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THAT'S GOLD: FEDERAL COURT GIVES GASCOYNE DOCA THE GREEN LIGHT

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Legal Briefings – By **David John and Peter Keeves**

On 29 September 2020, the Federal Court of Australia published its much anticipated decision in *Habrok (Dalgaranga) Pty Ltd v Gascoyne Resources Ltd* [2020] FCA 1395, dismissing Habrok's attempt to set aside a Deed of Company Arrangement (**DOCA**). The DOCA had been the culmination of a 15 month administration, and facilitated the recapitalisation, refinance, and relisting of the gold miner Gascoyne Resources Ltd (**GCY**) and its subsidiaries (together with GCY, the **GCY Group**). The DOCA is expected to return creditors 100c in the dollar.

The decision gave the GCY Group the green light to pursue its $85 million capital raising and put in place a $40m refinance facility that would see GCY relisted on the ASX, retain its employees, meet creditor claims in full, and position the company to leverage strong gold prices to effect a revival of the Western Australian gold miner's fortunes, having demonstrated consistent production performance during 2020.

The decision represents a potential turning point for the GCY Group, and Justice Beach provided some useful guidance for the broader restructuring market on:

- the standing of interested parties seeking to challenge a DOCA;
- the proper role of administrators prior to their formal appointment; and
- the factors which a court will consider when deciding whether to terminate a DOCA and appoint liquidators to a company.

Prior to the restructure, GCY's existing debt exceeded $115m, including bank debt of approximately $80 million. After the restructure, GCY has a well-capitalised balance sheet with a cash balance of over $30 million with the refinanced bank debt reduced to $40 million.

On 21 October 2020, GCY was reinstated to trading on the ASX following the successful capital raise, refinancing, and effectuation of the DOCA. Herbert Smith Freehills acted for the administrators including in respect of the successful recapitalisation and court hearing.

BACKGROUND

During the first half of 2019, the GCY Group encountered financial difficulties due to operational issues, lower grade ore being produced, and large amounts of waste. In May 2019, forecasts indicated that despite capital injections, the GCY Group continued to face cash flow deficiencies. On 2 June 2020, the directors appointed administrators from FTI Consulting (the **Administrators**) to each company in the GCY Group. Prior to the GCY Group entering administration, FTI Consulting had been engaged by the group in a limited advisory role, the relevance of which is discussed further below.

SALES PROCESS AND DOCA

Upon appointment, the Administrators pursued a 'dual-track' process: simultaneously pursuing sale and recapitalisation options. The sales process did not result in any offers which the Administrators were willing to accept, and their attention turned to achieving a recapitalisation. An extensive process was undertaken to identify parties willing to participate. Canaccord Genuity (Australia) Limited was appointed to lead the fully underwritten capital raise.

On 25 June 2020, at the second meeting of creditors (which had been extended on three occasions), the Administrators proposed a DOCA which provided for an $85 million capital raising (fully underwritten) and a $40 million refinance facility, and would result in all creditors of the GCY Group receiving value up to 100c of their debt. Though GCY and GNT Resources Pty Ltd were the only members of the GCY Group with significant liabilities owed to external parties, creditors of each company in the group were subject to the DOCA in order to allow all GCY Group companies to be efficiently returned to their directors.

The proceeds of the capital raise and facility would be used to pay the senior secured creditors (owed ~$80 million) in full. NRW, the mining contractor (owed ~$32.7 million), would receive an upfront payment of $7m, shares in GCY valued at $12m, and quarterly instalments thereafter for the balance owing. Unsecured creditors (totalling ~$6.4 million) with amounts owing less than $10,000 would be paid in full, and larger unsecured creditors would receive $10,000 upfront and their remaining amount through a combination of shares in GCY and cash.

The Administrators' DOCA proposal was approved by:

- 93% of unsecured creditors by value for GNT Resources (a member of the GCY Group); and
- 92% of GCY's unsecured creditors.[1]

The returns to unsecured creditors of GCY and GNT Resources was potentially different, but given the administrator's proposal offered the potential for a 100% return and greater certainty than liquidation, the DOCA facilitated claims against both companies being moved to a single creditors' trust.

