IN THE SUPREME COURT OF NEW ZEALAND SC 103/2017

BETWEEN TRENDS PUBLISHING INTERNATIONAL LIMITED
Appellant

AND ADVICEWISE PEOPLE LIMITED
First Respondent

CALLAGHAN INNOVATION
Second Respondent

MEDIAWORKS RADIO LIMITED
Third Respondent

WEBSTAR, a division of **BLUESTAR GROUP (NEW ZEALAND) LIMITED**
Fourth Respondent

Hearing:	22 February 2018
Coram:	Elias CJ William Young J Glazebrook J O'Regan J Ellen France J
Appearances:	A M Glenie and G A Barkle for the Appellant S M Bisley and O C Gascoigne for the Respondents

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CIVIL APPEAL

MR GLENIE:

May it please the Court, my name is Glenie. I appear with Ms Barkle for the appellant.

ELIAS CJ:

Thank you, Mr Glenie, Ms Barkle.

MR BISLEY:

May it please the Court, my name is Bisley and I appear for the respondents, together with my learned friend Mr Gascoigne.

ELIAS CJ:

Thank you Mr Bisley and Mr Gascoigne.

Yes, Mr Glenie.

MR GLENIE:

Good morning, Your Honours.

The appellants have prepared a roadmap of submissions. That is the one-page document which is available for you, and that really just was an optimistic attempt to try and put some structure around what I had to say today, but you'll see from that roadmap that at the very start I had in mind to make five factual points just very briefly. The facts are already traversed in the submissions. These are just discrete points which have emerged from that exchange.

The first of those points, Trends' financial outlook, there is a bit of a flavour in the respondents' documents that Trends was insolvent for an extended period. I just wanted to note that that is resisted. Trends is a business that was undergoing a change. It had been a traditional media business, and was reshaping itself into a new tech business. It had come up with what it called the Trends platform. That was the platform for growth. That was the reason that Callaghan got interested in Trends because they saw the potential for this

thing to become an export earner. It's what Mr Johnson called his "really big entrepreneurial idea". And he had put some money into it and Callaghan had agreed to put some further money into it, because they saw the potential. But everything came to a grinding halt with the SFO investigation in late 2014. That had a dramatic effect on turnover. The business really stopped and that was the reason why a compromise was proposed in the first few months of 2015.

I really only say that just to note that the perception that Trends was in some way insolvent for years prior to the compromise, it might be a little unfair to think that of a company which was, in effect, a tech start-up which was reshaping itself into a new, aspirational company.

The second point is perhaps slightly more important. The position of the insider creditors – and I'm sure there'll be some discussion of these points today – the compromise proposal was circulated on 12 May and that proposal included the three insider creditors, Thecircle (the property-owning company) Ms Messer and Mr Taylor, the latter two employees of the business, and there were questions raised at a very early stage about how The circle was participating, given that it had a security in respect of its $3.5 million debt.

The respondents have suggested that that security was susceptible to challenge. It was given in February 2015, clearly within the two-year period, and they have suggested that it would be tipped over if the company had ended up in liquidation. That's obviously not Trends' perspective. Trends' perspective is that it was a valid security but it was validly waived. It was given away by Thecircle.

WILLIAM YOUNG J:
But it wasn't entirely waived, was it?

MR GLENIE:
It was waived $3 million out of the $3.5 million.

WILLIAM YOUNG J:

So they're insisting on the security as $0.5 million?

MR GLENIE:

I believe that's correct, Your Honour.

ELIAS CJ:

Where do we find it formally recorded? It's not in the compromise proposal, is it?

MR GLENIE:

No, Your Honour.

ELIAS CJ:

And similarly the waiver of ability to share in the distributions from the various pools. Where is that recorded in the contemporary documents?

MR GLENIE:

Not well-recorded, Your Honour. It's recorded in the meeting minutes and the –

ELIAS CJ:

So it was something that was explained at the meeting, was it?

MR GLENIE:

It's certainly the waiver of security and the waiver of the right to distributions was well-covered at the meeting. I can't recall –

ELIAS CJ:

Well, it may have been well-covered, but what substantiation and what notification of it was there? None, was there? No notification?

MR GLENIE:

I'll have to accept that that's right now. In the break I will check whether there was any mention in the documents surrounding the compromise but I can't now recall that there was any formal document recording the waiver of the security or the waiver of the right to payment.

ELIAS CJ:

And so it's recorded only in the minutes of the meeting. Can you just take me to those, tell me where they are?

MR GLENIE:

Those are at tab 79, I believe, Chief Justice.

ELIAS CJ:

Where are we looking at? Oh, this is the Scott says/David says stuff that's quoted in the judgments.

MR GLENIE:

At page 784, three-quarters of the way down the page. There is a passage that reads, "Scott states that Thecircle is a secured creditor. Secured creditors are not able to vote. So has Thecircle waived their debt?" Simon answers, "Yes, a portion. $3 million." Scott asks how much. $3.5.

WILLIAM YOUNG J:

Doesn't that – I may be wrong, I probably am wrong – but doesn't that suggest that Thecircle was in a different position from the other creditors because it had a security for $500,000 that was arguably susceptible to challenge which would be defeated if the compromise was approved?

MR GLENIE:

It's in the same boat as the other creditors insofar as the $3 million is no longer –

WILLIAM YOUNG J:

I know, but – all right. Leaving aside whether it's interest or rights or both, it is actually in a quite different position from the other creditors generally, because the other creditors aren't getting an advantage from deferral of liquidation.

MR GLENIE:

The other creditors aren't getting a deferral from the liquidation – sorry, I missed that final …

WILLIAM YOUNG J:

Well, if liquidation is deferred, the ability to challenge the security eventually is either lost or compromised.

MR GLENIE:

After the passage of two years, yes.

WILLIAM YOUNG J:

Right. So Thecircle has a secured – a doubtful security for $500,000 which becomes less doubtful if the compromise is approved.

MR GLENIE:

With the passage of time, yes, Your Honour.

WILLIAM YOUNG J:

And that's an interest that's entirely unrelated to its interest or right – it's entirely unrelated to its rights as a creditor.

ELIAS CJ:

Unsecured creditor.

WILLIAM YOUNG J:

As an unsecured creditor.

MR GLENIE:

Correct, Your Honour. So it has retained an interest in repayment of that $500,000 and that would be secured after the passage of the claw-back period.

WILLIAM YOUNG J:

That seems to me – I mean, I'm finding it difficult to articulate it, you know, with great precision. But that point itself troubles me, that they are really – mixing Thecircle with the others is a chalk and cheese mix. Thecircle really wants the company to continue because it's got a security that gets better over time. The others have got to make a decision whether liquidation now is best.

MR GLENIE:

Indeed, and that interest is one of the – that motivation is one of the reasons why Thecircle could legitimately vote with all of the other creditors because they had an interest in receiving their payment now. Admittedly, it's a subtly different – it is a different interest from the creditors in that their interest was in repayment of the $500,000, but it is a reason why the waiver of the entitlement to the payment does not distinguish Thecircle, Messer, and Taylor from the other creditors.

WILLIAM YOUNG J:

No, what's troubling me is not so much that, it's the securable portion of their debt that distinguishes them from the other creditors.

MR GLENIE:

In relation to that portion of their debt. In relation to the $3 million, they're obviously the same. I think what Your Honour is saying, they may have had different motivations in voting as a creditor in the unsecured pool.

ELIAS CJ:

Well, a related point is – sorry, you were going to also then show us the waiver of the right to participate because there's a related point in respect of that.

MR GLENIE:

I'll just need to find that reference for you, Chief Justice. I wonder if I might ask my junior to help.

ELIAS CJ:

Well, similarly, then. Assuming it's there somewhere, and this is a very odd and informal waiver, I would have thought, of the security but similarly if there's a waiver of right to participate in the pool generated by the compromise, what interest does Thecircle have in the compromise?

MR GLENIE:

And equally Ms Messer and Mr Taylor, what interest did they have because they weren't receiving any money from it?

ELIAS CJ:

Yes.

MR GLENIE:

That's one of the key points of difference between the respondents and the appellants, and the answer that the appellant gives to that is that although they were not taking any money from the initial pool, the first point is that that was a –

ELIAS CJ:

Well, is it only the initial pool?

MR GLENIE:

Indeed. The subsequent payments as well, so the monthly payment.

ELIAS CJ:

Well, they weren't then going to get any payments under the compromise?

MR GLENIE:

That's correct.

ELIAS CJ:

Well, why doesn't that mean that they're not creditors, really, for the purposes of this exercise?

MR GLENIE:

I think the first point is that they were creditors prior to the compromise. They remained creditors with a zero cent claim if that's not too fine a distinction. They certainly had a right to payment prior to the compromise, and they were in that respect no different from any of the other creditors who voted in the pool on that day, but they have given away their rights to payment because they wanted to ensure that the other creditors received payment. They've done what they thought was a generous thing. All three of Thecircle, Messer and Taylor, they have given away that right to ensure that everybody else shares in a greater pool of money.

ELIAS CJ:

But they weren't generous enough to allow the affected creditors to make the determination?

MR GLENIE:

Well, that's perhaps the point to come back on, Your Honour. The generosity is in the sharing of the funds that were available at that time and the second part of it, the second part of their motivation is that both Thecircle and Messer and Taylor had an interest in the business surviving – firstly in the way in which Justice Young has just explained. Thecircle retained a debt which was not to be paid as part of the compromise but which would remain available if the company was to survive perhaps down the line.

ELIAS CJ:

How does it remain available to it under the terms of the compromise? Because I thought the creditors compromise all their claims.

MR GLENIE:

The effect of the compromise was to compromise those debts which were the subject of the compromise, and only $3 million of the debt owing to Thecircle was compromised, meaning that $500,000 would remain.

ELIAS CJ:

Well, that's the – you say the record of that is in the minutes where they – oh, I see, that's the waiver of the portion of the debt.

GLAZEBROOK J:

That's the waiver of security, but …

ELIAS CJ:

No, I think it may be a bit more than that. Has waived their debt.

GLAZEBROOK J:

It's not exactly clear from that, is it?

MR GLENIE:

My junior, Ms Barkle, has pointed me towards page 704, which is the original compromise statement.

ELIAS CJ:

Sorry, what is this document? Oh, this is a statement that was distributed with the proposal?

MR GLENIE:

Correct. Indeed, captures the proposal. It's the statement which is required under section 229.

ELIAS CJ:

Oh, yes. Sorry, what page?

MR GLENIE:

704 under the heading "What interests do directors have in the compromise?" and it notes that Mr Johnson is the director of Thecircle, Mr Taylor is the director of Trends, and also a creditor. The board highlights that Thecircle and Mr Taylor reserve their right to vote but have elected not to participate in any distributions from the compromise. I'm not sure why there was no mention of Ms Messer made at that point, but perhaps the reason why this was in connection with disclosure of directors' interests. Mr Taylor was a director and an employee. Ms Messer was just an employee.

ELIAS CJ:

So how does this preserve the $500,000 – is it $500,000?

MR GLENIE:

That statement alone doesn't. It may be that there was insufficient disclosure of exactly what was being done.

ELLEN FRANCE J:

Well, in the list at page 17 of that document of Thecircle, the figure for Thecircle is the 3 million figure.

MR GLENIE:

Correct.

ELIAS CJ:

What does that mean?

WILLIAM YOUNG J:

What's the effect – the entitled creditors, do they lose their claims? They don't, do they?

MR GLENIE:

They lose their claims in the sense that they are replaced with a further claim to 13 cents or 17 cents in the distribution. So the claims are –

WILLIAM YOUNG J:

Okay. Sorry – the insider creditors, their claims aren't affected, are they?

MR GLENIE:

Their claims to the $3 million for Thecircle, Messer and Taylor, those claims are wiped.

WILLIAM YOUNG J:

Where does it say they're wiped?

MR GLENIE:

Well, that's the effect of the terms of the compromise which is set out on – I think it is page 707.

ELIAS CJ:

Is it the –

WILLIAM YOUNG J:

So they're compromise creditors, they're within the definition of compromise creditors?

MR GLENIE:

Correct, and everybody's claim is wiped subject to the entitled creditors receiving the entitlement to the payment. So the distinction is that the three insider creditors are not entitled creditors and so therefore wouldn't receive any money.

WILLIAM YOUNG J:

Okay, I understand.

MR GLENIE:

So the purpose behind all of that –

ELIAS CJ:

Sorry, is the significance of the schedule, Appendix 2, that it is reduced to $3 million?

MR GLENIE:

It's not made as clear as it could have been.

ELIAS CJ:

Well, this all seems pretty material irregularity.

MR GLENIE:

I'm not sure that I would accept that just yet, Your Honour, but the point of the schedule is that it was disclosing that a very substantial debt was being waived by Thecircle and the –

ELIAS CJ:

But that they were voting in respect of it, that interest.

MR GLENIE:

Correct, and the reason that they were voting in relation to a proposal which, as the respondents say, they had no interest is they had interest in preserving the company. So Mr Johnson had an interest in preserving the company which he had built up over decades. He had a bit of founder's pride, if that's the right way of putting it. He wanted to see his employees looked after. He wanted to see the creditors receive what he called the maximum recovery. Thecircle wanted to see the company survive because Thecircle was the landlord of the property in which Trends operated. So if Trends folded, Thecircle would then need to find another tenant and there would be some awkwardness about that.

ELIAS CJ:

But as founder and director, he doesn't have any voting rights in the compromise.

MR GLENIE:

Only as creditor, only via Thecircle as a creditor, but he is connected with Thecircle. I think that's acknowledged. And Messer and Taylor, they both had relatively substantial claims, but again, those were loyal employees. They had worked for Mr Johnson for a very long time and they stood to remain employed. I think that's the key point, that they thought that if they didn't give this money away, they independently came to the view that the company would fold and these quite senior people would then have to find other employment, so they may have had a reason to vote in that sense.

So that's intended to give some explanation for why they gave away that entitlement to payment.

Are there any further questions on the waiver of payment?

O'REGAN J:

How much would they have received if they hadn't waived it?

MR GLENIE:

I haven't done that maths, but it would be a small proportion of the 120,000 owed to Ms Messer and the 30,000 owed to Mr Taylor, a few thousand dollars, I expect. I'll need to figure that out.

O'REGAN J:

So it was a gesture rather than a matter of economics?

MR GLENIE:

It was a gesture in the sense that they gave away quite large entitlements. 120,000 for an employee is quite a large number and they gave away the much smaller proportion that they might have received.

O'REGAN J:

But they were going to get 1% of it or something.

MR GLENIE:

Quite a small proportion, that's right.

O'REGAN J:

How small?

MR GLENIE:

I would need to figure that out.

O'REGAN J:

Well, it just seems to me to say it's generous when in fact it's pretty much petty cash seems a bit of a misnomer.

MR GLENIE:

I'm not sure that it's quite petty cash. Admittedly if Thecircle was to participate in the distribution as well the proportions for everybody would change because of the money available. I think Thecircle had three million out of four point something million dollars in debt and that would take most of that pool, and that's the reason Johnson didn't want to take any of the money, because he saw that he would drain the pool of funds that were available. But that would mean that everybody else would have received a much lower pay-out, and as it was, they stood to receive somewhere between – I think it's 11 cents and 18 cents. And if they had all participated, they would all have received – perhaps it is one to two cents.

ELIAS CJ:

The compromise did favour, I suppose, the very small creditors.

MR GLENIE:

The minor creditors.

ELIAS CJ:

Yes.

MR GLENIE:

I think the –

ELIAS CJ:

So it gave priority to them, really, ahead of the other – it's so trivial that it doesn't much matter but that's a curious feature, too.

MR GLENIE:

I think on these facts it doesn't affect the outcome. The minor creditors are relatively numerous but also very small, so one of them was owed $4, I think, and a few others were owed in the hundreds of dollars.

ELIAS CJ:

So how many who made up the 6% are of non-conflicted, non-plaintiff creditors were in that category? What of that percentage?

MR GLENIE:

Let me see if I can answer that question slightly indirectly. There were 25 minor creditors. 17 of those voted for the compromise and there were 37 entitled non-minor, non-insider creditors.

ELIAS CJ:

Yes.

MR GLENIE:

And of those a number didn't vote. Nine voted against the compromise but 19 voted in favour of the compromise, so if Your Honour's question is what percentage of the non-minor, non-insider creditors voted for –

ELIAS CJ:

The 6% that is referred to in the submissions, 6% point something.

MR GLENIE:

I'd need to try and find it.

ELIAS CJ:

Don't worry. It all comes – you know, it's not really material, I wouldn't have thought, but I was just curious.

MR GLENIE:

And, you know, there is a legitimate question to be asked about why the minor creditors were treated in this way, and I think the answer is that there was a desire to ensure that those parties who are often quite small businesses were receiving their full entitlement because they're cutting them back to 1 or 2% or even 11% would mean that on $700 they might receive something quite derisory, $50, you know, something along those lines, which would have been potentially quite unfair to those people. So the view was taken that there would be a certain payment made to everybody and then a certain percentage distributed to everyone above $1000.

O'REGAN J:

But doesn't that just mean they would have been more likely to oppose it?

MR GLENIE:

They?

O'REGAN J:

If everybody had been treated equally, these small creditors would have been more likely to oppose it if their $700 debt was going to become $10.

MR GLENIE:

To the extent that they were motivated to vote. So a feature of some of these compromises is that the people who only have, for instance $4 don't bother.

O'REGAN J:

But it does mean the proposal is completely different for them and then a proposal under which you get paid a debt from a company almost in liquidation in full immediately is a lot different from a proposal where you're going to be paid 10% of the debt, isn't it?

MR GLENIE:

Correct.

O'REGAN J:

So their interests are completely different as well.

MR GLENIE:

Yes, I think that's probably true. The important point to remember is that everybody was getting the first $1000.

O'REGAN J:

Well, except the rights they were getting under the proposal would be different from the rights everybody else was getting under the proposal.

MR GLENIE:

That's true. There is a difference in the rights insofar as everyone – the ones who had more than $1000 would only receive a proportion above $1000 and that's – you know, some of them were taking a haircut whereas some of them weren't. That's certainly true.

WILLIAM YOUNG J:

Can I just ask you this? I can see practical reasons why one might have a sort of a rats and mice threshold. But I can also see why that would be a very helpful way of making sure you get 50% by number of creditors. Now, are there any cases on this?

MR GLENIE:

We didn't find any, Your Honour, and the intention, I think, was if there's no indication of any intention to try and inflate the numbers who voted for the proposal and, indeed, the minor creditors aren't relied upon, they aren't necessary in order to get over that 50% threshold.

WILLIAM YOUNG J:

Are they not? So they're still – if you excluded them entirely, is there still 50% by number?

MR GLENIE:

Yes.

ELIAS CJ:

Until this amendment to the Companies Act, or until the new Companies Act, have you come across any cases which have involved this sort of manoeuvring with waiving security and waiving entitlement to distributions?

MR GLENIE:

No, not in New Zealand, Your Honour, but I can –

ELIAS CJ:

Is there some sort of …

MR GLENIE:

New device?

ELIAS CJ:

New device.

MR GLENIE:

No. I was just going to add that there are a couple of offshore cases where a manoeuvre of this type was put into effect. *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* [2001] HKCFA 19, (2001) 4 HKCFAR 358 in

Hong Kong is one of those cases, where the insider creditors did actually give away their rights, and *Re Jax Marine Pty Ltd* [1967] 1 NSWR 145 (SC). That was a case where, again, an insider group gave away their rights and –

ELIAS CJ:

Well, gave away their rights as secured creditors, wasn't it, in order to participate in the class of unsecured creditors.

MR GLENIE:

I'm not sure if that – if I can say that.

ELIAS CJ:

Did they give away their rights to participate in the compromise?

MR GLENIE:

That was the key point that I recall from *Jax Marine*, that the payment contemplated was 65 cents in compromise. They were likely to get 50 cents in liquidation, and the reason that the 65 cents was materially higher was because the Smithson Group – the insiders – had agreed to take no distribution. So that was a case where the insiders had given away their rights to payment in order to ensure that everybody else received as much as they possibly could.

ELIAS CJ:

And is that under the old approval regime?

MR GLENIE:

Yes. We've called it the sanction regime.

ELIAS CJ:

The sanction regime?

MR GLENIE:

The sanction regime, meaning –

WILLIAM YOUNG J:
Section 205.

MR GLENIE:
Correct.

ELIAS CJ:
Yes, section 205 but did you say “sanction”?

MR GLENIE:
I did, but only because that’s the word that the cases tend to use in relation to what the Court is asked to do at that third stage.

ELIAS CJ:
Oh, approval.

MR GLENIE:
Correct.

ELIAS CJ:
Funny use of the word “sanction”.

WILLIAM YOUNG J:
Well, it required the sanction of the Court.

ELIAS CJ:
Yes, yes.

MR GLENIE:
It’s one of those 19th century words that’s flowed through the case-law.

