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**SUMMATIVE (FORMAL) ASSESSMENT: MODULE 8A**

**AUSTRALIA**

This is the **summative (formal) assessment** for **Module 8A** of this course and must be submitted by all candidates who **selected this module as one of their elective modules**.

**The mark awarded for this assessment will determine your final mark for Module 8A**. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

**INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT**

**Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.**

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question (where this must be done is indicated under each question).

2. All assessments must be **submitted electronically in MS Word format**, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters – please do not change the document settings in any way. **DO NOT** **submit your assessment in PDF format** as it will be returned to you unmarked.

3. No limit has been set for the length of your answers to each question. More often than not, one fact / statement will earn one mark, but it is also possible that half marks are awarded (this should be clear from the context of the question, or in the context of the answer).

4. You must save this document using the following format: **[studentID.assessment8A]**. An example would be as follows 202122-336.assessment8A. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentID” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked**.

5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see paragraph 7 of the Course Handbook, specifically the information on pages 15 and 16, which deals with plagiarism and dishonesty in the submission of assessments. **Please note that plagiarism includes copying text from the guidance text and pasting it into your assessment as your answer**.

6.The final time and date for the submission of this assessment is **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. The assessment submission portal will close at 23:00 (11 pm) BST (GMT +1) on 31 July 2022. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.

7. Prior to being populated with your answers, this assessment consists of **8 pages**.

**ANSWER ALL THE QUESTIONS**

**QUESTION 1 (multiple-choice questions) [10 marks in total]**

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and mark your selection on the answer sheet by highlighting the relevant paragraph **in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

**Question 1.1**

**Select the correct answer**:

If a creditor is dissatisfied with the bankruptcy trustee or liquidator’s decision in respect of its proof of debt, the creditor may:

1. apply to AFSA or ASIC for the decision to be reversed or varied.
2. apply to the bankruptcy trustee or liquidator for the decision to be reversed or varied.
3. bring court proceedings for a money judgment in respect of the debt.
4. apply to the court for the decision to be reversed or varied.

**Question 1.2**

Which of the following **is not** a collective insolvency process:

1. Receivership.
2. Liquidation.
3. Deed of company arrangement.
4. Voluntary administration.

**Question 1.3**

**Select the correct answer**:

Which of the following insolvency procedures **requires** court involvement:

1. creditors’ scheme of arrangement.
2. deed of company arrangement.
3. creditors’ voluntary liquidation.
4. voluntary administration.
5. small company restructuring plan.

**Question 1.4**

**Select the correct answer**:

Newco Pty Ltd has three (3) employees and an annual turnover of AUD 950,000. It currently owes AUD 300,000 to its trade creditors and it has a AUD 800,000 secured loan from its bank. Which of these restructuring processes is Newco **ineligible**for?

1. A voluntary administration followed by a deed of company arrangement.
2. An informal restructuring with the agreement of creditors.
3. A small business restructuring plan.
4. A deed of company arrangement.

**Question 1.5**

**Select the correct answer**:

Which of the following **is not** “divisible property” in a bankruptcy?

1. Wages earned by the bankrupt.
2. Fine art.
3. Choses in action relating to the debtors’ assets.
4. The bankrupt’s family home.
5. Superannuation funds.

**Question 1.6**

Which of the following **is not** a relevant period for the entry into a transaction which constitutes an unfair preference in a liquidation?

1. The six-month period ending on the “relation back day”.
2. The one-year period ending on the relation back day where the creditor had reasonable grounds for suspecting that the company was insolvent.
3. The four-year period ending on the relation back day where the creditor is a related entity of the company.
4. The 10-year period ending on the relation back day where the transaction was entered into for a purpose that included defeating, delaying or interfering with the rights of creditors in the event of insolvency.
5. After the relation back day but on or before the liquidator was appointed.

**Question 1.7**

**Select the correct answer**:

A company can only be placed into voluntary administration if:

1. the directors declare that the company’s liabilities exceed its assets.
2. the creditors resolve that the company is unable to pay its debts as and when they fall due.
3. a liquidator declares that the company is insolvent or likely to become insolvent.
4. the directors resolve that the company is insolvent or likely to become insolvent.

