International Corporate Rescue

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2017 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

ARTICLE

High Court Finds that a Form of Holding DOCA Does Not Sidestep Part 5.3A of the Corporations Act

Cameron Belyea, Partner, and **Rebecca Hanrahan**, Senior Associate, Clayton Utz, Sydney, Australia

Synopsis

1. DOCAs can be proposed for the sole purpose of securing a moratorium on claims if other disclosure and statutory requirements are met.
2. DOCAs can be proposed as part of a recapitalisation or restructuring, even if the specifics of the balance sheet or operational terms remain to be determined. This is particularly so when the recapitalisation seeks to protect value in the exchange listing of an entity (protecting the prospects of a shell restructure).
3. The Courts recognise that the primary stakeholders in determining the fate of companies under administration are majority creditors voting in plenary.
4. The Courts recognise that, once a DOCA has been entered into, the onus moves to dissatisfied minority creditors to prove oppression, unfair prejudice or some other form of invalidation of a DOCA on substantive rather than procedural grounds

Introduction

Not since *Lehman Brothers* has the High Court of Australia opined on deeds of company arrangement.

In a highly anticipated judgment, the majority of the High Court found that a particular form of 'holding' deed of company arrangement ('DOCA') we prepared for the Deed Administrators, was valid ('Deed').[1]

Over the past two decades, holding DOCAs of various forms have been used by practitioners to protect value in an exchange based listing of public companies in Australia, allowing administrators time to explore ways to recapitalise the company. If undertaken properly, recapitalisation – whether undertaken as part of a debt for equity transaction, investment of new funds, acquisition of a new business with concomitant capital raising, asset or securities transfer, compositions on creditor classes or other changes in the capital structure – should see better returns achieved for creditors and other stakeholders and often enables continuation of the underlying or a new business.

The Deed examined by the High Court was not a 'garden variety' deed of company arrangement in that it was intended to continue for only six months, and was proposed by the administrators, rather than a proponent, to pursue a series of steps disclosed by the administrators as being necessary to recapitalise or restructure the company or raise a fund for creditors. The Deed also required the administrators to seek proposals for recapitalisation and investigate potential causes of action. the Deed did not itself provide for a return to creditors, though has subsequently been varied to permit a sale of assets and settlement of cash proceeds negotiated within the six month 'holding' period.[2]

Background to the High Court appeal

The appeal was made by Mighty River, a creditor of Mesa Minerals Limited ('Mesa'), which sought to terminate or set aside the deed of company arrangement ('Deed') entered into by the creditors of Mesa, on two broad grounds:

1. that the Deed had failed to specify the property to be distributed to creditors on the basis that by extending time to seek recapitalisation proposals, self-evidently there was no distribution of property under the Deed (the 'property point'); and
2. the concept of a 'holding DOCA' was contrary to the law (the 'invalidity point').

The relevant Deed had several components, including:

– that the administrators were to 'investigate any claims that [Mesa] may have against any third parties', to 'seek Proposals to reconstruct [Mesa]

Notes

1 Mighty River described it as a 'holding DOCA'. The label 'holding DOCA' was described by Keifel CJ and Edelman as one which was 'best avoided' as it may create an ill-defined sub-class of deed of company arrangement. Refer: *Mighty River International Limited v Hughes* [2018] HCA 38 [28].

2 This is unfortunately the subject of further, separate proceedings commenced by Mighty River.

with a view to reaching a position where [Mesa's] securities may be re-quoted for trading on the ASX, including Proposals for the partial or full sale of [Mesa's] assets, and, prior to any proposal being accepted, to convene a further meeting of creditors to put to them such a proposal'.[3]

– a moratorium, during which time no steps could be taken by creditors to wind up Mesa, institute or prosecute any proceedings, enforce debts, exercise any rights of set off or defence, cross-claim or cross-action to which the creditors would not have been entitled on winding up, or commence arbitration against the company.[4]

– subject to its variation, 'there will be no property of [Mesa] available for distribution to Creditors under the deed'.[5]

At trial, the Supreme Court of Western Australia found that the Deed was valid. On Appeal, in separate judgments, the Court of Appeal upheld the Deed. Mighty River sought and obtained special leave to appeal to the High Court of Australia.

