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IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY
COMMERCIAL LIST

CIV-2013-404-4413
[2013] NZHC 3458

IN THEMATTER	of the Companies Act 1993
BETWEEN	THE BANK OF TOKYO-MITSUBISHI UFJ, LTD Plaintiff
AND	SOLID ENERGY NEW ZEALAND LIMITED Defendant
AND	ANZ BANK NEW ZEALAND LIMITED, BANK OF NEW ZEALAND LIMITED, COMMONWEALTH BANK OF AUSTRALIA and WESTPAC NEW ZEALAND LIMITED Interested Parties Ordered to be Served

Hearing:	25-27 November 2013
Appearances:	J A Farmer QC, M Dunning QC and M Drumm for plaintiff A R Galbraith QC, T C Stephens and G M Joe for defendant R B Stewart QC and M D Arthur for interested parties (on 25 & 26 November) M D Arthur and J A McMillan for interested parties (on 27 November)
Judgment:	18 December 2013

JUDGMENT OF WINKELMANN J

This judgment was delivered by me on 18 December 2013 at 12 noon pursuant to Rule 11.5 of the High Court Rules.

Registrar/ Deputy Registrar

A. Introduction

[1] The two questions for determination in this proceeding are whether creditor compromises purportedly implemented by the defendant, Solid Energy New Zealand Ltd (Solid Energy), under Part 14 of the Companies Act 1993 (the Act) are valid, and if they are, whether the plaintiff, the Bank of Tokyo-Mitsubishi UFJ, Ltd (Bank of Tokyo), should be bound by them.

[2] Bank of Tokyo, along with the interested parties in this proceeding, ANZ Bank New Zealand Ltd (ANZ), Bank of New Zealand Ltd (BNZ), Commonwealth Bank of Australia (CBA) and Westpac New Zealand Ltd (Westpac) (referred to collectively as "the Banks"), lent money to Solid Energy on an unsecured basis. Since the beginning of 2013 Solid Energy has required the support of these banks to continue trading. As part of this support the Banks entered into "standstill" arrangements with Solid Energy and its sole shareholder, the Crown. The Banks agreed not to take enforcement action for a period of time to enable the Banks and Treasury (on behalf of the Crown) to try to design and agree a plan to restructure Solid Energy's business and capital, and thus allow Solid Energy to continue in business in the medium term. This arrangement was documented in a Support Deed, executed on 14 March 2013 and subsequently extended on a number of occasions.

[3] In October 2013, some of Solid Energy's creditors passed special resolutions approving two creditors' compromises under Part 14 of the Act. These comprised a debt rescheduling compromise and a debt exchange compromise. Under the debt rescheduling compromise, the terms of Solid Energy's indebtedness under bilateral facility agreements with the Banks were varied and rescheduled on the terms of a single syndicated facilities agreement, which included an extended maturity date. Under the debt exchange compromise, a total of $75 million of debt owed by Solid Energy to its bank creditors was exchanged for $75 million of equity in Solid Energy in the form of redeemable preference shares. The bank creditors bound by the debt exchange compromise were the same as those bound by the debt rescheduling compromise, with the addition of TSB Bank Ltd (TSB), which held wholesale medium term notes issued by Solid Energy.

[4] The special resolutions were passed by the required margin. Although it voted against the resolutions, Bank of Tokyo is nevertheless bound by the compromises (subject to the outcome of this proceeding) by virtue of the provisions of Part 14 of the Act, so that the repayment date of its loan has been rescheduled, and part of its loan has been exchanged for redeemable preference shares in Solid Energy.

[5] Bank of Tokyo now pleads four causes of action against Solid Energy:

(i) In the first Bank of Tokyo seeks a declaration that the creditors' compromises are legally invalid and unenforceable because they were entered into without the prior written approval of Bank of Tokyo, which Bank of Tokyo says was required by the terms of the Support Deed, and because of the course of dealings between the Banks, Solid Energy and the Crown.

(ii) In the second cause of action Bank of Tokyo seeks a declaration that the creditors' compromises are invalid and unenforceable on the basis that the compromises were not within the permissible scope of Part 14 of the Act. Part 14, Bank of Tokyo says, is not intended to apply to a complex restructuring of the nature approved by the creditors. Such a restructuring should have been effected under the provisions of Part 15 of the Act.

(iii) In the third cause of action Bank of Tokyo alleges that there were material irregularities in the way in which the compromises were approved by the creditors, because the classes of creditors were improperly or inadequately defined by Solid Energy. Inconsistencies in the selection of creditors make it plain that creditors were selected to ensure that the parties known to support the compromises would be able to reach the required voting threshold. Bank of Tokyo also alleges that Solid Energy was obliged to notify all its known creditors of the meeting, but failed to do so. It is alleged that these defects constitute both material irregularities and evidence of unfair prejudice to Bank of Tokyo. Bank of Tokyo should therefore be released from the compromise pursuant to the Court's power contained in s 232(3) of the Act.

(iv) Finally, it is alleged that the compromises are unfairly prejudicial to Bank of Tokyo in terms of s 232(3)(c) of the Act because of inconsistency of treatment and outcomes for creditors, and as a consequence Bank of Tokyo should be released from the compromises.

B. Relevant background

[6] The following narrative is drawn from the extensive affidavits filed by each party to this proceeding. Reading through these affidavits it is apparent that there is little conflict between the parties as to the events that occurred although some detail offered differs between the affidavits. Those points of difference are not, for the purposes of this judgment, material.

[7] Solid Energy is a state-owned enterprise. Under the terms of the State-Owned Enterprises Act 1986 only the Crown may own ordinary shares in it.[1] It is New Zealand's largest coal producer and its operations are supported by around 1,000 permanent and fixed term staff.

[8] In the five years prior to 2011, Solid Energy produced good profits and operating cash flows year on year. Those results were contributed to by the fact that the benchmark hard coking coal price had, for the most part of 2007 to 2011, sat well above the historic trend line. By mid to late 2012 however it became obvious that Solid Energy was in serious financial difficulties because of tough trading conditions and the extent of its liabilities. Between its peak at the start of 2011 and the end of 2012, the benchmark hard coking coal price declined by over 50 per cent in USD terms. This fall was in large part attributable to a drop in demand for Chinese steel. Although a price decline like this was not unprecedented, the absence of any price

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1 State-Owned Enterprises Act 1986, s 11.

recovery was. The situation was exacerbated by the fact that at the same time the USD/NZD cross-rate remained unfavourably high.

[9] Contributing to Solid Energy's difficult position were its significant liabilities. Solid Energy was a borrower on an unsecured basis under bilateral facility agreements with the following banks:

(1) ANZ in the amount of $40 million;

(2) BNZ in the amount of $80 million;

(3) CBA in the amount of $45 million;

(4) Westpac in the amount of $55.5 million; and

(5) Bank of Tokyo in the amount of $80 million.

[10] Solid Energy also had other unsecured liabilities which, as at 31 December 2012, were as follows:[2]

(1) Wholesale medium term notes issued to various holders under a Deed Poll to a total value of $95 million, with TSB holding approximately $67.5 million of those notes.

(2) Performance bonds issued by ANZ, CBA and Westpac securing various remediation obligations owed by Solid Energy to third parties, with a value of approximately $58.4 million.

(3) A prospective settlement obligation owing to a creditor, referred to in this judgment as company B, in the amount of approximately $23 million.

(4) Rehabilitation liabilities owed to various authorities in an aggregate amount of approximately $145 million.

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2 See affidavit of David John Patterson sworn 5 November 2013.

(5) Other general debts and liabilities, including to employees and trade creditors, of approximately $106 million.

[11] Solid Energy also had liabilities under operating leases with ANZ and CBA of approximately $120 million, and a finance lease with Kiwi Rail in respect of Cobden Bridge of approximately $11.1 million. As is the nature of operating leases, these liabilities were to a certain extent secured, but unsecured in respect of any indebtedness in excess of the value of the relevant leased assets. Solid Energy also had contingent liabilities to banks in respect of derivative contracts it had entered into.

[12] In August 2012 Solid Energy had discussions with Bank of Tokyo, seeking relaxation of financial covenants in the Bank of Tokyo facility agreement. In late August, Bank of Tokyo formally relaxed some of the covenants. In October 2012, Solid Energy promoted the idea of amalgamating all of the bilateral lending facility agreements into a syndicated facility agreement. The Banks agreed to this proposal and by December 2012 had reached a consensus on the negotiated form of the syndicated facilities agreement. Settlement was to occur in December 2012 but ultimately did not proceed as new directors and a new Chairman of Solid Energy were not prepared to enter into the syndicated facility agreement at that time.

[13] On 29 January 2013, Solid Energy advised both the Banks and Treasury that Solid Energy could not deliver a compliance certificate in respect of a scheduled $120 million facilities rollover. This was because the directors were not sure, based on the information available to them, they could give all the necessary representations and warranties. Solid Energy sought the Banks' agreement to waive the requirement for such a certificate and to rollover the advances. During discussions at a meeting that day in connection with the request for the rollover, the Crown confirmed it would continue to support Solid Energy. As to that support, Ms McKeown, director and head of Syndications & Agency at ANZ, says the Banks were told by Treasury that "it wasn't a question of if, but rather what form and how much". Mr Ryff, General Manager of the Auckland branch for the Bank of Tokyo, says that at that meeting a Treasury spokesperson spoke briefly to highlight that government support of Solid Energy in the form of equity was being considered and

discussed with the relevant Ministers. It is clear that it was on this basis that the Banks agreed to the $120 million rollover sought by Solid Energy.

[14] On 15 February 2013, the Banks, Treasury and Solid Energy met to discuss the possibility of the Crown providing financial support to Solid Energy and the Banks agreeing to standstill arrangements with Solid Energy and the Crown in order to:

(i) Provide support to Solid Energy during the period in which investigating accountants prepared and delivered a report;

(ii) Allow the Banks and Solid Energy time to review Solid Energy's business profile for the future; and

(iii) Give the Banks, the Crown and Solid Energy time to properly consider available options, including developing and implementing a restructuring plan for Solid Energy's business and capital structure.

At that meeting the Crown confirmed it was prepared to provide Solid Energy with interim funding support on a secured basis, but Treasury communicated the Crown's view that the Crown's equity in Solid Energy no longer had any value.

[15] Following the 15 February 2013 meeting, the Banks cancelled their undrawn facility limits, with the exception of Bank of Tokyo. Bank of Tokyo's facility was already fully drawn. The cancellation of the undrawn portion of the facilities immediately created an issue as to how Solid Energy's ongoing working capital requirements were to be met. As a consequence, the Banks entered into an inter-creditor agreement pursuant to which ANZ agreed to provide a $10 million unsecured overdraft to Solid Energy to assist it with its cashflow. Each of the Crown, Solid Energy and the Banks agreed that as between themselves, ANZ's advance would be repaid in full by Solid Energy before any other principal amount was repaid by Solid Energy to any other bank or the Crown.

[16] On 21 February the Banks were provided with a copy of a turnaround plan prepared for Solid Energy's board by an external advisor. The plan recorded that due to impairments to be booked in the accounts as at 31 December 2012, if Solid Energy delivered the compliance certificate it was required to deliver on 1 March, it would show that Solid Energy was in breach of its gearing ratio. This would have been an event of default under the bilateral facilities.

[17] The turnaround plan recorded the need for an urgent restructuring of the company and made various requests of its key stakeholders. It requested from the Crown, as shareholder, interim financial support of $75 million, plus recapitalisation of the balance sheet. From the Banks it requested working capital support in the form of reinstated working capital facilities, and interim and long term financial support to allow the restructuring to proceed and succeed. It also asked those Banks to enter into a standstill agreement to give Solid Energy time to work with its shareholder to negotiate its long term capital structure.

[18] All Banks endorsed the general approach to Solid Energy's problems recommended by the external advisor. On 14 March 2013 the Banks, Solid Energy, various subsidiary guarantors and the Crown entered into a Support Deed to implement the standstill agreement recommended by the advisor. In return for the Crown providing liquidity support, each of the Banks agreed in the Deed not to undertake certain actions in respect of the relevant bank debt during the standstill period. There were some conditions attached to this undertaking including the Crown's commitment to provide defined liquidity and working capital support. The Support Deed was expressed to terminate on 31 May 2013 or any later date the Banks and the Crown agreed in writing. The Deed was subsequently extended on several occasions by all parties. It is this Support Deed and related arrangements which is the subject of the challenges in the first cause of action.

[19] Following execution of the Deed, the Crown (by Treasury) and the Banks actively engaged in discussions to attempt to agree a suitable restructuring. Solid Energy was not initially a party to the discussions because it was constrained by the terms of its Deed Poll for medium term notes from entering into such dealings with its creditors.

[20] ANZ acted as coordinating bank in the restructuring of Solid Energy, a role that involved coordinating and facilitating discussions between the Banks, TSB, the Crown and Solid Energy. Ms McKeown (from ANZ) was the central point of communication between the Crown and the Banks.

[21] The Support Deed included a requirement for Solid Energy to engage KordaMentha to investigate the affairs and financial position of Solid Energy and report to the Banks and the Crown in respect of those investigations. On 6 June 2013 KordaMentha presented a report which highlighted the need to restructure Solid Energy's balance sheet if Solid Energy was to continue as a going concern. KordaMentha's estimate was that Solid Energy would have negative equity at 30 June 2013 in the vicinity of $24 million, while noting a range of possible outcomes based on various sensitivities, from negative equity of $15 million to negative equity of $106 million. KordaMentha's opinion was that if Solid Energy was to continue as a going concern a further $100 million of equity and ongoing cashflow support was required.

[22] That report sparked lengthy and complicated negotiations between the Banks and Treasury regarding the restructuring of Solid Energy. At a meeting on 7 June Treasury advised the Banks that following its review of the KordaMentha report the Crown was not prepared to inject further equity into Solid Energy to solve the capital structure issues. Treasury expected the Banks and TSB to participate in the restructuring of Solid Energy's balance sheet. It maintained the Crown position, first expressed in February, that the Crown had "no economic interest" in Solid Energy. But for the first time it said that failing resolution of the capital structure issues by the Banks, the Crown was prepared to liquidate Solid Energy. Mr Ryff describes the Crown's negotiating position as follows:

> It was indicated that the option preferred by the Crown was a managed selldown of [Solid Energy's] assets, but since [Solid Energy] was in the Crown's view effectively owned by the creditors now, it was up to them what to do.

