Daewoo Singapore Pte Ltd v CEL Tractors Pte Ltd
[2001] SGCA 53

Case Number : CA 600031/2001

Decision Date : 20 August 2001

Tribunal/Court : Court of Appeal

Coram : Chao Hick Tin JA; L P Thean JA; Yong Pung How CJ

Counsel Name(s) : Tan Cheng Han (Tan Cheng Yew & Partners) for the appellant; Vinodh S Coomaraswamy and David Chan (Shook Lin & Bok) for the respondent

Parties : Daewoo Singapore Pte Ltd — CEL Tractors Pte Ltd

Companies – Schemes of arrangement – Binding effect due to contract and operation of law – When s to 210 invoked – ss 210 & 210(3) Companies Act (Cap 50, 1994 Ed)

Companies – Schemes of arrangement – Nature – Objectives – Court's duty when approving schemes – s 210 Companies Act (Cap 50, 1994 Ed)

Companies – Schemes of arrangement – Scheme incorporating term releasing third party guarantor from liability for loans of debtor company – Whether scheme can incorporate such term – Effect of scheme on creditor's rights against third party guarantor and company – Whether term valid and effectual – s 210 Companies Act (Cap 50, 1994 Ed)

(delivering the judgment of the court):

Introduction

This is an appeal against the decision of Kan Ting Chiu J sanctioning a scheme of arrangement made between the company, CEL Tractors Pte Ltd (`CEL Tractors`) and ten creditors under s 210 of the Companies Act (Cap 50, 1994 Ed) (`the Companies Act`). One of the creditors, Daewoo Singapore Pte Ltd (`Daewoo`) objected to the scheme and now appeals against Kan J`s decision.

The facts

The facts are not in dispute and are briefly these. CEL Tractors have proposed a scheme of arrangement dated 23 February 2001 (`the scheme`) expressed to be made between CEL Tractors and ten creditors, one of whom was Daewoo. All the ten creditors hold guarantees in respect of loans and liabilities owed by CEL Tractors to them respectively. In particular Daewoo has a guarantee given by one Mr Lim Chee Seng (`Mr Lim`) in respect of moneys owing to them by CEL Tractors. Mr Lim is a director of CEL Tractors.

For the purpose of this appeal, the material terms of the scheme are those contained in cl 4. Briefly they are as follows. Under cl 4.1, CEL Tractors are obliged to pay certain sums of money to the creditors within certain times; and under cl 4.2, CEL Tractors are obliged to grant to the respective creditors an option entitling them to require CEL Tractors to allot and issue to them certain numbers of shares credited as fully paid in the capital of CEL Tractors. All these options become exercisable at a certain time. The controversial part of the scheme is cl 4.3, which is as follows:

> *4.3 Release of Security Documents and Guarantees*
>
> *4.3.1 Upon the Company fulfilling its obligations under Clause 4.1.1.1 and Clause*

4.1.1.2, (a) the Bank Creditors shall fully and completely discharge all and any of its rights under the Deed of Debenture and the Creditors` Mortgage, and save for Keppel TatLee Bank Limited, shall fully and completely release each and every Bank Guarantor from his obligations under any and each Bank Guarantee, and (b) Daewoo Singapore Pte Ltd shall fully and completely release the Daewoo Guarantor from his obligations under the Daewoo Guarantee.

4.3.2 Upon the Company fulfilling its obligations under Clause 4.1.1, Keppel TatLee Bank Limited shall fully and completely discharge all and any of its rights under the Keppel Mortgage, and shall fully and completely release each and every Bank Guarantor from his obligations under any and each Bank Guarantee in its favour.

4.3.3 If the Creditors decide to exercise the option for the First Tranche and the second Tranche pursuant to Clause 4.2.3, (a) the Bank Creditors shall fully and completely discharge all and any of its rights under the Deed of Debenture and the Creditors` Mortgage, and save for Keppel TatLee Bank Limited, shall fully and completely release each and every Bank Guarantor from his obligations under any and each Bank Guarantee, and (b) Daewoo Singapore Pte Ltd shall fully and completely release the Daewoo Guarantor from his obligations under the Daewoo Guarantee.

Section 210 of the Companies Act allows, among other things, a compromise or arrangement to be made between the company and its creditors or any class of creditors. In so far as relevant, the provisions of s 210 are as follows:

(1) Where a compromise or arrangement is proposed between a company and its creditors or any class of them ... the Court may, on the application in a summary way of the company or of any creditor ... order a meeting of the creditors or class of creditors ... to be summoned in such manner as the Court directs.

(2) ...

(3) If a majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members present and voting either in person or by proxy at the meeting or the adjourned meeting agrees to any compromise or arrangement, the compromise or arrangement shall, if approved by order of the Court, be binding on all the creditors or 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.

We should mention that, in the case of a compromise or arrangement with creditors of a company, s 210 is applicable only if the compromise or arrangement as proposed is one made between the company and all its creditors or any class of its creditors. It is unclear from the facts deposed in the affidavits whether the ten creditors are all the creditors of CEL Tractors or they form a class of the

creditors of CEL Tractors. However, no issue was raised on this point, and for the purpose of this appeal, we assume that the ten creditors are either all the creditors or form a class of the creditors of CEL Tractors.

Pursuant to s 210(1), an order of court was obtained by CEL Tractors on 2 February 2001, directing them to convene a meeting of the ten creditors for the purpose of considering and, if thought fit, approving the scheme. Accordingly, a meeting of the creditors was duly convened for the purpose. At the meeting, the scheme was put to vote and was approved by a majority representing not less than three-fourths in value of the debts of the creditors present and voting, namely eight out of the ten creditors, holding 95.62% of the debts, with one creditor abstaining. Only Daewoo voted against the scheme.

