INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
in INTERNATIONAL INSOLVENCY LAW

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.

2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 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 the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).

4. You must save this document using the following format: **[studentnumber.assessment8A]**. An example would be something along the following lines: 202021IFU-314.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 "studentnumber" 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 the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words**.

6. The final submission date for this assessment is **31 July 2021**. The assessment submission portal will close at **23:00 (11 pm) GMT on 31 July 2021**. 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 **7 pages**.

ANSWER ALL THE QUESTIONS

Commented [DB1]: 32 out of 50 = 64%

QUESTION 1 (multiple-choice questions) [10 marks in total] 8/10

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:

(a) apply to AFSA or ASIC for the decision to be reversed or varied.

(b) apply to the bankruptcy trustee or liquidator for the decision to be reversed or varied.

(c) bring court proceedings for a money judgment in respect of the debt.

(d) 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:

(a) Receivership.

(b) Liquidation.

(c) Deed of company arrangement.

(d) Voluntary administration.

Question 1.3

Select the correct answer:

The purpose of the Assetless Administration Fund is to:

(a) finance preliminary investigations and reports by AFSA to trustees into the bankruptcies of individuals with few or no assets, to assist trustees in deciding whether to commence enforcement action.

(b) finance preliminary investigations and reports by ASIC to liquidators into the failure of companies with few or no assets, to assist liquidators in deciding whether to commence enforcement action.

(c) finance preliminary investigations and reports to AFSA by trustees into the bankruptcies of individuals with few or no assets, to assist AFSA in deciding whether to commence enforcement action.

(d) finance preliminary investigations and reports to ASIC by liquidators into the failure of companies with few or no assets, to assist ASIC in deciding whether to commence enforcement action.

Question 1.4

Select the correct answer:

Newco Pty Ltd has 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?

(a) A voluntary administration followed by a deed of company arrangement.

(b) An informal restructuring with the agreement of creditors.

(c) A small business restructuring plan.

(d) A deed of company arrangement.

Question 1.5

Select the correct answer:

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

(a) Wages earned by the bankrupt.

(b) Fine art.

(c) Choses in action relating to the debtors' assets.

(d) The bankrupt's family home.

(e) 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?

(a) The six-month period ending on the "relation back day".

(b) The one-year period ending on the relation back day where the creditor had reasonable grounds for suspecting that the company was insolvent.

(c) The four-year period ending on the relation back day where the creditor is a related entity of the company.

(d) 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.

(e) After the relation back day but on or before the liquidator was appointed.

Question 1.7

Select the correct answer:

A receiver:

(a) is an agent of the secured creditor that appointed the receiver.

(b) owes a duty of care to unsecured creditors.

(c) is an agent of the company and not of the secured creditor that appointed the receiver.

(d) is an agent of the company until the appointment of a liquidator to the company.

(e) is required to meet the priority claims of employees out of assets subject to a non-circulating security interest.

Question 1.8

Select the correct answer:

A voluntary administrator must convene and hold a first meeting of creditors within how many business days of his appointment?

(a) 3 business days.

(b) 8 business days.

(c) 12 business days.

(d) 24 business days.

(e) 45 business days.

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:

(a) The part dealing with schemes of arrangement.

(b) The part dealing with windings up of companies by the court on grounds of insolvency.

(c) The part dealing with taxes and penalties payable to foreign revenue creditors.

(d) The part dealing with the supervision of voluntary administrators.

(e) 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:

(a) an *ipso facto* moratorium in voluntary administrations and liquidations.

(b) simplified restructuring and liquidation regimes for small companies.

(c) reducing the default bankruptcy period from three years to one year.

(d) a safe harbour from insolvent trading liability.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 3 marks] 1.5/3

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.

Answer 2.1: Under the Bankruptcy Act of Australia, a bankruptcy trustee can bring court proceedings to reverse the effects of below three types of voidable transactions:

1. undervalued transactions
2. transfers to defeat creditors and
3. preferential payments to creditors.

Most of these transactions should fall under a look back period which is pre-determined in the legislature.

You identified the types of voidable transactions that can be reversed, but a discussion of the circumstances in which those transactions will not be reversable was required to address the second half of the question and obtain full marks.