The third factual point I was going to just comment on very briefly really touches on the point about information. I haven’t noted the tab reference, but

page 723 – which is tab 67 in the bundle – that's a letter from Buddle Findlay which was sent two days after that compromise proposal was circulated.

ELIAS CJ:

Sorry, what are you taking us to?

MR GLENIE:

I don't want to go through this letter in detail. I just want to note that that's a letter from the lawyers acting for Callaghan expressing some concerns about the proposal put forward and identifying some respects in which they consider that the proposal was informationally deficient. So they point out that there was insufficient detail about the fresh capital – that's in paragraph 3(a) – and then in 3(b) no financial information is provided and then in 3(c) questions raised about Thecircle and then in 3(d) and 3(e) the same sort of questions in relation to Taylor and Messer. It might feel a little bit strange for me to take you to those paragraphs, but the point that I really wanted to make is that that was a letter that was circulated widely by Callaghan's lawyers. So it went to all of the creditors for whom they had contact details and in fact it was subsequently circulated to all creditors along with Trends' response. So these issues were put on the table for all of the creditors. Everyone was made aware of these things that were troubling Callaghan, and indeed Trends tried to respond to one or two of those.

GLAZEBROOK J:

Is the response – what tab is that?

MR GLENIE:

The circulation of the responses – I think that is the following tab – tab 72 is the circulation of the responses by Waterstone, the insolvency consultants.

ELLEN FRANCE J:

And the actual response from Trends?

MR GLENIE:

Preceding, so tab 70 is the letter from Johnson and there's a letter from Messer as well at tab 69.

ELLEN FRANCE J:

Yes.

GLAZEBROOK J:

Sorry, I can't see it, what tab?

MR GLENIE:

Which letter are you looking for, Justice Glazebrook?

GLAZEBROOK J:

I'm looking at the reply from Trends.

MR GLENIE:

That's at 70, I believe, page 731. I'm sure my friend will say that those responses were inadequate, I don't actually want to –

GLAZEBROOK J:

I was going to say, it doesn't seem to be responding apart from saying they're not going to respond, doesn't it?

MR GLENIE:

Indeed, there are some deficiencies. There are one or two requests made by Buddle Findlay that seemed a little bit unnecessary. For instance, they were asking for accounts from 2013 in order to assess a compromise in 2015, so perhaps the request went a bit far. But I didn't want to spend time with Your Honours wading through what was asked for and what was provided, it seems a bit detailed. The point that I really wanted to make was that everything that Callaghan has said about information was put on the table and, as I will suggest in a moment, didn't affect the minds of the entitled creditors. So I mentioned before that of the 28 entitled creditors 19 voted for

it, so 19 of these voters weren't concerned about these informational, alleged informational deficiencies. They looked at the information that they –

O'REGAN J:

But why does that help you? It's up to the proponent to disclose matters, not the people opposing it.

MR GLENIE:

Indeed, under the Act the burden is placed on the proponent and we say that we complied with the requirements of s 229. We ticked off each of those boxes in terms of preparing the statement, and what the respondents are saying is that notwithstanding compliance with that shopping list you've got to go further and provide a whole bunch of other information.

O'REGAN J:

Well, if you're saying we're going to introduce fresh capital don't you have to say how much, isn't that a material matter?

MR GLENIE:

Indeed …

O'REGAN J:

If it turns out it was actually $50,000, which was again petty cash?

MR GLENIE:

Wouldn't seem petty cash to me, but it's not as much as some of the sums owed, certainly, $3 million debt owed by Thecircle that …

O'REGAN J:

But why didn't they just say, "We've got $50,000"? That would have been truthful wouldn't it?

MR GLENIE:

I can't answer that for you, Your Honour. But the point that I really wanted to make is that no one else was concerned, it's only Callaghan that asked these questions.

ELIAS CJ:

Well, so what though, if they are and they come to the Court and express that concern, why does it matter what others …

MR GLENIE:

Well, there's two points, I think. One is that, as I will suggest in a second, Callaghan has another reason for resisting this compromise, which is to do with the counterclaim. So Callaghan may have a barrow to push in order to make sure that this compromise is derailed because it wants to avoid what is now a $60 million liability.

ELIAS CJ:

Well, I'm not sure that that is other than relatively speculative. But I still don't see why it would preclude dealing with the merit in the case that they bring to the Court. You're not able to say that there's a conflict of interest which is disqualifying or anything like that.

MR GLENIE:

Well, that would be a slightly strange outcome because it would actually result in Callaghan going into another class. But certainly we would say that there was something else acting on Callaghan's mind, its own witness acknowledged that it was one of the issues.

ELIAS CJ:

But I don't know, I just – why are we concerned with that if we're concerned with unfair prejudice and irregularity, or material irregularity?

MR GLENIE:

I think…

ELIAS CJ:

In the compromise proposed.

MR GLENIE:

If I understand you correctly, Chief Justice, you're saying we should look at the complaint made by Callaghan and its three allies in this Court and ask whether the compromise was unfairly prejudicial to those creditors, and I'm suggesting that the test for unfair prejudice – I'll come on to this later – could actually allow regard to be had to the fact that Callaghan was running this campaign, was circulating its letters to all of its creditors, because it had a very strong interest in avoiding the compromise, just as it alleges that Trends had a very strong interest in avoiding the liquidation.

O'REGAN J:

But we all know that the proposal would have failed if the insider creditors hadn't swamped the rest of it. I mean, it was a lay down misere with the insider creditors, they already had 75% before the game even started.

MR GLENIE:

They certainly had more than 75% before, at the point where the compromise proposal was circulated. Interestingly those numbers weren't right. As it turned out when they went to the vote they had less than 75%, but it's minor.

O'REGAN J:

But they could have just waived the other $500,000 to get there. I mean, they completely controlled the process from beginning to end didn't they?

MR GLENIE:

And when one first comes to this case that might seem strange and perhaps improper. But equally this was a company which had provided a lot of funding. Thecircle had provided a lot of funding to Trends over a very extended period. That was part of the funding arrangements. It had clocked up a large debt and –

O'REGAN J:

But it was just rent, wasn't it?

MR GLENIE:

It was unpaid rent.

ELIAS CJ:

Unpaid from 2009?

MR GLENIE:

Indeed, and the submission is that that is part of the funding arrangements. It's a feature of this particular structure that Thecircle was associated with the Johnson family and was able to provide some funding to Trends by not pursuing that rent for a period.

ELIAS CJ:

It doesn't sound like a very solvent company.

MR GLENIE:

Well, that's one perspective. Another perspective is that the – all companies require a debt and equity capital of various types and quanta, and this is one way in which a form of – perhaps debt, perhaps equity capital was provided through not pursuing that $3 million in unpaid rent, but the …

ELIAS CJ:

But the compromise precluded any ability to assess the validity of that debt.

MR GLENIE:

Insofar as the $3 million was waived. Certainly there would be no examination of that portion. But is Your Honour's question concerning the remaining 500 and the propriety of that?

ELIAS CJ:

Well, I was looking at the original one because after all you are relying on the full extent in order to vote.

MR GLENIE:

Well, only the $3 million. So they rely on the $3 million and say, "We are an unsecured creditor, just like all of the other unsecured creditors." To Justice O'Regan's question, it strikes as a feature of the case when one first approaches it that there is a waiver and participation in the vote by this insider creditor, but again, it's just an unsecured creditor. Its rights are no different from any other of those creditors.

O'REGAN J:

Well, its interests are different, though, aren't they?

GLAZEBROOK J:

It also assumes the debt is valid for rent, which I think was the Chief Justice's point which certainly Mr Barker, I think, was suggesting that the security wasn't valid but I think he might also have been asking about the rent itself.

MR GLENIE:

I'm not immediately sure how he could say that the debt itself was not valid, given that he'd been –

ELIAS CJ:

Well, it's not – I mean, no one's looked at it, really, have they?

MR GLENIE:

No, but Mr Barker certainly went into that meeting prepared to make some – to challenge the –

ELIAS CJ:

Yes, but he had no facts. He had no information, so it was just a talkfest, really, at that stage, wasn't it?

MR GLENIE:

Yes, and one of the interesting points about that meeting is that – I should come on to this later but – I will come on to it later. It will make more sense later. But as to the question about whether the debt was properly incurred, I'm not sure that there has been a proper suggestion that it was not properly incurred. I'm not sure.

ELIAS CJ:

Well, it's just that the plaintiffs don't know and it is an interested party arrangement. It's one that one would imagine a liquidator would look at.

MR GLENIE:

The fact that the original debt arose rather than a waiver of the security?

ELIAS CJ:

Yes, yes.

MR GLENIE:

I suppose that that question could theoretically be asked.

ELIAS CJ:

It's just really unknowable. There is only an assertion of it.

MR GLENIE:

Indeed, on these facts. There may well be better evidence. There was only limited evidence put before the High Court on this particular point. I won't dwell too much on this but on 20 May Callaghan's lawyers again sent another letter complaining about – this is at page 767, I think that's tab 74 – and I'm paraphrasing rather than taking you through all this but you'll see at paragraph 4(a): "We attach for the benefit of the other creditors a spreadsheet outlining the payments." I really only draw your attention to that. This is Callaghan, a single creditor, which is going to the lengths of indicating to all other creditors what they stand to be paid in the proposal, and I just say that

the significance of that is that Callaghan obviously had a strength of opposition to this particular proposal.

ELIAS CJ:
Well, it had quite a big debt compared to everyone else.

MR GLENIE:
Callaghan? Indeed. That debt is disputed.

ELIAS CJ:
Stood to lose more.

MR GLENIE:
It stood to lose a lot more than the minor creditors, certainly. Perhaps it's stood to lose more in a compromise situation from the lawsuit.

The – I won't spend time going through that letter but Your Honours will see that there are questions raised about the IRD and I really only take you to this to say that all of this stuff was on the table. All of these questions have been raised. Whether or not they have been fully answered, the point really is that they didn't affect the vote. That was the point that I wanted to make.

GLAZEBROOK J:
And actually just looking at this, I was just looking at paragraph 4C. There is a complaint that Trends has refused to explain how the debt arose.

MR GLENIE:
Yes, Your Honour.

ELLEN FRANCE J:
Mr Graham in his evidence did express some concern as to the amount of the debt to Thecircle.

MR GLENIE:
I think that's correct, Your Honour.

Just while we're on Mr Graham's evidence, so that's a big part of the respondents' case. They say: "We've got an independent expert insolvency practitioner to take an ex post look at this and he has concluded that there might be claims floating around."

The first thing that I wanted to say, I won't take you to Mr Graham's affidavit, but it is in very diffident terms. He does only talk about "could investigate" and "potentially recover". That's to be expected, obviously.

O'REGAN J:
But all of this could have been answered by Mr Khov from Waterstone, the man from Waterstone.

MR GLENIE:
Well, he had some familiarity with those facts and Your Honour is right, that he didn't give evidence. I wasn't involved and I don't know why that choice was made.

O'REGAN J:
It's not a matter of criticism. It's just it's an irresistible inference that he could have given evidence and he didn't. What do you expect the Court to infer? I mean, what the High Court Judge did seems to me to be the only thing he could have done in the circumstances.

MR GLENIE:
Yes. Well, two points on that, Your Honour. The first point is that Justice Heath said, "I've heard from Mr Graham. I've seen his affidavit and I've heard him examined." But then – and this is in paragraphs 117 to 118 of His Honour's judgment in the High Court – "The costs and risks of that litigation are unknown. There are potentially enforcement issues. There are security issues." So he came to the conclusion that it could not be said that

the liquidation outcome was better than the compromise outcome. That's the first point.

The second point – which I have to confess dawned on me rather belatedly – is that Mr Graham's ex-post analysis needs to be set alongside Deloitte's ex-ante analysis, which is at tab 78. This, I think, is worth taking Your Honours to. That's tab 78, page – it starts at 777. It's a letter of 21 May and Deloitte, who have been looking into Trends over a number of months, reviewing the Callaghan grant and advising Callaghan in relation to that, had now been asked for their observations and comments in connection with the compromise proposal and when one turns to page 778, which is the next page.

ELIAS CJ:
Sorry, page?

MR GLENIE:
The next page, 778. There are a number of points that leap out of that. The first line – BNZ and Thecircle – are secured creditors. Assuming their credit is valid, they would receive all of the realisations from Trends. And then paragraph (e), BNZ would suffer a shortfall. So the BNZ, which I think was owed 1.2, might not recover enough to satisfy its own debt so there would certainly be nothing left for other creditors from the realisation stage.

And then in paragraph (f), Waterstone is correct. In a liquidation, unsecured creditors would almost certainly receive dollars nil.

O'REGAN J:
That's assuming you can't sue the directors.

MR GLENIE:
Correct, which is noted in the next paragraph.

So they go on to say an independent person examines all of the recovery actions, but the key point is down the bottom of the page. They present the choice between those two options, accepting 16 cents in the dollar – the compromise sum – or, B, having a liquidator appointed to independently examine all the affairs of the company – which is Justice O'Regan's point – including director conduct and claims against related party companies with the realisation, however, that there is a very high probability that unsecured creditors will receive less than 16 cents. And admittedly, that's not the same as saying absolutely no prospect, but it is a very negative view. Mr Perry from Callaghan, I think, described it as being not very optimistic, and that's the advice that they received the day before the meeting. So the day before the meeting, their accountants who have been wading through the detail of Trends have come to the view it's not worth it. You should go with the compromise. 16 cents rather than dollars nil.

But despite all of that – I think this is the final factual point that I wanted to take Your Honours to and we're back to the minutes, which are at tab 79 – and again, rather than dwelling on the details, Your Honours will see that six out of the 10 pages or so of those minutes involved Mr Barker asking very searching questions, making points of the Trends people and the Waterstone people, and equally Mr Baker, who represented Callaghan on the day, and Mr Baker goes so far as to – perhaps this is worth looking at – on page 787 right in the middle of the page Ross states Trends had been trading recklessly. That's not a question. It's just a statement. It's an allegation. And then on page 789, again, towards the middle of the page, "People should be called to account when they misuse taxpayers' money." And in a creditors' meeting those would have, no doubt, been quite inflammatory comments. But the point, really, that drops out of this is that Mr Barker, who was representing Times, one of the other creditors who's actually not one of the respondents, had already posted its vote on 19 May and that fact is recorded in the examination of Mr Loh, who I think is one of the executives of Times. I won't take you to it, but that's on page 265.

ELIAS CJ:

Sorry, but what's the point you're taking from that.

MR GLENIE:

The point is that Mr Loh confirmed in examination that Times had already posted in its vote against the compromise. It had already said we oppose this on 19 May, and then it had engaged Mr Barker to carry out some very intense questioning of –

ELIAS CJ:

So are you saying is there anything wrong with that? I mean, there was still a compromise that was going to be imposed and a meeting at which it was being discussed. Was it wrong for them to participate in that?

MR GLENIE:

Oh, no. All that I say is that there's a very lengthy period of questioning from Mr Barker and none of the answers to the questions that he asked could have influenced the position of his client, Times. It had already voted.

ELIAS CJ:

But presumably it was directed at those who hadn't voted.

MR GLENIE:

Indeed, and that's really what I'm suggesting that Mr Barker, who is from Buddle Findlay, the lawyers who act for Callaghan, and Mr Baker, who is from Callaghan himself, approached that meeting not with the intention of eliciting further information to affect their votes but with the intention of swaying the vote their way.

ELIAS CJ:

So what?

O'REGAN J:

What's wrong with that? That's exactly what the meeting is for. I mean, they might have been trying to persuade the insiders that they were putting themselves at great risk of litigation if they went ahead.

MR GLENIE:

Indeed, or eliciting information that could be later used in litigation against those directors.

O'REGAN J:

Well, that was fair warning, wasn't it?

GLAZEBROOK J:

Or in persuading the other creditors, which I would have thought was perfectly legitimate, not to vote in favour of a compromise that would then affect their position. So what's wrong with that?

MR GLENIE:

And the points I'm making – I really only make the point insofar as in each of those criticisms is valid, the point really is that they carried on the campaign which they had commenced by circulating letters to all of the creditors, again, we would say because they have an interest in avoiding the lawsuit which Trends might have brought against them, and at the meeting there were only a limited number of people who attended. I made a note. But on the front page of the minutes on page 781 there's a list of the people who attended that meeting and there's only – I think it is eight, might be seven or eight creditors there. And despite all of the information that was elicited and all of the concerns that were expressed, two of the entitled non-minor creditors who attended still voted no. And that really comes back to the point we were discussing earlier about the democratic process of voting. 19 out of the 28 entitled creditors voted yes, voted for the compromise. 19 out of the 28 voted for the compromise, including a couple of the creditors who –

ELIAS CJ:

This isn't really a regime of such …

MR GLENIE:

Democracy?

ELIAS CJ:

– dogmatic – yes, democracy, I suppose, in that setting. It does have protections built into it which are for – including for individual creditors.

MR GLENIE:

Correct. A couple of points on that. One is the very majorities that are built into the voting mechanism. It's not unanimity. It's not consensus. It's 50% by head and 75% by dollar, and that in itself contemplates 50% of the people who might go away from this feeling unhappy.

ELIAS CJ:

Well – but one of the reasons they might be going away unhappy is because there has been a wrongful vote which can't be tested if a debt is not valid. It's – well, you're going to come –

O'REGAN J:

It's all predicated on it not being unfairly prejudicial.

MR GLENIE:

I think I'd accept that. The way in which I had put it in the submissions was to say that there is a safety valve for someone who does feel that they were in the nine of the 28 who didn't like the compromise. They can still go to Court and say, "We were the subject of this compromise. It was foisted upon us and it's a terrible compromise," and so the Court has the ability to say, "We agree, and we're going to let these creditors out of the compromise."

ELIAS CJ:

It isn't just a system of creditor compromise, though. It's one that has to be – it has to follow the scheme in the legislation in which creditors can't in fact make a proposal except with the approval of the Court.

MR GLENIE:

Correct.

ELIAS CJ:

So what you have here is because you had a director proposal the scheme of section 228, it doesn't seem to me, is really that you have conflicted directors who wear both hats as creditors and as directors. So that's, you know, really what we are arguing about, I think, here.

MR GLENIE:

Is whether or not conflicted creditors or creditors associated with insiders should be permitted to vote alongside people who are different from outsiders.

ELIAS CJ:

And the point that I make is that the scheme of section 228 in who can propose a compromise isn't as fervent about creditor-led compromises as you might be suggesting.

MR GLENIE:

And I don't mean to. If that's what I said, then I shouldn't have. The genesis of compromises is typically within the company so they are driven by the board of directors or a receiver, I suppose.

ELIAS CJ:

Or a receiver or liquidator.

MR GLENIE:

That's true. I suppose in those situations the company has already hit the rocks and the person charged with trying to get it off the rocks is taking

control. But you're certainly correct, Chief Justice, that in 228(1)(d) you need the leave of the Court as a creditor to put forward one of these compromises. That is true. But the point that I wanted to make about the – what I've called the safety valve, the unfair prejudice safety valve which allows an unhappy creditor to seek the Court's assistance –

GLAZEBROOK J:
But what would be the grounds of that if you say that this vote was valid?

MR GLENIE:
Of an unfair prejudice challenge?

GLAZEBROOK J:
Yes.

MR GLENIE:
I think our position is that the definition of the classes was properly carried out and the vote was able to be carried out, but then there could be an alternative – a secondary inquiry into whether or not this creditor, this particular challenging creditor, has been unfairly prejudiced and –

GLAZEBROOK J:
But how's that going to be? Because of course you're unfairly prejudiced if you're forced to accept a compromise that you didn't want in a colloquial sense, but that can't be what the legal meaning of that is. So what is the content of that power of the Court if the classes is, as you say, was properly constituted and the vote was properly done?

MR GLENIE:
We say that the bar is a little higher than just having been unhappy with a compromise.

GLAZEBROOK J:

Well, it would have to be higher than that, because it just doesn't make any sense otherwise. So what I'm asking is what is the content of the power of the Court in that situation in your submission?

MR GLENIE:

At the unfair prejudice stage, and I think our submission is that the unfair prejudice test asks the Court to look at the circumstances, to look at the – as they existed on the day of the vote at the time when the vote was made, bearing in mind that the challenging creditors bear the onus of proving unfair prejudice and asking what the picture looks like in terms of the horizontal and vertical comparison. Those are the terms that come out of the case-law.

GLAZEBROOK J:

Well, what does that mean?

MR GLENIE:

I always get these back-to-front. I think the horizontal comparison is creditor versus creditor, so if you –

GLAZEBROOK J:

Well, no, what I'm saying is, if you say they had a valid vote, what can somebody say? They can say – well, I suppose in this case they can say, "Well, the smaller creditors are getting everything and I'm not," but let's assume – let's leave the smaller creditors out. What could the creditors who lost a vote say?