Having obtained the requisite majority of the creditors at the meeting, CEL Tractors applied to court for approval of the scheme under s 210(3) of the Companies Act. At the hearing of the application, predictably Daewoo objected to the scheme. They raised two objections. The first objection was that the scheme as drafted requires them to release the guarantor from his obligations under the guarantee given to them for the debt of CEL Tractors. That was the guarantee issued by Mr Lim in favour of Daewoo. Under the guarantee, Mr Lim guaranteed the payment of all moneys and liabilities owing by CEL Tractors to Daewoo. It was contended on their behalf that such release was unfair to Daewoo as the guarantee was a valuable security to them. The second objection is that a scheme of arrangement under s 210 of the Companies Act could not embody a term which had the effect of discharging the liability of a third party, such as a guarantor, for the debt or liability of CEL Tractors or make such a term as part of the scheme. Mr Lee Young Kwon, the finance manager of Daewoo, in his affidavit filed in opposition to the scheme, said at paras 7, 11 and 12 as follows:

> *7 The principle (**sic**) reason why Daewoo is objecting to the scheme of arrangement is because the scheme of arrangement as drafted/passed requires Daewoo to release a guarantee given by a director of CEL on 15 August 1998 i.e. one Lim Chee Seng. A copy of the said guarantee is now produced and shown to me marked as "YKL-1".*
>
> *11 I wish to state that sanction of the scheme is unfair to Daewoo as the said Lim Chee Seng`s debt to Daewoo under the said guarantee is a personal debt which he owes to Daewoo, wherein he contracts as principle (**sic**) debtor. By allowing the scheme to encompass the guarantee, Daewoo would be losing a valuable security and/or an opportunity to recover its losses from an independent third party, which is over and above the debt which CEL owes to Daewoo.*
>
> *12 I verily believe that a scheme of arrangement under Section 210 of the Companies Act cannot encompass a scheme which allows the debts or financial obligations of a non-company or third party individual to be forgiven or to form part of a comprehensive settlement of a company`s debts as Section 210 of the Companies Act should only allow a scheme of arrangement in relation to debts owed by the Company itself.*

The first objection raises the question of fairness of the scheme to Daewoo, which, however, was not canvassed before the court below. It was not suggested that the scheme was unfair to Daewoo in any way. True it is that cl 4.3.1 of the scheme requires Daewoo to release the guarantor, Mr Lim,

from his liability under the guarantee in respect of CEL Tractors` debts owed to them. But Daewoo have not been singled out in this respect. All the other creditors have been treated alike. They are required to discharge their securities and also to release their guarantors from the guarantees respectively. In particular, the bank creditors (as described therein) are required to discharge the securities given to them, such as the mortgages and debenture, and also to release the `the Bank Guarantors` from their guarantees respectively.

The second objection is this. The scheme expressly incorporates provisions requiring the creditors to discharge and release their securities and further to release the guarantors from their liabilities under the guarantees for the debts and liabilities of CEL Tractors. It was argued that a scheme of arrangement under s 210 of the Companies Act could not encompass such provisions on the ground that a scheme under that section bound only the company and the creditors and therefore could only discharge or affect the debts and liabilities of the company and not the liability of a third party, such as a guarantor, for the same debts and liabilities of the company.

The decision below

The judge examined the Australian and English cases dealing with statutory schemes of arrangement, and acknowledged that there were authorities to the effect that a scheme of arrangement could not affect the rights of third parties. However, he regarded the authorities as only persuasive and chose to adopt the approach in the analogous case of **Johnson v Davies** [1998] 2 BCLC 252[1998] 2 All ER 649 decided by the English Court of Appeal. The judge agreed with the reasoning in ***Johnson v Davies*** and accordingly held that a scheme of arrangement could similarly discharge the liability of a third party such as a guarantor. He also justified this proposition on the ground of policy. He said ([2001] 2 SLR 549 at [para]26-28):

> *26 In my view s 210(3) should be given its plain meaning, ie that an approved arrangement binds all the creditors. It cannot matter that an objecting creditor has not consented to be bound because he is nevertheless bound by the operation of law. I do not see any reason why the arrangement has to have his support for the provision to take effect and for the arrangement to bind him.*
>
> *27 I do not agree that an arrangement cannot discharge the liability of a party who is not a party to it. That view ignores the commercial framework of such arrangements. It is not unusual for the creditors of a company to hold guarantees from the major shareholders and directors of the company. It is not uncommon for these shareholders and directors to be the main players in seeking an arrangement with the creditors by offering their own assets in satisfaction of the debts owed by the company in return for the release of their guarantees. In such situation the creditors cannot be permitted to take the benefits offered by the arrangement and also retain the benefit of the guarantees.*
>
> *28 The better policy is to allow the release of guarantors when that has been expressly provided for, than to refuse it. It should be remembered that a scheme of arrangement must have the support of the majority of the creditors and approved by court before it takes effect. After a scheme is accepted by the creditors, an objecting creditor can persuade the court to withhold its approval, or to approve it subject to such alternatives or conditions as it thinks fit (see s 210(4)). The objecting creditor would succeed if he can show that the*

> *creditors did not vote bona fide for the benefit of the creditors or the company as a whole (see **Re Wedgwood Coal and Iron Co** [1877] 6 Ch D 627), or that the scheme is not fair and reasonable (see **Re Dorman, Long & Co** [1934] Ch 635). I find it difficult to agree that as a matter of policy or principle an arrangement cannot be allowed to release guarantors, regardless of its terms.*

The appeal

Before us it has not been suggested that the scheme is in any way unfair or discriminatory or that the majority creditors in approving the scheme were not acting bona fide and that Daewoo being the minority were coerced to promote the interests of the majority. Therefore, no issue of unfairness, discrimination or absence of bona fides arises in this appeal.

