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feature

SETTING ASIDE A DOCA – THE INTERESTS OF THE CREDITORS

Insights from the Retail Adventures decisions into the consideration of the interests of creditors where the outcome of the creditors meeting is determined by related party votes.

Before its collapse in 2012, Retail Adventures ran a wide range of discount variety stores including Crazy Clarks, Sam's Warehouse, Go-Lo Discount Stores and Chickenfeed. The central element of the restructuring of Retail Adventures was a deed of company arrangement accepted primarily by related party creditors. That deed was successfully challenged in the NSW Supreme Court and the company was wound up.

The Retail Adventures decisions at both first instance and on appeal provide interesting insights into the exercise by the Court of its powers under s 600A and consideration of the interests of creditors where the outcome of the creditors meeting is determined by related party votes.

This article discusses two decisions relating to the attempted restructure of Retail Adventures Pty Ltd (RAPL). The decision at first instance, *Hellenic Pty Ltd v Retail Adventures Pty Ltd (Administrators Appointed)* [2014] NSWSC 1973, was a decision of Justice Robb in the Supreme Court of New South Wales delivered on 23 December 2013. The Court of Appeal dismissed an Appeal on 7 March 2014 and delivered reasons on 3 April 2014: *DSG Holdings Australia Pty Ltd v Hellenic Pty Ltd* [2014] NSWCA 96.

THE RISE AND THE FALL

RAPL operated 268 retail stores, two distribution centres, and a head office, and employed approximately 500 staff.

On 26 October 2012, Administrators were appointed and on the same day entered into a Licence Agreement with DSG Holdings Australia Pty Ltd (DSG) to operate the business of RAPL.

On 11 February 2013, the Administrators entered into a Sale Agreement selling the business as a going concern to DSG. This agreement was subject to a condition precedent which required the Administrators to obtain an order extending the convening period for the meeting under s 439A for a period of not less than 180 days. The Federal Court subsequently granted this extension.

On 7 August 2013, DSG and its holding company Bicheno Investments Pty Ltd (Bicheno), put forward a proposal for a deed which was expected to give creditors a dividend of six cents in the dollar.

The Administrators' report to creditors of 19 August 2013 expressed the opinion that it was not in the interests of creditors to resolve that RAPL enter into a deed of company arrangement. The Administrators noted that they were satisfied there were substantial insolvent trading and preference claims, and after allowing for the costs and uncertainties of liquidation, estimated the return to creditors in a liquidation would be between 20.71 and 45.12 cents in the dollar.

THE CREDITORS MEETING

At the meeting on 2 September 2013, 606 creditors with debt of $46,052,678 voted in favour of the resolution, while 122 creditors with $36,490,655 of debt voted against the resolution.

Significantly, if the related party votes of DSG and Bicheno had been disregarded, the result would have been about 122 creditors with debts valued at $36,490,655 voting against the resolution, and 604 creditors with debts valued at $11,065,720 voting in its favour. Of the 604 creditors, 499 were employees who had used a proxy form prepared by DSG to cast their votes.

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THE PRIMARY JUDGMENT

In his judgment delivered on 23 September 2013, Justice Robb set aside the resolution that the company execute a deed of company arrangement, and ordered that RAPL be wound up.

Sections 600A(1)(a) and (b) were satisfied because the resolution for the deed would not have been passed if the related party votes were disregarded.

The applicant was however unsuccessful in arguing that s 600A(1)(c)(i) was relevant. This section requires the Court to find that the resolution:

> *... is contrary to the* ***interests of the creditors as a whole*** *or of that class of creditors as a whole, as the case may be.' [emphasis added]*

His Honour was troubled as to how the interest of the creditors as a whole should be determined. He referred to *Mediterranean Olives Financial Pty Ltd v Loaders Traders Pty Ltd (subject to Deed of Company Arrangement) (No. 2)* (2011) 82 ACSR 300 where Justice Dodds-Streeton commented:

> *[189] The legislation does not prescribe or limit the factors relevant to determining whether the resolution to enter a DOCA is contrary to the interests of the creditors as a whole under s 600A(1)(c)(i). Some guidance is provided by the authorities, although analysis of s 600A(1)(c)(i) is sparse*
>
> *[190] ... conflict between the interests of particular groups which together constitute the creditors of the company as a whole may further complicate the equation ...*

His Honour found for the plaintiffs under s 600A(1)(c)(ii) on the basis the resolution 'has prejudiced, or is reasonably likely to prejudice, the interests of creditors who voted against the proposed resolution ... to an extent that it is unreasonable.'

His Honour accepted that the plaintiffs could prove prejudice on a number of grounds including:

(a) the wording of the deed proposal prevented the deed administrator from taking any formal steps to recover the deed contribution and, if the deed contribution was not paid, the consequences were uncertain,
(b) the Court was satisfied that it should attach some weight to the administrator's assessment that the dividend in a liquidation, even on a worst case scenario, was estimated to be significantly higher than the deed dividend,
(c) the value to the related creditors of avoiding insolvent trading claims significantly exceeded the value of the proposed deed contribution: 'a substantially inadequate price for the release of the obligations of the related creditors' [187].

