IN THE HIGH COURT OF NEW ZEALAND
NEW PLYMOUTH REGISTRY

7/6

M.12/87

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HIGH PRIORITY

IN THE MATTER OF The Companies Act 1955

AND

IN THE MATTER OF THE FARMERS' CO-OPERATIVE ORGANISATION SOCIETY OF NEW ZEALAND LIMITED
a duly incorporated company having its registered office at Hawera

Hearing: 14 November 1990 and 23 April 1991

Counsel: P.R. Heath and R. Wilson for Applicant
W.G. Clayton for Respondent

31 MAY 1991

Judgment:

JUDGMENT OF GALLEN J.

The Farmers' Co-operative Organisation Society of New Zealand Limited is a Taranaki based company which got into financial difficulty some years ago. Eventually in order to preserve its situation, the company applied to the Court under the provisions of s.205 (2) of the Companies Act 1955 for an order sanctioning a scheme of arrangement between the company, its members, secured creditors and three classes of unsecured creditors. Separate meetings were held for all classes. Of the members, 99% in numbers and 98% in value voted for the resolution to affirm the scheme of arrangement. Of the client creditors, 100% in numbers and value voted for the resolution.

Of the secured creditors, 100% in numbers and value voted for the resolution. Of other secured creditors in a separate class, 97% in numbers and 58% in value voted for the resolution and in respect of trade creditors paid interest, 90% in numbers and 70% in value voted for the resolution.

S.205 (2) of the Act requires a majority in numbers representing 3/4ths in value of the creditors or class of creditors as the case may be and on the basis of the figures to which reference has already been made, the Chairman of the various meetings was unable to say that the necessary 75% majority in value had been achieved as required. However a question arose as to the right of certain creditors to vote and the amount of the debts in dispute. At the meeting of other unsecured creditors, creditors claiming to be entitled to recover the total sum of $1,161,855.78 were present and voted against the resolution. All the debts concerned were disputed by the company on one basis or another.

At the meeting of that class described as trade creditors paid interest, there was only one vote cast against the resolution but that vote was from Elders Pastoral Limited which claimed a debt of $1,132,220.09, but that debt was also disputed by the company.

The various matters in dispute in respect of the proposed scheme were set down for hearing in the High Court but before they were reached, by memorandum counsel on behalf of Elders Pastoral Limited and another company, Mount Stewart Grain Company Limited, indicated that neither company was a disinterested party and it was agreed that the adverse votes of those companies should not be counted for the purpose of determining whether the necessary majorities were attained.

The various matters in dispute came before Quilliam J. on 24 July 1987. On 29 July 1987 he indicated because of the urgency of the situation, that he intended to make an order approving the scheme and on 4 August 1987 gave his reasons for doing so. The matters in dispute fell under three heads. First, whether direct competitors were entitled to vote for the purposes of determining the requisite majority under s.205 (2). Secondly, how the value of disputed debts were to be ascertained. Thirdly, whether amounts owing to the company by way of set-off should be taken into account in determining the value of a vote.

It should be noted that Quilliam J. was considering whether or not to sanction the scheme put before him. The creditors already referred to, Elders Pastoral Limited and Mount Stewart Grain Company Limited, had accepted they were not disinterested parties and that the adverse votes cast by them

were not to be counted for the purposes of the requisite majority. It is not wholly clear from the judgment of Quilliam J. whether he was determining the question of validity in the absolute sense relating to the majorities required by statute, or for the purpose of exercising a discretion in respect of sanction in the particular case.

After considering the authorities, Quilliam J. came to the conclusion that if any of the votes in dispute were tainted by personal or special interest then they ought to be discarded; that the value of the disputed debts was to be determined by the Court by making an assessment on the basis of the probabilities and that the value of a debt was to be assessed with regard to any set-off claimed against the creditor.