The only objection raised before us by Mr Tan Cheng Han, counsel for Daewoo, is that the scheme cannot contain or embody a term which has the effect of discharging the liability of a third party, such as a guarantor, for any indebtedness or liability of the company or make such a term as part of the scheme. The basis for this objection is that it is settled law that a scheme of arrangement made between a company and its creditors and approved under s 210 of the Companies Act does not affect the liability of a guarantor to pay the debt of the company which he has guaranteed. In support, counsel relies on some Australian and English cases. As we will show in a moment, these cases are concerned with the question as to the effect of a scheme of arrangement on the liability of a co-debtor or surety of the company which is subjected to the scheme of arrangement, and not really with the question whether a scheme of arrangement can embody a term seeking to discharge the liability of a co-debtor or surety of the company.

Effect of a statutory scheme of arrangement

We turn first to the leading case of **Hill v Anderson Meat Industries** [1971] 1 NSWLR 868. There, a company, Anderson Meat Industries Ltd (`Anderson") and its five subsidiaries were in financial difficulties, and schemes of arrangement were made between the subsidiaries and their creditors respectively under s 181(1) of the Companies Act 1961 (the equivalent of our s 210) whereby, among other things, in consideration of a payment to the creditors amounting to 60[cent] to the dollar the debts owed to the creditors would be extinguished and discharged. One of the subsidiaries, Anderson Meat Packing Co Pty Ld, was indebted to a Mrs Hill, and the debt was guaranteed by Anderson. Mrs Hill voted against the scheme. There was no provision in the schemes which discharged any guarantee given for the debts and liabilities of the subsidiaries. The schemes were approved by the requisite majority and by the court. Mrs Hill later sued Anderson for the amount due under the guarantee, contending that Anderson remained liable to her under the guarantee, notwithstanding the schemes. At first instance, Street J, having considered the distinction between a debt discharged by contract and one discharged by operation of law, said at p 875:

> *Essentially the point for present determination turns upon whether there is a valid distinction between a composition within the bankruptcy legislation or a scheme within a current winding up on the one hand, and a scheme outside a winding up upon the other. In my judgment the point of distinction, although it exists, is too fine to be recognized. Where, as here, a scheme of arrangement is propounded in connection with the affairs of an insolvent company, then the court`s approval under s 181 will give to the scheme a statutory operation*

upon the relationship between the debtor and its creditors, and so far as concerns a guarantor, in the absence of any special provision in the guarantee agreement, the guarantor`s liability subsists in exactly the same manner as if the scheme had been formally approved within a current winding up.

The learned judge therefore held that the liability of Anderson under the guarantee was not discharged. On appeal, his decision was affirmed: [1972] 2 NSWLR 704. Jacobs P said at p 706:

What has been submitted to this Court is that by the terms of the scheme, particularly cl 3 which I have set out, the debt owing by the packing company to Mrs Hill is extinguished. Next, because a guarantee is an accessory obligation, upon the extinguishment of the principal indebtedness the guarantee goes also, as a result of the fact that there is no principal debt to which the accessory liability can attach. It is conceded, as of course it must be, that these principles do not apply where the obligation is extinguished by operation of law, as for instance in the case of bankruptcy or the winding up of a company, but it is submitted that the obligation in the present case is not extinguished by operation of law but rather is extinguished by the terms of the scheme which impose not only upon those creditors who assent to it, but upon all creditors, the effect of the document which constitutes the scheme. In this way it is submitted that the cases which are referred to by Street J are distinguishable.

The argument is not substantially different from that which was propounded before the judge at first instance. He rejected it upon the ground that there is in fact a discharge of the obligation by operation of the law. I agree with this conclusion. Mrs Hill was never a party to the release of the obligation. The release came through the operation of a law which bound her as though she were a party. This seems to me in principle to be within that line of authority which so clearly establishes that the extinguishment of a principal obligation, when it is brought about by operation of law, does not result in a discharge of the surety.

The decision in ***Hill*** (supra) was followed in Australia. In particular, in **Gan v Sanders** [1994] 15 ACSR 298, the Supreme Court of Victoria held that the deed of arrangement entered into between Luxville Pte Ltd (the debtor company) and its creditors did not discharge the third party surety. Mandie J said at p 301:

It is true that cl 5 speaks of a discharge although that discharge is in consideration of the entitlements of creditors under the deed. It is clear from cll 4, 5, 6 and 12(c) that the creditors remain entitled to participate in distributions as referred to therein. Indeed, cl 6 refers to the extinguishment of debts and claims "if the administrator has paid to the creditors their full entitlements under this deed". The deed takes and is binding by virtue of ss 444D, 444E and 444G of the Corporation Law.