The recapitalisation effected by the DOCA also received support from GCY's shareholders at an EGM held on 5 August, where shareholders passed resolutions to facilitate the share issues and capital raising required to give effect to the DOCA.[2]

CHALLENGE BY HABROK

Habrok commenced proceedings after shareholders had voted to approve the share issues necessary to effect the DOCA. In order to acquire standing, Habrok purchased the debt of an existing unsecured creditor the day before it commenced proceedings. It applied to the Federal Court seeking orders terminating the approved DOCA and appointing liquidators to the GCY Group under section 445D and section 447A of the *Corporations Act 2001* (Cth) (the **Act**).

Habrok was effectively an SPV that was established primarily for the purpose of acquiring the assets of the GCY Group. It was previously a subsidiary of Habrok Mining, a gold and iron ore investment company,[3] and related entity of Remagen Capital, a private equity firm that specialises in distressed asset investments. Habrok Mining had initially attempted to acquire the assets of the group via a competing DOCA proposal (submitted on the eve of the second creditors' meeting) but the proposal was not endorsed by the Administrators nor supported by creditors.[4] An entity associated with Habrok Mining had also participated in the sales process, but had not been the highest bidder.

Habrok acknowledged that it had sought these orders to facilitate an acquisition of the GCY Group's assets by Habrok in a winding up scenario.[5]

Habrok's application was based on several alleged deficiencies regarding the conduct of the administration. Habrok argued that the Administrators had "pursued their plan for the DOCA with single-minded determination" to the exclusion of other potential options.[6] This broad theme of Habrok's application raised several questions for the Court, namely:

1. whether Habrok had standing to challenge the DOCA which had been approved by the creditors;

2. whether FTI's involvement with the GCY Group prior to the administration placed the Administrators in a position of conflict;

3. whether the Administrators had properly conducted the sale process and given appropriate consideration to two rival DOCA proposals; and

4. whether the position of NRW, the GCY Group's second largest creditor and mining contractor, was unfairly preferred by the Administrators.

HABROK'S STANDING

The Administrators argued that Habrok lacked standing because it was not a creditor of the GCY Group or "any other interested person" for the purposes of s 445D and 447A of the Act,[7] primarily because it was not a creditor as at the date of the second creditors' meeting.

Beach J acknowledged the circumstances of Habrok's acquisition of debt would be relevant in the exercise of his discretion to set aside the DOCA,[8] but ultimately concluded that Habrok did have standing as a creditor or "any other interested person", as the assignment of debt gave Habrok an economic interest in the operation of the DOCA, even where the DOCA would result in the assigned debt being paid in full.[9]

THE PRE-ADMINISTRATION ROLE

The primary focus of Habrok's case at trial was that FTI's (alleged) extensive pre-appointment work gave rise to an apprehension of bias which justified terminating the DOCA, citing *Ten Network Holdings Ltd* (2017) 252 FCR 519. Habrok also claimed that the Administrators conducted inadequate investigations into potential liquidator claims, by virtue of having to review their own work.

APPREHENDED BIAS

Beach J concluded that there was no evidence of actual or apprehended bias on the part of either the Administrators or HSF (who provided legal advice to the Administrators (on a limited scope basis), but who had also been advising the GCY Group prior to the administration).

Relevantly, Beach J concluded that FTI's role was confined to:[10]

- reviewing the GCY Group's current working capital position;
- reviewing the GCY Group's economic modelling / cash flow forecasting systems and tools;
- rebuilding the Company's financial model to reflect the company's evolving mining operations; and
- advising on generic elements of a restructuring plan.

Importantly, FTI's role did *not* involve work that would require the Administrators to (effectively) investigate their own conduct upon being appointed, such as:[11]

- giving solvency / insolvency advice;
- providing safe harbour advice;
- managing the day-to-day cash situation; and
- advising management of the GCY Group.