**Question 1.8**

**Select the correct answer**:

A receiver:

1. is an agent of the secured creditor that appointed the receiver.
2. owes a duty of care to unsecured creditors.
3. is an agent of the company and not of the secured creditor that appointed the receiver.
4. is an agent of the company until the appointment of a liquidator to the company.
5. is required to meet the priority claims of employees out of assets subject to a non-circulating security interest.

**Question 1.9**

**Select the correct answer**:

Australia has excluded from the definition of “laws relating to insolvency” for the purposes of Article 1 of the Model Law the following parts of the Corporations Act:

1. The part dealing with schemes of arrangement.
2. The part dealing with windings up of companies by the court on grounds of insolvency.
3. The part dealing with taxes and penalties payable to foreign revenue creditors.
4. The part dealing with the supervision of voluntary administrators.
5. The part dealing with receivers, and other controllers, of property of the corporation.

**Question 1.10**

**Select the correct answer**:

Laws regarding the following came into effect on 1 January 2021:

1. an *ipso facto* moratorium in voluntary administrations and liquidations.
2. simplified restructuring and liquidation regimes for small companies.
3. reducing the default bankruptcy period from three years to one year.
4. a safe harbour from insolvent trading liability*.*

**QUESTION 2 (direct questions) [10 marks]**

**Question 2.1 [maximum 3 marks]**

Name the three types of voidable transactions that can be reversed by a bankruptcy trustee and describe the circumstances in which such a transaction will not be reversible.

* Types of voidable transactions that can be reversed by a bankruptcy trustee are (a) undervalue transactions (b) transaction involving transfers to defeat creditors and (c) preferential payment to creditors.
* Circumstances in which such a transaction will not be reversible are (a) transactions that are in good faith (b) transactions that were done in the ordinary course of business and (c) transactions where there was no knowledge (notice) of the petition for bankruptcy.

**Question 2.2 [maximum 3 marks]**

How does a court determine the scope of the stay in relation to a corporate debtor under Australia’s implementation of Article 20 of the Model Law?

* Section 16 of the Cross-Border Insolvency Act 2008 (CBIA 2018), in relation to **Effects of recognition of a foreign main proceeding** provides that “*For the purposes of paragraph 2 of Article 20 of the Model Law (as it has the force of law in Australia), the scope and the modification or termination of the stay or suspension referred to in paragraph 1 of that Article, are the same as would apply if the stay or suspension arose under: (a) the Bankruptcy Act 1966; or (b) Chapter 5 (other than Parts 5.2 and 5.4A) of the Corporations Act 2001; as the case requires*”
* Australian court will consider whether the foreign main proceeding is a rescue proceeding or liquidation proceeding. If the foreign main proceeding is more analogous to a recue proceeding, the stay will affect (cover / apply to) secured creditors. However, if it is more analogous to a liquidation proceeding, the stay will affect (cover /apply to) unsecured creditors, not secured creditors.
* However, in the application of s 16 CBIA 2018, there may be difficulty in determining which applies when there is a lack of clarity as to whether the foreign main proceeding is a rescue proceeding or liquidation proceeding: *Board of Directors of Rizzo-Bottiglieri-de Carlini Armatori SpA* [2018].

**Question 2.3 [maximum 4 marks]**

What is an *ipso facto* clause and what is the relevance of *ipso facto* clauses in liquidations?

* *Ipso facto* is a Latin phrase which means “by the fact or act”. In the insolvency context, it is often used in the context of referring to a clause that allows one party to terminate (or modify) the contract upon the occurrence of a specified insolvency event; for example, if defaults happen, the direct consequence (termination of contract) will follow.
* The relevance of *ipso facto* clauses in liquidation relates to whether a party (creditor / supplier for example) can terminate a pre-liquidation contract when a debtor is placed in liquidation.
* To the extent that *ipso facto* clause can be invoked to terminate a contract, it has the potential of destroying the company’s enterprise value, leaving it very little room (scope) to carry out an orderly liquidation or sale of business (assuming that the contract is needed for an orderly cessation or sale of the debtor company business as a “going-concern or “a single business operation” as opposed to a break-up sale).
* With effect from 1 July 2018, there is a statutory moratorium (stay) on the enforcement of *ipso facto* clauses relating to certain type of insolvency regime – for example, when a debtor company is in a creditor’s scheme of arrangement, voluntary administration, or receivership where the receiver is appointed over the whole or substantially the whole of the debtor’s business. However, the statutory moratorium does not apply to a company placed in liquidation.
* To the extent that the enforcement of *ipso facto* clauses can potentially destroy the enterprise value of a debtor company, one might consider invoking (placing the debtor company) a creditor’s scheme of arrangement or voluntary administration (thereby triggering the statutory moratorium (stay) immediately before creditor’s voluntary liquidation.