*In **Hill v Anderson Meat Industries Ltd** [1972] 2 NSWLR 704, there was a scheme of arrangement which had been approved by the court under the then provisions of the Companies Act. The scheme, like the deed in this case, in substance substituted a right to participate in distributions for the original debt which was extinguished. The New South Wales Court of Appeal held that the extinguishment of the principal debt occurred by operation of law and hence did not result in the discharge of the surety. In my view, the present case is indistinguishable.*

The New Zealand courts have likewise followed suit. In the High Court case of **Re Southern World Airlines** [1993] 1 NZLR 597, a scheme of arrangement was designed to resuscitate Southern World Airlines Ltd with a `buy-out` by a new operator. The scheme, among other things, expressly provided for the assignment of the debts of the company to a nominee of the new operator and further provided that thereafter the creditors would have no further claim against the company. Upon the application to court for sanction of the scheme, two creditors objected to the scheme. One of the objections made was that one of the two creditors held a guarantee from another party for part of the debt owed by the company and that the scheme might discharge the guarantee. However, there was no term in the scheme which sought to extinguish the rights of the creditor under the guarantee. Williams J held that the scheme did not extinguish third party liabilities. He said at p 605:

> *In the present case the scheme of arrangement required the creditors in consideration of their receipt of certain money from the scheme manager to assign the amount of their debts and the creditors "shall not henceforth assert against the company any claim action or proceeding arising from any indebtedness matter instrument or thing existing prior to the commencement date. It was submitted that what would happen to the creditors` debts under this scheme just as in the other forms of scheme, occurred by operation of law and not by the voluntary act of the creditor so there could not be a discharge of the guarantor ...*
>
> *In summary the applicant submitted that it was not the form of the scheme which mattered in terms of whether the guarantee was discharged but rather whether the scheme of arrangement occurred by operation of law. Fine distinctions between schemes were immaterial - the key issue was the principle expounded in **Hill v Anderson Meat** which was of general application. I uphold those contentions.*

Similar pronouncement was made in **Buttle v Allan as Official Liquidator of Buttle & Co Sharebrokers (in liquidation)** [1994] 1 NZLR 396 at 404, where the New Zealand Court of Appeal said:

> *We accept **Hill**`s case as being a correct statement of the law in New Zealand as well as in Australia. The sanctioning of a scheme of arrangement does not discharge the original debt for all purposes any more than does the adjudication in bankruptcy of the debtor or the winding up of a debtor company. It does not affect the liability of a guarantor, even though that liability is expressed in the form of a guarantee of the original debt.*

We now turn to the English authorities. In **Ex p Jacobs, re Jacobs** [1875] LR 10 Ch App 211, one James Martin was the holder of a bill of exchange which was drawn by a person called Sydney Jacobs upon one Samuel Phillips. The bill was dishonoured, and Phillips, being unable to pay his debts, called a meeting of his creditors, and a composition was agreed upon between him and the requisite number of creditors pursuant to ss 125 and 126 of the English Bankruptcy Act 1869. The issue for determination before the court was whether Jacobs`s liability to Martin was discharged by virtue of the composition. The court held that the discharge of Phillips was by operation of law and that Jacobs was not discharged. Mellish LJ said at p 213:

> *There can be no doubt that, if the holder of a bill, by becoming party to a deed or agreement, independently of any bankruptcy Act, agrees to accept a composition from the acceptor, he thereby discharges the drawer; but, on the other hand, it is equally clear that if the acceptor is discharged from his liability by operation of law by becoming a bankrupt, the liability of the drawer to the holder is not thereby affected.*

In **Re London Chartered Bank of Australia** [1893] 3 Ch 540, Vaughan Williams J considered a scheme of arrangement proposed by a bank under s 2 of the Joint Stock Companies Arrangement Act 1870 (which, so far as material, is substantially similar to our s 210). An objection was made to the scheme on the ground that it did not reserve the right of the creditors against the sureties of the company for the latter`s debts. The learned judge held that there was no need to insert such a reservation in the scheme. In considering the terms and the effect of the scheme, the learned judge said at pp 546-547:

> *The scheme contains no release of the bank or the contributories; it contains no covenant not to sue, and it is by operation of law that the scheme becomes effective to relieve the company and contributories from further liability than that contemplated or imposed by the scheme. The scheme of arrangement under the Act of 1870 is - as I have had occasion to point out in several cases - an alternative mode of liquidation which the law allows the statutory majority of creditors to substitute for the pending winding-up, whether voluntary or under the Court, just as the **Bankruptcy Act**, 1869, allowed the creditors the substituted liquidation by arrangement under sect. 125, or composition under sect. 126, of that Act, for a pending bankruptcy. The discharge of the bankrupt in such case was statutory and not conventional, and therefore by operation of law. Just so here, under the Act of 1870. The discharge of the company or contributories under the **Joint Stock Companies Arrangement Act**, 1870, is by operation of law effected by the stay of actions imposed ... It seems to me, then, that, the discharge being clearly by operation of law consequent upon statutory liquidation, the principles laid down by Lord Justice Mellish in **In re Jacobs** [1875] LR 10 Ch App 211 apply, and that, therefore, there is no need, and it would not be right, to introduce a reservation of rights against sureties into the scheme of arrangement.*

In a similar vein was the case of **Dane v Mortgage Insurance Corp** [1894] 1 QB 54 decided by the Court of Appeal. There, the defendants by an instrument purported to be a `policy of insurance` guaranteed the plaintiff that they would pay her a certain sum of money, if a certain bank defaulted in making payment on a loan agreement. Subsequently, the bank defaulted and proposed a scheme of arrangement with the creditors under the Australian legislation, and the scheme was approved by the requisite majority of creditors and the court. The plaintiff did not assent to the scheme, which however under the legislation was binding on her. She later brought an action against the defendants under the guarantee. Although the court was undecided as to whether the liability of the defendants was in the nature of a suretyship or an insurance contract, it was unanimous that the defendants were liable notwithstanding the scheme of arrangement. Kay LJ following ***Re Jacobs*** (supra) said at pp 63-64:

