(2019) 7 NIBLeJ 4

Compromises with Creditors – New Zealand Supreme Court Considers the Issue of whether Creditors' Economic Interests are Relevant to Class Composition

Victoria STACE*

'COMPROMISES WITH CREDITORS' REGIMES - OVERVIEW

England, Australia, Hong Kong, and Singapore all have compromises with creditors provisions in their insolvency laws that are versions of section 206 of the Companies Act 1948 (UK). These provisions are intended to facilitate a company entering into an arrangement with all or some of its creditors to restructure debt. Broadly speaking, this procedure involves three stages: an initial court application to approve the process, a meeting of affected creditors to vote on the proposal, and a second court hearing at which the court decides whether to approve the proposal or not. Under this procedure, described in this note as the 'traditional compromise regime', if a majority in number and 75% (or more) in value of the creditors vote in favour of the compromise, and the court approves it, it becomes binding on all creditors included in the compromise.

Instead of a three-stage process, a binding compromise with creditors can be effected in New Zealand under Part 14 of the Companies Act 1993 (NZ), without any court approval. Part 14 was introduced in 1993 and was intended to provide a more useful procedure for facilitating compromises with creditors than the traditional compromise regime (which had been the law under the previous New Zealand Companies Act). The court only gets involved if an application is made to it by the debtor, or a creditor complains about the compromise on one of three permitted grounds: insufficient notice, material irregularity or unfair prejudice. Under Part 14, the traditional compromise regime has effectively been collapsed into one stage, or potentially two stages. The first stage is the creditors' voting and the second is a court hearing, but a hearing will only happen if an application is brought by the debtor or a creditor.

A body of case law has grown up around the traditional compromise regime. That case law establishes what the court will consider at the first court hearing and the questions it will ask when deciding whether to give approval at the second court

hearing. The court's power at the approval hearing in particular is to ensure that the majority are not coercing the minority in order to promote interests adverse to or different from those of the class they purport to represent.

Turning to the issue of when creditors will be required to vote in separate classes, the approach that has been adopted in the UK, Australia, Hong Kong and Singapore is that if the creditors' *rights* are so dissimilar that they cannot sensibly consult together to consider the compromise proposed, then they must vote in separate classes. This usually involves looking at the creditors' rights under the compromise proposed, and their rights in the absence of a compromise. In particular, the creditors' rights in the alternative scenario of a liquidation are commonly considered. Several of the cases have expressly rejected arguments that the test should focus on whether the creditors have different *interests*.[1]

Pre-2002 case law had established that the question of whether the creditor classes have been correctly constituted is more properly to be determined at the approval hearing.[2] If the classes have been incorrectly constituted, that goes to jurisdiction, meaning that the court has no power to sanction the compromise at the approval hearing.[3] The inefficiency of this approach was recognised in *Re Hawk Insurance Co Ltd*[4] and that led to the issuing of a new Practice Statement in 2002 by the English Chancery Court, effecting a change in practice.[5] The new procedure is "designed to enable so far as possible the determination of all issues in relation to the composition of the class or classes of creditors or members for the purposes of a scheme to take place at the hearing of the application for leave to convene meetings."[6] Creditors who consider themselves unfairly treated will still be able to raise objections at the approval hearing, although the court will expect a good explanation for why they were not raised earlier.[7]

The issue of how creditors are to be grouped into classes in the context of a Part 14 compromise came before the New Zealand Supreme Court in the recent decision of *Trends Publishing International Ltd v Advicewise People Ltd (Trends Publishing).*[8] The New Zealand Supreme Court was divided, three to two, effectively in favour of

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*Victoria Stace (LLB(Hons) VUW, LLM (Cambridge)), Senior Lecturer, Victoria University of Wellington, Law School.

[1] See for example *Re Jax Marine Pty Ltd* [1967] 1 NSWR 145, 148, *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358, [27], *Re Telewest Communications Plc* [2004] EWHC 924 (Ch), [19], *Re HIH Casualty and General Insurance Ltd* [2006] NSWSC 485, [70], *The Royal Bank of Scotland NV v TT International Ltd* [2012] SGCA 9, [140] and *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116, [78].

[2] See for example *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358 at [13] and *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241 at [19].

[3] *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358 at [13], [14] and [27].

[4] *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241.