MR GLENIE:

Only that they have been unfairly prejudiced.

GLAZEBROOK J:

Yes, but what grounds would you say they had to say that if the class was absolutely correct and there wasn't some procedural irregularity that, you know, somebody had been carted off to hospital just before the vote and they

went ahead with the vote anyway, despite seeing the ambulance disappearing into the ether.

MR GLENIE:

Yes. Apologies if I'm not making this easy. I think what I am saying is that at the point where it is necessary to assess whether or not there has been unfair prejudice to that creditor, that is the point at which you ask how that creditor has been affected as against the other creditor. So you carry out the comparison and say have you been wrongly harmed by this proposal and in the context where the classes have been properly defined and all creditors are treated alike, by hypothesis then there is no unfair prejudice and there should be no remedy.

GLAZEBROOK J:

Well, that's what I was asking you because, I mean, they'd just been treated like everybody else, leaving aside the small creditors. So what – so you say they would have no ability to challenge absent some procedural irregularity, probably lack of information, but you certainly, I wouldn't have thought, either, would be able to challenge on the basis that you can say, well, we'd have done better in liquidation, because the whole idea of a compromise is that the creditors decide that. And, I mean, they might do better in the liquidation but the creditors have decided to cut them some slack because they think the company has a future as well, which is the whole idea of the compromise.

MR GLENIE:

If I've understood correctly, you were saying that the position in liquidation would not be relevant but I think it is on the case-law.

GLAZEBROOK J:

Right. Well, the case-law is not really looking at this type of unfair prejudice, is it? So I'm just asking you what you say. So absent – if the classes are properly defined – it would only be a procedural irregularity, lack of information, what?

MR GLENIE:

If the classes are properly defined, then any creditor would have the ability to go to Court saying informational problems under 229 – sorry, 232(3)(a).

ELIAS CJ:

So they are formal matters of process that haven't been properly complied with?

MR GLENIE:

Sorry, I didn't want to dwell on that but 232(2)(a) is insufficient notice. 232(2)(b) is material irregularity, something has gone wrong with the voting process. So somebody's votes weren't counted or the time wasn't taken into account, time zones or something along those lines. And then unfair prejudice where a creditor who voted against a proposal could still say, "I have been unfairly prejudiced" and at that point the Court –

GLAZEBROOK J:

Yes, but is it just procedural irregularity or informational problems or what?

MR GLENIE:

No. It's a substantive assessment of the creditor's position as it was – sorry, the creditor's position under –

GLAZEBROOK J:

So could the creditor say, "Well, I would have done better in liquidation and the compromise shouldn't have been made"?

MR GLENIE:

Correct. That is the –

GLAZEBROOK J:

On what basis is that, because the creditor decides that, don't they? Creditors, if they think that they're going to be able to carry on their businesses just by compromising this credit, people do it all the time. "I've got

faith in this company. I think it's going to carry on. I want to vote in favour of a compromise because although I'll do better in liquidation now that wouldn't be the long-term position."

O'REGAN J:

But if your debt's being actually cancelled that is the position, isn't it? If it was a moratorium you might say, well, it's better to wait. But here you are just being cut off at 11 cents and that's the end of the game, no matter how well the company does.

MR GLENIE:

And picking up on that, the resulting compromise could be 11 cents and the result in liquidation could be zero cents, which is the Deloitte indication.

GLAZEBROOK J:

Say it was 15 cents, but these creditors think it's better taking the compromise now because in the future this company that I think will be a really good company is going to order all their stuff from me because they'll be so grateful for me cancelling the debt. And so I think as a creditor that even though I'd get 15 cents now as against 11 cents I'm still better getting the 11 cents, letting this company carry on, and then my business is safe.

MR GLENIE:

I think – I can't say anything against that. It could well be the decision that a creditor has made that because of its ongoing relationship with the company –

GLAZEBROOK J:

All I'm challenging you on is your assertion that you can come along as the creditor who doesn't have an ongoing view of the business and say, "Well, I only got 11 cents and I would have got 22 cents under a liquidation."

MR GLENIE:

Well, that's the respondents' position, that they would have got more in liquidation than they would have got in a compromise.

GLAZEBROOK J:

I understand that, but I'm just wanting to know what your position is on unfair prejudice and what you can come and say.

MR GLENIE:

I am making heavy weather of this. Apologies. I think what I am saying is that the unfair prejudice part of the test, that part of the exercise, involves comparing the creditor's position with the counterfactual, its own position in the counterfactual, and I can see that Your Honour's right that you should take into account the ongoing relationship and so on. But also comparing that creditor's position with everyone else's creditor's position, so if you have a perfectly validly constituted class vote on a proposal which says nine out of 10 creditors will get 11 cents and the 10th creditor will get five cents, in that situation that unhappy creditor would be able to go to the Court and say, "I'm no different from the other nine. Why am I being asked to take a far greater haircut than anyone else?" Is that a …

GLAZEBROOK J:

Yes, I can understand. I suppose I should say one of the issues in this case is even if the class is validly compromised, validly instituted, and even if you're right that at that stage you just look at rights, so all – basically that all secured creditors would be in the same boat whether they're insider creditors or not, the other route of doing this is to say, well, nevertheless the Court can look at this afterwards and say those insider creditors shouldn't have voted, and that would presumably be the backup argument of the respondents. So I was really just wanting your …

MR GLENIE:

Yes, and at the point where we're talking about classes you're right that the simple, the workable, the just solution is to treat all unsecured creditors alike, leaving open the safety valve of applying to the Court under 232 and at that point the respondents will say, "Well, we were unfairly prejudiced," and the appellants would resist that. The appellant will say, "Well, you weren't unfairly

prejudiced. You did better in compromise than you would have done in liquidation and you did just as well as every other creditor."

ELIAS CJ:

Well, I must say, I am not sure whether we need to make quite as much a meal of this case as to dwell to the extent that has been done on the various classes, although it may not matter very much how you look at it. But what's wrong with simply saying that there's unfair prejudice here because a questionable debt owed to the promoters of the compromise was not able to be investigated.

MR GLENIE:

The unpaid rent, is that what you had in mind?

ELIAS CJ:

Yes. All the plaintiffs in this case are materially affected by that.

MR GLENIE:

Well, they're materially affected by the compromise in that they have to take a haircut.

ELIAS CJ:

Well, they're materially affected if the – by the existence of the questionable debt.

MR GLENIE:

Which was largely waived. I mean, it is –

ELIAS CJ:

Well, not in respect of the voting. I mean, it's quite understandable if you have a section 203 regime in which most of the cases are developed to concentrate on setting up the process in which everyone will be – everyone will – you can trust the process to deliver an appropriate result, and the Court supervises that. But here it's just left to the people who have standing to promote a

compromise to do it and then I'm not so sure why we're quite as hung-up on setting up the process correctly here and why you can't simply – if this had come before a Judge under the old 203 regime, surely the Judge would have said, "Well, I don't like the fact that the directors are the principal creditors here and they're going to blitz the others, so I'm going to set up different classes." That's probably what they would have done.

MR GLENIE:

They could have done that, certainly. But that's not what they did in *Jax* and that's not what the Judges did in *UDL*. They looked at it and said, "We've got insider creditors who are giving away their entitlements, are still participating, but we're comfortable with that."

ELIAS CJ:

Yes, but at least they'd have looked at it. At least it had been looked at by the Court. But here it's the fact that it's being wholly imposed and surely that must mean that you can have recourse to the unfair prejudice or material irregularity grounds of opening it all up.

MR GLENIE:

I think I'd accept that. That's the purpose, the structure of the new regime. This might be a good point just to recall one of the notes that we made in those submissions that the Law Commission indicated that the purpose of the reform in Part 14 was to do away with the old sanction regime which the Law Commission thought was not working as well as it could, and the phrase that sticks in my memory is "slow, complex and expensive with undue involvement from the Court". So they looked at what happened in cases like *Re Stewart & Sullivan Farms Ltd* [1981] 1 NZLR 712 (HC) from the '80s and decided that this structure where we go to Court first and we define some classes, then we have a vote, then we go back to Court and yes, the Judge has that wide power to decide how – whether or not to approve the compromise. We want to move on from that. We want to push the power back to the creditors, and indeed there's another comment somewhere in the Law Commission's report which I should find which indicates that they didn't want to take that

paternalistic approach. They wanted to focus on the creditors and allow them to control the process, hence the emphasis on the voting. So it's certainly true, Chief Justice, that the scheme will be –

ELIAS CJ:
But the legislation does control who can propose the compromise.

MR GLENIE:
Correct.

ELIAS CJ:
And it doesn't envisage insider directors or creditor directors imposing a compromise.

MR GLENIE:
No, it doesn't but it doesn't say that's impermissible either.

ELIAS CJ:
No, but it may be that that flavours what is unfair prejudice, and if you have an additional circumstance like the fact that the debt is questionable then why is not the remedy that's been taken in the lower Courts open to them because then an independent – the likelihood is that a liquidator will be appointed.

MR GLENIE:
It's certainly true that if the compromise hadn't been validated that a liquidator would have been appointed and could have looked into a number of matters and could indeed have pursued the claim against Callaghan just as it could have pursued the claims against the directors and potentially this questionable – the status of the questionable debt, as Your Honour puts it. But the wider – I think the wider question that you're asking, if I've understood correctly, is what is the Court being asked to do at the unfair prejudice stage? And it's not a matter of simply saying insider creditors participated in the vote, therefore there must have been unfair prejudice. Our submission is that the case-law in the UK in particular but also here suggests that you need to look at the

position of the individual creditors. You can't just play the trump card of saying, "Well, insiders voted and therefore there is unfair prejudice," because that will just mean if you think all the way back to the start the people who designed these schemes will think, well, we're going to have to split the classes up, so we're going to have to put the insiders over there. We're going to have to put all the other creditors over there and that would have resulted in defeat of this particular compromise and liquidation of the company. That was the inevitable – the most likely, at least, outcome absent the compromise. And the first point about that is that the compromise is intended – as Lord Millett puts it – a beneficent procedure. It's intended to try and save these companies from foundering on the rocks and putting money in the hands of liquidators and litigators. What we want to do is to try and save the company. We want to try and find a way of doing that rather than just saying we'll give a minority veto to the entitled creditors.

O'REGAN J:
But if it was intended to do that wouldn't it have just been a moratorium rather than a cancellation of the debt?

MR GLENIE:
You mean delaying rather than cancelling the debt?

O'REGAN J:
Well – yes, correct.

MR GLENIE:
I don't know why that approach wasn't taken, I think the view probably was that we should cancel the debt and draw a line under everything and move on from there. I can't explain why they took that approach.

I think we've moved into classes, I think we have. Just very quickly, a couple points about the text. Section 116, I didn't explain this very well in the written submissions. The point that was on my mind was just that in relation to shares section 116 indicates that should divide – sorry, one looks at the rights

attached to the shares, 116 indicates that it's a rights test for shares, that's really all that I'm saying. And then moving on from that, the concept of class of shareholders sits very close to the concept of class of creditors in 236, so that indicates that a similar approach should be taken. It would be strange if you were to define class of shareholders by reference to rights and class of creditors by reference to something different, whether it's interests or what.

And the final textual point is this, 236A, which was inserted a few years ago to deal with code companies, takeovers of code companies, which plugs into Schedule 10, and Schedule 10 in our submission just makes it very clear that Parliament understood that the common law test was a rights test rather than an interests test. There is a copy of Schedule 10 in the bundle.

O'REGAN J:
So do you say the rights are the rights that the creditor has before the compromise or do you accept that it would also incorporate the rights the creditor gets out of the compromise?

MR GLENIE:
I think we would have to concede that it is both the post rights as well, but our submission is that the rights of the insider creditors after the fact were no different in character from the rights which the other unsecured creditors have, and I say that with reference to *UDL.* So in that case the insider creditors gave away their right to payment and Lord Millett said, with all of the other Judges on the Hong Kong Court, "That's okay, you can vote with all of the –

GLAZEBROOK J:
Do you want to just take us to that passage?

MR GLENIE:
Indeed. Now, that is tab 5 in the appellant's bundle of authorities. And there's a lot of interesting stuff in *UDL* obviously, but the treatment of the "internal creditors" as they're called begins at paragraph 33. And in that paragraph Your Honours will see one interesting statement in the middle, "The internal

creditors, and particularly the companies which were putting their own Schemes forward, undoubtedly had a special interest in promoting the Schemes, but this did not disqualify them from being treated as ordinary creditors." And in 35 it deals with the point about waiver of entitlement to payment, and Lord Millett makes the point that this entitlement to payment was not being forced upon the insider creditors, it was something that they were willingly giving. They were giving away their rights to object to this compromise, they were participating of their free will.

ELIAS CJ:

But the last sentence in 33 acknowledging that the Court was bound to take the presence of the insider dimension into account when considering whether to exercise the discretion makes it quite clear that you just can't pick up this authority and drop it into our statutory regime.

MR GLENIE:

Correct, and I shouldn't have suggested that you could.

ELIAS CJ:

No, no, you probably didn't.

MR GLENIE:

It's a sanction regime, so it is still that old three-step process which we were trying to move away from in 1993 with Part 14. This point only goes to class definition, which is still relevant under our new regime, but Your Honour is quite right that the points it made at the back end of 33 is, well, we'll sweep it all up at the sanction stage and –

GLAZEBROOK J:

Well – but so it comes back to my question to you, why can't it all be swept up at the unfair prejudice stage? I was unfairly prejudiced because there were insiders who overwhelmed the vote.

MR GLENIE:

And I think that the right answer to that has to be that it can't just be a matter of automatic unfair prejudice simply by reason of the presence of insider creditors because that's the same as saying –

GLAZEBROOK J:

Well, it may not be, but it may be more of a discretionary thing that if the facts had been different in *UDL* then the Judge mightn't have been right taking account of the position of those creditors to sanction the scheme.

MR GLENIE:

Indeed. That could be true. I wonder if it would help just to make the –

GLAZEBROOK J:

And I suppose the follow-up question is, well, what makes this different in terms of – why shouldn't the slightly odd circumstances of this arising in the first place and the very – oh, actually, the refusal to give details about the debt that was owed.

MR GLENIE:

Why should that not mean that it is automatically unfairly prejudicial?

GLAZEBROOK J:

Well, not automatically, but just taking everything into account, there's material prejudice. But you'll probably be dealing with that in a more generic sense, so I'll leave you to come to it as you do but just keep in mind that it's not necessarily just the class definition. It may well be material prejudice, as well. Sorry, I said material prejudice.

MR GLENIE:

You mean unfair prejudice, yes.

There were a couple of comments just about practical solutions that might have been available to people putting forward their schemes when they

anticipate that there might be one problematic creditor. The respondents said, "Well, you could just cut that creditor out." So hypothetically let's say that Callaghan was the only dissentient. You could have solved this problem just by putting them to one side. To the extent that that means putting them in their own class, that obviously doesn't work because it gives Callaghan a unilateral veto and that can't be right. To the extent that it means cutting them out of the compromise altogether and saying, "We are not going to cancel Callaghan's debt. It will remain on foot," then that will make it much more likely – much more unlikely that the creditors will vote in favour of the proposal because they will look at what Callaghan is getting, special treatment, and they will think, "Well, that's unfairly prejudicial to me. So why would we vote for that?"

The third practical solution which I think the respondents have raised is the ability for a proponent to seek directions as to procedural requirements, which is in 232(1)(a). So if it is the case that you could solve this problem by going to the Court on day 1 and saying, "Here's what I think I should do in relation to classes. Is it okay?" then really you'll just thrust it back to a sanction regime and that will have all of the usual negatives associated with using up the Court's resources. It will also mean that you'll end up in a regime that looks very similar to Part 15, so why would you not just go to Part 15 instead which provides for, indeed, any creditor to go to the Court under Part 15 and ask for a compromise to be validated? And so all of those things will just mean that practitioners will stop using Part 14 and it will all become a bit of a dead letter.

O'REGAN J:
But given the contest here, maybe it would have been better to use Part 15. You could have had the argument before the commitment was made to the proposal.

MR GLENIE:
Well, I don't know. I don't know whether thought was given to that but certainly it would have taken time to get that to Court, perhaps months, even in a very expedited way.

O'REGAN J:
I don't think so.

MR GLENIE:
Well, I'm speculating slightly as to how long it would have taken to get time in the Auckland High Court. I can tell you that does take a while.

WILLIAM YOUNG J:
Was the first – I can't recall now. Was the order sanctioning the calling of meetings obtained ex parte or on notice?

MR GLENIE:
There was no sanction sought in this case. In the old regime.

WILLIAM YOUNG J:
No, no. In section 205.

MR GLENIE:
I will need to check but I think ordinarily it was ex parte. So it was just the company. It was heard at the first stage. Just moving on –

WILLIAM YOUNG J:
So that wouldn't have taken any time at all. I mean, that would have taken a week or so, probably.

MR GLENIE:
Correct, unless it was thought necessary, given Callaghan's quite strong opposition for them to be given the opportunity to address the Court at that early stage, there might have been argument about whether or not Callaghan could appear on such an ex parte application. But that's historic to the extent that we're talking about the ability to go and get procedural requirements dividing up classes so you could see that, you know, if this is right then the proponents of the scheme might go to the Court and say, "Can I please do a

class which includes everybody? Can I please run everyone together?" and Callaghan would certainly oppose that.

O'REGAN J:
Yes, but the fact that you would have had to go to the law might have led to, in fact, a different regime or the proposal not going ahead because it was obviously not going to succeed.

MR GLENIE:
Correct. That might have moved the proponents to change the scheme in some way but it's difficult to imagine how they could have made this scheme more favourable towards creditors. You know, there was only very limited amount of money available at the time and the money was all going –

O'REGAN J:
Apart from anything else, you would have had to tell the Court how much money was available. That would have helped, wouldn't it?

MR GLENIE:
That is true, but it wouldn't have changed the fact that there was only a limited pool available, which was all going to the external creditors. There was no money being siphoned off by the insiders.

Just quickly on flexibility and predictability, we say the Court of Appeal was right to say that it's easier to advise and plan on these things if you take a rights approach to classes. I think everyone seems to agree that rights is a much easier touchstone than interests because if interests are the relevant tests the proponent would have to spend time and resources looking into the interests, the motivations, the position of each creditor.

GLAZEBROOK J:
Well, are you sure that can be sustained because surely they'd only be looking at their rights and interests in relation to the company so I was just looking – there's a case there with that first debenture holders were voting and

they had second debentures and it was said that they were – they shouldn't have been the same class. The Court said no, but that could be taken into account later at the sanction stage.

MR GLENIE:
Indeed.

GLAZEBROOK J:
But here when you have a different scheme surely you don't say, well, when you don't have anything taken into account at the sanction stage absent the ability to go to the Court later and say they've been prejudiced, would it be that hard to see whether someone's also a second debenture holder or a shareholder?

MR GLENIE:
Probably not in that case. That's just a matter of checking the registers. But in our case –

GLAZEBROOK J:
But they may be indirect shareholders or something which would be more difficult but on that – I mean, you could ask people, couldn't you?

MR GLENIE:
Well, you could.

GLAZEBROOK J:
Do you have any other direct or indirect interest in the company, in which case, maybe you should be in a separate class?

MR GLENIE:
And that might throw up one important distinction between different classes – different groups, to use a neutral term, of creditors. Some of them would have had an ongoing relationship with Trends and therefore potentially be motivated to be in favour of the survival of the company whereas some of

them might be under cash flow constraints and need money in their hands now. So –

GLAZEBROOK J:

But surely that wouldn't be the type of interest that you could take into account. If you're taking rights and interests into account, it must be related to the company rather than private interest, surely.

MR GLENIE:

Do you mean the scheme company?

GLAZEBROOK J:

Either they're a second debenture holder, they're a …

MR GLENIE:

I don't know that the respondents would put the point quite so narrowly.

GLAZEBROOK J:

Well, they may not, but they don't need to put it any wider, do they?

MR GLENIE:

In terms of whether they have different – ultimately whether or not they are a shareholder or a first or second debenture holder boils down to do you have rights against the company which are sufficiently dissimilar for it to be impossible for you to consult with everyone else.

GLAZEBROOK J:

Well, no. What they say – well, that's certainly the respondents' position in terms of saying it's wider than merely rights, so that you could take other rights against the company into account is what I understand from that in setting in the class. So somebody who is a first debenture holder and also a second debenture holder may be in a different class from someone who's merely a first or merely a second debenture holder on the respondents' argument.