> *It was decided in **Ex parte Jacobs** [1875] LR 10 Ch App 211 that a resolution for liquidation or composition, though binding on all the creditors, is a discharge of the debtor by operation of law, and does not discharge the surety. Assuming that this contract was, as contended by the defendants` counsel, a mere contract of guarantee or suretyship, it seems to me that default did occur*

> *within the meaning of that contract, and that therefore a right of action vested in the plaintiff to which what occurred afterwards affords no kind of defence.*

In **Re Garner`s Motors** [1937] Ch 594, two companies Sentinel Waggons Works Ltd (`Sentinel`) and Garner`s Motors Ltd (`Garner`s Motors`) were under a joint and several liability to Temple Press Ltd in respect of certain payments. Sentinel went into receivership and a scheme of arrangement was proposed by Sentinel to be made with its creditors and shareholders under s 153 of the Companies Act 1929 (which was identical in all material respects with our s 210). The scheme was sanctioned by the court. Pursuant to the scheme of arrangement, Temple Press Ltd accepted a certain payment from Sentinel, which discharged all the liability of Sentinel. Later, Garner`s Motors went into liquidation, and Temple Press lodged a proof of debt for the balance sum owing. The proof was rejected by the liquidators of Garner`s Motors. The question was whether the scheme of arrangement of Sentinel discharged the liability of Garner`s Motors to Temple Press Ltd. Crossman J held that a statutory scheme did not have this effect and said, at pp 598-599:

> *It is settled law that accord and satisfaction between a creditor and one of several debtors, who are jointly and severally liable to the creditor, discharges the other debtors unless it appears from the terms of the agreement or the surrounding circumstances that the creditor intended to reserve his rights against them ... But in my judgment a discharge of one of several joint debtors by operation of law does not discharge the other debtors. In my judgment the effect of s. 153 of the Companies Act, 1929, is to give to a scheme when sanctioned by the Court under the section a statutory operation. The scheme when sanctioned by the Court becomes something quite different from a mere agreement signed by the parties. It becomes a statutory scheme. In my judgment, therefore, the discharge of Sentinel Waggon Works, Ld., from the debt to Temple Press, Ld., which was effected under clause 15 of the scheme sanctioned by the Court on March 23, 1936, did not have the effect of discharging Garner`s Motors, Ld., from its liability in respect of the debt. It is settled law that a discharge of one of several judgment-debtors by operation of law does not release the other debtors. But in my judgment the effect of s. 153 of the Companies Act, 1929, is to give a scheme when sanctioned by the Court a statutory operation.*

Settled law

On the basis of these authorities, it is settled law that a scheme of arrangement or compromise made between a company and its creditors in relation to its debts and liabilities, approved by the requisite majority of the creditors and by the court, affects only the rights of the creditors against the company, and does not affect the rights of the creditors against a third party, such as a guarantor, for the same debts and liabilities of the company. Consequently, where such scheme discharges either in whole or in part the debts owed by the company to its creditors, it does not operate as a discharge of the liability of the guarantor for the same debts or liabilities of the company. However, in all these cases, the schemes in question did not contain any express term requiring the creditors to extinguish or discharge the liability of a third party, such as a guarantor, for the debts or liabilities of the company concerned. In the instant case, the scheme contains an express provision to the effect that upon the company, CEL Tractors, observing and performing their obligations under the scheme, the creditors will release the guarantors from their obligations under the respective guarantees. In this respect, the instant case is distinguishable from these cases, which therefore do not really assist in the resolution of the issue before us.

Issues

It seems to us that in this case there are really two issues for determination. The first is whether it is permissible to incorporate in a scheme of arrangement or compromise under s 210 of the Companies Act, as was incorporated in the present scheme under consideration, a term to the effect that, upon the company performing its obligations as regards payments and other things vis-.-vis the creditors under the scheme, the creditors will release the guarantors from their obligations under the respective guarantee. The second is whether such a term is valid and effectual for the purpose.

On the first question, we can see no reason in principle why a scheme of arrangement or compromise under s 210 of the Companies Act cannot incorporate such a term. No cases have been cited to us to say that such a term cannot be embodied in a scheme. After all, a scheme of arrangement or compromise proposed by a company to be made with its creditors or a class of creditors under s 210 of the Companies Act is no more than a proposal to vary or modify its obligations in relation to its debts and liabilities owed to its creditors or a class of creditors on certain terms and conditions. In seeking so to vary or modify its obligations, there is nothing to prevent the company from proposing, as part of a wider scheme, inter alia, a term to the effect that, in consideration of what the company has provided under the scheme, the creditors will, upon implementation of the scheme, discharge not only the debts and liabilities of the company but also the liabilities of the guarantors for the same debts and liabilities of the company. Whether such a term is agreeable to its creditors is a different matter; it all depends on the circumstances of the case and what the company has to offer under the scheme as a quid pro quo for the discharge of these liabilities.

