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]: 40 out of 50 = 80% Well done!

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] 2.5/3

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.

Three types of voidable transactions that can be reversed by a bankruptcy trustee under the Bankruptcy Act, 1966 (cth) ("Bankruptcy Acy") are as follow:

(i) **Undervalued transactions** – section 120 of the Bankruptcy Act;

Such a transaction however will not be reversible if:

a) Incase the transaction was entered into with a related party, it took place more than 4 years before the commencement of the bankruptcy;
b) In any other case, it took place more than 2 years before the commencement of the bankruptcy; or
c) The transferee proves that at the time of the transfers, the transferor was solvent.

(ii) **Transfers to defeat creditors** – section 121 of the *Bankruptcy Act*

Such a transaction however will not be reversible if:

a) the consideration that the transferee gave for the transfer was at least as valuable as the market value of the property; and
b) the transferee did not know, and could not reasonably have inferred, that the transferor's main purpose in making the transfer was the purpose described in paragraph (1)(b) of Section 121, and that the intention of the transfer to defeat creditors was not the main purpose of the transfer; and
c) the transferee could not reasonably have inferred that, at the time of the transfer, the transferor was, or was about to become, insolvent.

(iii) **Transactions giving preference to one creditor over other creditors** – section 122 of the *Bankruptcy Act*

Such a transaction however will not be reversible if evidence is provided to prove that the transaction pursuant to the claim does not affect the remaining creditors or is not detrimental to other creditors in favour of one creditor.

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] 3/3

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?

The scope of stay under Article 20 of the UNCITRAL Model Law on Cross Border Insolvency (in CBIA s 16) has been described as being the same as applicable if the stay or suspension was initiate under the Bankruptcy Act 1966 or Chapter V of the Corporations Act 2001 (Cth) (other than Parts 5.2 and 5.4A), as the case requires.

Therefore, while determining the scope of stay while considering an application requesting recognition of a foreign insolvency proceeding, the Australian court has to make a determination as to whether the case requires the broader voluntary administration stay which affects secured creditors or the standard liquidation stay that only concerns and affects the unsecured creditors. This determination is made basis the nature of proceedings (such as if the proceeding is a business recue procedure in which case the moratorium of former nature will be more appropriate, or if it is analogous to a liquidation proceeding, in which case the latter shall be more appropriate etc) and is therefore not a matter of discretion (*Tai-Soo Suk v Hanjin Shipping Co Ltd* [2016] FCA 1404 at [24]). Excellent answer.

Question 2.3 [maximum 4 marks] 4/4

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

An ipso facto clause is a contractual provision that allows one party to a contract to terminate or modify the operation of the contract upon the occurrence of a specified insolvency related event (such as the appointment of an administrator, receiver or liquidator, compromise or arrangement, a creditors' scheme of arrangement (including certain steps leading up to the scheme, voluntary administration, receivership but only where e receiver is appointed over the whole or substantially the whole of the property of the company, or a restructuring) as set out under Sections 415D, 434J, 451E, and 454N of the Corporations Act in respect of another party. After the introduction of clauses relating to restructuring of small businesses as specified under Part 5.3 B of the Corporations Act with effect from January 01, 2021, the moratorium on reliance on "ipso facto" contractual clauses triggered by the counterparty becoming subject to certain specified formal corporate insolvency events has been extended to capture the new restructuring regime as well. Such a stay is, however aloes accompanied by a stay on the ability of the party subject to the insolvency regime to enforce contractual rights against the counterparty to advance new money or credit under the contract.

With respect to liquidation, the automatic stay on enforcement of *ipso facto* clauses is not available, at least in circumstances where the liquidation does not immediately follow an administration, creditors' scheme or restructuring), so a supplier generally reserves its rights to terminate its contract with the company as soon as the company enters liquidation. In the latter circumstances, the *ipso facto* moratorium introduced as part of the recent amendments to the Corporations Act is available for invocation. However, despite this right to invoke the ipso facto clause, the clause itself shall not be void as in cases of bankruptcy.

Good answer! Well done, most students did not properly address what happens to ipso facto clauses in a liquidation.