MR GLENIE:

Correct. I think that's *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213 (CA). I think that in that case it was accepted – I may have the case wrong – that the fact that you might be both the first and second debenture holder, or a debenture holder and a shareholder, might mean that your rights are different from someone who is purely a debenture holder. The issues that arise here are slightly different in that there is no suggestion of someone having a shareholder, there are obviously some slightly more nuanced connections between the persons who control Trends and Thecircle and so on. But the point about different rights doesn't really arise here. I think the respondents are just saying, "We want you to take into account the different interests which the insider creditors had," and those are interests in avoiding liquidation, avoiding scrutiny by a liquidator. And equally I think they'd have to concede that Callaghan has an interest in avoiding compromise and avoiding the lawsuit, and our submission is that just gets too hard, you end up having to spend too much time, people will game that sort of a process, a creditor will try to stall or give, you know, potentially partial information if it wants to move a particular proposal in one way. It just becomes fraught trying to apply an interests test.

I think my next note was about authority. I have a feeling that we've covered most of these other than – most of the key authorities – other than to note that *Stewart* is not really a rights case – sorry, not really an interests case, and indeed in the High Court Justice Heath says this could be understood as a rights case, so it's not as simple as saying, "We always applied an interests approach pre '93." And it's certainly not the case that we've applied an interests approach post-1993, and most recently Justice Winkelmann in *Bank of Tokyo-Mitsubishi UFJ Ltd v Solid Energy New Zealand Ltd* [2013] NZHC 3458 applied a rights test – now that I look at it correctly – in, that's paragraph 162 of *Bank of Tokyo.* So there are –

ELIAS CJ:

Sorry, but that's because interest could be taken into account in approving the compromise? So rights determined the procedure or the classes, but it wasn't to say that interests pre '93 weren't taken into account?

MR GLENIE:

At the sanction stage, the approval stage, correct. Certainly not true in relation to *Bank of Tokyo* two or three years ago under Part 14, so in that context the class definition issue was approached, I believe, as a rights question and –

GLAZEBROOK J:

You've got that in your authorities haven't you? Yes, I've seen that.

MR GLENIE:

It's in the respondents' bundle actually, tab 1 I'm told.

ELLEN FRANCE J:

Just in terms of *Bank of Tokyo*, do you agree with the way that unfair prejudice is approached in that case?

MR GLENIE:

I will need to remind myself exactly how that was done. If it's all right with you I'll deal with that when I'm dealing with unfair prejudice?

I'm just conscious of the time, but I wonder if I could wrap up on applying the classes, the various classes approaches. We've talked about a lot of the factors which are relevant, applying a rights approach to class definition. Yes, post-rights are relevant as well. In this case we say that the insiders have waived payment, just like the insiders in *UDL*, and so therefore the insider creditors are in on a rights approach. And when one moves to an interests approach – I might be repeating some of the ground we've covered – but the starting point has to be everyone has the same rights, so let's put them all in a pile first, unless there is a good reason why they need to be separated. And

the interests test must contemplate keeping people together if they have a sufficiently common interest for it to be possible for them to consult together. So that doesn't mean that they can't have different interests as long as they have a sufficiently substantial common interest on a particular proposal, and in this instance we say that there was indeed a common interest of that type, for slightly different reasons. Mr Johnson, Thecircle, Messer, Taylor, they all wanted to keep the company afloat for the reasons that we spoke about quite early on, and the creditors wanted to go down the compromise road because they would get their 13 cents instead of their zero cents in liquidation. So in that sense they both had a common interest in pursuing the liquidation. It is also an aligned interest, in the sense that Mr Johnson in particular and the employees, over time they might rebuild the business, there might be some benefit to shareholders, you know, that would be an interest which favoured compromise as well, which is just similar to the interest that the creditors have in voting for compromise instead of liquidation. So it is true that that depends upon the negative, the zero worth of the claims in liquidation as Deloitte put it, they said, "There's nothing here in liquidation." And that would suggest that the insider creditors did actually have the same interest as the other creditors in voting on this particular proposal.

I think I'm able to just make this point very briefly before we break. There's a suggestion that Callaghan should have been put in a separate class. Clearly that would have given them a veto. And it's very difficult to understand why Callaghan should be given superior rights, superior power, in relation to the compromise when it only had at best a contingent claim against Trends. Everybody else's claim was liquidated, undisputed. So it seems that Callaghan is saying, "Well, you should put us to one side because we're different, we only have a contingent claim." But the effect of a compromise is to cancel the debt and to replace it with the 13 cent entitlement. It's a bit hard to understand why Callaghan feels that it shouldn't be affected by the compromise in the same way. And, relevantly, there's no objection in the minutes from Callaghan to being included.

That's all I had to say about classes.

ELIAS CJ:

How much longer do you think, Mr Glenie, you're going to be?

MR GLENIE:

I've spoken with Mr Bisley and we had anticipated that I would finish somewhere between 12 and 12.15, depending on Your Honours' questions.

ELIAS CJ:

Excellent. All right, thank you, we'll take the morning adjournment now.

COURT ADJOURNS: 11.32 AM

COURT RESUMES 11.47 AM

ELIAS CJ:

Yes, Mr Glenie.

MR GLENIE:

Just moving through the roadmap, I think we had finished 2. I think we've actually made a lot more progress than that. That suggests, I think, we'll be able to get through 3, 4 and 5 quite quickly.

Information – there's really only one or two extra things that I had hoped to add, and the first of those, it might be assisted if Your Honours have the appellant's bundle of authority open at tab 8, which is the extracts from the Companies Act.

I can't tell you exactly which page, but down the bottom it says 398, so it's the Schedule 5. It should be towards the back of tab 8 of the appellant's bundle of authority.

Schedule 5 is the schedule which sets out the procedures and rules for meetings of creditors, but it applies across a range of different types of meetings, and it does cover meetings convened under section 230. The

information requirement that the respondents have relied on is the one set out in subclause 2(a) which reads, “The notice must state the nature of the business to be transacted at the meeting in sufficient detail to enable the creditor to form a reasoned judgment,” and the only point I wanted to make is that the text of that provision just says “state the nature of the business”. It does not say provide a wide range of information. Your Honours may consider that it is necessary to read that in, but I did just want to point out that the text is limited to stating the nature of the business.

Then when one flicks back to section 229 in the same tab, at the bottom of page 173, there’s the list of seven items, seven things which need to be dealt with in the compromise statement, the thing which kicks off the whole process. And in our submission, that list is intended to be exhaustive in stating the nature of the business to be transacted at a meeting of this type, a meeting of creditors under 230.

And the danger in saying that those things are not to be confined to the items set out in 229, it’s obvious it will just mean that proponents might have to overprovide information. They might have to field requests for any range of information, for instance, accounts from 2013.

I mentioned earlier that Callaghan sent some letters to other creditors in order to make sure that every other creditor was aware of the issues that were troubling –

ELIAS CJ:

Is that argument just a little bit circular? You say that the requirement to state the nature of the business takes you back to the information contained in 229. Is that what you’re saying? But 229 itself says that notice is to be in accordance with Schedule 5 so it does bring in sufficient information to form a judgment in the nature of the business.

MR GLENIE:

Correct. I'm not saying that 2(a) should have no application. I'm just saying that –

ELIAS CJ:

No, no. What I'm saying is that 229 doesn't really seem to be – just simply going through what would be covered in 229 doesn't seem to be enough. It does seem that Schedule 5 is really where you find out what you have to provide and that is sufficient detail to enable them to form a reasoned judgment on the business being transacted.

MR GLENIE:

Indeed, Your Honour, and all that I'm saying is that the first few words of subclause (a) state the nature of the business to be transacted just says this is what we are proposing to do. Here is some context. It doesn't say that you need to provide three years of financial statements. That's all that I'm suggesting.

ELIAS CJ:

Yes, I see. Thank you.

GLAZEBROOK J:

But you might have to if that was necessary to understand the nature of the business to be transacted, isn't it? Because the business is the compromise.

MR GLENIE:

No one's suggesting that you should provide a misleading context for the decision. I think – I'm only saying that there is a danger that if one is to be expected to provide a range of – for instance – financial information a company which is already in trouble because otherwise it wouldn't be in Part 14 might find it, you know, onerous, difficult, time-consuming, to collate everything and it would be incentivised to overprovide in order to avoid a subsequent challenge by a creditor. So in this context, I don't think any

thought was given to whether or not it would be necessary to provide those accounts from 2013 in order to provide context for the decision.

GLAZEBROOK J:
The Deloitte's report wasn't provided, was it?

MR GLENIE:
No, I don't believe so. That wasn't available until late April but I think that you're right, that that was available prior to the compromise.

The final point I wanted to make is just the point that I think Justice Heath picked up on, which is, even if there has been some error in the information provided, that doesn't go anywhere because the challenging creditors all voted against the compromise. It would be a very different situation if the challenging creditors said, "You told us X. That proved to be untrue, and we voted for, and therefore we are seeking some form of remedy."

GLAZEBROOK J:
But if it was something that would have made a difference to how the other creditors would have voted, surely they can say, "Well, that meeting was procedurally" …

MR GLENIE:
I have to concede that. I think the answer to that is that all of these issues were ventilated in the Callaghan letters. Everybody else read those letters and still thought, no, we're voting for – these aren't material, these aren't things that would persuade us to vote against this compromise.

Unfair prejudice – I've reflected just briefly on the issues that Your Honours raised before the break. I think the answer is that our perspective on the unfair prejudice assessment is that it needs to be contextual. That doesn't mean that it's a wide open discretion in the way that the section 205 sanction discretion might have been wide open, but certainly it is something that should take account of the circumstances surrounding the particular compromise. It

needs to be done as at the date of the vote, obviously. And I think – I always struggle to explain these points, this particular point – but the focus of Justice Winkelmann in *Bank of Tokyo* is to deploy the vertical and horizontal comparison as a way of inquiring in whether or not there has been unfair prejudice in this particular case. So it might help if I take you to tab 1 of the respondents' bundle of authorities, which is *Bank of Tokyo,* and starting at paragraph 186 – no, 182, if you start at around paragraph 182.

So this is the Solid Energy restructure. There was a syndicate of banks, there was a proposal put forward that the maturity dates of those facility be changed and that there be a debt for equity swap as well, so obviously quite a big deal. And the part of the analysis that I'm taking Your Honours to now is the unfair prejudice analysis which Justice Winkelmann carried out, from 180 onwards. But I just wanted to point out in 182, at the back end of that paragraph, "The Court's role does not involve substituting its views of the compromise for that of the required majority of creditors. Nor does it involve the Court in second guessing the wisdom or sense of fairness of creditors in voting by," just an incidental comment.

In 185, the judgment just explains in better detail than I could offer the difference between a vertical comparison and a horizontal comparison. "A vertical comparison is a comparison between the position that a creditor would occupy in a hypothetical liquidation," the liquidation counterfactual, as compared with the compromise situation. "It has been suggested that this identifies the irreducible minimum." A horizontal comparison is a comparison between that creditor and other creditors effectively. And then –

ELIAS CJ:

Are we looking at any such difference here?

MR GLENIE:

Between creditors?

ELIAS CJ:

Yes.

MR GLENIE:

No. I'll come on to explain that in just a second, but I think this may help answer your question, Justice Glazebrook: if one looks at 186 and 187, the allegation there was that the classes had been manipulated in order to swamp Bank of Tokyo in order to make the vote a foregone conclusion. And in that particular case Justice Winkelmann says – this is at 187 – no such manipulation. "As set out earlier, there were sound commercial and practical reasons for the inclusion of the creditors," and, "There is no evidence that these decisions were made with a view to ensuring that Bank of Tokyo could not veto." So obviously that's particular to those circumstances, but the same inquiry could be carried out here: was there a sound commercial practical reason for what the insider creditors did? And our submission is there was, because – traversed this in some detail this morning – the intention of each of those creditors was to keep the business afloat, keep the employees employed, maximum recovery for the creditors at that particular time. They wanted to get past the cashflow squeeze such that the business could keep going. And a lot of those creditors would – for instance, one of them was a power company, one of them was a telecommunications company, one of them was a courier company – they would be able to do business with Trends going forward…

O'REGAN J:

Well, they might not want to, if they got 11 cents in the dollar.

MR GLENIE:

They might not want to, that is true. But at least they would have the opportunity of doing that.

ELIAS CJ:

Well, they didn't explore, as we've discussed, a moratorium.

MR GLENIE:

A delay, no. No, for whatever reason this was the proposal that was put forward. There may have been timing issues, you know, these things are often done under serious time constraint, and indeed the period between the compromise and the meeting itself was 10 or 12 days, that would suggest, looking at it from the outside, that there was an issue with timing, and that may be why they pushed it forward. Sorry, did you have another question?

ELIAS CJ:

But what was the commercial reason to waive the security and reduce the take? It was simply to be able to out-vote the other unsecured creditors, wasn't it?

MR GLENIE:

I think the respondents would say that Thecircle didn't have a valid security; it was an unsecured creditor just like everyone else. And so the starting point is actually that everyone's in the same boat, all of the unsecured creditors – as in any compromise, any liquidation – they are all in the same boat. They are looking at a loss. And so the question really is not whether they had to manoeuvre themselves into that position. That's where they were. That's what they were facing. And the waiver of security, you know, there are questions about that, the giving of that security. I have to confront that. But the security was in any event waived as a gesture by the insider creditors. "We want to be treated like everyone else," and then the next question, "Why would you give up the money? Why would you give up any entitlement to payment?" is because it would drain the –

ELIAS CJ:

Sorry, I just want to be sure of what you're saying. You're saying the security was suspect?

MR GLENIE:

Well, the respondents would say that. I have to acknowledge that it was within the two-year voidable charge period and everyone would have known

that at the time, but certainly from the appellant's point of view they didn't think about that. They thought it was valid security and that they were doing a good thing for the company by giving it up, by not seeking to ascertain such that they would then drain the pool in any event. So their desire was to make sure that creditors got paid. If they asserted their security or their entitlement to payment, creditors wouldn't get paid. They'd get their derisory one cent, whatever it is.

I think again the facts of *Bank of Tokyo* will be different but at 191 there is a comment made that *Bank of Tokyo* is not being treated differently from other bank creditors. That's just a reflection of the horizontal comparison. So in this circumstance, Callaghan, Advicewise and Webstar are all being offered the same payment as all of the other entitled creditors. So the dollars are all slightly different, obviously, but the proposal is the same. There is no difference between those creditors – there is a difference between those entitled creditors and the insider creditors but it hardly, hardly to the detriment of the external creditors. So they are in actual fact being treated just alike with everyone else.

And in terms of the – I think this is the vertical comparison – the difference between, the compromised outcome and the liquidation outcome, as I said this morning, there was no prospect of recovery in the liquidation outcome. Deloitte were quite confident that there will be a nil recovery and so none of the creditors, none of the entitled creditors, could say that they were being unfairly prejudiced in that sense.

GLAZEBROOK J:
Well, there's certainly on the evidence a chance of greater recovery in terms of actions against the directors, isn't there?

MR GLENIE:
That's Mr Graham's evidence, yes. He does say –

GLAZEBROOK J:

And obviously one can't be absolutely certain to succeed, or even if they did succeed that there'd be money there.

MR GLENIE:

Indeed.

GLAZEBROOK J:

But you can't equally say they would not be better off under a liquidation.

MR GLENIE:

I don't know that anybody could say that ex ante. I don't know that anybody is currently in a position to say that. The evidence hasn't been tested in a trial of that particular point. All that I can say is that Mr Johnson and his colleagues were confident that the company could be – could recover. Deloitte were confident that there would be no recovery, and looking backwards as an expert Mr Graham has looked at some material and only drawn those diffident conclusions.

GLAZEBROOK J:

Well, Deloitte only said absent action against the directors there'd be no recovery.

MR GLENIE:

Well, indeed that's a way of reading the Deloitte letter. But in any event, Your Honour, you're right. You couldn't entirely exclude the possibility of claims in this circumstance, which sort of points to a wider issue if that is the case.

ELIAS CJ:

Sorry, I missed that in Deloitte's report. Remind me.

GLAZEBROOK J:

It was paragraph (c). They said there'd be no recovery and then paragraph (c) said of course there could be claims against the director. I think it was paragraph (c). Is that right?

MR GLENIE:

I think it was perhaps (e) and (f). I can take Your Honours back to it but they certainly acknowledged the possibility of claims and then at the conclusion, down the bottom of that page, they said two options, 16 cents in compromise, or liquidation with the possibility of claims. However, we think that there is a very high probability that you will get nil.

ELIAS CJ:

So the possibility of claims was part of the circumstances, was it? I just can't remember the way Deloitte had put it.

MR GLENIE:

I wonder if I might take you back to tab 78 of the case on appeal, which is page 778.

ELIAS CJ:

Which volume is it?

O'REGAN J:

Volume 5. The yellow one.

MR GLENIE:

I don't shy away from those paragraphs. They do raise those issues, but I say that in paragraph (b) down the bottom of the page Deloitte, the experts, the ones most familiar with the company said, despite all that, "With the realisation, however, that there is a very high probability that unsecured creditors will get nil."

GLAZEBROOK J:

Who were Deloitte acting for in this?

MR GLENIE:

Callaghan. They had been instructed by Callaghan to carry out a review on –

GLAZEBROOK J:

So did anybody get this?

MR GLENIE:

I don't believe it was circulated to the other creditors.

GLAZEBROOK J:

So it's really just advice to Callaghan?

ELIAS CJ:

Yes, sorry, I was thinking it had gone further.

MR GLENIE:

Correct. I don't know why this report wasn't shared with the other creditors. But it certainly addressed to and probably paid for by Callaghan.

GLAZEBROOK J:

Well, possibly because they weren't taking the advice.

MR GLENIE:

Perhaps.

GLAZEBROOK J:

And did you say that Deloitte had knowledge of the company?

MR GLENIE:

The circumstances leading up to the compromise – and I brushed over these at the very start – Callaghan had injected a certain sum of money in 2014.

GLAZEBROOK J:

I understand that. So Deloitte – what I was really asking, if Deloitte had actually had knowledge of the company through that process.

MR GLENIE:

Yes. They received some information from Trends. They gave a draft report, I believe, in December. That led to the SFO release. They finalised their report in April. They had carried out a –

ELIAS CJ:

So their report went to Trends?

MR GLENIE:

I believe so.

ELIAS CJ:

Which preceded that – so that's part of the circumstances here, isn't it?

MR GLENIE:

It is, it is.

ELIAS CJ:

The objective circumstances. I'm just trying to note down the possible circumstances. I'm going to add that to the list.

MR GLENIE:

Well, one of the other circumstances about the Deloitte report from April 2015 is that it didn't conclusively state that Trends was insolvent. So the outfit which had spent the most time looking at Trends, the specialist accountants, had not concluded that this was an insolvent company or, indeed, had not said slam-dunk there is a claim against the directors. So the difficulty is that if one admits of the possibility of claims raising a different interest for insider creditors or the potential for unfair prejudice is that one always has to

separate out – if that was the rule one would always have to put insider creditors in a different class.

ELIAS CJ:

Or directors, potentially, I suppose.

MR GLENIE:

That could be a subset of those, indeed.

ELIAS CJ:

Or of the creditors, yes, yes.

MR GLENIE:

Yes, that group as well. That would mean that people who have indeed –

ELIAS CJ:

I'm just thinking about director proposals.

MR GLENIE:

Correct. This was, in effect, a board proposal. It was put forward by the directors, but it also included some other folk. That was why I was …

GLAZEBROOK J:

We don't have the earlier Deloitte's report?

MR GLENIE:

There is an extract from the draft report, which is at – it's in the case on appeal. It's from December.

ELLEN FRANCE J:

We do have the April one at tab 59, I think it is. So volume 4.

MR GLENIE:

Tab 47 is the draft report and Your Honour you said 57?

ELLEN FRANCE J:

59.

MR GLENIE:

59, sorry, is the Deloitte report.

ELIAS CJ:

That's the full report?

MR GLENIE:

Correct.

ELIAS CJ:

Sorry, who did that go to again?

MR GLENIE:

Callaghan and I believe it was shared with Trends. I can't now point to proof of that.

ELLEN FRANCE J:

Certainly it says at the start of the April 2015 one that the earlier draft report had been shared with Trends.

MR GLENIE:

Correct. They were invited to comment on it, I think, and they do say from the looks of the Deloitte report things like Trends is under significant financial pressure, but this is April. This is after the SFO. Everyone accepts that they were under financial pressure. You wouldn't do a compromise if you weren't under financial pressure and they said at high risk of being insolvent, but even then they weren't able to say there has been reckless trading.

GLAZEBROOK J:

And where was the draft report, sorry?

MR GLENIE:

Tab 47.

GLAZEBROOK J:

I missed that.

MR GLENIE:

Tab 47.

GLAZEBROOK J:

Tab 47, thank you.

ELIAS CJ:

So is – because the one at 59 seems to be April as well.

MR GLENIE:

I think it may be mis-dated, I think the final report is intended to be April 2015.

ELIAS CJ:

Oh, it is 2015, sorry, I just looked at it.

MR GLENIE:

I think that is right.

ELIAS CJ:

Yes.