[5] *Practice Statement (Companies: Schemes of Arrangement)* 2002 WL 347191.

[6] *Re Telewest Communications Plc* [2004] EWHC 924 (Ch), at [11].

[7] *Practice Statement (Companies: Schemes of Arrangement),* n 4, at [7].

[8] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62.

allowing differences in economic interests to require different classes of creditors to be constituted. The dissenting judgment more closely followed the prevailing English view, that class composition is to be decided by reference to differences in legal rights alone. The minority, which included the Chief Justice, suggested that the approach adopted by the majority may be taking New Zealand on a different path from other common law jurisdictions and that it is "likely to encourage highly contestable bases for differentiation of classes which could invite reopening of compromises after the event".[9]

However, the majority's approach recognises that under Part 14, the court will only have one opportunity (if at all) to review the way a compromise with creditors has been put to and voted on by creditors. The approach adopted by the majority was that, however the classes have in fact been comprised, the question to ask is, has the process produced a compromise which, in accordance with the policy of the Act, appropriately binds those who voted against it? [10] This involves a pragmatic assessment by the court at the end of the process extending to consideration of what happened at the meeting or meetings.[11] This is broadly in line with the approach taken by the English courts at the stage of the approval hearing.[12]

THE PREVAILING ENGLISH APPROACH – CREDITORS ARE TO BE GROUPED BY REFERENCE TO LEGAL RIGHTS

As recognised by the majority in *Trends Publishing*,[13] the first significant case to consider classification of creditors was *Sovereign Life Assurance Co v Dodd*.[14] The case concerned an arrangement entered into by a life insurance company in the course of winding up that affected the entitlements of policyholders. One issue was whether policyholders should have been separated into different classes for the purpose of voting on the arrangement (in particular, whether policyholders whose policies had not matured should have been put in a different class from those whose policies had matured). The most frequently cited passage is from the decision of Bowen LJ, who said the word 'class' in the relevant legislation "must be confined to those persons whose *rights* are not so dissimilar as to make it impossible for them to consult together with a view to their common interest."[15] Lord Esher MR in the same case stated that the reason why the relevant Act contemplated that the creditors

[9] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [133].

[10] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62**,** at [65].

[11] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [47].

[12] See for example Lord Millett's summary of the court's role at the approval hearing in *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358, [27]: "The Court will decline to sanction a Scheme unless it is satisfied, not only that the meetings were properly constituted and that the proposals were approved by the requisite majorities, but that the result of each meeting fairly reflected the views of the creditors concerned." See also *Re Apcoa Parking Holdings GMBH* [2014] EWHC 3849 (Ch), at [126].

[13] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [42].

[14] *Sovereign Life Assurance v Dodd* [1892] 2 QB 573.

[15] *Sovereign Life Assurance v Dodd* [1892] 2 QB 573, at 583.

would be divided into classes was because "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 judgement, they must be divided into different classes."[16] As noted by the minority in *Trends Publishing*, "[t]here is nothing in *Sovereign Life* to suggest that Lord Esher was referring to "interests" in any broader sense than interests recognised by law,"[17] in other words, interests arising from rights. In any event, the notion that creditor classes are to be determined by reference to rights rather than interests has become the accepted approach, not only in the UK, but also Australia, Hong Kong and Singapore.[18]

A recent decision of the England and Wales High Court, *Re Apcoa Parking Holdings GMBH,*[19] reviewed the relevant case law since *Sovereign Life Assurance Co v Dodd* and confirmed that the test for class composition is based on a comparison of rights. Here, a group of companies applied for sanction to a scheme of arrangement to effect a restructuring to avoid formal insolvency procedures. The scheme was ultimately sanctioned but only after amendment following the court initially declining to sanction the arrangement. Each stage of the court process was opposed by one creditor. When setting out the test for class composition, Hildyard J stated that, while some uncertainty had been created by *Re Hellenic & General Trust Ltd*[20] (discussed below), the "principle was clear."[21] He acknowledged that the "classic" formulation of the test by Bowen LJ had been refined in *Re Hawk Insurance Co Ltd,*[22] where Chadwick LJ had introduced the idea that one compromise might on a true analysis "be two or more linked compromises or arrangements with creditors whose rights put them in several and distinct classes."[23] Hildyard J also approved Chadwick LJ's statement that "it is necessary to ensure not only that those whose rights really are so dissimilar that they cannot consult together with a view to a common interest should be treated as parties to distinct arrangements – so that they should have their own separate meetings – but also that those whose rights are sufficiently similar to the rights of others that they can properly consult together should be required to do so; lest by ordering separate meetings the court gives a veto to a minority group."[24]