**QUESTION 3 (essay-type questions) [15 marks in total]**

“Australia’s insolvency and restructuring options have in the past been very creditor-friendly. However, recent reforms have made Australia more of a debtor-friendly jurisdiction.“

Critically discuss this statement and indicate whether you agree or disagree with it, providing reasons for your answer.

Australia insolvency and restructuring options are generally considered creditor-friendly. The insolvency regimes, broadly, is focused on protection of creditors’ rights. However, there are debtor-friendly features within the insolvency regimes that protect the debtor. These factors they are discussed below.

**Bankruptcy of an individual**

* A person (debtor) can be placed in bankruptcy by a creditor(s) petition if the person is not able to pay his debts as and when they fall due (cash flow test). The petitioning creditor must be owed a debt(s) of AUD 5,000 and above. The threshold is relatively low and is creditor-friendly. However, there are debtor-friendly features, and they include (a) divisible property does not form party of the bankruptcy estate (b) a bankrupt is automatically discharged 3 years from the date the debtor files the statement of affairs with the trustee, unless the trustee objects on the ground of lack of co-operation from the bankrupt and (c) a bankrupt may also agree with creditors for a scheme of arrangement with the creditors, and if agreed, the bankruptcy will come to an end.

**Receivership**

* Receivers are primarily appointed under a security agreement providing the creditor (usually a lender) to appoint a receiver to take control of the assets charged (normally over the whole or substantially the whole of the debtor’s assets) under the security agreement. The court may also appoint a receiver under certain circumstances. Receivership regime is creditor-friendly, enabling the creditor to realise the assets charged to it, often without involvement of the court.
* The debtor-friendly *ipso facto* clause will prevent the termination of a contract by the counter-party if the security agreement is such that there is a charge over the whole or substantially the whole of the debtor’s assets.

**Liquidation**

* This allows a financial distress company to be wound-up, often on the petition of a creditor who is owed money. A court judgment is not needed. Liquidation can be said to be a creditor-friendly collective recovery scheme for the creditors.

**Creditors’ Scheme of Arrangement**

* The management continues to be in control of the debtor (somewhat akin to a debtor-in-possession restructuring) while it works out a restructuring scheme with the creditors.
* The creditors scheme of arrangement involves the court process. Broadly, the debtor company applies to the court to request for a court convened meeting. If the court allows it, a restructuring proposal will be tabled to the creditors for voting. If it is approved with the requisite majority, the debtor company will seek court sanction of the scheme.
* The requisite majority are (a) majority of creditors in number present and voting and (b) they represent at least 75% of the debts. The creditors must be divided into classes and each class needs to have the requisite majority voting in favour.
* During the creditors’ scheme of arrangement, there is also debtor-friendly moratorium preventing the enforcement of *ipso facto* clauses, thus the debtor has a better prospect of “turning around” the company.
* If the court approves the scheme, it binds all creditors. The scheme can be said to be both debtor-friendly in that the management of the company continues to be in the free hands of the debtor. It can also be said to be creditor-friendly as the approval or rejection of the restructuring scheme is in the hands of the creditors.