As a result, Quilliam J. reached the conclusion that sanction to the scheme as proposed was appropriate. The scheme as approved contemplated that the company under the guidance of three scheme managers, would continue to trade for a period of 1 year. The scheme also provided that the term of the scheme could itself be extended provided that the extension could only take place if the necessary 75% majority was obtained at meetings called for the purposes of considering any extension.

After the scheme had been in force for a year, the managers sought the authority of creditors in terms of the

scheme to continue it for a further period of 1 year. The necessary meetings were held as contemplated by the scheme. The majorities required were achieved and the scheme continued for a further year.

By June 1988 the company had repaid $7,390,000 of secured debt and had re-financed an additional $5,000,000 by secured debt by conversion to redeemable preference shares. $530,588 had been paid to unsecured creditors and a loss in 1987 of $4,815,000 had been turned to a profit as at May 1988 of $120,000.

On 20 July 1989 the managers called a meeting for extending the scheme for a further year. On that occasion a Mr Illston a potential creditor, voted against. Mr Illston had at the time of the original scheme, proved in respect of the sum of $664,951.06 and had exercised his vote against approval of the scheme. Mr Illston's claim involved certain liquidated sums, general damages, exemplary damages and compound interest. Quilliam J. held that his claim was to be assessed for the purposes of approval of the scheme at the total sum claimed in respect of liquidated sums together with simple interest and on that basis the amount was insufficient to reduce the majority below the 75% necessary in the class. Mr Illston voted in favour of the first extension. In 1989 he voted against.

The trustees of the scheme applied to the Court to have the scheme extended or to obtain a declaration to the effect either that Mr Illston's claim should not include simple interest or that on the basis of principles accepted by Quilliam J. in respect of other creditors, his vote should not be taken into account. The matter came before me and on 31 July 1989 I held that interest was not to be taken into account for the purposes of computing Mr Illston's claim. The result of that determination was that the vote within the class attained the necessary 75% and the scheme continued for a further year.

On 17 July 1990 the managers called a meeting to consider a resolution that the scheme of arrangement be formally extended for a further year to 31 July 1991. At that meeting, Elders Pastoral Limited voted against the resolution in the class 'trade creditors paid interest' and in the class 'other unsecured creditors', Wrightson voted in favour of the resolution. The chairman following the conclusion of Quilliam J. already referred to, directed that the scrutineers were to disregard the votes of Elders Pastoral Limited or its subsidiary companies and Wrightson and its subsidiary companies. The vote against by Elders Pastoral Limited being disregarded the necessary majority was obtained. In the meantime Mr Illston's claim against the company has been dealt with in the High Court and according to the affidavits the company was successful.

Mr Heath for Elders Pastoral Limited, submits that the situation now differs from that which was before Quilliam J. in that -

(1) Elders Pastoral Limited had conceded before Quilliam J. that a vote on its part should not be taken into account because of its competitor status, but that that is no longer the case. No such concession is made now.

(2) That the situation differs when considering an extension as distinct from original approval.

(3) That whatever the situation may have been in 1987, factually the situation now differs in that the company is itself competing on very favourable terms with Elders Pastoral Limited and is using as its financial basis, the amounts which it owes creditors and which it has been relieved of the immediate obligation to pay so that the creditors are to some extent financing a competitor.

He says that these matters are sufficient to distinguish the present situation from that which was before Quilliam J. but that if the situations are indistinguishable, then Quilliam J. was wrong, that I am not bound by his decision and should not follow it.

Both counsel are agreed that in the special circumstances of this case taking into account the positions adopted by the parties in negotiating at various stages, no

res judicata arises. When the matter first came before me, the factual position of the claims between the Farmers' Co-operative Organisation Society of New Zealand Limited and Elders Pastoral had not been resolved. Subsequently the issues between them as to liability and quantum have been made the subject of arbitration proceedings which have not yet been determined. Because of that I have now been asked to determine the matter on a rather more restricted basis and to determine at least at this stage only one question which is in the following terms:-

> "On the assumption that Elders Pastoral Limited is properly to be regarded as a contingent or actual creditor of THE FARMERS CO-OPERATIVE ORGANISATION SOCIETY OF NEW ZEALAND LIMITED, was the Chairman entitled, in law, to disregard the votes of ELDERS PASTORAL LIMITED at the meetings of creditors of THE FARMERS CO-OPERATIVE ORGANISATION SOCIETY OF NEW ZEALAND LIMITED held on 17 July 1990 solely because ELDERS PASTORAL LIMITED is a competitor of THE FARMERS CO-OPERATIVE ORGANISATION SOCIETY OF NEW ZEALAND LIMITED?"