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[16] *Sovereign Life Assurance v Dodd* [1892] 2 QB 573, at 580.
[17] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [128].
[18] See *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241 at [23]- [33], *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358 at [17], *Re Telewest Communications Plc* [2004] EWHC 924 (Ch) at [19],
The Royal Bank of Scotland NV v TT International Ltd [2012] SGCA 9 at [130]-[131], *Re Apcoa Parking Holdings GMBH* [2014] EWHC 3849 (Ch) at [47], and *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116 at [77]-[78].
[19] *Re Apcoa Parking Holdings GMBH* [2014] EWHC 3849 (Ch).
[20] *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123.
[21] *Re Apcoa Parking Holdings GMBH* [2014] EWHC 3849 (Ch), at [47].
[22] *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241.
[23] *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241, at [16].
[24] *Re Apcoa Parking Holdings GMBH* [2014] EWHC 3849 (Ch), at [47].

The notion that it is more than just any dissimilarity in rights that leads to separate classes was highlighted by Hildyard J in *Re Apcoa*, drawing on *Re Telewest Communications Plc (No 1)*[25] and *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin (UDL Argos)*[26] as authority for the proposition that the differences in rights must be such that it is impossible for all the creditors in the group to sensibly consult with a view to their common interests.[27] Ultimately, Hildyard J found that the "modern approach" is to "ask first whether there is any difference between the creditors in point of strict legal right, and only to proceed to the second question, at the Convening stage, if there is; and if there is, to postulate, by reference to the alternative if the scheme were to fail, whether objectively there would be more to unite than divide the creditors in the proposed class, ignoring for that purpose any personal or extraneous interest or subjective motivation operating in the case of any particular creditor(s)."[28]

In *UDL Argos*, the Hong Kong Court of Final Appeal confirmed that in relation to the Hong Kong equivalent of the traditional compromise procedure,[29] which mirrors section 206 of the Companies Act 1948 (UK), the test for composition of classes is based on consideration of the rights of the creditors. That case involved creditors objecting to an application to sanction a scheme of arrangement, on the basis that separate classes should have been established for preferential creditors and related creditors. The court undertook a thorough examination of the English cases and rejected an approach that focused on the interests of the creditors. The approach the court took was that creditors who had different interests (but not different rights), for example other members of the same group of companies as the debtor, would be allowed to vote on the proposal in the same class as non-related creditors but the court retained the power to discount or disregard their votes at the stage when deciding whether to approve the compromise. The reasons given for allowing creditors who were associated with the debtor to vote in the same class included that it would be impractical to base class composition on similarity of interests, and also the risk that fragmenting creditors into separate classes might enable a small minority to thwart the interests of the majority. In effect, differing interests amongst creditors was not a matter requiring voting in separate classes, but might give grounds for the court to exercise its discretion to decline approval.[30] Lord Millett NPJ reserved a right for the court, at the stage of approval of the compromise, to "discount or disregard altogether the votes of those who, though entitled to vote at a meeting as a member of the class concerned, have such personal or special interests in supporting the proposals that their views cannot be regarded as fairly

[25] *Re Telewest Communications Plc* [2004] EWHC 924 (Ch).
[26] *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358,
[27] *Re Apcoa Parking Holdings GMBH* [2014] EWHC 3849 (Ch), at [48] and [49].
[28] *Re Apcoa Parking Holdings GMBH* [2014] EWHC 3849 (Ch), at [52].
[29] Then contained in the Companies Ordinance Cap 32 (HK), s 166 and now in the Companies Ordinance Cap 622 (HK), ss 666-677.
[30] *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358, at [26] and [27].

representative of the class in question."[31]

