

Australian Court of Appeal Approves Use of "Holding" Deed of Company Arrangement

IN SHORT

The Situation: Frequently, the statutory moratorium period provided to voluntary administrators to restructure an insolvent company is too short to find a solution. Administrators often utilise "holding" deeds of company arrangement to extend the period of moratorium and "buy" time to investigate potential restructuring opportunities for the future of the company. A creditor recently challenged this industrywide 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.

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In *Mighty River International Ltd v Hughes* [2017] WASCA 152, the Western Australian Court of Appeal delivered a landmark decision approving the use of a "holding" deed of company arrangement ("DOCA").

Factual Background

On 13 July 2016, Mesa Minerals Ltd ("Mesa") was placed in voluntary administration. At the first meeting of creditors, the administrators indicated that as they had only just begun their investigations and were not in a position to make recommendations, it was likely that they would recommend a holding DOCA.

Mighty River International Ltd ("Mighty River"), a shareholder and creditor of Mesa, queried why a holding DOCA was preferable to liquidation and indicated that the administrators should seek Court orders to extend the convening period for the second meeting of creditors, rather than hold the second meeting of creditors and enter into a holding DOCA.

In their subsequent report, the administrators said they were of the opinion that it was in the creditors' interest to vote in favour of executing the proposed DOCA as it "may deliver an improved outcome to creditors".



The Court of Appeal held that the holding DOCA was designed to at least provide the opportunity for a better return for creditors than would result from an immediate winding-up.



At the second creditors' meeting, the administrators recommended approval of a holding DOCA, its objectives being:

to provide sufficient time for the administrators to conduct further investigations into [Mesa's] property and affairs, and to explore the possibility of a restructure or recapitalisation of [Mesa] to determine the likely outcomes to creditors and form an opinion as to whether a deed of company arrangement or liquidation is in the best interests of creditors of [Mesa].

The deed provided that no Mesa property would be available for distribution to creditors. However, it also provided that the deed administrators would need to call a meeting of creditors, where the creditors would vote on Mesa's future.

The majority of creditors voted in favour of the holding DOCA, which was subsequently executed ("Mesa Holding DOCA"). Mighty River commenced proceedings alleging that the holding DOCA was invalid.

First Decision

Master Sanderson held that the Mesa Holding DOCA was valid as it is consistent with the purposes of pt 5.3 of the *Corporations Act 2001* (Cth) ("Act"). As set out in s 435A, the objects are to provide for the business, property and affairs of an insolvent company to be administered in a way that: (i) maximises the chances of the company, or as much as possible of its business, continuing in existence; or (ii) if it is not possible for the company or its business to continue in existence, results in a better return for the company's creditors and members than would result from an immediate winding-up of the company.

The Master also noted that holding DOCAs are in widespread use by insolvency practitioners.

Appeal Grounds

The Court essentially dealt with the subsequent Mighty River appeal by considering three grounds.

- Was the Mesa Holding DOCA invalid because it did not specify, pursuant to s 444A(4)(b), some property of the company that is to be available to pay creditors' claims?
- Was the Mesa Holding DOCA invalid because it sought, in effect, to circumvent s 439A(6) under which the administrators could apply for an extension of time to convene the second meeting of creditors?
- Was the Mesa Holding DOCA inconsistent with the objects of pt 5.3A in that it did not maximise the chance of the business continuing as a going concern and does not produce any return to creditors?

Findings

The Court of Appeal unanimously held that the Mesa Holding DOCA was valid, by examining the terms of the deed in the context of the statutory scheme in pt 5.3A of the Act.

First Ground. The Court of Appeal noted that s 444A(4)(b) requires a DOCA to particularise or address expressly the extent to which the company's present or future property is to be available to pay creditors' claims. It was held that because the Mesa Holding DOCA specified that no property will be available for distribution to the creditors, the deed complied with s 444A(4)(b).

Second Ground. The Court of Appeal considered the statutory context and noted the time constraints administrators face when conducting the administration process. It was held that it is open to the administrators to: (i) recommend a holding DOCA to creditors; or (ii) to seek an extension of time to convene the second meeting of creditors under s 439(6), in order to allow time for further investigations into or the enhancement of a significant asset of the company to be undertaken.

Third Ground. The Court of Appeal found that the Mesa Holding DOCA was not inconsistent with the objects of pt 5.3A and was a valid DOCA. It was unanimously held that the Mesa Holding DOCA was designed to at least provide the opportunity for a better return for creditors than would result from an immediate winding-up.

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. It is valid for a holding DOCA to provide that, subject to a variation of the deed, no property will be available to creditors.

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