



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).
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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:

- (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. 1 mark**

Question 1.2

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

- (a) Receivership. 1 mark**
- (b) Liquidation.
- (c) Deed of company arrangement.
- (d) Voluntary administration.

Question 1.3

Select the correct answer:

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

- (a) creditors' scheme of arrangement. 1 mark**
- (b) deed of company arrangement.
- (c) creditors' voluntary liquidation.
- (d) voluntary administration.
- (e) 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?

- (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. 1 mark
- (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. 1 mark

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. 1 mark
- (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 company can only be placed into voluntary administration if:

- (a) the directors declare that the company's liabilities exceed its assets.
- (b) the creditors resolve that the company is unable to pay its debts as and when they fall due.
- (c) a liquidator declares that the company is insolvent or likely to become insolvent.
- (d) the directors resolve that the company is insolvent or likely to become insolvent. 1 mark**

Question 1.8

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. 1 mark**
- (e) 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:

- (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. 1 mark**

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. 1 mark
- (c) reducing the default bankruptcy period from three years to one year.
- (d) a safe harbour from insolvent trading liability.

10/10 marks

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.

The following transactions are considered as voidable transactions:

1. Undervalued Transactions (s. 120 of the Corporations Act)
2. Transfers to Defeat Creditors (s. 121 of the Corporations Act)
3. Preferential Payments

Most voidable transactions can be reversed during what is referred to as the “relation-back period”, which a certain time before the commencement of bankruptcy. When the ‘commencement of bankruptcy’ takes place depends on whether it is voluntary or involuntary.

In any event, there are circumstances where such transactions are not reversible, such as where:

1. Certain transactions (as set out in section 123(1)(a) – (d) of the Bankruptcy Act) if
 - a. *“the transaction took place before the day on which the debtor became a bankrupt;*
 - b. *the person, other than the debtor, with whom it took place, did not, at the time of the transaction, have notice of the presentation of a petition against the debtor; and*
 - c. *the transaction was in good faith and in the ordinary course of business.”*
(section 123(1)(e) – (g) of the Bankruptcy Act)
2. the original transferee, who is now found to be bankrupt, transfers the property to a third party and the said third party receives the property in good faith and for market value (section s 120(6), s 121(8))

3/3 marks

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?

Article 20 of the Model law refers to the “Effects of recognition of a foreign main proceeding”. Article 20(1) of the Model Law states that, inter alia, upon recognition of a foreign proceeding that is a foreign main proceeding, the:

- (a) Commencement or continuation of individual actions or individual proceedings concerning the debtor’s assets, rights, obligations or liabilities is stayed;
- (b) Execution against the debtor’s assets is stayed;
- (c) The right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.

Article 20(2) of the Model Law provides for the scope of the stay and suspension referred to in Article 20(1). Section 16 of the Cross-Border Insolvency Act 2008 sets out the manner in which the scope and the modification or termination of the stay or suspension referred to in Article 20(1) is to be determined.

This Article 16 allows for the stay to apply in the same way that it would if a stay or suspension were allowed under:

1. the Corporations Act - Chapter 5 (other than Parts 5.2 and 5.4A)
2. the Bankruptcy Act

As far as a corporate debtor is concerned, the court needs to determine whether the stay that the case requires is the stay implemented

- a. during voluntary administration (ss 440B and 440F), which is broader in that it also applies to unsecured creditors;
- b. in liquidation (ss. 471B and 500(2)) which only applies to unsecured creditors

As for the court’s determination of the stay order under Article 16 of the Cross-Border Insolvency Act 2008, quoting the explanatory memorandum to the Cross-Border Insolvency Bill 2008, it was established in the case of *Tai-Soo Suk v Hanjin Shipping Co Ltd*¹ that “It is left to the court to decide which stay should apply in any particular case, having regard to all the circumstances of the case ...”