MR GLENIE:

So just to close out on unfair prejudice, I think Your Honours will know what our submissions are on that fact. We would say that there is no differential treatment for the challenging creditors, they were treated alike and in fact better than the insiders, and they were treated better than they would have been treated in liquidation. So on that basis no unfair prejudice.

Now I suppose one other fact that might be relevant if one takes a wide circumstantial, a wide view, and looks at all of the circumstances in connection with that question, one should just bear in mind where Callaghan stood in all of this, it's the lawsuit again. They had a really good reason to push the company into liquidation because there was no guarantee that a liquidator would pursue the claim against Callaghan as vigorously as Mr Johnson and the claimants in that party – in that litigation. Now that's going to trial, I think in the middle of the year.

Did Your Honours have any other questions on unfair prejudice?

If it's all right I would like to invite my junior to address you on the question of relief, which is focused on what happens if there is indeed unfair prejudice.

ELIAS CJ:
Thank you, Mr Glenie. Yes, Ms Barkle.

MS BARKLE:
May it please the Court. I am conscious of the time so I'll do my best to be brief, or rather concise.

The starting point here is that I will engage with the respondents' submissions as to discretionary relief, which is at 10 of their submissions. They correctly note *Kacem v Bashir* [2010] NZSC 112, [2011] 2 NZLR 1 and the instances in which a court may alter a lower court's exercise of discretion.

Now it's the appellant's submission that there are two reasons why it is open to the Supreme Court to alter the exercise of Justice Heath's discretion, the first being that there are now a number of new considerations that weren't able to be taken into account by Justice Heath at the time, and quite simply that is that the time of passage has meant that the compromise has largely been complied with now. If I could briefly take you to Justice Heath's decision, which you'll find at – I believe it's meant to be tab 8 but it's actually

sitting at tab 9 and I apologise for that. On page 190 in paragraph 135 Justice Heath at (c) and (d) refers to the fact that compromise payments hadn't been made. That is no longer the case. Nearly all of the compromised payments have been made, and therefore in our submission that is a relevant consideration to take into account now.

ELIAS CJ:

Do we have information about what has been paid before us?

MS BARKLE:

I'm afraid the most up to date evidence that's available today is at – my apologies, I'll be there in just a moment. In the case on appeal there are two affidavits at tab 90.

WILLIAM YOUNG J:

90 or 19?

MS BARKLE:

90, my apologies. At 90 is an affidavit of David Johnson, and at paragraph 9 of that affidavit he refers to the minor creditors having been paid in full, and that the entitled creditors had also been paid the amount they were due under the compromise that day.

ELIAS CJ:

That day?

MS BARKLE:

Yes, Your Honour.

ELIAS CJ:

So is this – but does that cover the nine payments spread over nine months, or are we talking about the first payment out of the first pool?

MS BARKLE:

My understanding is that the total they were entitled to receive under the compromise, so this whole amount.

ELIAS CJ:

Right, thank you.

MS BARKLE:

And there's evidence to similar effect in tab 91, which is an affidavit of Ewen Groves, and that's at paragraph 8, although there's no need to look at that unless you please. It says essentially the same thing.

Now, because of the changed circumstances it's our submission that even if the Court found that there was unfair prejudice to the challenging creditors, the compromise ought to stand as against all of the other creditors.

ELIAS CJ:

Well, the ones that have been fully paid out in terms of the compromise, do you mean, or do you mean?

MS BARKLE:

Yes, Your Honour, or rather all of the creditors involved in the compromise that haven't challenged – that aren't the respondents.

ELIAS CJ:

I see.

WILLIAM YOUNG J:

Sorry, what's happened to the Trends building?

MS BARKLE:

The Trends building, I assume you looked at the reference that there was investigations into selling it.

WILLIAM YOUNG J:

Yes.

MS BARKLE:

My understanding – although I could be wrong – is that it's still owned by Thecircle.

ELIAS CJ:

So that was – sorry, I had written down the amount. So that's a total of about $800,000 or something that's been paid out, is it?

MS BARKLE:

My understanding is that it's less than that, in the realm of closer to $200,000.

ELIAS CJ:

Oh. I thought – oh well.

O'REGAN J:

So who are you saying it should remain in place for? Everyone except the respondents?

MS BARKLE:

Yes, Your Honour. And that is largely because first of all given there's a change in circumstances the status quo ought to stand, and that is in line with the fact that the majority of the creditors voted in favour of the compromise, and their actions demonstrate that they're content with the outcome of the compromise, which is that they're satisfied.

O'REGAN J:

But in practice, does it make any difference? I mean, once Callaghan are out of it they're going to put the company into liquidation, aren't they?

MS BARKLE:

Your Honour, it would practically be that each creditor would then have to go about claiming their original debt, whereas they're satisfied now with the status quo and –

GLAZEBROOK J:

Well, they may not be satisfied if the company nevertheless goes into liquidation, might they?

WILLIAM YOUNG J:

Or put another way, they might not be very satisfied if Callaghan was paid out in full.

MS BARKLE:

Yes, Your Honours. I appreciate that, but to that it must be that especially for those who have voted for the compromise can't almost hedge your bet both ways.

ELIAS CJ:

Would we decide this or would it be left to them if they chose to do so to seek to prove in the litigation – in the liquidation and have it said that they had compromised it?

WILLIAM YOUNG J:

That's assuming a liquidation.

MS BARKLE:

My expectation would be –

ELIAS CJ:

Yes, but I thought you were.

WILLIAM YOUNG J:

No, you might say Thecircle simply paid out these creditors.

ELIAS CJ:
Yes, I see.

MS BARKLE:
Unless you had any more questions on the point that we say that given there are new circumstances, the status quo should remain as in relation to the non-respondent creditors.

The second point in relation to relief is that given the finding of unfair prejudice related to only the challenging creditors, being the respondents, Justice Heath oughtn't have set the whole compromise aside, rather he should have ordered only that the challenging creditors not be bound by the compromise. And the appellant submits that the discretion, which is set out in 232(3), is limited to the most appropriate remedy to meet a challenging creditor's successful complaint and that by setting the compromise aside that went further than remedying the challenging creditors' successful complaint.

Your Honours, you'll see that in tab 3 of the respondents' bundle is the case *Polperro Corp Limited v International Marine Services Limited* HC Auckland CIV-2006-404-2390, 16 July 2007 (Associate Judge Doogue) and this was a case that was discussed under the heading of relief by Justice Heath in the High Court and, although I won't traverse it in full, in that instance there was a finding that the plaintiff *Polperro* had been unfairly prejudiced and it's our submission that the Judge in that case was correct to hold that only *Polperro* ought not be bound by the comprise as opposed to set the whole compromise aside.

ELIAS CJ:
Well, I suppose it really does depend on what ground we were to uphold the determinations below. If it's done on the material irregularity, if it was material to the whole compromise, it might be appropriate to set the whole thing aside. But if it's unfair prejudice for the plaintiffs then I understand your point.

MS BARKLE:

Yes, Your Honour, absolutely. It is irresistible that if it is a material irregularity finding then it would be open to the Court to set the whole compromise aside. It was just that where it's an unfair prejudice finding, on the words of section 232 it ought only be set aside in – or rather ordered – that the person who, the creditor that suffered unfair prejudice, be not bound.

And unless Your Honours had any questions or I could assist you any further, that concludes the appellant's submissions.

GLAZEBROOK J:

What about the issue of – because probably not in this case, but one can conceive of situations where if they'd known somebody wasn't going to be bound by it the creditors wouldn't have voted in favour of the proposal. But it's probably not an issue here.

MS BARKLE:

That the, factually that any of the creditors that did vote in favour of the compromise wouldn't have otherwise – if, for example, they knew that somebody –

GLAZEBROOK J:

Well, one can imagine the situation where it says, "Well, I voted in favour of it because I thought everyone was taking a hit. I didn't vote in favour of it on the basis that certain creditors would be excluded from the hit." But we don't have any information on that is the slight difficulty. But then I suppose you'd say, well, they could have come and said, "Well, don't put it aside for us in the High Court."

MS BARKLE:

Yes, Your Honour, absolutely. It was always open to them to come and make submissions, and in that case would have been able to submit that setting it aside was inappropriate because it may well have meant that at the vote it would have gone another way.

ELIAS CJ:

Thank you, Ms Barkle.

MS BARKLE:

As the Court pleases.

ELIAS CJ:

Yes, Mr Bisley.

MR BISLEY:

Thank you, Ma'am. I'll just take one second to bring my various bits of paper.

ELIAS CJ:

Yes, organise.

MR BISLEY:

Just by way of housekeeping, Your Honours, I have also prepared a short outline of my oral submissions and so I'll hand that up with the Court's permission. I'm also going to hand up, if I can, a copy of *Commissioner of Inland Revenue v Atlas Food and Beverage Ltd* (2010) 24 NZTC 24,096, which is the decision which was intended to be included in our bundle but mistakenly we included a different *Commissioner of Inland Revenue.* I apologise for the duplication of documents.

ELIAS CJ:

It was really seeing this case that made me wonder whether this is a – I'm trying to think of a less pejorative word – a tactic that is not uncommon in insolvency post 1993.

MR BISLEY:

Well, Ma'am, in my submission it is a tactic which is uncommon and which is in fact very serious, because it goes to the heart of what a Part 14 compromise is trying to do.

Now there are a number of issues which I would like to take the Court through, but I thought I might indirectly address Your Honour's question by making really three points at the outset.

The first is to take the Court to a case which is invariably referred to in the context of schemes of arrangement, a similar but different process, and which notably hasn't been given any emphasis by my learned friend, and in my submission the case that is helpful understanding the context for the interpretative exercise that the Court is called upon to do today is *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573 (CA), in which Bowen LJ makes some observations about the nature of the English scheme of arrangement process. If I can ask Your Honours to go to the appellant's bundle of authorities, tab 1, and at page 582 Lord Justice Bowen says, "This question of a release depends upon the construction of the release document and, secondly, upon the effect of the statute upon that document," the statute that provides for schemes of arrangement. "What is the proper construction of that statute? It makes the majority of creditors or of a class of creditors bind the minority; it exercises a most formidable compulsion upon dissentient, or would-be dissentient, creditors; and it therefore requires to be construed with care, so as not to place in the hands of some of the creditors the means and opportunity of forcing dissentients to do that which it is unreasonable to require them to do, or of making a mere jest of the interests of the minority." Now my submission will be, Your Honours, that that is precisely what the interests associated with Trends are attempting to do here.

Now the second point that I wanted to make is that in this proceeding we've heard rather a lot from my learned friends about the entitled creditors leaving aside the insider creditors and also the minor creditors, and they have made great play of the fact that of those creditors, 28 of them, 19 were in favour of the compromise and 9 were against. Now what that does, of course, in my submission, is focus entirely upon only one of the two voting tests that is put forward for a Part 14 compromise. It focuses on the majority by number but ignores the majority by value. If Your Honours turn to page 24 of the respondents' submission you can see that we've carried out, effectively, this

exercise in table 4, and you'll see that when those votes are broken down – this is the second-to-bottom row – we have other entitled creditors, 19 votes, just as my learned friend says, representing a value of 27.4% of the debt at issue. And against them we have eight other entitled creditors including the respondents, who control 32.76% of the debt at issue. So that's no longer including the insider creditors and no longer including the minor creditors.

Now, even if we include the minor creditors in this assessment for value purposes, as we do in the last line, Your Honours will see that there's a value of only 28.10% in favour of the compromise as opposed to 71.9% against. So if the insider creditors hadn't voted, that is where this compromise would have ended up, not with the statutory majority by value in favour, but with something very, very close to the statutory majority in value against.

Why is that – and this perhaps is my third point – a serious problem, to answer Your Honour the Chief Justice's question, is this a common strategy, and should we therefore accept it? Well, in my submission very strongly not. At trial, His Honour Justice Heath listened to the evidence given by Mr Johnson, which in many respects was unsatisfactory, listened to the explanation which is now advanced very ably by my learned friend for the appellants as to why it was that Mr Johnson cast his vote, or effectively cast his vote because, of course, he controlled Thecircle, as he did, and dismissed that evidence as implausible. He said he didn't believe it.

His Honour also observed that neither Mr Taylor nor Ms Messer had been called to give evidence when they could have been, and observed that the other person who very significantly had not been called to give evidence was Mr Khov, the insolvency professional responsible for structuring the compromise. And His Honour said that in the absence of that evidence, he was left to draw inferences as to why the votes had been cast as they were and why the compromise had been structured as it was, and unsurprisingly and inevitably the inferences that he drew were that the very reasons my learned friend advances for this compromise that it was intended as a gift to

the creditors to ensure they did well and to preserve the company were not right.

Now, in my submission just by way of opening, Your Honours, it really is right to find that that explanation is implausible and this is a point that came out quite early in my learned friend's submissions in response, I think, to questions from Justice O'Regan. Why was it that the insider creditors retained the ability to vote, yet received nothing from the compromise on its terms? There can be no good explanation, in my submission, of those two facts, retain ability to vote but received nothing beyond a desire to push the compromise through against all odds, and of course you can immediately see that the position isn't really helped if Thecircle had retained its debt – well, had waived security in its debt and then sought to be paid in respect of it, because at that point Thecircle would have become concerned that the compromise was not going to garner sufficient support, because almost all of the value would have gone to it.

The last general point, Your Honour, which is perhaps worth making before I turn to the facts, is that in my submission the tenor of my learned friend for the appellant's presentation was very much that the Court should find in cases like this that a company wishing to propose a compromise can force it through using related party votes. That is absolutely fine. It can adopt a process which effectively removes the democratic protection for creditors, and I should note in this context that it's going to be far from unusual that the shareholders in a company which is going into insolvency have very significant debts from that company. In fact, that's an observation made by Mr Graham. Frequently they will have been propping the company up for some time. Equally frequently they just will have made capital contributions in the ordinary course as debt. That's the usual method for doing it. So the mechanism for doing this will readily be available.

So my learned friend says, "Well, that's all right. We should let them do that. But then we should require the creditors to take steps to challenge the compromise in the Courts, and the creditors at that point should carry the

burden of proof of demonstrating that the compromise is in some sense substantively unfair to them, that it fails on a vertical comparison or a horizontal comparison, that should be for the creditors to do." Well, in my submission that presentation simply can't be reconciled with the policy which sits at the heart of these provisions, which is that identified by Lord Justice Bowen. This is a process exercising a formidable compulsion that allows the minority to be compelled. That should be done with great care.

That, perhaps, also goes to Your Honour Justice Glazebrook's questions relating to the point at which this inquiry arises. Now, again, I shan't engage with that in detail now. The only points I wished to make in that regard were first that in my submission, really, in this appeal, that question is somewhat academic, because quite clearly there has been a voting manipulation. Something that the Hong Kong Court of Appeal described as a form of dishonesty. So it doesn't matter at what stage this Court takes it into account, because here we are. We have had an application under section 232 for relief, but many compromises will not be in that position. In many cases, there will be no application by creditors because their value is very different to perceive, and really this case underlines the difficulties in obtaining proper information about the outcome in a liquidation from a company that is vigorously attempting to propose a compromise and using related party votes to force it through. In my submission, the right answer – although, as I say, perhaps this is academic from my client's perspective – is that these issues should be frontloaded and the way to do that is to include them in class composition, just has been the case under section 205 rather than leaving them until the end, until what the Court – the High Court in *Public Trust v Silverfern Vineyards Ltd* [2015] NZHC 3078 described as the "belated and occasional" involvement of the Court.

Those are my prefatory comments on this appeal.

Against that background, it's probably appropriate to turn next to the first item in my outline of oral submissions, which is to take a snapshot of the position of

Trends at the point it proposed this compromise, which has been the subject of some attention by my learned friend.

Now, my learned friend says he understands that the respondents say that Trends was in financial difficulty and that that is a conclusion which is hotly contested by him. In fact, Your Honours, in my submission it's no longer really open to my learned friend to contest that conclusion. There are two reasons for that. The first – and I have the reference here to Mr Graham's evidence – is that Mr Graham gave a lengthy expert analysis of the financial documents that he had been able to obtain from Trends.

Now, his conclusion, having reviewed those documents, was that Trends had been in financial difficulties for quite some time, and he refers to a number of factors in support of that conclusion. But they include such obvious red flags as the fact that by 2015 Trends hadn't been paying its rent for some six years. It had been late paying wages since May 2014, a point that both Mr Johnson and Mr Groves sought to dispute in evidence in the High Court, but were forced to accept.

It had been engaged in a lengthy correspondence with its bank about the bank's concern at the numerous breaches of bank requests that additional capital be included and that an independent financial advisor be appointed to assist it. It had obvious and serious credit arraigning and a large number of creditors overdue and they had been overdue for some time. Now, that was a point that was addressed in the High Court in cross-examination of Mr Graham and in the course of that cross-examination, as Your Honours may have seen, he conceded that he couldn't possibly know what terms all of that debt was repayable on and therefore his prognosis might not be perfectly accurate. But it's clear that the majority of the creditors were substantially in arrears at that point and certainly that was accepted in relation to Times Printers, one of the nay-saying creditors which was owed a substantial amount of money.

There's also – and this goes to Your Honour the Chief Justice's question about the nature of the debt owed to Thecircle – a real question about how that was being treated, and it may be worth just taking the Court to one reference in that respect. If I can ask Your Honours to go to volume 2 of the bundle and turn to tab 21, page 311 – actually perhaps it's best to start one page back on page 59.

GLAZEBROOK J:
Sorry, I need you to go through the tabs again.

MR BISLEY:
I'm sorry, it's tab 21, Ma'am, in volume 2, and I've asked you to go to page 310, just to give some context to the part I want to take you to.

Now what Mr Graham is doing here is summarising Trends' statement of financial position as at 31 March 2015, and he presents the balance in the same categories as Trends presents them in its statement of financial position but aggregates some of the balances. And he notes in this context, if Your Honours look, he's set out the table of Trends' financial position and he's aggregated right down the bottom under the heading "Equity", "Related party loans and current account," which is set down as having a value of $12 million. He notes that $12.5 million of that equity includes these related party balances, and then over the page says, well, "I haven't seen any documentation regarding these balances, but equity is of a capital nature, ie most generally seen when a party pays for shares in the business, and this translates to share capital, otherwise it's unusual for parties to advance sums to a company without any expectation of being repaid. Given the descriptions of the balances in the statements and the narrations of entries I have seen in the general ledger, these balances are clearly liabilities." Now you know the complexity of Trends' financial affairs is really cast into a stark light when one reads down through paragraphs 62 and 63. So Mr Graham observes that the balances have been classified as equity effectively to prop up the balance sheet, a process which has been going on for some time. And then he observes that part of those related party balances described in Trends' own

accounts as equity are Thecircle's current account of $3.544 million, which is the very sum which is now, well, which is later I should say, sought to be voted in the compromise, and he observes that it could not have done unless Waterstone Insolvency deemed the current account to be a liability. In the course of cross-examination, Mr Johnson having been taken through various of these points and in particular the late payment of wages, accepted that in fact Trends had been in financial difficulty for some considerable time before we get to 2014 and 2015. He was always disposed to argue that, sometimes unrealistically. For example, he described a very firm letter from the bank expressing serious concerns as the bank asking ordinary questions of him. But in my submission it just is not open to the appellant on this appeal to say, "Well, the financial difficulties that we experienced only arose in late 2014 and early 2015."

Now it might be worth my pausing just to explain why that's important, because Your Honours may very well say, "Well, so what?". In my submission it's important for two pretty closely related reasons. The first is the reason identified by Mr Graham, which is that in circumstances where the directors have been allowing a company to trade on, incurring liabilities, they are plainly on the hook, and it's highly significant to note that Mr Taylor resigned as a director the day the compromise was passed. No explanation of that of course, because he wasn't there to give evidence. Secondly, it's relevant because one of the many failings of the information that was provided to creditors in advance of the compromise is that it claimed that Trends' financial difficulties were of a very recent vintage and were caused by Callaghan Innovation. Now Trends' case throughout this proceedings, despite the fact that I am here representing a number of creditors, has been to try to thrust Callaghan front and centre and say that this is all driven by Callaghan's concern about the litigation that is brought against it. Well, there just isn't any evidence to that. As one of Your Honours, I'm afraid I now forget who, observed in the course of my learned friend's submissions, it's a speculative assertion.

So that's where we are as at May 2015, and I note further down in my outline of the oral submissions that by May 2015 it's indebted to three insider creditors being Thecircle, Paul Taylor and Louise Messer, and that Callaghan has agreed to provide funding in April 2014, which is shortly afterwards suspended, in December 2014.