Mr Heath draws attention to the fact that there is a distinction between the situation now under consideration by the Court and that which was dealt with by Quilliam J. who was required to sanction the scheme itself and decide the question of the status of Elders Pastoral Limited in relation to that obligation. S.205 (2) of the Companies Act is in the following terms:-

> "If a majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members, as the case may be, voting in person or, where proxies are allowed, by

> proxy at the meeting agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors or the class of creditors, or on the members or class of members, as the case may be, and also on the company, or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company."

Cl.16 of the scheme is in the following terms:-

> "THE Moratorium Period may be extended on the recommendation of the Managers by resolutions of separate meetings of the Secured Creditors (if any), the Trade Creditors Paid Interest, the Client Creditors and the Other Unsecured Creditors convened by the Managers for that purpose and passed by the majorities set out in clause 12. If the total amount owing by the Company to Client Creditors is then less than $50,000 it shall not be necessary to convene a meeting of the Client Creditors to sanction an extension of the Moratorium Period."

An extension of the scheme therefore is provided for by the scheme itself rather than directly by statute and does not require the sanction of the Court. All that is necessary is that the requisite majority provided by cl.12 be attained. It is in that context that the matter must be approached. The task of the Chairman of the meeting was to ascertain whether the requisite majority agreed to the extension. That differed from the situation where the Court is required to exercise its discretion in sanctioning or otherwise a scheme which is put forward for approval.

The question then arises as to whether or not Elders Pastoral Limited, assuming that it has established that it is a creditor, has a right to vote in respect of any such proposed extension. It is conceded that it remains a competitor. Both counsel accepted whatever the position may have been in respect of the original proposals, the right of Elders Pastoral Limited to a vote in respect of a proposed extension was not determined by any decision relating to the original sanction.

Quilliam J. started with the decision of the Privy Council in British America Nickel Corporation Limited and Others v. M.J. O'Brien Limited 1927 A.C. 369. In that case a trust deed gave power to a majority of bond holders consisting of not less than 3/4ths in value to sanction any modification of the rights of the bond holders. A scheme of modification was sanctioned by the requisite majority of bond holders but that majority included the vote of a particular bond holder whose support for the scheme was obtained by the promise of a large block of ordinary stock. Viscount Haldane in delivering the advice of the Board at p.371 said:-

> "To give a power to modify the terms on which debentures in a company are secured is not uncommon in practice. The business interests of the company may render such a power expedient, even in the interests of the class of debenture holders as a whole. The provision is usually made in the form of a power, conferred by the instrument constituting the debenture security, upon the majority of the class of holders. It often enables them to modify, by resolution properly passed, the security itself. The provision of such a power to a majority bears some analogy to such a power as that conferred by s.13 of the English Companies Act

of 1908, which enables a majority of the shareholders by special resolution to alter the articles of association. There is, however, a restriction of such powers, when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities; namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only. Subject to this, the power may be unrestricted."

At pp.373 and 378 he said:-

"......while usually a holder of shares or debentures may vote as his interest directs, he is subject to the further principle that where his vote is conferred on him as a member of a class he must conform to the interest of the class itself when seeking to exercise the power conferred on him in his capacity of being a member.....No doubt he was entitled in giving his vote to consider his own interests. But as that vote had come to him as a member of a class he was bound to exercise it with the interests of the class itself kept in view as dominant.....Their duty was to look to the difficulties of the bondholders as a class, and not to give any one of these bondholders a special personal advantage, not forming part of the scheme to be voted for, in order to induce him to assent."