It was also established by the same case that “The stay which “should apply” is the stay the “case requires” which is determined by the nature of the foreign proceedings compared to the nature of proceedings under the relevant Parts of the Corporations Act.”² For instance, whether a stay from all creditors is required (as in the case allowed in broader voluntary administration) or whether a stay from unsecured creditors will suffice (as in the case of liquidations)

3/3 marks

Question 2.3 [maximum 4 marks]

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

An *ipso facto* clause is a clause in a contract which purports to allow the counterparty (as opposed to the insolvent party) to terminate or modify the contract and/or repossess the property upon the occurrence of a certain event such as the commencement of insolvency proceedings, the appointment of a liquidator etc.

In the case of bankruptcy, such *ipso facto* clauses are rendered void upon the debtor’s bankruptcy.

¹ [2016] FCA 1404 at [23]

² *Tai-Soo Suk v Hanjin Shipping Co Ltd* [2016] FCA 1404 at [24]

This was extended to certain other insolvency mechanisms, as a moratorium on reliance on “ipso facto” contractual clauses came into effect in 2018 in respect of:³

1. a creditors’ scheme of arrangement (including certain steps leading up to the scheme);
2. a voluntary administration; or
3. a receivership but only where the receiver is appointed over the whole or substantially the whole of the property of the company

However, there is no moratorium on the application of ipso facto clauses in the case in liquidation, with the exception of one circumstance, meaning that in liquidation there will be nothing to prevent the counterparty to a contract from enforcing the ipso facto clause in a contract.

However, the exception is that where a creditor’s voluntary liquidation immediately follows a prior voluntary arrangement or a creditor’s scheme of arrangement, then the stay on the ipso facto clauses will apply.

The reliance on ipso facto clauses does not concern the counterparty’s desire to terminate for reasons independent of the ipso facto clauses, such as due to the non-performance of the debtor’s obligations under the contract etc.

4/4 marks

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 is a creditor-friendly jurisdiction that is said to even be the “..leader in creditor protection (amongst the UK, US, France, Germany and India) with a persistently high ranking..”.⁴ Meaning that Australia’s insolvency regime is, for the most part, primarily focused towards protecting the rights and interests of creditors over the interests of debtors.⁵

Whether or not a jurisdiction is creditor-friendly would depend on several features, some of which include the level of control that can be exerted by a creditor over a debtor’s behaviour that might impair the creditors’ ability to recover while the company is a going concern, credit contract rules that allow self-protection, rights during insolvency (or external administration).⁶

Some of the features of the Australian insolvency system that make it creditor friendly are that:

1. Creditor’s rights during insolvency proceedings

³ Baker McKenzie, “The “Ipso Facto” Prohibition in the Corporations Act Applicable to Corporate Insolvency” 2020, < https://www.bakermckenzie.com/-/media/files/insight/publications/2020/03/ipso_facto_may_2020.pdf>

⁴ The Evolution of Shareholder and Creditor Protection in Australia: An International Comparison – International and Comparative Law Quarterly 61, 2012 pp 171–207, p200

⁵ Legal500, “Australia: Restructuring & Insolvency”, <<https://www.legal500.com/guides/chapter/australia-restructuring-insolvency/>>

⁶ The Evolution of Shareholder and Creditor Protection in Australia: An International Comparison – International and Comparative Law Quarterly 61, 2012 pp 171–207, p180