THE APPEAL

DSG obtained a stay of the judgment and appealed. The stay lapsed before the hearing of the Appeal and RAPL went into liquidation.

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> A key issue for the Court of Appeal was whether the Court should grant leave to the Appellants to continue the Appeal against RAPL whilst it was in liquidation.

In this context, the Court looked at a number of discretionary factors and was satisfied that leave should *not* be given. This article discusses the comments made by Justice Leeming in his carefully reasoned judgment which was adopted by Justice Meagher and also by Chief Justice Bergin with the exception only of some *obiter* which she felt was unnecessary.

SECTION 600A IN CONTEXT

Justice Leeming noted that if there were a clear case with appellable error on the face of the reasons of the primary judge in relation to s 600A, that would strongly favour a grant of leave.

His Honour placed s 600A in context by looking at the Harmer Report (Australian Law Reform Commission), General Insolvency Inquiry DP 32 (1997) and ALRC 45 (1998) which stated:

> *It is anticipated that the interests of particular classes of creditors will be protected by the provision allowing for avoidance of the Deed, which should be exercised if the interests of the creditors had been overborne by the creditors as a whole. The class rule was developed in relation to schemes of arrangement would necessarily be required to be considered when meetings are convened.*

Justice Leeming noted that a resolution in favour of a Deed resembles a creditor's vote in favour of a creditors' scheme of arrangement, but unlike a scheme, court approval is not required before a deed of company arrangement becomes effective.

Section 600A was therefore the balancing mechanism in the context that the detailed provisions for supervising a scheme, under Part 5.1, are replaced with a single (second) meeting of creditors and a comparatively inexpensive procedure.

EVALUATION

In considering the possible application of the section Justice Leeming noted that s 600A(1) will be engaged if the resolution passed on the votes of related party creditors:

(a) is contrary to the interests of creditors as a whole, or
(b) the prejudice or likely prejudice to the dissenting creditors is unreasonable.

His Honour then noted a number of propositions which included:

(c) the onus lies upon the applicant to make out the elements,
(d) the provision applies to creditors who were creditors when the resolution was passed,
(e) the 'interests of creditors' is to be construed as identical to the creditors' interests to be addressed in the opinions required by s 438A to be formed by the Administrator and the s 439A report,
(f) the 'interests of creditors' are to be construed in such a way as would best promote the express objects of Part 5.3A, namely to maximise the chances of the company's continuing existence or if this is not possible, to obtain a better return to the company's creditors and members than would result from an immediate winding up.

INTERESTS OF CREDITORS

Robb J had considered the concept of 'interest of creditors' and concluded 'there is a significant level of abstraction in this concept, and if it has any concrete meaning it is elusive' [150].

Leeming J refers to the comments of Lindgren J 'whose views command a great weight in a matter of this nature' in *Federal Commissioner of Taxation v Wellnora Pty Ltd* [2007] FCA 1234 from which he notes that the creditors can and must vote in a single class under Part 5.3A in contradistinction to what occurs in a creditors' scheme of arrangement, and that the uniting characteristic that creditors share under Part 5.3A is the debt owed to them by the company.

After noting parallels with some English legislation and decisions, Leeming J noted that the examination of prejudice is not limited to a comparison of the expected returns but that it should also consider whether a trading outcome may be preferable for the creditors as a whole.

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Balancing these objectives may give rise to difficulties in assessing the requirement of *unreasonable prejudice*.

His Honour noted however that ongoing trading was not relevant here as the business had already been sold to DSG, and 'the dividend from winding up although less certain and more prolonged, is many multiples what would be received under the proposed Deed of Company Arrangement.'

When discussing the specific grounds of appeal, Justice Leeming returned to the issue of interest of creditors as creditors, noting the fact that a creditor's potential liability to a liquidator for a preference claim or an insolvent claim is not to the point [111]. His Honour further said:

> *In my opinion, an analysis of the conflicting interests of the creditor who is also a potential defendant is precisely the analysis which is not required by the section [134].*

His Honour had no difficulty in accepting that the RAPL resolution was against the interests of creditors as a whole when the deed would see non-related creditors paid six cents in the dollar in circumstances where there is a strong basis for concluding that all creditors would be paid many multiples of that amount in a winding up. He noted:

> *The question [of the interests of creditors] focuses simply on the interests all creditors have in recovering the money they are owed by the company.*

THE LESSONS

An Administrator in a s 439A report is required to consider 'the interests of creditors'. A court when evaluating whether or not it should exercise a discretionary power under s 600A must also *consider* 'the interests of creditors'.

The Court of Appeal has now provided a comprehensive analysis which highlights the need to focus on the interests of creditors *as creditors* together with the possible need for an administrator to balance a potential trading outcome, the expected returns under the proposed deed, and the expected return in a winding up.

The approach of the Court of Appeal overcomes the uncertainties and confusion raised by earlier decisions which attempted also to consider the potential interests of creditors in capacities other than as creditors.