[23] No bank favoured liquidation. Mr Ryff says that following the 7 June meeting the Banks broadly discussed two options amongst themselves, including whether a proposal could be achieved whereby some portion of debt was converted

to an instrument that achieved equity for accounting purposes, sufficient to solve the balance sheet insolvency identified by KordaMentha. The Banks requested a further report from KordaMentha to consider “insolvency regimes that could be utilised if an insolvency administration of [Solid Energy] were required”. When the further report was received (11 June 2013) KordaMentha outlined restructuring through formal processes of either a scheme of arrangement under Part 15 of the Act or voluntary administration under Part 15A. Its report also made clear that the Banks’ prospects in a liquidation were bleak; KordaMentha estimated the likely liquidation recovery range for the Banks as between 19 and 28 per cent.

[24] As a separate exercise, the solicitors acting for the Banks at that time, Chapman Tripp, prepared a paper regarding redeemable preference shares for consideration. Because only the Crown can be an ordinary shareholder of a state-owned enterprise, redeemable preference shares were the only available equity option if the Banks were to contribute equity to the balance sheet.

[25] On 24 June 2013 the Banks agreed to the formation of a working group which subsequently met on a weekly basis to explore options to restructure Solid Energy. Bank of Tokyo was an active participant in the working group and it is common ground that it contributed in a positive and constructive way to those discussions. The redeemable preference share option for restructuring was discussed at those meetings but Bank of Tokyo had made it clear, at a relatively early stage of the negotiations, that debt for equity should be the final option, not the first option. In response to the Chapman Tripp paper, Bank of Tokyo said it would not agree to a debt for equity swap involving the issue of redeemable preference shares to the Banks. In its view, the Crown as shareholder should provide the equity, with the Banks agreeing to a rescheduling of debt. Bank of Tokyo’s position became more entrenched when by the beginning of July the financial information from KordaMentha indicated that Solid Energy had positive net equity (of about $75 million). Bank of Tokyo said that it could not agree to a debt for equity swap where Solid Energy had positive equity, as it could lead to regulatory issues in Japan, or the directors being sued.

[26] Consistent with its position that it was not prepared to contribute equity as part of a restructuring, in late July the Bank of Tokyo provided to the other banks a subordinated debt proposal as an alternative to Bank of Tokyo participating in a debt for equity swap. Ms McKeown says that this proposal was not acceptable to the other banks because it involved Bank of Tokyo taking subordinated debt, which would rank ahead of the proposed redeemable preference shares. She says that as a matter of commercial practice, one bank creditor could not be favoured over other bank creditors. Such a proposal was unlikely to obtain the necessary credit approval from each bank. Nevertheless the other banks indicated that they were prepared to consider Bank of Tokyo's proposal if it could come up with a structure that delivered an economically equivalent outcome for Bank of Tokyo as for the other banks.

[27] By this time the Banks had decided that TSB, as a major lender to Solid Energy with $67.5 million of principal owed to it, should participate in the restructuring on the same terms as the Banks. Mr Alton Pollard, senior manager in the credit restructuring group at Westpac, said that treating all parties equally required that TSB be joined into the negotiations and any eventual restructuring:

> Although TSB held notes, rather than debt provided under a bilateral facility agreement, each of TSB and the Banks were banks carrying on business in New Zealand, and each held significant unsecured and unsubordinated debt.

[28] The Banks met with TSB for the first time in mid July, but before doing so required TSB to sign a confidentiality agreement in favour of the Banks, which also contained an agreement not to accelerate or transfer its notes. From then on TSB was included in all working group discussions.

[29] During this period of negotiation Solid Energy continued to trade, relying on the ANZ facility and sales to meet its working capital needs. According to Ms McKeown the Banks' and TSB's understanding was that if the restructuring was not agreed by 30 September then Solid Energy's directors might resign, or appoint a voluntary administrator or the Crown would appoint a liquidator. 30 September 2013 was, according to Mr Patterson, a director of Solid Energy, looming as a critical date for the company's directors. The terms of the State-Owned Enterprises Act required the company to deliver audited financial statements for the financial year ending 30 June 2013 by that date. In order for the financial statements to be

finalised on a going concern basis, the board needed to be able to form the view that over at least the next succeeding 12 months, all things being equal, Solid Energy would have adequate cashflows and would not breach covenants which would render term debt current or cause credit lines to be withdrawn. Yet by mid August, Mr Patterson says the Banks and the Crown had yet to reach agreement on a final restructuring package for the company.

[30] It is apparent from the evidence of all who were involved in these communications that tension and a sense of time pressure began to build by August 2013. Significant risk was caused to the viability of Solid Energy's business by delay, publicity, and the possibility that the directors would not be prepared to support the company's ongoing operation. An arrangement under Part 14, rather than Part 15, began to be favoured, because it could be implemented more quickly.

[31] In a 14 August meeting with all banks, including TSB and Bank of Tokyo, Treasury said the Crown would be prepared to contribute $25 million in cash in consideration for redeemable preference shares ranking equally with any issued to the banks as part of a debt for equity exchange. However, Treasury said that the restructuring needed to be concluded by 30 September 2013.

[32] Later on that same day, Treasury briefed the Solid Energy board as to the status of current negotiations. From that point on, Solid Energy began to play a role in developing the proposed restructuring. On 19 August 2013, the Chairman of Solid Energy, Mr Ford, wrote to Treasury outlining Solid Energy's financial position and the implications for its operations. He said that whilst the operational and management restructuring the company had undertaken meant it was now set up to operate successfully, its capital structure needed to be addressed. He requested that the company's equity be increased by $100 million in order to rebalance the capital structure, and provide the company with a better opportunity to pay off its debts and return to profitability.

[33] Mr Ford's letter attached the company's draft financial accounts which showed a better equity position than had previously been thought likely. The accounts showed $91.6 million in equity as at 30 June 2013. This more positive

equity outlook echoed the information already received from KordaMentha. Mr Patterson's evidence is that notwithstanding the draft accounts, Solid Energy's equity position was subject to change. There was considerable fluctuation in the coal price because of movements in both the coal price and the exchange rate and the board was of the view that additional equity was necessary in order to continue trading to the medium term.

[34] Up until late August 2013 Bank of Tokyo had been working alongside the other banks in developing restructuring options for Solid Energy but had remained consistent in its refusal to consider contributing equity in any form. On 15 August 2013, ANZ wrote to the Banks and TSB, summarising (among other things) Bank of Tokyo's unwillingness to convert part of its loan to redeemable preference shares and noting that the other banks were considering options to force Bank of Tokyo to participate in the redeemable preference shares conversion on the same basis as the other banks. In that email ANZ said that the other banks would prefer to reach agreement on a consensual restructuring with Bank of Tokyo. In the absence of Bank of Tokyo agreeing to participate in the redeemable preference share proposal, the other banks would be prepared to consider a deeply subordinated debt contribution by Bank of Tokyo. ANZ noted that the solution would need to:

> (a) ensure there was no preference/priority provided to [Bank of Tokyo]. Specifically this would require that Sub Debt could not be repaid ahead of the [redeemable preference shares] being redeemed, capitalisation of interest etc. – i.e. same economic impact as [redeemable preference shares]; and
>
> (b) be able to satisfy Solid Energy that the Sub Debt terms allow it to be characterised as equity and therefore able to participate on a pro-rata basis in the NZD100m equity solution required by Solid Energy directors.

[35] At a meeting on 20 August 2013 Bank of Tokyo informed the other banks that it could not participate in the redeemable preference share proposal, and it withdrew its tentative proposal for a subordinated debt position. Ms McKeown's account of the meeting, which does not seem contentious, is that Bank of Tokyo said that while it was prepared to help solve Solid Energy's liquidity position, it could not participate in a solution for the company's capital structure. It said that a debt for redeemable preference share exchange did not satisfy various legal, regulatory and

policy constraints by which Bank of Tokyo was bound. It said that Solid Energy's positive equity position of $91.6 million made it more difficult to consider deeply subordinated debt or redeemable preference shares. Although it was prepared to extend the term of its debt, release covenants and reduce its interest rate as required, it considered that it should be the Crown who injected the required equity. It asked that each bank also tell the Crown that it should be the one to provide the equity solution.

[36] It is clear from the various affidavits filed that at that time it was the assessment of all the other banks that the Crown would not contribute all of the necessary equity. Ms McKeown says that the other banks were becoming frustrated with Bank of Tokyo's position. There was a consensus that they should support a creditors' compromise process which would bind Bank of Tokyo into the capital structure solution of the restructuring proposal. The other banks agreed that Bank of Tokyo should leave the meeting to give the remaining banks the opportunity to consider how the restructuring could be implemented in the absence of Bank of Tokyo's agreement to the debt for equity exchange. Bank of Tokyo does not seem to have protested this decision.

[37] Following Bank of Tokyo's departure from the working group and through to September, the other banks continued to develop a restructuring package, now dealing with Solid Energy and Treasury. Towards the end of August it became plain that there was a need to again extend the Support Deed. This time Bank of Tokyo was not prepared to join with the others in extending the existing Support Deed unless it was modified. It sought to impose conditions which were ultimately agreed to by the other parties. The third Notice of Extension and Amendment of the Support Deed (extending its operation to 30 September 2013) stipulated that the Deed did not prevent Bank of Tokyo seeking to set aside or challenge any compromise or scheme of arrangement, that restrictions on its ability to transfer debt did not apply, and that Bank of Tokyo could unilaterally terminate the Support Deed in certain circumstances.

[38] During this same period of late August and September, Bank of Tokyo continued to attempt to engage directly with Treasury and the Crown outside of the

working group. But on 25 September 2013 Bank of Tokyo received confirmation from the Minister of Finance that the Government had now agreed with the other banks a "final form of support package". The Minister said that the package involved the Banks, TSB and the Crown making financial contributions in different ways, including a joint recapitalisation of Solid Energy through the issue of redeemable preference shares.

[39] On 26 September Bank of Tokyo wrote to ANZ as the coordinating bank. Bank of Tokyo referred to the letter from the Minister of Finance. It said it had been prejudiced by the delay in advising it of the agreement because it had:

> … clearly indicated to Treasury it was holding off from exercising rights it has under the Support Deed and under its facility with Solid Energy, in the encouraged, but now apparently mistaken, belief a constructive response would be received.

It gave notice that it might challenge any proposed compromise.

[40] On 27 September all banks other than Bank of Tokyo received advice through Treasury that the directors of Solid Energy were shortly (that day) going to pass resolutions winding up the company unless the term sheet for the rescheduled facilities agreement was agreed and finalised immediately. In light of the letter Ms McKeown sent to Bank of Tokyo later that day it seems that the required agreement was reached. In her letter she referred to the advice Bank of Tokyo had received from the Minister of Finance that the final form of support package had been agreed. She continued, "earlier this afternoon, the Banks reached conditional agreement on the commercial terms of a support package." She said that the banks were happy to meet with Bank of Tokyo to explain the package. She explained that because of Bank of Tokyo's opposition to any debt for equity exchange, the other banks, the Crown and Solid Energy had been considering use of a creditor's compromise. If the banks proceed in that way, and assuming Bank of Tokyo's position had not changed, Bank of Tokyo would receive notice in accordance with Part 14 of the Act. She concluded by saying that in the circumstances the banks intended to enter into a new standstill Support Deed on 30 September, and that the other banks expected that Bank of Tokyo would grant a unilateral standstill.

[41] Also on 27 September Bank of Tokyo signed a letter to extend the Support Deed to 31 October, but the extension was expressed to be conditional upon all other parties signing the letter. They did not. Instead Bank of Tokyo was advised on 30 September that the other banks had entered into their own standstill agreement, and that a notice of compromise would be served on Bank of Tokyo.

[42] In early October Bank of Tokyo asked the other banks to meet so that the proposed restructuring could be explained to it. The banks agreed to the meeting in principle, but imposed conditions, including that Bank of Tokyo confirm it had granted Solid Energy a durable standstill, that it was genuinely considering participating in the restructuring and that it would give confidentiality undertakings. Bank of Tokyo did not accept these conditions, or at least not to the satisfaction of the other banks. No meeting took place.

[43] These proceedings were issued challenging the validity of the use of Part 14 for the restructuring at the beginning of October. On 14 October the board of Solid Energy resolved to propose two compromises, a debt restructuring compromise and a debt exchange compromise. On that same day the Board issued a formal notice to each of the banks in respect of the two meetings of creditors to approve the proposed compromises. The key elements of the restructuring proposal put to creditors were as follows:

1. A rescheduling of the company's existing bilateral bank loan debt and performance bond facilities into a syndicated three year facility, of which ANZ was to be the facility manager. This rescheduled the date upon which principal would fall due in respect of each of the bilateral loan facilities, and extended the period for which the banks holding performance bond obligations would remain at risk for those obligations. For all facilities the maturity date was extended to late 2016. The compromise would also deprive each bank of its contractual rights in respect of the outstanding principal and interest arising under the bilateral facility agreements. Each bank would instead have rights under the new syndicated facility agreement. This compromise included all banks, with the exception of TSB.

2. A pro-rata exchange of a portion of each bank's loan debt (excluding any performance bond obligations) as well as a portion of the wholesale medium term notes held by TSB, for $75 million of non-voting redeemable preference shares. This was in effect a debt for equity exchange, converting some of Solid Energy's existing bank debt into a form of equity. All banks, including Bank of Tokyo, ceased to be creditors of Solid Energy in respect of that portion of the indebtedness that was exchanged for redeemable preference shares.

[44] Under the debt exchange compromise, Bank of Tokyo was bound to exchange approximately $16 million of its outstanding principal debt for approximately 16 million redeemable preference shares. The other banks were similarly bound to make an exchange, with the amounts exchanged being proportionate to the size of each bank's loan to Solid Energy. The amount exchanged by BNZ was exactly the same as Bank of Tokyo. For the other banks, the exchanges involved various but lesser amounts.

[45] The redeemable preference shares exchanged for debt were issued on terms that Solid Energy agree not to pay any dividend, or make any other form of distribution to ordinary shareholders until the redeemable preference shares are redeemed. The date of redemption is at the discretion of the board. Redeemable preference shares are also entitled to a pro-rated share in all dividends declared by the board of directors ahead of ordinary shareholders. The redemption amount includes 5 per cent per annum compounding quarterly from the date of issue less any dividends paid to the redeemable preference shareholders.

[46] The two compromises proposed were conditional upon the approval of the other. The debt exchange compromise was also conditional upon the approval of noteholders under the Deed Poll because TSB needed to be released from certain restraints imposed on it by the Deed Poll to participate in the compromise. Each compromise also included a term that should a court order that any of the creditors the subject of the compromise is not bound by all or part of it, then no creditor is bound by it.