- (a) Secured creditors can control the voluntary administration regime to the exclusion of the management and the members
 - (b) Whilst unsecured creditors are prevented from taking certain action in relation to all “provable debt” under s. 58(3) of the Bankruptcy Act, secured creditors are not bound by the bankruptcy moratorium. Therefore, they remain entitled to enforce their rights to realize or otherwise deal with his or her security as per s. 58(5) of the Bankruptcy Act.
 - (c) Receivership is still practiced in Australia, meaning that secured creditors have a means of realizing the assets of the debtor over which they have a security
 - (d) Exceptions to the statutory moratorium during voluntary administration granted to secured creditors where:
 - (i) creditors with security over the whole or substantially the whole of a company’s property are entitled to enforce their security interest, generally by appointing a receiver over the top of a voluntary administrator, within the stipulated time period (ss 9, 441A of the Bankruptcy Act)
 - (ii) a secured creditor, or an owner or lessor, seeks to either continue with enforcement action commenced prior to the appointment of the voluntary administrator or to otherwise recover perishable property
2. Focus on maximizing the return to be distributed among creditors
 - (a) One of the purposes of voluntary administration is to maximise the return that can be produced for the creditors and its members otherwise than through immediate liquidation, although another purpose is to try to rescue the company
 3. Creditor’s involvement in restructuring and insolvency processes
 - (a) Creditors (including ordinary unsecured creditors) have the right to receive information and participate in meetings which may have the effect of determining the future of the debtor
 4. Priority given to creditors
 - (a) Secured creditors and employees enjoy statutory priority in distribution of assets
 - (b) Unsecured creditors will have legal right of priority only in certain circumstances, such as where they are suppliers of essential services
 5. Other rights which maximize the ability of a creditor to recover
 - (a) Liquidators are entitled to recover substantial sums from directors where the directors have allowed a company to incur debts whilst insolvent
 - (b) transactions to be clawed back on the basis of being ‘voidable transactions’, for the benefit of creditors over a substantial period of years and without having to prove improper conduct such as an intention to defeat creditors.

While Australia is generally considered a creditor friendly jurisdiction, small steps towards being more debtor-friendly have been implemented. These steps are designed to encourage a stronger corporate and business rescue culture. This should not necessarily be seen as adverse to creditor’s rights but a promotion of the longevity of the company through which the creditors are intended to benefit.

Some such measures are:

1. maximizing the chance of insolvent companies through voluntary administration, which was one of the recommendations of the Harmer Report

2. restrictions/ bans on the enforcement of ipso facto clauses which would have otherwise enabled creditors to enforce their contractual rights on a company's insolvency or entry into an external administration, where
 - a. in voluntary administration an ipso facto clause cannot be enforced
 - b. in bankruptcy ipso facto clauses are void altogether
3. since September 2017, where directors can take refuge under 'Safe harbour rights' which would allow the directors to incur debts with a view to implementing an informal restructuring attempt

Conclusion

Australia's insolvency and restructuring landscape appears to have been more creditor friendly prior to certain amendments. However, since the amendments introduced pursuant to the Harmer report and the more recent amendments introduced in 2017 and 2018, it appears that Australia's insolvency and restructuring regime progressively became more creditor friendly. However, an alleged preference of voluntary liquidation over voluntary administration raises questions as to the effectiveness of the amendments.⁷

13/15 – an excellent answer. You should also have mentioned small company restructurings, which are the new debtor-in-possession proceeding (although with a supervising insolvency practitioner).

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 Lyonessean. 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 Lyonessean 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 Lyonessean 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 Lyonessean liquidation.

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

⁷ Karen O'flynn, *The Harmer Amendments: 15 years on*, 2008, <https://www.claytonutz.com/knowledge/2008/october/the-harmer-amendments-15-years-on>

In order for the Lyonesian liquidation to be recognised in Australia as a foreign main proceeding, Lyonesse, in which Aussiebee is registered, would have to be recognised as the Centre of Main Proceedings (“COMI”).

What is the COMI under Australian Model Law?

The case of *Ackers v Saad Investments* held that the principles laid out in *Re Eurofoods IFSC Ltd* would be followed in determining where a debtors COMI was, in that it would be determined having regard to the objectively ascertainable factors of the debtor.

In the case of *Eurofood*, the ECJ held that “*in determining the centre of the main interests of a debtor company, the simple presumption laid down by the Community Legislature in favour of the registered office [...] can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect...*”. In England the ‘third parties’ (referred to in the case of *Eurofood*) with whom the court will be most concerned will be the creditors.

