[HIGH COURT OF AUSTRALIA.]

ISLES . . . . . APPELLANT;
PLAINTIFF,

AND

THE DAILY MAIL NEWSPAPER LIMITED AND OTHERS . . . . . RESPONDENTS.
DEFENDANTS,

ON APPEAL FROM THE SUPREME COURT OF QUEENSLAND.

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BRISBANE, *April* 29, 30; *May* 1.

Griffith C.J., Barton and Isaacs JJ.

Company debentures—Modification of rights of debenture holders by majority—Compromise or arrangement—Jurisdiction—Companies Act Amendment Act 1889 (*Qd.*) (53 *Vict. No.* 18), *sec.* 35.

The holders of three-fourths in value of certain debentures issued by a Company were empowered to modify the rights of all the debenture holders, by sanctioning any modification proposed by the Company, or any compromise or arrangement which would under the *Companies Act Amendment Act* 1889 be such as the Court would have jurisdiction to sanction.

Held, that an arrangement that the debenture holders should accept fully paid up shares in a new Company in satisfaction of the debenture debt was a compromise that the Court would have jurisdiction to sanction, and having been *bonâ fide* agreed to by the required majority was binding on all the debenture holders.

Held also, that whether some other proposal was or might have been more beneficial did not affect the validity of the compromise.

Decision of the Supreme Court (*Cooper* C.J.) affirmed.

APPEAL from the Supreme Court of Queensland.

The plaintiff, who sued on behalf of himself and all other holders of a series of 300 debentures issued by the defendants, the Daily Mail Newspaper Ltd. (hereinafter called "the old

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Company "), brought an action against that Company and the Queensland Daily Mail Ltd. (hereinafter called " the new Company "), asking for a declaration that certain agreements made in September 1908 and November 1910 between the old Company and certain of the debenture holders was not binding on him.

The facts are sufficiently set out in the judgments hereunder.

The action was heard by *Cooper* C.J., who held that these agreements were made in good faith and were binding, and gave judgment for the defendants.

From this decision the plaintiff appealed to the High Court.

Stumm K.C. and *Graham*, for the appellant. Isles offered to buy all shares in the new Company and all their rights, and to pay £1,000 to the old shareholders on account of deferred interest This was a more beneficial arrangement than the one accepted by the three-fourths majority.

The scheme must be one which the Court in its jurisdiction would sanction. [They referred to *Halsbury's Laws of England*, vol. v., p. 607, par. 1046; *Companies Act Amendment Act* 1889, sec. 35; *Sneath* v. *Valley Gold, Ltd.* (1); *Mercantile Investment and General Trust Co.* v. *International Co. of Mexico* (2).] The clause in the latter case is wider than that in the present case. The Court will look at the assets of the Company. They had sufficient assets and the necessity for a compromise had not arisen.

Had they accepted Isles's offer they would have had a stronger company than the one then existing. *In re Alabama, New Orleans, Texas and Pacific Junction Railway Co.* (3). Circumstances justifying a compromise have not arisen and the plaintiff is still a mortgagee. They also referred to *Mercantile Investment and General Trust Co.* v. *River Plate Trust, Loan and Agency Co.* (4).

Feez K.C. and *Woolcock*, for the respondents. It is not incumbent on respondents to show that this was the best scheme or that it was a good one, so long as it was honest, and one that a

(1) (1893) 1 Ch., 477.
(2) (1893) 1 Ch., 484*n*.
(3) (1891) 1 Ch., 213.
(4) (1894) 1 Ch., 578.

reasonable man of business would accept: *In re English, Scottish and Australian Chartered Bank* (1). As to what the Court would have jurisdiction to sanction, see *Shaw* v. *Royce, Ltd.* (2). The old Company was a party to the agreement: *In re Labuan and Borneo, Ltd.*; *Peirson* v. *Labuan and Borneo, Ltd.* (3); *Mammoth Copperopolis of Utah Ltd.* (4).

[GRIFFITH C.J.—If an agreement is valid, does it become invalid because a third party comes in ?]

In re Empire Mining Co. (5). Isles lent his money subject to the conditions set out in the memorandum of association, under which a three-fourths majority could bind all: *Palmer's Company Precedents*, 10th ed., Pt. III., pp. 145-6.