[47] On 14 October 2013 Bank of Tokyo wrote to Solid Energy terminating its unilateral standstill arrangement. It gave notice that the $80 million owing under its bilateral facility was due and owing, and that if it was not paid by 29 October, that would constitute an event of default under the facility agreement.

[48] On 22 October a series of meetings took place in connection with the proposed compromises. At the first, noteholders passed an extraordinary resolution amending the terms of the notes to allow the debt exchange compromise to proceed. The second meeting was for consideration by the debt rescheduling creditors of a resolution to approve the debt rescheduling compromise. With Bank of Tokyo voting against the proposal, the debt rescheduling compromise was approved with a majority in number, representing 77.7% in value of the debt rescheduling creditors.

[49] Later on that same day, the meeting with the debt exchange creditors took place. The resolution approving that compromise was passed by a majority in number of creditors representing 78.3% in value of the debt exchange creditors. Again, Bank of Tokyo voted against the proposal.

[50] Part of the restructuring of Solid Energy was the introduction of new financial support from the Crown in the form of:

(a) $25 million in cash as the subscription price for redeemable preference shares.

(b) New working capital, term loan and stand-by facilities secured against the assets of Solid Energy, under the terms of which the Crown agreed to make available up to $130 million.

This new support was not part of the compromises, but was conditional upon their approval.

[51] Following approval of the compromises, all of the banks, except Bank of Tokyo, entered into an agreement with the Crown and Solid Energy called the Direct Agreement. That agreement recorded the parties' "understandings regarding their

rights and powers relating to their respective facility arrangements following the restructuring". Bank of Tokyo was given the opportunity to sign the agreement but declined.

[52] The restructuring, of which the debt rescheduling and debt exchange compromises formed an integral part, has enabled Solid Energy to continue to trade. Mr Patterson explains the effect as follows:

> As a consequence of obtaining an acceptable financial restructuring package, of which the Debt Rescheduling Compromise and the Debt Exchange Compromise form an integral part, Solid Energy now has the opportunity to trade its way back to a viable and financially stable position over the medium term.
>
> The rescheduling of the company's bank debt and performance bond facilities, when coupled with the reduction of term debt, has brought the company's financing to a position which the board considers the company will be able to meet in the medium term. The introduction of $130 million of new facilities from the Crown markedly improves the company's liquidity position. The $100 million improvement in the company's equity position means that the company has achieved the rebalancing of its capital structure referred to in Mr Ford's letter of 19 August 2013.

C. First cause of action: breach of standstill agreement and course of dealing between parties

Bank of Tokyo's claim

[53] Bank of Tokyo relies upon cl 6.1(q) of the Support Deed as the basis for the allegation that the interested party banks and Treasury were in breach of contract in failing to obtain the prior written approval of Bank of Tokyo to the compromises. Clause 6.1(q) in material part provides:

> The Crown … and each Bank agrees that it will not do any of the following during the Standstill Period … unless expressly permitted by this document:
>
> ...
>
> (q) propose any corporate or other action or legal proceeding or agree to a composition, compromise, assignment or arrangement with any class of creditors of an Obligor that has not previously been approved by each other Bank and the Crown; ...

[54] Bank of Tokyo says the whole purpose of the standstill arrangement was to allow all parties – Solid Energy, the Banks and the Crown – to attempt to agree a

solution to Solid Energy's trading difficulties in the knowledge that no action could be taken by any of the Banks against Solid Energy during the period. The need for unanimity flowed from the fact that any approved compromise would have the effect of permanently depriving each of the Banks of its right to take bilateral action against Solid Energy. In the absence of the moratorium contained in the document, Bank of Tokyo would have been free to take action as it saw fit, including making demand for a payment of its debt. Bank of Tokyo says that unknown to it, it effectively gave up all of its rights under the bilateral facility permanently at the time it entered into the Support Deed. The suspension of its rights enabled the other banks and the Crown, and eventually Solid Energy, to design an arrangement which would be binding on Bank of Tokyo when the standstill arrangements ceased. And by that time, it could not enforce its rights.

[55] Bank of Tokyo argues that the expression "agree to a compromise" during the standstill period must be interpreted in this context. The interpretation adopted must ensure that the Support Deed does not allow its parties to use the protection conferred by it in order to negotiate or agree a course of action not agreed to by all the parties.

[56] Bank of Tokyo says the Crown and the other banks breached the clause when they reached agreement with the Crown as to the form of compromise. To succeed, Bank of Tokyo must frame its allegation in this way, as the binding vote in favour of the compromise occurred in late October, by which time the unilateral support arrangements involving Bank of Tokyo had expired. Bank of Tokyo argues that it does not need to prove the existence of a legally enforceable agreement to show breach. It is enough if it shows that the parties considered themselves to have reached agreement, such as by agreeing to use Part 14 of the Act to implement a restructuring without obtaining Bank of Tokyo's approval. It says that although there was arguably a breach of this nature from mid August, there is clear evidence that an agreement had been reached by 25 September, when Bank of Tokyo received advice from the Minister of Finance that the Government had agreed with the other banks a "final form of support package". Bank of Tokyo says therefore that from 25 September the Crown and the other banks were in breach. Bank of Tokyo says that the existence of such an agreement is evidenced by the fact that by late

September the board of Solid Energy had approved the restructuring, and had clearly been provided with sufficient comfort as to the nature and level of creditor and shareholder support to enable the directors to sign off on the financial accounts of Solid Energy on the basis that Solid Energy was a going concern.

Analysis

[57] The first, and I consider insurmountable, difficulty with this cause of action is that, as Bank of Tokyo concedes, cl 6.1(q) did not bind Solid Energy. Solid Energy's action in proposing the compromises could not have been a breach for the purposes of the provision. But it is Solid Energy that Bank of Tokyo sues for breach of contract and against whom relief is sought.

[58] Secondly, even if the other banks and the Crown had breached the clause, it is difficult to see how that could invalidate the compromises. Bank of Tokyo sought in argument, to invoke the Court's inherent jurisdiction to invalidate the compromises on the grounds that they flowed out of conduct which was in breach of contract. There is no principled or coherent basis upon which this Court's inherent jurisdiction could be exercised for that purpose. I consider that, at best, such a breach would be relevant when considering Bank of Tokyo's application for release from the compromises on the grounds that they are unfairly prejudicial. It is for this latter reason that I proceed to consider the merits of the argument Bank of Tokyo makes, that the Crown and the other banks breached cl 6.1(q) in some way.

[59] The purpose of contractual interpretation is to ascertain the "meaning the parties intended their words to bear".[3] In commercial contracts, the courts must take into account the commercial purpose of the contract, the background of the transaction and the relevant market.[4] Where the contract is ambiguous, the court is entitled to adopt the interpretation most consistent with business common sense.[5] Even where the natural meaning appears clear, the courts may nevertheless search

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3 *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444 at [19].

4 *Vector Gas Ltd*, above n 3, at [58], citing *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 1 WLR 989 (HL) at 995-996.

5 *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900 at [21].

for another interpretation if the ordinary meaning offends against business common sense such that the parties cannot be taken to have agreed to it.[6]

[60] It is relevant to the task of contractual interpretation in this case that the parties to this agreement were sophisticated commercial parties, and can be expected to have used language with some precision. In the opening words of cl 6, “agree” is used to describe a legally enforceable commitment, but the construction argued for by Bank of Tokyo involves giving it a different meaning when it appears later in the same clause.

[61] In the context of the sub-clause the word “agree” is best understood as referring to a legally enforceable agreement. The act of agreeing to a “composition, compromise, assignment or arrangement with any class of creditors” sounds very much like the act of voting for a proposal in the context of a class meeting, just as the proposals referred to are best understood as formal proposals for voting by those entitled to vote on them, rather than proposals in the sense of mere suggestions.

[62] This interpretation is consistent with the commercial purpose of the agreement. As is submitted by the interested party banks, since the entire purpose of the Support Deed was to enable the creditors’ group to investigate and negotiate a potential restructuring, to construe “agree” as meaning something short of the formal step of legally committing to a compromise would undermine that purpose. It would be a significant obstacle in the way of negotiation were parties at constant risk of breaching an agreement by simply putting forward suggested structures and indicating a willingness or otherwise to be bound by that structure should that be carried forward into the restructuring. Bank of Tokyo’s favoured interpretation would also mean that any party had a right of veto from day one of the restructuring negotiations, obstructing the development of thinking and discussion in connection with possible solutions. I note that it would also mean that had Bank of Tokyo been successful in the unilateral discussions it was pursuing with the Crown to reach some sort of understanding, it too would have been in breach.

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6 *Vector Gas Ltd*, above n 3.

[63] I am satisfied for these reasons that cl 6.1(q) is to be interpreted so that "agree" means legally bind themselves to the compromise. The banks did not agree, in the sense of bind themselves to the compromises, until they voted in favour of them. That occurred on 22 October 2013, well after the Support Deed had expired on 30 September.

[64] Post-contractual conduct can also be taken into account in interpreting a contract, although the following caution expressed by Tipping J in *Gibbons Holdings Ltd v Wholesale Distributors Ltd* must be borne in mind:[7]

> Evidence of subsequent conduct does not invite a subsequent meaning. It is directed to the original meaning; that is, the meaning of the contract when it was signed.

When considering evidence of subsequent conduct, the focus will still be on objective conduct rather than expressions of subjective intention or understanding.[8] Further:[9]

> If the Court can be confident from their conduct what both parties intended their words to mean, and the words are capable of bearing that meaning, it would be inappropriate to presume that they meant something else.

[65] In this case, Bank of Tokyo raises the issue of the parties' conduct in the period after they bound themselves to the standstill arrangements. Having considered that conduct in some detail, I have found all parties' conduct corroborative of the interpretation set out above and inconsistent with the interpretation of cl 6.1(q) Bank of Tokyo now contends for.

[66] When Bank of Tokyo left the working party meeting in August 2013, it knew that the other banks intended to proceed to develop the restructuring proposal, the essential terms of which had already been sketched out between them, but not agreed to by Bank of Tokyo. Yet there is no evidence it protested its exclusion from the working group, or suggested to the banks that they were acting or were about to act in breach of the Support Deed.

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7 *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37, [2008] 1 NZLR 277 at [59].

8 At [60].

9 At [63].

[67] Shortly after the parting of the ways, Bank of Tokyo agreed to an extension of the Support Deed to 30 September. That was even after it received a letter from Treasury dated 29 August 2013, in which the Deputy Secretary of the commercial transactions group, Mr Crawford, said:

> As you are aware the Banks and the Crown have been and continue to be in discussions with a view to implementing a managed resolution for [Solid Energy]. The current proposals incorporate a plan for a formal Part 14 compromise under the Companies Act. This has only been necessary because of [Bank of Tokyo's] opposition to the framework for a managed resolution put forward by the other Banks, an element of which includes the conversion of a portion of each Bank's debt into equity, and the contribution by the Crown of new equity.
>
> Last week the Banks (other than [Bank of Tokyo]) submitted a refined version of the managed resolution framework, which the Crown now considers provides a reasonable basis for negotiations. Good progress has been made on the negotiations although there is still work to be done. The managed resolution needs to be in place before the end of September in order to enable [Solid Energy] to finalise it annual accounts on a going concern basis.

[68] It is also significant that when, at the end of August, it agreed to extend the Support Deed until 30 September, Bank of Tokyo renegotiated aspects of the Deed. In particular the definition of "standstill period" was amended to stipulate as one of the possible terminating dates:

> ... the day on which [Bank of Tokyo] provides a notice of termination to the Borrower which may be given by [Bank of Tokyo] at any time following any person proposing or agreeing to any composition, assignment, scheme of arrangement or restructuring howsoever effected involving any Obligor that [Bank of Tokyo] has not approved in writing.

I attach some significance to the fact that Bank of Tokyo did not purport to exercise that right. Indeed Bank of Tokyo never acted to terminate the group support arrangements in reliance on this clause or any other. These came to an end when the other banks made their own standstill arrangements which excluded Bank of Tokyo.

[69] I also note that in the various letters protesting the compromise and signalling a potential challenge, references to cl 6.1(q) occurred in the context of a warning from Bank of Tokyo that any compromise would be in breach of that clause unless

unanimously agreed to, not that the discussions and consensus that had emerged were a breach of the clause.[10]

[70] During the hearing I raised with counsel for Bank of Tokyo that it had not conducted itself as if it considered that the other banks and the Crown were in breach. Counsel's response was that Bank of Tokyo understood right up until 25 September that the Crown was ready to negotiate with it. Mr Kosuge, Chief Officer in Charge, Office of the Regional Head for Australia and New Zealand for Bank of Tokyo, says that in dealings with the Crown in August and September, he was led to believe that the Crown was open to negotiation, and it is for that reason that Bank of Tokyo took no legal action.

[71] The Crown did make offers for Ministers to meet with Bank of Tokyo, but these offers do not seem to have been pursued by Bank of Tokyo for whatever reason. There is also no evidence to suggest that these offers to meet and discuss were not genuine, although Bank of Tokyo's submission seems to assume that. In any case, even from Mr Kosuge's narrative of dealings, it is clear Bank of Tokyo knew that the other banks and the Crown were continuing to work up the detail of the proposed restructuring including creditor compromises through this period. There is nothing in the correspondence to suggest that Bank of Tokyo was given anything other than a clear account of the state of discussions regarding the proposed restructuring.

[72] Accordingly Bank of Tokyo has not proved a breach of cl 6.1(q). I note that even if I was persuaded that Bank of Tokyo's interpretation was correct, the detail of a potential restructuring was only agreed by the banks, the Crown and Solid Energy on 27 September, following the board's threat to put the company into liquidation unless the terms of the restructuring were agreed. 27 September is, of course, only three days prior to the expiry of the Support Deed. From 30 September 2013 Bank of Tokyo was free to act unilaterally in its own interests, yet it did nothing until 14 October 2013. It was not bound by the standstill arrangements it offered in its letters

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10 For example, see 11 September and 26 September letters to Treasury, and letter to ANZ of 26 September.

as that offer was conditional on the other banks agreeing to be bound also. The other banks did not agree to those arrangements.

D. Second cause of action: proper scope of Part 14 of the Act

[73] Bank of Tokyo argues that the type of restructuring effected by the compromises falls outside the scope of what can be achieved under Part 14 of the Act. These should have been implemented under Part 15, but were not. They are therefore invalid and unenforceable. It advances a number of arguments in support of this cause of action.

