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.

1. Undervalued transactions

The circumstance under which an undervalue transaction will be irreversible is for the transferee to show that the transfer took place more than two (2) years or more than four years ago for a related party transaction before the commencement of the bankruptcy; and the transferee proves that, at the time of the transfer, the transferor was solvent. (Section 120(3) of the Bankruptcy Act 1966)

2. Transfers to defeat creditors

The transaction is irreversible if the transferee can show that:
(a) the consideration that the he gave for the transfer was at least as valuable as the market value of the property; and
(b) He did not know, or could not reasonably have inferred, that the transferor's main purpose in making the transfer was defeating creditors; and
(c) He could not reasonably have inferred that, at the time of the transfer, the transferor was, or was about to become, insolvent.
(Section 121(4) of Bankruptcy Act 1966)

3. Preferential payments to creditors

The transaction is irreversible if the creditor can show that the transaction occurred in the ordinary course of business and he acted in good faith and gave valuable consideration at least as valuable as the market value of the property. (Section 122 (2)(a) of Bankruptcy Act 1966)

You correctly identified the 3 types and the specific defence for transfers to defeat creditors and for preferential payments, but you did not identify the general defences for all voidable transactions (not just preferential payments):

- 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)).

2/3 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 provides that upon recognition of a foreign main proceeding Commencement or continuation of individual actions or proceedings concerning the debtor's assets is stayed and Execution against the debtor's assets is stayed and lastly the right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.
Article 20 is subject to section 16 of the Cross Border Insolvency Act 2008 which provides that the scope of the stay or suspension in Article 20 is the same as that which would apply if it arose under:

(a) the Bankruptcy Act or
(b) Chapter 5 (other than Parts 5.2 and 5.4A) of the Corporations Act. 1 mark

As applied in the Tai-Soo Suk v Hanjin Shopping Co Ltd, the court needs to identify what the "case requires" which means that the court is required to identify whether the case requires the broader voluntary administration stay which affects secured creditors only or other standard liquidations stay that will affect only unsecured creditors. 1 mark If the foreign proceeding is a business rescue procedure the broader voluntary administration is appropriate. 1 mark

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 a contract which allows one party to the contract to modify or terminate the operation of the contract on the occurrence of a specified insolvency event (including bankruptcy) in respect of the other party.

In liquidations ipso facto moratorium do not apply, so a supplier is able to terminate his contract with the company as soon as it enters liquidation. An exception only relates to a situation where a creditor's voluntary liquidation immediately follows a prior voluntary administration in which situation an ipso factor moratorium will apply due to the amendments to the Corporations Act. Even though the moratorium will be in force the ipso clause will not be void.

In conclusion, a ipso facto clause allows a supplier or contractor to terminate its contract with the company when the company is in liquidation assuming the contract contained an ipso factor clause.

4/4 marks – good answer

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.

The term Insolvency in Australia refers to companies facing financial distress, while the term 'bankruptcy' generally refers to natural persons in financial distress. Personal bankruptcy in Australia is governed by the Bankruptcy Act 1966 and the Bankruptcy Regulations 1996 made under the Bankruptcy Act.

Insolvency regimes are largely classified as either creditor or debtor-friendly based on how the regime is perceived in protecting either creditors or debtors.

A creditor-friendly regime is a regime that is perceived as largely protecting the rights of creditors over debtors. creditor interests are protected and given greater weight than those of other stakeholders. A jurisdiction is considered debtor-friendly if it is perceived that it protects the rights of debtors over creditors. Jurisdiction largely referred to as debtor-friendly include debtor-in-possession reorganisation model.
Australia is a creditor-friendly jurisdiction because creditor interests are protected and given greater weight than those of other stakeholders. The primary focus is on the protection of creditors rights in insolvency situations.

Some of the reason why Australia is regarded as a creditor-friendly regime include:

The administration regime is controlled by creditors to the exclusion of management and members and the its purpose is designed to maximize creditor returns. For instance, when a company is in voluntary administration, the first task of a voluntary administrator is to convene and hold a first creditors meeting within eight business days of their appointment. The creditors have power to remove and replace the administrator or appoint a committee of inspection to represent creditors interest in their dealings with the administrator. Also, when the administrator recommends that the company should be returned to its directors or that a deed of company arrangements should be approved for execution, the creditors have power to agree to the recommendations or otherwise.

Secured creditors are also entitled to enforce their rights during the bankruptcy and liquidation process. In Australia, secured creditors are ranked first in that they are paid first before tax claims and employee claims when a debtor has defaulted outside an insolvency procedure. Usually bankruptcy procedure, a bankruptcy moratorium will apply but secured creditors are not bound by the moratorium and are still entitled to enforce their rights. Additionally, should a secured creditor realize his security and there still remains a shortfall, he is entitled to submit a proof of debt for the shortfall. Secured creditors are not subject to the Moratorium in the voluntary administration and liquidation procedures and broadly speaking are not bound by formal insolvency processes. Ordinary unsecured creditors play an active role in formal restructuring and insolvency processes, and are afforded extensive rights to receive information and participate at meetings that can determine the future of the debtor.