Stumm K.C., in reply.

Cur. adv. vult.

GRIFFITH C.J. This is an action brought by the plaintiff for a declaration that an agreement made in November 1910 between the defendants the Daily Mail Newspaper Company and the holders of debentures in that Company is not binding upon him as the holder of some of the debentures. The learned Chief Justice before whom the case was heard dismissed the action. The question arises primarily upon a condition of the debentures. The Company had issued in 1904 300 debentures of £50 each, subject to certain conditions which were indorsed upon them. One of those conditions, No. 22, was as follows:—"The holders of three-fourths in value of the debentures of this series for the time being outstanding may, by writing under their hands, sanction any modification of the rights of the debenture-holders of this series which shall be proposed by the Company, and any compromise or arrangement proposed to be made between the Company and the holders of the debentures of this series, provided that it is one which the Court would have jurisdiction to sanction under the *Companies Act Amendment Act* 1889, or any statutory modification thereof if the Company were being wound up and the requisite majority at a meeting of the deben-

(1) (1893) 3 Ch., 385.
(2) (1911) 1 Ch., 138.
(3) 18 T.L.R., 216.
(4) Palmer's Company Precedents, 3rd ed., p. 606.
(5) 44 Ch. D., 402.

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ture holders summoned pursuant to that Act, or any modification thereof had agreed thereto: and any modification or arrangement so sanctioned shall be binding on all the holders of debentures of this series and notice thereof shall be given to them accordingly, and each holder shall be bound thereupon to produce his debentures to the Company and to permit a note of such modification to be placed thereon."

The reference to the *Companies Act Amendment Act* 1889 is to sec. 35, which provides that: "Where any compromise or arrangement shall be proposed between a Company which is, at the time of the passing of this Act, or afterwards, in the course of being wound up, either voluntarily or by or under the supervision of the Court, under the Principal Act, and the creditors of such Company, or any class of such creditors, it shall be lawful for the Court, in addition to any other of its powers, on the application in a summary way of any creditor or the liquidator, to order that a meeting of such creditors or class of creditors shall be summoned in such manner as the Court shall direct; and if a majority in number representing three-fourths in value of such creditors or class of creditors present either in person or by proxy at such meeting shall agree to any arrangement or compromise, such arrangement or compromise shall, if sanctioned by an order of the Court, be binding on all such creditors or class of creditors, as the case may be, and also on the liquidator and contributories of the said Company."

On an application to the Court under that section to sanction a compromise or arrangement two questions arise—first, whether the Court has jurisdiction to sanction it; and secondly, if it has, whether it will exercise its jurisdiction in favour of the bargain. Under clause 22 of the debentures now under consideration the first question only is material, the judgment of three-fourths in value of the holders of debentures being substituted for the judicial exercise of the jurisdiction of the Court, if it has jurisdiction. The form is a common form, which is found in *Palmer's Company Precedents*, and several cases are reported in which a similar condition has been under the consideration of the Court. As to the question of jurisdiction, which is the only one for our consideration, the transaction must be a compromise or

arrangement. Every compromise or arrangement is a bargain, but not every bargain can be fairly described as a compromise or arrangement with creditors—for instance, a bargain by which creditors would become debtors to the Company instead of creditors. It is, therefore, necessary to consider whether the transaction is really and in substance of the nature of a compromise or arrangement with creditors. For the purposes of illustration I will refer to the case of the *Mercantile Investment and General Trust Co.* v. *International Co. of Mexico* (1). In that case the compromise set up was an agreement made by the stipulated majority of debenture holders to release their security and take in exchange fully paid preference shares in a new Company. The Court of Appeal held, upon the evidence before it, that the transaction was not really and in substance a compromise, since the debenture holders had ample security for their debt, so that in reality it was a mere voluntary relinquishment of a right which could not be regarded as a compromise. On that ground they held that the transaction was not within the section—not that it was not one that ought not to be sanctioned, if within the Act, but that it was one that the Court had no jurisdiction to sanction.