[74] All of the issues raised by Bank of Tokyo in connection with this cause of action engage the question of how Part 14 of the Act is to be interpreted. A statute is, of course, to be interpreted in light of its text and its purpose.[11] To satisfy s 5 of the Interpretation Act, meaning must be cross-checked against purpose. As stated in *Earthquake Commission v Tower Insurance Ltd*, to determine purpose:[12]

> ... the court must consider both the immediate and the general legislative context, including legislative history, and it may be relevant to consider the social, commercial or other objective of the statute.

[75] Bank of Tokyo starts with the observation that the overall scheme of Parts 14 and 15 suggest that Part 14 is to be used for straightforward, simple arrangements between a debtor and its creditors, by which the creditor accepts reduced rights or money in satisfaction of the entirety of its claim. Part 14 cannot be used to sanction a debt for equity swap, particularly where the principal purpose of the compromise is to address issues of balance sheet rather than cash flow solvency. Secondly, it says that an exchange of debt for equity is not a "compromise" in the sense that word is used in Part 14.

[76] Bank of Tokyo points to the simplicity of the procedure in which no court approval or oversight is required of the processes which lead up to the creditors' meeting, and in which the proposal is not required to be sanctioned by the court before it becomes binding. In contrast, Part 15 provides a much greater degree of

11 Interpretation Act 1999, s 5(1).
12 *Earthquake Commission v Tower Insurance Ltd* HC Christchurch CIV-2011-485-1137, 2 September 2011 at [27].

court supervision, including the requirement that the court approve the scheme of arrangement, amalgamation or compromise, and empowering the court to give directions as to meetings of shareholders or creditors or such classes of shareholders or creditors as the court may specify. Bank of Tokyo says it is significant that the court is empowered under Part 15 to make a number of other orders to assist or effect implementation of such a scheme, which it is not empowered to make under Part 14. These powers include orders directing the issue of shares or securities. Similarly the definition of "arrangement" in Part 15 includes a reorganisation of the share capital of the company, while there is no reference to shares in Part 14.

Can a compromise under Part 14 include a debt for equity swap?

[77] I start with the statutory scheme. Part 14 is one of the three "corporate rescue" parts of the Act. The Part is headed "Compromises with creditors". It provides for compromises between a company and some or all of its creditors to be binding in certain circumstances. A compromise may be proposed by, amongst others, the directors of a company if they have reason to believe that a company is or will be unable to pay its debts within the meaning of s 287 of the Act.

[78] A "compromise" is defined as follows:[13]

> **Compromise** means a compromise between a company and its creditors, including a compromise–
>
> (a) Cancelling all or part of a debt of the company; or
>
> (b) Varying the rights of its creditors or the terms of a debt; or
>
> (c) Relating to an alteration of a company's constitution that affects the likelihood of the company being able to pay a debt.

[79] The proposer of the compromise formulates and then circulates a proposal, together with certain prescribed information, to the company's creditors. The creditors then vote upon the compromise at the convened meeting. The creditors vote in classes. If the compromise is approved by a majority in number, representing

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[13] Companies Act 1993, s 227.

75 per cent in value of those creditors voting, it will be binding on the company and upon all creditors to whom notice of the compromise was given.

[80] Court approval of the compromise is not required before the compromise is effective. However, individual creditors have a right to apply under s 232 of the Act for an order that they are not bound by the compromise, as Bank of Tokyo has done in this proceeding. To succeed with an application under s 232, the creditor must establish that it voted against the compromise and that there was a material irregularity in obtaining approval of the compromise or that the compromise is unfairly prejudicial to that creditor or to the class of creditors to which the creditor belongs.

[81] Part 15 is headed "Approval of arrangements, amalgamations, and compromises by Court". Under Part 15 the court can order that an arrangement, amalgamation or compromise is binding on a company and on such other persons or classes of persons as the court specifies, on terms and conditions ordered by the court. The procedure set out in Part 15 allows the court to make directions as to service, holdings of meetings, entitlements, standing to be heard on the matter, and for the preparation of reports in advance of the meeting or meetings convened to consider approving the arrangement, amalgamation or compromise. The court may approve an arrangement, amalgamation or compromise even though it is not supported by the required majority of those who will be affected by it.

[82] Section 235 defines arrangement as follows:

> In this Part of this Act, unless the context otherwise requires,—
>
> **Arrangement** includes a reorganisation of the share capital of a company by the consolidation of shares of different classes, or by the division of shares into shares of different classes, or by both those methods.

There is no definition of "compromise". The natural conclusion to be drawn from this is that the definition of compromise in Part 14 carries over into Part 15, and indeed it has been held that the word compromise has the same meaning in both Parts 14 and 15.[14]

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14 *Suspended Ceilings (Wellington) Ltd v Commissioner of Inland Revenue* [1995] 3 NZLR 143

[83] A key provision in Part 15 is s 237. This enables the Court to make orders to give effect to any arrangement, amalgamation or compromise transferring or providing for any prescribed terms and conditions relating to:[15]

> (a) The transfer or vesting of real or personal property, assets, rights, powers, interests, liabilities, contracts, and engagements:
>
> (b) The issue of shares, securities, or policies of any kind:
>
> (c) The continuation of legal proceedings:
>
> (d) The liquidation of any company:
>
> (e) The provisions to be made for persons who voted against the arrangement or amalgamation or compromise at any meeting called in accordance with any order made under subsection (2)(b) of that section or who appeared before the Court in opposition to the application to approve the arrangement or amalgamation or compromise:
>
> (f) Such other matters that are necessary or desirable to give effect to the arrangement or amalgamation or compromise.

[84] Finally, I note s 238. The heading to that section is "Parts 13 and 14 not affected". Section 238(b) provides that the court "may approve a compromise under 236 of this Act even though the compromise could be approved under Part 14 of this Act".

[85] It is apparent from the statutory scheme therefore, that Parts 14 and 15 are not intended to operate as watertight compartments. Insofar as it relates to compromises, the intent behind Part 15 seems to have been to create the ability to bind creditors to compromises even where the required consent is not obtainable (whether because of lack of will of the required majority or some other practical consideration) or to assist the implementation of the compromise where that cannot be done without court order.

[86] It is helpful to have regard to the legislative history of the Part to see if this bears out this interpretation. It was a Law Commission report which led to the

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(CA) at 145.

15 Companies Act, s 237(1).

enactment of the Companies Act 1993.[16] That report discussed the deficiencies in the 1955 Act as it related to corporate rescue as follows:[17]

> The provisions of the 1955 Act have the disadvantage that they require intervention of the Court in all cases. This may be necessary in the case of creditors because of the need to identify those affected and determine in an authoritative way matters such as service upon them. In most reconstructions of insolvent companies, however, Court supervision will be unnecessary although the draft Act provides it as a backstop for cases where there is difficulty in identifying the class of shareholders or the creditors affected.

[87] The report attached a draft Act. Part 13 of that draft related to compromises and is clearly the first public draft of what would eventually become Part 14. In the chapter introducing Part 13 the Commission said:[18]

> In the course of consultation with insolvency practitioners about possible changes to the statutory law on corporate insolvency and liquidations it became clear that compromises with creditors under s 205 of the 1955 Act are rarely attempted. The present procedure is perceived as slow, complex and expensive with an unnecessary degree of involvement by the Court. As a compromise should be a constructive alternative to liquidation of a company, the present state of affairs is most unsatisfactory. Part 13 of the draft Act is designed to provide a more useful procedure which features a greater provision of information by those proposing a compromise but limits the role of the Court to one of review on specified grounds.

[88] The draft Act introduced the concept that the compromise should be binding if supported by the required number of creditors, but reserved a residual power to the Court to prevent abuse of the procedure. The draft Act attached to that Law Commission report did not include an equivalent of Part 15.

[89] The Companies Bill was introduced to Parliament in September 1990. It was based on the Law Commission draft.[19] Again there was no equivalent of the present Part 15, but the explanatory note to Part 13 (now Part 14) stated that it was "designed to provide a more useful procedure for effecting compromises with creditors ….". It was also designed to limit the role of the court to one of review on specified grounds.[20]

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16 Law Commission *Company Law: Reform and Restatement* (NZCLC R9, 1989).
17 At [626].
18 At [635].
19 Revised as at June 1990 to correct minor proofreading issues.
20 Companies Bill 1990 (50-1) (explanatory note) at ix.

[90] The Department of Justice reported to the Justice and Law Reform Committee on the submissions received on the Bill, and set out its recommendation. In light of submissions received it recommended broadening the Act's provisions in relation to court approval of amalgamation proposals to deal with "[c]orporate reconstructions and arrangements and compromises with creditors that cannot be practically effected under Part 12 or Part 13."[21] This recommendation was accepted by the Committee. The result was the enactment of Part 15.

[91] Bank of Tokyo places weight on the fact that Part 15 was included in response to submissions received and in particular, in response to submissions from the New Zealand Law Society. It says that the omission identified by the Law Society in its submission was the absence of any ability to deal with the reorganisation of debt and equity. In fact the concern expressed by the Law Society was the absence of any provision enabling the court to effect an arrangement in the case of companies which are not insolvent, and where it is impracticable or impossible to effect the reconstruction under the amalgamation (Part 13) or the other provisions of the Act.[22]

[92] The Law Society was also concerned with the definition of "compromise". It thought that the inclusion of an exhaustive definition (as it was in the Bill) might tend to narrow the range of possible compromises. The Department of Justice summarised the submissions in relation to the definition of "compromise":[23]

> Two submissions say that the definition of "compromise" is unduly restrictive. It should be widened to include any type of arrangement between a company and its creditors which affects the obligations of the company to those creditors. Another submission is of a similar view, and recommends that paragraphs (a) to (c) be made inclusive rather than definitive, by saying "compromise" means a compromise between a company and its creditors including …

[93] These recommendations flowed through to Parts 14 and 15 as enacted. The new Part 15 was therefore a response to the need to empower the court to provide more assistance in complex amalgamations, arrangements and compromises where

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21 Department of Justice "Companies Bill – Amalgamations and Compromises with Creditors" (14 July 1992) at 2.

22 New Zealand Law Society "Submissions to the Justice and Law Reform Select Committee on the Companies Bill 1990" at 126-134.

23 At 8.

that was needed, and without any threshold requirement of insolvency. It is in this context that a power in the court to direct the issues of shares was included in Part 15. I do not consider that the inclusion of this power indicates that Part 14 may not be used where the compromise involves a debt for equity swap. The concern to include a broad non-exclusive definition of compromise is also inconsistent with the interpretation argued for by Bank of Tokyo.

[94] The legislative history and purpose of Parts 14 and 15 therefore bears out the interpretation suggested by the text. Parts 14 and 15 were not viewed as mutually exclusive jurisdictions in relation to the compromises that can be affected under them, as Bank of Tokyo's submission assumes.

[95] Bank of Tokyo says that the use of the word "compromise" in other statutory contexts in New Zealand also supports the argument that the scope of the compromise concept is limited to the acceptance of reduced rights or money in satisfaction of the entirety of the claim. In the Insolvency Act 2006, s 29(1)(b)(ii) provides "to compromise the amount owing on terms that satisfy the Court or the creditor", and s 326(2)(c) provides "an offer to compromise the insolvent's debts at less than 100 cents in the dollar". This argument is not persuasive. The word "compromise" in Part 14 is to be interpreted in its statutory context, in light of both the statutory definition of compromise and that Part's purpose. It does not fall to be interpreted in the context of another statute or statutes with their own issues of interpretation.

[96] Bank of Tokyo has other arguments that a debt for equity swap cannot possibly be within the scope of a compromise with creditors. It relies upon the decision of the English Court of Appeal in *Mercantile Investment & General Trust Co v International Company of Mexico* as authority for the proposition that a transaction in which debenture holders relinquished their debt in exchange for shares in a company is not a compromise, but rather an extinguishment of rights.[24] Here it says the legal effect of the debt for equity swap goes beyond merely modifying

[24] *Mercantile Investment & General Trust Co v International Company of Mexico* (1893) 1 Ch 484 (CA).

rights, instead replacing those existing rights with entirely different rights. It is not a compromise.

[97] Although Bank of Tokyo concedes that there is a body of case law which could support a broad interpretation of the word “compromise”, it argues those cases concern court-approved schemes, or the construction of a contract. It argues that a more limited interpretation should be given to the term in light of the statutory context of the Act.

[98] The only report of *Mercantile* appears as a footnote in the decision of *Sneath v Valley Gold Ltd*.[25] In *Sneath* Lindley LJ (also a judge in *Mercantile*) said that *Mercantile* was decided on the basis of the principle “that there was no such dispute or difficulty as to bring the power of compromising into play”; that is, that there had to be a dispute or difficulty before there could be a binding compromise.[26] That is the proposition for which that case has regularly been cited, and I am satisfied is the proposition for which it stands. The statement by Fry LJ upon which Bank of Tokyo relies is as follows:[27]

> In my opinion the transaction embodied in the resolution is not a modification of the rights of debenture-holders against the company or their property; it is the extinction of all their rights against the company or its property.

That statement really stands for no more than the conventional proposition that a compromise cannot involve the total surrender of one party, since a party who abandons his claim is not compromising it. There must be some “give and take”.[28]

[99] In connection with this principle, I observe that the statutory definition of compromise may be sufficiently broad to encompass a total surrender of rights, as it extends to “cancelling all or part of a debt of the company”. However, I do not need to decide that issue, as there was no total extinction of rights here. Only a portion of the debt was exchanged for redeemable preference shares. To the extent there was an exchange, the redeemable preference shares received in return clearly have value.

25 *Sneath v Valley Gold Limited* [1893] 1 Ch 477 (CA).
26 At 494.
27 At 490-491.
28 *Re NFU Development Trust* [1972] WLR 1548 (Ch) at 1555.

[100] There are numerous authorities which emphasise the flexibility and breadth of the concept of "compromise". In *Suspended Ceilings (Wellington) Ltd v Commissioner of Inland Revenue*, the Court of Appeal considered the meaning of "compromise" in the context of Part 15 of the Companies Act.[29] It said that the word "compromise" in Part 15 bears the same meaning as in Part 14, and that a narrow meaning should not be given to it.[30]

[101] In *Fowler v Lindholm* the Federal Court of Australia held that:[31]

> No narrow interpretation should be given to the expressions "compromise" or "arrangement" … there is no reason to construe the term in s 411 as restricting in any way the nature of the bargain that might be made between company and creditors (*Re Sonodyne International Ltd* (1994) 15 ACSR 494 at 497-498), subject only to the additional requirement that the arrangement must be within the power of the company and not in contravention of the Corporations Act. …
>
> A scheme of arrangement between a company and its creditors or a class of creditors is no more than a proposal to vary or modify the company's obligations in relation to its debt and liabilities owed to the creditors or class of creditors.