**Voluntary Administration**

* While the primary aim is to provide a distress debtor breathing space (statutory moratorium or stay will take effect) to restructure its financial affairs, a restructuring scheme is expected to be structured such that returns to the creditors are maximised. It is therefore a corporate rescue regime, not exclusively for the benefit of the debtors. There are other interests to protect, for example, jobs, suppliers, and keeping the business active.
* Voluntary Administration may also be used to sell the company’s business as a going concern if the voluntary administrator thinks that it would maximise recovery to the creditors. Interests of the creditors are central.
* Upon the appointment of the voluntary administrator, the powers of the directors are suspended. The voluntary administrator takes control for the company and affairs. In short, the debtor loses powers and control over the company (it is not a debtor-friendly feature).
* Creditors’ decisions determine the fate of the debtor. For example, creditors decide (vote) whether the company is to be returned to the directors or to be placed in liquidation, towards the end of the voluntary administration process.
* However, a creditor(s) with security over the whole or substantially the whole of the company’s assets remained entitled to enforce their security (subject to certain restrictions) even though the voluntary administration is in place.
* On balance, voluntary administration is creditor-friendly although there is debtor-friendly moratorium to protect the debtor during the process.

**Void and voidable transactions**

It allows the creditors to clawback the value of such transactions for the benefit of creditors if (a) the transaction fall within the statutory time-frame and (b) it does not fall within the exceptions mentioned above. These are friendly-creditor features protecting the interest of creditors.

***Ipso facto*r**

* With effect from 1 July 2018, there is debtor-friendly statutory moratorium (stay) on the enforcement of *ipso facto* clauses relating to regimes involving creditor’s scheme of arrangement, voluntary administration, or receivership where the receiver is appointed over the whole or substantially the whole of the debtor’s business. However, the statutory moratorium does not apply to a company placed in liquidation.

**Moratorium**

* Secured creditors – they are entitled to enforce their rights during the individual bankruptcy process and liquidation process of a company. This is another creditor-friendly feature.

**Insolvent trading**

* This allows a liquidator (on behalf of creditors) to pursue a claim against the directors for insolvent trading, when there no reasonable ground to believe that the company can pay its debts at the time it incurs the debt. This protects the creditors (creditor-friendly). However, there is also the debtor-friendly safe harbour provision that was introduced in Sept 2017. It is a defence to the debtor (director) under the safe harbour provision if the director(s) take action(s) that are reasonably likely to lead to a better outcome for the company; s 588GA.

**Anti-phoenixing laws**

* This is creditor-friendly feature in the insolvency regimes to punish directors and protect creditors from phoenixing activities.

**Reform – Small companies**

* Simplified liquidation and restructuring process for small companies were introduced in 2020. It assists small companies with (a) the liquidation or (b) restructuring process, making it easier, quicker, and less costly. However, this can be also said to be creditor-friendly in that it is designed such that it maximises the returns to the creditors.

**UNICITRAL Model Law**

* It is observed that while Australia insolvency process is more creditor-friendly, it has also adopted UNCITRAL Model Law, which contains recognising an insolvency foreign proceeding, providing a debtor-friendly moratorium to a foreign proceeding involving in a rescue plan.

**Concluding comments**

* Secured creditors are generally able to enforce their security (and not subject to stay or moratorium). Unsecured creditors have an active role, and a restructuring (compromise) scheme is subject to their approvals.
* A small shift is debtor-friendly can be seen in features such as safe harbour provision, restriction in the enforcement of ipso facto rights

**QUESTION 4 (fact-based application-type question) [15 marks in total]**

**Question 4.1 [maximum 9 marks]**

Aussiebee Pty Ltd (Aussiebee), a company incorporated in the fictional country of Lyonesse, sells chocolates flavoured with Australian native plants. The chocolates are manufactured in Australia by NewYums Pty Ltd (NewYums), an Australian-incorporated wholly-owned subsidiary of Aussiebee.

Aussiebee has offices and warehouses in both Sydney and in Lyonesse. Aussiebee regularly sells its chocolates all over the world, from both its Lyonesse and its Sydney offices and warehouses. Aussiebee and NewYums share a board of directors, made up of six Australians and one Lyonessian. Aussiebee employed 40 staff: 20 in Sydney and 20 in Lyonesse. Aussiebee’s CEO is an Australian, but resident in Lyonesse. Aussiebee’s CFO is an Australian, resident in Australia.

Aussiebee is insolvent. NewYums, however, remains solvent.

A liquidator has been appointed to Aussiebee in Lyonesse. She applies to the Federal Court of Australia for recognition of the Lyonessian liquidation as a foreign main proceeding, and for orders entrusting Aussiebee’s assets (including Aussiebee’s shares in NewYums which are worth AUD 20 million) to her, so that she can realise them for the benefit of creditors in the Lyonessian liquidation.