The same transaction came before the Court of Chancery again in a later case between parties who were not bound by the former decision. *Mercantile Investment and General Trust Co.* v. *River Plate Trust, Loan and Agency Co.* (2). The case was heard before *Romer* J., and upon the facts proved before him it appeared that, so far from the debenture holders having ample security for their debt, they practically had none, so that the transaction really was a compromise. *Romer* J. laid down what he considered to be the test. He said (3): "But what I have to consider is not whether, if the debenture-holders did not accept the resolution, they would altogether lose their security or all chance of being paid, but whether there were not difficulties in the way of their enforcing their rights of so substantial a character that the majority of debenture-holders might *bonâ fide* come to the conclusion that it was desirable, in face of those

(1) (1893) 1 Ch., 484*n*. (2) (1894) 1 Ch., 578.
(3) (1894) 1 Ch., 578, at p. 596.

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difficulties, to compromise those rights on the terms of the resolution."

That is, possibly, a limited view of the jurisdiction of the Court, but it is sufficient for the purpose of this case. If those conditions exist, the Court has jurisdiction to give its sanction. But, of course, although the Court has jurisdiction to sanction a compromise or arrangement it will not do so if it can be successfully impeached on the ground of fraud or *mala fides*. The same principle applies to an arrangement made under clause 22 of the conditions of these debentures. If it could be shown that the transaction, although in form a compromise, was not made *bonâ fide*, then the Court in the exercise of its general jurisdiction to set aside dishonest or fraudulent transactions, would declare the transaction not binding. That point was suggested, although not very distinctly raised, before the learned Chief Justice, who found the facts against the plaintiff.

This being the law to be applied, I will briefly state the facts of the present case, so far as they are material. The Daily Mail Newspaper Co., which I will call the old Company, was incorporated with a nominal capital of £50,000 in £1 shares, of which about 20,000 were issued. In September 1904 the debentures were issued. The Company afterwards fell into difficulties, and became short of working capital. In December 1907 a new Company, the other defendants, The Queensland Daily Mail Limited, which I will call the new Company, were incorporated with a nominal capital of £25,000 in £1 shares, of which only 6,200 were issued, upon which 8s. only had been paid up in 1910. In February 1908 an agreement was made between the old Company and the new Company, the effect of which in substance was this: the old Company leased its assets to the new Company for 3 years from 2nd December 1907, which was the date of the incorporation of the new Company, the assets being valued at £12,500. The new Company agreed to preserve the assets at that value or to make up any deficiency. They also agreed to discharge the old Company's debenture debt and pay the interest on the debentures, which was to be a first charge on the assets of the new Company and paid in priority to any dividends. The new Company were to be at liberty to purchase the whole of the pro-

perty for a sum equal to £1,000 more than the amount of the outstanding debentures. In September 1908 a majority of three-fourths of the debenture holders agreed, under the powers conferred by Clause 22, that they would not ask for interest on the debentures until the three years had expired. In 1910 further difficulties arose, the new Company's capital was very small, and it was necessary to do something. Various schemes were propounded and discussed by the directors of the old Company, and, I suppose, the directors of the new Company, and the debenture holders. The proposal finally adopted is thus stated in the recitals in the deed of compromise :—"Whereas the old Company is proposed to be wound up altogether voluntarily and that the whole of its business and property is proposed to be transferred to the new Company, and it is proposed that the liquidator of the old Company should pursuant to sec. 151 of the *Companies Act* 1863 receive in compensation for such transfer shares paid up to 10s. per share in the new Company for the purpose of distribution amongst the members of the old Company, and it is further proposed that every debenture holder of the old Company should be entitled at any time within one month from the date of the agreement proposed to be entered into for giving effect to the above object to request the new Company to allot him fifty fully paid up £1 shares in the new Company in respect of and in exchange for each £50 debenture held by him in the old Company and in discharge of all principal secured by such debenture and eight fully paid up £1 shares in the new Company in respect of the interest still unpaid on each of the said debentures and in discharge of all such interest and that the new Company should comply with such request." It will be observed that under this proposal, the debenture holders were to receive fully paid up shares in the new Company in exchange for debentures nominally of the same value. That such an agreement is not objectionable in substance is shown by the decision in *In re Empire Mining Company* (1). I need not refer to any other authority on that point. This proposal was adopted and on 16th November an agreement was made between the old Company of the first part, the new Company of the second part, and other

(1) 44 Ch. D., 402.

