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DOCA FUNDS – A TRUST FOR DEED CREDITORS OR COMPANY PROPERTY?

Can deed creditors be sure that they will get the benefit of a DOCA fund?

Many deeds of company arrangement (DOCAs) provide for the deed fund to be created over time from contributions made by the company. At their heart, arrangements of this type involve an agreement by the deed creditors to forego their right to an immediate winding up in return for a promise, from the company, to accumulate a fund for distribution amongst those creditors whose claims have been deferred or compromised.

Arrangements of this type may be undone as a result of unprofitable post-deed trading by the company or even, as evidenced by the facts in the NSW Supreme Court decision of *Antqip Hire Pty Ltd (subject to deed of company arrangement) (in liquidation)* [2020] NSWSC 487 (*Antqip*), a change of mind on behalf of those who propounded the DOCA.

Either development can produce the result, as it did in *Antqip*, that the company is subject both to a DOCA which can still be performed (because there are assets sitting in a deed fund which could be applied to pay some level of dividend) and a winding-up in which a different set of creditors will have claims against the insolvent debtor and in which the prospect of any dividend at all might be very much reduced.

Those cases which have considered the question have tended to favour the result that all assets (including whatever is held in the deed fund) and liabilities should be dealt with in a single administration-namely a winding up.[1] This may well be consistent with one of the fundamental tenets of Australian insolvency law: *pari passu* distribution of the insolvent debtor's assets amongst creditors.

However, it might equally be said, on behalf of the deed creditors, that the existing commercial compromise reflected in the DOCA should not be overturned so as to deliver benefits to post-deed creditors, who have accepted the risk of extending credit to a company which is operating 'subject to a deed of company arrangement'.

This article considers the question posed by *Antqip* and previous decisions. When a DOCA involving creation of a fund is being promoted to creditors, can they be sure that they will get the benefit of the fund if the company subsequently goes into liquidation? If the answer is 'no' or even 'probably not', that is a matter which ought to be brought expressly to the attention of creditors to weigh in the balance when considering a DOCA proposal.

A CREDITORS' TRUST?

This article does not consider the alternative option of creating a 'creditors' trust'. That is one means by which the deed fund can be preserved for the benefit of deed creditors, though it is generally motivated by the desire for an early, often immediate, exit from external administration. Arrangements of that type have their advantages and, equally, their risks[2] but those are different to the issues raised in *Antqip* and related cases.

THE FACTS IN ANTQIP

DOCAs were executed by related companies, Antqip Hire Pty Ltd and Antqip Pty Ltd in 2014. They gave effect to an arrangement of a relatively common type.

1 *Re Spargold Enterprises Pty Ltd* [1999] NSWSC 623; *Lombe v Wagga Leagues Club Ltd* [2006] NSWSC 3; *Re Jick Holdings Pty Ltd (in liq)* [2009] NSWSC.

The DOCAs were proposed by the sole director/secretary and shareholder of the two companies.

Under both DOCAs a deed fund would be constituted from contributions made, over time, from property of the companies. The fund would be available to unsecured/unrelated creditors. The director, other related creditors, as well as the secured creditor were excluded from receiving any dividends. The director had provided a guarantee of the company's debt to the secured creditor and that guarantee remained in place.

The DOCAs expressly provided that:

> *... the Deed Administrator has [sic] taken to act as agent for and on behalf of the Company, except in the receipt of payments, if any, under clause 4 hereof, which shall be received as Agent for and on behalf of the creditors of the Company ... and which funds shall not be refundable in the event of the termination of this Deed.'*

In 2019, after the deeds had been operating for five years, the director, as sole shareholder of the two companies, passed resolutions that the companies be voluntarily wound up. Between execution of the DOCAs and the liquidation, the companies had incurred debts of $5 million to the secured creditor whose claim was not recoverable from the deed fund.