It was also held in the case of *Eurofood* that “the mere fact” that a parent company made economic choices (for example, for tax reasons) as to where the registered office of its subsidiary might be situated would not be enough to rebut the presumption. However, the presumption would be rebuttable in the case of a “letterbox” company that carries on no business in the place of registration.⁸

Since the registered office of Aussiebee is in Lyonesse, there is a presumption in favour of the fact that the COMI should be in Lyonesse. The fact that they have offices and warehouses in Lyonesse and also sell their products from Lyonesse, suggest that the incorporation in Lyonesse is not just that of a “letterbox” company. Therefore, the existence of offices and warehouses in Sydney and the board of directors comprising mainly of Australians, is unlikely to be able to rebut this presumption. **Good issue spotting and good consideration of the relevant factors.**

This case resembles the case of *Ackers v Deputy Commissioner of Taxation* (2014) 223 FCR 8 (“*Ackers*”). The case of *Ackers* dealt with the application of Article 22 of the Model Law, which states that the court must be satisfied that the interests of the creditors and other interested parties are “adequately protected” when granting relief under Article 19 (“Relief that may be granted upon application for recognition of a foreign proceeding”).

The case of *Ackers* concerned the liquidation of a company registered in the Cayman Islands (the “Cayman Island Proceedings”). The said Cayman Island Proceedings had been recognised as a foreign main proceeding in Australia. The foreign representatives of the Cayman Island Proceedings applied to remit the proceeds of the sale of the Australian assets of the company to the Cayman Islands. However, the company owed over AUD 83 million in tax and penalties in Australia. In the case of *Ackers* too, like in the present case, the debt payable to a foreign revenue creditor is not admissible to proof in a Cayman Islands liquidation.

In the case of *Ackers*, upon the application of the Deputy Commissioner of Taxation (DCT), the Federal court permitted the DCT to enforce its claim in Australia to recover an amount up to the *pari passu* amount the ATO would have received had they been entitled to prove the tax debt as an unsecured creditor in the foreign main proceeding. The Federal Court relied on article 20.3 which preserves the Court’s power to grant leave under s 471B of the

⁸ PracticalLaw, [Forum shopping in insolvency proceedings](#)

Corporations Act and article 22 for that result.⁹ This was held on appeal to be an appropriate way to ensure that the interests of the DCT as a creditor were adequately protected.

The debt owed to ATO would not be recognised as matter of course since the debt payable to a foreign revenue creditor is not admissible to proof in a Cayman Islands liquidation. However, as in the case of Ackers, ATO can apply to the Federal Court for leave to enforce its claim against Aussiebee in Australia for the purpose of recovering an amount up to the *pari passu* amount ATO would have received if they were entitled to prove for the tax debt as an unsecured creditor in the foreign main proceeding to protect or improve its position. However, in this case since the debt owed to the ATO is less than the assets of Aussiebee in Australia, ATO may receive its full amount. **Good**

The one other thing you could have considered: if the ATO could establish that Aussiebee's COMI was in Australia, it could then have applied to wind up Aussiebee as a foreign company carrying on business in Australia.

8.5/9 marks

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.

⁹ INSOL International/UNCITRAL/World Bank Judicial Colloquium in Insolvency, Lessons from recent cases on cross-board insolvency – Australia, 21 March 2015, <
https://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/Pre-2015%20Speeches/Black/black_20150321.pdf>

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?