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persons being the holders of three-fourths in value of the debenture holders of the third part. The agreement was in these terms: "(1) The proposed arrangement to wind up the old Company altogether voluntarily and to transfer its business and property to the new Company upon the terms hereinbefore mentioned is hereby sanctioned and approved. (2) Immediately upon the execution of an agreement for giving effect to the said proposed arrangement, each of the debenture holders of the old Company shall surrender to the new Company to be cancelled the debentures of the old Company held by him and the new Company shall allot to him fifty fully paid up £1 shares in the capital of the new Company in respect of and in exchange for each £50 debenture so surrendered by him, and he shall accept the same in discharge of all principal money secured by the surrendered debenture or debentures and the new Company shall allot to each of the debenture holders of the old Company eight fully paid up £1 shares in the capital of the new Company in respect of the interest unpaid to such debenture holder on each of the debentures surrendered by him as aforesaid and each such debenture holder shall accept the said shares in discharge of all such interest."

It is quite obvious that it is of the essence of a compromise by which fully paid up shares in another Company are to be given in exchange for debentures in the old Company that the new Company should concur in the transaction. It would be idle for one company to agree to give shares in another company unless it first obtains the consent of that company; and it is no objection to the exercise of the jurisdiction of the Court, that the new company shall have already agreed to give effect to the proposed transaction. The agreement of the debenture holders was expressed to be conditional upon the execution of an agreement giving effect to the proposed arrangement, and, as I have just said, the agreement giving effect to the proposed arrangement would necessarily be an agreement to which the new Company would be a party. Upon that condition being performed this agreement to discharge the debentures was to come into operation. An agreement was accordingly executed on 21st December 1910 between the liquidator of the old Company and the new Com-

pany by which the new Company agreed to give full effect to the proposed arrangement, and it has been since carried out. Under these circumstances it is clear that the Court would have jurisdiction to sanction the arrangement. If, then, the Court would have had jurisdiction in the winding-up of the old Company to sanction the agreement, and if it cannot be impeached on the ground of fraud, or *mala fides*, there is nothing more to be said. The holders of three-fourths in value of the debentures are entitled to make the agreement and by so doing to bind the dissentient minority. Really, the only serious argument that was addressed to us was that, although that may be so *primâ facie*, yet the Court will in some way consider whether, on the whole, it was a wise transaction—whether some other proposal was or might have been made which might have been more beneficial. That is a matter of opinion, not a matter of jurisdiction. What the Court has to consider is whether the case falls within the words I have read from the judgment of *Romer* J.—whether it was a case in which the majority of the debenture holders could *bonâ fide* come to the conclusion that it was desirable in the face of difficulties to compromise their rights on the terms of this arrangement? On the evidence it is impossible to come to any other conclusion. The decision of the learned Chief Justice was therefore clearly right, and this appeal should be dismissed.

BARTON J. It was my intention to add some observations, but as his Honor has dealt with the matter fully, and has made the position of affairs quite clear, I am relieved from doing so. I agree that the appeal should be dismissed.

ISAACS J. If the only power given to the majority were as to a "modification of rights," I should hesitate to uphold the transaction. See *per Lindley* L.J. in *Mercantile Investment and General Trust Company* v. *International Company of Mexico* (1).

But "compromise" is larger, and "arrangement" is larger still, and the latter is certainly sufficient. The only matter of

(1) (1893) 1 Ch., 484*n*.

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real doubt lay in the proviso which confined the power of the majority to the limits given by Statute to the Court.

The arguments lead to the consideration of three separate questions: (1) Did the occasion arise for an arrangement at all; (2) was there a true exercise of the power; and (3) was the transaction within the proviso. Whether the transaction assumes the form of a compromise or an arrangement one thing is clear: the power is not given to be exercised capriciously, or without some fair reason. It is not to be applied to circumstances which it was clearly not intended to meet. *Chitty* J. in *In re Dominion of Canada Freehold Estate and Timber Co. Ltd.* (1) points out that such clauses, like the statutory provision they follow, are for the purpose of overcoming the difficulty of any particular individual holding out against a scheme, however meritorious and beneficial, in order that he might get, generally speaking, some special advantage, or because he did not even take a fair view of the advantage to be gained. But that connotes an appropriate occasion, one which reasonable business men could honestly consider as requiring some adjustment or negotiation to avoid disadvantage.

