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 (where this must be done is indicated under each question).

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

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

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

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

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

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

ANSWER ALL THE QUESTIONS

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

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

Question 1.1

Select the correct answer:

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

(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.

Australia has a voidable transaction regime, which allows transactions to be clawed back for the benefit of creditors, often spanning back a number of years and not necessarily with the need to show improper conduct. These transactions are: Undervalued Transactions, Transfers to defeat creditors and Preferential Payments to Creditors.

However, an undervalued transaction cannot be reversed if the transferee can demonstrate the debtor was solvent at the time of the transaction, provided the transaction occurred more than two years prior (or four years prior for a connected party). Also absence of a notice of the bankruptcy petition

The Transfer to Defeat Creditors transaction, usually of property, cannot be reversed if the transferee can demonstrate that market value consideration was paid for the property. It also cannot be reversed if the transferee can reasonably demonstrate that they could not possibly have known the either the transferor intended to defeat creditors, was insolvent at that time or was about to become insolvent. Important good faith requirement

Preferential Payments to Creditors cannot be reversed if the creditor can demonstrate that the payment was received in good faith, in line with the ordinary course of business and proper 'at value' consideration was exchanged i.e. the good or service in exchange for the payment.

2.5/3 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?

Under Article 20 of the Model Law, it is determined that the scope of the stay is the same as would apply if the stay arose under Chapter 5 (excluding parts 5.2 and 5.4A) of the Corporations Act.

When the Australian Court is considering the scope, it must determine whether the standard liquidation stay (affecting only unsecured creditors) is sufficient, or whether the broader voluntary administration stay is required which affects secured creditors too. This is often always determined by the nature of the proceeding, rather than Judge's discretion, and it will be looked at whether this is a business rescue procedure or whether the foreign proceedings are actually similar to how they would occur domestically.

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 provision in an agreement which allows for its termination as a result of bankruptcy or insolvency of one of the parties to the agreement.

In a liquidation, however, the liquidator has the benefit of *ipso facto* prohibition, which 'renders void any provision in a contract that purports to provide the party with the right to terminate'. This would allow a liquidator to maintain contracts deemed necessary for a period of time, if needed during the course of the liquidation.

1/4 marks – liquidations do not get benefit of *ipso facto* protection. However, *ipso facto* clauses that are triggered by a prior voluntary administration or attempt to negotiate a creditors' scheme of arrangement continue to be subject to the moratorium during a subsequent liquidation.

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

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

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

Australia has certainly always been a creditor-friendly jurisdiction, with the primary focus being on the protection of creditors' rights in both personal and corporate insolvency matters.

In most insolvency procedures in Australia, an external administrator / supervisor is appointed to manage the process. Only in a Scheme of Arrangement and small business restructurings are they 'debtor in possession' processes and even then, a qualified insolvency practitioner must be appointed as an advisor to the process.

Further, in a voluntary administration (which is one of the primary formal rescue processes in Australia) though the primary aim is to maximise the rescue of the business, an alternative aim is for a return to be achieved sufficient to distribute to creditors, thereby, demonstrating a very creditor focused position.

Of particular interest is that a secured creditor can enforce their rights during the insolvency proceedings of both individuals and corporate debtors. A liquidation moratorium and stay of proceedings does not apply to secured creditors or affect their rights under their security. Major creditors with security over a property are also entitled to appoint a receiver above a voluntary

administrator. Where there is perishable property, non-major secured creditors may continue with any enforcement action they were taking prior to the commencement of the proceedings.

In addition, Australia has a clear set out voidable transaction regime which allows the claw back of transactions for the benefit of creditors which spans back over a substantial period of years. In addition, the requirement to prove improper conduct is not necessary.

However, as noted in the above statement, there have been some reforms of late that have brought focus further onto business rescue, taking away some of the emphasis on creditor rights. Firstly, the voluntary administration regime now focuses on maximising the rescue of the company. *Ipso facto* contractual rights are no longer enforceable by creditors and in fact, in accordance with the Bankruptcy Act, are actually considered void when a person becomes bankrupt. N.B – an *ipso facto* provision permits the termination of a contract due to the bankruptcy or insolvency of a party.