Habrok further argued that the Declaration of Relevant Relationships and Indemnities (**DIRRI**) provided by the Administrators did not properly disclose their relationship with the GCY Group. Beach J usefully clarified the required level of disclosure in a DIRRI, finding that:

[The Administrators] candidly identified some meetings that were not disclosed in the administrator's DIRRI. Yet, what was required was no more than disclosure of the prior relationship or connection. The alleged omissions from the DIRRI do not show that there was non-disclosure of the prior relationship or connection.[12]

INADEQUATE INVESTIGATIONS

Habrok alleged that inadequate investigations had been conducted into potential claims relating to insolvent trading, previous capital raisings and the GCY Group's dealings with NRW.[13] The Court did not agree, finding that independent lawyers had been retained solely to advise on potential claims relating to the GCY Group's solvency position, and that there was no evidence to support Habrok's claim.[14]

SALES PROCESS AND RIVAL DOCAS

Habrok alleged that the sales process conducted by the Administrators and the treatment and assessment of competing proposals to the DOCA were inadequate.[15] The Administrators had appointed Investec Australia Ltd to assist in facilitating the sales process.[16]

Beach J held that the Administrators were under no obligation to indefinitely maintain a sales process, and that the Administrators were entitled to reduce their efforts on the sales process in circumstances where none of the offers they received would support a return to creditors comparable to that available under a recapitalisation.[17]

Administrators who pursue a dual-track process in the future will also find some support in Beach J's findings that:

- electing to prioritise the recapitalisation efforts was a judgment call that the Administrators were entitled to make;[18] and
- even if the sales process was found to be deficient, it was not apparent how it could have the effect of rendering the DOCA oppressive or unfairly prejudicial to creditors under s 445D(1)(f)(i) of the Act.[19]

Habrok also contended that the Administrators ought to have adjourned the second creditors' meeting to allow the rival DOCA proposals to be further explored, rather than put a resolution to adjourn to a vote of the GCY Group's creditors. Beach J did not agree, finding that the decision to put the resolution to the creditors' meeting was entirely appropriate in circumstances where an adjournment would threaten a relatively certain proposal that had support of the major stakeholders and would be more favourable than rival DOCAs, which contained a number of execution risks.[20]

TREATMENT OF NRW

Habrok alleged that the Administrators had given preferential treatment to NRW, the principal mining contractor owed approximately $32 million, both during the administration period, and in the DOCA proposal. Habrok's claims included allegations of inadequate investigations into NRW's security position, inflated mining rates, favourable treatment under the DOCA, and improper dealings while NRW was on the committee of inspection. The Court did not entertain any of these claims, and found that they did not justify terminating the DOCA.

Acknowledging the practical realities of operating while in administration, Beach J accepted that there would be significant cash flow consequences if NRW stopped providing mining services, and that NRW held significant power during the course of the administration. However, his Honour held that the relationship with NRW was conducted at arm's length and that the GCY Group and Administrators negotiated hard with NRW when improving performance of the mine afforded them greater negotiating strength.

DISCRETION TO SET ASIDE A DOCA

Beach J made it clear that even if some of Habrok complaints regarding the conduct of the Administrators were upheld (which they were not), the Court retained discretion as to whether to terminate a DOCA under s 445D and 447A of the Act. His Honour found that this was a case where the Court should decline to exercise its power to terminate the DOCA, even if its power were enlivened.[21]

Beach J noted that in considering whether to exercise the Court's discretion to terminate a DOCA, the interests of creditors is the primary consideration, but that this may be outweighed where the DOCA has a fraudulent or wrongful purpose. Here, where the DOCA would allow the GCY Group to continue to trade, causing the company to be wound up was an inappropriate outcome.[22] On the exercise of discretion in this case, Beach J concluded:

Now I do accept that in some cases, even if a DOCA offers more than a liquidation, nevertheless the public interest and commercial morality might justify terminating the DOCA. But that is not the present case. I accept that the Court may set aside a DOCA pursuant to s 445D even where creditors may be better off under the DOCA than with a liquidation. And the public interest can sometimes justify the termination of a DOCA even where it is not established that this would necessarily be in the creditors' interests. And to grant such relief may sometimes be in the interests of "commercial morality" in the sense that expression is used in the authorities. But we are here nowhere close to such a scenario for reasons that I have already given. The investigations were adequate in context. Further, the DOCA was not proposed in order to protect the directors or NRW from the scrutiny of a liquidator. Further, the suggested potential recoveries in a liquidation are very speculative and nowhere near the benefits to be provided by the DOCA.[23]