Now while I'm on that subject perhaps it's perhaps worth making a couple of clarifications in relation to the Deloitte report and what role that plays in this process. The issue is explained in the affidavit of Mr Perry, who wasn't really cross-examined on this topic. Mr Perry explains that Callaghan agreed to provide funding, having been assured among other things that Trends was solvent and was running a solvent business. There's reason, and you'll see in the cross-examination of Mr Johnson, that he concedes that this is fair to doubt that that was the case. Callaghan received two claims for funding which are calculated by reference to a proportion of the spend of the company on resource and development – on research and development, I'm sorry. It's –

ELIAS CJ:
I don't really want to interrupt you, but I'm just wondering whether it's really necessary for us to have chapter and verse on this rather than – perhaps it is …

MR BISLEY:
Ma'am …

ELIAS CJ:
Do others want to – rather than your submission?

GLAZEBROOK J:
I was wondering the same thing …

MR BISLEY:

Yes, Ma'am. I was only going to say that Callaghan's sort of concerns were aroused, and therefore just for the purposes of instructing the role of – of describing the role of Deloitte really, that was the only point I was seeking to make, because that was something that my learned friend made some play of later on, he said, "Well, Deloitte didn't find that there was insolvency and they had all the financial information."

ELIAS CJ:

So you're taking us to indicate that it was concerns about the viability of Trends that led to Callaghan bringing in Deloittes?

MR BISLEY:

Not at all, Ma'am –

ELIAS CJ:

No.

MR BISLEY:

In fact that is precisely the fact I want to clarify, so thank you for raising it. What I'm attempting to explain is that Callaghan became concerned at the money that had been sought, it became concerned the money was being misapplied, it remains concerned about that, and it asked Deloitte to investigate that issue, not Trends' solvency.

ELIAS CJ:

What, the application of the money?

MR BISLEY:

Exactly, Ma'am. The money was earmarked for certain expenditures and Callaghan believed that the money wasn't being spent properly and it asked Deloitte to come and carry out a review to that end, which it did. So that was the scope of the Deloitte review. And it obtained information that gave it some

concern about solvency, but that was not what it was looking at, and that's why the issue was never really progressed.

Now the last point I want to make in this snapshot of Trends' financial position before the compromise is in relation to the security that was obtained in February 2015. Now even on Trends' case that it ran into financial difficulties after Callaghan pulled the ground in December 2014, this was a point at which it was in financial difficulties. Notwithstanding that, the directors enter into a resolution in which they grant Thecircle security, and to do that they are obliged to certify that Trends is able to meet its debts as they fall due. So there are some real concerns about the circumstances in which this is done and the basis upon which it's been done, which of course are now more difficult to examine. I've given a reference to the certification in my outline.

That brings us to what's really before the Court today, which is the compromise proposal and what do we do about it, and it may be worth just having a look at that document, in part to clarify some of the points made by my learned friend. It's in volume 5, as Your Honours know, and it consists of two parts: first, a statement relating to the compromise and, second, the compromise proposal itself.

Now Your Honours were absolutely right to observe that there is no formal waiver of security, that is something we are simply told has been done to allow Thecircle to vote and there's no evidence as to Thecircle incurring that vote, as Mr Graham has noted. There is, though, some evidence of what my learned friend describes as waiver of the entitled – sorry, the insider creditors' rights to payments under the compromise, and that is really just that it's a term of the compromise itself. So Your Honours will have seen the "compromise creditor" is defined as all of the creditors. And then "entitled creditors" is defined as all of the compromised creditors, excluding Thecircle, Ms Messer, and Mr Taylor. Then if we turn over the page to the distributions clause 2, you can see that those distributions are only to be made to the entitled creditors. So the contractual effect of the document is that Thecircle, Ms Messer and Mr Taylor lose all of their debts, lose the benefit of all of their debts owed by

Trends. But they don't receive the same legal rights as the other creditors because they don't have any legal right to a distribution.

The next point, Your Honours, that I want to draw attention to relates to the statement about the compromise. Now, in my submission the statement about the compromise is insufficient in two respects. First, some of –

ELIAS CJ:
You're referring to the earlier document, are you?

MR BISLEY:
I am, Ma'am. I'm sorry, I should have said. What I've done is I've gone straight to the appendix and I'm now going back, essentially, to page 703, which is the information that's provided to all creditors.

Now, the problem with this document, in my submission, is that in some respects it is wrong, and in other respects it makes material omissions.

The first respect in which it is simply wrong is that – as we've discussed – it says down the bottom of page 703, "The present difficulties facing the company have arisen due to the revocation of a funding grant in June 2014." Now, that's wrong in two respects. First, the company had been in these difficulties for quite some time. Secondly, in any event, the grant wasn't revoked in June 2014. It was paid. It wasn't suspended until December 2014.

Over the page, at the top of page 704, the document records the orders 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 the company had the compromise as a key element of this. In particular, the board has received a commitment from a third party to introduce capital into the company. The board is confident that this commitment will not be revoked.

Now, as Mr Graham observes in his discussion with Justice Heath in the High Court, one of the real drawcards – and this is a point which has been touched on this afternoon – for a creditor considering a compromise is the possibility of continuing to trade with the company. So that statement is obviously pretty important. We have a company which is in trouble and creditors will want to be sure that they can continue to trade. It's probably most important for those creditors who are sort of somewhere between about $1000 or a little over and the 20 trade creditors who are going to take a reasonable hit but might be able to recoup that. It's not going to affect the minor creditors because they're getting everything, and it's not going to affect the really big creditors, one assumes, because it's going to take them a long time to recoup those losses.

My learned friend has taken Your Honours to the questions that were asked by Buddle Findlay about this issue, what is meant by fresh capital? How much? What is the commitment? Would it be available in any event in liquidation? And Your Honours have observed that the answer from Trends is essentially, "No comment. We won't tell you that."

Now, it transpires on discovery – and only on discovery in this proceeding – that what is really meant is $50,000 paid by a friend of Mr Johnson's, which will be used to meet that first pool under the compromise in its entirety, so there'll be $50,000 which will immediately be swallowed by the compromise. Now in my submission that fact is plainly material to those trade creditors that I have described. It's plainly relevant to them.

It's perhaps worth pausing at this point to engage with my learned friend's submission that these issues were in a sense before the creditors because they were raised in correspondence from Buddle Findlay, as Callaghan's solicitors. It's an interesting submission, Your Honours. It puts one in mind of some of the larger political debates of the day. The idea that it is sufficient for creditors if questions are answered and refused – questions are asked and refused to be answered is, in my submission, just nonsensical. One sees pretty frequently people – President Trump is perhaps an example of this –

declining to provide information that is plainly pertinent in circumstances where you can see that if the information was provided people's suspicions would be confirmed.

In my submission, it just can't be an answer to an obligation to disclose sufficient information to say, "Well, I didn't give the information but I was asked about it, and then I refused." Of course, one of the things that does is creates great uncertainty for people who wish to consider how they should respond to the compromise in the future, so not only should they vote in favour, but what should they do if the compromise is passed regardless?

The next point that I wish to draw out on this document is further down on page 704, where Trends' directors say, "If this compromise is not implemented, the board is of the view that liquidation or voluntary administration of the company will be the likely outcome. In the event that liquidation or voluntary administration of the company occurs, unsecured creditors are unlikely to receive a distribution." Now, that's been the subject of some discussion this morning. In my submission, that is simply an inaccurate statement and I'd like to explain why. First, plainly the directors and Mr Khov at this stage have not really carried out any investigation into this issue. They haven't considered it. The compromise has only been on foot for two weeks, and in that time Mr Khov has only received that statement of the company's creditors' position. As Justice Heath notes in his judgment, when we get to the meeting Mr Khov is plainly unable to answer reasonable, basic financial questions and defers to Mr Simon Groves, the company's then-financial controller on those points. There is no information provided at all to explain this bland statement that recoveries in liquidation will not be much.

What do we have to tell us what recoveries might be available in liquidation? Well, perhaps the starting point here is, as it was for Ms Messer and Mr Taylor's motivations, Trends has all of the information we need to answer these points. It has its own accounts. It's able to inform us whether the claims that have been tentatively identified against it would stand or fall. What actually happens? Well, what actually happens is that there is a discovery

process in which documents are very slowly trickle-fed to the respondents and this is described in Mr Graham's affidavit, culminating in bank correspondence expressing serious concerns being provided after his primary evidence but just before his reply. Mr Graham takes this incomplete financial information and again he describes the problems with it and says, "Look, these accounts just are not in a good state." Your Honours can see that for yourself because many of them are in the case on appeal.

And he says, "Well, on the basis of this I have identified a number of potential claims," and the two I'd particularly like to mention here are first the claim against reckless trading, which I've already – against the directors for reckless trading, which I've already flagged, and second a really substantial claim against related parties, including Mr Johnson, including trusts associated with Mr Johnson for around $2 million, which he says is available either on the basis of money that has been paid to them as a loan by the company, so it's repayable on demand, or on the basis that they have entered into transactions with the company within the voidable period of two years and are related parties. I haven't given sufficient value in exchange. So he identifies a really substantial claim.

Now, I think we finish at 1 o'clock.

ELIAS CJ:
That's right. Where are you on your outline?

MR BISLEY:
I've made my way through, Ma'am, to paragraph 2.2.

ELIAS CJ:
And how much time do you think you will require, Mr Bisley?

MR BISLEY:
Well, Ma'am, I have talked about this with my learned friend and we had anticipated that I would finish somewhere between about 3.00 and 3.15. My

learned friend went slightly over, so perhaps if I could have grace until 3.30, but I wouldn't anticipate any difficulty in being finished before then.

ELIAS CJ:
All right.

MR BISLEY:
I'm very close to being finished with my account of the facts. I'm trying to sweep up my responses to my learned friend as I go.

ELIAS CJ:
All right, thank you. We'll take the adjournment now until 2.15.

COURT ADJOURNS 1.01 PM

COURT RESUMES: 2.17 PM

ELIAS CJ:
Yes, Mr Bisley.

MR BISLEY:
Thank you, Ma'am.

Immediately before lunch I was really bringing to a close my submissions on the assertion in the statement in support of this compromise that no better return was available in a liquidation. Now I propose to leave that paragraph now and move through to the correspondence that my learned friend talked about.

But before I do that I did want to make one last point which, if memory serves, I did not manage to make before lunch. I had explained that Mr Graham was instructed as an expert witness in this case and that he identified a number of claims that were available in a liquidation that might result in return to creditors. Now my learned friend says in response to that, "Well, hang about,

all of those claims are hypothetical, they may or may not work, we cannot know how much will be recovered, and in fact some of them may not be available." The only further point that I wished to make in response to that argument is that Mr Graham was the only expert evidence before the High Court on this point. So Mr Graham filed an affidavit as an expert witness and no expert evidence was called to rebut him. Now that omission in my submission, Your Honours, is just as significant as the omission of the witnesses I have already identified by Trends. All of the information needed to rebut these assertions was unequivocally in Trends' possession. Did it attempt to do so? No, it did not.

That brings us on, Your Honours, to that correspondence that my learned friend described. And I shan't spend long on that, save to say that he is quite right to say that various questions were identified by Buddle Findlay on behalf of Callaghan Innovation, and to say that there were then responses from both Ms Messer and Mr Johnson. Those responses are pretty short, and essentially what they do is, first, in the case of Ms Messer, reiterate this, as I say, incorrect assertion that the financial pressure Trends found itself under was caused by Callaghan Innovation. And on the part of Mr Johnson – and it's perhaps worth just having a quick look at this, saying – the document is at tab 70 of volume 5 of the case on appeal and I'm looking at the second page of the letter, so page 732 – having declined to answer Callaghan Innovation's questions and complained that Callaghan should already have historical information that would allow it to answer them, he says at paragraph 6, "We plan on making ourselves available to creditors to discuss the financial affairs of Trends on an individual basis should they wish to do so. No financial information will be released to any party that has the possibility of ending up in the public domain." Well, in my submission, any creditor reading that would think, "That is not a fulsome invitation to request information."

There's then a further exchange of correspondence. I should say before I leave that point that those three letters are then circulated to creditors by Waterstone Insolvency, so the impression is that Callaghan has asked these

questions and they have been answered by Mr Johnson and Ms Messer, and that anyway this is in some sense Callaghan's fault.

There's then a further letter from Buddle Findlay asking for further information which I shan't take Your Honours through, save to note two points about the response. The first is that if Your Honours go a bit further through that bundle to tab 75, you'll see that Waterstone is asked to circulate the Buddle Findlay letter to creditors and declines to do so. If you go to the tab after that – and this is important in the context of that very short Deloitte comment that Mr Glenie relies upon – there is a letter from Waterstone Insolvency sent just to Buddle Findlay which attaches a financial position statement. This is at tab 76. The position statement is at page 518.

Now, that financial position statement has two significances. The first is that it is that information on which Deloitte relies when preparing its very short comment, which is at tab 78, and you can see that from paragraph (d) on the first page of their response. "We have looked at the financial information from an insolvency/liquidation perspective. Effectively this recognises the Waterstone financial summary." So point 1, that is what Deloitte is relying upon. Point 2, Mr Graham comes to look at this financial statement in the context of giving expert evidence, and he says in his first affidavit – now, I don't know that Your Honours need to turn to this.

ELIAS CJ:
Sorry, I'm just getting a little lost at what this is – why you're taking us through all of this in this detail. What is the point you're making?

MR BISLEY:
Ma'am, the points are really twofold. The first is that one of the issues that this Court has to decide today is whether the information that was provided by Trends was sufficient, and I say it wasn't because it was misleading, which is what Mr Graham says, to cut to the chase. In his affidavit, he says the financial position statement is inaccurate.

The second is that when Mr Glenie comes to make his arguments about the recoveries that might have been available in a hypothetical liquidation, he founds his arguments squarely on this document and says, "This is what the Court should have regard to," and in it Deloitte says there is no recovery available, and he says that's preferable because it's ex ante rather than ex post, as Mr Graham's affidavit is.

Well, I say, Ma'am, and really this is perhaps where I can leave the point, not at all. This is not a terribly helpful document. Deloitte take a robust view in a very short period of time based on incomplete information. Is that enough to discharge or to deal with the much more detailed analysis carried out by Mr Graham? Well, in my submission it isn't.

ELIAS CJ:
Thank you.

MR BISLEY:
So, Ma'am, that really is the only point. It just goes to, was the information accurate and what happens in a liquidation.

The last point that I had intended to take Your Honours to in terms of information provided relates to the meeting minutes, because there again in my submission we can see that creditors are being misinformed about what is to occur. And perhaps I can just take Your Honours very quickly through those points, although I'm equally happy to be moved along if Your Honours would prefer me to get onto the law. I'm conscious that I have limited time, but I do think it's important to understand the context of this compromise, really.

The minutes are at tab 79 of volume 5, and the first point that I wish to draw the Court's attention to is down the bottom of that page, the first page, 782. Your Honours will see that there's a broad overview from Mr Johnson, and he says at the second-to-last bullet point of that overview, David explains that he had advice to put the company into liquidation but feels that Part 14 was the

way to go. He feels that the company would trade profitably and then would be able to pay back the creditors. Well, as Justice Heath observes in his judgment, that is a serious misstatement of the effect of the compromise. Creditors will not be paid back. Instead, they will receive a varying but inevitably small return on the dollar unless they're owed less than $1000.

The next point, and I shan't attempt to take Your Honours through this but just note it in passing – again, it's a point made by Justice Heath – there is some discussion of intercompany loans, and a pretty concerted effort by particularly Steven Khov to say, well, the intercompany loans don't matter because they've all been consolidated. Well, as Justice Heath observes, of course, they are relevant to creditors.

The next point is – and perhaps this is the last point I rely on these minutes for – there is a question from Mr Barker – Scott Barker – as to whether or not Trends has directors and liability insurance, and the answer turns out to be yes. Now, I don't say that's misinformation. But I do say it's relevant to potential recoveries in liquidation.

So that's the compromise information that we have, and as Your Honours know the respondents' submission is that it is just not accurate in what it does say. There are also two very important points it doesn't make. It does not explain that there is a potential claim against Callaghan Innovation. Now, of course, Callaghan Innovation does not accept that that claim is going to succeed. But the information is very relevant to creditors, because that is a potential asset of the business. That simply isn't disclosed, despite having been flagged up to Callaghan sometime in advance.

The second point that isn't disclosed is that there is an ongoing liability to both the bank and to the Inland Revenue Department, and that both of them have been approached and invited to join in the compromise, and both have declined to do so in advance of the compromise being formulated. Again, that's pretty significant to a creditor who might expect to recoup some benefit from trading of the company going forward.

Before I leave the facts and move on to the law, there are two last points to make. The first arises from Mr Johnson's cross-examination. In the course of that cross-examination, I put to him that after he had spoken to Mr Taylor and Ms Messer and obtained their commitment to vote in favour of the compromise despite not receiving a distribution, and after he had decided to waive some but not all of the security held by Thecircle so that the total of those three people's vote was 75% or just over, he must have known that he could meet the value threshold and he said the maths added up. So he knows by the time he gets to the compromise vote that he controls the compromise majority.

The second – and this will become relevant when we come to relief – is that thereafter Trends absolutely fails to comply with the terms of the compromise it has purported to pass. So by the time we get to the hearing of this matter, which is over a year after the compromise has passed, it's evident that Trends has taken no steps to make any payments to any creditors, hasn't complied at all. There's then, following Justice Heath's judgment, a stay application and, as my learned friend for the appellant says, there's some evidence that payments have been made in accordance with the compromise, although at that point there is also evidence that other arrangements have been entered into with other creditors. So in my submission really by this –

ELIAS CJ:
But all of this is post-compromise …

MR BISLEY:
Post-compromise, that's right, Ma'am.

ELIAS CJ:
And we're really only concerned with the compromise aren't we, and whether it's binding?

MR BISLEY:

Yes, Ma'am. We're concerned with the post-compromise conduct only in the sense that my learned friends have put it in issue in relation to relief. And so I'm really just attempting to run through the facts.

ELIAS CJ:

Well, but I don't see how those facts bear on the submission, which was simply that to the extent that it has been performed it shouldn't be unwound and rather it should simply be that your clients are not bound by it, if we get to that point.

MR BISLEY:

Yes, Ma'am. It only bears on the question of relief insofar as my learned friend is right to say that Justice Heath had regard to the fact it hadn't been performed when he set the compromise aside, and perhaps there's also the legal point that after it was set aside there is no question of this Court recognising its continued existence, it does not exist, effectively this Court would be re-imposing it, in circumstances where Trends has not complied with it in the intervening period.

ELIAS CJ:

I'm not quite sure that I'm following this but …

MR BISLEY:

Perhaps I should return to it on relief, Ma'am. The only point I was trying to make in the context of the factual narrative is that Trends doesn't comply with it, having passed it it doesn't comply, there's no more to it than that.

That brings us to the law, which is where I expect to spend the bulk of my time, my remaining time on this appeal.

Now I've taken Your Honours to the excerpt from Lord Justice Bowen's classical statement of the law in *Sovereign v Dodd* and the formidable compulsion that is exercised by these kinds of arrangements where you have

the power to compel some creditors to give up their legal rights and the need for great care in interpreting it or in construing the statute.

Now in my outline of my oral submissions at paragraph 3.2 I try to make three points about the nature of that process. The first, which applies particularly to Part 14 compromises, is that it is fundamentally a democratic process. I say that of course because we have a vote and we have classes and we have two thresholds that have to be overcome. There are two concerns that are traditionally expressed, they're expressed by the Court in relation to these kinds of democratic processes, and the first is the concern that Lord Justice Bowen expresses in *Sovereign Assurance v Dodd*, which is that where you have the ability to vote you have the possibility of oppressing a minority because you can force their vote down, you can take their rights away, and so that is something that the courts have to be astute to control. And the second – and this is really the point on which my learned friend founds his case – is that you also have the potential for the oppression of a majority in the sense that you may have a beneficial compromise which can be effectively blocked by a sufficiently large yet nonetheless small number creditors, 26% by value is the obvious example.

So those are the two considerations that the courts and the various legislatures that have dealt with these issues have attempted to reconcile. How do we deal with these two things, how do we at the one time protect the minority while simultaneously protecting the majority, and there are a series of different processes that have been used to try to reconcile these tensions. And one of the important things that I do want to say in the context of this appeal is it is important to recognise that these processes are in some senses different.

There are really three that emerge in the written submissions. The first is the scheme of arrangement, which is the English process. Now that was the previous process under section 205 of the Companies Act 1955. Under the scheme of arrangement you have three stages. So you have a voting stage, yes, absolutely, once the Court has determined your classes. And then you

have, as we've discussed, the sanction stage, where the Court considers having regard to that vote, whether the scheme should be approved.

Two important points emerge from that three-stage process. The first is that under a scheme of arrangement the statue is so structured that the Court only has jurisdiction to sanction the scheme if the class vote is passed, it can't do it otherwise.

Now, in my submission that is part of the reason that as my learned friend correctly says in a scheme of arrangement from about 2001 the focus has been very tightly on legal rights, because the Court in a process in which it is involved wishes to get to the point where it can assess the scheme of arrangement and decide whether or not to sanction it.