In addition, directors are now also allowed to continue trading and allowing the company to incur debts if the purpose is to undertake an informal restructuring attempt under the supervision of an expert. This is a "safe harbour" for the directors from insolvent trading liability.

Taking into consideration all of the above, I am not fully inclined to agree with the statement. Though the reforms that have been introduced certainly do have more of a balanced interest in terms of debtor and creditor positions, I do think that overall Australia's insolvency regime is largely weighted toward the interests of creditors. Even the reforms that have been introduced really only take steps to even the balance between debtors and creditors; the creditors' position is of course still paramount in the changes.

Ultimately, even where corporate business rescue is supported and encouraged and debtors' are protected from certain creditor action to allow for such, couldn't it be argued that the ultimate desirable outcome from business rescue is for the benefit of the creditors anyway? Either via a debt repayment or restructuring regime together with the ongoing trade of the business. Therefore, even a business rescue focused regime still has the interests of creditors at the forefront of the picture.

12/15 marks – this was a strong response with a logical and rational conclusion on Australia's approach. This response could have been strengthened by a more specific focus on the particular insolvency and restructuring procedures in which the shift to debtor-friendly regimes has been most apparent. For example, the new small company restructuring is a debtor-in-possession regime as it leaves the directors in control of the company and only requires the advice of an insolvency practitioner, rather than appointing the insolvency practitioner as controller of the company's affairs.

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

Question 4.1 [maximum 9 marks]

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

Aussiebee has offices and warehouses in both Sydney and in Lyonesse. Aussiebee regularly sells its chocolates all over the world, from both its Lyonesse and its Sydney offices and warehouses. Aussiebee and NewYums share a board of directors, made up of six Australians and one Lyonessian. Aussiebee employed 40 staff: 20 in Sydney and 20 in Lyonesse.

Aussiebee's CEO is an Australian, but resident in Lyonesse. Aussiebee's CFO is an Australian, resident in Australia.

Aussiebee is insolvent. NewYums, however, remains solvent.

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

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

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

By way of a background, in 2008, Australia adopted the UNCITRAL Model Law on Cross Border Insolvency. Article 13 of the Model Law covers access of foreign creditors to an Australian proceeding and has been adopted in such a way that the exclusion of foreign tax claims from insolvency proceedings is preserved. However, unfortunately for ATO, my advice to them would be that there is no element of reciprocity in the Model Law, therefore, such treatment of the tax claim cannot be expected to be applied in Lyonesse. Good point that the Model Law does not require reciprocity, but in this case both Australia and Lyonesse exclude foreign tax claims so reciprocity would not have helped the ATO.

The case of *Ackers v Deputy Commissioner of Taxation* is key case law here to base our advice on. Whilst we cannot be certain that the jurisdiction of Lyonesse doesn't have certain provisions that would determine this advice is applicable, it should still certainly be considered. In this case, in a similar way, the debt payable to a foreign revenue creditor was not admissible in the foreign liquidation (in this case a Cayman Islands liquidation). However, on the application of the Deputy Commissioner of Taxation, the Federal Court modified the recognition order allowing the DCT to take steps to enforce its claim in Australia, specifically for the purpose of recovering an amount up to the *pari passu* amount the ATO would have received if they were entitled to claim as an unsecured creditor in the foreign main proceedings. The decision was upheld and it was determined that this modification of the recognition order was the most appropriate way to protect the interests of the DCT.

I would therefore advise the ATO to pursue a similar application to modify the recognition order being pursued by the liquidator of Aussiebee Good.

In addition, noting that Aussiebee has six Australian directors, an Australian CEO and an Australian CFO, The issue you were intended to spot from these facts is whether Aussiebee's COMI is in Lyonesse, or in Australia.

