term, Callaghan takes issue with its use. I have used the more neutral word "review". Nothing turns on the terminology.

(g) Later, a press release was issued that confirmed the involvement of the Serious Fraud Office. Mr Johnson deposes that the "press release had a dramatic effect on Trends' business, both in the company's ability to generate … revenue and on staff morale". Clients withdrew support. An overdraft facility was recalled. Within a relatively short time, Trends had lost 60 percent of its staff and had to curtail its business strategy.

(h) A final report from Deloitte was received by Trends on 21 April 2015. At the same time, a letter was delivered to Trends, by which Callaghan purported to terminate the grant. It required funds paid to that date to be repaid within 10 working days. A draft media release was provided to explain what information Callaghan would give to the press.

[16] After seeking advice, initially from Ernst & Young, Mr Johnson was referred to Mr Khov. At the time he made an approach, Mr Johnson was aware of options involving receivership, "a fire sale to another media outlet" and recapitalising the company. A business friend was prepared to provide some funds to assist.

[17] In late April 2015, Mr Johnson, and the financial controller of Trends, Mr Simon Groves, met Mr Khov. They explained Trends' circumstances. Mr Johnson deposed:

> 9.2 In late April 2015, [Mr Khov] met with [Mr Simon Groves] and I. [Mr Simon Groves] and I explained Trends' circumstances. [Mr Khov] said that we should consider a compromise. He explained to me what a Part 14 Compromise was. He asked for our creditor position, which [Mr Simon Groves] delivered the next day. [Mr Khov] then said they would come back to us with a more detailed proposition. [Mr Khov] told me that I had to be sure that Trends could continue on in business in a profitable manner after this compromise had been put in place.
>
> 9.3 [Mr Khov] later suggested that Trends pay an initial payment to each creditor of $1,000 or, if their debt was less, the value of their debt. I thought that was a good idea as the vast majority of creditors would get a high percentage of their money back. [Mr Khov] also asked us what money Trends could guarantee to pay over a nine month period.

> 9.4 I spoke to the business friend whose financial advisor had suggested Waterstone. He said that he would provide $50,000 to allow for payment of the first initial distribution, if the compromise was passed.
>
> 9.5 I had to talk to [Mr Simon Groves] and we looked at Trends cash flow projections. Trends could guarantee $13,000 per month. So the total pool was approximately $170,000 to be distributed to those creditors. *I thought that if [Thecircle], a company associated with me and creditor of Trends, participated in the payment plan then the majority of pool would go to me. That did not seem fair. I want to show good faith. I wanted to give Trends' creditors the maximum amount. I raised this with Paul Taylor (a director of Trends) and Louise Messer, who also were owed money by Trends. They also agreed not to participate in the payment. I later raised this with [Mr Khov] from Waterstone. He said that do that and that would mean there would be more money in the pool for the other creditors. I thought that would be seen as a show of good faith.*
>
> …
>
> 9.7 I determined the best course of action for creditors would be the creditor compromise. I decided this was the most pragmatic and cost effective step to take to try and save the business and keep our employees employed. Waterstone implemented this.
>
> (Emphasis added)

Mr Johnson's explanation of why Thecircle, Mr Taylor and Ms Messer decided not to participate in any distribution under the compromise assumes some importance in the context of the "unfair prejudice" issue.[18] Notwithstanding the reasons given by Mr Johnson for Thecircle, Mr Taylor and Ms Messer agreeing not to participate, there is no evidence to explain why they were to *vote* on the proposal, if they were not interested in receiving a distribution from it.

(b) Evidential issues

[18] Neither Mr Taylor nor Ms Messer has given evidence. That means that I do not have any explanation from either of them about:

> (a) Their motives for agreeing not to participate in the proposed distribution.

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[18] See para [4] above. See also para 9.5 of Mr Johnson's affidavit, set out at para [17] above.

(b) Why, given their decision not to participate in the distribution, they decided that it was appropriate to exercise a vote.

(c) Whether there was any "understanding" that they might receive a benefit from a third party to satisfy their debts.

[19] During the hearing, I expressed surprise that no evidence had been provided by Mr Khov. As the person who advised on and later formulated the compromise, he was best placed to give independent evidence to explain why it had been decided that Thecircle, Mr Taylor and Ms Messer would vote on the proposed compromise, yet not participate in any distribution from available funds.

[20] Mr Khov could also have given some helpful evidence on the topic of inter-company debts. As well as having been raised in correspondence from the solicitors for Callaghan before the compromise meeting on 22 May 2015, it was the subject of discussion at the meeting itself.[19] Because the compromise was proposed only in respect of Trends, creditors ought to have been provided with full disclosure of inter-company debts, so that they could assess the amount of money that might be payable to Trends in the event of liquidation. While the ability to set off mutual debts on liquidation would have been relevant to that assessment, the suggestions made by Mr Johnson and Mr Simon Groves that the information was irrelevant due to the fact that all inter-company debts were eliminated when consolidated accounts for the group were prepared is beside the point.

[21] Evidence about what motivated Mr Taylor and Ms Messer to act as they did is something within their exclusive knowledge. They were witnesses who were available to Trends, on the current application. Mr Khov was uniquely placed to provide a plausible explanation of the reasons why the compromise was framed in the form circulated to affected creditors.

[22] The absence of evidence from Mr Taylor, Ms Messer and (more importantly) Mr Khov on those topics means that I must determine questions of motivation on

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[19] See para 6 of the letter from Buddle Findlay to Mr Khov, Mr Johnson and Ms Messer of 20 May 2015, set out at para [33] below. See also the first seven bullet points from the minutes of the meeting of 22 May 2015, set out at para [38] below.

incomplete evidence. In applying the *maxim* that all evidence must be weighed according to the proof which it was in the power of one side to have produced and in the power of the other to have contradicted,[20] Mr Khov's silence speaks volumes.

(c) The compromise proposal documents

[23] On 12 May 2015, Mr Khov sent to affected creditors a letter which enclosed the documents that creditors had to consider under the Part 14 proposal. After advising that he and Mr Damien Grant were the proposed "Compromise Managers", Mr Khov continued:

> **RE: <u>COMPROMISE WITH CREDITORS UNDER PART 14 OF THE COMPANIES ACT 1993 – TRENDS PUBLISHING INTERNATIONAL LIMITED ("TRENDS")</u>**
>
> …
>
> Part 14 of the Act allows for a company to proactively engage with its creditors in an attempt to achieve a compromise with the debt the company owes to creditors before any formal insolvency process is adopted. *A successful compromise allows the company the chance to continue trading where there is a real prospect of the company being successful and profitable going forward*.
>
> We believe that Trends is a well-known brand and business and is a leader in its industry. Over the years significant time, effort and money has been expended into Trends however the business has been affected by some unforeseen circumstances which has impacted the business financially. *By adopting the proposed compromise, creditors will allow the company to continue trading and with your support it will allow the company to improve its financial position going forward*.
>
> …
>
> (Emphasis added)

[24] The "Statement Relating to Compromise", required by s 229(2)(b) of the Act,[21] provided specific information to affected creditors, and was signed by the two directors of Trends, Messrs Johnson and Taylor. In summary:

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[20] See, for example, *Fairchild v Glenhaven Funeral Services Ltd* [2002] UKHL 22, [2003] 1 AC 32 (HL) at para [13]. As to the ability of the Court to draw adverse inferences from the absence of material evidence, see *Yan v Commissioner of Police* [2015] NZCA 576, [2016] 2 NZLR 593 (CA) at para [101].

[21] Set out at para [61] above.

(a) The affected creditors were listed in Appendix 2.[22] All debts were calculated as at 8 May 2015. As well as including all of the challenging creditors and Times Printers, the three insider creditors were listed. Although, by 8 May 2015, Trends had signalled that it would bring a claim for damages against Callaghan, it calculated Callaghan's debt without reference to it. That meant that there was no need for the Chair of the meeting to determine the amount in respect of which Callaghan could vote.[23]

(b) If the compromise were approved, it would be administered by Messrs Khov and Grant (the proposed managers). Although the wording is not entirely clear, as I read the document, affected creditors were being told that the proposed managers had power to get in the moneys to which the compromise proposal referred, and distribute them in accordance with its terms. The compromise document itself[24] disclosed that Trends had an obligation to "procure the lodgement of required moneys in the trust account of [the proposed managers] to enable the distributions to be effected".

(c) The reason for the compromise was explained:

> [Trends] was incorporated on 23 December 1992. The present difficulties facing [Trends] have arisen due to the revocation of a funding grant in June 2014 resulting in cash flow issues. In particular, this has caused the Board to economise operations and halt research and development into products.
>
> The Board considers that if the compromise is passed, [Trends] will be able to continue trading.
>
> Accordingly, *the Board is committed to continuing the business so that it will be viable and financially stable and has a strong and coherent strategy to rebuild value. The introduction of fresh capital into [Trends] and the Compromise is a key element of this. In particular, the Board has received a commitment from a third party to*

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22 In fact, an amended version of Appendix 2 which was sent to affected creditors by the proposed managers at 5.21pm on 12 May 2015.

23 Compare with *Guest v Duffy* [1991] 1 NZLR 183 (CA).

24 Annexed as Appendix 1 to the "Statement Relating to Compromise": see paras [26]–[29] below.

introduce capital into [Trends]. The Board is confident that this commitment will not be revoked.

(Emphasis added)

(d) If the compromise were approved, it was "reasonably foreseeable" that Trends would be "able to trade on into the future". But, if not approved, Trends was unlikely to continue trading. It was said that, in the event of liquidation or voluntary administration, "unsecured creditors [were] unlikely to receive a distribution".

(e) Mr Johnson had a personal interest in the compromise, as sole director and indirect shareholder of Thecircle, "a creditor that is subject to the Compromise". Further, Mr Taylor, as director, was disclosed as a creditor who was subject to the compromise. Creditors were told that while Thecircle and Mr Taylor "reserve the right" to vote at the meeting of creditors, they had "elected not to participate in any distributions from the Compromise".

(f) If the proposed compromise were approved by a majority in number, who together represented at least 75 percent in value of the creditors, the compromise would be binding on all affected creditors.

[25] Mr Johnson and Mr Taylor made a recommendation, stating:

> The directors believe that passing the resolution to approve the Compromise is in the best interest of the Creditors as a whole and accordingly recommends (sic) that the Creditors vote in favour of the resolution to approve the proposed Compromise.

[26] The "Compromise Proposal" was attached as Appendix 1 to the "Statement Relating to Compromise". It was based on distributions of what were called an "Initial Pool" and a "Subsequent Pool". Those terms were defined:

Initial Pool	Refers to the initial amount of NZD$50,000 (Fifty thousand dollars) made available for distribution to the Entitled Creditors.
Subsequent Pool	Refers to 9 subsequent payments of NZ$13,300 (Thirteen Thousand and Three Hundred Dollars) to be deposited by the Company on the last working

day of every month to be made available for distribution to Entitled Creditors.