HA's assets

1. Oil re-refining plant in Sydney
2. Second re-refining plant in Perth
3. three large trucks

Liabilities

1. Order from the Supreme court of Australia on 1 October 2020 against HA to pay AUD 4.6 million in damages to BOR
2. Unsecured loan of AUD 30 million payable to shareholder of HGL - first payment due at the end of 2021
3. Borrowings of AUD 5 million from its parent company HGL
4. A AUD 3 million loan from the Commonwealth Bank of Australia (CBA) – secured by a mortgage over HA's 3 trucks (unregistered)

Special facts/issues that need to be considered:

1. HA is a subsidiary of HGL as the shares in HA are owned by HA's parent company, HGL. Therefore, HA is a part of a group of companies. Therefore, there may be an opportunity to pool provisions (or at least obtain contribution orders). **Interesting point that no other student made.**
2. Unsecured loan of AUD 30 million payable to shareholder of HGL - first payment due at the end of 2021
3. Ipso facto clause in the loan agreement for AUD 30 million, that is that the loan becomes automatically due and payable in full if HA enters into any formal insolvency or restructuring process in Australia
4. Secured loan of AUD 3 million from CBA, but unregistered (security – mortgages over the trucks)
5. 1 October 2020, the Supreme Court found in favour of BOR, ordering that HA pay AUD 4.6 million in damages to BOR.
6. Continuous trading by HA between October 2020 and October 2021
7. borrowing AUD 5 million from its parent company HGL
8. The Board tells you that HA has been insolvent since the judgment was handed down in October 2020

The unregistered secured loan of AUD 3 million from CBA will automatically vest in the grantor (usually the debtor) immediately prior to the commencement of a bankruptcy, voluntary administration or liquidation of the grantor, unless:

1. the security interest was registered at least six months before the commencement of the external administration; or

2. if created during the six months prior to external administration, the security interest was registered within 20 days of it having been created and more than 20 days before the commencement of the external administration; or
3. for any security interest that came into force under the law of a foreign jurisdiction but first became enforceable in Australia during the six months prior to external administration, the security interest was registered within 56 days of it having become enforceable in Australia and more than 56 days before the commencement of the external administration; or
4. the court extends the time for registration, on an application by the secured party showing sufficient cause

Therefore, the time at which the relevant insolvency procedure is commenced will have a bearing on when the security interest will vest in the grantor. **Good.**

As for the various insolvency procedures, the Board should be advised of its options. Since it is insolvent, it will be required to start some insolvency process through which to either restructure the loans and revive the company or go into liquidation. **Not quite: in Australia there is no duty to put an insolvency company into an insolvency process, but the practical effect of insolvent trading liability for directors is that once they understand the company is insolvent, if properly advised, and unless they can enter safe harbour protection, they will always put the company into an insolvency process.** Since HA is a corporation, this leaves the options of

1. corporate liquidation
2. receivership or
3. a form of Corporate rescue such as voluntary administration, a creditors scheme of arrangement, a New small company restructuring process or Informal restructuring

In considering the most suitable options, the Board should consider factors such as

1. the moratoriums on the enforcement of the debts that may be imposed as a result of the insolvency process that is chosen
2. the moratoriums on the enforcement of contractual clauses such as ipso fact clauses
3. the involvement of the court and thereby the cost of the procedure
4. the time taken for the procedure

Receivership

A receiver is generally appointed by a creditor having a security interest over the whole, or substantially the whole, of a company's property. However, a receiver may also be appointed by the court.

In this case, we have no details of the plant that ceased operations in 2020. However, the second re-refining plant in Perth was funded by a AUD 30 million unsecured loan from a major shareholder of HGL. Even if this can be assumed to be "*the whole, or substantially the whole, of a company's property*", since it is an unsecured loan, the creditor, that is the shareholder of HGL who provided the loan, cannot appoint a receiver. Therefore, receivership is unlikely to play a part in this case.

New small company restructuring process

HA will not qualify for a New small company restructuring process as the company's total liabilities exceed AUD 1 million. This is an automatic disqualification under regulation 5.3B.03(1) of the Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020.