The High Court decision

All members of the High Court dismissed the 'property point'. Keifel CJ and Edelman J delivered a joint judgment and dismissed the 'invalidity point', upholding the validity of the Deed. Gageler J agreed and published an additional judgment also rejecting the 'invalidity point'. Nettle and Gordon JJ delivered a dissenting judgment on the 'invalidity point', but agreed the 'property point' should be dismissed.

The majority found that:

1. the deed of was *not* contrary to the object of Pt 5.3A of the *Corporations Act* 2001 (Cth) ('Act');
2. the deed did *not* invalidly seek to circumvent or 'sidestep' the requirement in s 439A(6) of the Act for a court order extending the short convening period during which a second meeting of creditors must be convened by an administrator;
3. the deed complied with an alleged requirement in s 444A(4)(b) of the Act to deal with property of Mesa Minerals;
4. the administrators had *not* failed to form the opinions required by s 438A(b) and at the relevant time s 439A(4).

The statutory scheme

The voluntary administration process is creditor driven opposed to court driven.[6] The process is contained in Pt 5.3A of the Act.

The object of Pt 5.3A is to administer an insolvent company in a way that (a) maximises the chance of the company, or its business, continuing in existence, or (b) if that is not possible, provides a better return for the company's creditors and members than would result from an immediate winding up of the company.[7]

The form of a deed of company arrangement is not mandated by the Act, and it has been described that Pt 5.3A promotes flexibility and a wide variety of different possible deeds of company arrangement.[8]

However, the administration process was also designed to be fast and efficient for creditors.

After a company's directors have resolved to place the company in voluntary administration, an administrator must convene a meeting of creditors within 8 business days.[9] The statutory purpose is to consider whether a committee of creditors (now described in the *Corporations Act* as a committee of inspection)[10] should be appointed and whether to appoint someone else as administrator.[11]

An administrator must convene the second meeting of the company's creditors within the convening period as fixed by s 439A(5), ordinarily within 20 business days after the administration begins. However, an administrator could apply to court to extend the convening period under s 439A(6),[12] or the meeting could be adjourned for a period of up to 45 days.[13]

Importantly, an administrator must provide the creditors with written notice of the meeting accompanied by a report by the administrator about the company's

Notes

3 *Mighty River International Limited v Hughes* [2018] HCA 38 [21].
4 *Ibid.*, [22].
5 *Ibid.*, [21].
6 Keifel CJ and Edelman J otherwise observed that the chief difference between Part 5.3A and earlier provisions dealing with arrangements in corporate insolvency was the role played by the Court. Earlier provisions required court approval before the scheme was effective; Pt 5.3A provides for disallowance by the Court after the deed has been made. Refer: *Mighty River International Limited v Hughes* [2018] HCA 38 [6].
7 *Corporations Act* 2001 (Cth) s 435A.
8 Australia, House of Representatives, Parliamentary Debates (Hansard), 3 November 1992 at 2404; Australia, House of Representatives, Corporate Law Reform Bill 1992, Explanatory Memorandum at [448], [577].
9 *Corporations Act* 2001 (Cth) s 436E(2).
10 *Corporations Act* 2001 (Cth) s 436E(1).
11 *Corporations Act* 2001 (Cth) s 436E(4).
12 *Corporations Act* 2001 (Cth) s 439A(1).
13 *Corporations Act* 2001 (Cth) s 439A(2).

business, property, affairs and financial circumstances and a statement setting out the administrator's opinion as to whether it would be in the creditors' interests for the company to execute a deed of company arrangement, or for the administration to end, or for the company to be wound up.[14] This was formerly known as a 's 439A report'.[15]

The requirements of the instrument or deed are contained in s 444A(4), which was of central importance to this matter.

