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. Correct answer

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. 0 marks

(d) the directors resolve that the company is insolvent or likely to become insolvent. Correct answer

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. 0 marks

(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. Correct answer

(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.

7/10 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 three types of voidable transactions are the ones that (i) are undervalued; (ii) made to defeat creditors; and (iii) give preferential payment to creditors. 1 mark

The undervalued transactions are not void if performed more than 2 years before the bankruptcy – or 4 years, if the transferee is related to the debtor – and the debtor was proved solvent at the time that the transaction was made (section 120 (3) of the Bankruptcy Act).

Secondly, the transaction made with the purpose of harming the creditors can be maintained if the transfer of property was made with an equivalent consideration by the transferee or if the transferee didn't know about the insolvency status of the debtor and didn't know or doesn't have reason to believe that the debtor had the intention of harming its creditors (section 121 (4) of the Bankruptcy Act). 1 mark

Finally, the operation of preferential payment won't be reversed if the creditor proves that they received the payment in the ordinary course of business, in good faith or if it was made in return of an equivalent consideration (section 122 (2) of the Bankruptcy Act). 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 Model Law provides in its article 20 that the commencement or continuation of all individual action and execution against the debtor is stayed after the recognition of a main proceeding. Acts of the debtor to dispose or transfer assets are also stayed.

However, when Australia adopted the Model Law, the Cross-Border Insolvency Act 2008 established that the stay granted to the debtor will be the same one applied to the bankruptcy, liquidation or the restructuring proceedings provided by the Corporations Act

(section 16 of CBIA) and the application of one or another type of stay would depend on the case and specifically the type of proceeding that was opened in another country.

This means essentially that the court must decide if the stay will affect both secured and unsecured creditors or just the latter. In practice, the stay that has an impact on secured creditors (applied in the voluntary administration proceeding) is usually granted when the proceeding opened has the goal of restructuring the company from the financial distress (voluntary administration moratorium); the stay applied only to unsecured creditors commonly is given to proceedings that aim to pay creditors and close the company (liquidation moratorium).

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?

The ipso facto clause is a contractual clause – usually inserted in an executory contract – where the creditor has the right to terminate or modify the contract if the debtor becomes insolvent. That clause may establish that this termination is automatic in cases where a debtor enters into an insolvency or restructuring proceeding. 1 mark

In a context of insolvency proceeding as a liquidation in Australia, for example, a creditor that has the right of ipso facto could terminate the contract as soon as the debtor enters in liquidation, which means that even if it's an essential contract to maintain ongoing business–selling, for example – or if it is a lucrative deal to the estate, the contract may be terminated by the creditor exercising this right.

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.

3/4 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.

Provisions such as the guarantee of secured creditors enforces its security even when the debtor is under bankruptcy or liquidation proceedings with a moratorium granted. The possibility of appointment of a receiver to administrate and realise assets to enforce the security when the security was given over the whole or significant part of the debtor's assets, the liability of directors for voidable transactions and the shareholder's credits being the last one in the priority ranking of creditors in a liquidation, between other examples, makes possible the conclusion that the Australian has a creditor-friendly insolvency system.

A creditor-friendly approach usually means that the focus on the structure of the insolvency system is to protect the creditor's interest and its trust in the financial and economic system in general. Being simplistic, with more trust of the enforcement of its credits, the companies have more incentive to continue doing business with other companies, which in the end, improves the economy overall.

Despite this historic creditor-friendly approach, recent modifications in the Australian insolvency law (specifically in 2017/2018) to strengthen the restructuring proceedings,

especially the voluntary administration, which embraced some provisions in favour of the debtors such as the moratorium granted specifically for the ipso facto cause, which prevents the creditor from enforcing its right to terminate or modify contracts solely because the debtor initiated a voluntary administration and the application of the stay to secured creditors, besides the creation of the "safe harbour" to prevent the directors of liabilities from insolvent trading, is changing, even if just a little bit, the intensity of the pro-creditor's rules existing.

Personally, despite agreeing that these new rules provide more protection for the debtor and gives to it better chances to be rescued from a financial distress, I don't think that it makes the Australian's insolvency a debtor-friendly system.

Even though the importance of the protection to creditor's right to the confidence in the financial system, multiple adversities may have an impact on the regular course of a viable business, so the debtor needs to have the necessary tools to pass through the financial difficulty and maintain the business, which consequently will preserve employment and tax collection.

One important tool that needs to be available to guarantee an effective restructuring of a viable business is a debtor-in-possession restructuring proceeding (this exists now for more company with less than $1m in debt, under the new small company restructuring process), that should give to the debtor a breath space – with the stay applied to all creditors, secured or not – to negotiate with creditors and getting to a solution that will be beneficial to everyone. Naturally it won't be a perfect solution for anyone, so all parties need to be aware that everyone needs to compromise for this common solution that is, in many cases, better than the closing of the company.