During the course of the trial, Habrok accepted that its application was not brought for the purity of legal doctrine. The circumstances in which Habrok acquired its standing, and the purposes for which these proceedings were brought, were also found to be relevant to his Honour's exercise of discretion against Habrok's application:

Habrok acquired Orlando's debt for the purpose of commencing this action. This discloses a collateral purpose. Further, other than recovering the $308,476.50 which Habrok paid to acquire Orlando's debt, Habrok does not stand to further benefit financially as a creditor under the DOCA, since any balance received over and above what Habrok paid is apparently to be remitted to Orlando under the terms of the assignment. Further, Mr Raftery accepted that Habrok brought this action, not in its interests as a creditor of GNT Resources, but as an attempt to acquire the assets of the GCY Group in a winding up. Mr Raftery was entirely honest and frank on Habrok's true collateral purpose. Indeed and more generally, many of the arguments put by the defendants on Habrok's lack of standing, which I rejected, nevertheless apply to justify why I ought not terminate the DOCA at the behest of Habrok. Further, for completion, the support given by two other creditors to Habrok's application adds little to the calculus.[24]

TAKEAWAYS FROM THE DECISION

The judgment of the Federal Court builds upon the decision of *Ten Network,* providing further guidance regarding the proper role of insolvency practitioners who provide advice to companies prior to an appointment as administrators or liquidators. By avoiding circumstances in which they were:

- "in the tent" with management; and
- providing safe harbour or solvency advice,

and by retaining independent advisors where appropriate, the Administrators were able to successfully counter Habrok's allegations of a conflict arising from pre-administration advice.

The judgment clearly demonstrates that the Court will not exercise its discretion to terminate a DOCA where the administration and the DOCA are consistent with the primary intent of Part 5.3A of the Act – to resurrect companies subject to financial distress, in the interests of creditors and stakeholders. There must be compelling reasons for setting aside a DOCA which results in a better return for creditors than a liquidation.

Even if Habrok had been successful in showing its several grounds for enlivening the Court's discretion under s 445D of the Act, Beach J noted that the Court would have declined to exercise its discretion to appoint liquidators to a company that was not only able to continue as a going concern, but to also provide creditors with a return of 100 cents in the dollar.[25]

The judgment is a reminder of the crucial role that the Court plays in the oversight of Part 5.3A. Where administrators act with honesty, integrity and in the best interests of creditors, they can take comfort from the judgment that their decisions will not be lightly second guessed. This outcome reinforces the deference that Courts will give to administrator's commercial judgments and decision making throughout complex and evolving situations.

DISCOVER MORE

Please contact any of the Herbert Smith Freehills' Restructuring Turnaround and Insolvency team below for further details on the Gascoyne restructuring, or to discuss your specific circumstances.

ENDNOTES

1. *Habrok (Dalgaranga) Pty Ltd v Gascoyne Resources Ltd* [2020] FCA 1395 [94], [96] (***Gascoyne***).
2. Ibid [103]-[104], [837].
3. Ibid [28].
4. Ibid [335].
5. Ibid [840].
6. Ibid [8].
7. *Corporations Act 2001* (Cth) ss 445D(2), 447A(4).
8. *Gascoyne* (n 1) [404], [840].
9. Ibid [401]-[403].
10. Ibid [477]-[478], [511].
11. Ibid [487], [493]-[497].
12. Ibid [502].
13. Ibid [533].
14. Ibid [540].
15. Ibid [7].

16. Ibid [75].
17. Ibid [234].
18. Ibid [233].
19. Ibid [243].
20. Ibid [327] – [335] and [795]-[796].
21. Ibid [411]-[415].
22. Ibid [410].
23. Ibid [827].
24. Ibid [840].
25. Ibid [829]-[840].

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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