The 'property point': the instrument did not contravene s 444A(4)(b)

Section 444A(4) provides a list of nine matters which must be addressed in a deed of company arrangement, including: (a) who will administer the deed; (c) and (d) any moratorium in the release of debts; (e) and (f) conditions precedent and subsequent; (g) circumstances of termination.[16]

The key provision in this case was section 444A(4)(b), which provides a deed of company arrangement specify 'the property of the company (whether or not already owned by the company when it executes the deed) that is to be available to pay creditors' claims'.

Mighty River submitted that s 444A(4)(b) required that the instrument specify some property to be available to pay creditors' claims. It submitted that the instrument prepared by the administrators contravened s 444A(4)b) because it provided that, subject to variation, 'there will be no property of the Company available for distribution to Creditors under this deed.'[17]

Keifel CJ and Edelman J found that the purpose of s 444A(4) is to direct the attention of the creditors to those particular important matters that must be addressed in the instrument.[18] Section 444A(4)(b) requires the property to be divided into two sets; property that is available to pay creditors' claims, and unlike a winding up, property that is not.[19] Critically, the provision did not prescribe some minimum obligation upon the administrator to distribute some property, however little, to creditors.[20]

Further, Keifel CJ and Edelman J referred to the numerous examples of deeds of company arrangement that involved no property of the company being made available for distribution, including debt for equity swaps, creditors' trust and transfer of shares in the company from members to creditors.[21] These examples were described as consistent with the intended flexibility of approach to deeds of company arrangement.[22] Additionally, that flexibility would be undermined if these deeds were required to provide for the distribution of some property of the company.[23]

Nettle and Gordon JJ also rejected the contention that the Deed would fail on the grounds that it did not comply with s 444A(4)(b).

The 'invalidity point': not contrary to the object of Pt 5.3A of the Corporations Act

Keifel CJ and Edelman J found that the Deed created and conferred genuine rights and duties (such as the duty to investigate claims and to seek proposals for the restructure and re-quotation on the Australian Securities Exchange).[24] The *quid pro quo* for these duties placed upon the administrators was that the creditors accepted a moratorium on their claims.[25]

There were three reasons why the administrators' undertaking, and the Deed itself, were not contrary to the object of Pt 5.3A and did not invalidate the Deed:

1. The operation of the Deed aimed to fulfil the object of Pt 5.3A by maximising the chance of Mesa's survival, or otherwise providing a better return to creditors than would result from its immediate winding up. In the s 439A report and the supplementary report that preceded the Deed, the administrators opined that it was not in the interests of creditors that Mesa be wound up.[26] Even if an approved variation to the Deed caused all Mesa's assets to be sold to realise its debts, this would be preferable to winding up Mesa's because, as the Master explained, the valuable Australian Securities Exchange listed shell would be preserved.[27] There was evidence before the Master that the

Notes

14 *Corporations Act* 2001 (Cth), s 439A(3) and (4).
15 Provisions of the *Corporations Act* 2001 (Cth) have since been amended.
16 *Mighty River International Limited v Hughes* [2018] HCA 38 [44].
17 *Ibid.*, [39].
18 *Ibid.*, [44].
19 *Ibid.*, [44].
20 *Ibid.*, [44].
21 *Ibid.*, [45].
22 *Ibid.*, [45].
23 *Ibid.*, [45].
24 *Ibid.*, [34].
25 *Ibid.*, [34].
26 *Ibid.*, [35].
27 *Ibid.*, [35].

value of a listing could be between $400,000 and $900,000.[28]

2. The history of schemes of arrangement showed that it was a valid purpose for the Deed to provide for a moratorium on claims while Mesa's position was further assessed. A scheme of arrangement could be devised with the sole purpose of securing a moratorium on claims. If a moratorium only scheme was, and is, permissible then a fortiori a deed, which is intended to be a more flexible device for managing a company' affairs, may provide predominantly, or solely, for a moratorium.[29]
3. The provision of a short convening period before the second creditors' meeting, reducing the period of the statutory stay which automatically occurs when a company is in administration under s 440D, was for the protection of creditors. The objectives of speed and efficiency in Pt 5.3A were not compromised if the creditors choose, in a deed of company arrangement, to extend a moratorium beyond the period that they would otherwise have had outside an administration.[30]