[102] Debt for equity compromises have been sanctioned by courts in other jurisdictions, even though that sanction involves dissident creditors becoming shareholders without their consent.[32] Bank of Tokyo says that these cases arise in a different statutory context, under Part 15 or its equivalent in other jurisdictions. It is true that these cases have involved schemes requiring court sanction under Part 15 or its equivalent, but that does not seem a relevant point of distinction. The statutory scheme of Part 14 is that a creditor may be bound by the consent of the required majority of its class. There is no reason why they should not be bound by a debt for equity exchange. Nor has any reason been articulated why a compromise involving a debt for equity swap does or should require the Court's supervision or approval under Part 15. The redeemable preference shares could be issued without court order. Redeemable preference shares are simply assets. It is true that their value is

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29 *Suspended Ceilings*, above n 14.

30 At 28; see also *Elders New Zealand Ltd v PGG Wrightson Ltd* [2008] NZSC 104, [2009] 1 NZLR 577 at [31].

31 *Fowler v Lindholm* (2009) 178 FCR 563 at 578.

32 *Re Bluebrook Ltd* [2009] EWHC 2114, [2010] 1 BCLC 338 (Ch); *Re Nine Entertainment Group Ltd (No 1)* (2012) 211 FCR 439.

tied to the profitability of Solid Energy, but so too was the value of the debt asset it replaced.

[103] Finally, there is a lack of logic in the proposition that a creditor could agree under Part 14 to accept a lesser sum in repayment, but could not be bound by an agreement to accept a lesser repayment on its debt in exchange for some asset from the company. Such an arrangement involves the very kind of give and take that is the essence of compromise.

[104] Therefore, I am satisfied that a compromise which is more complex than a simple acceptance of a lesser amount of money by a creditor in full satisfaction of the debt can be effected under Part 14, including a compromise that involves an exchange of debt for redeemable preference shares.

Can a compromise encompass a complex rearrangement of contractual debt including the imposition of liabilities?

[105] Bank of Tokyo argues that Part 14 cannot be used to compel Bank of Tokyo into dealings with parties outside of the bilateral debtor/creditor relationship because "compromise" is defined as being between a company and its creditors. Here, it says the compromises did compel Bank of Tokyo into dealings with parties outside the bilateral relationship as Bank of Tokyo now has rights and obligations with the other syndicate members.

[106] The document relied upon by Bank of Tokyo, the syndicated facility agreement, is a standard form of syndicated bank facility, a point accepted by Bank of Tokyo. In this case, bilateral funding arrangements were swapped for a syndicated facility agreement. Syndication appears to fall neatly within the s 227 definition of compromise, involving as it does the variation of a creditor's rights or terms of debt. In corporate insolvency, a reorganisation of creditors' rights will often involve a tidying up of bilateral facility arrangements to align rights and obligations between financing creditors and the borrowing company. This not only assists the borrower in its dealing with its banks, it assists the banks in their dealing with the borrower *and* provides each bank with comfort that while it continues to support the borrower, other banks do not recover preferential payments.

[107] There is no reason why a compromise "between a company and its creditors" cannot encompass the rearrangement of contractual rights and obligations so as to create multilateral rights and obligations. The definition of compromise certainly does not exclude that possibility.

[108] In *Te Runanga O Ngai Tahu v Glenharrow Holdings Ltd* the issue before the court was whether a compromise between a company and its creditors could involve contractual relations with a party external to the debtor/creditor relationship.[33] The compromise involved the debts of unsecured creditors being sold by assignment to a third party for five cents in the dollar. If Bank of Tokyo's argument were correct, such an arrangement would fall outside the definition of compromise for the purposes of Part 14. Chisholm J said of this proposal:[34]

> It is not uncommon for third parties to be involved in compromises between a company and its creditors under Part XIV. Often the involvement of the third party is a crucial factor, as it was here, to the implementation of a compromise. I do not accept the proposition that the involvement of a third party takes the compromise outside the definition in s 227 or that on a proper analysis of the arrangement in this case the defendant was not a party to it. In my view the compromise in this case needs to be construed as a whole and when such approach is taken it is clearly within the ambit of the definition.

[109] In the case of Solid Energy the others involved in the syndicated facility are not external third parties as was the case in *Te Runanga*, but rather members of the same voting class. The point made in *Te Runanga* nevertheless applies with equal force.

[110] Another point made by Bank of Tokyo is in respect of obligations and potential liabilities imposed on Bank of Tokyo by the syndicated bank facility. It says that when the Act is read as a whole it is evident that the Act consistently recognises that liabilities should not be imposed without consent of the person who would bear the liability unless the court orders otherwise (citing ss 50, 84 and 101). Even where the court is empowered to impose new or increased liabilities on persons, express words are required (referring to ss 237 and 239A(b) of the Act). The Act also makes a clear distinction in many places between rights and liabilities.

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33 *Te Runanga O Ngai Tahu v Glenharrow Holdings Ltd* HC Christchurch CIV-2005-409-15, 12 August 2005.
34 At [14].

There is nothing in Part 14 that supports a reading of it as enabling the imposition of liabilities upon Bank of Tokyo without its consent.

[111] Under the syndicated facility agreement which came into effect pursuant to the debt rescheduling compromise, Bank of Tokyo says it is exposed to liabilities to which it did not consent. It is now obliged to indemnify the facility agent in certain circumstances. It has liabilities to other lenders in the syndicate under the sharing provisions of the facility documentation.

[112] The indemnity arises under cl 29.9 of the syndicated facility agreement which provides that each lender will indemnify the facility agent against cost, loss or liability incurred by the facility agent in acting as such. Since the facility agent is enabled to act in relation to a direction from the majority of the lenders in connection with an insolvent or near insolvent mining company, Bank of Tokyo says this may expose the facility agent to very real risks. For example, it is possible that the facility agent, acting on the instructions of the majority of lenders, could conduct its affairs in relation to Solid Energy in a manner which resulted in it incurring liability in respect of Solid Energy's operations. It might appoint a voluntary administrator in respect of Solid Energy, exposing members to environmental liabilities or it could put the company into liquidation exposing it to possible actions by Solid Energy's shareholders or other disaffected creditors. Bank of Tokyo says therefore that the indemnity obligations are not merely theoretical, and could be onerous.

[113] The facility agreement also provides for a proportionate sharing regime, so that if any lender receives or recovers all or any part of any amount due to it, the lender has an obligation to disgorge that money to the facility agent so that it may be applied proportionately amongst the other lenders. While acknowledging that this is a standard feature of syndicated facility agreements, Bank of Tokyo says that the point remains that this is a new liability which it did not have prior to the debt rescheduling compromise.

[114] I deal first with Bank of Tokyo's argument that the scheme of the Act makes clear that consent or express statutory authority is required for the imposition of the liability. That is true and it is also true that the Act makes consent central to a Part

14 compromise. It is the consent of a special majority specified in cl 5(2) of sch 5. Therefore a compromise under Part 14 may involve the imposition of liabilities upon a creditor, although the extent and nature of those liabilities may well be relevant to an allegation of unfair prejudice.

[115] Further, Bank of Tokyo complains of the proportionate sharing regime. This simply prevents any bank receiving a preferential payment. And as Bank of Tokyo concedes, this is a market standard clause. Such a clause was included in the syndicated facility documents that Bank of Tokyo had agreed in 2012, but which were not ultimately committed to by Solid Energy.

[116] I also consider that Bank of Tokyo overstates the significance of the indemnity obligation imposed upon it by the facility agreement. The indemnity included is a standard provision. Again a similar provision was included in the 2012 syndicate facility documentation. The indemnity for costs relates to costs that the agent incurs through acting on behalf of Bank of Tokyo and the other syndicate banks. It only applies if the costs are not recoverable from Solid Energy. As the interested parties submit, in that sense it relates to liabilities that would otherwise be Bank of Tokyo's and so arguably creates no additional exposure or burden.

[117] I also accept the interested parties' submission that the examples Bank of Tokyo gives of potential exposure under health and safety legislation are unrealistic. The syndicate manager has no power to appoint a liquidator or voluntary administrator. Any such appointment would be a court appointment. Bank of Tokyo would be under no obligation under the contractual indemnity, or under the general law, to indemnify such an appointee unless it chose to offer such an indemnity.

Was the debt for equity compromise invalid because it was addressed to balance sheet rather than cash flow solvency?

[118] The final point that Bank of Tokyo makes in connection with this cause of action is that Part 14 is not appropriate where the concern being addressed is balance sheet rather than cash flow solvency. A debt for equity exchange in order to improve Solid Energy's balance sheet liquidity is not a permissible compromise under Part 14.

[119] Bank of Tokyo submits that the key objective of the debt exchange compromise was to achieve optimal gearing for Solid Energy and to deal with medium term profitability and shareholder returns, rather than immediate liquidity/cash flow solvency issues. Such a proposal should have been made, if at all, under Part 15. That Part does not have a cash flow solvency prerequisite, but it does provide for judicial scrutiny of the proposal according to the standard of whether an intelligent and honest business person, a member of the class concerned and acting in respect of that interest, might reasonably approve, and the further standard of whether the proposal is fair and equitable.[35]

[120] Although the threshold for Part 14 is expressed in terms of cash flow solvency, it is not in dispute that threshold was met here. In the proposal the Board made the following statement:

> Unless Solid Energy restructured its financial indebtedness, a key aspect of which is the "Debt Exchange Compromise", the Board is of the view that the company will become unable to pay its debts, and therefore will be unable to continue trading.

[121] I accept Solid Energy and the interested parties' argument that the distinction Bank of Tokyo seeks to draw between balance sheet liquidity and cash flow liquidity is an artificial and uncommercial distinction. When cash flow issues are addressed, this will usually assist the balance sheet. And the reverse is also true.

[122] Mr Farmer QC for Bank of Tokyo submits that in reality a balance sheet crisis did not exist. The Crown was simply using its negotiating position to gain capital for Solid Energy, tagged on to the debt restructuring. He refers to the information from KordaMentha which showed an improved equity position from that which had been thought to apply when the Banks initially engaged with Treasury in connection with a proposed restructuring.

[123] It is true that by the time the proposal was taking detailed shape, it seemed that Solid Energy had positive equity. However, as Mr Ford explained in his letter to Treasury of 19 August, that was based on the KordaMentha business plan, and

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35 *In re C M Banks Ltd* [1944] NZLR 248 (SC); *Re Milne & Choyce Ltd* [1953] NZLR 724 (SC); *Weatherston v Waltus Property Investments Ltd* [2001] 2 NZLR 103 (CA).

although KordaMentha applied conservative prices in constructing this, prices were at the time of the letter below the modelled prices. Moreover, while results were modelled to improve, they were expected to show further losses of more than $100 million for Solid Energy over the next three years. That included financing charges of $32 million if the current debt equity balance was not adjusted. Mr Ford said:

> An equity injection of $100 million would result in gearing levels remaining high relative to peers [in] the volatile market environment, but will provide the business with the necessary latitude within which it can continue to work with its lenders and shareholder in order to return towards a sustainable long term business model.

[124] In his affidavit Mr Patterson says that at the Solid Energy board meeting on 25 September 2013, the update from management as to projected working capital balances indicated that from mid November 2013 until at least the second quarter of 2014, Solid Energy would have negative working capital. That projection did not factor in the withdrawal of the ANZ $10 million overdraft facility, which ceased to be available from 1 October, nor the exposure to the Banks of around $360 million, which could, at the end of the standstill arrangement, become due. It was against that background that the directors formed the view that they needed an injection of $100 million working capital.

[125] Mr Patterson explains that the directors saw the two types of solvency as inextricably linked. He said of the 30 September 2013 deadline for the company directors:

> The terms of the State-Owned Enterprises Act 1986 require the company to deliver audited financial statements for the financial year ending 30 June 2013 by that date. In order for the financial statements to be finalised on a going concern basis, the board needed to be able to form the view that over at least the succeeding 12 months, all things being equal, the company would have adequate cashflows and would not breach covenants which would render term debt current or cause credit lines to be withdrawn.

[126] I am satisfied therefore that this was not a recapitalisation of a healthy company, undertaken purely for the shareholder's benefit and at the Banks' (and TSB's) expense. It was necessary for Solid Energy to address both the issue of its undercapitalisation and the term of its debt in order to secure sufficient cash flow into the short and medium term to be able to pay its creditors. These two

compromises, although voted on separately, were conditional upon each other because they needed to operate together to address the solvency of Solid Energy into the medium term.

E. Third cause of action: inadequate or improper definition of classes of creditors and defective service

Were the notice requirements complied with?

[127] In the third cause of action Bank of Tokyo seeks relief under s 232(3)(a) and (b) of the Act which provide:

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

[128] It relies first on s 232(3)(a) and says that not all creditors were served with notice of the proposed compromises as required by the Act.

[129] Section 229 provides in material part:

> (1) The proponent must compile, in relation to each class of creditors of the company, a list of creditors known to the proponent who would be affected by the proposed compromise, setting out—
>
> (a) The amount owing or estimated to be owing to each of them; and
>
> (b) The number of votes which each of them is entitled to cast on a resolution approving the compromise.
>
> (2) The proponent must give to each known creditor, the company, any receiver or liquidator, and deliver to the Registrar for registration,—

(a) Notice in accordance with Schedule 5 to this Act of the intention to hold a meeting of creditors, or any 2 or more classes of creditors, for the purpose of voting on the resolution; and

(b) A statement—

(i) Containing the name and address of the proponent and the capacity in which the proponent is acting; and

(ii) Containing the address and telephone number to which inquiries may be directed during normal business hours; and

(iii) Setting out the terms of the proposed compromise and the reasons for it; and

(iv) Setting out the reasonably foreseeable consequences for creditors of the company of the compromise being approved; and

(v) Setting out the extent of any interest of a director in the proposed compromise; and

(vi) Explaining that the proposed compromise and any amendment to it proposed at a meeting of creditors or any classes of creditors will be binding on all creditors, or on all creditors of that class, if approved in accordance with section 230 of this Act; and

(vii) Containing details of any procedure proposed as part of the proposed compromise for varying the compromise following its approval; and

(c) A copy of the list or lists of creditors referred to in subsection (1) of this section.

