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. 0 marks

(e) Superannuation funds.

Question 1.6

Which of the following **is not** a relevant period for the entry into a transaction which constitutes an unfair preference in a liquidation?

(a) The six-month period ending on the "relation back day".

(b) The one-year period ending on the relation back day where the creditor had reasonable grounds for suspecting that the company was insolvent. 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.

9/10 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 types of avoidable transactions that can be reversed by a bankruptcy trustee are undervalued transactions, transfers to defect creditors and preferential payments to creditors. 1 mark

An undervalued transaction will not be reversible if the transaction took place more than 5 years before the commencement of the bankruptcy. If a transaction occurred within the 5 year period, the transaction will not be reversible if the transferee can be shown that the transaction occurred more than 2 years ago and that the debtor was solvent at that time.

A transfer to defect creditors will not be reversible if the debtor is able to show that it paid market value for the property and at the time of the transfer, the transferee did not know and could not reasonably have inferred that the transferor had the main purpose of defeating creditors or the transferor was insolvent or about to become insolvent. 1 mark

A preferential payment will not be reversible if the transfer of property by the debtor to the creditor occurred more than 6 months prior to the presentation of the bankruptcy petition and if the debtor was solvent at the time of transfer. The transaction will not be reversible if it can be shown by the creditor that the payment was received in good faith, in the ordinary course of business and in return of valuable consideration. 1 mark

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?

The scope of stay under Article 20 of the Model Law implemented by Australia is regarded as the same as the Bankruptcy or Chapter 5 of the Corporation Act, as the case requires. 1 mark

In order to determine what the case requires, the Court would need to ascertain whether the case requires the broader voluntary administration stay which affects secured creditors or the standard liquidation stay that affects only unsecured creditors. 1 mark The Court would need to determine the nature of the proceeding – if the foreign proceeding is a business rescue procedure, the stay applicable to voluntary administration would be more appropriate.

On the other hand, if the foreign proceeding is more similar to liquidation then stay under the liquidation route will be more applicable – i.e. stay on enforcement action against the assets pf the company and/or stay of proceedings against the company. 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?

Ipso facto clauses allow a party to terminate or modify the operation of a contract upon the occurrence of certain events of default such as the counterparty's insolvency or restructuring. 1 mark

During liquidation, a liquidator who intends to maintain an important supply contract for a period of time to assist the temporary conduct of the debtor company's business pending any transaction, the liquidator will not have the benefit of the ipso facto enforcement prohibition that applies during bankruptcy. 1 mark Therefore, with an ipso facto clause in place, a supplier, contractor or a party is generally able to terminate its contract with the company as soon as the company enters into liquidation.

An exception to the above general principle which enables liquidator to rely on the ipso facto clause prohibition, is in a creditors' voluntary liquidation scenario which immediately follows a prior voluntary administration or attempt to negotiate a creditor's scheme of arrangement 1 mark – in such scenario, a moratorium introduced under the Corporations Act kicks in. The ipso facto moratorium applies to contracts entered into with a company on or before 1.7.2018, where a company is in the process of voluntary administration – a corporate rescue mechanism. 1 mark

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.

I respectfully disagree with the statement for reasons to be discussed below. While developments in Australia's insolvency and restructuring regimes have seen an effort in moving away from a creditors' rights dominance stance, it cannot be said to have become a debtor-friendly jurisdiction.

The following points support the proposition that Australia's insolvency and restructuring regimes is indeed creditor-friendly:

(a) In bankruptcy (insolvent individual) and liquidation (insolvent company) scenarios, secured creditors are not bound by the bankruptcy moratorium and remain entitled to enforce their rights against the individual/company.

(b) In a voluntary administration scenario, an alternative aim of the option is to enable a maximum return to be achieved for distribution to creditors as envisaged by the Corporations Act.

(c) In a voluntary administration scenario, a secured creditor with interest over the whole, or substantially the whole of a company's property, can enforce its security right by appointing a receiver, within the decision period of 13 business days from the commencement of the voluntary administration or from the secured party receiving notice of appointment of the voluntary administrator.

(d) In a voluntary administration scenario, non-major secured creditors, owners and lessors bearing enforcement rights, can continue with enforcement proceedings which had been commenced prior to the appointment of a voluntary administrator or which relates to perishable property or otherwise with the consent of the court.

(e) Under the law related to insolvent trading liability, liquidator is able to recover substantial sums from directors, from directors' and officers' insurance policy, where directors have allowed a company to incur debts whilst being insolvent.

(f) Under the law related to voidable regime, particularly in corporate liquidation, certain transactions could be challenged and clawed back for the benefits of creditors over a substantial period of years and without having to prove improper conduct such as an intention to defeat creditors.

Having said the above, recent developments in the corporate rescue and corporate insolvency regime in Australia appear to encourage a stronger corporate and business rescue culture and promote a move away from the existing and long-established notion of creditors' rights dominance. This can be observed in the following:

(g) In a voluntary administration scenario, the primary goal is to maximise the chance of an insolvent company, or as much as possible of its business, continuing n existence under the terms of a DOCA.

(h) As of 1 July 2018, there is an ipso facto moratorium whereby creditors are prevented from enforcing an ipso facto contractual rights contingent only on a company's insolvency or entry into an external administration, subject to an exception.