Those circumstances include the following two:

- Transactions which occurred during the relation back period but were transacted in good faith, in the ordinary course of business and in the absence of notice of a creditor's petition or debtor's petition, are not recoverable under the voidable transaction provisions (s 123).
- Also, the bankruptcy trustee will not be able to recover property if the original transferee has since transferred the property to a third party and the third party received the property in good faith and for market value (s 120(1)).

Question 2.2 [maximum 3 marks] 2.5/3

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?

Answer 2.2: Below two are the situations which has been specified under Australia's implementation of Article 20 of the Model Law (in CBIA, s 16):

A. the Bankruptcy Act or,
B. Chapter (other than Parts 5.2 and 5.4A) of the Corporations Act,

Where the situation requires. Good.

Further, to explain, when a court in Australia is deciding about a recognition application in relation to a corporate debtor, it will see if the case is brought in for the business rescue or under a liquidation proceedings, accordingly and appropriately the court will decide whether the application should be accepted under administration or liquidation. However, it would be difficult to decide if the foreign proceeding is not clearly in either business rescue or liquidation like. Good, but needed a bit more detail on the nature of administration stays (which is broader, and affects secured creditors) v standard liquidation stays (which affects only unsecured creditors).

Also could add that it is not a question of discretion but rather which stay should apply according to the nature of the proceeding: *Tai-Soo Suk v Hanjin Shipping Co Ltd* [2016] FCA 1404 at [24].

Question 2.3 [maximum 4 marks] 3.5/4

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

Answer 2.3: In Contractual provisions of any contract between the parties, an ipso facto clause, allows one party to terminate or modify the implementation of a contract upon the occurrence of a specified event which can be any insolvency related event as well. e.g. upon a debtor's bankruptcy (s 301 Bankruptcy Act), or upon the company entering voluntary administration or because of the company's general financial position while it remains in voluntary administration (s 451E Corporations Act). In Australia, from 1 July 2018, a stay on enforcement of ipso facto rights have been imposed (resulting in moratorium), with certain exclusions and exceptions. Further, on 1 January 2021, the scope of the moratorium was amended to reflect the new restructuring regime in Part 5.3B of the Corporations Act.

As per the ipso facto clause, a creditor is now prevented from relying on the clause to terminate the contract with the company solely for the reason that the company has entered voluntary administration or generally week financial position. However, the ipso facto moratorium will not apply if the creditor seeks to enforce a contractual right on the independent basis if the company has not complied with a payment /obligation performance after it enters voluntary administration.

Although there are some exceptions to the ipso facto moratorium:

- A derivative contract
- A contract related to securities and financial products
- An underwriting contract
- A business or share sale agreement
- A factoring arrangement or
- Some Building and construction contracts. Good

Apart from the above the ipso facto moratorium is also not applicable under below mentioned circumstances by reason of the counterparty becoming subject to the following insolvency regimes:

- a receiver or other controller appointment that is not over the whole or substantially the whole of the company's property
- a deed of company arrangement
- a liquidation (at least in circumstances where the liquidation does not immediately follow an administration, creditors' scheme or restructuring)
- a restructuring plan

So, if we analyse the above in case of liquidation, prima facie it is not applicable once liquidation is ordered of the corporate debtor. Excellent. Many students failed to realise this! Although, for better realisation of assets, if liquidator deems fit, can apply to the relevant court for some reliefs. Not really any relief that a liquidator could get which would stop an ipso facto clause from operation in liquidation.

QUESTION 3 (essay-type questions) [15 marks in total] **10/15**

"Creditors' schemes of arrangement are costly and time-consuming and are an ineffective corporate rescue mechanism in Australia."

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

Answer 3: To answer the question first we need to understand that what is 'Creditors' schemes of arrangement is all about.
Creditors' scheme of arrangement:

When the directors of a financially distressed company enter into negotiations with company's creditors formally in an effort to secure their support for restructuring of existing debts of the company, under the corporations act it is called Creditors' scheme of arrangement.