11/15 marks – this is a good response. You identified some of the key developments which have sought to uphold the interests of debtors. Your summary of the aspects of Australia's system which are creditor-friendly should have included the new small company reforms and elaborated on why those mechanisms assist creditors in particular. The conclusions at which you arrived are both reasonable and supported by evidence.

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?

Considering the Aussiebee's operation in Sydney and the existence of assets owned by Aussiebee in Australia, it is possible to conclude that the foreign main proceeding would be recognized by the Australian Court according to article 1 (a) of the Model Law.

Considering that the foreign main proceeding would be recognized, the Model Law provides the possibility of the court, before the decision or upon recognition of a main foreign insolvency proceeding, to grant a feel type of relief to provide more effectiveness to the foreign insolvency proceeding (articles 19 and 21). One of the reliefs is entrusting the foreign representative with the assets of the debtor located in the State where the recognition is sought.

However, this kind of relief just can be given if the interest of local creditors is properly secured.

In this specific case, the ATO are not entitled to prove its credit in the Lyonessian liquidation, which means that the ATO wouldn't be paid under the Lyionessian proceeding and, consequently, if the foreign representative of Aussiebee's liquidation was entrusted with all of Aussiebee's assets in Sydney for the purpose of realisation, the product of the realization would be used to pay the creditors that were proved under the Lyionessian proceeding with the exclusion of ATO's credit, in violation of the *pari passu* principle.

Having this fact in mind and considering the Ackers v Deputy Commissioner of Taxation case, when the Federal Court of Australia held that if a credit can't be proven in the foreign main proceeding, a relief that allows the foreign representative the realization of assets situated in the territory where the relief was granted is contrary to the *pari passu* principle and the security of local creditors.

In that case, the Federal Court allows the Deputy Commissioner of Taxation to enforce its claim in Australia in order to receive the same amount as it would receive if the proof of the debt was possible in the foreign main proceeding.

For that reason, I would advise the ATO to apply to the Federal Court of Australia requiring the rejection of the order to entrust the foreign representative with the Aussiebee's assets in Australia with the purpose of the realisation. The ATO should also apply for an order to allow the enforcement of its claim to receive the same amount as the other unsecured creditors that will be received with the liquidation. Good.

- The other issue that you should have picked up on is that the ATO could argue 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.

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?

According to the information above, the principal debts owned by HA are loans taken from (i) a shareholder of HGL, which, despite being the bigger in amount, is unsecured but is granted in favour of the creditor's ipso facto right; (ii) CBA, which has an unregistered security but needs to be repaid in the short-term and (iii) HGL.

Considering these debts, it is important to make the following considerations:

(i) The Australian law (section 267 of the Personal Property Securities Act) establishes that an unregistered security can be vested in favour of the grantor (the debtor, in this case) in case of liquidation of the debtor. Good. Also if the debtor goes into voluntary administration, rather than liquidation.

(ii) The ipso facto clause in the HGL major shareholder's loan, which gives to the creditor the right to claim the whole credit in case HA enters into a formal

insolvency or restructuring proceeding, is important to highlight the provision of sections 451D and 451E which provides an ipso facto moratorium when the debtor starts a voluntary administration. Excellent

It's also important to underline the fact that HA continued to trade even when the insolvency status was initiated. Despite that there's no obligation to a company that initiates a formal insolvency proceeding if it became insolvent, the conduct of the directors during this period and the transactions made for them may bring some personal liabilities. Good

Examples of these liabilities that directors are subjected to is for insolvent trading, which is a compensation that the former director may be liable to repair the company when it's been proven that some transactions shouldn't have been made. Yes, and the holding company HGL can also be liable for insolvent trading of HA.

One of the obligations of the directors is to take some actions to prevent the insolvency of the company or at least to manage the assets and liabilities to minimize the financial prejudice to the company and its creditors.

On the other hand, when the directors promote actions to prevent the insolvency or to minimize the economic effect of the insolvency status, the Companies Act provides a mechanism to protect the directors from the liability, the "safe harbour". Yes, but there are not really any facts in this case that would bring the directors within the "safe harbour".

Keeping those facts and provisions of Australian law in mind, I would advise the boarder to recognize the insolvency status of HA and would initiate a voluntary administration in order to stay the enforcement of claims from HGL shareholder and CBA to try a rearrangement with the creditors or at least a better liquidation of the company and, at the same time, try to avoid liabilities to the directors. Excellent, you spotted all of the issues and you reached the best conclusion: voluntary administration. But voluntary administration only provides breathing space. After a VA the company will either go straight into liquidation or into a DOCA:

- 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.

5/6 marks

*** End of Assessment ***

37/50 total