

Addisons FocusPapers

Creditors' Trusts – The Death of Deeds of Company Agreement?

In *Parkview Constructions Pty Ltd v Tayeh* [2009] NSWSC 186, Justice Barrett expressed concern about a deed of company arrangement (“**DOCA**”) which involved a creditors’ trust.

Facts

Parkview Constructions Pty Ltd (“**Parkview**”) was a debtor of, Sydney Civil Excavation Pty Ltd (“**Sydney Civil**”) for fees on building projects. Sydney Civil obtained judgments against Parkview after filing adjudication certificates under the *Building and Construction Industry Security of Payment Act* (1999) (NSW). Parkview was also a creditor as it had commenced proceedings against Sydney Civil for breach of contract, damages for defective work, and restitution of the amounts Parkview was liable to pay to Sydney Civil under the adjudications.

Sydney Civil had executed a DOCA which required (at clause 4.1) the parties to the DOCA to execute a trust deed (which creates a creditors’ trust), implementation deed and charge. Once clause 4.1 was satisfied, unsecured creditors’ claims were extinguished, and the DOCA ended (clause 21). The effect of clause 21 was that Sydney Civil came out of voluntary administration and control was returned to its directors.

The effect of the trust deed, implementation deed and charge was that:

- the claims of unsecured creditors of Sydney Civil were extinguished;
- each creditor “releases, discharges and forever holds the Company harmless from any claim to set-off that it may otherwise be entitled to assert...”
- the unsecured creditors become beneficiaries under the creditors’ trust, with participation in proportion to their extinguished debts; and
- 25% of the “net recovery” of fees collected by Sydney Civil from debtors were to be paid into the trust and distributed to beneficiaries.

Addisons FocusPapers

Arguments

Parkview sought an order under s445D *Corporations Act* for the DOCA to be terminated as unjust, oppressive, discriminatory and unfair, and that it was procured by a report to creditors which was misleading. The effect of the DOCA on Parkview was that 100% of its claim against Sydney Civil was extinguished, but it would only share in 25% of fees it pays Sydney Civil with other creditors. Parkview argued the DOCA was a “contrivance” to extinguish its claim for breach of contract and defective work, and its right to have the adjudicated amounts reduced or eliminated by set-off if the claims against Sydney Civil for faulty work had been established.

Sydney Civil submitted that the Court cannot make an order terminating the DOCA as the DOCA had already been terminated in accordance with clause 21 (when the requirements of clause 4.1 were satisfied).

Findings

Justice Barrett found that as the DOCA had indeed already terminated, an order terminating the DOCA under s445D would be of little utility. An order under s445D does not affect the previous operation of the DOCA (s445H). Accordingly, an order terminating the DOCA was not made.

Parkview then sought an order for the DOCA to be terminated *ab initio*, i.e. as if it never existed in the first place. Parkview sought to rely on s447A (general power to make orders) in its submissions in reply. The Court found it was not open for Parkview to advance a new and different case in submissions in reply.

Important point for insolvency practitioners

Even if Parkview had relied on s447A in its originating process, the Court found that the trust deed, implementation deed and charge (“**the 3 documents**”) created independent sources of rights and obligations distinct from the rights and obligations created by the DOCA. The provisions of Part 5.3A *Corporations Act* do not regulate the rights created by the 3 documents.

Justice Barrett found that no order under s447A modifying the operation of Part 5.3A in relation to Sydney Civil could abolish or neutralise the rights and obligations created by the 3 documents. Even if such an order was effective, Justice Barrett was of the view that there would be substantial doubt as to whether the Court had power under s447A to make such an order.

Counsel for Sydney Civil referred to ASIC Regulatory Guide 82 entitled “External administration: Deeds of company arrangement involving a creditor’s trust” which says:

- 1.5 “Usually, the DOCA is ‘effectuated’ (and terminates) after the creditors’ claims against the company have been removed in this way. In most cases the DOCA terminates immediately upon creation of the trust, which usually occurs when or shortly after the DOCA is executed.
- 1.6 When the DOCA terminates, the company ceases to be externally administered, the directors regain full control of the company and the

Addisons FocusPapers

company is no longer required to use the notification ‘subject to deed of company arrangement’ on its public documents as otherwise would be required by s 450E(2) of the Act.”

Justice Barrett noted:

[74] “...once the creditors’ trust has been constituted and the deed of company arrangement pursuant to which it was established as an independent source of rights and obligations has terminated, the protective mechanisms created by Part 5.3A cease to apply. The trust and the covenants associated with it are not governed by Part 5.3A. The various aspects of the court’s statutory jurisdiction intended to underwrite the integrity of the Part 5.3A processes are no longer operative.

[75] A scheme such as the present could have been implemented wholly within a deed of company arrangement. Had that approach been taken so that a deed of company arrangement remained the governing instrument throughout, the supervisory and remedial jurisdiction of the court under s 445D, s 447A and other applicable provisions of Part 5.3A would have been preserved. In the events that happened, the scheme is being implemented outside Part 5.3A and creditors are denied those safeguards.

[76] Administrators recommending to creditors the adoption of a deed of company arrangement that will give birth immediately to a creditors’ trust and then itself promptly die bear a heavy burden of explaining to creditors the implications of the shift from a regime incorporating a court administered scheme of creditor protection to one in which creditors become passive trust beneficiaries.”

The result caused Justice Barrett “considerable disquiet” because even if the scheme set up by the DOCA and the 3 documents was unjust (an issue which His Honour did not have to decide upon), the court is unable to take any remedial action. Further, “it is a matter for concern, at a public policy level, that the protective aspects of Part 5.3A in relation to deeds of company arrangement, including the role of the court, can be and have been avoided by the creation through a deed of company arrangement of a parallel but essentially unregulated regime of administration.”

Summary

In summary, if a DOCA is proposed which involves the establishment of a creditors’ trust outside the protection of Part 5.3A, an insolvency practitioner ought to consider such an arrangement carefully in making its recommendations to creditors and explaining the implications to creditors. Creditors’ trusts are usually used to maintain a listed public company. It is unusual to see it used in relation to a private company, with the apparent purpose of extinguishing any right to set-off against amounts adjudicated under the *Building and Construction Industry Security of Payment Act* (1999) (NSW).



Addisons FocusPapers

For more information please contact:

Phil Stern, Partner

Telephone: +61 2 8915 1096

Facsimile: +61 2 8916 2096

Email: phil.stern@addisonslawyers.com.au

Peggy Wong, Solicitor

Telephone: +61 2 8915 1023

Facsimile: +61 2 8916 2023

Email: peggy.wong@addisonslawyers.com.au