Quilliam J. referred to the New Zealand decision of In re C.M. Banks Limited 1944 N.Z.L.R. 248. That was a case where approval of the Court was sought to a scheme of arrangement between a company and preference shareholders under s.159 of the Companies Act 1933, the predecessor of the present s.205. The necessary majority approved the scheme but the question arose whether the arrangement had been fairly put to the shareholders concerned as the circular sent to preference shareholders had not correctly stated the basis on which the

scheme was being put forward. Smith J. accepted the statement of principle made by Astbury J. in In Re Anglo-Contintental Supply Company Limited (1922) 2 Ch.723:-

> In exercising its power of sanction under s.120 (our s.159 and further (s.205)) the Court will see: First, that the provisions of the statute have been complied with. Secondly, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class they purport to represent, and, Thirdly, that the arrangement is such that a man of business would reasonably approve....."

Quilliam J. then referred to Re Holders Investment Trust Limited (1971) 2 All E.R. 289. That was a case involving a reduction of capital which required approval by an extraordinary resolution of a class meeting of preference shareholders. It appeared that the holders of a substantial number of preference shares had voted in support of a resolution from motives other than the general body of interest of members of the class, they being also the holders of over half the company's equity capital. Megarry J. said at p.294 after referring to certain letters:-

> That exchange of letters seems to me to make it perfectly clear that the advice sought, the advice given, and the advice acted on, was all on the basis of what was for the benefit of the trusts as a whole, having regard to their large holdings of the equity capital. From the point of view of equity, and disregarding company law, this is a perfectly proper basis; but that is not the question before me. I have to determine whether the supporting trustees voted for the reduction in the bona fide belief that

> they were acting in the interests of the general body of members of that class. From first to last I can see no evidence that the trustees ever applied their minds to what, under company law, was the right question, or that they ever had the bona fide belief that is requisite for an effectual sanction of the reduction."

In Australia the matter was considered in Re Jax Marine Pty. Limited and Companies Act 1961 (1967) 1 N.S.W.R. 145. That was a case where the approval of the Court was sought to the approval of a scheme of arrangement. A particular group of creditors known as the Smithson group had a special interest in the scheme. Street J. said at p.148:-

> "To say that the Smithson group's interests do not preclude their being members of the class is, of course, far from saying that their vote will, if and when a petition is subsequently presented, carry equal weight to that of an unsecured creditor who is not shown to have any special interest. When the petition if there be a petition, comes before the Court there is ample room within the Court's statutory discretion to decide the petition in accordance with the requirements of justice and equity as those requirements appear to affect the rights of the class and its members. Quite frequently it is necessary to discount, even to the point of discarding from consideration the vote of a creditor who, although a member of a class, may have such personal or special interest as to render his view a self-centred view rather than a class-promoting view. A common instance is the case of a manufacturer who, in relation to a meeting of creditors of a retailer, may desire, even though the retailer's fortunes are doomed, to keep the retailer on foot as an outlet for future production. Another common circumstance which may render a particular creditor's wishes properly the subject of some discount, is where the creditor happens to be a shareholder or director of the company whose affairs are under consideration."

On the basis of the views expressed in those cases, Quilliam J. came to the conclusion that if any of the votes in

dispute were tainted by personal or special interest then they ought to be discarded. He came to the conclusion that Elders Pastoral Limited was a direct competitor of the applicant company. He also came to the conclusion that its vote and the votes of its subsidiary companies could not be said to have been exercised for the purpose of benefiting the class as a whole.

I have already referred to the fact that Quilliam J. was dealing with the discretion contained in s.205 of the Act as to a decision relating to the sanction of the scheme and the majority of the cases to which he referred were in the same category. In such a situation the discretion is a significant aspect, see for example In re Jax Marine Pty. Limited and Companies Act 1961 (supra), but in British America Nickel Corporation Limited v. M.J. O'Brien Limited, the Privy Council was dealing with a situation where the validity of resolutions was in question. It was not a case where the Courts were required to exercise a discretionary function and in that context it was clearly the view of the Privy Council that a right to vote was not unrestricted in the particular case, that is where a majority of a special class had a power to bind a minority. This is of course not such a case and the question arises as to whether the Privy Council was dealing with a particular category of case only or whether it is possible to say that a general principle can be deduced from that and the other cases.