Once, the directors have the support of the major secured creditors of the company, they can file an application to the court to avail an order to convene a meeting of the creditors to fetch the vote to approve the scheme. In case of differential treatment to creditors there would be a need to hold separate meetings of the class of creditors. And the requisite requirements for all the classes separately to pass the scheme would be as under:

- a majority of creditors in fact present and voting at the meeting
- 75% of the total amount of the debts and claims of creditors present and voting at the meeting

In case of meeting the above requirement happens then another application would be required to be filed to approve the scheme. If court approves the scheme then it would be implemented as per the terms of the scheme document and generally an administrator is not required under the act though it is desirable to appoint an administrator if the scheme is for a protracted time period. To give the scheme more effect moratorium on ipso facto rights will also be there, with exclusions.

The scheme of arrangement is definitely a costly and time-consuming affair in comparison to the other options available like voluntary administration and/or DOCA (Deed of company arrangement) as it requires minimum two applications to filed and it can take three months or more to approve the scheme. Though, in my views it is an effective manner of restructuring because of below reasons:

- It can bind dissenting secured creditors

- It can include the release of creditors rights against third parties other than the company.

The above stated advantages give an edge to the scheme and actually in practise because of increased complexities related to finance and restructuring and global nature of businesses, creditors scheme of arrangement is a preferred option because of its binding nature on all stakeholders with the blessings of the court and actually in Australia many high profile and large restructurings have happened under the scheme such as Boart Longyear, Atlas Iron, Lehman Brothers Australia, Nine Entertainment Group, Opes Prime Group and Alinta Limited to name a few.

So, in my opinion creditors scheme of arrangement is an effective method to resolve insolvencies and the popularity of the same is expected to grow.

You could have gone beyond pp 54-55 of the Guidance text by making the following points: Other points include: DOCAs can be terminated by the court, schemes are already approved by the court so are not vulnerable to being terminated by the court. In preparing a DOCA, the company has the benefit of the broad stay on all creditor action that applies during a voluntary administration. That stay does not apply while preparing a scheme.

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

Question 4.1 [maximum 9 marks] **4.5/9**

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?

Answer 4.1: Taking cue from a case law mentioned in the course book, namely Ackers V Deputy Commissioner of Taxation, my advise to the ATO would be to file an application under Article 22 of the Model law to the Federal Court, either to modify the recognition order (if that is already been done under the article 19 of the Model law filed by the liquidator of Aussiebee)

or if that has not happened then an interjection application to recognise ATO as a revenue creditor of Aussiebee in Australia.

As per the judgement in the cited case law, a debt payable to a foreign revenue creditor is not admissible in the state ordered liquidation. As in this case the liquidation of Aussiebee is ordered in Lyonesse. But if the court is satisfied that the interests of the creditors are 'adequately protected' when granting relief under Article 19, here article 21, not article 19, but the principle remains the same it can order for revenue creditor to take steps to enforce its claim in Australia, expressly for the purpose of recovering an amount up to the pari passu amount the ATO would have received if he were entitled to prove for the tax debt as an unsecured creditor in the foreign main proceedings.

More so in this case, because when NewYums is solvent which is a company incorporated in Australia and is a wholly owned subsidiary of Aussiebee. And as per the numbers stated in the description, a fair chance is that ATO would be able to collect reasonably good amount in recovery for its debt against Aussiebee.

You missed the other issue, being whether recognition will be granted at all and whether main or non-main. The ATO should intervene on the recognition application, arguing that:

- The COMI of Aussiebee is Australia, not Lyonesse, and so the assets of Aussibee should not be entrusted to the Lyonessian liquidator.
    - *Ackers v Saad Investments* is the leading Australian decision on COMI. It followed and expressly adopted the principles in *Re Eurofoods IFSC Ltd* that COMI is to be determined having regard to the objectively ascertainable factors of the debtor.
    - Need to displace presumption that place of incorporation is COMI
    - Six of the seven directors are Australians
    - The CEO is Australian (although resident in Lyonesse)
    - The CFO is Australian and resident in Australia
    - Sells Australian product, manufactured by its subsidiary in Australia.
    - Do not know whether Aussiebee holds itself out to be an Australian-based company, but its name and its product seem to indicate that it does.
- The court might still find that the company's COMI is in Lyonesse, and therefore the Lyonesse proceeding is a main proceeding, but it would be worth the ATO running the above argument to see if they can convince the court that the COMI is in Australia, and so the shares should not be remitted to Lyonesse at all.