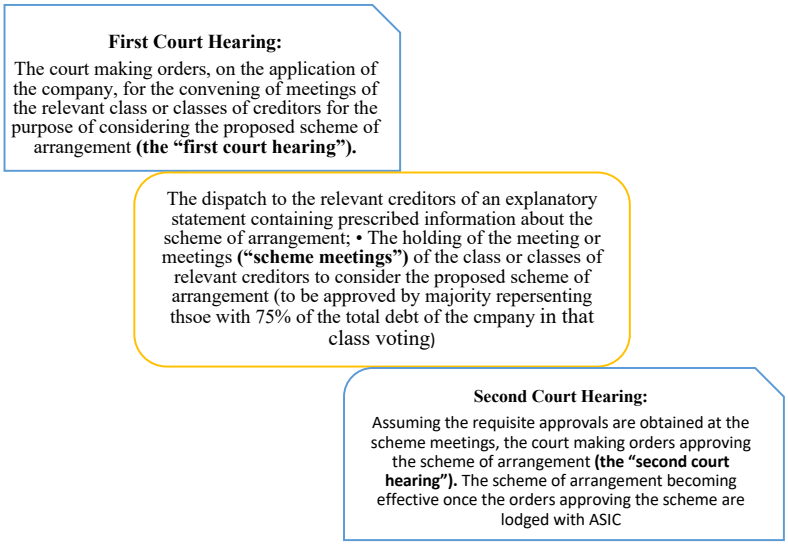
QUESTION 3 (essay-type questions) [15 marks in total] 15/15

"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.

A creditor's scheme of arrangement is generally said to be a costlier, time consuming and complicated process in comparison to other forms of corporate rescue mechanisms contemplated under the Corporations Act. This is on account of the elaborate procedure for implementing a creditors' scheme of arrangement (as set out under Part 5.1 of the Corporations Act) and consequent cost incidences associated with each of them which renders the process costly and a time-consuming affair.

The process generally entails:



In addition to the statutorily prescribes court approvals and applications, there may be further instances when material situations or circumstances may have to be brought to the notice and record of the court, thereby further lengthening the process. This is in contrast to a process of voluntary administration followed by a deed of company arrangement ("**DOCA**"), which process does not entail or require court involvement. The said process may infact not involve the court process at all if the voluntary administrator or deed administrator does not apply to the court in order to seek directions from the court at any stage of the process and no creditor approaches the court challenging the conduct of the voluntary administrator or the terms of the DOCA.

However, a creditors' scheme of arrangement offers various advantages over a DOCA, such as:

a) a scheme need only be voted on by those classes of creditors whose rights are affected by it, whereas a DOCA must be voted on and approved by all secured and unsecured creditors as one homogenous group;
b) a successful scheme can bind dissenting secured creditors, but a DOCA generally only binds those secured creditors who vote in favour of it; and
c) a DOCA is not generally able to include effective releases given by creditors in favour of third parties, whereas a scheme can (*as upheld in Lehman Brothers Holdings Inc v City of Swan & Ors; Lehman Brothers Asia Holdings Limited (in liquidation) v City of Swan & Ors (2010) 240 CLR 509*.)
d) the court has power to cause part or all of the property or liabilities of the moribund company, including contracts, to transfer to a properly capitalised newco.
e) entities in corporate groups can be dealt with together.
f) Australian Taxation Office rollover relief rules (allowing the taxpayer to defer or disregard a capital gain or from a forcible transfer of assets or scrip) are easier to satisfy when the transfer occurs under court order.

One of the most significant advantages of a creditors scheme of arrangement is the ability to alter to alter secured creditor's rights without their consent.

Therefore, to sum up, even if the creditors' scheme of arrangement may have been seem to being replaced with the voluntary administration coming into vogue on account of its cost efficient and cost friendly approach. However, mega corporate turnarounds that would require the advantages of statutory moratoriums, cramdown rights, liability transfer, or other mechanism-based charge will opt for a more formal process in the nature of that of a creditors scheme of arrangement. Also, the court driven process will always continue to be the chosen mode of restructuring when more certainty and transparency are required to be attached to the restructuring process, excellent point increasingly so with respect to companies / restructuring entities with more complex balance sheet or tax affairs, or greater spread of shareholders or creditors across jurisdictions (including Australia ofcourse), where a formal creditor's scheme of arrangements with some degree of court supervision may be the preferred tool of corporate rescue and restructuring to ensure a controlled outcome.

Excellent answer!

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?