Aussiebee owes AUD 12 million in taxes in Australia, payable to the Australian Taxation Office (ATO). Assume that revenue creditors such as the ATO are not entitled to prove in the Lyonessian liquidation.

You are advising the ATO. What should the ATO do to protect or improve its position?

* Australia adopted the UNCITRAL Model Law on Cross-Border Insolvency (Model Law) under the Cross-Border Insolvency Act 2008 (CBIA 2008). CBIA 2018 gives the Model Law the force of law in Australia.
* For the model law to apply or recognised in Australia, the proceeding must be an “insolvency proceeding”. The recognition of a proceeding can be a foreign main proceeding or foreign non-main proceeding. Further, it also recognises a foreign representative (example - the liquidator of Aussiebee).
* There are few issues – (a) whether the proceeding is an insolvency proceeding (b) if it is, whether it is a foreign main proceeding or foreign non-main proceeding (c) whether the liquidator can be recognised as a foreign representative.
* On the facts, it appears that it is an insolvency proceeding and the liquidator had been validly appointed. The liquidator had applied to Australia to recognise the proceeding as foreign main-proceeding.
* To qualify as a foreign main proceeding, it must be such that the debtor (Aussiebee) has the centre of main interests (COMI) located in Aussiebee. While the Model Law does not define COMI, there is a rebuttable presumption that the country of incorporation is the COMI. The other factors to consider are the location of its major assets, major liabilities, the location of its headquarters and its key personnel (nerve centre).
* On the facts, Aussiebee was incorporated in Lyonnessian. However, it is noted that the CEO is based in Lyonessian, but the CFO is based in Australia. It is not clear whether the key business, its debtors and creditors are Lyonnessian or Australia.
* On the basis that the COMI is Lyonnessian, the court in Australia will recognise it as a foreign main-proceeding. If the liquidator cannot establish that Lyonnessian is the COMI, her application will fail.
* For this question, it is assumed that the liquidator application for recognition as a foreign main proceeding is successful. What would be the impact to ATO and how it could protect itself or the AUD 12 million owing to it.
* Article 21 of the Model Law provides that *“Upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor’s assets located in this State to the foreign representative, or another person designated by the court, provided that the court is satisfied that the* ***interests of creditors in this State are adequately protected****”.*
* Article 22 *of the Model Law further provides that “In granting or denying relief under article 19 or 21, or in modifying or terminating relief under paragraph 3 of the present article, the court must be satisfied that the* ***interests of the creditors and other interested persons, including the debtor, are adequately protected.****”*
* In *Ackers v Deputy Commissioner of Taxation* [2014], the Federal Court of Australia held that the court must be satisfied that the interests of the creditors are **“adequately protected”** when granting relief under Article 19. In that case, the Cayman Islands liquidator, after having its proceeding recognised as a foreign main proceeding in Australia, wanted to remit about AUD 7 million to Cayman Islands for distribution to its creditors. However, in Cayman Islands, a debt payable to a foreign revenue as creditor is not admissible and therefore cannot file proof of claim. The Federal Court of Australia in that case ordered that the tax authority in Australia be allowed to enforce its claim in Australia, by allowing the tax authority in Australia to recover an amount up to the amount that the tax authority in Australia would have received if it was allowed to proof the debts and its debts admitted.
* The facts in *Ackers v Deputy Commissioner of Tax* [2014] are similar to the facts at hand – that is money is owed to revenue authority (ATO) and it is not allowed to proof its debts in Lyonnessian. Based on the Article 21 and 22 (***interests of creditors in Australia are adequately protected)*** together with the legal precedent in *Ackers v Deputy Commissioner of Tax* [2014], ATO is advised to seek similar order from the Federal Court of Australia.

**Question 4.2 [maximum 6 marks]**

Hyrofine Australia Pty Ltd (HA) is a company incorporated in Australia. It is in the business of re-refining waste oil from electric substations in Australia and selling the re-refined oil. All of the shares in HA are owned by HA’s parent company, Hyrofine Group Ltd (HGL), also incorporated in Australia. The same Board of directors controls both HGL and HA.