Neither company had, during the post-DOCA period, incurred any further unsecured debt. At the time of liquidation, the whole of the deed contributions under the Antqip Hire DOCA had been paid, and of the $3,318,633 to be paid under the Antqip DOCA, $3,165,633 had been paid. The effect of winding up and termination of the DOCA was that those monies would become subject to the claim by the secured creditor.

To the extent the secured creditor's claim was thereby reduced, so was the director's liability under his guarantee. On the other hand, the deed creditors would be prejudiced as their claims to the accumulated fund would be completely overtaken by that of the secured creditor who, if the DOCA was terminated, would be entitled to rely on its security to claim repayment from that fund (assuming it constituted property of the company).[3]

PRIOR DECISIONS

Re Spargold Enterprises Pty Ltd [1999] NSWSC 623 (*Spargold*)

In *Spargold*, the company incurred further debt after executing a DOCA and became hopelessly insolvent.

The deed administrator acts as the agent of the company and, in that role, owed fiduciary duties which included a duty to act impartially as between all creditors, not just participating deed creditors.

The deed administrators applied to the court for the termination of the DOCA out of fairness to the post-deed creditors (who would receive nothing if a distribution under the DOCA was made).

The terms of the DOCA were not set out in the judgment, so it is assumed that there was a deed fund and it is not known whether there was a provision of the deed which required the deed administrator to hold the deed fund for the benefit of the deed creditors to the exclusion of post-deed creditors.

Santow J noted that:

- The deed administrator acts as the agent of the company and, in that role, owed fiduciary duties which included a duty to act impartially as between all creditors, not just participating deed creditors.
- The company's trading post-DOCA was (presumably) financed by the post-DOCA creditors. It was not appropriate for the profits generated from that trading to be quarantined for the benefit of just pre-DOCA creditors.

Thus, the deed fund was to be available for all creditors. As the DOCA served no further purpose, it was terminated, and the deed fund was transferred to the liquidators for distribution under s 556 of the *Corporations Law*.

2 These are described in the ASIC Regulatory Guide, RG 82, concerning such arrangements. **3** Rees J appreciated the apparent unfairness of this – see [3] of the judgment.

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***Dean-Willcocks v ACG Engineering Pty Ltd (in liquidation)* [2003] NSWSC 353 (*Dean–Willcocks v ACG*)**

By contrast, in *Dean-Willcocks v ACG*, the court determined that the DOCA created a trust in favour of the deed creditors.

The company had executed a DOCA under which the company and its directors were required to pay $112,730 for the deed creditors (which excluded the directors and associated entities) and the administrator's costs.

The company continued to trade and incur debts following execution of the DOCA.

The deed fund was fully constituted, and the deed administrator had announced his intention to pay a final dividend under the DOCA. The director then passed a resolution that the company was insolvent and should be wound up. It was duly placed in liquidation.

There were two scenarios for distribution of the company's funds:

1. Distribution of the deed fund to deed creditors (providing them 22 cents in the dollar) and other funds available in the liquidation, excluding the deed fund, to post-deed creditors (providing them 12 cents in the dollar).
2. Distribution of all funds to all creditors (providing all creditors 16 cents in the dollar).

Austin J considered that the terms of the DOCA 'make it plain the Administration Fund is not an asset of the company'.

In particular, the DOCA provided that the deed administrator was to *'hold'* the deed fund in accordance with the terms of the DOCA and that money paid to the deed administrator by the company or any third party on behalf of the company was not refundable to the company.

His Honour concluded:

> *Where property is vested in a person subject to a legally enforceable obligation to 'hold' the property so as to make a distribution to someone else, the natural conclusion, under our law, is that a trust has been created.*

There was therefore an express trust of the deed fund for the benefit of the participating deed creditors as beneficiaries.

Although the DOCA appointed the deed administrator as agent of the company (Schedule 8A to the *Corporations Regulations* was not excluded), that was only to carry out various duties and exercise various powers.

Austin J found that the deed administrator's duty of impartiality was not relevant, because he was required to hold the funds on trust for one class of creditors to the exclusion of another class and was obliged to act consistently with the rights of the beneficiary class.