[27] The definition of the term "Entitled Creditors" had the effect of excluding the insider creditors from the distribution regime. The essence of the proposal for "Entitled Creditors" was:[25]

> **2. DISTRIBUTIONS**
>
> The distributions under this Compromise are to be made as follows:
>
> 1. The Entitled Creditors are to receive from the Initial Pool a distribution of:
>
> a. 100c/$1 (one hundred cents in the dollar) for the first NZD$1,000 (One thousand dollars) of their debt held respectively. This shall be distributed within 72 hours of the Commencement Date;
>
> AND
>
> b. A further distribution on a pro-rata basis from any remaining funds in the Initial Pool. This shall be distributed within 72 hours of the Commencement Date.
>
> 2. The Entitled Creditors are to receive from the Subsequent Pool 9 monthly distributions on a pro-rata basis. This shall be distributed within the first week of the month for a period of 9 months with the first distribution commencing on the first week of July 2015.
>
> **3. COMPROMISE BINDING**
>
> This Compromise shall be, and remain binding on all Compromise Creditors to the extent of the Debt.
>
> By entering into this Compromise, the Compromise Creditors agree to cancel all Debts owed by the Company.
>
> **4. MORATORIUM ON RECOVERY PROCEEDINGS**
>
> In the event that the compromise is adopted, unless otherwise permitted by law or contract no Compromise Creditor shall in respect of its Debt:
>
> a. initiate or continue any claim, action or proceeding against the Company; and/or
>
> b. enforce any judgment or issue any execution or otherwise enforce or seek to enforce any judgment or order against the Company; and/or

[25] The term "Compromise Creditors" was defined in terms that included all of the affected creditors listed in Appendix 2.

c. seek to apply set off or any rights of counterclaim for debts owed by the Company under this Compromise; and/or

d. apply for the liquidation of the Company or proceed on any application for liquidation which may have been presented prior to the adoption of this Compromise; and/or

e. exercise any rights of forfeiture, foreclosure, or entry into possession, or take any action under any lease relating to any property of the Company; and/or

f. assert any rights as unpaid vendor and supplier of goods pursuant to any reservation of title clause forming part of any contract for supply.

[28] If the compromise were approved, all creditors who were owed $1000 or less (the minor creditors) were to be paid in full.[26] Inevitably, those creditors would vote in favour of approval. The moratorium provisions of the compromise operated to ensure the payment represented a full accord and satisfaction of those debts.

[29] Having received required proofs of debt, it was for the proposed managers to determine whether claims should be accepted for voting purposes. The proposal made it clear that if a proof of debt had not been received by the proposed managers by 10.30am on 20 May 2015 (subject to the exercise of a discretion by the proposed managers) the debt would be regarded as waived. The compromise was to be terminated if Trends was "placed in liquidation, receivership or voluntary administration".

The meeting of creditors

[30] Among the documents sent to creditors on 12 May 2015 was a notice of intention to hold a meeting of creditors to consider the proposed compromise. The meeting was scheduled for 10.30am on 22 May 2015, with creditors to register claims from 10am that day. Information about postal and proxy voting was provided in that document. A proof of debt form was attached to be completed and received by the proposed compromise managers no later than 10.30am on 20 May 2015.

[31] The agenda for the meeting stated:

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[26] This arises out of the way in which the "initial pool" was to be distributed; see cl 2(1)(a) of the "Statement Relating to Compromise", set out at para [27] above.

AGENDA FOR MEETING OF COMPROMISE WITH CREDITORS TO BE HELD ON FRIDAY 22 MAY 2015

1. Introduction by the proposed Compromise Manager.

2. Overview by the Board.

3. Meeting opens for questions.

4. Consideration for the Compromise.

5. Voting by Compromise Creditors that the Compromise dated 12 May 2015 be accepted.

[32] In the period leading up to the meeting, there was correspondence between Buddle Findlay, solicitors, Auckland (on behalf of Callaghan)[27] and the proposed managers raising queries about the proposal. For present purposes, it is sufficient to note:

(a) In a letter dated 14 May 2015, Buddle Findlay questioned whether sufficient information had been provided to enable any of the affected creditors to make a reasoned decision about whether to vote for or against the proposal. Additional information was sought. Among other things, the position of the creditors who intended to vote but not participate in any distributions was raised.

(b) The proposed managers forwarded Buddle Findlay's letter of 14 May 2015 to Trends for a response. Trends expressed concern about the information being requested on behalf of Callaghan, having regard to the Deloitte report that had been obtained at Callaghan's instigation in 2014. Trends indicated that Callaghan had had access to full financial statements for the years ended "March 2011, 2012, 2013 and 2014".

(c) On 18 May 2015, the proposed managers circulated those letters to other affected creditors. In addition, they sent to those persons a response (contained in a letter dated 15 May 2015 that she intended to be provided to the affected creditors) from Ms Messer to suggestions

[27] Buddle Findlay are the solicitors on the record for all of the challenging creditors in the present proceeding. A principal of the firm also represented Times Printers at the meeting of creditors.

that she was foregoing her entitlement for an ulterior purpose. She denied that allegation.

[33] On 20 May 2015, Buddle Findlay wrote to Mr Khov, Mr Johnson and Ms Messer responding to their letters. They asked for that letter to be circulated to affected creditors. Buddle Findlay rejected the proposition that Callaghan was in possession of all relevant financial records, and expressed views to the effect that the compromise should not be approved. They said:

> **Effect of compromise**
>
> 4. Callaghan Innovation's view is that the compromise, as it stands, is not to the benefit of creditors:
>
> (a) We attach for the benefit of the other creditors a spreadsheet outlining the payments that each listed creditor participating in the compromise would receive if the Proposal is approved. On its face, the Proposal is very unattractive to all creditors with debts exceeding $2,000, who would end up taking a discount of between 50%–88% on the debt owed to them (not counting Thecircle.co.nz Ltd (Thecircle), Paul Taylor and Louise Messer) to allow Trends to continue trading.
>
> (b) Without detailed financial information, it is impossible for creditors to assess whether they would receive more from a liquidation. Given the apparent funding commitment by a third party, the high related party debts, and possible claims against directors, unsecured creditors may well receive more in a liquidation.
>
> (c) Thecircle is a related party creditor. It is allegedly owed over $3 million, or around 71% of the total value of the debt. Trends has refused to explain how that debt arose. In the proposal, it expressly reserves Thecircle's right to vote on the compromise. That is unusual, given that Thecirule holds security over Trends' property (so should not be entitled to vote on a proposal for unsecured creditors without losing its security).
>
> In the absence of a proper explanation, it is hard to avoid the inference that Thecircle has been included by Trends' directors to allow Trends to force through the 75% majority in value that is required to adopt the Proposal, despite having no interest in the Proposal itself.
>
> 5. Also, the Inland Revenue Department is not included in the list of unsecured creditors. What tax exposure does Trends currently have, and is this covered by a separate compromise proposal? If so, what are the terms of that proposal?

> 6. At the very least, creditors should have a clear picture of Trends' current financial position and of the nature of the related party debts. Without that information, it is simply not possible to assess the benefit of the Proposal. Callaghan Innovation's suggestion is that the relevant information is now provided to all creditors, on an equal footing, and that the proposed meeting (which is scheduled to take place in three working days, a very short timeframe) is delayed to allow the creditors to consider that information in the usual way.

No reply to that letter was produced in evidence.

[34] The meeting was chaired by Mr Khov. It began at 10.30am on 22 May 2015 and ended at 11.41am. Seven people from the proposed managers' firm attended, including two in-house solicitors. Mr Scott Barker, from Buddle Findlay, was shown as representing Times Printers at the meeting. During the meeting, he acknowledged that he was also acting for Callaghan.

[35] Minutes of the meeting were prepared. They have been signed as correct by Mr Khov. The minutes record that, after explaining the agenda, Mr Khov introduced the proposal in these terms:[28]

> "Waterstone Insolvency was engaged to prepare and administer the proposed compromise that has been put to the creditors and has been circulated. I confirm that prior to Waterstone being engaged in the compromise, we have not done any work for Trends previously. *The scope of our work was to prepare and administer the compromise that has been put to the creditors. This compromise encompasses all the unsecured creditors of the company. It does exclude secured creditors and preferential creditors*".
>
> (Emphasis added)

[36] Mr Johnson spoke on behalf of the board of Trends. The minutes appear to summarise Mr Johnson's "brief overview of the business":

> - Discusses GST and how the business took 3–4 years to bring the business back on track subsequent to the GST coming through.
> - [Mr Johnson] adds that it is public knowledge that they have had a considerable involvement with Callaghan Innovation.
> - [Mr Johnson] then states he heavily invested 80% of the investment and other people put in 20%.

[28] As these words appear in quotation marks within the minutes, I infer that they represent a complete and accurate record of what was said by Mr Khov at this stage of the meeting.

- Adds that they have lost about 95% of the R&D people working in that business.

- *[Mr Johnson] explains that he had advice to put the company into liquidation, but feels that the Part 14 compromise was the way to go. He feels that the company would trade profitably and then would be able to pay back the creditors*.

- [Mr Johnson] sincerely apologises for bringing everyone to this meeting.

(Emphasis added)

[37] A number of questions were put to both Mr Johnson and Mr Khov about the financial position of Trends, and associated persons or entities. It is clear that Mr Khov was not in a position to answer some of the questions, even though they were relatively basic and plainly relevant to a creditor's assessment of whether a proposal of this type should be accepted.

[38] Some of the exchanges recorded in the minutes illustrate the type of questions that were being put and the extent to which Mr Khov deferred to Trends' then financial controller, Mr Simon Groves:

- *[Mr Barker] questions if there are inter-company loans. [Mr Khov] advises he can answer, yes.*

- *[Mr Barker] asks how much. [Mr Khov] answers, he doesn't know how much, but there are inter-company loans/debtors.*

- [Mr Barker] states that they weren't shown on the information circulated to the creditors.

- [Mr Khov] states they were shown as assets and goes onto say that Trends, a number of related parties or subsidiary parties overseas and Trends, the magazine, is printed by the company, Trends Publishing International. They would then get the magazines published and shipped to the subsidiary company. *He then states that, yes, there would be an inter-company account in the sense that that company owed money back to Trends Publishing International for the magazines that were shipped.*

- *[Mr Barker] asks what the total related party inter-company indebtedness is currently. [Mr Khov] states that [Mr Simon Groves] would be able to answer this question.*

- *[Mr Simon Groves] says on a consolidated figure there is no indebtedness to other subsidiary related companies.*

- *[Mr Barker] says he is not interested in a consolidated amount and questions, what is the amount owed by other Trends companies to this company currently. [Mr Simon Groves] answers, zero*.

…

- [Mr Barker] questions why [Thecircle] got given a security after the suspension of funding to Callaghan before the compromise was run. [Mr Simon Groves] says they have now waived $3 million of that security.

- [Mr Barker] asks why the security got granted by Trends at the time when Trends was impartible financially. [Mr Simon Groves] says they were given legal advice.

- [Mr Barker] asks again, why did they take it, did they want to improve their position against other creditors. [Mr Simon Groves] answers, they were following legal advice.

- [Mr Barker] states that the effect was to improve their position against other secured creditors. [Mr Khov] states the company granted a GSA, we do not know what the reason was but if Trends didn't grant that GSA, [Thecircle] could have kicked them out as a landlord for unpaid rent. [Mr Khov] states, how would a landlord as a creditor improve their position by allowing the tenant to stay in the premises, by granting a security.

- [Mr Barker] asks [Mr Simon Groves] whether the $3 million to [Thecircle] will be written off and what the arrangements are between Trends and [Thecircle] for paying the rent, given it has struggled in the past. [Mr Johnson] answers, [Thecircle] is vulnerable to Trends, 58% is rent. They have restructured it so that they are vulnerable to 8% of rent.