I think that it is possible to deduce such a general principle which may be expressed in the following way. While generally in company matters a member of a class has a right to vote in his or her own interests, where the equities of a particular situation require it, that right to so vote may be restricted. The decision of the Privy Council in the British America Nickel Corporation case is an illustration of circumstances where the right is so restricted. Where a vote is conferred on a person by reason of his membership of a class, then that person must conform to the interests of the class when seeking to exercise the power conferred. That case also illustrates the principle that there may be circumstances where a majority may not in equity coerce a minority.

In Re Anglo-Continental Supply Company Limited, reference was made to the majority acting bona fide and a similar comment appeared in Re Holders Investment Trust Limited. Questions of motivation will therefore affect the equities of the situation. Further illustrations appear in Re Jax Marine Pty. Limited.

It follows I think that if a creditor is acting from ulterior motives and the equities of the situation require it, then his or her vote may need to be discounted. From comments in some cases, notably Jax Marine Pty. Limited, it could be concluded that such a restriction applies only to the discretionary stage under s.205 and such a view was expressed

in an article to which my attention was drawn entitled Creditors' right to vote in s.205 proceedings by Andrew Beck 1988 N.Z.L.J.22.

There are however decisions such as Re Anglo-Continental Supply Company Limited where the Courts exercised an over-riding control and I think it follows that in a limited number of situations the right to vote or the value of a vote may be discounted. Such rights as may relate to or follow from inclusion in or exclusion from a particular class can be the subject of the discretion in the case of approval of a scheme as was the case in Jax Marine Pty. Limited.

Quilliam J. in this case when sanction was considered, came to the conclusion that certain creditors including Elders Pastoral Limited were motivated by a concern for competitive advantage and that this was a motive which invalidated their votes to the extent that the votes should be entirely discounted. While both parties accept in the circumstances of this case that is not to be taken as a res judicata, I do not think it can be ignored, it must have formed the basis of many decisions of the managers and perhaps other creditors since.

Applying those principles to the particular case, I think that first, Elders Pastoral Limited is not necessarily prevented from voting in the class of which it is a member in a proposal for extension, but having already been found to have a

personal or special interest which disqualified it from voting against the original proposal, it could not now vote against the proposed extension unless it satisfied the Chairman of the meeting that its motivation was no longer suspect. That it would have to do by convincing the Chairman that it was voting on the merits or otherwise of the proposal and not in its own interest as a competitor. I do not think that that necessarily raises insuperable difficulties for the Chairman. The starting point will be the conclusion which has already been expressed in respect of the sanction by the Court of the original proposal.

It follows that it will be the obligation of Elders Pastoral Limited to satisfy the Chairman that that factual situation no longer exists either generally or in relation to the exercise of its vote. In so far as it seeks to do so by reference to the merits of the scheme, that may very well not be an easy task if the other creditors consider an extension appropriate.

The question now posed therefore is answered in the following way:-

> "The Chairman was not entitled to disregard the vote of Elders Pastoral Limited at meetings of creditors of the Farmers' Co-operative Organsiation Society of New Zealand Limited held on 17 July 1990 solely because Elders Pastoral Limited is a competitor of the Farmers' Co-operative Organisation Society of

New Zealand Limited, but before the vote could be taken into account it would be necessary for Elders Pastoral Limited to satisfy the Chairman that its motivation in voting was directed towards the appropriateness of the proposed extension and was not in any way affected by the fact that Elders Pastoral Limited is a competitor."

I should like to make it clear that while I have endeavoured to express the principle in general terms, the application in this case mut be regarded as a most unusual one coloured by the unique background facts.

RJ Gallen

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