The financial situation of the old Company was such as to leave no doubt that the debenture principal and interest were both in peril. It was a most suitable occasion to make some fresh arrangement. *Lindley* L.J. in *Sneath* v. *Valley Gold, Ltd.* (2) said: "All that is required is some difficulty that cannot be got over without some arrangement."

Then was the power lawfully exercised? Twice within the last few weeks I have read the statement of the law by Lord *Lindley* in *British Equitable Assurance Co. Ltd.* v. *Baily* (3), a statement of fundamental importance, and applicable in an infinity of instances, and I will read it again. He said:—"Powers must be exercised *bonâ fide*, and having regard to the purposes for which they were created, and to the rights of persons affected by them." That terse formula sums up all material considerations. In *In re Alabama, New Orleans, Texas and Pacific Junction Railway Co.* (4), the necessity for good faith is insisted on, and, if the

(1) 55 L.T., 347, at p. 351.
(2) (1893) 1 Ch., 477, at p. 494.
(3) (1906) A.C., 35, at p. 42.
(4) (1891) 1 Ch., 213.

majority are coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, the Court will not uphold it.

It is a material circumstance in construing such a clause, and especially when it is accompanied with such a proviso as we have here, to bear in mind that it is only an adaptation to companies in liquidation or financial difficulties, of provisions long familiar in bankruptcy.

Arrangements as they are familiarly called, with individual debtors were and are common enough. In *In re London Chartered Bank of Australia* (1), *Vaughan Williams* J. repeated that the scheme of arrangement under the Act of 1870, sec. 2, which is contained in the Queensland Act of 1889, sec. 35, is an alternative mode of liquidation which the law allows the statutory majority of creditors to substitute, just as the *Bankruptcy Act* 1869 allowed the creditors the substituted liquidation by arrangement under sec. 125 or sec. 126 for a pending bankruptcy.

The system of arrangement in bankruptcy, as I have said, is long established, it goes back very much further than 1869. Without any earlier reference than the Act of 1861, I may mention the case of *Ex parte Cowen; In re Cowen* (2), because it lays down some valuable principles, as applicable to sec. 35 of the Act of 1889 as to bankruptcy. In each case there is what *Cockburn* C.J. in *Hart* v. *Smith* (3) called a "commercial domestic forum." And as they are based on fundamental considerations, they apply equally to a simple power of compromise or arrangement not referring to the Statute. *Turner* L.J. said in *Ex parte Cowen; In re Cowen* (4):—"How could a court of justice determine what would be reasonable for creditors to accept under all the varied circumstances of arrangements between debtors and their creditors? I am not disposed to go further than to say that in my opinion it is necessary in order to render a deed of such description as we have here to deal with binding upon non-assenting creditors, that the deed should be free from all taint of fraud, and should be made *bonâ fide* with a view to the benefit of all the creditors."

(1) (1893) 3 Ch., 540, at p. 546.
(2) L.R. 2 Ch., 563.
(3) L.R. 4 Q.B., 61, at p. 70.
(4) L.R. 2 Ch., 563, at p. 567.

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Lord *Cairns* said in the same case (1):—"It was much pressed in argument that, wherever the Court finds a deed to be unreasonable in its provisions it will be treated as invalid, and that it is unreasonable if the amount of composition be not in fair proportion to what the debtor is able to pay. But in my opinion there is a statutory power given to the majority of the creditors to bind the minority. They are made the judges of the propriety of the arrangement, so long as they exercise their power *bonâ fide*; and it certainly seems to me that it would be contrary to the spirit of the Act that this Court should sit in review on their decision as regards the quantum of composition they may agree to accept." So far, the learned Lord's observations answer the contention made here, that the scheme adopted was less beneficial to the debenture holders than that suggested by Mr. Isles. Lord *Cairns* then continues:—"But this is subject to the paramount obligation that this power, like all other powers, must be exercised fairly, so that there may be a *bonâ fide* bargain between the creditors and the debtors. If it should be found that the bargain was tainted with fraud, the arrangement will not be binding on the non-assenting creditor. If, for example, it was found that there was a bargain with some of the creditors to give them, some particular benefit, that would be a fraud. But even without any ingredient of fraud, if the creditors, from motives of charity and benevolence, which might be highly honorable to them were willing to give the debtor a discharge on payment of a composition wholly disproportioned to his assets, that would not be such a bargain as the Act requires, and would not bind the non-assenting minority." Lord *Cairns's* judgment is especially valuable because he enforces the fact that an arrangement made by the majority from motives of kindness and generosity to the debtor is as much outside the ambit of the power—and so not a *bonâ fide* exercise of it—as if it were done to defraud the minority. In the present case, however, there is nothing to indicate the power was used for any improper purpose.