…

- [Mr Khov] states that the only creditor that has waived a portion of their security is [Thecircle]. [Mr Khov] says there are other "PMSI" security holders which would be "secured". Konica Minolta, [Mr Khov] states that they are a creditor who supplied the machine which they have a security over, the debt that is owing to Konica Minolta is for consumables only which would be the "unsecured" portion of their debt. [Mr Khov] asks Konica Minolta in the room to confirm this is correct. They answer, yes correct.

…

- *[Mr Barker] questions the creditors' claims if the compromise is approved, would they be wiped. [Mr Khov] answers, yes they would be compromised unless the company goes into liquidation, receivership or voluntary administration.*

- *[Mr Barker] asks [Mr Khov] whether he can confirm with the creditors that that is the case. [Mr Khov] questions whether [Mr*

Barker] is asking about any counter-claims that Trends may have against a creditor.

- *[Mr Barker] states there is no reference in the compromise deed for a set off. [Mr Khov] states that is not dealt with in the compromise deed but admits that is a grey area. It is not factored in the compromise deed, but [Mr Khov] says he understands a potential set off would be against Callaghan. ….*

(Emphasis added)

Approval of the compromise proposal

[39] 48 creditors were present at the meeting and entitled to vote. Of those, 39 voted in favour of approval, representing 81.25 percent of affected creditors. In summary:

(a) Thecircle voted in favour. Its debt ($3,080,361.80) represented 72.21 percent of all affected creditors.

(b) The insider creditors together cast three votes, in respect of debts totalling $3,230,391.50. Together, those debts represented 75.73 percent of the total value of affected creditors. On the basis of those three votes, the 75 percent in value requirement was met.

(c) All 17 minor creditors voted in favour of approval. They comprised 35.4 percent of those entitled to vote, but only 0.17 percent of the total value of debts owed to affected creditors.

(d) A further 19 creditors voted in favour of the proposal. They comprised 6.65 percent of the debts owed to affected creditors.

[40] After questions from the floor, Mr Khov put the resolution that the compromise be approved. It was passed.[29]

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[29] The majorities are set out at para [39] above.

Competing contentions

[41] In their amended statement of claim, the challenging creditors particularise their allegations of material irregularity and unfair prejudice. As Ms Langston, for Trends, emphasised that she was responding to the pleaded case, I start with those allegations.

[42] The four challenging creditors founded their allegations of "material irregularity" on five propositions. My reformulation of them follows:

(a) Trends failed to provide affected creditors with adequate information about its financial affairs, so as to enable them to make a reasoned judgment about the merits of the proposal.

(b) The insider creditors ought to have been excluded from voting on the compromise because they were not affected economically by the proposal. As parties who did not intend to participate in the distribution, logically they had no interest in its outcome. Alternatively, they should have been put into a different class for voting purposes.

(c) The minor creditors ought to have been put into a separate class to reflect the fact that, on approval of the proposal, they would (unlike other creditors) be paid in full.

(d) Either Callaghan ought to have been excluded from the compromise or put into its own class because the debt alleged to be due to it was the only one disputed by Trends.

[43] The "unfair prejudice" complaints were based on six propositions, which I reformulate into four:

(a) The minor creditors ought to have been put into a separate class to reflect the fact that, on approval of the proposal, they would be paid in full.

(b) As a result of the way in which available funds of $169,700 were to be distributed, Trends would be released from a debt totalling $1,061,014.58. That result has been achieved against the wishes of 70.15 percent in value of affected creditors.

(c) The challenging creditors would have achieved a better outcome if Trends had been placed in liquidation.

(d) Trends failed to provide affected creditors with adequate information about its financial affairs so that they could form a reasoned judgment about whether to accept the proposal.

[44] Ms Langston, for Trends, submitted that there was no basis for the Court to intervene. In general terms, she submitted:

(a) For whatever reason, Trends was in a position of insolvency (or at least imminent insolvency) when the proposal was made. Thus, it was entitled to make and have the compromise considered.

(b) There was no need for minor creditors to be separated into a different class.

(c) It was unnecessary for the insider creditors to be put into a different class from other affected creditors.

(d) As a result of waiver of payment of debts due to Thecircle, Mr Taylor and Ms Messer, the affected creditors were to receive more from the compromise than could have been gained through a liquidation, or other formal insolvency regime.

[45] The various grounds on which the challenging creditors rely to establish material irregularity and unfair prejudice overlap. In closing submissions, Mr Bisley was disposed to accept that the fundamental question for determination was whether the proponents had manipulated the way in which voting was to take place in order

to manufacture a successful outcome.[30] In my view, this point turns on whether the challenging creditors were unfairly prejudiced by the insider creditors' ability to vote in favour of the compromise even though they were to receive no benefit from it.

[46] Although the amended statement of claim puts the "manipulation" point under the head of "material irregularity", I consider it should be addressed under the rubric of "unfair prejudice". Notwithstanding Ms Langston's concerns about responding to the pleaded case, I am satisfied that no prejudice results to Trends by dealing with the point in that way. It has had a full opportunity to adduce evidence on the underlying factual questions and the legal principles that apply.

Analysis

(a) My approach

[47] After explaining the scheme and purpose of Part 14,[31] I analyse the issues in this order:

(a) First, was the approved compromise unfairly prejudicial to all or any of the challenging creditors as a result of a manipulation of voting designed to achieve an outcome consistent with the interests of Trends and Mr Johnson?

(b) Second, I deal with each of the remaining complaints, whether made under the headings of material irregularity or unfair prejudice.

(c) Third, I address questions of relief.

(b) Part 14 of the Act: scheme and purpose

[48] Until Part 14 of the Act came into force on 1 July 1994, a company that wished to compromise its debts with creditors, in circumstances where not all creditors agreed with its proposal, had to formulate a scheme of arrangement and

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30 See para [42](b) below.
31 See paras [48]–[66] below.

obtain the Court's sanction to it. That was done under s 205 of the Companies Act 1955 (the 1955 Act).

[49] The s 205 procedure had been inherited from English law. It was widely used throughout the Commonwealth. The Court was empowered to call meetings of creditors and, if requisite majorities were attained, to sanction a scheme. On sanction, the scheme became binding on dissenting creditors. Relevantly, s 205(1) and (2) provided:

> **205 Power To Compromise With Creditors And Members**
>
> (1) Where a compromise or arrangement is proposed between a company and its creditors or any class of them, or between the company and its members or any class of them, the Court may, on the application in a summary way of the company or of any creditor or member of the company, or, in the case of a company being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members of the company or class of members, as the case may be, to be summoned in such manner as the Court directs. If any question arises under this section as to whether or not any members or creditors of a company constitute a class of members or a class of creditors, as the case may be, it shall be determined by the Court as in the circumstances it thinks proper.
>
> (2) If a majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members, as the case may be, voting in person or, where proxies are allowed, by proxy at the meeting agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors or the class of creditors, or on the members or class of members, as the case may be, and also on the company, or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company.
>
> …

[50] The Court's discretion to approve a scheme was considered in *Re C M Banks, Limited*,[32] a decision that was later approved by the Court of Appeal in *Re Milne and Choyce, Ltd*.[33] Both cases involved a predecessor to s 205, namely s 159 of the Companies Act 1933. In giving judgment on the application for sanction in *Re C M Banks*, *Limited*, Smith J said:[34]

> … In the light of the cases cited, the duty of the Court may be summarized as follows: The duty of the Court is to see (1) that there has been compliance with the statutory provisions as to meetings, resolutions, the application to

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32 *Re C M Banks, Limited* [1944] NZLR 248 (SC).
33 *Re Milne and Choyce Ltd* [1953] NZLR 724 (SC and CA) at 744–745.
34 *Re C M Banks, Limited* [1944] NZLR 248 (SC) at 253.

> the Court, and the like; (2) that the scheme has been fairly put before the class or classes concerned; and that if a circular or circulars have been sent out, as is usual, whether before or after the making of the application to the Court, they give all the information reasonably necessary to enable the recipients to judge and vote upon the proposals; (3) 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 (4) that the scheme is such that an intelligent and honest man of business, a member of the class concerned and acting in respect of his interest, might reasonably approve.

[51] In *Milne and Choyce*, a submission was made to the Court of Appeal that a fifth test should be added, to the effect that "the scheme must be fair and reasonable to all the classes concerned". Delivering the judgment of the Court of Appeal, P B Cooke J said:[35]

> … In our view, however, this test is implicit in the fourth of those tests, although we should perhaps add that leading counsel for the company admitted that, if this were not so, he would accept it as an added requirement. The necessity for fairness between the different classes concerned was recognized by North J, as long ago as the [*Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* case] ([1891] 1 Ch 213, 230) and has always been regarded as an important matter for consideration. That this test is implied in the fourth of the above tests is, however, shown by the fact that the hypothetical person referred to in that fourth test is to be "a member of the class concerned and acting in respect of his interest".

[52] In exercising the discretion to approve a scheme under the 1955 Act, the Court was also required to consider whether there were any public policy reasons why approval should be declined.[36]

[53] When recommending replacement of the s 205 scheme by a new compromise procedure, the Law Commission said:[37]

> 635 In the course of consultation with insolvency practitioners about possible changes to the statutory law on corporate insolvency and liquidations it became clear that compromises with creditors under section 205 of the 1955 Act are rarely attempted. The present procedure is perceived

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35 *Re Milne and Choyce Ltd* [1953] NZLR 724 (SC and CA) at 745.

36 *Re Primacq Holdings Ltd* (1991) 5 NZCLC 66,999 (HC) and *Re Southern World Airlines Ltd* [1993] 1 NZLR 597 (HC). See also Heath & Whale, *Insolvency Law in New Zealand* (looseleaf LexisNexis, 2nd ed) at paras 14.21 and 14.22, in the context of Part 15 of the Companies Act 1993.

37 Law Commission *Company Law: Reform and Restatement* (NZLC R 9, 1989) at paras 635, 637 and 638. For a detailed discussion of the genesis of Part 14, see *Bank of Tokyo-Mitsubishi UFJ, Ltd v Solid Energy New Zealand Ltd* [2013] NZHC 3458.

> as slow, complex and expensive with an unnecessary degree of involvement by the Court. As a compromise should be a constructive alternative to liquidation of a company, the present state of affairs is most unsatisfactory. *Part 13 of the draft Act [now Part 14 of the Act] is designed to provide a more useful procedure which features a greater provision of information by those proposing a compromise but limits the role of the Court to one of review on specified grounds*.
>
> …
>
> 637 The ability of a 75 percent majority to bind the majority of relevant creditors is retained in section 198 [of the draft Act] but is subject to notice of the proposal being given to a creditor as well as the grounds for challenge set out in section 200(2). The details of information required in section 199 support the central theme that the compromise must be able to be properly considered by creditors affected, and opportunity afforded for other views to be made known.
>
> 638 *As mentioned in the immediately preceding paragraphs, the role of the Court is quite different from that under section 205 of the 1955 Act. The fate of the compromise should rest with the voting creditors unless the information supplied or procedures followed are irregular. The "unfairly prejudicial" limb (section 200(2)(c)) provides a residual power which will be available to prevent abuse of the new procedure*.
>
> (Emphasis added)

[54] Although the Court has a limited role in the compromise procedure, one of its functions (as contemplated by the Law Commission) is to protect creditors against the effect of a compromise that is either materially irregular or unfairly prejudicial to a creditor, or a class to which it belongs. That aspect of the Court's powers is derived from s 232(3) of the Act:

> **232 Powers of the court**
>
> …
>
> (3) If the court is satisfied, on the application of a creditor of a company who was entitled to vote on a compromise that—
>
> (a) insufficient notice of the meeting or of the matter required to be notified under section 229 was given to that creditor; or
>
> (b) there was some other material irregularity in obtaining approval of the compromise; or
>
> (c) in the case of a creditor who voted against the compromise, the compromise is unfairly prejudicial to that creditor, or to the class of creditors to which that creditor belongs,—
>
> the court may order that the creditor is not bound by the compromise or make such other order as it thinks fit.