Question 4.2 [maximum 6 marks] 2/6

Shipmin Pty Ltd (Shipmin) is a company incorporated in Australia. Shipmin owned two cargo ships, one valued at AUD 20 million, the other at AUD 15 million. About 3 months ago, Shipmin sold the AUD 20 million cargo ship and paid the full proceeds of AUD 20 million to its parent company Shipmax Ltd (Shipmax) to reduce Shipmin's intercompany debt to Shipmax. Shipmax is also incorporated in Australia and owns 100% of the shares in Shipmin.

Shipmin now owns only the one cargo ship with a value of AUD 15 million. Shipmin owes AUD 20 million to the Commonwealth Bank of Australia (CBA), which is secured by a mortgage over the remaining ship. The mortgage is not registered on the Personal Property Securities Register.

Shipmin's debt to CBA has been guaranteed by Shipmax. Shipmin owes Shipmax AUD 180 million in inter-company debt. Shipmin has no other creditors.

Shipmax has been placed into liquidation. Advise Shipmax's liquidator on the best way to bring the operations of Shipmin to an end and maximise the return to Shipmax from the assets of Shipmin.

Answer 4.2: With a presumption that Australia is a creditor friendly economy and on World Bank measures, scores an 11 (on a scale of 0-12), it protects the rights of secured creditors.

Although, as per the Security law of Australia all the security interests created should be registered either in the relevant state law registry (for land mortgages) or on the national Personal Property Securities Register (PPSR) for all other security interests. Failing to do so will result in loss of security interest on the commencement of an external administration/liquidation and security interest will automatically vest in the grantor (usually the debtor) immediately prior to the commencement of liquidation. Exactly

Now, Shipmin and Shipmax both are Australian companies registered in Australia and all the laws of Australia are applicable to both companies, we can proceed on understanding the issue and possible outcome of the above stated case study.

In the above cited case, although Commonwealth Bank of Australia (CBA) has a security interest on a ship owned by Shipmin, but the security interest is not registered with PPSR, so for that reason CBA cannot have priority on the payments towards the creditors. And Shipmin being the grantor of the interest and further Shipmin being a subsidary of Shipmax and owing it AUD 180 million in inter-company debt, Shipmax would be a creditor in priority. No. CBA and Shipmax will both rank equally as unsecured creditors. So, the liquidator of Shipmax can sell the assets of Shipmin and set of the inter company liability and CBA would be at loss.

Shipmax's liquidator should, using her power as the sole shareholder of Shipmin, have the directors of Shipmin place Shipmin into voluntary administration on the grounds of insolvency or likely future insolvency (it owes CBA more than the present value of its only major asset – whilst this is balance sheet insolvency, it may well lead to cash flow insolvency when combined with the collapse of its parent company).

Immediately before the Shipmin enters voluntary administration, the mortgage over the ship will vest in the voluntary administrator because CBA failed to register its security interest on the PPSA. Unperfected (ie unregistered) interests vest in the voluntary administrator immediately before the commencement of a voluntary administration (*Personal Property Securities Act*, s 267).

The voluntary administration can then sell the ship to provide a return to unsecured creditors, or the creditors can vote to place Shipmin into a DOCA. Shipmax will carry any vote on value, as there are only two creditors and Shipmax holds the overwhelming majority of the debt.

You missed the other major issue: a liquidation would be risky, because Shipmax may find itself the target of:

- a preference claim by the liquidator for the $20 million already repaid to Shipmax in the last 12 months. Shipmax as the parent company would have had knowledge of Shipmin's insolvency.
- creditor-defeating disposition claim (see Guidance Text, pp 75-76)

If Shipmax can get Shipmin into a DOCA whereby the remaining ship is sold and the proceeds paid equally to all unsecured creditors, Shipmax will receive most of the assets of

Shipmin, as its unsecred debt to Shipmax ($200m) swamps the now-unsecured debt to CBA ($20m).