HA operated an oil re-refining plant near Sydney, Australia as a joint venture with Best Oil Refining Pty Ltd (BOR). The joint venture proved to be unprofitable and the plant ceased operations in mid-2020.

HA’s major remaining asset is a second re-refining plant that it operates near Perth, Western Australia. This plant has only been in operation for one year. The funding for the Perth plant has been provided by a major shareholder of HGL as an unsecured loan for AUD 30 million. The loan agreement provides that the loan is repayable by monthly instalments over a term of 5 years with the first payment due at the end of 2021. The loan agreement also provides that the loan becomes automatically due and payable in full if HA enters into any formal insolvency or restructuring process in Australia.

HA also owns three large trucks that transport waste oil to the Perth re-refining plant and transport re-refined oil to HA’s customers. Those trucks were purchased with a AUD 3 million loan from the Commonwealth Bank of Australia (CBA). That loan is secured by mortgages over the three trucks. The mortgages are not registered on the Personal Property Securities Register.

In July 2020, BOR commenced proceedings against HA in the Supreme Court of New South Wales for damages in respect of the failed joint venture. On 1 October 2020, the Supreme Court found in favour of BOR, ordering that HA pay AUD 4.6 million in damages to BOR.

Between October 2020 and October 2021, HA continued to trade, incurring debts to trade creditors as well as borrowing AUD 5 million from its parent company HGL. It made only a small profit from its Perth re-refining plant.

In October 2021, you are called in to advise the Board of directors of HGL and HA about the financial predicament of HA. The Board tells you that HA has been insolvent since the judgment was handed down in October 2020, because HA does not earn enough from its second refining plant to meet the judgment debt and to start repaying CBA at the end of 2021. The Board also tells you that there is no more funding available for HA’s operations, and that they have exhausted all possibilities for refinancing HA’s debts.

What do you advise the Board to do about HA? What are the main issues that the board of HGL and HA should be aware of in light of the facts set out above?

**Advice to the Board on HA**

* Under the Australian Corporation Act 2001 (CA 2001), it provides for insolvent trading liability on the part of directors. Broadly, it penalises the directors in allowing a company to incur debts when it is insolvent. Offending the provision of insolvent trading provision may result in the court ordering the director to compensate the company, on the application of the company’s liquidator.
* Under section 588V CA 2001, it imposes insolvent trading liability on a holding company for the debt of insolvent subsidiary. Therefore, the directors of the holding company (HGL) and HA can be held liable for insolvent trading, with the result that the directors may be ordered by the court to compensate the company for losses suffered due to insolvent trading.
* There are defences available under s 588H CA 2001 – it provides that “it is a defence if it is proved that, at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt … the person had reasonable grounds to believe or did believe … that a competent and reliable person was responsible for providing to the first-mentioned person adequate information about whether the company was solvent … the person took all reasonable steps to prevent the company from incurring the debt …”
* Since Sept 2017, CA 2001 has also introduced the “safe harbour” provision. Under s 588 GA, it is a defence if the person “starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company … the appointment of an administrator, or liquidator, for the company”.
* In relation to “working out a course of action that is reasonably likely to lead to a better outcome”, s 588 GA provides that regards must be had to whether the person “is obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice” or “is developing or implementing a plan for restructuring the company to improve its financial position”.
* Safe harbour provision is not an “absolute immunity” against any legal suit by the liquidator on insolvent trading. The directors are expected to be diligently monitor and ensure that the actions taken (to be taken) are reasonably likely to lead to a better outcome.
* It is noted that the Board had formed the view that HA has been insolvent since October 2020, since it loses the legal case to BOR. The Board is therefore advised to immediately consider the defences available to avoid (mitigate) the risk of insolvent trading. To this end, HA should consider appointing an insolvency specialist to carry out restructuring (business rescue) in the form of a form a formal or informal restructuring. Options of restructuring include (a) informal restructuring (b) creditors scheme of arrangement or (c) voluntary administration.
* For informal restructuring, the restructuring will be in the form of multi-lateral discussions with creditors to agree to a restructuring (or compromise). The management will still be in control of the company. The disadvantage of this approach is that the restructuring (scheme) will require 100% approval from the creditors, which is unlikely to be practical.
* For creditors scheme of arrangement, the management is still in the control of management (debtor in possession restructuring scheme). However, the process involves the court, in that the application needs to be made to the court for the court convene creditors meeting, creditors will vote for the scheme (in favour or against) and the court will consider whether to sanction the scheme if the scheme meets the requisite majority voting. One advantage of this scheme is that it is debtor in possession and the requisite majority is “majority in number and 75% in value of the creditors (or class of creditors)”. It does not require 100% approval from the creditors.
* For voluntary administration, the powers to manage the company rest with the voluntary administrator. While the directors continue to be in office, the directors’ powers are suspended. It is for the voluntary administrator to manage the company and at the same time, consider whether it is viable to develop a restructuring (compromise) scheme with the creditors.