The second point is this. In a scheme of arrangement, the Court unequivocally has regard to the question of interest of voters, and that emerges from all of the cases that have been put before Your Honours. So it does pay attention to the question, were these parties parties with such different interests that they couldn't sensibly consult together?

Now, on the approach my learned friend recommends for Part 14, because under Part 14 we don't have that third stage except occasionally, essentially the Court would be dispensing with that protection. It would be dispensing with the compulsory process in a scheme where the votes are vetted for interest-based voting.

Now, one of the questions posed to me at the outset by Your Honour the Chief Justice was, is this a frequent practice? You know, is this something that happens often that you have related parties in schemes and they vote and that's absolutely fine. So in the lunch break – now, that's a somewhat difficult question to –

ELIAS CJ:

Well, I was really asking about this sort of arrangement with parties waiving security and waiving part of their claim.

MR BISLEY:

Yes, Ma'am. Absolutely.

ELIAS CJ:

Well, we've got one example, anyway, the *Atlas* case.

MR BISLEY:

Atlas is absolutely an answer. So what I did in the lunch break was I quickly went through the cases that we have in the bundle and broke them down into cases in which you have related party voters where that was a problem, and cases where it wasn't a problem, and the answer is in short that *Atlas*, *Public Trust*, *Re Hellenic & General Trust Ltd* [1975] 3 All ER 382 (Ch) and *Re Jax* all dealt with related party voting in circumstances where either the Court said, "I would have found that this related party voting was unfairly prejudicial," as, for example, in *Public Trust* and as, for example, in *Re Hellenic* – actually, that was dealt with as a class composition issue – or as in *Re Jax*. The Court said "I am prepared to allow this vote to proceed but when I come to the sanction stage I will be closely vetting the vote to make sure that these interests haven't swamped other interests".

So it does happen, Ma'am, but the response of the courts has almost always been to say, "This is not appropriate. This is not an appropriate use of the process." In my submission, the reasons for that are pretty clearly outlined by Lord Justice Bowen. If related parties are allowed to push through votes with no ability to review that process, then really you have a process which runs the risk of making a jest of the interests of the minority. This case is an excellent example, in my submission, of precisely that.

ELIAS CJ:

Well, we have here a statutory review mechanism. The real question for us is whether we're within it.

MR BISLEY:

Yes, Ma'am. Yes. That's right. So –

ELIAS CJ:

You are going to get on to the current legislation, because a lot of this is background, really, isn't it, against which you say the current law has to be understood?

MR BISLEY:

Well, that's right, Ma'am. Perhaps it's best seen partly as background and partly as a response to my learned friend's reliance upon scheme of arrangement cases which are dealing with the first stage of the assessment to say only rights are relevant, because I say the context for that is you must understand there is still a second stage at which these issues are taken into account.

The reason I say that's relevant that in my submission it cannot be the correct construction of Part 14 that it was intended to dispense with that protection for the minority, that it was intended to dispense with the ability to deal with related party voting, which is a clear problem with any voting scheme.

O'REGAN J:

But should it be dealt with by separating classes, or should it just be dealt with by the Court's sweep-up power later to say it's an unfair scheme?

MR BISLEY:

Yes, Sir. Well, the reason I spent some time on the facts is to make the point that in my submission here it should be dealt with under one or the other, and whichever it is my client should succeed.

O'REGAN J:

Well, that was rather an equivocal answer to it.

MR BISLEY:

I don't mean it to be so.

O'REGAN J:

Is it one or the other? I mean …

MR BISLEY:

In my submission it's properly dealt with under class construction, and really I have two reasons for saying that. The first is that as Justice Heath observes in the High Court, in New Zealand the composition of classes in the scheme of arrangements has not been by reference just to rights. The New Zealand Courts have taken a broader approach. In fact, as Mr Josling points out in his article about interest versus rights and classes [Michael Josling "An analysis of the rights test in determining classes of creditors" (2010) 18 Insolv LJ 110], the shift to a very tight rights-only focus is relatively recent. It occurred in about 2001 with the judgments in *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241, [2001] 2 BCLC 480 and *UDL Argos*. So it post-dated the introduction of the Companies Act.

Now, I know, Ma'am, that you were involved in the Law Commission that considered these reviews, so I'm somewhat nervous about making submissions about what the Law Commission may have meant.

ELIAS CJ:

It was a long time ago.

MR BISLEY:

Yes, well, that's what I hope, Ma'am.

ELIAS CJ:

Yes.

MR BISLEY:

In my submission, that must have been part of the context that the Law Commission was considering. You know, it had a working process where interests and rights were taken into account and where the courts erred on the side of more classes of minority protection rather than on the much tighter definition of class just by reference to rights that my learned friend relies upon and that occurred afterwards, occurred in 2001.

The second point –

GLAZEBROOK J:

Well, have you got a theory on why that occurred afterwards?

MR BISLEY:

Why that occurred afterwards, well, yes, I do, Ma'am, and really this is what I was perhaps clumsily trying to explain a minute ago in relation to schemes of arrangement. It's an issue that's discussed by Mr Josling but essentially the English Courts construed the scheme of arrangement provisions that they had as having a jurisdictional stage and then a sanction stage, and what they would do is they would invite – when a scheme of arrangement was proposed it would be a very quick ex parte hearing.

ELIAS CJ:

Well, isn't one way of looking at this – maybe I'm being overly simplistic – is that we do have this statutory scheme. Why can't we simply apply it? Why can't we simply ask whether it's unfair prejudice? Do we have to be quite as analytical about it as …

GLAZEBROOK J:

I think he's just explaining why he thinks we should be, because – and I think part of it was the unfair of creditors later having to come along and have the onus of proof of showing that there was unfair prejudice instead of being put into the proper classes in the first place?

ELIAS CJ:

Well, I'm not even sure that there is an onus of proof. I mean, if we started with the statute perhaps we could address all of those things, but we're starting an awfully long way back, it seems to me. However, I shouldn't interrupt you and perhaps you should complete what you're saying on this point.

MR BISLEY:

Yes, Ma'am. Well, the point I was making in answer to Her Honour Justice Glazebrook was simply that the English Courts – having held the jurisdiction – was only available where the classes were properly comprised, then took a reasonably liberal approach to classes. Because otherwise, you know, having gone to all the trouble of holding the schemes, they would just get knocked over on jurisdictional grounds, whether they were any good or not. So in my submission, that was essentially the reason for that retrenching of the notion of class.

The question that Your Honour the Chief Justice asks is, you know, well, hang on, can't we just use the statute? And of course you have to. There is a question about the onus of proof, but the difficulty with the statute, if we look at it, is that it requires a proponent of a compromise to identify classes of creditors but doesn't explain, really, what that means. So I say, well, let's look at the history, and the history supports my definition of class.

It then requires that there's a vote, and says that the vote can be set aside on the application of a creditor where there is material irregularity or unfair prejudice. But again, those terms aren't defined.

The Law Commission gives us some further insight into the meaning of unfair prejudice because it says that it's intended to provide a residual power to deal with abuses of the process. So, really, those are the indicia that we have as to the meaning of those words. They're not much. And it's a very foreshortened process, unlike a scheme of arrangement. In a scheme of

arrangement, and really in all of the other processes of this sort that I've reviewed, you have an independent third party who looks at what's happened and assesses whether it's appropriate and whether the information that's been provided is sufficient and so forth and so on. But in a Part 14 compromise, you have none of those things. You just have a vote that is passed, and then effectively the creditors and the company are bound by the outcome. And that can only be addressed in any way if there's an application to the Court.

Now, Your Honour asks a really important and, I think, interesting practical question which is, well, hang on – and tell me if I'm mischaracterising your question – but we're only going to deal with these issues when the thing comes before the Court anyway. I mean, for the Court to consider whether there have been voting irregularities, you still need to engage with the Court through the Court's remedial jurisdiction.

Does that make sense, Ma'am? Perhaps not.

ELIAS CJ:
Well, it seems to be a statement of the obvious but you have to invoke the jurisdiction by going to the Court.

MR BISLEY:
It is, and so there is a sense in which I think the question should this arise at the point of unfair prejudice or should it arise in the context of class definition is somewhat academic, because even if Your Honours hold that it arises at the point of class definition, there will still have to be an application to get rid of the compromise. The compromise won't have any effect – sorry, will have effect until there is an application regardless.

GLAZEBROOK J:
Well, although presumably if it is at the class stage then people will read the cases and know how to set the class and will know in the future that if they have a conflict of interest of this nature that they can't swamp the other voters.

MR BISLEY:

Your Honour is precisely right. That's exactly the point I was going to come to. Actually, what is needed in my submission is clear guidance that applies all the time and applies to classes, and why should it apply to the word "class"? Well, in my submission that is because fundamentally this is a process which has a democratic method of approval. It relies upon democratic approval, and for that democratic approval to protect minorities as it is supposed to do. In my submission, you have to take out the voters who are going to skew the vote at the outset, or the democratic process is fundamentally undermined. That is why it shouldn't be an issue which is left just to a sort of sweep-up by the Court. It's probably –

O'REGAN J:

But you've also got the balance that if you do that, if you go too far the other way you get the oppression of the majority by giving veto rights to small numbers of creditors. So it's not that easy to just come up with a rule. That's why the scheme of arrangement system said you had to go to Court and put it in front of the Court and get its approval. So – and if we're going to say that interests come into account as well as rights, there does have to be something which says not every single different interest between creditors leads to them forming a different class and having, you know, multiple meetings and therefore multiple vetos.

MR BISLEY:

No. That's absolutely right. And I think there are two parts to that, Sir. The first part is what interests will be engaged? You know, what sort of an interest will be sufficient to break up the classes to make a different class, and the second issue is practically speaking, how does the Court deal – or how do proponents deal – with the potential problem of a proliferation of classes? As to which interests are engaged, in my submission, really, the appropriate test is just the same test as is already engaged for rights. Classes aren't formulated just because of different rights. This is a point made by His Honour Justice Street in *Re Jax*. They are made where the rights that the parties hold are so different that they cannot consult together with a view to

their common interest. That's the test that he applies, and that is why in that particular case he says, "I will allow the sort of insider creditors, if you want, the Smithsons, to participate." In point of fact, the Smithsons were to receive some dividends from that process. So they weren't in an identical place to the creditors, to the insider creditors, in this case.

So that's the –

O'REGAN J:
But, again, that is a test that's used in a context where the Court gets to scrutinise it and say, yes, that passes muster or no, it doesn't. I mean, just stating that as a test doesn't help that much to someone who's proposing a scheme and trying to make it a scheme that won't be able to be challenged.

MR BISLEY:
No, Sir, and in short I think the answer is there is no perfect answer. There is no bright line test that can be applied here, because of the enormous number of circumstances that may come within this part. But that is also the case with rights, and the answer is actually in my submission really the same as it is in a scheme of arrangement.

Perhaps it's –

ELIAS CJ:
Well, if your classification was done according to rights as opposed to interests, what categories are available if you're looking at classes of creditors? Is there anything in the scheme of the Act that suggests anything other than unsecured and unsecured?

MR BISLEY:
Well, there are a number of categories that have caused the Courts some difficulties in the context of schemes. Another common one is the situation where you have creditors who are guaranteed by a third party and so you'll

have some creditors who have the benefit of the guarantee and others who don't.

ELIAS CJ:
I'm really trying to get away from – maybe you can't but which is, I think, what Justice Glazebrook is saying, but I'm just trying to look at this as a matter of statutory interpretation and what was meant by the reference to classes of creditors in this part of the Act, if there's anything in the statute itself which gives any clues to that.

MR BISLEY:
Yes, Ma'am. In terms of the text of the statute, I think both my learned friend and I have found it difficult to find any very helpful material. There are two things that have been identified, one by him, one by me.

In terms of the point that I have identified, it is the reference in section 229(1) to the proponent being required to compile in relation to each class of creditors a list of creditors known to the proponent who would be affected by the proposed compromise. So the starting point when you attempt to formulate these classes is that you identify the creditors who are "affected". The question then becomes, what does the word "affected" mean? And there Justice Winkelmann has held in *Bank of Tokyo*, in my submission correctly, that the word "affected" must mean somebody whose interests have been negatively affected. It doesn't just mean that their rights are in some way affected because, of course, creditors may have a real interest in what happens with the compromise, even where their rights are not in play. It means the creditors who are affected by the compromise.

Now, the wording of the statute isn't absolutely perfect. But in my submission, if you are compiling in relation to each class a list of affected creditors and then giving those affected creditors notice – which is what Her Honour Justice Winkelmann held subsection (2) required – that must be the basis upon which those classes are being construed, otherwise the thing ceases to make sense if, at that point, one reverts to a rights assessment.

So that is one piece of statutory interpretation relying just upon the text of the Act which, in my submission, assists.

GLAZEBROOK J:
What does that do to the point just made by the Chief Justice? Because – is that on the basis that you could have a compromise that's affecting half of the unsecured creditors?

MR BISLEY:
Yes.

ELIAS CJ:
So that's a classification according to whether you're affected or as the language seems to refer to each class of creditors and then the list needs to include those who'd be affected by the proposed compromise doesn't quite meet, does it, because you're –

MR BISLEY:
It doesn't quite meet, no, Ma'am. I would accept that. But in my submission, if you're compiling a list of each class of creditors and you have to include the people in that list who are affected – which means their interests are affected – then your list is plainly going to involve people by reference – your list is going to encompass a group of people, some of whom may have no rights in play.

ELIAS CJ:
I'm not sure that that is right, really, which is why I ask whether in the statute there is anything that identifies any other possible classes of creditors other than secured and unsecured.

MR BISLEY:
No, there isn't, Ma'am. There is absolutely no guidance given as to what classes should be set up. That's one of the –

O'REGAN J:

One problem is the provision that says that you can't have an unfairly prejudicial scheme, so presumably the classes have got to be designed in a way that doesn't allow the scheme to inflict unfair prejudice on a particular creditor.

MR BISLEY:

I do apologise for making a number of submissions which aren't tightly focused on the statute but really that's because of my attempts to find helpful submissions based on the statute. I have come up pretty short with the exception of this point. There isn't a lot. What we are left with is the history and the purpose.

O'REGAN J:

So are you saying that a difference here is that those on – those who are insiders and therefore have another interest in the prevention of a liquidation should be a different class? Is that the point you're making?

MR BISLEY:

Yes, quite right. What I say, Sir, is that –

O'REGAN J:

So it's their interest, the thing that differentiates is that they have a different interest in the company from their creditor interest?

MR BISLEY:

Yes. That's right. In my submission, they actually have a number of different interests, so there isn't just one intersection. There are several intersections here. First, Mr Johnson and Mr Taylor face potential claims as directors. Secondly, Ms Messer as an employee with a special interest as a consequence of that both arising from her loyalty and hope of future employment. Third, Thecircle has the potential of recovering its remaining

debt in the future. Fourth, Mr Johnson is a shareholder of Trends so if he gets rid of all of the debt –

ELIAS CJ:

They'd still have to vote, wouldn't they, in a different class on the proposal? How do matters advance if you're just going to have a whole lot of different voting mechanisms?

MR BISLEY:

Ma'am, this is perhaps the point about the protection of minority and how it works, because what should have happened, in my submission, here, just dealing with the insider creditors and forgetting about Callaghan for the moment, is that there should have been two classes. One class would consist of the insider creditors who stood to receive nothing. Now, as my submission that happens as a matter of rights as well, but let's leave that to one side. On the other hand, we have a class of –

ELIAS CJ:

Sorry, one of the insider creditors who stood to receive nothing?

MR BISLEY:

All of the insider creditors stood to receive nothing.

ELIAS CJ:

Under the terms of the compromise?

MR BISLEY:

Under the terms of the compromise, correct.

ELIAS CJ:

Oh, well, depends what position you look from.

O'REGAN J:

Yes. I mean, looking ahead that's not really going to be a very helpful distinguishing class, is it? Because in the next proposal somebody in Mr Johnson's position would just say, "Well, I will take the same as everybody else and then I'm not in a different class."

MR BISLEY:

That's a very fair point, Sir. Perhaps I should have said – I think I'm trying to conflate two points. So let me deal with it just on an interests basis. On the one hand, you should have had the creditors who are closely associated with the company, which is the insider creditors here, and they would have voted as one distinct class.

ELLEN FRANCE J:

Sorry, how did you describe that group?

MR BISLEY:

The creditors who are closely associated with the company, the insider creditors.

On the other hand, you should have had all of the other creditors who were at arm's length to the company.

ELIAS CJ:

In this case, the directors are – they're the proponents of this but you could have a proposal that's not actually been put forward by the conflicted, if you like, or the creditors who wear two hats. On your approach, you'd still set up a different class for them, and then they'd be in a position to block a proposal that was being put forward, would they, by another creditor with the leave of the Court?

MR BISLEY:

Well, yes, Ma'am. What happens in my submission is that you formulate classes. Those classes then have to vote, and the classes are defined by a

community of interest. Now, each of those classes has the opportunity to reject the proposal and that's quite right. That is an entitlement that they should have. It isn't simply a question of pejorative blocking. It's that they can each assess whether, for themselves, this is a compromise that they should accept or shouldn't accept. So that is the very mechanism that the Act uses to decide whether or not the compromise should go ahead and it's perfectly appropriate for a creditor who does not believe that the compromise is in their best interests to vote against it, and if the thresholds then are not met …

ELIAS CJ:

The more different classes you have, the more opportunity for a class to thwart a proposal.

MR BISLEY:

Yes. You could perhaps put it like this, Ma'am. The more classes you have, the greater your risk of majority oppression, so a small class will make it easier to defeat a proposal. The fewer classes you have, the greater the risk of minority oppression. If you lump everyone in together, including the related parties, the related parties will probably be able to force it through.

ELIAS CJ:

Well, what about if the legislation really cuts through all of that complexity and simply allows you to say, "What are the features of this proposal which cause it to be unfair in substance?"

MR BISLEY:

Yes, Ma'am, although what the legislation expressly does – and I think this is a point on which my learned friend and I agree – is to direct the Court away from that kind of substantive review, so it says it is for the creditors to choose, and the Court's role is to ensure that that happens in a proper way that protects their rights, essentially of process.

ELIAS CJ:

All right. I understand.

GLAZEBROOK J:

Can I just – just coming back to the Companies Act and perhaps taking something different that is dealt with in the Act, contingent creditors, because the Act does treat contingent creditors slightly differently. Obviously in a liquidation they can prove but I think they can only cause a liquidation with the consent of the Court, for instance. So do you see contingent creditors as having different rights or – because the proposition that's being put to you is that the only classes of creditors are unsecured, secured and, presumably, preferential.

MR BISLEY:

Yes.

GLAZEBROOK J:

And that those are the only ones recognised under the Act.

MR BISLEY:

Yes. Well, perhaps there are two parts to my answer. Yes, in my submission contingent creditors may well be a different class and that's been recognised in the authorities. It's not always recognised. In insurance schemes, for example, where there are schemes with complicated valuation processes, they are sometimes dealt with in the same class as non-contingent creditors.

WILLIAM YOUNG J:

The trouble is, if we have contingent creditors as a separate class then the creditors with the weakest claim get a veto.

MR BISLEY:

Well, if you include them, Sir.

WILLIAM YOUNG J:

But if you treat them as a separate class –

ELIAS CJ:

They have to be included, don't they?

MR BISLEY:

Well, no, they don't, Ma'am. This is –

WILLIAM YOUNG J:

Okay. So you can say, "Okay, we're not binding them."

MR BISLEY:

That's right. You can do a compromise with whichever creditors you want. There is no restriction on which creditors you can have a compromise with.

WILLIAM YOUNG J:

The problem is that, for the creditors who are bound, they wouldn't particularly want to see someone else get paid in full.

MR BISLEY:

Well, no. Although if they're contingent creditors with very weak claims they probably wouldn't be so.

WILLIAM YOUNG J:

Well, they might be. Okay.

MR BISLEY:

There are essentially two ways of dealing with this. There is perhaps another point –

GLAZEBROOK J:

Well, they can vote down the scheme in those circumstances, then, presumably. The people who wouldn't want the contingent. They can say, "Well, I'm not having the scheme unless the contingent creditors are included with it as well."

MR BISLEY:

That's it, Ma'am, precisely. I mean, it is for the creditors.

WILLIAM YOUNG J:

But that means if you treat the contingent creditors as separate, you're giving them a veto.

MR BISLEY:

Well, not necessarily, Sir. There are two ways to deal with contingent creditors which absolutely wouldn't give them a veto. The first, as I've said, is to exclude them.

WILLIAM YOUNG J:

Yes, but that may exclude practical ability of getting anyone else to sign up.

MR BISLEY:

Well, perhaps but that is just an obstacle that you have to overcome if you wish to promulgate a compromise, and my very strong submission is that, you know, the purpose of this process is not to make compromises as easy as possible. It is to make them workable, respecting the interests both of the company and the creditors.