…

(c) Part 14 of the Act: procedural requirements

[55] A company that is, or will be unable to, pay its debts,[38] may initiate a compromise proposal. A proposal may be made by the board of directors of the company, a receiver or a liquidator (in each case, the proponent).[39] A creditor or shareholder may also propose a compromise, with the leave of this Court.[40] In the present case, the board of directors of Trends was the proponent.

[56] Section 230 of the Act sets out the effect of a compromise, if approved at a meeting:

> **230 Effect of compromise**
>
> …
>
> (2) A compromise, including any amendment, approved by creditors or a class of creditors of a company in accordance with this Part is binding on the company and on—
>
> (a) all creditors; or
>
> (b) if there is more than 1 class of creditors, on all creditors of that class—
>
> to whom notice of the proposal was given under section 229.
>
> (3) *If a resolution proposing a compromise, including any amendment, is put to the vote of more than 1 class of creditors, it is to be presumed, unless the contrary is expressly stated in the resolution, that the approval of the compromise, including any amendment, by each class is conditional on the approval of the compromise, including any amendment, by every other class voting on the resolution*.
>
> (4) The proponent must give written notice of the result of the voting to each known creditor, the company, any receiver or liquidator, and the Registrar.
>
> (Emphasis added)

[57] Section 230(3) of the Act is an important provision. It provides the foundation for the principle that each class of creditor must approve a compromise

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38 The term "unable to pay its debts" is borrowed from s 287 of the Act, which deals with the consequence of failure to comply with a statutory demand.

39 Ibid, s 228(1)(a)–(c).

40 Ibid, s 228(1)(d).

by the requisite statutory majorities before it becomes operative. The need for each class to vote in favour of the proposal recognises the need for those who are influenced by materially different considerations to consider and form a reasoned judgement on whether to support the proposal.

[58] The need to identify appropriate classes of creditors can best be understood by reference to cases decided under s 205 of the 1955 Act, and its predecessors. In *Re C M Banks, Limited*,[41] the need for compliance with statutory provisions as to meetings, resolutions, applications to the Court and the like, together with the need to ensure that the compromise had been fairly put before the "class or classes concerned", are of a character consistent with the procedural irregularity limb of s 232(3)(a) and (b) of the Act.[42] On the other hand, the need to ensure that a specific class of creditor is identified and fairly represented by those who attend the meeting is something that goes to unfair prejudice.[43] In the absence of concerns of that type, the fact that the statutory majorities were attained will ordinarily be compelling evidence that the scheme was such that an "intelligent and honest" business person, as a member of the class concerned, had acted reasonably in approving the compromise.[44]

[59] Plainly, if an entity wishes to persuade its creditors to compromise debt, it must provide sufficient information on which an informed decision can be made by a creditor about whether it is in its best interests to agree to the compromise. The primary obligation for identifying material information rests with the proponent.

[60] In that regard, s 229 and cl 2(2)(a) of Schedule 5 of the Act provide guidance. They specify, in general terms, the type of information to be sent to creditors, so that they can make their respective decisions. An attempt to distill the differing aspects of those provisions follows.

[61] The first involves a proponent engaging in good faith with all affected creditors. That obligation captures the need for material disclosure. Affected

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41 *Re C M Banks, Limited* [1944] NZLR 248 (SC) at 253, set out at para [50] above.
42 Section 232(3) is set out at para [54] below.
43 Ibid, s 232(3)(c) is set out at para [54] below.
44 *Re C M Banks, Limited* [1944] NZLR 248 (SC) at 253, set out at para [50] above. Compare with the principles identified in para [60] below.

creditors must be provided with a transparent explanation of "the terms of the proposed compromise and the reasons for it". Section 229(1) and (2)(b)(iii)–(vi) of the Act provides:

> **229 Notice of proposed compromise**
>
> (1) The proponent must compile, in relation to each class of creditors of the company, a list of creditors known to the proponent who would be affected by the proposed compromise, setting out—
>
> (a) the amount owing or estimated to be owing to each of them; and
>
> (b) the number of votes which each of them is entitled to cast on a resolution approving the compromise.
>
> (2) The proponent must give to each known creditor, the company, any receiver or liquidator, and deliver to the Registrar for registration,—
>
> …
>
> (b) a statement—
>
> …
>
> (iii) setting out the terms of the proposed compromise and the reasons for it; and
>
> (iv) setting out the reasonably foreseeable consequences for creditors of the company of the compromise being approved; and
>
> (v) setting out the extent of any interest of a director in the proposed compromise; and
>
> (vi) explaining that the proposed compromise and any amendment to it proposed at a meeting of creditors or any classes of creditors will be binding on all creditors, or on all creditors of that class, if approved in accordance with section 230; and
>
> ….

[62] The proponent's obligation is to provide full disclosure of the company's predicament to all affected creditors. That is why the notice of proposed compromise must "state the nature of the business to be transacted at the meeting in sufficient detail to enable a creditor to form a reasoned judgment in relation to it".[45] That generic, rather than prescriptive, approach to the type of information to be

[45] Companies Act 1993, Schedule 5, cl 5(2)(a).

conveyed to creditors recognises that the circumstances in which a compromise may be proposed vary significantly. A different level of disclosure may be required to enable a creditor to make a reasoned judgment, depending on whether (for example) it is being asked to accept five cents in the dollar in full and final satisfaction of a claim for $2,000 or $2,000,000.

[63] Another aspect of material disclosure is the need to identify all affected creditors, and the "class"[46] into which their respective debts fall. The notice must present, "in relation to each class", a list of creditors known to the proponent who would be affected by the proposed compromise. That list must identify the amount owing or estimated to be owing to each creditor, and the number of votes which each is entitled to cast on a resolution to approve the compromise.[47] This recognises the need to identify groups of creditors who may have distinct interests in approving a compromise, to prevent a proponent from presenting a compromise in a manner that is designed to allow one "class" of creditors to override the interests of others.[48] It also provides information that enables affected creditors to consult with each other before a meeting is held.

[64] The second is the need for a super-majority, consisting of a simple majority in number but 75 percent in value, of affected debt. This recognises the need for more than just majority support if a compromise were to become binding on dissenting creditors. The majorities relate to each "class of creditors".[49]

[65] The third recognises the need for the good faith participation of affected creditors in the compromise process. It is inherent in the ability of the super-majority to bind other affected creditors to a compromise with which they disagree, that the creditors participating in it should exercise their voting powers in good faith, and for proper purposes.[50] They may vote in a manner that suits their own

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46 A useful survey of relevant case law about the nature of a "class" of creditor is contained in Michael Josling "An analysis of the rights test in determining classes of creditors" (2010) 18 Insolv LJ 110.

47 Companies Act 1993, s 229(1).

48 For example, see *Re Jax Marine Pty Ltd* [1967] 1 NSWR 145 (NSWSC) at 148.

49 Ibid, Schedule 5, cl 5(1) and (2).

50 For a recent discussion of the "proper purposes" doctrine, albeit in the context of a corporate takeover "raid", see *Eclairs Group Ltd v JKX Oil & Gas plc* [2015] UKSC 71, [2015] WLR (D) 497 at para 15 (per Lord Sumption, with whom, on this point, other members of the Court

commercial purposes, so long as they "are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent".[51]

[66] Cases dealing with the obligation of a chairperson of the meeting to be satisfied that a creditor is not voting to promote an interest adverse to the class in which it has been put support this proposition. By way of example, I refer to *British America Nickel Corporation Ltd v M J O'Brien Ltd*[52] and *Re Farmers' Co-Operative Organisation Society of New Zealand Ltd*.[53] In the latter, dealing with a problem emerging from the fact that one of the unsecured creditors was a competitor, Gallen J took the view that an obligation was cast on the potentially tainted creditor to satisfy the chairperson that it was acting in good faith, and for proper purposes.[54]

(d) Unfair prejudice: classes of creditors

(i) The test

[67] Authorities dealing with sanction applications under the scheme of arrangement model have identified two approaches to the way in which "classes" of creditors are determined. The first is based on similarity of *legal rights*. The other is based on similarity of *interests*. Although the New Zealand authorities have not analysed which of those approaches should be preferred, they tend to favour a "liberal" interpretation of the word "classes"; one which will "err on the side of calling separate meetings".[55]

[68] Under s 205 of the 1955 Act, three distinct steps were required, two of which required Court participation:[56]

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agreed).

51 *Re C M Banks, Limited* [1944] NZLR 248 (SC) at 253.

52 *British America Nickel Corporation Ltd v M J O'Brien Ltd* [1927] AC 369 (PC) at 371.

53 *Re Farmers' Co-Operative Organisation Society of New Zealand Ltd* [1992] 1 NZLR 348 (HC) at 354–355.

54 Ibid, at 355.

55 *Re Stewart & Sullivan Farms Ltd* [1981] 1 NZLR 711 (HC) at 719.

56 I have based my summary on Chadwick LJ's description of the process in *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241, [2001] 2 BCLC 480 (ChD and CA) at paras [11] and [12]. Chadwick LJ delivered the principal judgment, with which Pill LJ and Wright J agreed. The judgment was given in the context of s 425 of the Companies Act 1985 (UK), which was materially the same as s 205 of the Companies Act 1955.

(a) The first was an application by the proponent to the Court for an order convening a meeting or meetings of creditors. At that stage, the person drafting the application and proposed scheme had to decide whether meetings of different classes were required. The Court's role was to determine whether to convene meetings in the form proposed. This role was typically undertaken on a without notice application.

(b) The second was for the proponent to put the proposals to the meeting or meetings, in accordance with the Court's order. After voting at the meeting or meetings, it was apparent whether requisite majorities had been obtained.

(c) The third was for the proponent to seek the sanction of the Court to the proposed scheme. At this stage, it was open to the Court to reconsider whether any particular meeting was "unrepresentative", in the sense that a creditor with a "special interest to promote" could thwart the views of other creditors who had been grouped within its class.[57]

[69] The judgment of Bowen LJ in *Sovereign Life Assurance Co v Dodd*[58] is often cited as a litmus test for determining whether separate classes of creditors are required. However, in that case, Lord Esher MR and Bowen LJ expressed themselves differently:

(a) In the most frequently cited passage, Bowen LJ, with reference to "rights", said:[59]

> The word "class" is vague, and to find out what is meant by it we must look at the scope of the section, which is a section enabling the court to order a meeting of a class of creditors to be called. It seems plain that we must give such meaning to the term "class" as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so

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57 See *Re BTR Plc* [2000] 1 BCLC 740 (CA) at 747.
58 *Sovereign Life Assurance Co Ltd v Dodd* [1892] 2 QB 573 (CA).
59 Ibid, at 583.

> dissimilar as to make it impossible for them to consult together with a view to their common interest.