Informal restructuring

This is where the directors can take over the restructuring process without risking liability for insolvent trading. This is referred to as “safe harbour”. However, this ‘safe harbour’ is only applicable where:

- the debt is incurred directly or indirectly in connection with any such course of action developed by a person at a particular time after the person starts to suspect the company may become or be insolvent and
- the said course of action is reasonably likely to lead to a better outcome for the company

this ‘safe harbour’ shall be applicable during a reasonable period of suspecting that the company may be insolvent. However, the Board appears to have been aware that HA was insolvent since October 2020 and yet has not even sought advice until October 2021. Therefore, the defence of “safe harbour” is unlikely to be applicable in the case of HA or any of its directors and the time to implement any ‘informal restructuring’ has most likely passed, unless the board’s attempts to ‘refinance the loans’ can be seen as a ‘restructuring attempt’. However, for the ‘safe harbour’ rights to apply the Board must show that:

- they pursued a restructuring attempt under the advice of a specialist restructuring expert
- they remained actively involved in the development of a restructuring plan and diligently monitored the company’s financial performance

Therefore, the most viable options for HA appear to be

1. Voluntary administration
2. Schemes of arrangement
3. Corporate liquidation

Voluntary administration

The process of Voluntary administration can have the effect of either

- Increase the chances of rescuing the company through its continued business; or
- Maximise the return to the company’s creditors and members than an immediate liquidation of the company

If the Board of HA decides to go with Voluntary administration, the Board can attempt to rescue the company or sell it as a going concern, failing which, liquidate the company and obtain the maximum return for HA’s creditors and members.

If the Board decides to go ahead with voluntary administration, there are several advantages:

1. Moratorium on the enforcement of the creditors rights, both secured and unsecured, during voluntary administration, unless for a creditor with a security interest over the whole, or substantially the whole, of a company’s property or with an order from the court to either continue with enforcement action commenced prior to the appointment of the voluntary administrator or to otherwise recover perishable property
2. the liability of a director (or spouse or relative of a director) who has provided a guarantee in favour of the company cannot be enforced during voluntary administration without the leave of the court
3. statutory moratorium on the enforcement of ipso facto clauses in contracts entered into after 1 July 2018, subject to the creditor obtaining a court order permitting enforcement where it is in the interests of justice
4. at the second meeting of the creditors the creditors can vote to liquidate if the DOCA cannot be implemented or where there is a prospect of significant recoveries under the voidable transaction provisions or insolvent trading provisions of the Corporations Act

5. Court does not necessarily need to be involved, therefore it is a less costly and time consuming process

As far as HA is concerned, Voluntary administration will be beneficial (over going directly into liquidation) in the following ways:

1. Moratorium against both secured and unsecured creditors from enforcing their rights against HA. Therefore, the shareholder of HGL, CBA, BOR, and HGL cannot enforce their rights against HA. It should be noted that none of the exceptions are likely to apply here.
2. The ipso facto clause in the loan agreement between HA and the shareholder of HGL will not apply
3. The creditors can agree to liquidate the company where it cannot be rescued. In this case, the moratorium on the enforcement on the ipso facto clause in the loan agreement will continue to apply (whereas it would not have been available if HA went directly into liquidation.)

Scheme of arrangement

The scheme of arrangement is similar to the implementation of a DOCA, although there are significant differences.

The directors of a financially distressed company may enter into negotiations with the company's creditors in an effort to secure their support for a formal restructure of the company's debts and existing operations. The scheme would involve disclosure of the financial details of the company to the creditors and the creditors' expected dividends under the scheme compared to a winding up. If the directors are able to garner a good level of support for the scheme, the directors should then cause the company to make an initial application to the court for an order convening a meeting of all creditors to consider whether to approve the scheme.

a resolution approving

the scheme at the meeting subsequently held requires the support of:

- a majority of creditors in fact present and voting at the meeting (whether in person or by proxy, attorney or corporate representative); and
- 75 per cent of the total amount of the debts and claims of creditors present and voting at the meeting

If the Members vote on the scheme, the court needs to approve it. If court approval is obtained, the scheme will be implemented.