We understand that a liquidator appointed for Aussiebee in Lyonesse has applied for recognition of the said proceedings as foreign main proceeding in the Federal Court of Australia ("**Application for Recognition**"), and that Aussibie owes AUD 12 million in taxes in Australia payable to the Australian Tax Office.

In the given circumstance that the ATO is not entitled to submit or prove its claim of debt owed to the office in the liquidation proceedings of Aussiebie currently underway in Lyonesse, it is advised that the ATO files an intervention application in the Application for Recognition for its rights to be recognised as an unsecured creditor and to grant it leave for enforcing its claim against the rights or claims of Aussiebee including with respect to assets locates in Australia.

The Federal Court of Australia incharge of dealing with the Application for Recognition has to , under the terms of its adopted Model Law on Cross Border Insolvency in Article 21 of the Cross-Border Insolvency Act, 2008 ensure 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 the state to the foreign representative , being the liquidator in the given case, provided that the court is satisfied that the interests of creditors in this State are adequately protected. Accordingly, while entertaining the plea for recognition and vesting in of the properties of Aussibie located in Australia, the Federal Court of Australia has the jurisdiction to deal with and dispose of the intervention application filed by ATO, it being one of the creditors to Aussibie in the state of Australia.

Reference may be drawn to the case of *Akers* v *Deputy Commissioner of Taxation* [2014] FCAFC 57; where the full court upheld notions of 'modified universalism' noting that 'the sacrifice of the rights (or the value in the rights) of local creditors upon an altar of universalism may be to take the general informing notion of universalism too far', and said it may be more appropriate to describe the Model Law regime as '"modified universalism" for what such an appellation is worth'.

You dealt very well with the *Ackers v DCT* issue, but you did not address the question of whether the recognition granted would be main or non-main. If non-main, the ATO could argue that the shares should not be vested in the Lyonessian liquidator at all. 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.

Question 4.2 [maximum 6 marks] 1/6

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.

Given that the assets of Shipmin is less than the liabilities in the given facts of the case, the same may be treated as an indicator of insolvency in light of the judgment by the Supreme Court of Victoria in the case of *ASIC v Plymin & Ors (2003) 46 ASCR 12*. In this case, the apex court prescribed a liquidity ratio below 1 (a ratio of current assets to liabilities) as one of the indicators of insolvency of a company. Accordingly, a presumption of insolvency lies in regards Shipmen. Be careful using the *Plymin* indicators. They are only indicators, not conclusive of insolvency. The Australian test is *cash flow insolvency*, not *balance sheet insolvency*. Here, Shipmin is clearly balance sheet insolvent. It could then safely be assumed that it is also likely to be cash flow insolvent for the purposes of answering the rest of the question. It is advised that Shipmax issues a statutory demand notice to Shipmin requiring Shipmin to pay the debt of AUD 180 million (alongwith applicable interest) granted as inter-company debt to Shipmin. Yes, this would properly establish cash flow insolvency, by reason of the presumption on failure to comply with a statutory demand. It is likely that such a demand shall return unpaid by Shipmin and fail to comply with the statutory demand in terms of Section

459 F of the Corporations Act on account if its apparent insolvency. The application foe winding up can also be filed on non-insolvency grounds such as in circumstances where there is a special resolution passed to that effect.

Shipmax, therefore, being a 100% member and shareholder of Shipmax and also an unpaid creditor, through its liquidator can bring an action and can apply to the court for its compulsory liquidation in terms of Section 459A and 459P of the Corporations Act.

A creditor's voluntary liquidation may also be initiated against Shipmin upon its shareholders being Shipmax resolving to liquidate Shipman and appointing a liquidator (on account of its liabilities exceeding the assets of the company. As a result, it is likely that losses may only be increasing and without a turnaround in the business's fortune the directors are conscious that continuing to trade might infringe on wrongful trading) Because the right to appoint the liquidator in this kind of liquidation vests in the shareholders, Shipmax may resolve to appoint the same liquidator as in its case of liquidation to also deal with and realise the assets of Shipmin in order to maximise return from Shipmin's assets. Yes. However, the better option is probably voluntary administration.

You missed the two big issues: 1) CBA's security will vest back in Shipmin if there is a VA or liquidation of Shipmix. 2) in a liquidation of Shipmin, Shipmax will be exposed to a preference claim for the $20m that Shipmax recently received.

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.

However, note that 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).