It is trite law that, where a scheme of arrangement or compromise (containing such a term) is approved by all the creditors of the company, it is binding on the company as well as its creditors. In such a case, there is no need on the part of the company to invoke s 210 of the Companies Act. The scheme is wholly a contractual scheme. Where, as is usually the case, it is not practical or practicable to secure the unanimous agreement of all the creditors, s 210 is invoked. And when s 210 is invoked, and the scheme is approved by the requisite majority of the creditors and the court, the scheme becomes binding on all the creditors or the class of creditors (as the case may be). That is provided in s 210(3) of the Act. The binding effect of the scheme is given by the court order approving the scheme. As Street J said in **Re Norfolk Island and Byron Bay Whaling Co** (Unreported) at 354 with reference to s 181 of the Companies Act 1961 of the State of New South Wales (which is the equivalent of our s 210), the section is intended to provide a machinery (1) for overcoming the impossibility or impracticability of obtaining the individual consent of every member of the class intended to be bound thereby, and (2) for preventing, in appropriate circumstances, a minority of class members frustrating a beneficial scheme.

We now turn to another aspect of a scheme of arrangement or compromise under s 210 of the Companies Act. It is permissible in law to incorporate in a scheme an involvement or participation by an outsider, that is, a party not a party to the scheme. Indeed, quite often, a scheme does provide for such involvement or participation by an outsider. Quite often, a scheme as devised provides for a `buy out` or an injection of cash by an outsider and it has been held that such a scheme falls within the purview of that section. In **Re A and C Constructions** [1970] SASR 565, the Supreme Court of South Australia held that the court would not refuse to approve a scheme under s 181 of the Companies Act 1962-1968 (which was the equivalent of our s 210) merely because (1) the scheme provided for an outsider to purchase the company structure in order to obtain a tax benefit, and (2) that a person other than the company, its members and creditors was a party to the scheme. Bray CJ said at p 568:

> *An order of the court under s 181(2) is necessary so that a dissentient, non-voting or absentee minority of creditors or members may be bound by the scheme. Otherwise everything could be done contractually. The order of the court in the terms of the sub-section is made binding only on the creditors or members, or particular class of creditors or members, and on the company, or, if the company is being wound up, also on its liquidator and contributories. It is, however, in my view, a fallacy to assume that therefore no other person can be a party to the scheme. In my view, so long as the scheme can properly be described as a compromise or arrangement between a company and its members or creditors or any class of them within the meaning of s 181(1), it is immaterial that other persons are parties to it, but its binding force on such other parties will derive from the scheme as a contract, or from some other contract, and not from the order of the court.*

A similar pronouncement was made by another member of the court, Wells J who said at p 574:

> *A scheme that includes provisions that may without doubt be said to constitute a compromise or arrangement of the kind described by s 181 does not cease to fall within the jurisdiction conferred upon the court by that section by reason only of the inclusion within the scheme of an outsider - a person not the company, a member or a creditor - but the extent to which the stranger will be bound by the scheme will depend on the inherent contractual validity of the scheme with respect to the stranger, and not upon any order of the court under s 181 signifying its approval of the scheme.*

In **Re Glendale Land Development (in liquidation)** [1982] 7 ACLR 171, a scheme of arrangement proposed by the company under s 315(1) of the Companies (NSW) Code involved a third party in the implementation of the scheme. On the application by the company for directions to convene a meeting of creditors, McLelland J of the Supreme Court of New South Wales considered whether the scheme could contain such a provision involving an `outsider`. He held that an arrangement between a company and its relevant creditors was not outside the scope of s 315 merely because it was part of a wider scheme involving an outsider or an outsider was a necessary party to the implementation of the scheme. The learned judge said at p 173:

> *[A]n arrangement between a company and its relevant creditors or members is not outside the scope of such a provision as s 315 merely because it is part of a wider scheme involving outsiders, or an outsider is a necessary party to its implementation. This is in any event made abundantly clear by the provisions of s 317.*

In coming to this conclusion, the learned judge followed the decision in ***Re A and C Constructions*** (supra) and adopted those parts of the judgments of Bray CJ and Wells J quoted above.

The scheme before us involves also third parties but in a passive way. Under cl 4.3 of the scheme, the creditors of CEL Tractors are required, upon CEL Tractors performing their obligations under the scheme, to release the guarantors from the obligations to pay the debts and liabilities of the company under the respective guarantees. In our judgment, there is no reason why the scheme may not contain such a provision.

We now turn to the second question, which is whether such a term is valid and effectual, bearing in

mind that the guarantors are not a party to the scheme. It has been held in a couple of Australian cases that even if a scheme contained a term seeking to discharge the rights of the creditors against the guarantors, such a scheme would not affect the rights of the creditors against the guarantors for the debt or liability of the company concerned.

The first is **Re Buildmat (Aust)** [1981] 5 ACLR 689 which is relied upon by Daewoo. A company, Buildmat, had covenanted to pay to the landlord of certain premises the rents and other outgoings of the tenant, Piermat. The latter subsequently entered into an arrangement with its creditors whereby, among other things, upon certain payments being made, Piermat would be under no further liability to its creditors. The scheme also contained a term to the effect that the creditors would relinquish all their rights under the guarantees and indemnities given in respect of Piermat`s indebtedness. The scheme was approved by the requisite majority of Piermat`s creditors and by the court. The landlord subsequently petitioned for the winding up of Buildmat relying on the latter`s failure to meet their obligations to make certain payments due under the lease. Needham J of the Supreme Court of New South Wales held that, notwithstanding the express provision in the scheme of arrangement, the scheme did not discharge the liability of Buildmat. He said at pp 691-692:

> *In my opinion, cl 15 of the lease is not an indemnity: it creates a joint and several liability in the lessee and the covenantor ... However, it does not seem to me to matter, in this case, whether I am right or wrong in that conclusion, because, even if cl 15 constitutes an indemnity, the scheme does not effect a discharge of that indemnity ...*
>
> *It is, I think, well established by decisions binding on me that the contractual relationship existing between the creditors of a company and the company after the approval by the court of a scheme of arrangement under s 181 of the Companies Act 1961, is a relationship created by the operation of the Act on the order of the court ... It follows, as the Court of Appeal has held (in **Hill v Anderson Meat Industries** [1972] 2 NSWLR 704) that, where a creditor`s debt has been discharged by the operation of a scheme of arrangement approved by the court, the approval of the scheme does not affect the right of a creditor bound by the scheme to take proceedings for recovery against a guarantor.*

We would make two observations. First, what the learned judge said is, in our respectful view, strictly correct; that was clearly the position as between the creditor and the guarantor, Buildmat. However, it does not follow that as between the creditor and Piermat such a term had no effect and was not binding on the creditor, and that Piermat could not take proceedings to enforce that term. This particular point was not discussed or mentioned by Needham J in his judgment. Secondly, the learned judge founded his decision on ***Hill*** , but the schemes in ***Hill*** did not contain such an express term extinguishing the rights of the creditors against the guarantors. To that extent, ***Hill*** is distinguishable from ***Buildmat*** .

The next case is **Re Andersens Home Furnishing Co** [1996] 14 ACLC 1. There, the directors of a company, Edshar, appointed an administrator under Pt 5.3A of the Corporation Law, and the administrator drew up a deed of arrangement proposed to be made between the company and its creditors. Under the deed the directors were to sell their house and to use the proceeds to pay the creditors and upon such payment the creditors were deemed to have released the directors from their guarantees. At a meeting of creditors called to consider the proposed deed, the motion that the deed be approved and executed was carried with the requisite majority. Two of the creditors who were against the deed had guarantees given by the directors of the company. One of these two creditors applied to court to terminate the deed on the ground that it was unfairly discriminatory against it.

Demack J, following ***Hill v Anderson Meat Industries*** (supra), held that the deed did not extinguish the rights of the creditors against the guarantors. The learned judge said at p 1,714:

> *Applying that decision here, Lacys [the guarantors] have given a guarantee to Andersens that they will meet Edshar`s debts. If the deed operates as a discharge of Edshar`s obligations to Andersens, it does so by virtue of s 444D and not by virtue of any agreement between Edshar and Andersens. In those circumstances it does not discharge Lacys`s obligations to Andersens. In the words of s 444D(1), the deed binds all creditors of the company so far as it concerns claims arising on or before the day specified in the deed. The claims that are referred to are claims against the company, not claims a creditor might make against a person who has guaranteed the payment of the debts of the company ...*

Later the learned judge said:

> *However, by this deed, the creditors` meeting has purported to release Lacys from personal obligations they have assumed towards Andersens and the landlord. There is no statutory authority to do this. There is no common law or equitable basis for doing this. Consequently, cl 5.3 is beyond the power of the creditors` meeting, unless, of course, the creditors who are affected by the clause vote in favour of the execution of the deed. The provision, cl 5.3, is unfairly discriminatory against Andersens, which voted against the motion to execute the deed.*

Here again, we observe that the learned judge`s decision was founded on ***Hill v Anderson Meat Industries*** (supra). As we have said, the schemes of arrangement in ***Hill*** did not contain any provision seeking to discharge the rights of the creditors against the guarantors of the company concerned. Nor did the learned judge consider the binding effect of the arrangement as between Edshar and its creditors, and in particular whether Edshar could in principle enforce the term relating to the discharge of the guarantors.

True it is that a scheme of arrangement or compromise made between a company and its creditors under s 210 of the Companies Act binds only the company and the creditors. The guarantors of the company`s debts and liabilities are not a party to the scheme, and hence as between the creditors and the guarantors of the debts and liabilities of the company, the scheme of arrangement by itself, of course, does not affect directly the rights and obligations of these parties under the guarantees. Consequently, as and when the scheme is approved by the requisite majority of the creditors and by the court under s 210, as between the creditors and the guarantors of the company, the rights and obligations of the parties under the guarantees remain unaffected by the scheme. On the other hand, as the scheme is binding on the company and its creditors, there is no reason in principle why the company cannot in principle enforce the terms of the scheme as against the creditors. It must be borne in mind that the scheme contains reciprocal rights and obligations of the company and the creditors, and once the company has observed and performed all its obligations under the scheme, the creditors likewise must observe and perform their obligations thereunder, and if they fail or refuse to do so, the company is entitled to take proceedings to enforce their obligations under the scheme.

It follows therefore that in this case, if CEL Tractors duly perform their obligations under the scheme vis-.-vis the creditors, the latter must likewise perform their obligations thereunder, and if they refuse or fail to do so, eg if they take legal proceedings to enforce the guarantees, CEL Tractors are entitled

to seek equitable reliefs in the form of an injunction and specific performance against the creditors concerned, because if the creditors seek to enforce the guarantees, the guarantors will inevitably seek to have a recourse against CEL Tractors for an indemnity. Such a position would entirely negate the provisions of cl 4.3 of the scheme.