Kiefel CJ and Edelman J found that the Deed did not involve an impermissible sidestepping of the option of applying to court for an extension of the convening period.[31] Although an extension of time under s 439A can only be obtained by a court order, they found an otherwise compliant deed of company arrangement can incidentally extend time of an administrator's investigations pending a subsequent variation to it.[32]

An additional rejection of Mighty River's case

Gageler J agreed with Kiefel CJ and Edelman J and delivered an additional judgement to separately explain an additional rejection, at the principle level, of the argument that the Deed was non-compliant with procedural requirements of Pt 5.3A.[33]

Gageler J found that the scheme of Pt 5.3A exhibits no reason why creditors should not be able to decide that it is in their own best interests that a deed of company arrangement be entered into which provides for an agreed moratorium on repayment of the company's debt while further investigations are conducted by a deed administrator under the deed with a view to coming up with a further proposal which could be reflected in an amendment to the deed.[34]

Additionally, Gageler J said that the Pt 5.3A scheme was designed to operate to place the onus on minority creditors to establish a basis for the intervention of the court.[35] The need to establish an affirmative basis for curial intervention is the price paid for a scheme designed to provide for 'minimisation of expensive and time-consuming court involvement' and 'flexibility of action at key stages in the administration process'.[36] The Pt 5.3A scheme works by empowering creditors, deciding by majority, to determine what is in the interests of creditors.[37]

A different perspective

Nettle and Gordon JJ had a different view to the majority, and considered that the Deed was not a deed of company arrangement as it did no more than purport to extend the administration of Mesa.[38]

The Justices found that courts have recognised that significant extra time may be required for the convening period, and should be allowed, in complex cases,[39] but creditors are not able to extend the convening period.[40] Nettle and Gordon JJ concluded that the Deed purported to effect essentially the same result as a court-ordered extension of the convening period under s 439A(6) or s 447A(1), except that the extension was determined by the creditors and was to be indefinite.[41] In their view, the Deed ran counter to the evident policy of Pt 5.3A that the only permissible extensions of the convening period are those granted by the Court.[42]

The key issue for Nettle and Gordon JJ was that the Deed did not provide for an arrangement alternative to liquidation for the whole or partial payment or satisfaction of creditors' debts or claims against Mesa.[43]

Notes

28 *Ibid.*, [35].
29 *Ibid.*, [36].
30 *Ibid.*, [37].
31 *Corporations Act* 2001 (Cth) s 439A(6).
32 *Mighty River International Limited v Hughes* [2018] HCA 38 [34].
33 *Ibid.*, [58].
34 *Ibid.*, [63].
35 *Ibid.*, [66].
36 *Ibid.*, [66].
37 *Ibid.*, [66].
38 *Ibid.*, [70].
39 *Ibid.*, [73].
40 *Ibid.*, [74].
41 *Ibid.*, [82]. This appears contrary to the facts, as the Deed concluded after 6 months.
42 *Ibid.*, [83].
43 *Ibid.*, [83].

For this reason, the Deed was not a deed of company arrangement within the meaning of Pt 5.3A.[44]

A clarification of approach

The clarification from the majority of the High Court of Australia has caused restructuring and insolvency practitioners to breathe a sigh of relief.

The majority decision permits insolvency practitioners to recommend a similar deed of company arrangement where circumstances provide that this is a better option than liquidation, or making an application to the court. The circumstances may include where there is a listed company with value that is attributable to the listing, which would be lost if the company were to be wound up.

The decision provides that a moratorium deed may conform with the requirements of a deed of company arrangement provided the matters in s 444A(4) are specified in the deed of the company arrangement, which for the purposes of s 444A(4)(b) must mean that the property of the company that is to be available to creditors for distribution be provided, not that the deed must provide for property of the company to be distributed to creditors.

Notes

44 *Ibid.*, [83].

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, US Corner, Economists' Outlook and Case Review Section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

For more information about *International Corporate Rescue*, please visit www.chasecambria.com