[130] Section 229(2) appears to provide that all known creditors of Solid Energy must be notified of a proposed compromise. This did not happen. Only those creditors who were to be asked to vote on the compromises received notice of them. Bank of Tokyo acknowledges that there is an argument that s 229(2) should be read down such that notice is only required to be given to "affected creditors." However it argues that the provisions of s 229(1) and (2) can and should be read to provide that although only affected creditors are entitled to vote, all creditors should be given notice. The provision of notice to the widest possible pool of creditors enables creditors to argue for an entitlement to vote and thereby ensures that those who are affected obtain the right to vote. For that reason, the requirement to give notice to

each known creditor must be interpreted to mean that notice must be given to all creditors of the company who are known to the proponent, not just affected creditors.

[131] Having had regard to the two imperatives of statutory interpretation[36] I am satisfied that the only sensible reading of s 229 is that the expression "creditor" in s 229(2) should be read down in light of s 229(1), so that it is only known creditors who are "affected" by the proposed compromises who are entitled to notice. Although "known creditors" is an expression clearly capable of bearing the meaning "all known creditors", I attach significance to the fact that this expression follows on from the discussion of the compilation of a list of creditors in s 229(1). That subsection provides that the proponent must compile a list of creditors "known to the proponent who would be affected by the proposed compromise". An available reading of "known creditors" is therefore that it is used as a shorthand expression for the sub-group of creditors earlier referred to in s 229(1).

[132] I am strengthened in my view that this is the appropriate interpretation by the fact that were Bank of Tokyo's interpretation adopted, creditors who would not be affected by the proposal, and who would therefore not be entitled to vote on it, would receive extensive legal documentation. To take the Solid Energy example, all creditors (including trade creditors and employees) would have received copies of the documents necessary to effect the compromise, including the syndicated bank facility documentation. To make sense of this complex and extensive legal documentation, many would need to seek legal advice – wasted expenditure for those not affected.

[133] As the interested parties submit, this would not only be unduly burdensome, it would also probably cause confusion. Receipt of notice might result in people attending meetings who will have no right to vote or, worse still, voting at the meeting, leading to further procedural irregularities of the type discussed in *Commissioner of Inland Revenue v Atlas Food and Beverage Ltd*.[37]

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36 A provision is to be interpreted in light of its text and its purpose: Interpretation Act, s 5(1).
37 *Commissioner of Inland Revenue v Atlas Food and Beverage Ltd* (2010) 24 NZTC 24,096 (HC).

[134] It is also of significance that s 230 provides that the compromise, once approved, is binding on all creditors to whom notice of the proposal was given under s 229. If the notice was served more extensively than those entitled to vote, it would follow that the compromise would be binding on creditors who had no right to vote in respect of it. This would be a perverse outcome.

[135] Further support for this interpretation comes from the fifth schedule to the Act which provides that notice of the Part 14 meeting "must be sent to every creditor entitled to attend the meeting, and to any liquidator not less than 5 working days before the meeting".[38] This, a provision enacted at the same time as the rest of the Act, is consistent with the interpretation I have set out above.[39]

[136] I also note that if the interpretation I have described is adopted, it creates a scheme similar to that in comparable jurisdictions. For example, in *Re British & Commonwealth Holdings plc (No 3)*, a case decided under s 425 of the Companies Act 1985 (UK), it was held that where a creditor has no right to vote at the scheme, they were not entitled to receive notice of the scheme.[40]

[137] As to who is an affected creditor, Bank of Tokyo suggests that a creditor is affected if there is *any* economic impact upon its rights, whether the impact is positive or adverse. If this test is applied, there would have been a deficiency in service as all creditors would be affected by the conversion of debt to equity, since the compromises improves Solid Energy's balance sheet and thereby enhances prospects of repayment.

[138] There is some apparent support for Bank of Tokyo's view in the comments of Mann J in *Re Bluebrook Ltd* who said that only those whose rights or economic interests are affected by the compromise are entitled to notice.[41] However, this statement begs the question of what "affected" means in context. In that case the particular point (of whether a creditor whose economic interests are only positively

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38 Companies Act, sch 5, cl 2(1).

39 In *Earthquake Commission*, above n 12, at [28], the Court noted that regulations may "be a reliable guide to the meaning of an Act where 'the Act provides a framework built on by contemporaneously prepared regulations" (citations omitted). This point applies with even greater strength in the context of a contemporaneously enacted schedule.

40 *Re British & Commonwealth Holdings plc (No 3)* [1992] 1 WLR 672 (Ch) at 682.

41 *Re Bluebrook Ltd*, above n 32.

affected is entitled to notice) was not at issue. I am satisfied that, as a matter of statutory interpretation it is not enough that the creditor receives the benefit of an improved balance sheet or the company's improved liquidity as achieved by the compromise. If the definition of "affected" were set so wide, all creditors would again be entitled to notice, with the same deleterious results as outlined above. Unless they are to be allowed to vote, there would seem to be no purpose to them receiving notice, and the utility of creditors who only benefit from the compromise having a right to vote on it must be doubted.

[139] The interested parties suggested that the definition of "affected" creditor be limited to those whose legal rights are affected, but that would be too narrow a definition. A creditor's prospects of repayment may be substantially adversely affected without any alteration to its legal rights. For these reasons the definition of "affected" must encompass adverse affects to both legal rights and economic interests. I am therefore satisfied that for the purposes of Part 14, "affected" creditor is to be read to mean a creditor whose legal rights or economic interests would be adversely affected by the proposed compromise.

[140] In this case it seems that the only creditors who are adversely affected by the compromise were the banks, and they of course received notice.

[141] In any case, even were Bank of Tokyo correct, cl 2(3) of sch 5 is a rather large stumbling block in its way:

> An irregularity in or a failure to receive a notice of meeting of creditors does not invalidate anything done by a meeting of creditors if –
>
> (a) The irregularity of failure is not material; or
>
> (b) All the creditors entitled to attend and vote at the meeting attend the meeting without protest as to the irregularity or failure; or
>
> (c) All such creditors agree to waive the irregularity or failure.

Bank of Tokyo does not argue that it, or indeed any creditor, has been prejudiced by this alleged deficiency in the giving of notice.

Invalid selection of classes of creditors

[142] Bank of Tokyo also submits that the selection of the voting classes under each of the proposals – which differed as between each proposal – was made in an unprincipled way, with a view to ensuring that Bank of Tokyo would be outvoted in each case. It argues that this gives rise to a material irregularity for the purposes of s 232(3)(b).

[143] Bank of Tokyo makes the following points. In respect of the debt exchange compromise the major banks were included, but only for their term loan indebtedness (excluding the operating leases, derivative and performance bond exposure of ANZ, CBA and Westpac). TSB's indebtedness under the notes was included, but not that of any other noteholders. The inclusion of TSB's indebtedness diluted the effect of Bank of Tokyo's voting against the proposal so that it lost what would have otherwise been a blocking vote.

[144] In relation to the debt rescheduling compromise, the contingent indebtedness of ANZ, CBA and Westpac under performance bonds was included at full voting value. The inclusion of the performance bond indebtedness again prevented Bank of Tokyo blocking the proposal.

[145] Bank of Tokyo submits that the case law supports its argument that the contingent liabilities under the performance bonds should have voted in a separate class in relation to the debt rescheduling compromise, or at least that the Chairman of the meeting should have discounted the votes attached to that debt. Neither of those things happened. It says different classes were appropriate because, whereas holders of term debt have an immediate interest in receiving repayment of the term debt owing to them at that time, holders of contingent debt have different interests. Their interest lies in ensuring that the debtor is able to satisfy the underlying obligation in respect of which the performance bond has been issued and, in doing so, ensuring that the contingent obligation never arises. Accordingly the interests of those banks who also have exposure to Solid Energy under performance bonds differ from those of the Banks holding only term debt, and differ in such a manner as to make it impossible for them to consult together with a view to their common interest.

[146] Bank of Tokyo anticipates the argument that no separate class or discount was justified on the basis that there is no conceptual difference between the term debt and the contingent debt. It says that if this is correct it follows that there was no justification for having excluded the contingent debt from the debt exchange compromise.

[147] Bank of Tokyo further argues that the banks who provided operating leases (ANZ and CBA) should also have voted in a separate class, as those banks are secured creditors to the extent that they have recourse to the asset the subject of the particular operating lease. Again, Bank of Tokyo's share of the term loan debt would be sufficient to provide it with a blocking stake in the passing of a compromise, had ANZ and CBA not been in Bank of Tokyo's class.

[148] Finally, Bank of Tokyo complains of the failure to include a number of Solid Energy's creditors in either compromise, and in particular the minority noteholders, company B, the agencies to whom Solid Energy has rehabilitation liabilities, Kiwi Rail in respect of Solid Energy's Cobden Bridge finance lease exposure, and all trade and general creditors. It also complains of the failure to include TSB in the debt rescheduling compromise.

[149] Bank of Tokyo says that as a result of these irregularities in obtaining approval of the compromises, the compromises should either be considered invalid, or Bank of Tokyo should be entitled to apply for relief under s 232(3) of the Act in relation to a material irregularity.

Relevant principles

[150] Section 229(1) of the Act requires the proponent of a compromise to compile in relation to each "class of" creditors, a list of those who would be affected by the proposed compromise. There is no statutory definition of what a class is, nor statutory criteria to be applied in selecting a class. However a substantial body of case law has developed in New Zealand and other jurisdictions in connection with how a class is to be selected, and the obligations of the debtor company in that regard. The relevant principles that emerge from these cases are not in dispute.

[151] A company is free to select the creditors and debts it wishes to compromise. A company does not have to compromise all of its debts nor all of its debts within a class.[42] Nevertheless different treatment of creditors, including the exclusion of creditors from the compromise, may well be a relevant factor when the court comes to consider whether the creditor has been unfairly prejudiced for the purposes of s 232(3)(c).

[152] The test as to what constitutes a class of creditors can be traced through a line of English and appellate level decisions in other jurisdictions, adopted into New Zealand law at least by this Court.[43] The starting point is the classic formulation of Bowen LJ in *Sovereign Life Assurance Company (in liq) v Dodd*.[44] The issue in that case was whether the defendant, the holder of a policy of insurance which had already matured, was bound by a scheme of arrangement between the company which had issued the policy and its policy holders. The scheme provided that policies written by the company, which was in liquidation, should be replaced with policies issued by another life assurance company on less generous terms. The effect of the scheme was that each policy holder was bound to accept reduced payments from the new company in full satisfaction of claims against the old company. A single meeting of policy holders was held, grouping together those whose policies were ongoing with those whose policies had matured.

[153] The majority found that a separate meeting should have been held for those whose policies had matured. Bowen LJ said:[45]

> What is the proper construction of that statute? It makes the majority of the 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 to not 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. If we are to construe the section as it is suggested on behalf of the plaintiffs it ought to be construed, we should be holding that a class of policy-holders whose interests are uncertain may by a mere majority in value override the interests of those

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42 *Re Bluebrook Ltd*, above n 32, at [24]; *Sea Assets Ltd v Perusahaan Perseroan (Persero) PT Perusahaan Penerbangan Garuda Indonesia* (2001) EWCA Civ 1696 (CA) at [22]-[24] and [33]-[51] per Peter Gibson LJ and at [66] per Laws LJ.

43 *Atlas Food and Beverage Ltd*, above n 37, at [27] and [28].

44 *Sovereign Life Assurance Co (in liq) v Dodd* [1892] 2 QB 573 (CA).

45 At 582-583.

who have nothing to do with futurity, and whose rights have already been ascertained. … It seems plain that we must give such a meaning to the term “class” as will prevent the section being so worked as to result in confiscation and injustice, *and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest*.

(emphasis added)

[154] In *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin*, Millett LJ noted the use in *Sovereign* and in subsequent cases of the word “interest”, and said:[46]

> But it is important not to be distracted by mere terminology. Judges frequently use imprecise language when precision is not material to the question to be decided, and in many contexts the words "interests" and "rights" are interchangeable.

He suggested the following formulation:[47]

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

[155] In explaining the decision in *Sovereign* Millett LJ observed that the defendant in that case was in a different position from the holders of continuing policies because he suffered an additional variation of rights not suffered by the others, in as much as his rights under a policy which had already matured were being replaced by the rights he would have had on death had his policy not matured. His Lordship said:[48]

> The question is whether the rights which are to be released or varied under the Scheme or the new rights which the Scheme gives in their place are so different the Scheme must be treated as a compromise or arrangement with more than one class.

[156] The Judge discussed the point that on this formulation of the principle some creditors may have private interests of their own which will inform their vote but who would still vote in the same class. He asked the question:[49]

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46 *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* [2001] 3 HKLRD 634 (HKCFA) at [22].

47 At [17].

48 At [27(4)].

49 At [26].

> Why, it may be asked, should persons with divergent interests be allowed to vote as members of the same class for the purpose of ascertaining whether the Scheme has been approved by the necessary 75% majority, if their votes are only to be discounted or disregarded by the Court when considering whether to sanction it? There seem to be three reasons. The first is the impracticality in many cases of constituting classes based on similarity of interest as distinct from similarity of rights. … A second is that the risk of empowering the majority to oppress the minority to which Bowen LJ referred in *Sovereign Life Assurance Company (in liquidation) v Dodd* is not the only danger. It must be balanced against the opposite risk of enabling a small minority to thwart the wishes of the majority. Fragmenting creditors into different classes gives each class the power to veto the Scheme and would deprive a beneficent procedure of much of its value. The former danger is averted by requiring those whose rights are so dissimilar that they cannot consult together with a view to their common interest to have their own separate meeting; the latter by requiring those whose rights are sufficiently similar that they can properly consult together to do so. The third reason is that this is mandated by the rationale which underlies the calling of separate meetings. A company can be regarded as entering into separate but linked arrangements with groups whose members have different rights or who are to receive different treatment. It cannot sensibly be regarded as entering into a separate arrangement with every person or group of persons with his or their own private motives or extraneous interests to consider.
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> (citations omitted)

[157] The various criticisms made by Bank of Tokyo fall into two categories. Criticisms that a creditor was included in a class and criticisms that creditors were excluded from the compromises.

Inclusion of certain creditors in a class

[158] The criticism in relation to the contingent creditors includes criticism of the inclusion of the banks which had performance bond exposure in the same class as other banks for the purposes of voting. Having included them in the same class, Solid Energy is also said to have got it wrong in attributing the full value for the purposes of voting to the performance bond portion of each bank's credit exposure.

[159] Bank of Tokyo relies upon two decisions as authority for its argument: *Atlas Food & Beverage Ltd*[50] and *Re Audax Developments Ltd (in rec)*.[51]

[160] In *Atlas Food & Beverage Ltd* Panckhurst J said:[52]

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[50] *Atlas Food & Beverage Ltd*, above n 37.