(b) On the other hand, Lord Esher MR placed emphasis on differing "interests". The Master of the Rolls said:[60]

> … [policyholders whose claims had matured] must be divided into different classes [from policyholders whose claims had not matured] … because the creditors composing the different classes have different interests; and, therefore, if we find a different state of facts existing among different creditors which may differently affect their minds and their judgment, they must be divided into different classes.

[70] While tending to focus on the language used by Bowen LJ in *Sovereign Life Assurance Co Ltd*, Courts in this country have interpreted the word "rights" more liberally than in other jurisdictions. They have done so by reference to Bowen LJ's earlier observations (in *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co*),[61] about the scheme of arrangement process, and the need for "extreme care" to avoid an injustice being perpetrated on minority creditors. His Lordship had said:

> It is in my judgment desirable to call attention to [the equivalent to s 205 of the 1955 Act], and to the extreme care which ought to be brought to bear upon the holding of meetings under it. It enables a compromise to be forced upon the outside creditors by a majority of the body, or upon a class of the outside creditors by a majority of that class. It would be most unjust to bind creditors or classes of creditors by the decision of three-fourths in value of those who attend a particular meeting, unless you have secured that the meeting shall adequately represent the entire body.

[71] In *Re Stewart & Sullivan Farms Ltd*,[62] Barker J took the view that a determination of whether a meeting of creditors was required for a particular "class" had to be assessed on a fact-specific basis. In that case, the essence of his approach was to consider whether a single meeting of creditors could have met the needs of both secured and unsecured creditors. Recognising that cases will exist where a sufficient community of interest was present, Barker J said:[63]

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60 Ibid, at 580.

61 *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213 (CA) at 245.

62 *Re Stewart & Sullivan Farms Ltd* [1981] 1 NZLR 712 (HC).

63 Ibid, at 719.

> It will not be necessary in every case to hold separate meetings of secured and unsecured creditors; moreover, it does not necessarily follow that secured creditors are always likely to vote in a way contrary to the interests of the unsecured creditors. When such an application for convening meetings of creditors is before it, the Court must be given full information to enable a decision to be made; the cases indicate that the Court will err on the side of calling separate meetings and will err on giving a liberal meaning to the word "class" of creditor or shareholder. Not all the cases, of course, concern creditors. The *Sovereign Life* case concerned creditors; *Re United Provident Assurance Co Ltd* [1910] 2 Ch 477 and *Re Hellenic & General Trust Ltd* concerned various classes of shareholders.
>
> In the instant case, of the secured creditors, one had security not over land but over chattels; it may have been inappropriate to restrict that creditor from utilising its rights for the period of a moratorium. The point I am making is that these secured creditors should have been given the chance of deciding for themselves on the desirability of the proposal; moreover, the Court should have been fully informed of the extent of their security. Even today, the Court is unaware of the security held by Lombard and AGC.

[72] In making those observations, Barker J did not differentiate between the "rights" and "interests" approaches articulated by Bowen LJ and Lord Esher MR respectively, in *Sovereign Life*.[64] That was understandable. The different considerations that the secured and unsecured creditors might have had in *Stewart & Sullivan Farms* could just as easily be explained as differing legal rights (arising out of the nature of the securities held) as opposed to competing interests that might have influenced each differently.

[73] The *Stewart & Sullivan Farms* approach was followed in both *Re The National Dairy Association of New Zealand Ltd*[65] and *New Zealand Municipalities Co-operative Insurance Company Ltd v Dunedin City Council*.[66] In the latter, McGechan J, after referring to *Sovereign Life*,[67] said:[68]

> … I *follow [the approach taken by Bowen LJ], restated as a converse, ie that there is not one class where persons have rights so dissimilar as to make it impossible for them to consult together with a view to their common interest*. Borderline cases can produce difficulties. One approach expressed recently by the Full Court of the Supreme Court of Victoria in *Re International Harvester Credit Corporation of Australia Ltd (rec & man aptd)*; *Re*

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64 See para [69] above.

65 *Re The National Dairy Association of New Zealand Ltd* [1987] 2 NZLR 607 (HC).

66 *New Zealand Municipalities Co-operative Insurance Company Ltd v Dunedin City Council* (1989) 4 NZCLC 65,044 (HC).

67 See para [69](a) above.

68 *New Zealand Municipalities Co-operative Insurance Company Ltd v Dunedin City Council* (1989) 3 NZCLC 65,044 (HC) at 65,052.

International Harvester (Aust) Ltd (rec & man aptd) (1983) 1 ACLC 889 at p 893; (1983) 7 ACLR 796 at p 799 is:

> To break creditors up into classes, however, will give each class an opportunity to veto the scheme, a process which undermines the basic approach; of decision by a large majority, and one which should only be permitted if there are dissimilar interests related to the company and its scheme to be protected.

Mere differences of opinion do not constitute differences in class. Another, with an arguably different emphasis, is that of Barker J in *Re Stewart & Sullivan Farms Limited* (1981) 1 NZCLC 95-017 at p 98,163; [1981] 1 NZLR 712 at p 719. His Honour ruled on authority that:

> ... the cases indicate that the Court will err on the side of calling the separate meetings and will err on giving a liberal meaning to the word 'class'... .

That same liberal approach to "class" was followed by Smellie J in *Re The National Dairy Association of New Zealand Limited* (supra) at pp 64,208-64,209. With respect, I adopt the same approach. The section permits a potentially serious derogation from established rights. It is proper for the Court to ensure so far as practicable that all interests have a genuine opportunity to participate, and that small classes are not drowned in the flood. *Where there is some doubt whether a separate class exists, as opposed merely to dissentients, the benefit of that doubt should work in favour of recognition of the separate class*. …

(Emphasis added)

[74] The principle I detect from the New Zealand authorities that deal with s 205 of the 1955 Act[69] is that the Court will be astute to ensure that creditors whose legal rights or economic interests are so dissimilar as to make it impossible for them to consult together with a view to their common interest have the opportunity to consider the proposal as separate classes. This approach is consistent to that applied when questions of "proper purpose" are in issue.[70] It seems clear enough that in cases of doubt, a separate meeting was to be ordered.[71]

[75] Although I am satisfied that the s 205 authorities justify a broader approach based on differing "interests", there is room for argument about whether it should prevail. First, as Ms Langston pointed out, an approach based on "legal rights" was preferred by the Court of Final Appeal of Hong Kong, after a full review of relevant

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69 See also, more generally, *Te Runanga O Ngai Tahu v Glenharrow Holdings* Ltd HC Christchurch CIV-2005-409-15, 12 August 2015 (Chisholm J) and *Morris Contractors Ltd (in rec) v Matai Mining Ltd* HC Christchurch CIV-2010-409-724, 7 September 2011 (Associate Judge Osborne).

70 See para [65] above.

71 See para [71] and [73] above.

authorities.[72] Second, there is the question whether the scheme and purpose of Part 14 of the Act requires a different approach. Although the "legal rights" test was not directly applied in either, it formed the basis for discussion, in both *Bank of Tokyo-Mitsubishi UFJ Ltd v Solid Energy of New Zealand Ltd*[73] and *Public Trust v Silverfern Vineyards Ltd*,[74] of the question whether meetings of separate classes should have been convened.

(ii) The s 205 model: "Legal rights" or "interests"?

[76] I start with the Court of Final Appeal's judgment in *UDL Argos Engineering and Heavy Industries Ltd v Li Oi Lin*.[75] Delivering the principal judgment of the Court, Lord Millett NPJ[76] sought to explain that "legal rights" underpinned the nature of a decision to create a class of creditor. In rejecting an "interests" based test, Lord Millett said:

> 26. Why, it may be asked, should persons with divergent interests be allowed to vote as members of the same class…The first is the impracticality in many cases of constituting classes based on similarity of interest as distinct from similarity of rights. **…**A second is that the risk of empowering the majority to oppress the minority…is not the only danger. It must be balanced against the opposite risk of enabling a small minority to thwart the wishes of the majority. Fragmenting creditors into different classes gives each class the power to veto the Scheme and would deprive a beneficent procedure of much of its value. The former danger is averted by requiring those whose rights are so dissimilar that they cannot consult together with a view to their common interest to have their own separate meetings; the latter by requiring those whose rights are sufficiently similar that they can properly consult together to do so. The third reason is that this is mandated by the rationale which underlies the calling of separate meetings. A company can be regarded as entering into separate but linked arrangements with groups whose members have different rights or who are to receive different treatment. It cannot sensibly be regarded as entering into a separate arrangement with every person or group of persons with his or their own private motives or extraneous interests to consider.

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72 *UDL Argos Engineering and Heavy Industries Ltd v Li Oi Lin* [2001] HKCFA 19, [2001] 3 HKLRD 634.

73 *Bank of Tokyo-Mitsubishi UFJ v Solid Energy of New Zealand Ltd* [2013] NZHC 3458 at para [154].

74 *Public Trust v Silverfern Vineyards Ltd* [2015] NZHC 3078 at paras [75]–[82].

75 *UDL Argos Engineering and Heavy Industries Ltd v Li Oi Lin* [2001] HKCFA 19, [2001] 3 HKLRD 634.

76 With whom Li CJ, Bokhary, Chan and Ribeiro PJJ agreed.

[77] That approach conflicted directly with a judgment given by Templeman J in *Re Hellenic & General Trust Ltd.*[77] In that case, a scheme proposed that $15 million of ordinary shares of 10p each of a company were to be cancelled, and new ordinary shares of the same amount and value created. The object was that those shares would be credited as fully paid to a company called Hambros Ltd. Hambros, in return, was to pay ordinary shareholders 48p per share to compensate them for loss of their shareholding. Through a wholly owned subsidiary, Hambros owned 53.01 percent of the ordinary shares. Use of that voting power at the meeting of shareholders convened by Court order assisted significantly in obtaining the requisite majorities to approve the scheme.

[78] A minority shareholder, who held 13.95 percent of the ordinary shares, voted against the arrangement. It argued that the interests of a wholly owned subsidiary of an intended purchaser of shares were different from those of other ordinary shareholders. Different considerations would influence each in determining whether to vote in favour of the scheme. On that basis, that shareholder contended that the wholly owned subsidiary ought to have been put into a different class, and the Court had no jurisdiction to sanction the scheme.

[79] Templeman J began his analysis by reference to the two passages from *Sovereign Life Assurance Co v Dodd*, to which I have already referred.[78] In the context of the case before him, the Judge said that:[79]

> Vendors consulting together with a view to their common interest in an offer made by a purchaser would look askance at the presence among them of a wholly owned subsidiary of the purchaser.

[80] It was put to Templeman J that directors of a company holding one type of shares were "under a duty to consider whether the arrangement was beneficial to the whole class of ordinary shareholders, and they were capable of forming an independent and unbiased judgment, irrespective of the interests of the parent company". Templeman J responded:[80]

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77 *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123 (ChD).
78 See para [69] above.
79 *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123 (ChD) at 126.
80 Ibid.

> This seems to me to be unreal. Hambros are purchasers making an offer. When the vendors meet to discuss and vote whether or not to accept the offer, it is incongruous that the loudest voice in theory and the most significant vote in practice should come from the wholly owned subsidiary of the purchaser.