A scheme of arrangement, whilst more cumbersome and costly than Voluntary administration, has certain benefits

- Like a Voluntary administration there is a the moratorium on the enforcement of ipso facto rights under contracts entered into with a company on or after 1 July 2018
- Unlike Voluntary administration, the scheme of arrangement can
 - bind dissenting secured creditors (provided the scheme has been approved by a statutory majority of creditors); and
 - include the release of creditors' rights against third parties other than the company.

In the present case, in order for the Scheme of arrangement to work, the directors of HA must obtain the votes of majority of creditors, that is at least 3 creditors (the shareholder of HGL, CBA, BOR, and/or HGL) and 75 per cent of the total amount of the debts and claims of creditors. This would undoubtedly require the approval of the shareholder of HGL.

Corporate liquidation

The directors also have the option of resolving to liquidate directly. However, a drawback of this would mean that

1. Secured creditors are permitted to enforce any rights that they have under any valid security interest.
2. There is no moratorium on the enforcement of ipso facto clauses, unless the liquidation is immediately followed by voluntary administration.

Other matters

Pooling provisions

There is at the moment, no pooling provision (either in voluntary administration or liquidation) where solvent companies in a group of companies can be ordered to contribute to additional funds where it appears to be just to do so. Therefore, none of the companies in the group of companies (of which HA is a part, including HGL) can be required to contribute to the assets of HA for the distribution among the creditors.

Liability for insolvent trading

The directors could be found to be liable for insolvent trading from the period October 2020 to October 2021 as stated above.

According to s 588G of the Corporations Act, the director will be personally liable for insolvent trading where:

- he or she was a director at the time a debt was incurred;
- the company was insolvent when the debt was incurred, or became insolvent as a result;
- there were reasonable grounds for suspecting the company was insolvent or would become so by incurring the debt;
- the director failed to prevent the company from incurring the debt; and
- the director was aware that there were reasonable grounds for suspecting the company was insolvent when it incurred the debt or a reasonable person in a like position in the company's circumstances would be so aware.

There are defences available to directors who may be found liable for insolvent trading, in s. 588H of the Corporations Act, although none seem to be applicable in this case.

Similarly, since the directors of both HA and HGL are the same, HGL is also likely to be liable for the insolvent trading of its subsidiary under s. 588V of the Corporations.

Further, as stated above, the provisions on "safe harbour" also do not seem to be applicable to the directors of HA and HGL.

Liability for unfair transactions

If HA decides to go ahead with liquidation, the liquidator can challenge an "unfair loan" provided to the company at any time before the appointment of the liquidator. This will apply to HGL's loan to HA. However, as per s. 588FD a loan is deemed by the Corporations Act to be "unfair" if the interest or charges in relation to the loan are or at any time have been extortionate. We have no details here whether interest was changed by HGL and whether it would be considered to be 'extortionate'.

Further, any transaction that is deemed to be a an 'uncommercial transaction' under s. 588FE of the Corporations Act can also be challenged by a liquidator in court.

Conclusion

Considering the advantages of the various insolvency processes, it appears that voluntary administration, followed by the implementation of a DOCA and/or by liquidation would offer the best solution to HA. Therefore, the directors should take steps to appoint a voluntary administrator in accordance with section 436A of the Corporations Act.

A very comprehensive analysis, well done!

A DOCA would be far preferable, as it would avoid all insolvent trading liability. The VAs, or HGP, could propose a DOCA if HGP is willing to tip in some cash to create a fund to pay creditors (which would incentivise creditors to vote for the DOCA), or if they can find a purchaser for the Perth plant.

All creditors will get to vote on the DOCA, HGP appears to only be owed \$5m so it will not be able to out-vote the other creditors. But HGP's major shareholder is the major creditor of HA, so they will out-vote the other creditors and will presumably want a DOCA rather than a liquidation.

5.5/6 marks

*** End of Assessment ***

TOTAL MARKS: 47/50