The approach in Australia to grouping creditors is also rights-focused, as demonstrated by a line of cases that includes *Re Jax Marine,*[32] *Re Landmark Corp Ltd,*[33] *Re Opus Prime Stockbroking Ltd (No 2)*[34] and *First Pacific Advisors Ltd v Boart Longyear Ltd*.[35] *Re Jax Marine* and *Re Landmark Corp* both involved related creditors voting in the same class as non-related creditors. Adopting the rights-based test from Bowen LJ's judgment in *Sovereign Life Assurance v Dodd,* which he described as "the accepted test",[36] Street J in *Re Jax Marine* found that the existence of a personal interest did not "render it impossible for them to pursue their own interests concurrently with their participating in the pursuit of the interests of the class…". However, those votes would not necessarily carry equal weight at the approval stage. "Quite frequently it is necessary to discount, even to the point of discarding from consideration, the vote of a creditor who, although a member of a class, may have such personal or special interest as to render his view a self-centred view rather than a class-promoting view."[37]

A recent Australian decision is *First Pacific Advisors Ltd v Boart Longyear Ltd,*[38] which concerned two proposed compromises, one for secured creditors and the other for unsecured creditors. The proposed arrangements were complex and the amounts of debt involved, large. The estimated return to creditors in the alternative scenario of liquidation was significantly lower (at least in relation to the secured creditor compromise) than that proposed under the compromises. The New South Wales Court of Appeal discussed its role at the preliminary hearing, and acknowledged that the court's role at this stage is generally limited.[39] Even if a decision was reached at the preliminary hearing on class composition, the court stated that did not preclude debate on the same issue at the later approval hearing.[40]

The court acknowledged that there were differences in the rights granted under the compromises proposed, to different creditors who were put in the same class. There were also "substantial differences in commercial interests."[41] The arguments around differences in rights focused on the fact that the main related creditor would achieve a majority shareholding in the debtor company and get director appointment rights. Counsel for the complaining creditor drew support from the 1975 English High

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[31] *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358, at [27].
[32] *Re Jax Marine Pty Ltd* [1967] 1 NSWR 145.
[33] *Re Landmark Corp Ltd* [1968] 1 NSWR 759.
[34] *Re Opus Prime Stockbroking Ltd (No 2)* [2009] FCA 813.
[35] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116.
[36] *Re Jax Marine Pty Ltd* [1967] 1 NSWR 145, at 148.
[37] *Re Jax Marine Pty Ltd* [1967] 1 NSWR 145, at 148.
[38] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116.
[39] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116, at [39]-[40].
[40] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116, at [40].
[41] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116, at [45], quoting from the primary judge's decision of 10 May 2017 in *Re Boart Longyear Limited* [2017] NSWSC 567, at [74].

Court decision in *Re Hellenic & General Trust Ltd*[42] (discussed below) when focusing on the change in control that would be achieved for the related creditor, and to an earlier Australian decision where the court had found that certain creditors had their rights and position affected by the proposed compromise in such a way that community of interest was destroyed, meaning they could not consult together.[43] The court however found that differences in commercial financial interests do not come under consideration when addressing class constitution.[44] When assessing if the *rights* of creditors were different enough to warrant voting in separate classes, the question was whether "viewed in the totality of the scheme's context, are [the rights and entitlements] so dissimilar as to make it impossible for them to consult together with a view to their common interest."[45] In considering whether any difference in rights or different treatment of rights would make it impossible for creditors to consult together as a class, the context in which the scheme is propounded was considered of importance. In this case the only alternative was insolvency. The court found that the rights of the creditors, while dissimilar, were not so dissimilar as to require voting in different classes.

The court also confirmed, following *UDL Argos*, that it is not bound by the decision of the creditors' meeting. If the result of the meeting did not fairly reflect the views of the creditors concerned, then the court has the ability to disregard the votes of those who "have such personal or special interest in supporting the proposal that their views cannot be regarded as fairly representative of the class in question."[46]

The strongest authority in support of an argument that economic interests as well as rights must be considered when considering the correct composition of a class of creditors comes from *Re Hellenic & General Trust Ltd.*[47] *Re Hellenic* involved a proposed compromise under section 206 of the Companies Act 1948 (UK) (which contained the traditional compromise procedure). The proposal involved an arrangement for restructuring the shareholding in the company, Hellenic, so that Hellenic would become a subsidiary of Hambros. Section 206 (and its re-enactment in sections 896-899 of the Companies Act 2006 (UK)) allowed for an arrangement between the company and its members (as well as between a company and its creditors). The court held that it had no jurisdiction to sanction the arrangement because the necessary agreement of the appropriate class of members had not been obtained. There were, said the court, two classes of member, M (which was a subsidiary of Hambros) forming a separate class because "no one can be both a