[81] A literal interpretation of what Templeman J had said in *Re Hellenic & General Trust* was rejected by the Court of Final Appeal in *UDL Argos*. Lord Millett said:[81]

> 22. [*Re Hellenic & General Trust Ltd*] was relied on by the present appellants as showing that separate meetings should have been held because the shareholders had conflicting interests rather than different rights, and it is true that Templeman J consistently referred to the parties respective "interests" rather than their "rights". But it is important not to be distracted by mere terminology. Judges frequently use imprecise language when precision is not material to the question to be decided, and in many contexts the words "interests" and "rights" are interchangeable. They key to the decision is that M was effectively identified with H. It would plainly have been inappropriate to include M in the same class as the other shareholders if it had been buying their shares; it should not make a difference that the purchase was its parent company.
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> (Emphasis added)

[82] An interesting aspect of Lord Millett's interpretation of *Hellenic & General Trust* is that he regarded the terms "interests" and "rights" as "interchangeable" in "many contexts". In light of those observations, and with respect, I find it difficult to understand the distinction that His Lordship drew to distinguish *Hellenic & General Trust*. Lord Templeman's approach was grounded firmly on the proposition that a meeting among vendors "to discuss and vote whether or not to accept the offer" should not be dominated by a party that was closely associated with the purchaser, as a "wholly owned subsidiary".[82] Lord Millett premised his point of distinction on the need to elide the interests of parent and subsidiary company, so as to equate one with the other.[83]

[83] The approach favoured by Templeman J accords with that adopted by McGechan J in *New Zealand Municipalities*. In common with *Hellenic & General*

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81 *UDL Argos Engineering and Heavy Industries Ltd v Li Oi Lin* [2001] HKCFA 19, [2001] 3 HKLRD 634 at para [22].

82 *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123 (ChD) at 126, set out at para [80] above.

83 *UDL Argos Engineering and Heavy Industries Ltd v Li Oi Lin* [2001] HKCFA 19, [2001] 3 HKLRD 634 set out at para [81] above.

Trust, that case involved meetings of shareholders rather than creditors. McGechan J drew a distinction between members who had ceased to pay premiums into a co-operative insurance scheme, and those who continued to pay. He focussed on the different *interests* of each grouping. It could not be sensibly suggested that the two factions had different *legal* interests. McGechan J said:[84]

> I am afraid this situation goes beyond a mere difference of opinion amongst those with an overall common interest. Those who wish to carry on supporting the Company have an interest in locking in funds which might otherwise be extracted by others. Those who no longer wish to support the Company may have an interest in blocking any move to lock in funds which might, as they see it, otherwise be extracted now. As this proceeding demonstrates, the interests at this ultimate point are too dissimilar for the groups to talk. In the circumstances, it would be "proper" to recognise separate classes. It may of course turn out in the end that a sufficient majority at a meeting of all members who no longer support the Company will favour the proposal for a notional winding up distribution despite that distribution then being locked in to share capital, preferring a bird in the hand to one in the bush. That however is a matter for such a meeting, and not for this Court. I cannot escape the conclusion there are separate classes. There was and is a requirement for separate meetings.

[84] So, the question is whether, in the context of Part 14, the test favoured by Lord Millett in *UDL Argos* should be preferred to that which has found favour in New Zealand. To recapitulate:

(a) Lord Millett said that:[85]

> 17. … The principle upon which the classes of creditors or members are to be constituted is that they should depend upon the similarity or dissimilarity of their rights against the company and the way in which those rights are affected by the Scheme, and not upon the similarity or dissimilarity of their private interests arising from matters extraneous to such rights.

(b) The New Zealand approach is more flexible, erring on the side of convening separate meetings in cases of doubt. Both legal rights and economic interests are brought to bear in evaluating the need to create different classes of creditors.[86]

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84 *New Zealand Municipalities Co-operative Insurance Company Ltd v Dunedin City Council* (1989) 4 NZCLC 65,044 (HC) at 65,053.

85 *UDL Argos Engineering and Heavy Industries Ltd v Li Oi Lin* [2001] HKCFA 19, [2001] 3 HKLRD 634 at para 17.

86 See para [74] above.

[85] While it is difficult to quarrel with any of the policy factors to which Lord Millett referred in *UDL Argos,*[87] an approach limited to consideration of legal rights does not sit easily beside the need to ensure that dissenting creditors are not unjustly bound to a scheme.[88] In my view, a pragmatic business-oriented approach should be taken so that the question becomes whether the legal rights or economic interests of creditors who cannot meaningfully consult with each.[89] If those rights or interests were so diverse, separate class meetings should be convened. Commercial imperatives are important in an area of law which has the potential to prevent creditors from exercising legal rights to enforce the payment of debts lawfully owing to them.

(iii) The Part 14 procedure: "Legal rights" or "interests"?

[86] The Part 14 procedure is less paternalistic than the old s 205 scheme of arrangement. It places greater emphasis on the desirability of business people making commercial decisions about what is in their best interests. In contrast, under the s 205 procedure, it was open to the Court to override even a unanimous agreement of creditors if the Court took the view that the scheme was such that an "intelligent and honest" business person might not approve it.[90] Also, the Court lacked jurisdiction to sanction the scheme if proper "class" meetings had not been convened.[91]

[87] Under Part 14:

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87 *UDL Argos Engineering and Heavy Industries Ltd v Li Oi Lin* [2001] HKCFA 19, [2001] 3 HKLRD 634 at para 26, set out at para [76] above.

88 See para [70] above.

89 See para [74] above.

90 Generally, see *Re C M Banks, Limited* [1944] NZLR 248 (SC) at 253 and *Re Milne and Choyce Ltd* [1953] NZLR 724 (SC and CA) at 744–745, set out at paras [50] and [51] above.

91 In *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241, [2001] BCLC 480 at paras [16]–[20], the Court of Appeal held that, if the correct decision had not been made at the first stage as to the classes of creditors in respect of which meetings were required, the Court did not have jurisdiction to sanction the scheme. That brought about the unfortunate situation in which creditors may have acted on the basis of voting prescribed by the first Court order, yet could not have their compromise sanctioned because, at the second Court hearing, it was decided that the first order was wrong. In that case, Arden J, at first instance, had refused to sanction a scheme notwithstanding the absence of any objection to it, or criticism of its commercial efficacy. See also *Re Stewart & Sullivan Farms Ltd* [1981] 1 NZLR 712 (HC) at 718, applying what was said by Templeman J in *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123 (ChD) at 125.

(a) The proponent chooses the classes of creditors that meet to consider whether to accept the compromise.[92]

(b) The classes of creditors chosen by the proponent meet and, if the compromise were approved by a majority in number and 75 percent in value of each, the proposal is accepted. From that moment, the scheme is operative: it is self-executing, rather than dependent upon Court sanction.[93]

(c) There are limited circumstances in which a dissenting creditor can seek to be excluded from an approved compromise. The grounds of challenge focus on material irregularities or unfair prejudice to a particular creditor, or a class to which a creditor belongs.[94]

(d) While the Court has a general discretion when granting relief, the only specified means by which the Court may remedy any problem is by ordering that a challenging creditor is not bound by the compromise.[95]

[88] The absence of the need for Court sanction before a compromise becomes effective means that the jurisdictional bar to imposing the will of the statutory majorities on dissenting creditors is removed. In that situation, it is appropriate for the Court to take a broad view of circumstances, particularly those relating to the definition of a class of creditors, which might act to unfairly prejudice a dissenting creditor.

[89] The basic principle, espoused by Bowen LJ in *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co*, remains applicable.[96] In my view, the Court must be astute to ensure that the proponent's ability to control the process does not bring about a manipulation of majorities to achieve a result that best meets its own interests, or those of insiders.

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92 See para [64] above.
93 See para [63] above.
94 Companies Act 1993, s 232(3), set out at para [54] above. See also para [53] above.
95 Ibid.
96 The extract from Bowen LJ's judgment in *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213 (CA) at 245 is set out at para [70] above.

[90] In a helpful article, Mr Michael Josling concluded with a plea for a "more flexible test" to determine whether different classes of creditors should meet to consider a Part 14 proposal.[97] In doing so, the author promoted the type of interests-based test that I have favoured. In a passage with which I respectfully agree, Mr Josling suggested that:[98]

> … Class voting is to provide for the situation where the process of give and take between the creditors becomes impossible. Or in terms of [a quotation taken from a decision of the Supreme Court of the United States in *Canada Southern Railway Company v Gebhard* (1883) 109 US 529, 536], where individuals interests become so opposed that any concept of "general good" is illusory. And as a result, it is no longer possible for creditors to conduct themselves for the common good.

[91] Even if (contrary to the view I have expressed[99]) the *UDL Argos* approach were appropriate under the old s 205 regime, the different purpose of Part 14 requires a flexible approach to relief. In determining whether particular conduct has been "unfairly prejudicial" to a creditor, or a class of creditor, it is necessary to look at the different means by which such unfair prejudice could arise. In the context of a claim based on unfair prejudice arising out of the failure to create a particular class of creditor, cases such as *Re Hellenic & General Trust* (on the one hand) and *UDL Argos* (on the other) demonstrate that such prejudice can arise either through creditors with different legal rights or economic interests being required to vote within the same class. Accordingly, a more general test, that entitles the Court to consider both legal rights and economic interests, is justified solely on the basis of the differences between the old s 205 schemes and Part 14 compromises.

(iv) Was there unfair prejudice?

[92] In the context of the present case, two issues arise on the challenging creditors' submission that they have been unfairly prejudiced by the proponents' decision to hold one meeting of creditors. The first is whether the insider creditors ought to have been put into a different class, for voting purposes. The second is

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97 Michael Josling "An analysis of the rights test in determining classes of creditors" (2010) 18 Insolv LJ 110 at 134.

98 Ibid, at 135.

99 See para [85] above.

whether any prejudice to the challenging creditors, as a result of the use of a single meeting, can properly be labelled "unfair".

[93] The first is a legal question to be determined by reference to the test I have identified. That is whether the legal rights or economic interests of the challenging creditors (on the one hand) and the remaining affected creditors (on the other) were so dissimilar that they could not consult together to promote a common interest.[100] The second concerns the motivation of the proponent. If a single meeting were convened in a deliberate attempt to manipulate voting, so as to achieve "manufactured" statutory majorities, any prejudice suffered by the challenging creditors would undoubtedly be unfair.

[94] In my view, the insider creditors ought to have been put into a separate class for the purpose of voting on the compromise. Their interests were not such that they could properly consult with other creditors (including the challenging creditors) for a common purpose.[101]

[95] Although the proposal involved capital being injected by an unnamed third party for the benefit of affected creditors, Mr Johnson persisted in a view that the compromise was advantageous to all affected creditors. This is evidenced by the terms of the "Statement Relating to Compromise" signed by Messrs Johnson and Taylor in which they explained why the compromise was being put[102] and Mr Johnson's explanation to the meeting of creditors that advice to put the company into liquidation had been rejected because he considered that Trends "would trade profitably and then would be able to pay back the creditors".[103] The latter comment was patently wrong. If the compromise were approved, those creditors participating in the distribution would receive a payment in full and final satisfaction of their debts. They would have no legal recourse against Trends to recover the balance of their debts if the company was rescued.

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100 See *New Zealand Municipalities Co-operative Insurance Company Ltd v Dunedin City Council* (1989) 4 NZCLC 65,044 (HC) at 65,052, the relevant extract from which is set out at para [73] above.

101 I deal separately with the argument that the minor creditors should have been put into a class of their own: see paras [107]–[111] below.

102 See para [24](c) above.

103 See the penultimate bullet point set out in para [36] above.

[96] In addition, nothing credible was put to affected creditors to explain why the insider creditors should vote even though they were not participating in the compromise distribution. A consistent approach to voting would have seen similar voting rights conferred on other creditors who were not to participate in any distributions; for example, Trends' bankers and preferential creditors, including the Commissioner of Inland Revenue.