His Honour opined that the judgment in Spargold meant only that a deed administrator is not *necessarily* a trustee by virtue of his or her function and duties, and does not exclude an express trust being created by the terms of the DOCA.

Although by its terms the DOCA had been terminated on the liquidator's appointment, the trust over the deed fund in favour of the deed creditors remained.

***Lombe v Wagga Leagues Club Ltd* [2006] NSWSC 3 (*Lombe*)**

In *Lombe* a clause provided that the deed fund was to be held on trust, and that payments into the deed fund were not refundable.

The DOCA was terminated and the company was placed in liquidation by resolution of the company's creditors at a meeting convened under s 445F of the *Corporations Act*. The catalyst for the resolution was the refusal of two third parties to continue contributing money to the deed fund.

Therefore, at the time of the appointment of the liquidators, the deed fund was yet to be fully constituted.

Barrett J held that it was possible for a DOCA to operate so that the deed fund is held on trust for deed creditors. However, to create a trust, there must be a divesting by the company of its beneficial interest in that property.

That is entirely orthodox; the very nature of a trust is that whilst legal title is held by the trustee, the trust property is held for the benefit of the beneficiaries.

His Honour formed the view, based upon an examination of the terms of the DOCA, that payment to the participating creditors from the deed fund was intended as the quid pro quo for the elimination of the claims of those creditors against the company and that:

> *That intention is incompatible with the creation of a trust in respect of the property concerned. It is consistent with the application of company property for company benefit.*

The adoption of clause 1 of Schedule 8A of the *Corporations Regulations* in a DOCA had the ordinary result that the deed fund was held by the deed administrators as agent *for the company*. Thus, the company had not relinquished its beneficial interest in that property.

Justice Barrett considered that the use of the term 'on

trust' in describing the basis on which the deed fund was held, was colloquial rather than technical. It emphasised the fiduciary position of the deed administrators and their *'trustee-like responsibility'* when applying the company's property in accordance with the DOCA.

Justice Barrett did not in terms express disagreement with *Dean-Willcocks v ACG* but his Honour held that merely segregating the company's property for it to be applied by a deed administrator as the company's agent in accordance with a DOCA does not, of itself, give rise to a trust.

The description of the deed fund as 'not refundable' to the company meant only that the company or third party could not exercise a unilateral right to prevent application of the deed fund in accordance with the DOCA. However, termination of a DOCA puts an end to obligations and powers under the DOCA, including the power, capacity or duty to apply any unexpended residue of the deed fund, as trustee or otherwise.

Since the deed fund was never fully constituted, and the deed creditors' claims against the company were not extinguished, even if there had been a trust it would have failed in any event. The trust fund would then have become the subject of a resulting trust in favour of the company, and available to its liquidator for distribution amongst all creditors.

***Re Jick Holdings Pty Ltd (in liquidation)* [2009] NSWSC 574 (*Re Jick Holdings*)**

The company had executed a DOCA under which the company was to establish a deed fund from which the claims of creditors were to be satisfied.

In this case, the DOCA did not expressly purport to create a trust, and it incorporated Clause 1 of Schedule 8A of the *Corporations Regulations*.

The company incurred further debts post execution of the DOCA, and became hopelessly insolvent. To avoid personal liability for the company's taxation liabilities, the director took steps to have the company wound-up.

The deed administrator sought orders that the DOCA be terminated and directions as to how to apply the deed fund. The majority, but not all, of the money intended to constitute the deed fund had been received.

White J concluded that the deed fund was an asset of the company and not an asset held on trust for creditors under the DOCA.

The termination of a DOCA puts an end to obligations and powers under the DOCA, including the power, capacity or duty to apply any unexpended residue of the deed fund, as trustee or otherwise.

The DOCA simply required the company to provide funds for the payment of the claims of participating creditors. The court was not prepared to imply from the language of the DOCA that a trust was intended to be created.

