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]: 35.5 out of 50 = 71%

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

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] 3/3

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.

The three types of voidable transactions are:
- undervalued transactions which occurred within a 5-year "relation-back period" and for which the transferee gave either no or less-than-market-value consideration). Such transactions may not be reversible if it can be proven that the transaction took place more than 2 years prior to the commencement of bankruptcy (for non-related party transactions) or more than 4 years prior to the commencement of bankruptcy (fpr related party transactions) and that the debtor was solvent at that time
- transfers to defeat creditors. Such transactions may not be reversible if it can be proven by the transferee that market value was paid and, at the time of transfer, it did not know and could not reasonably have been inferred to have known that the transferor had the main purpose of defeating creditors or that the transferor was insolvent or about to enter into insolvency; and
- preferential payments to creditors which occurred within the 6-month period prior to the presentation of a debtor's or creditor's petition provided the debtor was insolvent at that time and the effect of the transfer was to grant the transferee creditor a preference, priority or advantage over other creditors. Such transactions may not be reversible if it can be proven that the transferee creditor received the payment in good faith, in the ordinary course of business and in exchange for valuable consideration.

For involuntary bankruptcies, commencement of bankruptcy is the time of commission of the earliest act of bankruptcy. For voluntary bankruptcies, commencement of bankruptcy is usually the date when the debtor's petition is presented, although it can be determined to be earlier.

Question 2.2 [maximum 3 marks] 1/3

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?

An Australian court determines the scope of the stay, in relation to a corporate debtor under Australia's implementation of Article 20 of the Model Law (in s 16 CBIA), as being the same as would apply under the Bankruptcy Act or Chapter 5 (excluding Parts 5.2 and 5.4A) of the Corporations Acts, as the facts of the case may require. Good.

We were also looking for a more detailed discussion on what is meant by "as the case requires", i.e. looking at the nature of the proceeding; rather than it being a question of discretion: *Tai-Soo Suk*. Also needed examples of proceedings where a broader voluntary administration stay (affects secured creditors) will be more appropriate vs proceedings where a standard liquidation stay (affects only unsecured creditors) will be appropriate.

Question 2.3 [maximum 4 marks] 1/4

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

An ipso facto clause is a provision in agreements that specifies the consequences in case of insolvency or bankruptcy of one of the parties to the contract.

The relevance of ipso facto clauses, in liquidations, is that the insolvent entity's contractual counter-parties may use the clause to escape executiory contracts entered into prior to insolvency, thereby complicating the task of either rescuing the insolvent entity or alternatively maximising the distribution to creditors. No.

The answer is that the stay on the operation of *ipso facto* clauses only applies to restructurings, so once a company is in liquidation, the *ipso facto* clause will operate and the liquidator will not be able to keep contracts with *ipso facto* clauses on foot. See Guidance Text, p 30.

QUESTION 3 (essay-type questions) [15 marks in total] 11/15

"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.

Creditors' schemes of arrangement are limited to companies registered under the Corporations Act (Part 5.1). They are not available to sole proprietorshuips or partnerships. Due to their complexity, they are increasingly used in larger and more complex insolvencies but still do not form a major proportion of formal corporate rescues in Australia. Correct.

Under the creditors' scheme of arrangement, directors of a financially distressed company enter into negotiations with creditors, generally prior to the commencement of formal insolvency,in order to secure the creditors' support for a formal restructuring of the company's debts and current operations. Under this arrangement, it is mandated to disclose and discuss with creditors (via a proposed scheme document), among other matters, creditors' expected dividends under the scheme compared with a winding-up, the extent and quantum of creditors' claims and comprehensive information about the company's financial and other operational matters.

If the directors are confident of creditors' support, application is made to the court which would order the convening of one or more meetings of creditors, dependent on the classes

of creditors. At such meeting(s), the scheme needs approval by a majority of the number of creditors and 75% by value of creditors, present and voting (whether in person or by way of proxy). These voting conditions apply to each separate class of creditors, at each meeting. A subsequent court application is then required for the court to formally approve the scheme.

Due to the multiple court applications (at least 2 and possibly more) and the minimum time required for all logistical matters and court application to be fulfillled (a minimum of 3 months and more likely 6 months or even more), makes a creditors' scheme of arrangement costly, time-consuming and inefficient for smaller and less complex insolvencies. Yes

However, for larger and / or more complex insolvencies, there are certain advantages offered by going the route of a creditors' scheme of arrangement, which cannot be achieved via a DOCA. It can bind secured creditors even if they dissent (even though the voting majorities are difficult to achieve in practice) and it can include the release of creditors' rights against third parties other than the insolvent company. Good.

Thus, a more creative and broad corporate restructure may possible under a creditors scheme of arrangement, which can potentially outweigh the costs, time and difficulty involved in pursuing such schemes. Good

Thus, while it may be accurate to describe creditors' schemes of arrangement as being costly and time-consuming, it would not be entirely accurate to make sweeping statements on the effectiveness of this potential corporate rescue mechanism, especially for larger and more complex insolvent entities where the potential benefits (as described above) may outwiegh the costs (money, time and difficulty).