[97] On the other hand, the challenging creditors were to consider whether to accept a relatively small payment in full and final satisfaction of their debts, or to retain the right to seek a liquidation order in an endeavour to recover moneys from directors of Trends. Whether, on full financial analysis, the dividend offered would have produced a better result than the risk of proceeding through liquidation is beside the point. The question is whether the challenging creditors ought to have been able to make that decision for themselves, together with other unsecured creditors. On the facts of this case, it did not matter whether minor creditors were or were not in the same class as the challenging creditors because, without the insider creditors, a 75 percent majority in value of affected creditors could not have been achieved.

[98] As a result of the failure of the proponent to allow for at least two classes of unsecured creditors (the insider creditors and remaining affected creditors respectively), the challenging creditors were prejudiced. If separate classes had been created the requisite majorities would not have been achieved.

[99] The second question is whether that prejudice was unfair; or, put another way, was one or more of the challenging creditors unfairly prejudiced by the proponents' decision to convene only one meeting of creditors? In this case, that question turns on whether there has been a deliberate manipulation of the voting rights to achieve a goal consistent with the needs of the proponent, and its insiders.

[100] In *Bank of Tokyo-Mitsubishi UFJ, Ltd v Solid Energy New Zealand Ltd*, Winkelmann J considered this point. Although, on the facts with which she was

confronted, it was unnecessary to address the question of alleged class manipulation, the Judge said:[104]

> [186] Although not an argument advanced under this cause of action, the argument that Bank of Tokyo made in respect of the third cause of action that the classes have been manipulated is clearly an argument that more properly relates to this cause of action. If the classes of creditor were manipulated for the purposes of the compromise in order to swamp Bank of Tokyo's vote, that might amount to an abuse for the purposes of s 232(3)(c).

[101] On my analysis of the evidence, I can see no good commercial reason for including the insider creditors within the group of affected creditors who were to vote on the proposed compromise. The explanation given by Mr Johnson is implausible.[105] In the absence of a credible explanation from Mr Johnson or Mr Khov, I find that the decision to include the insider creditors for voting purposes was deliberate. Both Mr Khov and Mr Johnson must have been aware of the effect of the insider creditors voting; in particular, the need for all three to be counted in order to be sure that the statutory majority in value was attained.

[102] I infer[106] that the meeting of creditors was structured deliberately to ensure that occurred, in a situation that both Mr Khov and Mr Johnson knew would bring about that result. Accordingly, I find that each of the challenging creditors was unfairly prejudiced by the decision to call only one meeting of creditors. In my view, such a manipulation is precisely the type of abuse of process at which s 232(3)(c) of the Act is aimed.[107]

(e) The remaining grounds of complaint

(i) Adequacy of financial information

[103] The challenging creditors contend that the proponents failed to provide adequate information about the financial affairs of Trends.[108] It is said that the

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104 *Bank of Tokyo-Mitsubishi UFJ, Ltd v Solid Energy New Zealand Ltd* [2013] NZHC 3458 at para [186]. The Law Commission's proposed approach is set out in *Company Law: Reform and Restatement* (NZLC R 9, 1989) at para 638, set out at para [53] above.

105 See the highlighted part of para 9.5 of his affidavit, set out at para [17] above.

106 See paras [19]–[22] above.

107 Section 232(3)(c) is set out at para [54] above. See also *Bank of Tokyo-Mitsubishi UFJ, Ltd v Solid Energy New Zealand Ltd* [2013] NZHC 3458 at para [186], set out at para [100] above.

108 See para [39](a) above.

information actually provided was insufficient to enable each of them to make an informed and reasoned decision whether to accept the proposal.

[104] The allegation of failure to provide adequate financial information is referable to s 229(2)(b) and cl 2(2)(a) of Schedule 5 of the Act.[109] As previously indicated, a generic approach has been taken to this obligation of material disclosure.[110] There is no requirement for a proponent to disclose financial statements. The assumption is that a proponent will make as fulsome disclosure as it deems necessary in the circumstances.

[105] In my view, while it is clear that the solicitors for Callaghan had concerns about the quality of financial information provided,[111] I do not consider that the proponents' failure to provide more information materially prejudiced that creditor, in a way that would have affected decision making at the meeting of creditors. The existence of the correspondence demonstrates an ability for individual creditors to seek additional information. A decision to vote against the scheme could be made just as much on the basis of inadequate information as on an evaluation of all disclosed financial information.

[106] I do not consider there was any causal nexus between the absence of information of the type sought and the way in which voting was undertaken. On any view, had the insider creditors not voted in favour of the scheme, it could not have been approved.

(ii) Did the minor creditors represent a different class?

[107] Mr Bisley argued that the minor creditors should have been placed in a different class because they, unlike other affected creditors, were to be paid in full if the compromise were approved.[112]

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109 The relevant parts of s 229(2)(b) are set out at para [61] above. See also para [62] above, in relation to the obligations stemming from cl 2(2)(a) of Schedule 5 to the Act.

110 See para [62] above.

111 Generally, see my summary of the exchange of correspondence set out at paras [32] and [33] above.

112 See paras [42](c) and [43](a) above.

[108] In some cases, it may be necessary for minor creditors (particularly trade creditors) to be placed in a different class from others. The number of such creditors could operate to achieve a majority in number of those voting in favour, but is unlikely to result in a 75 percent in value majority being attained. Necessarily, that means the question whether a separate class is required is one of degree. An informed judgment must be made by a proponent before the compromise is forwarded to affected creditors for their consideration.

[109] Often, a compromise will provide for payment of minor creditors to reduce administration costs and/or to encourage trade creditors to continue to provide goods or services for the continuing business enterprise. In such cases, there will be benefits to a general body of creditors.

[110] The factors that differentiate interests of trade creditors from those of others were identified helpfully by Miller J, in his separate judgment in *McIntosh v Fisk.*[113] His Honour said:

> [101] I will elaborate briefly on these conclusions. I begin by noting that trade creditors form a distinct class, for two reasons. First, trade credit is a species of business financing in which the supply of goods and services is bundled with a credit transaction. It is by no means inevitable that firms should finance themselves in this way; payment could be made on delivery or firms could turn to third party lenders such as banks. A standard explanation for trade credit appears to be that suppliers enjoy a monitoring advantage over banks; indeed, their presence may encourage banks to lend. Dependency on the debtor offers another explanation. Whatever the explanation, the prevalence of trade credit and its persistence across time indicate that it performs a valuable economic function. Hence the relevance of finality of payment, or commercial confidence, when examining apparently preferential transactions with trade creditors.
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> [102] Second, trade credit exhibits several characteristics that distinguish it from other lending in relevant ways. Trade creditors supply value in kind, in the form of goods or services. It appears that very seldom do they lend cash. Payment terms are short, usually somewhere in the range seven to 90 days. And it appears that credit is seldom rolled over. The creditors in Allied Concrete appear to have exhibited these characteristics, which enabled them to point to some discrete asset that the debtor obtained in return for a payment made soon afterward. Where such connection is sufficiently close, it may be that no distributional unfairness is done to other unsecured creditors by allowing the creditor to retain the payment; they may not recover the money, but the asset it purchased is available for realisation.

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[113] *McIntosh v Fisk* [2016] NZCA 74, [2016] 2 NZLR 783.

> [103] Those who lend cash are not in the same position. The debtor may benefit from a loan, of course, but the connection between an unsecured loan and an asset is likely to be less immediate. Nor is there any reason to prefer lenders as a class; they are third parties, such as banks, that are in the business of lending money and likely to take security.
>
> (footnotes omitted)

[111] On the facts of this case, it is unnecessary to explore whether the minor creditors ought to have been separated into a different class. Their removal from the general body of creditors and the absence of their votes could not have affected the outcome if the insider creditors had been permitted to vote alongside others. That means there is no causal link between any error in identifying a separate class and in the approval of the compromise that resulted from the vote.

(iii) Should Callaghan have been put in a separate class?[114]

[112] There are two unusual features of Callaghan's status as a creditor. The first is that, although a counterclaim has been brought by Trends against it, no attempt was made to nullify (or reduce the value of) its right to vote at the meeting of creditors. The second is that there was a contingent asset available to Trends, to the extent that any successful counterclaim might have exceeded Callaghan's proved debt. That was not disclosed in the compromise materials.

[113] The first did not adversely affect any of the challenging creditors, other than Callaghan. Their attempts to reject the compromise would have been thwarted, in any event, if the insider creditors had been able to vote in their class. By being in a separate category, Callaghan would have had an effective right of veto of the compromise. Even if all other creditors had voted in favour of it, the compromise would have been rejected at Callaghan's instigation. Such an approach would likely have been unfairly prejudicial to all other creditors.

[114] As to the second, the way in which the compromise was formulated meant that Trends would retain the benefit of any successful counterclaim, to the extent that it exceeded Callaghan's debt. In all likelihood, that approach could be regarded as unfairly prejudicial to challenging creditors other than Callaghan. However, I do not

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[114] See para [42](d) above.

need to determine that point having regard to my conclusion on the voting manipulation issue.

(iv) Would liquidation have produced a better result for creditors?

[115] The challenging creditors adduced evidence from an experienced insolvency practitioner, Mr Grant Graham, to support a submission that affected creditors were more likely to receive a greater return from a liquidation than through the compromise.[115] That is said to have resulted in the approved proposal being unfairly prejudicial to the challenging creditors.

[116] The expert opinions expressed by Mr Graham were sound. However, some of the assumptions on which he was asked to express his opinion are questionable. That is no criticism of Mr Graham. Rather, it is a reflection of the fact that, necessarily, his opinions have been based on incomplete information.

[117] In particular, the costs and risks of proceeding with claims against directors of the company are difficult to estimate. The costs of an investigation, notwithstanding the existence of the Deloitte report, are likely to be significant. So too, if proceedings were defended, are the costs of prosecuting them. Even if successful claims were brought, questions of enforcement would need to be addressed. Further, secured claims made by Thecircle, as well as those of the Bank of New Zealand and Trends' preferential creditors, would need to be brought to account. As a result, it is far from clear that any dividend that might be paid to the affected creditors under the compromise would be less than that otherwise recovered by a liquidator.

[118] In those circumstances, it cannot be said confidently that a better outcome would have been available to creditors if the compromise had not been approved.

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115 See para [43](c) above.

(f) The "relief" issue

(i) The nature of the discretion to grant relief

[119] The question of relief falls to be considered in the context of my finding that the failure to provide for a class meeting of insider creditors was unjustly prejudicial to each of the challenging creditors.

[120] It is implicit from the terms in which s 232(3) of the Act[116] is cast, that relief must be tailored to the particular breach that gives rise to the material irregularity or unjust prejudice. While the only specific form of relief set out in s 232(3) is the power to make an order that "the [challenging] creditor is not bound by the compromise", empowerment of the Court to "make such other order as it thinks fit" suggests a broad discretion that enables the Court to grant the most appropriate remedy to meet a challenging creditor's successful complaint.

[121] In approaching the question of relief, I bear in mind fundamental differences between the Part 14 procedure and scheme of arrangement processes in other jurisdictions. A Part 14 compromise is effective immediately upon approval by affected creditors, subject only to the Court's residual discretion to grant relief in cases of material irregularity or unjust prejudice.