[42] *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123.
[43] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116, at [64]. The case referred to was *Re HIH Casualty and General Insurance Ltd* [2006] NSWSC 485.
[44] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116, at [78].
[45] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116, at [81], citing from *Re Hills Motorway Ltd* (2002) 43 ACSR 101.
[46] *First Pacific Advisors Ltd v Boart Longyear Ltd* [2017] NSWCA 116, at [79]. This was also the law applied in *The Royal Bank of Scotland NV v TT International Ltd* [2012] SGCA 9, at [155].
[47] *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123.

vendor and a purchaser and …M were in the camp of the purchaser."[48]

The decision in *Re Hellenic* was explained by Lord Millett NPJ in *UDL Argos* in the following terms:[49] "The rights proposed to be conferred by the Scheme on M and the other shareholders were commercially so dissimilar as to make it impossible for M and the other shareholders to consult together with a view to their common interest, for they had none." In other words, Lord Millett NPJ saw the differences between the creditors as a matter of rights, not interests. Other courts have acknowledged that *Re Hellenic* creates an exception to the rights-based test, see for example, the decision of the Singapore Court of Appeal in *The Royal Bank of Scotland NV v TT International Ltd.*[50]

Given that Part 14 of the Companies Act 1993 (NZ) has collapsed the traditional compromise procedure into a one or possibly two-stage process, where the court may have no involvement at all, how is the law above to be applied in a New Zealand context? This is the issue that was addressed in *Trends Publishing*. The case is of note in particular because of the approach the majority took to the issue of whether economic interests, unrelated to the terms of the proposed compromise, were relevant in determining creditor class composition.

THE MAJORITY DECISION IN *TRENDS PUBLISHING*

Trends Publishing International Ltd (Trends) provided printing, publishing, marketing and advertising services. Its business was under financial pressure following the global financial crisis and it appeared arguably to be insolvent from around 2013. In May 2015, the directors of Trends put forward a proposal to unsecured creditors under Part 14 of the Companies Act 1993 (NZ) to restructure debt. This was prepared with the help of an insolvency practitioner. 74% of the debt was owed to 'inside' creditors, being a company under the control of a director of Trends, Trends' general manager, and another director. The inside creditors agreed not to participate at all in the pool of money to be made available under the compromise. The reason given for this was that this was a show of "good faith".[51] However, the inside creditors would still vote on the compromise. The compromise was approved by the requisite majority of affected creditors. The inside creditors all voted for it, as did all the creditors owed less than $1000 (who were to get paid out in full) and a number of others.

The unsecured creditors who were challenging the compromise would receive between 11% and 18% of the amounts owed to them and would have no further claim against the debtor. These creditors brought a claim under s 232 of the

[48] *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123, at [126].
[49] *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358, at [23].
[50] *The Royal Bank of Scotland NV v TT International Ltd* [2012] SGCA 9.
[51] *Advicewise People Ltd v Trends Publishing International Ltd* [2016] NZHC 2119, at [17].

Companies Act 1993 (NZ), alleging material irregularity and unfair prejudice, both being grounds on which the court can grant relief.

The majority of the Supreme Court found that, given that Part 14 was intended to provide an "easier and cheaper" approval mechanism than the traditional compromise regime,[52] and provides a more limited role for the court, a restated approach to the issue of classification was required. The approach the majority favoured was intended to build on the "purposive" approach taken by earlier New Zealand decisions.[53] By this, the majority meant that classification of creditors is not to be viewed as an end in itself but rather should be seen as instrumental in "facilitating a process that will produce compromises which, in accordance with the policy of the Act, appropriately bind those who voted against them."[54] The policy of the Act was identified as being that the approval of a compromise that reflects a "fair business assessment" by creditors, should be given effect to.[55] There is an assumption behind that policy (said the majority) that such business assessment will reflect the common interests of all those bound. If all creditors share a common interest in maximising the return on their debts, then differences either in rights or interests will be of no moment. In this situation, creditors will be expected to vote on the basis of a class-promoting view.[56] The majority identified two situations where that assumption is displaced, namely where creditors which have the same (pre-compromise) rights and interests are treated differently under the compromise, and secondly, where the benefits and drawbacks of the compromise are different for particular creditors (the example given being where a creditor is also a shareholder or director of the debtor company and by reason of that does not share the same class-promoting view as other creditors).[57]