(i) In a personal bankruptcy scenario, under the Bankruptcy Act, an ipso facto clauses is void outright when a person becomes a bankrupt.

(j) In an insolvent trading scenario, as of September 2017, company directors can take advantage of a "safe harbour" from insolvent trading liability, so that they can continue to allow a company to incur debts with a view to implementing a proposed restructuring attempt under the supervision of an appointed restructuring expert.

15/15 marks – this is a great response which coherently sets out the key components of Australia's insolvency and restructuring system which upholds the interests of creditors, and the key developments which have attempted to bolster the interests of debtors. Your conclusion, that the system still favours creditors, is well-argued and supported by reason.

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?

The ATO should firstly apply to court to challenge the recognition application filed by the Lyonesses liquidator. The challenge is not to object to the whole recognition application per se, but rather to seek the Court to modify the recognition order that the Australian Court would grant to the Lyonesse liquidator.

ATO should seek leave from the Court for ATO to initiate enforcement actions against Aussiebee in Australia, expressly for the purpose of recovering an amount up to the pari passu amount the ATO would have received as if ATO were entitled to the tax debt of 12 million owed by Aussiebee. This is to ensure that the interest of ATO, as a creditor in Australia is protected.

The facts of this matter is similar to the of the case of Ackers v Deputy Commissioner of Taxations, where in similar situations, the Federal Court had found it appropriate to modify a recognition order granted to a Cayman Island liquidator.

- The other issue raised on the facts that the ATO could argue is that the COMI of Aussiebee should be found to be in 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.

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?

Insolvent trading

Before discussing what are the options available to the Board and HA, it is important to first identify what are the potential issues that may arise given the circumstances. Assuming it is true that HA had been insolvent since October 2020 when BOR obtained a judgment against HA, the fact that HA continued trading for another year incurring further debts exposes the

directors of HA to claims of insolvent trading. Briefly, a director of HA may potentially be liable for insolvent trading as:

(a) The director(s) were directors of HA when the debt was incurred i.e. between period of October 2020 until October 2021;
(b) HA was insolvent when the debt was incurred;
(c) There were reasonable grounds for suspecting HA was insolvent and the directors were aware of such reasonable grounds – in particular, there is already an unsatisfied judgment sum owed by HA to BOR.
(d) The directors failed to prevent the company from incurring debts, especially between October 2020 until October 2021.

If the Court find that the director(s) are liable for insolvent trading, the Court would usually make a compensation order against the directors. The Court could also impose a civil penalty, a disqualification order and if a director has behaved dishonestly, a criminal penalty.

The directors may argue in defence that there are reasonable grounds to expect solvency or there is a reasonable expectation of solvency based on information provided by a competent and reliable person fulfilling responsibility to provide that information. Although there do not seem to be facts supporting this defence.

It is also crucial to note under the Corporations Act the liability for insolvent trading could extend to a holding company. In other words, for the debts of HA the liability for insolvent trading could potentially extent to HGL. Well spotted.

Safe harbour

With effect from September 2017, "safe harbour" provisions was introduced which provide that insolvent trading liability is not incurred where, after the time that directors begin to suspect that the company may be or may become insolvent, they start developing one or more courses of action that are reasonably likely to lead to a better outcome for the company. In other words, the directors of HA and HGL must have already taken or now take steps to that are reasonably likely to lead to a better outcome for the company – one of this steps being information informal restructuring (discussed below).

In order to rely on the safe harbour provisions, HA must continue to pay all employee entitlements (including superannuation) as and when they fall due and the company must complay with all tax reporting obligations.

Informal restructuring

The directors of HA are advised to formulate and implement a dedicated informal restructuring plan acting on the advice of an appointed specialist restructuring expert. It is likely far too late for this. The safe harbour, if even they could get into it now, will not prevent their insolvent trading liability for the whole period that they were trading whilst insolvent without meeting the safe harbour criteria.

An informal restructuring may be a more recommended option as compared to voluntary administration (discussed below) as in the latter, creditor may use the appointment of an administrator as the trigger to enforce their securities and ipso facto contractual rights. But there is an ipso facto moratorium during voluntary administration. This in turn will diminish the enterprise value of HA, minimising the success rate of reviving the company. With the safe harbour in place, by pursuing an informal restructuring, HA may be able to revive HA or at least preserve HA's business as a going concern. More importantly, an informal restructuring would avoid insolvent trading liability.

Voluntary Administration

Alternatively, HA can opt to initiate voluntary administration where a majority of HA's directors resolve that, in their opinion, HA is insolvent and that an administrator should be appointed.

As a side note, on the facts of the case, it appears that HA has been insolvent for at least 1 year since October 2020. Therefore, this effective rules out the option of member's voluntary liquidation because it is a pre-requisite for a company to be solvent to initiate a member's voluntary liquidation.

An issue you missed: 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 PPSR. 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 create a fund to provide a return to unsecured creditors.

Getting into a voluntary administration is a good first step, but it will inevitably lead to either a liquidation or a DOCA. If it leads to a liquidation, the directors and HGL will be sued for insolvent trading.

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 voite 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.

4/6 marks

*** End of Assessment ***

TOTAL MARKS: 43/50