JONES DAY

COMMENTARY

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(Mighty) River Runs Dry: Australian High Court Rules "Holding" DOCAs Are Valid

IN SHORT

The Situation: The statutory moratorium period for voluntary administrators to restructure an insolvent company often is too short to find a solution. Administrators frequently utilise "holding" deeds of company arrangement ("DOCAs") to extend the moratorium and "buy" time to investigate potential restructuring opportunities. A creditor challenged this practice by arguing that holding DOCAs are invalid.

The Question: Are holding DOCAs valid under the *Corporations Act 2001*(Cth)?

Looking Ahead: Holding DOCAs are permissible, but validity will turn on the circumstances in each case.

In *Mighty River International Limited v Hughes* [2018] HCA 38, the High Court of Australia recently affirmed the ability for an administrator to use a holding DOCA.

The case concerned the validity of a holding DOCA for Mesa Minerals Ltd ("Mesa"). Amongst other things, the DOCA provided for a moratorium on creditors' claims and required the deed administrators to conduct further investigations and report to creditors concerning possible variations to the DOCA within six months.

Mighty River International Ltd ("Mighty River") was a creditor of Mesa and intended to liquidate Mesa. Mighty River had previously sought to have the DOCA declared void in the Supreme Court of Western Australia and on appeal in the Western Australian Court of Appeal, but was unsuccessful in both instances. The factual background and the litigation history is set out in our previous *Commentary*, "Australian Court of Appeal Approves Use of "Holding" Deed of Company Arrangement".

High Court of Australia Appeal

Mighty River was granted special leave to appeal the Court of Appeal's decision to the High Court of Australia. Mighty River appealed on the following two grounds.

- The Mesa DOCA was not valid as it sought to circumvent or sidestep the requirement in s 439A(6) of the *Corporations Act 2001* (Cth) ("Act") for a court order extending the convening period during which a second meeting of creditors must be convened by an administrator and was contrary to the object of Pt 5.3A of the Act.
- If the Mesa DOCA was a deed of company arrangement, then it should have been declared void as the DOCA did not comply with an alleged requirement in s 444A(4)(b) of the Act to distribute some property of Mesa. In oral submissions, Mighty River also submitted that the administrators failed to comply with s 438A and s 439A(4) with respect to the requirements for the second meeting of creditors.

> The majority of the Court held that a holding DOCA is consistent with the objects of Part 5.3A of the *Corporations Act 2001*.

Findings of the High Court

The majority of the Court (Kiefel CJ and Edelman J in a joint judgment, with Gageler J agreeing) held that a holding DOCA is consistent with the objects of Part 5.3A of the Act for the following reasons.

- The operation of a holding DOCA is aimed at fulfilling the objects of Part 5.3A of the Act, which is concerned with maximising the chance of a company's survival or providing a better outcome to creditors than what would result from liquidation.
- The history of schemes of arrangement shows that it is a valid purpose for the Mesa DOCA to provide for a moratorium on claims while the company's position is further assessed by the deed administrators. The effect of extending the time for investigations by the deed administrators was only incidental to the purpose of the Mesa DOCA.
- The provision of a short convening period before the second creditors' meeting, thus reducing the period of the moratorium on claims under s 440D of the Act, is for the protection of creditors. The

majority held that that speed and efficiency are not undermined if creditors subsequently enter into a DOCA to provide for a longer moratorium period than would otherwise have been the case.

The majority also found that s 444A(4)(b) of the Act does not require that a holding DOCA make any property of the company available for distribution to creditors. The majority held that s 444A(4)(b) requires the property to be divided into two sets: property that can and property that cannot be used to pay creditors' claims. The majority noted examples of when DOCAs may not involve any property being distributed to creditors—for instance, a debt of equity swap.

The majority also addressed Mighty River's submission that the administrators of Mesa failed to comply with s 438A and s 439A(4) of the Act. Under s 438A, the administrators were required to form an opinion as to whether it would be in the interests of Mesa's creditors: (i) to execute a DOCA; (ii) for the administration to end; or (iii) that MESA be wound up. Section 439A(4) concerns an administrator's report to creditors for the second meeting of creditors in which the administrator recommends a course of action to creditors. The majority held that the administrators did not contravene either section, as they expressed their opinion about the options available to creditors. Importantly, the administrators informed creditors of the benefits of entering a DOCA: that is, that it may result in a better outcome then immediate liquidation.

TWO KEY TAKEAWAYS

1. Administrators can use "holding" DOCAs to gain more time to complete investigations and pursue possible options to secure the future of the company. However, the question of whether a particular DOCA is valid will turn on the circumstances in each case.
2. A DOCA can be valid even if it does not result in any of the company's property being available for distribution to creditors. This means administrators continue to have a wide range of options available to them (such as debt for equity swaps for creditors) without needing to distribute some property, however nominal, to creditors.


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