For completeness, we should consider the decision of the English Court of Appeal in the case of **Johnson v Davies** (Unreported) , which was relied upon by the judge below and by Mr Coomaraswamy, counsel for CEL Tractors, before us, although in our view it is not strictly relevant. In that case, the plaintiffs were the sureties of a lease taken in the name of their company. Later they sold their shares in the company to the two defendants and a third party, Hopkins, and in the sale agreement the defendants and Hopkins agreed to indemnify the plaintiffs against all claims arising under the lease. The company subsequently went into receivership and a claim was made against the plaintiffs which they met. At about that time, Hopkins entered into a voluntary arrangement with his creditors under Pt VII of the Insolvency Act 1986, under which, among other things, subject to certain payments made by Hopkins in a certain manner, he would be released from further liability to all his creditors. The plaintiffs were given notice of the meeting of the creditors convened for the purpose of approving the arrangement. The arrangement was approved. Under the Act, the plaintiffs were deemed to be bound by the arrangement. Subsequently, the plaintiffs brought proceedings against the defendants seeking to recover the sums they had paid under the lease. They applied for summary judgment, and the deputy district judge held that the defendants were discharged by the voluntary arrangement entered into between Hopkins and his creditors, including the plaintiffs, and accordingly, he dismissed the application. The plaintiffs appealed to the High Court judge. The judge took the view that the effect of the voluntary arrangement entered into by Hopkins under the Insolvency Act 1986 was not such as to release co-debtors, namely, the defendants from their liabilities under indemnity given to the plaintiffs. He therefore allowed the appeal. The defendants then appealed to the Court of Appeal. The court dismissed the appeal but on different grounds.

The question in that case was whether the voluntary arrangement made between Hopkins and his creditors under the Insolvency Act 1986 had the effect of releasing the defendants from their joint liability with Hopkins. The provision of the Insolvency Act 1986 applicable to arrangements made by individual persons is s 260, which so far as relevant provides:

> *(1) This section has effect where the meeting summoned under section 257 approves the proposed voluntary arrangement (with or without modifications).*
>
> *(2) The approved arrangement -*
>
> *(a) takes effect as if made by the debtor at meeting, and*
>
> *(b) binds every person who in accordance with the rules had notice of, and was entitled to vote at, the meeting (whether or not he was present or represented at it) as if he were a party to the arrangement.*

Chadwick LJ, with whom Ward and Kennedy LJJ concurred, held that the arrangement being a voluntary arrangement made under the Insolvency Act 1986, depending on its terms, could have the effect of discharging a co-debtor of Hopkins jointly liable for the same debt, but that on the terms of the arrangement it could not be construed to have such effect. Accordingly, the defendants remained liable to the plaintiffs under the indemnity. The learned judge rejected the contention that, even if there is any express term in an arrangement, which would or might otherwise have the effect of

discharging co-debtors and sureties of the debtor from any further liability, that will not be the effect if the arrangement is made under the provisions in Pt VIII of the Insolvency Act 1986. The learned judge took the view that the provisions of the Insolvency Act regarding voluntary arrangements introduce a statutory hypothesis of consent. As such, an arrangement under the Act is not to be considered `statutory` in nature, but were to be treated as consensual deeds which would accordingly be capable of releasing co-debtors. He said ([1998] 2 BCLC 252 at 269-270; [1998] 2 All ER 649 at 665):

> *There is an important - and, to my mind, crucial - distinction between the provisions in Pt VIII of the 1986 Act and those in ss 125 and 126 of the 1869 Act. Under the 1869 Act the discharge of the debtor took effect by virtue of the statute and the rules made under it: see* ***Megrath v Gray, Gray v Megrath*** *[1874] LR 9 CP 216 at 231 and* ***Ex p Jacobs, Re Jacobs*** *[1875] LR 10 Ch App 211 at 213. Under the various Companies Acts, considered in the authorities cited, the discharge takes place by virtue of a scheme which becomes operative when it is approved by the court. Under Pt VIII of the 1986 Act, the discharge of the debtor depends entirely on the terms of the arrangement. One must look at the arrangement, and nothing else, in order to find the terms (if any) under which the debtor is discharged. This is emphasised by the words in s 260(2) of the 1986 Act: `* ***The approved arrangement ... (b) binds every person ... as if he were a party to the arrangement****.` Unlike the earlier legislation, s 260(2) of the 1986 Act does not purport, directly, to impose the arrangement on a dissenting creditor whether or not he has agreed to its terms; rather, he is bound by the arrangement as the result of a statutory hypothesis. The statutory hypothesis requires him to be treated as if he had consented to the arrangement. The consequence, as it seems to me, is that the legislature must be taken to have intended that both the question whether the debtor is discharged by the arrangement and the question whether co-debtors and sureties are discharged by the arrangement were to be answered by treating the arrangement as consensual; that is to say, by construing its terms as if they were the terms of a consensual agreement between the debtor and all those creditors who, under the statutory hypothesis, must be treated as being consenting parties.*

We do not think it is necessary for us to deal with this analysis of Chadwick LJ. Suffice it to say that his analysis was based on the express wording in s 260 of the Insolvency Act 1986.

Generally speaking, in approving a scheme under s 210 of the Act, the duty of the court is to consider whether the statutory provisions have been complied with, whether the scheme is fair and reasonable to the creditors as a whole, whether the company and the majority creditors are acting bona fide, and whether the minority is being coerced to promote the interest of the majority: see **Re English, Scottish, and Australian Chartered Bank** [1893] 3 Ch 385; **Re Dorman, Long & Co** [1934] Ch 635. In our opinion, no question of unfairness, discrimination or absence of bona fides arises in this case. There is no reason why the scheme should not be approved. The judge below approved it. We would do so likewise.

Conclusion

For the reasons given above, we accordingly dismiss the appeal with costs. The security deposit together with the interest, if any, will be released to the respondents or their solicitors to account of costs.

Outcome:

Appeal dismissed.

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