The ATO should intervene on the recognition application, arguing that:

- The COMI of Aussiebee is Australia, not Lyonesse, and so the assets of Aussibee should not be entrusted to the Lyonessian liquidator.
    - *Ackers v Saad Investments* is the leading Australian decision on COMI. It followed and expressly adopted the principles in *Re Eurofoods IFSC Ltd* that COMI is to be determined having regard to the objectively ascertainable factors of the debtor.
    - Need to displace presumption that place of incorporation is COMI
    - Six of the seven directors are Australians

- The CEO is Australian (although resident in Lyonesse)
- The CFO is Australian and resident in Australia
- Sells Australian product, manufactured by its subsidiary in Australia.
- Do not know whether Aussiebee holds itself out to be an Australian-based company, but its name and its product seem to indicate that it does.

the ATO need to be aware that a director will face personal liability if they fail to prevent the company from entering into a creditor defeating position. The ATO have the ability to issue a director penalty notice to the directors in relation to their failure to properly deal with the tax affairs of the company. In the event the amounts owing are not settled in full within 21 days then the directors do become personally liable. Further provisions in this regard are covered in the Taxation Administration Act 1953 and this should be considered further by the ATO. I can see you have done further research, good effort.

The domino effect of such action is that NewYums share the same board of directors. Any action taken by the ATO against the directors will directly impact their ability to control and manage NewYums no real legal effect (unless bankrupted), but a practical effect I suppose as personal claims against them would distract them from managing NewYums and it could ultimately result in the winding up of NewYums too. In addition, if the directors are personally liable and unable to settle the debts due then the ATO may pursue personal bankruptcy proceedings against the directors. Correct If this happened, the current board of directors would no longer be able to serve on the board of NewYums and, in lieu of suitable replacements, NewYums would have to cease to trade.

6/9 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.

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?

In the first instance, the main issue that the board of HA and HGL should be aware of is Australia's voidable transaction regime, which allows transactions to be investigated and clawed back over a significant period, without having to prove improper conduct. Correct

Given that the board of HA advised me that the company has been insolvent since the judgment was handed down in October 2020, there is no question as to whether the directors knew or ought to have known the company was insolvent, as the admission is there. Therefore, trading whilst insolvent could be considered a breach of fiduciary duty (do not need breach of fiduciary duty – a liquidator can bring a straightforward personal claim against each of the directors under the *Corporations Act* for insolvent trading) and in fact should have been done under the supervision of an expert if in fact the ongoing trading was a rescue attempt for the company, under the "safe harbour" reform in respect of insolvent trading liability. Would have needed to be undertaking a legitimate restructure and there is no suggestion here that they were trying to do that.

Notwithstanding that, the board should be concerned about the fact that they can be liable for insolvent trading due to the fact that a) they were in office as directors when the debt was incurred; and b) due the company becoming insolvent as a result of the debt. If the company is wound up, a liquidator may pursue a compensation order against the directors and they are also at risk of disqualification.

I do not believe any of the insolvent trading defences apply here as it would appear that no appropriate steps were taken to prevent any misconduct as debts were continuing to be incurred and, in fact, additional funding was sought and a loan was taken from the parent company knowing the company was already insolvent. There did not appear to be any action taken to settle the amount owing under the unsatisfied judgment debt utilising the loan monies either, rather the funds were used for ongoing trade and no doubt director remuneration. If the latter is true then this could also be pursued as a voidable transaction to be clawed back for the benefit of the estate. Action was only taken by the directors when there was no further funding to continue, rather than earlier rescue efforts that should have been made. Good

The Board members could rescue the company (and avoid personal insolvent trading liability) in HA can be kept out of liquidation.

Critical advice: the directors should immediately put the company into voluntary administration because the company is insolvent. This will prevent them from incurring further insolvent trading liability.

Immediately before HA enters voluntary administration, the mortgages over the trucks will vest in the voluntary administrator because CBA failed to register its security interests 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 trucks to provide a return to unsecured creditors.

The VAs, or HGP, could propose a DOCA 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.

I would advise the board that any appointed liquidator could pursue the loan from the parent company as an uncommercial transaction, given that it would never have been entered into by a non-connected company given the circumstances of the company and the fact it already had an unsatisfied judgment debt. The transaction occurred with a connected party, well within the 4 year relevant period provided for in S588FE(4).

Another issue faced here is the fact that the mortgages over the three trucks are not registered on the Personal Properties Securities Register. The Personal Properties Securities Register has been adopted under the Personal Property Securities Act 2009, pursuant to which all personal property security interests are to be registered. There is a risk here to the lender that their security will be lost in the event of insolvency.

Ultimately, the shareholders and directors should now be taking steps to wind up HA.

Unfortunately you did not spot most of the real issues in this question.

2/6 marks

*** End of Assessment ***

TOTAL MARKS: 36.5/50