Relevantly, White J held:

- It is possible, consistent with the scheme of Part 5.3A, for a DOCA to provide that property of the company is to be held on trust for deed creditors, either by transferring the legal title of the property to the deed administrators, or by the company declaring itself to be trustee of the property.
- A trust of the deed fund is not created merely because the fund is to be held for and distributed to deed creditors. Such an arrangement does not divest the company of its beneficial ownership of the fund. For there to be a trust there needs to be a separation between legal title and beneficial ownership.

If a trust had been created, White J would have terminated the deed and extinguished the trust anyway. In his view there was no reason why post deed creditors who allowed the company to continue to trade should be postponed in any competition to company property.

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THE *ANTQIP* DECISION

Rees J determined that the deeds should be terminated and that the deed funds should be paid to the liquidators as property of the companies.

Her Honour was not satisfied that there was the certainty of intention or subject matter necessary to give rise to a trust.

The court placed particular importance on the fact that the terms of the DOCA described the deed administrators' role when receiving the deed funds as 'agent' rather than trustee. This suggested that the parties did not intend to create a trust, but rather intended that the deed administrators would have the attributes ascribed by the law of agency.

Further, there was no certainty of subject matter in either case, as with respect to Antqip the deed fund was yet to be fully constituted and with respect to Antqip Hire, the deed fund was to be constituted by 50 instalments made over several years.

Critically, the court held that the companies had not relinquished their beneficial interest in the deed fund. Her Honour saw nothing in the DOCA to distinguish it from the provisions that were considered in *Lombe* and *Re Jick Holdings*.

WHEN WILL A DOCA GIVE RISE TO A TRUST IN FAVOUR OF PARTICIPATING CREDITORS?

The preponderance of judicial opinion is that it is possible for a DOCA to give rise to a trust over the deed fund in favour of participating creditors without requiring the complexity of a creditors' trust arrangement. However, apart from a couple of early victories, those arguing for such an outcome in any particular case have failed.

So, what is required to establish such a trust and how, if at all, can the trust survive if, prior to the DOCA being effectuated, the company goes into liquidation? Must the deed creditors in that case always rank alongside those whose debts were incurred after the DOCA had been adopted?

Of critical importance will be the adoption of a mechanism by which the company divests itself of any claim to the property in the fund. That is not achieved merely by describing the property as held on trust or providing that the property is not refundable to the company.

Where the deed contributions are coming from third parties, divestiture could easily be achieved. The company should, in the DOCA, disavow any interest in the fund and the administrators should declare that they receive the deed contributions as principals (not as agents for the company) and that they hold the contributions on trust for the deed creditors.

Where the contributions are to come from assets sales or from future income of the company, the position is more complicated. At the very least, the deed ought provide that the administrators receive, and hold, the contributions as principals and on trust for the deed creditors.

The company ought to declare that, upon payment of the contribution, it relinquishes any interest in the fund. To the extent the deed fund comprises money in a bank account, the account should be held in the name of the administrators personally, albeit as trustees. If the DOCA incorporates clause 1 of Schedule 8A to the *Corporations Regulations*, it will be necessary to specify that the deed administrator does not act as the agent of the company in respect of the collection, retention or distribution of the deed.

Attention also needs to be given to the potential impact of any termination of the DOCA and/or a future winding up. The terms of any trust need to make it clear that it is intended that the trust is to survive any termination of the DOCA and, assuming the deed administrators are appointed as trustees of the deed fund, that that office is not vacated merely because the deed is terminated. The status of the deed creditors' claims against the company in such an event needs also to be considered.

Are those claims lost even if the deed fund is not fully constituted? That result might well answer the 'quid pro quo' reasoning which Justice Barrett found to be so important in Lombe. If that is the intention, then that risk needs to be carefully and expressly explained to creditors before the DOCA is voted upon.

THE TERMS OF THE DOCA

Ultimately, careful attention must be paid to the terms of the DOCA otherwise deed creditors may find, as they did in *Antqip*, that their sacrifice was to no avail and merely improved the position of others – in that case being the secured creditor and the director.