The majority reached this view after a review of the leading UK, Australian, and Hong Kong cases on this topic. Canadian authority was also referred to. The majority used Chadwick LJ's question from *Re Hawk Insurance* of "between whom is it proposed that a compromise or arrangement is to be made"[58] as the starting point for the discussion as to whether the creditor classification had resulted in unfair prejudice to creditors that had voted against the compromise. In *Trends Publishing*, there were in effect two groups of creditors, those who wished to see the company continue to trade (and were prepared to pay something to make that happen) and those who were seeking to recover money owed to them (and were prepared to compromise as to the amount paid so long as it was a reasonable compromise in the circumstances). Here, the inside creditors (said the majority) were effectively on both sides of the deal. It was therefore unfair that the dissenting creditors should be

[52] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [64].
[53] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [64].
[54] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [65].
[55] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [66].
[56] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [66].
[57] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [67].
[58] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [82].

bound by a decision made by those on the "other side" of the bargain.[59] Another unfair aspect of the proposal was that creditors who were owed less than $1000 were to be paid out in full. This represented 17 creditors (being 35.4% of those entitled to vote but only 0.17% of the debt). These creditors (said the majority) were not compromising their rights and were therefore being offered a "different deal". Unfair prejudice was therefore made out and the majority did not see it as important to differentiate between the court's powers under s 232(3)(b) (material irregularity) and s 232(3)(c) (unfair prejudice). The compromise was accordingly set aside.

THE MINORITY DECISION IN *TRENDS PUBLISHING*

The minority (which included the Chief Justice) would not have set the compromise aside but would have ordered that the complaining creditors not be bound by it. The minority took a fundamentally different approach from the majority to the issue of classification of creditors. The minority saw it as undermining the usefulness of the Part 14 procedure if those proposing a compromise must set up different classes according to creditors' different economic interests or other goals.[60] If creditors are grouped according to their similarity of legal rights then (said the minority) there is no irregularity under s 232(3)(b) and (on that ground alone) no unfair prejudice (s 232(3)(c)), even if the creditors have different economic interests.[61] This approach was supported by reference to previous New Zealand authority and was also said to be consistent with overseas authority. The statement by Lord Millett NPJ in *UDL Argos* regarding the impracticality of constituting classes based on similarity of interest (as distinct from similarity of rights) was cited with approval.[62]

However, the complaining creditors in this case would have been granted relief by the minority because the information they were provided with about the compromise was deficient. The minority found that material non-disclosure of information constituted material irregularity under s 232(3)(b). The minority also found there was unfair prejudice to the creditors that voted against the compromise. This resulted from a combination of the fact that the directors who put the compromise proposal forward risked potential liability if the company had been put into liquidation, and the way the compromise had been deliberately structured to ensure that the requisite voting thresholds would be achieved.

DISCUSSION OF THE NEW ZEALAND APPROACH

The law emerging from the majority decision in the Supreme Court in *Trends Publishing* would appear to require classification of creditors by reference to both legal rights and economic interests, and more generally by reference to a principle

[59] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [84].
[60] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [104].
[61] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [105].
[62] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [127].

that all creditors in a class must share a similarity of "interests"[63] so that the compromise "appropriately" binds those who vote against it.[64] If not all creditors in the class share a common interest in maximising the return on their debt, for a reason that relates to the nature of the proposal or to rights or interests in relation to the company (for example, as shareholders or directors of the debtor), then those creditors cannot vote in the same class (or if they do the vote may be challenged under s 232(3)).