[122] As the nature and extent of the discretion to grant relief is not one that has been analysed in any of the relevant authorities, I approach the question as one of first impression, informed by the purposes of Part 14 and the need to ensure that the procedure is not abused to the detriment of either a particular creditor, or a class of creditors.[117]

(ii) The options

[123] In this case, each of the challenging creditors sought an order that the compromise be set aside. No specific argument was advanced by Trends as to the

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116 Section 232(3) is set out at para [54] above.

117 Generally, see Law Commission *Company Law: Reform and Restatement* (NZLC R 9, 1989) at para 638 set out at para [53] above.

type of relief that might be granted. Its opposition was grounded firmly in its submission that there was neither material irregularity nor applicable unjust prejudice.

[124] Three options appear to be available:

(a) An order setting aside the compromise. [Option One] Such an order would have the effect of removing benefits to creditors who voted in favour of it.

(b) An order that the challenging creditors not be bound by the compromise. [Option Two] Such an order would leave the compromise binding on all creditors who were not parties to the s 232 application, including Times Printers.

(c) An order that the compromise not be binding on any creditor that voted against it. [Option Three]

[125] The effect of Option One would be to restore the *status quo* that existed immediately before the meeting of creditors on 22 May 2015. That would mean that minor creditors and others who voted in favour of the compromise would not receive any payment. That consequence is acute in the context of minor creditors, most of which stood to be paid in full. Although there is limited evidence on the point, it is likely that some suppliers of goods or services may have continued to trade with Trends on the faith of the *prima facie* agreement that their previous debt would be paid, at least substantially.

[126] The consequence of Option Two is that some of the affected creditors that voted against approval of the compromise would, nevertheless, be bound by its terms because each failed to bring an application for s 232(3) relief. Times Printers is one of the creditors that would fall into that category. Even though, through evidence given by an executive, Times Printers actively supported the applications by the challenging creditors, they would not benefit from Option Two relief because they were not prepared, for practical reasons, to join as parties to the applications.

[127] The consequence of Option Three would be to require compliance with the terms of the compromise, including waiver of security by Thecircle, even though affected creditors, in whose favour relief was granted could proceed to bring liquidation proceedings. Problems might then arise as to whether receipt of any funds could be treated by a liquidator as a voidable transaction, or would be protected based on principles discussed by the Supreme Court in *Allied Concrete Ltd v Meltzer*.[118]

(iii) Analysis

[128] On balance, I consider that the appropriate relief is to set aside the compromise, and to restore the *status quo*. That would mean that all of Trends' creditors (including those that were not included within the scope of the compromise) would be at liberty to pursue a liquidation, if satisfactory settlement arrangements could not be made. As the compromise would be set aside, the waiver of security for the purpose of voting could no longer be binding on Thecircle. Otherwise, Thecircle would be placed in a worse position than it would have been in had the compromise not been put to a vote.

[129] In reaching that conclusion, I have considered three authorities in which differing remedies have been considered. They are *PMP Print Ltd v POL (NZ) Ltd*,[119] *Polperro Corporation Ltd v International Marine Services Ltd*[120] and *Public Trust v Silverfern Vineyards Ltd*.[121]

[130] In *PMP Print Ltd*, Associate Judge Faire considered a case in which a debt had been artificially increased in order to ensure that a 75 percent majority in value was attained. Although he also considered a separate complaint, the Associate Judge was of the view that the manipulation of the claimed amount, of itself, was sufficient to represent the type of irregularity in respect of which relief was justified.[122] Having made that finding, the Associate Judge discussed the nature of relief that

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118 *Allied Concrete Ltd v Meltzer* [2015] NZSC 7, [2016] 1 NZLR 141.
119 *PMP Print Ltd v POL (NZ) Ltd* HC Auckland CIV-2004-404-3482 31 May 2005.
120 *Polperro Corporation Ltd v International Marine Services Ltd* HC Auckland CIV-2006-404-2390, 16 July 2007.
121 *Public Trust v Silverfern Vineyards Ltd* [2015] NZHC 3078.
122 *PMP Print Ltd v POL (NZ) Ltd* HC Auckland CIV-2004-404-3482 31 May 2005 at paras [20] and [21].

should be granted. In doing so, he raised a concern that has also troubled me. It relates to the position of creditors who voted on the compromise but who have not been joined as parties to this proceeding. Associate Judge Faire said:

> [24] There is, as I explained to counsel in the course of argument, an important consequence of finding the irregularity in this case. It strongly suggests that the Court should, as advanced in the notice of opposition, make an order that the compromise is binding on none of the creditors because of the irregularity. *I was concerned, in the first instance, at making such an order because all the creditors who had filed voting forms and proofs, save for the plaintiff and POL Corporate Publications Pty Limited, did not have notice of this application to the Court. What is significant, however, is that in each of their cases, that is the other creditors, the amounts of money are small by comparison with the position of the plaintiff and POL Corporate Publications Pty Limited. Further, and to put it beyond doubt, I make it plain that the order that I shall make is made in respect of the creditors other than the plaintiff and POL Corporate Publications Pty Limited, on an ex parte basis and therefore are subject to the position that applies in respect of ex parte orders so far as those creditors are concerned*. It seems to me, unlikely, because of the amounts involved, that they would want to contest, in any event, the order that I shall make. However, their position is protected by virtue of my declaring that the order in respect of them is made on an ex parte basis.
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> [25] To put the matter beyond doubt, I consider that, in terms of r256(2)(e) [of the High Court Rules] that the interests of justice is best served by my proceeding without requiring notice to those creditors.
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> (Emphasis added)

[131] In *Polperro*, Associate Judge Doogue made an order that the challenging creditor was not bound by the compromise into which International Marine Services Ltd (IMC) had entered with its creditors. Polperro (the landlord) was owed about $25,232.88 in settlement of overdue rent, interest and costs pursuant to a settlement agreement with IMS entered into on 10 March 2006. This was not paid and Polperro served a statutory demand on 16 March 2006. On 3 April IMS proposed a compromise to its creditors for 10 cents in the dollar in full and final settlement. Polperro voted against the compromise, but it was duly adopted at the meeting of affected creditors and, in accordance with its terms, Polperro received a cheque for $2,523.20 on 21 April 2006.

[132] The Associate Judge found that the largest unsecured creditor, Smartships, was not in fact a legitimate creditor of IMS and was therefore not entitled to vote;

without that vote the compromise would not have had the required 75% super majority. Judge Doogue said:

> [71] My conclusion is that the Court is authorised and required to enquire into whether Smartships was at the material time a creditor of IMS. Having carried out that enquiry, I conclude that Smartships was not a creditor as that term as defined in s 303 of the Companies Act 1993. Further, the fact that Smartships as a non-qualified creditor, voted on the compromise was a "material irregularity" or alternatively, being based upon, inter alia, the counting of a vote from an unqualified creditor, the resulting compromise was "unfairly prejudicial" to Polperro – within the meaning of s 232 of the Act. That being so, the Court has a discretion whether or not to make an order that Polperro is not bound by the compromise. In my view such an order ought to be made. IMS did not refer me to any countervailing considerations that would justify me in not exercising my discretion. Creditors in the position of Polperro are entitled to the Courts protection because they are vulnerable to misuse of the compromise mechanism contained in Part 14 of the Act. In circumstance where I have affirmatively concluded that there was no basis for the compromise, it would be wrong for the proceedings to conclude on any basis other than that Polperro is entitled to regard itself as free from the compromise and able to enforce its debt to its full extent against IMS.
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> [72] I order that the plaintiff is not bound by the compromise of creditors entered into 11 April 2006.

[133] In my view, an important factor in the grant of that type of relief was that the Associate Judge did not consider there were any "countervailing considerations" to require a different remedy. The Associate Judge's conclusion was primarily influenced by Polperro's vulnerability to misuse of the compromise mechanism. However, the Judge did not consider whether it would be unfair to allow Polperro to pursue a separate claim while leaving other creditors bound by the compromise. I assume the point was not argued. In any event, it appears that all unsecured creditors other than Polperro had accepted a payment in consequence of the approved compromise in full and final settlement.[123]

[134] In *Public Trust v Silverfern Vineyards Ltd*, Muir J found that a compromise agreement was not a valid agreement and was void.[124] The principal reason for that conclusion was that the agreement purported to include waivers of personal guarantees of third parties associated with the company, which the Judge considered

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123 *Polperro Corporation Ltd v International Marine Services Ltd* HC Auckland CIV-2006-404-2390, 16 July 2007, at para [13].

124 *Public Trust v Silverfern Vineyards Ltd* [2015] NZHC 3078 at para [96].

should only have proceeded under Part 15, and thereby Court supervision.[125] Muir J made *obiter* comments suggesting that, if he had not reached that view, he would have excluded the creditors from the compromise. While the Judge set aside the compromise, he did not discuss whether any alternative remedy was more appropriate.

[135] On balance, I consider that the compromise should be set aside because:

(a) As a result of a deliberate manipulation of the voting system, a fundamental error was made in failing to provide for a separate class for insider creditors.

(b) A good faith compromise proposal was never advanced.[126] The concept of good faith compromise is undermined in any case where a proponent has deliberately manipulated voting rights to manufacture a desired result; particularly, one beneficial to insiders.

(c) There is no clear evidence that Mr Khov and Mr Grant, as proposed "Compromise Managers",[127] have control of the funds to be paid under the compromise. It is far from clear that they have the ability to compel provision of the money from the third party.

(d) No payments have been made from the "Initial Pool" in the manner intended.[128] Thus, minor creditors have not been paid. As a result, they will not be called on to refund any dividend received.

(e) As Trends has brought a counterclaim against Callaghan seeking unquantified damages for defamation, if Callaghan were to issue a statutory demand to enforce its debt, it would be open to this Court to stay such a proceeding pending determination of the counterclaim. The fact that the counterclaim has been set down for hearing in

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125 Ibid, at para [55]. See also *Cargill International SA v Solid Energy New Zealand Ltd (subject to deed of company arrangement)* [2016] NZHC 1817 at paras [60]–[83].
126 See paras [61]–[63] below.
127 See para [23] above.
128 See paras [26]–[28] above.

November 2016 would be a relevant factor for the Court to consider on an application to set aside the statutory demand.[129]

[136] I have considered whether to make an order setting aside the compromise subject to an ability for all other creditors who voted at the meeting on 22 May 2015 to apply to rescind that order and ask for its reconsideration.[130] However, in circumstances where there has been a fundamental misuse of the compromise process and no payments have been made in accordance with its terms for a period in excess of one year, I do not consider that is necessary. I suggest that counsel for challenging creditors in other cases should consider carefully the extent to which other affected creditors need to be joined on an application for relief.

Result

[137] For the reasons given, I make an order that the compromise *prima facie* approved by affected creditors on 22 May 2015 is set aside, with immediate effect.

[138] I make an order for costs against Trends on a 2B basis, together with reasonable disbursements. As all challenging creditors were represented by the same firm of solicitors and counsel, one set of costs is ordered in their favour. I certify for second counsel.

[139] I thank counsel for their assistance.

P R Heath J

Delivered at 2.30pm on 7 September 2016

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[129] Companies Act 1993, s 290(4). As to the background to the counterclaim see paras [9]–[11] above. Alternatively, if Callaghan proceeded to file a liquidation proceeding without the benefit of non-compliance with a statutory demand, it would be open for Trends to apply for a stay: see s 247 of the Companies Act 1993.

[130] See para [130] above.