Now, as to the last question: Is the arrangement one which the Court would have jurisdiction to sanction under sec. 35? The only arrangements which it has jurisdiction to sanction are

(1) L.R. 2 Ch., 563, at p. 569.

those between the debtor and the creditor; putting it shortly, none others are stated to be bound, and therefore there are no others with whom, by force of the Statute operating on the curial order, the minority can be brought into compulsory contractual relation. It was consequently important to see whether the old Company had itself undertaken to procure—as I may term it—the issue of the fully paid-up shares by the new Company to the debenture holders. A deed to which three are parties may very well contain a covenant as to which one only is the covenantor. And it might well have been, as it appeared to me on first inspection of the agreement, that the old Company, for such valuable consideration as it thought adequate, agreed to transfer its own interest in the property to the new Company, leaving the latter to deal with the debenture holders direct with respect to their floating charge on the assets, by substituting shares for debentures. Unless it could be made out from the arrangement that the old Company had itself undertaken to the debenture holders that the new Company would on cancellation of the debentures issue the paid up shares, I should have thought the arrangement one which would have been beyond the jurisdiction of the Court to sanction. Mr. *Feez*, however, pointed out in the latter deed, which, though actually made between the two companies alone, is the complement and the expressly intended outcome of the earlier instrument, to which all are parties, that the issue of these paid up shares was to be part of the consideration for the transfer of the property. The old Company could therefore compel that issue, and reading both documents together as different, though connected, parts of the same transaction—see for instance, *Whitbread* v. *Smith* (1)—it removes any doubt or ambiguity as to whether the old Company had wholly ceased its connection with its affairs by transferring its assets, and getting the partly paid up shares for its members. As soon as that difficulty is removed the matter is clear. The mere fact that the substituted right is a paid up share instead of a debenture is no valid objection: *In re Empire Mining Co.* (2), or that it is an undertaking by another company: *Mammoth Copperopolis of Utah* (3), and *Mercantile*

(1) 3 DeG. M. & G., 727, at p. 739.
(2) 44 Ch. D., 402.
(3) Palmer's Company Precedents, 3rd ed., p. 606.

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Investment and General Trust Co. v. *International Co. of Mexico* (1). In the last-mentioned case the substituted rights consisted of fully paid 6 per cent. cumulative preference shares. The old bankruptcy system of arrangement supplies numerous instances. Sec. 126 of the English Act of 1869 enacted that the provisions of the composition should be binding on all the creditors shown in the statement and might be enforced by the Court of Bankruptcy. But *Ex parte Mirabita*; *In re Dale* (2) shows that under that Act a surety who had covenanted with the trustee for creditors was not subject to the jurisdiction of the Court of Bankruptcy when he failed to pay. The Court had no power to compel him; the trustee had simply his contract and was obliged to sue him. His promise had been procured by the debtor and was a valuable—perhaps the most valuable—part of the arrangement. Similarly, the promise of the new Company was apparently considered by the majority of the debenture holders to be the substantial means of minimizing loss, and, although the new Company could not be bound by the Court's sanction, it could by its contract with the old Company, that Company in turn being bound to see to the fulfilment of the obligation. This covers the whole ground of the appeal, and I agree it should be dismissed.

Appeal dismissed with costs.

Solicitors, for the appellant, *Atthow & McGregor.*
Solicitors, for the respondents, *Thynne & Macartney.*

N. McG.

(1) (1893) 1 Ch., 484*n*.

(2) L.R. 20 Eq., 772.