**Main issues that the board of HGL and HA should be aware of**

***In relation to - The loan agreement also provides that the loan becomes automatically due and payable in full if HA enters into any formal insolvency or restructuring process in Australia.***

* This is often referred to as an *ipso facto* clause – it allows a counter party to terminate an agreement if a certain event(s) happened. On the facts, the happening of any formal insolvency or restructuring process.
* This is a AUD 30 million unsecured loan. If the loan is vital to the survival of the business as a going concern, and HA cannot afford to allow this loan to be terminated (for example, it is needed for working capital while a restructuring (compromise) scheme is being worked out, HA should consider a formal restructuring scheme either in the form of (a) creditors scheme of arrangement or (b) voluntary administration, to defeat the *ipso facto* clauses. This gives the company (HA) breathing space to work out a restructuring (compromise) scheme with the creditors.

***In relation to - those trucks were purchased with a AUD 3 million loan from the Commonwealth Bank of Australia (CBA). That loan is secured by mortgages over the three trucks. The mortgages are not registered on the Personal Property Securities Register (PPSR).***

* Under PPSR – In order for the security to prevail over the claims against other creditors, the security granted must be registered. Failure to register may cause the loss of security on insolvency.
* Security interest must be registered at least 6 months before the commencement of external administration (voluntary administration or liquidation) and that the security interest is registered within 20 days from its creation (or such extended time as may be allowed by the court, with sufficient cause).
* Non-registration of security interests will have the effect of the property being vested in the grantor company (HA) immediately prior to the commencement of voluntary administration or liquidation.
* On the facts, the security has not been registered and therefore CBA will lose its security in the event of voluntary administration or liquidation.

***In relation to - In July 2020, BOR commenced proceedings against HA in the Supreme Court of New South Wales for damages in respect of the failed joint venture. On 1 October 2020, the Supreme Court found in favour of BOR, ordering that HA pay AUD 4.6 million in damages to BOR.***

* This is unlikely to be an insolvent trading event, as the transaction happened long before the directors had knowledge of potential insolvency.
* The claims by BOA will be an unsecured claim, to be dealt with in a restructuring (compromise) scheme. Otherwise, it will be dealt with in liquidation.

***In relation to - Between October 2020 and October 2021, HA continued to trade, incurring debts to trade creditors as well as borrowing AUD 5 million from its parent company HGL. It made only a small profit from its Perth re-refining plant.***

* It is noted that the Board informed us that that “HA has been insolvent since the judgment was handed down in October 2020”. The Board has knowledge of insolvency from Oct 2020 onwards.
* To the extent that the debts incurred by the company cannot be repaid from Oct 2020, the directors may be held liable for insolvency trading unless defences mentioned above apply. On the facts, the defences do not seem to apply.
* For transaction before Oct 2020 – there Board may also be held liable for insolvent trading, if the board had “reasonable grounds for suspecting the company was insolvent when it incurred the debtor or a reasonable person in a like position in the company’s circumstances would be so aware”. This is an objective reasonable person test.
* Therefore, even if the Board had no actual knowledge of insolvency, but a reasonable person in a like position would have concluded that it was insolvent, the Board may still be liable for insolvent trading.

**Concluding comments**

The Board should immediately engage an insolvency specialist and get advice on the next course of action, to avoid (mitigate) the risk of insolvent trading.

**\* End of Assessment \***