[51] *Re Audax Developments Ltd (in rec)* (1990) 5 NZCLC 66,798 (HC).

> Where a debt is contingent that fact should be revealed and the contingent creditor may need to be placed in a separate class, or at least their vote may need to be discounted to recognise the reality of the situation. ... The rationale for these requirements is the need to ensure that a class of creditors is bound by a community of interest …

Panckhurst J cited as authority for this approach the decision of Thomas J in *Re Audax.* In *Re Audax*, Thomas J held that a contingent creditor should not have been allowed to vote along with both secured and unsecured creditors in relation to a proposed compromise. He said:[53]

> I agree that a contingent creditor is in a different class from other unsecured creditors. If he or she is permitted to vote, the vote will or could be distorted as their debt may never become due and owing so as to place it on the same footing as other unsecured debts.

[161] I do not consider that it follows from these authorities that because some banks had only a contingent claim arising under the performance bonds, the banks with performance bond exposure should have been in a separate class. As Chadwick LJ said in *Re Hawk*:[54]

> … it will not necessarily follow, in every case, that the treatment under the scheme of vested and contingent rights, or the rights under matured and current policies, will be so dissimilar that the holders of those rights must be regarded as persons in different classes in the context of the question 'with whom is the compromise or arrangement made'. In each case the answer to that question will depend upon analysis (i) of the rights which are to be released or varied under the scheme and (ii) of the new rights (if any) which the scheme gives, by way of compromise or arrangement, to those whose rights are to be released or varied.

[162] The term debt and performance bond facilities were undoubtedly different in nature. Under the performance bond facilities the banks carry the risk that the contingency represents, that at some time the bank will be called upon to pay for Solid Energy's "make good" obligations. But, if the contingency crystallises, the banks will be left with an unsecured claim against Solid Energy in respect of the amount paid. This is the same sort of claim as the banks have in respect of the term debt. There is also similarity in the impact the debt rescheduling compromise has upon the performance bond and term debt creditors. Both sets of creditors are called

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52 At [45].
53 At 66,803.
54 *Re Hawk Insurance Co Ltd* [2001] EWCA CIV 241, [2002] BCC 30 at [30].

upon to extend the date upon which their facilities mature, thereby extending the time that their funds remained at risk. The rights they give up, and those they receive in return, are in this sense similar. Moreover, if the compromise did not proceed, each faced an equally bleak prospect of recovering from the company in liquidation. I am satisfied therefore that the rights against Solid Energy and the way in which those rights were affected by the debt rescheduling compromise were sufficiently similar that these creditors could consult together on the proposed compromise with a view to their common interest.

[163] Nor do I consider that it was inevitable, because they were contingent creditors, that a substantial discount should have been applied to their vote. The value of the contingency must be assessed before such a determination can be made. There are many different types of contingent creditors. Some creditors' claims against a company may be contingent upon events occurring which are unlikely, or the likelihood of which cannot be predicted or is very difficult to predict. It may be simple in the case of some contingent creditors to assess what the quantum of the claim will be if the contingency crystallises, whilst in the case of other contingent creditors, quantification may be difficult if not impossible.

[164] Here, the evidence is that if Solid Energy had gone into liquidation, the contingencies would have crystallised for the performance bond holders, because the "make good" obligations which the performance bonds secure would have been called upon. Since the make good obligations far exceeded the face value of the performance bonds, that was the amount the banks would almost certainly have been called upon to pay, which is in turn the amount that the banks would then have claimed against Solid Energy. Therefore the likelihood of the contingency crystallising was easily measured, as was the size of the resulting claim the contingent creditors would have.

[165] This is a very different case to *Atlas*. In that case, the Judge considered that the contingency needed proper evaluation but that evaluation had not been undertaken. It is difficult to determine what the precise concern with the contingency in *Audax* was, as the judgment does not include detail as to the nature of the contingency.

[166] The Act provides a model for valuation of contingent creditors' claims. For the purposes of Part 14, s 227 defines creditors to include:

> A person who, in liquidation, would be entitled to claim in accordance with section 303 of this Act that a debt is owing to that person by the company...

[167] Section 303 states that contingent debts may be admitted as a claim against the company in liquidation. Section 307 provides:

> (1) If a claim is subject to a contingency, or is for damages, or, if for some other reason, the amount of the claim is not certain, the liquidator may—
>
> (a) Make an estimate of the amount of the claim; or
>
> (b) Refer the matter to the Court for a decision on the amount of the claim.

[168] In this case, in circumstances where Solid Energy was known to be insolvent and would probably be placed in liquidation if the compromises were not adopted, it was reasonable to value the contingency at 100 per cent or close to 100 per cent of face value. A significant reduction in valuation was not justified. As counsel for the interested party banks submitted, the Chair would have had to reduce the voting power of the performance bond holders to one-third of their face value for Bank of Tokyo to obtain a blocking vote. Bank of Tokyo did not offer any evidence or argument to support a reduced valuation, other than the mere assertion that these were contingent liabilities and should not therefore have voted at full value.

[169] Bank of Tokyo further submits that the banks who also provided operating leases (ANZ and CBA) should have voted in a separate class as they are secured to the extent they have recourse to the asset the subject of the particular operating lease. Again, Bank of Tokyo says, it would have had a blocking vote had ANZ and CBA not been in Bank of Tokyo's class.

[170] The debt rescheduling compromise does not reschedule the term of any operating lease but does reschedule unsecured shortfall that may arise under the operating leases. ANZ and CBA are therefore included only in respect of the unsecured portions of the debt. I accept the interested parties' submission that for this reason the security the banks hold was irrelevant to the class analysis. There

could have been arguments as to the value those contingencies were included at, but ANZ and CBA did not exercise any vote in respect of those shortfalls.

Exclusion of some creditors

[171] Turning to the issue raised by Bank of Tokyo that some creditors were improperly excluded from the compromises, it also follows from the principles identified above that Solid Energy was free to compromise with whichever creditors it chose. It could compromise with some creditors of a class, but not all.

[172] In this case the proposal was made up of two separate compromises, although they were conditional on each other. The two compromises needed to be kept separate because they each dealt very differently with the rights and interests of creditors.[55] For each of these compromises, Solid Energy was free to choose which creditors it compromised with. Accordingly, the criticisms in relation to the exclusion of creditors from the compromises, or one or other of them, are not criticisms that can be brought on the basis of incorrect class composition. Whether they can found an accusation of abuse or unfair prejudice is another matter that arises under the fourth cause of action.

[173] Nevertheless, there are some particular points arising on the evidence in relation to the exclusion of creditors that should be addressed. The first, that the compromise proposals Solid Energy put forward were procedurally deficient because they only dealt with its bank creditors. There were however sound reasons behind Solid Energy's proposals to compromise only with its bank creditors. The banks were Solid Energy's largest creditors, and were the creditors with the most to lose in an insolvency. They had economic interests that were easily aligned, one with the other. They were sophisticated when it came to dealing with issues such as corporate restructuring and could move with the speed required in this case. For Solid Energy, it was both necessary and desirable to involve these creditors in the design of the restructuring and to reach some sort of compromise with them. If the compromises proposed were agreed to, that provided the conditions the board of Solid Energy needed to continue to trade. For that reason the proposed compromises were

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[55] *Re Hawk*, above n 54, at [15].

designed to deal with the banks and not other creditors, such as trade creditors and employees.

[174] Bank of Tokyo complains that TSB, a bank, was not included in the debt rescheduling compromise. Since the notes did not expire until after the 2016 date the term debt was extended to, there was no need to reschedule the notes.

[175] Bank of Tokyo further argues that performance bond holders should have been included in the debt exchange compromise. It says that if their rights in respect of performance bonds were similar enough to those in respect of the term debts, it follows they should have been included. I have found the logic of this proposition difficult to follow. In any case Solid Energy and the interested party banks say that the performance bonds were not included in the debt exchange compromise because the only way that Solid Energy needed to deal with the performance bond holders was to close out the risk that they would terminate those performance bonds, which would precipitate a liquidation. Mr Sare, Head of Strategic Business Services at BNZ explains that the interested party banks did not think the performance bond holders should be included in the debt exchange, as if Solid Energy survived, it was felt they should not have shares to represent a contingency which may never arise. This is the same reason ANZ and CBA were not included in the debt exchange compromise for the shortfall on the operating leases and derivatives.

[176] For Bank of Tokyo Mr Farmer submits that it would have been fairer if performance bond holders had been required to contribute cash for redeemable preference shares, calculated on the basis of some mathematical model which the banks could arrive at. He says that the creation of "synthetic" products such as this is well within the competence of banks to design. I return to this issue later in relation to the fourth cause of action. For the purposes of this cause of action, the fundamental flaw with the argument is that it was for Solid Energy to decide which creditors it compromised with. Although the compromises may have been differently constructed, it was for Solid Energy to decide which parties it included in the debt exchange compromise, and how the compromise that was offered was structured, while it was for the voting creditors to decide if they wished to accept the proposal.

[177] The final point made by Bank of Tokyo in respect of the debt exchange compromise is in relation to the inclusion of TSB, but the exclusion of the other noteholders. It says, had all of the noteholders been selected to participate in the debt exchange compromise and voted against it, it would not have been able to be approved by the 75 per cent majority.

[178] It is clear that TSB was, like the other creditors in the debt exchange, both a bank and a creditor with a large unsecured claim. The economic impact upon it of the compromise was likely to be the same as upon the other banks included. It was, as I think Bank of Tokyo accepts, properly included in the class of creditors voting on the compromise.

[179] As to the exclusion of the minority noteholders, Mr Sare says that when the interested party banks saw a copy of the legal register of noteholders, they discovered that a number of noteholders were nominees with the result that the interested party banks were unable to ascertain their beneficial interest in the notes. Including all the noteholders in the debt exchange compromise would also have added significant cost and delay, as the interested party banks thought the offer of redeemable preference shares to noteholders may have been considered an offer to the public, thus requiring a prospectus. The notes were widely held, and the next biggest holding of notes after TSB was only $5 million. Finally, I note that there is of course no evidence that all of the other noteholders would have voted against the debt exchange compromise if they had been included in it.

F. Fourth cause of action: is the compromise unfairly prejudicial?

[180] In the fourth cause of action Bank of Tokyo again asks the Court to exercise its discretion under s 232(3) of the Act to order that it is not bound by the compromises, this time on the basis that the compromises are unfairly prejudicial to it.

Relevant principles

[181] The relevant principles are not in dispute. In determining the meaning of "unfairly prejudicial", it is again helpful to start with the history of the relevant

provision. In discussing the equivalent provision in the draft Bill attached to the Law Commission report, the Commission said:[56]

> … the role of the Court is quite different from that under section 205 of the 1955 Act. The fate of the compromise should rest with the voting creditors unless the information supplied or procedures followed are irregular. The "unfairly prejudicial" limb … provides a residual power which will be available to prevent abuse of the new procedure.

Under the previous s 205 test, the Court assessed whether an intelligent and honest business person, being a member of the class concerned and acting in respect of that interest, might reasonably approve of the scheme.[57] That test continues in existence as part of the test for whether the Court will approve a compromise under s 236 in Part 15, absent the required consent.[58]

[182] The scheme and purpose of Part 14 makes clear that this test does not apply to s 232(3). The substantive merits of a proposed compromise is an issue for the creditors. As is apparent from the Law Commission report, the unfairly prejudicial limb was intended to provide a residual power to the Court, to prevent abuse of the procedure. 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 the required majorities in favour of the proposal.[59]

[183] The Law Commission suggested that there would be unfair prejudice where there had been an abuse of the process. That seems too narrow a formulation. It is however clearly not enough for a creditor to show that they oppose the proposal, or that the creditor is prejudiced by that proposal. It is after all in the nature of a creditor compromise that it prejudices the interests of creditors in some regard. Chisholm J commented on the significance of a creditor's dissent in *Te Runanga*:[60]

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[56] Law Commission, above n 16, at 149.
[57] *In re C M Banks*, above n 35, at 253.
[58] See *Weatherston*, above n 35, at 113, where the Court of Appeal stated that the test of whether the intelligent, honest business person would approve of the scheme should be supplemented by consideration of whether the arrangement was fair and equitable.
[59] *Morris Contractors Ltd (in rec) v Matai Mining Ltd* HC Christchurch CIV-2010-409-724, 7 September 2011.
[60] *Te Runanga*, above n 33, at [26].

> It is, of course, inherent in the statutory scheme under Part XIV of the Act that provided the necessary majority vote in favour of the proposal the minority will have to yield to the wish of the majority.

[184] Counsel were in agreement that a useful test for whether there has been unfair prejudice is that suggested in *Re Portsmouth City Football Club Ltd*,[61] which in turn relies upon a discussion of the issue in *Mourant & Co Trustees Ltd v Sixty UK Ltd (in admin)*[62] In those cases it was commented that in considering the question of whether unfair prejudice is caused by a voluntary arrangement, it is relevant to consider both "vertical" comparisons (impact of compromise on the applicant creditor) and "horizontal" comparisons (comparison between creditors).

[185] A vertical comparison is a comparison between the position that a creditor would occupy and the benefits it would enjoy in a hypothetical liquidation, as compared with its position under the compromise. It has been suggested that this analysis identifies the irreducible minimum below which the return in the voluntary arrangement cannot go.[63] A horizontal comparison is a comparison between the position of other creditors or classes of creditors and the applicant creditor. As to this, it is not necessarily unfair that one creditor or class of creditor should be paid in full, when others are not, although the fact they are dealt with differently may call for scrutiny. In *Mourant & Co Trustees Ltd* Henderson J said: [64]

> In considering the question of differential treatment, it is necessary to ask whether the imbalance in treatment is disproportionate, and also whether the differential treatment may be justified, for example by the need to secure the continuation of the company's business by paying essential suppliers or service providers.

Analysis

[186] Although not an argument advanced under this cause of action, the argument that Bank of Tokyo made in respect of the third cause of action that the classes have been manipulated is clearly an argument that more properly relates to this cause of action. If the classes of creditor were manipulated for the purposes of the

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61 *Re Portsmouth City Football Club Ltd (in admin)* [2010] EWHC 2013, [2011] BCC 149 (Ch).
62 *Mourant & Co Trustees Ltd v Sixty UK Ltd (in admin)* [2010] EWHC 1890, [2010] BCC 882 (Ch).
63 *Re T & N Ltd* [2004] EWHC 2361, [2005] 2 BCLC 488 (Ch) at [82].
64 At [67(d)].

compromise in order to swamp Bank of Tokyo's vote, that might amount to an abuse for the purposes of s 232(3)(c).