In Australia, major creditors with security over the whole or substantially the whole of the company's property are entitled to appoint a receiver over the top of a voluntary administrator. A moratorium is usually in enforce during voluntary administration however

secured creditors who hold a security interest over substantial or whole of the property of a company can enforce its security interest by appointing a receiver within the decision period of thirteen business days from the day of commencement of the voluntary administration or from the time the secured party received notice of the appointment of the voluntary administrator.

Also, non-major creditors, an owner or a lessor who has enforcement rights can continue with enforcement action which had been commenced before the appointment of the voluntary administrator or to recover a perishable property.

The regime also allows for voidable transactions to be clawed back for the creditors particularly in corporate liquidations. It allows recovery of voidable transactions over a substantial period of years and the liquidator will not have to prove improper conduct such as an intention to defeat creditors.

The Australian regime also allows for broad insolvent trading liability which in effect empowers the liquidator to recover substantial monies form the directors of the company usually through a directors' and officers' insurance policy where the directors have allowed the company to accrue debts whilst insolvent.

Lastly, almost all of Australia's bankruptcy and insolvency processes involve the appointment of an external administrator, rather than being debtor-in-possession processes except schemes of arrangement, and small business restructurings.
In conclusion, I disagree with the statement and posit that Australia's Insolvency and restructuring options have in the past been regarded as a debtor-friendly but recent reforms have made Australia more of a very creditor-friendly jurisdiction.

8/15 marks – this response provides a thorough and articulate summary of the factors of Australia's system which protect the interests of creditors in restructuring and insolvency, however, it fails to identify the debtor-friendly aspects and developments which have aimed to even the scales. For example, the *ipso facto* prohibition, the "safe harbour" regimes and the small company restructuring regimes which is largely a debtor-in-possession regime (albeit with the advice of an insolvency practitioner). Your conclusion that the jurisdiction should still be regarded as creditor-friendly is probably correct, however you failed to identify any of the factors which would suggest otherwise.

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?

"Foreign proceeding" means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation. (Article 2 (a) of Cross-Border Insolvency Act 2008)

"Foreign main proceeding" means a foreign proceeding taking place in the State where the debtor has the centre of its main interests. (Article 2 (b) of Cross-Border Insolvency Act 2008)

In the absence of proof to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the centre of the debtor's main interests. (Article 16 (3) of Cross-Border Insolvency Act 2008) Needed to consider whether, on the facts of this case, the COMI is really in Lyonesse or whether it might be in Australia.

- *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.

"Foreign representative" means a person or body, including one appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding. (Article 2 (d) of Cross-Border Insolvency Act 2008)

The legal principle that applies here is Section 22 of the Cross-Border Insolvency Act 2008.

Section 22 of CBA 2008 states that in granting or denying relief under article 19 (Relief that may be granted upon application for recognition of a foreign proceeding) or article 21 (Relief that may be granted upon recognition of a foreign proceeding), the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are

adequately protected. The court may also subject relief granted under article 19 or 21 to conditions it considers appropriate.

Since revenue creditors such as Australian Taxation Office (ATO) are not entitled to prove in the Lyonessian Liquidation, the ATO must make an application to the Federal Court to modify the recognition orders that will be granted to Liquidator to enable the ATO to enforce its claims in Australia for the purpose of recovering an amount *pari passu* entitlement the ATO would have received if they were supposed to prove for the tax debt as an unsecured creditor in the foreign main proceeding. Good, even though you did not refer to the case name, I can see that you are aware of and are correctly applying *Ackers v Deputy Commissioner of Taxation*.

In conclusion, to protect its position the ATO should make an application to the court seeking modification of recognition to the liquidator and secondly to improve its position the ATO should issue any statutory notices for the production of documents and information to any persons in exercise of the rights to recover its *pari passu* entitlement.

4.5/9 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.

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?

From the facts, HA is clearly financially distressed and the directors should consider putting the company in voluntary administration. Good

Administration is a formal corporate rescue process whereby a distressed company is placed in the hands of an independent professional known as a Voluntary Administrator whose duty is to investigate the company's affairs, to report to creditors and to recommend to creditors whether the company should enter into a Deed of Company Arrangement, Liquidation or be returned to the directors.

The directors may appoint the voluntary administrator after resolving that the company is insolvent or likely to become insolvent in the foreseen future.

The purpose of the voluntary administration is ensured for the company to be administered in a way that will maximize HA's chances of continuing in existence.

If the company is put in voluntary administration a moratorium will be in force which means that all creditors, both secured and unsecured cannot ensure their rights during the voluntary administration.

The loan of AUD 30 million is an unsecured loan and therefore will be affected by the moratorium.
The security interest in the three trucks will be vested in HA immediately before the HA enters administration because the mortgage was not registered on the Personal Property Securities Register. Good

The judgement debt of AUD 4.6 million will also be affected by the moratorium.

The other big risk that you needed to discuss is the risk of insolvent trading liability for the directors, and for HGL as the holding company, if HA were to go into liquidation.

Once HA is in voluntary administration, the VAs, or HGP, could propose a DOCA, either by HGL putting up some of its own money, 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.

4/6 marks

*** End of Assessment ***

TOTAL MARKS: 35.5/50