Additional points: 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] 6.5/9

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?

As Aussiebee is registered in Lyonesse, it would likely be presumed that the foreign liquidator and foreign insolvent proceedings would be recognised as foreign main proceedings and the foreign liquidator would have standing in Australian courts. Your conclusion is probably right, but need more analysis here:

- 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.

Australia has adopted in 2008 most provisions of the UNCITRAL Model Law, with certain exceptions, under the Schedule to the Cross-Border Insolvency Act 2008 (Cth) (CBIA). The CBIA gives legal authority to most provisions of the Model Law, in Australia and referencing relevant provisions in the Corporations Act and the Bankruptcy Act.

The relevant courts, competent to perform functions, under trhe Model Law, are the Federal Court or any Supreme Court, for corporate debtors.

In Article 13 of he Model Law, Australia has preserved the exclusion of foreign tax and social security claims from Australian insolvency proceedings. There is no requirement of reciprocity in the Model Law and Australia also does not require reciprocity in its implementation of the Model Law. Excellent point.

As laid out in case law (Ackers v Deputy Commissioner of Taxation) and upheld on appeal, and assuming a debt payable to a foreign revenue creditor is not admissible as proof of debt in Lyonesse (similarly as in Australia), even though the foreign liquidator is recognised, the Federal Court (where most such cross-border corporate insolvency cases are generally heard) is likely to modify the recognition orders (including any automatic stay on secondary proceedinds or enforcement actions in Australia), such that the Australian Tax Office would likely still be able to enforce its claim in Australia. However, such claim is likely to be limited only up to the *pari passu* amount as the ATO would have received - **if** the ATO had been entitled to prove for the tax debt and penalty, as an unsecured foreign creditor in the Lyonese / foreign main proceeding. Good.

Thus, the ATO would likely be able to claim for a certain amount of the tax debt and liability (as laid out above), based on a likely modified recognition order, as the Australian courts would find this an appropriate way to protect the interests of the ATO as a creditor.

Question 4.2 [maximum 6 marks] 3/6

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.

Shipmin is not in liquidation but became balance-sheet insolvent upon sale of the first shippayment of AUD 20 million to Shipmax (a related party, being a 100% owner of Shipmin) 5 months earlier, assuming Shipmin has no other substantial asset to cover the shortfall of AUD 5 million.

Secured creditors enjoy a high level of protection in Australia. Secured creditors, with security over the whole or substantially the whole of an insolvent company's property remain entitled, despite any insolvency proceeding, to appoint a receiver either in the first instance or "over the top" of an existing liquidator.

Australia allows transactions to be voidable, particularly in corporate insolvencies, to be clawed back for the benefit of secured creditors over many years, without having the burden of proving improper conduct such as an intention to defeat creditors.

Hence, Shipmin may be brought into creditors' compulsory liquidation by Commonwealth Bank of Australia (CBA), under a presumption of insolvency based on Shipmin's total assets likely being less than its total liabilities No. The test for insolvency in Australia is cash flow, not balance sheet. and especially if CBA resorts to issuing a statutory demand for repayment and Shipmin is unable to repay within 21 days. Yes, this would establish cash flow insolvency by reason of the presumption on failure to comply with a statutory demand.

CBA may then be able to enforce its rights over the remaining ship (AUD 15 million) as well as rights under the parent guarantee contract (as an unsecured creditor of Shipmax), to claw back the remaining AUD 5 million from Shipmax (which is already in liquidation).

However, CBA has not registered its security on the Personal Property Securities Register, which is the most common means of perfection of granted securiy. Provided, CBA does not have / is not allowed to have possession or control over the remaining shiip, these would (in totality) negate CBA's security over the ship. Hence, the security may not be enforceable, CBA's security interest would vest *automatically* in Shipmin the moment before Shipmin entered VA or liquidation. thus relegating CBA tro the status of an unsecured creditor of Shipmin, although it would still retain its rights (as an unsecured creditor) through its parent

company guarantee issued by Shipmax, although it would be stayed from enforcing these rights against Shipmax as Shipmax is already in insolvency, presumably with a stay on individual unsecured creditors such as CBA). Yes, good.

To avoid CBA taking any action, as an unsecured creditor (ie.e placing Shipmin under compulsory liquidation by issuing a repayment notice and assuming Shipmin is unable to repay within the requisit 21 days of the notice being issued), Shipmax's liquidator should apply to place Shipmin, being its 100% owned subsidiary and hence an asset under the control of Shipmax's liquiidator, in voluntary liquidation. No need to apply to the Court. Shipmax can cause Shipmin's directors to pass a resolution for creditors' voluntary liquidation or (better) for voluntary administration.

The unperfected security would then automatically vest in Shipmin immediately prior to the commencement of a voluntary administration. Yes. This should be done as soon as possible before CBA has the opportunity to perfect its security by registering its security 6 months prior to the start of the proposed voluntary administration. Good point.

You missed the other 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)

Therefore a voluntary administration is preferable. 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.

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).