[187] I have seen no evidence that there was such a manipulation. As set out earlier there were sound commercial and practical reasons for the inclusion of particular creditors and particular debts in the debt rescheduling and debt exchange compromises and for the exclusion of others. There is no evidence that these decisions were made with a view to ensuring that Bank of Tokyo could not veto the compromises.

[188] Another allegation of abuse is the allegation that the Crown's and the interested party banks' agreement to the proposal was in breach of the Support Deed. However I have held that there was no such breach.

[189] Bank of Tokyo directed its principal submissions under this cause of action to the horizontal and vertical analyses described above. It argues it is clearly unfairly prejudiced when the impact on it of the compromise is compared with the impact on other creditors. It says that if this horizontal analysis is applied, it is clear it was unfairly prejudiced under the debt rescheduling compromise because of the inclusion of the performance bond indebtedness of some banks and at full voting power. This is not an argument of horizontal unfairness but rather a reformulation of the voting class argument, already addressed when considering whether there has been a material irregularity. I am satisfied it has no merit.

[190] Bank of Tokyo's next point is that under the debt rescheduling compromise, a syndicated facilities agreement has been imposed where most matters concerning the Banks' relationship with Solid Energy are determined by majority voting. This has preferred their interests over those of Bank of Tokyo. It claims that Bank of Tokyo essentially no longer has any rights as the other banks are likely to act in concert with each other in the operation of a syndicated facility agreement. The other banks and the Crown have also entered into the Direct Agreement without consulting Bank of Tokyo, which shows it is likely that the other banks are acting together in concert.

[191] There is however no evidence of such a conspiracy operating against Bank of Tokyo, and in particular of a determination on the part of the other banks and the Crown to act in concert to defeat Bank of Tokyo's legitimate interests. The underlying rationale of a syndicated facility agreement is equal treatment, proportionate of course to the amount owed by each bank. The fundamental point is that Bank of Tokyo is not being treated differently to the other bank creditors. It has had its rights altered, but in the same fashion as have the other banks in the debt rescheduling compromise and alteration of rights is after all the essence of a compromise. The existence of the Direct Agreement is not evidence of the other banks acting together in concert. An offer was made to Bank of Tokyo to become a party to the Direct Agreement but it declined.

[192] Bank of Tokyo complains that some creditors were not dealt with in the compromises, particularly the debt exchange compromise. The fact that some creditors are dealt with in a compromise while others are not is not in itself evidence of unfair prejudice. If it were, then most compromises would fail as it will often if not usually be necessary for a company to deal with some creditors but not others. Some creditors may have a bargaining position that means they need not compromise their rights. Low value creditors may be too numerous to deal with in a cost effective or timely fashion. The structure of what the company needs to achieve may not require that all creditors be wrapped up in the compromise.

[193] However, unequal treatment which cannot be justified may well meet the threshold of unfair prejudice, at least if the inequality is materially significant.[65] As outlined above, here there were good reasons why Solid Energy, the interested party banks and the Crown structured the proposals as they did. I am therefore satisfied that the exclusion of non-bank creditors from the debt rescheduling and debt exchange compromises was justified and was not unfairly prejudicial to Bank of Tokyo.

[194] Bank of Tokyo further raises arguments in connection with what it says is the vertical analysis, although some of these are better categorised as relevant to the "horizontal" analysis arguments.

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65 *Mourant*, above, n 62, at [67(d)].

[195] Bank of Tokyo says it is unfairly prejudiced under the debt exchange compromise by reference to the other banks with performance bond indebtedness, who have not been required to exchange any of that indebtedness for redeemable preference shares. Solid Energy argues that performance bond indebtedness could have been included by creating some synthetic-type arrangement whereby the performance bond creditors paid in an amount for redeemable preference shares while reducing their exposure under the performance bonds.

[196] If performance bond indebtedness had been included this may have reduced the exchanged portion of Bank of Tokyo's debt. The interested party banks calculate that Bank of Tokyo's exchanged debt which totals $16.3 million might have been reduced to $14.6 million had the performance bonds been included. However, the fact that this was hypothetically a possible alternative compromise does not make it unfair that it was not implemented. This proposition is altogether too speculative to be taken into account in assessing the issue of unfair prejudice.[66] There is no evidence that this structure could have been achieved. It is also not clear what the consequential shortfall in performance bonds would have done for Solid Energy's ongoing ability to trade.

[197] Bank of Tokyo's argument that this is evidence of vertical unfairness also overlooks the fact that the assets that Bank of Tokyo received in return for its term debt were valuable assets, with some prospect of repayment. Although the effect of the debt for equity swap is that a portion of the amount owed to Bank of Tokyo pre-compromise is more subordinated than the rescheduled debt, there remain reasonable prospects that it will be repaid if the Solid Energy restructuring is successful. If it is not, of course, then there is little prospect that Bank of Tokyo will see a full repayment of the rescheduled debt, let alone a redemption of the redeemable preference shares.

[198] Bank of Tokyo says it is also unfairly prejudiced by reference to the other banks with contingent indebtedness under operating leases and derivative transactions who were not required to exchange a proportion of that indebtedness for redeemable preference shares. This argument has the same deficiency as the

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[66] *SISU Capital Fund Ltd v Tucker* [2005] EWHC 2170, [2006] BCC 463 (Ch) at [73].

argument advanced in connection with the performance bonds. It is not enough to conjure up other, notionally fairer schemes. There must be a proper evidentiary basis to establish that a fairer compromise would have been available.

[199] There is also an argument that company B, to whom Solid Energy had a very substantial contingent liability, has been preferred because the Crown has provided a facility which will see it paid. This affords that creditor preferential treatment to that accorded to the banks. There were however sound commercial reasons for treating other creditors differently to the banks, as discussed above. According to Ms McKeown, Bank of Tokyo itself acknowledged that some provision would need to be made for company B. Her evidence is that Bank of Tokyo said on one of the early meetings:

> It may be that all that is required is for the Crown to cover the potential for acceleration of the [obligation].

[200] Finally Bank of Tokyo objects to the preference which has been given to the Crown. It says it is now a creditor which has security. If the compromises had not been put in place and Solid Energy was liquidated the Crown would have had to claim as an unsecured creditor in relation to Solid Energy's rehabilitation liabilities. But following the compromises, the Crown has now strengthened its relative position on the rehabilitation liabilities by reducing the indebtedness owed by Solid Energy to unsecured creditors, through the debt exchange compromise and by requiring the Banks to reschedule debt through the debt rescheduling compromise.

[201] Although there is no evidence that the Crown is one of the potential rehabilitation creditors the point has no merit in any case. All non-bank creditors benefited from the compromise by the improved financial situation of Solid Energy. As discussed above, there were good reasons why only the banks were the subject of the compromise.

[202] In oral submissions the point was also made that the Crown has received security for the further capital injection. That grant of security would, prior to the compromises, have been a breach of the bilateral agreement Bank of Tokyo had with Solid Energy. It is however standard practice in a corporate rescue situation to put in

place arrangements so that the last money in is the first money out.[67] This provides appropriate incentives to lenders to continue to support a company in an insolvent or near insolvent position.

[203] It will be apparent from the above that Bank of Tokyo has not undertaken the vertical analysis suggested by the authorities it seeks to invoke. Such an analysis involves contrasting its situation in a hypothetical liquidation, with its situation under the compromise. The evidence is that it could have expected to recover 19 to 28 per cent of its loan in a liquidation. Under the compromises it retains a prospect of a full recovery of its principal, together with interest. Although the debt rescheduling compromise delays repayments, in a liquidation the limited recovery it could have expected would most certainly also have been delayed.

[204] To conclude on this point, I am not satisfied that Bank of Tokyo is unfairly prejudiced by the compromises. The impact upon Bank of Tokyo of the compromises is positive when compared to the alternative, liquidation. It has been fairly treated vis-à-vis other banks. To the extent it has been treated differently to other creditors there are a number of responses:

(a) So have the other banks.

(b) Unequal treatment in itself does not constitute unfair prejudice.

(c) Here there were good reasons why other creditors were treated differently, and there is no evidence of any abuse of the process by Solid Energy or the other creditors.

[205] For these reasons I am satisfied there is no unfair prejudice.

G. Summary of conclusions

[206] Bank of Tokyo brought this proceeding to challenge the validity of two creditor compromises implemented by Solid Energy under Part 14 of the Act. If valid, Bank of Tokyo said it nevertheless ought not be bound by them on the basis

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67 INSOL International, Statement of Principles for a Global Approach to Multi-Creditor Workouts (INSOL International, London, 2000) at 33.

that the compromises are unfairly prejudicial. I have found against Bank of Tokyo on all causes of action.

[207] In its first cause of action, Bank of Tokyo submitted that the compromises are invalid because they were entered into without its prior written approval, which was required by the Support Deed and the course of dealings between the parties. Clause 6.1(q) of the Support Deed provided that the Crown and the Banks would not propose any corporate action or legal proceeding, or agree to a composition, compromise, assignment or arrangement with any class of creditors without the prior approval of each bank and the Crown.

[208] Bank of Tokyo fails on this cause of action. Clause 6.1(q) did not bind Solid Energy, yet it is Solid Energy who is named as the defendant and against whom relief is sought. Nor did the banks and the Crown breach the clause. On its proper construction, the Support Deed only prohibited formal agreement to a compromise. Formal agreement only occurred after expiry of the Support Deed. If the Support Deed captured anything broader than entering into a legally binding compromise, the parties would have been unable to constructively negotiate without risking breach.

[209] In its second cause of action, Bank of Tokyo argued that the compromises fall outside of the proper scope of Part 14 of the Act. It said that Part 14 is intended only to be used for straightforward, simple arrangements, and cannot be used to implement a debt for equity swap, particularly where the compromise is directed to achieving balance sheet rather than cash flow solvency. Further, it argued that Part 14 cannot be used to impose liabilities on creditors, nor can it compel Bank of Tokyo into dealing with parties outside of the debtor/creditor relationship. Bank of Tokyo argued that the restructuring envisaged by the compromises could only be effected under Part 15.

[210] I found that Part 15 is designed to deal with compromises that cannot be achieved without the Court's assistance. The term "compromise" in Part 14 is a broad and flexible concept. A debt for equity swap involves the "give and take" element required by a compromise, and may be effected under Part 14.

[211] I have also found that there is no reason why a compromise cannot include the creation of multilateral rights and obligations and it follows that the syndicated facility agreement created by the debt rescheduling compromise is within the proper scope of Part 14.

[212] I rejected Bank of Tokyo's submission that a compromise under Part 14 cannot impose liabilities upon a creditor. In any event, the compromises in this case did not impose significant liabilities on Bank of Tokyo.

[213] I also found that there is no valid distinction between balance sheet and cash flow liquidity for these purposes. The two types of solvency were interconnected. Although Solid Energy had and was projected to have positive equity, there was evidence that it needed more capital to cope with the volatile trading conditions in which it was operating. Moreover, that projection of positive equity did not take account of the upcoming withdrawal of the ANZ $10 million overdraft facility, and that debts of approximately $360 million owing to the banks would fall due if the compromises were not agreed to.

[214] For these reasons, the second cause of action fails.

[215] In its third cause of action, Bank of Tokyo alleged a number of procedural irregularities. First, Bank of Tokyo said that s 229(2) of the Act required all known creditors to be served with notice of the proposed compromises, not simply those creditors who would be affected by the compromises.

[216] I found that s 229(2) only requires notice to be given to affected creditors. The interpretation Bank of Tokyo contends for would require sometimes complex and voluminous documentation to be served on all creditors, some of whom would then incur significant and wasted costs in seeking legal advice on matters that do not affect them. It may also cause confusion regarding who is entitled to vote, leading to further procedural irregularities. Finally, since compromises are binding on all those who receive notice it would be perverse if a compromise bound those who could not vote on it.

[217] Bank of Tokyo also argued that all "affected creditors" had not been served, because the economic interests of creditors not included in the compromises would be positively affected by the improved prospects of repayment the compromises brought about. Creditors whose prospects of repayment have been improved have not been served. However I held that the expression "affected creditors" does not include those whose interests have only been positively affected, so that all affected creditors have been served in this case.

[218] Bank of Tokyo next alleged that the voting classes under each compromise were selected in an unprincipled manner in order to ensure that Bank of Tokyo did not have a blocking vote.

[219] Bank of Tokyo challenged the inclusion of banks with performance bond and operating lease facilities in the same class as other banks to whom Solid Energy had only a contingent liability. I held they were properly included and at an appropriate value.

[220] Bank of Tokyo also challenged the exclusion of some creditors from the compromises. I found that it was for Solid Energy to decide which creditors it entered into compromises with, and there were valid reasons for excluding creditors other than banks from the compromise.

[221] To conclude in relation to the third cause of action, I found there were no procedural irregularities in the passing of the compromises.

[222] Finally, in its fourth cause of action, Bank of Tokyo argued that the compromises were unfairly prejudicial, and applied for an order under s 232(3) of the Act that it is not bound by the compromises.

[223] Bank of Tokyo's argued that the classes of creditors were manipulated to prevent it from having a blocking vote. If that were so that could amount to an abuse of the procedure sufficient to justify an order under s 232(3).

[224] However, I found that there is no evidence of manipulation. There were sound reasons for selecting the classes of the creditors ultimately chosen, and there is nothing to suggest that these decisions were made for the ulterior purpose of preventing Bank of Tokyo from holding the power of veto.

[225] I found that the compromises were not otherwise unfairly prejudicial to Bank of Tokyo. The impact upon Bank of Tokyo of the compromise is positive when compared to the alternative, liquidation. It has been fairly treated vis-à-vis other banks. To the extent it has been treated differently to other creditors there are a number of responses:

(a) So have the other banks.

(b) Unequal treatment in itself does not constitute unfair prejudice.

(c) Here there were good reasons why other creditors were treated differently, and there is no evidence of any abuse of the process by Solid Energy or the other creditors.

(d) Differential treatment between creditors in a compromise is not unfairly prejudicial if there is good reason for it.

H. Result

[226] All of Bank of Tokyo's claims are therefore dismissed. That leaves the issue of costs. In the event that the parties are not able to agree on quantum, I reserve leave for the parties to file memoranda. Given the approaching court vacation, any applications for costs must be filed within 45 working days of delivery of this judgment. Any memoranda in response must be filed within a further 10 working days.

Winkelmann J

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