The approach taken by the majority, while displaying a pragmatic approach designed to facilitate a mechanism for the approval of compromises that is "easier and cheaper" to negotiate than the traditional compromise regime,[65] arguably leaves debtors with little guidance as to how to structure creditor classes. The identified purpose, of producing a compromise that will "appropriately bind those who vote against [it]", and the notion of a "fair business assessment by the creditors",[66] are not precise guiding principles. Somewhat more useful is the test of whether all creditors share a common interest in maximising the return on their debt, and whether the assumption that this is the case is displaced on the facts by "other considerations."[67]

By contrast, the minority judgment closely aligns with the wording of s 232(3) of the Companies Act 1993 (NZ). If the statutory requirements have not been complied with (requisite meetings held and information provided, for example), or if there is an error in the constitution of a class (for example, including creditors with materially different legal rights), that constitutes a 'material irregularity'. If the creditors vote otherwise than in a class-promoting way or the scheme is not such that an intelligent and honest person of business might reasonably approve it, then that may constitute 'unfair prejudice'. The minority considered that the usefulness of Part 14 could be undermined if those proposing a compromise were required to set up different classes according to different economic interests.

Nevertheless it is suggested that, while the majority decision may arguably create some uncertainty at the front end of a compromise procedure around correct class composition, the majority approach is the preferable interpretation of section 232. In effect, the majority recognised that, under Part 14, the court has a limited role, being one of review at the end of the compromise process, if an application is made to it. In order to fulfil that review function, the court should apply the tests recognised in the various English, New Zealand and other cases that have articulated the court's role at the approval hearing (in other words, the third stage of the traditional compromise regime).[68] By contrast, the minority appeared to see section 232 as removing the requirement of court sanction (which encompasses an overall review),

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[63] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [47].
[64] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [65].
[65] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [64].
[66] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [65] and [66].
[67] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [67].
[68] See for example *Re Apcoa Parking Holdings GMBH* [2014] EWHC 3849 (Ch) at [126] to [130], *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358, at [27], *Re CM Banks Ltd* [1944] NZLR 248, at 253.

and replacing it with a power to grant unhappy creditors relief on specific grounds.[69] This is a more literal interpretation of the relevant statutory provision but seems to have left little room for any ultimate assessment of whether the vote of each class of creditors was fairly representative of the class in question.

When operating under the traditional compromise regime, there are several underlying and conflicting policy objectives which the courts are balancing when determining the issue of whether creditor classes have been correctly constituted. The first is the need to ensure that the majority does not unfairly force the proposed compromise onto the minority that oppose it, noting that once approved by the requisite voting threshold (and sanctioned by the court), an arrangement will bind the dissenting creditors. However, dividing the creditors into classes gives each class the ability to veto the arrangement, so proliferation of classes can result in giving the dissenting minority the power to hold out unfairly against the majority who want to see the compromise proceed. Layered on top of those concerns is a desire to promote an efficient procedure, being one where class composition can be easily determined and the voting proceed, without the risk that the court may later effectively overturn the result of the vote on jurisdictional grounds. Finally, there is the court's need for flexibility to revisit the way creditors voted, at the approval hearing, to ensure that the voting fairly reflected the views of the creditors concerned.

Notwithstanding the reduced role of the court under Part 14 of the Companies Act 1993 (NZ), each of those policy considerations is still relevant in New Zealand but the court only has one chance to consider and balance them, and that is at the end of the process (assuming an application is made to it). In particular, the wording of section 232 of the Companies Act reflects the policy of protecting minority creditors from a compromise that is unfairly imposed on them by the majority (either by reason of irregular procedure or improper class composition).

A guiding principle which can be drawn from the majority decision is that the vote must represent a fair business assessment by the requisite majority of the creditors in each class (or as a whole if all creditors vote as one class). The compromise proposal in *Trends Publishing* was never going to meet that standard. In particular, the facts that:

- the landlord creditor waived its security enabling it to vote on the compromise;
- the inside creditors voted but agreed to accept no payment;
- the creditors that were owed $1000 or less and representing 35% of those entitled to vote were fully paid out;
- the information given to creditors was deficient (for example they were not given information on intercompany indebtedness); and
- there was a suggestion that there may have been scope to recover against the directors under the reckless trading rules on a liquidation,

[69] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [120].

all suggested that the compromise was not put fairly to the creditors, did not represent a fair business assessment by the requisite majority and failed the test of "substantive fairness" said by the majority to be the focus of s 232(3)(c).[70]

Word count: 6384 (includes footnotes), 5171 (excludes footnotes)

[70] *Trends Publishing International Ltd v Advicewise People Ltd* [2018] NZSC 62, at [72].