And the second point, Sir, is that you can also provide that the vote of the class is not going to be binding on all of the creditors, although the consequence of that is that the creditors in that class are released. So this is section 230(3). If a resolution proposing a compromise is put to a vote of more than one class, 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 by every other class. So there is provision for expressly stating in your compromise that it is not conditional on the voting of every class.

Now, the last point which I want to make – and this is made in my written submissions as well – is that in my submission the control on, the concerns

that Your Honours have been expressing broadly relate to majority oppression, so a minority blocking the vote. And there is another way which is expressly provided in the statute for dealing with this, and that is section 232(1)(a), which provides that if you run into these tricky issues, if you are having a hard time working out who your classes are or you are concerned that a beneficial compromise is going to be blocked by a trenchant minority, then you can seek directions from the court, including varying any procedural requirement or waiving it.

So there is right within the Part a process by which these sorts of issues can be addressed. Now, my learned friend says, "Well, then we have to go to court," and to that I say yes. If you are proposing a compromise where there is a real risk that people who do not have sufficiently similar votes, interests, to consult together are in the same class, then that is an issue which requires some level of court sanction to ensure that we are not oppressing either the minority or the majority. In my submission, this isn't a process which operates to exclude the courts. It operates to reduce the need to go to court as much as possible, but still makes provision for that to happen where it's needed. So in answer to His Honour Justice O'Regan's question, you know, how would we deal with this, the second part seems in my submission to be by reference to the court where appropriate.

Now, for very straightforward compromises, that just won't need to happen. There will, of course, be compromises where there are no related parties or where all of the parties have very, very similar interests and you can structure your compromises in that way, and in that case you wave it through. But if it's complex, in my submission first the protection should arise at that point to ensure that creditors are not obliged to go to court. And second, if a proponent is in real doubt, they're entitled to obtain directions.

Now, that is a point which also applies in the context of Part 15, and I think in the context of my learned friend's submissions, one of Your Honours suggested that this would be a compromise that was better considered under Part 15. Well, quite right and there's plenty of jurisprudence in Justice

Winkelmann's judgment and *Bank of Tokyo* is perhaps the best example, making the point that these two processes are intended to function together and that the reason for the retention of Part 15 was to ensure that arrangements which will be reasonable and practicable under Part 14 could nonetheless be carried out. So perhaps in answer to Your Honour Chief Justice Elias's question, the statute does provide us with some further guidance as to how these things are dealt with because it has mechanisms for dealing with them. It's not directly helpful material, Ma'am, but it is indirectly helpful. It shows the scheme.

Now, unless Your Honours have any other questions in relation to the construction of classes, I think I have in one way or another covered most of my material under those topics.

The next point – and it may well be that I have also covered most of this – is should the insider creditors here have been in a different class? Well, my submission there is twofold. First, even if Your Honours are minded to adopt a rights approach, they have different rights because they did not acquire any right to payment out of the initial or subsequent pool under the compromise.

Now, my learned friend points to *UDL Argos* and says, well, in those cases the creditor and the company loans were disregarded. *UDL Argos* is a bit of a difficult decision. It makes a number of difficult distinctions between rights and interests. For example, it treats *Re Hellenic* as a case about rights rather than interests, and as a number of commentators, including Mr Josling and His Honour Justice Heath in this case have pointed out, it's a pretty fine distinction. But there perhaps the Court was principally motivated in my submission by the fact that the classes each have very, very high support, 99% in each case.

In any event, the very clear statement of law that emerges from *UDL Argos* is that both pre- and post-compromise rights are relevant and there just can't, in my submission, be any dispute that the insider creditors here acquire different rights.

As to interests, well, hopefully I've given Your Honours a sufficient understanding of the facts in my submission for the reasons why it is that the respondents have consistently submitted that the insider creditors simply could not have consulted with the other creditors, and perhaps the best piece of information in this regard is that disjunct that I identified right at the beginning of my submissions between on the one hand wishing to vote and on the other hand receiving nothing. If you receive nothing, why not just leave it to the other creditors, and in that case it must fail. That structure also demonstrates the right – the interests that those creditors had in passing this compromise. It's perhaps worth noting, before I leave this point, that Justice Heath, having heard evidence over three days, held that what we had here was a deliberate manipulation of the vote.

Next I say, well, Callaghan Innovation also finds itself with different rights and different interests. First there's the point that it has a contingent debt in the sense that it is subject to a substantial claim by Trends, who denies any breach of contract.

That gives rise to another sense in my submission in which its rights are different in a material sense, which is that in the claim that Callaghan faces it would expect to use its debt as a set-off. So if you consider what the other creditors are likely to receive from a liquidation, well, probably less than full value but Callaghan facing a claim, if the claim is successful, will be entitled to a full value setoff.

O'REGAN J:
That is foregoing the right to be paid any different from foregoing the right to exercise a set-off. You're still losing 89% of whatever the value of the right is.

MR BISLEY:
Yes, you are, and it's a point in my submission which demonstrates that the distinction between rights and interests is not always actually perfectly clear, because here Callaghan had a right of set-off that was engaged in the sense

that it was actually facing a claim, and in that sense I suppose it had a procedural right that was available to it which the others did not. I suppose if claims were brought against them they, too, could have raised –

O'REGAN J:
It really had a counterclaim, didn't it, as opposed to a set-off?

MR BISLEY:
Yes.

O'REGAN J:
Well, I'm not sure who was countering who here, but …

MR BISLEY:
It was a counterclaim brought against Callaghan in this proceeding, in fact. But as the Court of Appeal points out and, really, I'm perhaps best just to adopt Their Honours' reasoning, it's entirely inappropriate to bind somebody to a compromise who you are in the process of suing with the aim of getting rid of their claim against you so that you can proceed unfettered with your claim against them.

O'REGAN J:
But, I mean, I would see that as an unfair prejudice point rather than a class point.

MR BISLEY:
Yes. Your Honour may be right. In my submission, it probably works out either way and really the reason for construing it as a class point is number one, the historical context that I've identified for the meaning of class. There is a different interest. And number two, that –

O'REGAN J:
Well, I think that we've got to resist a view of the law that has classes of one person. I mean, everyone can say, "My claim is different from somebody

else's in some way." They're not identical, are they, but by and large if you're proving in a liquidation for the amount you've got a contractual entitlement to attain and you're just the creditor, aren't you?

MR BISLEY:
Well, yes. It doesn't seem to me that it makes any difference how many of you there are. In fact –

O'REGAN J:
Well, it does in a practical sense, because it gives you – in this case, if you're right, Callaghan could have just said, "Well, we're telling you now, we're not going to vote for it," and that would have been the end of the game.

MR BISLEY:
Yes, and at that point Callaghan could have been left out or a procedural direction could have been sought or …

O'REGAN J:
Well, it's not a very useful scheme if your most hostile creditor isn't in the scheme. If you're trying to avoid liquidation, it's not a great idea to have a hostile creditor left outstanding.

MR BISLEY:
No, Sir, but that is one of the difficulties that a scheme has to deal with. They have to deal with their hostile creditors. And actually, as Justice Heath remarked in the stay application, from memory, it wasn't really open to Callaghan just to move straight to a liquidation of Trends because, of course, its debt was disputed. So I suppose the other creditors might have known about that.

My point in response, I think, Sir, is simply that just because a class only has one person, doesn't necessarily mean it's a wrong class. That person is just as entitled to have their interests protected and there are a variety of ways of dealing with that within the statutory scheme.

Now, I'm very conscious of time and I think I should be able to get through this in the next 15 minutes without any trouble. The next point in the outline that I've provided is that the information that was provided was incomplete and misleading, and really I've been through the substance of that. I really don't have anything else to say about it.

So what was the effect of that? Well, first in my submission this is information that was required to be provided. So my learned friend says by reference to section 229 and clause 2 of Part 5, "Oh, look, there's a tick box list of the information that you need to hand up, and here that was satisfied." Well, in my submission if you look at the actual requirements, they are not a tick box list, and this is a point, really, that emerged in Your Honours' discussion with him during his submissions. The requirement is to provide enough information about the business to be transacted that a person is able to form a view on it, and in my submission that must mean the kind of financial information which wasn't provided here, or which was provided in an inaccurate way.

It's perhaps worth noting that in the English Creditors Voluntary Arrangement scheme which has some similarities with Part 14 – although also some important differences – there is a list of the financial information that's required to be provided, which is reasonably detailed and includes, for example, potential claims in a liquidation.

I also say that that interpretation – which is available just on the words of the statute – is doubly important where the control mechanism for a Part 14 compromise is that exercise of democratic rights. In order to vote, one must be informed. In order to be able to exercise one's vote to protect one's right, one must understand what is being proposed and what that effect will have.

Now, in my submission, that simply wasn't possible here, really, for the reasons I've given. I've also provided in 5.1 some references to Law Commission material where the Law Commission makes exactly that point. It

says the greater provision of information is a central feature of the scheme, for that democratic reason.

Does this all, then, constitute unfair prejudice? Does getting the classes wrong, does allowing the related parties to vote, constitute unfair prejudice for the purposes of the Act? Well, again, here the approach that's being taken in other jurisdictions and in New Zealand is very clear.

In *Bank of Tokyo*, Her Honour Justice Winkelmann explained at paragraph 186 that related party voting – if it had occurred, which she found it didn't – would have been a sufficient reason, would have been unfair prejudice. The same conclusion was reached by Justice Muir at paragraph 95 and in the English context of the CVA where there is also an unfair prejudice in a judgment, *Re T & N Ltd* [2004] EWHC 2361 (Ch), Justice David Richards, who was a notorious well-known expert in insolvency law, comes to the same conclusion. So he says precisely these sort of related party considerations that are looked at in the sanction scheme of arrangement, are relevant to unfair prejudice.

It's perhaps also worth noting that in my submission it's a very severe form of abuse of the process, and the authority I give for that proposition is the Hong Kong Court of Appeal in *Re PCCW Ltd* [2009] 3 HKC 292 (CA). Now, that case concerned a different type of voting manipulation. It concerned vote-splitting on a scheme. So, vote-splitting occurs where you transfer shares or debts to a large number of people to avoid the majority by number being achieved.

And there the Hong Kong Court of Appeal described vote-splitting as a form of dishonesty intended to prevent the process from working. Well, in my submission that's really precisely where we are in this case. We have a deliberate manipulation of the vote to force through a compromise that otherwise must inevitably have failed. If you took those insider creditors out, it could not possibly have succeeded. It would have failed by a large margin.

Unless Your Honours have any further questions about any of those points, I'd propose just to address relief very quickly.

ELLEN FRANCE J:

Sorry, could I just ask about onus? Section 232(3) refers to the court being satisfied . So where do you get the onus being on the applicant?

MR BISLEY:

Well, that was a submission made by my learned friend. Now, I have to admit, I haven't given careful thought to the question where would the onus lie beyond, I suppose, saying that in any application to the Court the onus is on the applicant to demonstrate that the basis for their claim to relief is made out. There's no statutory onus but there is a provision that the creditor will bring the challenge, and in my submission just the usual onus that applies to an applicant would apply in that situation. In that sense, I suppose you might say that the Part 14 process is again different from a scheme of arrangement where the Court comes to consider the question of sanction as a matter of course without any onus in either direction.

GLAZEBROOK J:

Although "the court is satisfied" could just be an evaluative view that the Court takes on the basis of whatever's put before it without – obviously there's an onus to put material before the Court upon which the Court can make a decision, but …

MR BISLEY:

Yes, Ma'am. Although what one is attempting to show is unfair prejudice, and it isn't a sort of standing review of the substance of the scheme. That's expressly left for the creditors. It's a review of the way in which the scheme operates both procedurally and, I suppose, substantively in the sense that if it is so prejudicial to one creditor that it can't stand it won't be set aside, but it's not a general substance review in the way that a scheme of arrangement sanction hearing is. I don't place tremendous weight on the onus. In my experience of these things, both parties turn up in Court and have to make the

case as best they can and questions of onus are very, very rarely determinative. But that is the source of that submission.

Now, the last question is what relief should be granted, and the starting point – and I make this submission in my written submissions – is, well, here we have an exercise by Justice Heath of his discretion which, as Your Honours will see from his judgment, is very carefully considered. He's thought very hard about it, and none of the grounds for interfering with that exercise of discretion are in my submission made out.

I'd also make two further points and then perhaps I will bring –

GLAZEBROOK J:
What does the statute say? Sorry, for some reason this isn't coming up properly.

MR BISLEY:
Ma'am, it says in 232(3), "If the court is satisfied, on the application of a creditor … that … material irregularity … or unfair prejudice … the court may order that the creditor is not bound by the compromise or make such other order as it thinks fit."

O'REGAN J:
Does it make any difference to your clients whether it's an order that they're not bound by it as opposed to an order in knowing the whole scheme?

MR BISLEY:
No, Sir, and in fact if Your Honour looks at the statement of claim you will see that the relief we sought was in those two terms. So we said, essentially, look, this is a compromise that has only been passed by the voting of these interests. They must be taken out. If they are taken out, it must fail. Therefore logically the whole thing should fall away, but equally, we seek orders that we not be bound by it. So those are the two forms of relief that we sought from the High Court.

WILLIAM YOUNG J:

Well, does it make any difference to your clients?

MR BISLEY:

It's really just a consequence of the nature of the abuse, Sir.

WILLIAM YOUNG J:

Yes, sorry, but does it make any difference to your clients, any practical difference?

MR BISLEY:

Well, no, Sir. I don't see that it does. I mean, it's a point which affects the other creditors and you'll see from his judgment that that's the subject which His Honour Justice Heath was most preoccupied by so he said, "I've given a great deal of thought to whether I should give other creditors an opportunity to come to me and talk to me about this and in the end I've decided that I shouldn't, especially in circumstances where the compromise has not been complied with."

O'REGAN J:

But we're being told now that a lot of the payments have been made, so the situation is slightly different now from what it was before Justice Heath.

GLAZEBROOK J:

And I think the submission is that it's actually not an at-large discretion. It's a discretion that is to fix up the wrong and by fixing up the wrong you actually throw the other creditors back, presumably owing the money back now that they've been paid.

MR BISLEY:

Well, not really, Ma'am, in my submission. So this is the point that I was coming to right at the end of my factual narrative. What happened was nobody paid anything under the compromise until we came to the point of a

stay application in relation to Justice Heath's judgment. At that point, Mr Johnson and Mr Grove filed affidavits saying, "Well, we paid most people. There is still some money left to be paid, and with yet other people we have entered into arrangements." Now, those arrangements are on different terms to the compromise. Justice Heath, on the stay application, said, "Well, am I going to exercise my jurisdiction to stay the judgment, thereby effectively re-imposing the compromise?" No, absolutely I'm not. Because what we now have is a situation where Trends has not complied with the compromise in a different way, because it's entered into different arrangements that are contemplated by the compromise with some creditors, and that cuts right to the heart, in my submission, of what we've been talking about, you know. Creditors to a compromise might very well be less than impressed by discovering that the proponent of the compromise had done more favourable deals with some people. There was a further problem with those affidavits, which was that following the stay hearing we wrote to Trends' solicitors and said, "Well, can you please tell us what these arrangements are so we can put it in front of the Court of Appeal?" and for quite a long time they refused to provide us with many details, and then eventually they did provide some details, some of which turned out to be wrong. We called one of the creditors and said we understand there's an arrangement with you under which you've said you don't want to be paid anything and they said, "To the contrary, we just sent an email saying, 'Please pay us the full debt.'" And that correspondence and that affidavit is before the Court in volume 5 for Mr Johnson and Mr Grove's affidavits and then the creditor's affidavit provided by one Mr Iskandar is in volume 3.

So where we are now is really with, in my submission, a mess. Now, to the extent Trends has paid people some money, Ma'am, in answer to your question, that money wouldn't be repayable. It's simply paid as against their much larger debts. So Trends wouldn't be entitled to turn around after today and say, "Well, I would like that money back," because for this entirety –

ELIAS CJ:

It might be money paid under a mistake. There would be a set-off.

MR BISLEY:

There would be a set-off and it would be very hard to say it was paid under mistaken circumstances where there's a judgment of the High Court setting aside the compromise at the time the payments were made. So in my submission the position isn't nearly as straightforward as my learned friend suggests. It is, in fact, quite complex, and there would be some practical difficulties with the court effectively now, in 2018 …

ELIAS CJ:

So you say it's actually more practicable to set it all aside?

MR BISLEY:

Well, to leave it set aside, I suppose, Ma'am.

ELIAS CJ:

To leave it set aside, yes.

MR BISLEY:

To leave it where it has lain for the last three years.

Now, unless Your Honours have any other questions, those are the submissions for the respondents.

ELIAS CJ:

Thank you.

Yes, Mr Glenie.

MR GLENIE:

I think I only have four points and they're hopefully relevantly discrete.

The first point, I just wanted to pick up on a question that Justice O'Regan asked about the next scheme, the point about the waiver of interest, and the

waiver of right to payment and what that would mean. You can anticipate that the next scheme would provide that outsider creditors would receive 13 cents, similar to this one, and insider creditors might receive one cent, being the bare minimum that they would need to be paid, obviously sharing the rest of it for division amongst the others but it's sufficient to say we are interested, we have sufficient interest, and that seems – it's obviously a question of degree and it would depend on the cases, but that seems a relatively artificial position to get to where there will be an incentive to give a small payment to the insiders just so that they can say that they are interested. I'm sure Your Honours have already thought about that point.

The next point is a point of detail in connection with Callaghan, and I'll need to take you to tab 18 which is the examination of Mr Perry of Callaghan, volume 2, at page 290. Questions from the Court, by Justice Heath, of Mr Perry. Mr Perry is employed by Callaghan, and starting at about line 8. Justice Heath asks a separate issue, and that is the reciprocity issue that Callaghan is being asked about claims against trends. There's no prohibition on claims being made against Callaghan. To what extent did that issue have in the attitude that Callaghan took to the compromise? It wasn't just something that was a side issue and the first sentence, I would say it was one of the issues but it wasn't the primary issue we were aware of. We were certainly aware that that was a potential consequence, and I don't want to suggest that it wasn't considered. It goes on in that fashion, and then the final line, the other considerations being the three driver considerations with that, perhaps, sitting underneath – sorry, I don't mean to downplay the other considerations but I was just trying to save time. The only point being a bit of evidence from Callaghan saying we were cognisant that this was a reason why we might want to oppose the compromise, why we would favour liquidation, because it would prevent the suit against Callaghan.

In relation to the associated point that the statement doesn't refer to the Callaghan claim, that's true. I can't contest that.

GLAZEBROOK J:
Sorry, I didn't catch that.

MR GLENIE:
In relation to the associated point that the statement doesn't refer to the potential claim against Callaghan. That is true. But the first Buddle Findlay letter of 14 May – and I've forgotten the tab number of that already – did actually make reference in elliptical terms to such claims. That's at paragraph 4A of that letter, and I'll just give you the page reference. It's at tab 67 on page 724, paragraph 4B. Further, the compromise requires creditors to cancel all debts, yet offers them no reciprocal protection from any counterclaims or other claims that Trends or its liquidators might bring in future. I'm just saying there was an opportunity there for Callaghan to say, by the way, we've received notice of a claim and obviously Mr Bisley would say, "Well, the onus of disclosing that lies on the company rather than on Callaghan" and I acknowledge that. I'm just saying there was an opportunity there for it to raise it and it didn't take it.

I think this is almost the final point. Just to pick up on a question that the Chief Justice asked about how to approach all of this. I think it's probably implicit in what we've said today and I'm sure Your Honours have already clicked to how this could be approached. But a nice simple theory, a nice simple approach to these problems under the Companies Act would be to start by dividing classes by rights, it's clear, it's easy, it's simple. You would, for instance, cut them up into secured creditors, unsecured creditors, preferential creditors. You'd just have three classes and that will be administratively easy, everyone will know how that is being done, they will make it easy to prepare the lists of creditors. Second step, ask which of those creditors is affected by the proposal, and obviously those creditors whose rights have been changed or the value of their rights have been changed would be affected, so it may be that within each class there's only a certain proportion of the creditors who would be affected. Third step, have the votes in the usual way and then the fourth step, allow the disgruntled creditors to take advantage of the safety valve by bringing it back to Court which,

obviously, puts the emphasis on 232(3), which is the unfair prejudice and material irregularity part, and at that point the Court can say, "Okay, I hear that. You're unhappy about the class definition but were you actually unfairly prejudiced?" And this is a case we say for the complicated horizontal and vertical reasons that the creditors – even if they're right – that the classes were wrong, and I'm not saying that they're right – even if they were right they weren't unfairly prejudiced. They got the same as everyone else and they got more than they would have got in a liquidation.

I think that may actually be the final point that I had in mind to make. Did Your Honours have any questions?

ELIAS CJ:
No, thank you, Mr Glenie.

Thank you, counsel. We will take time to consider our decision in this matter, but thank you for your submissions.

HEARING CONCLUDES