



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**.

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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.

a) Undervalue transactions

Undervalue transaction must have occurred 5 years period before the commencement of bankruptcy and the transferee gave no/less consideration for the transfer.

It is a defence for a transferee to show that the transaction occurred more than two years ago (or more than four years ago for related party transactions) and that the debtor was solvent at that time.

b) Transfers to defeat creditors

Transfer to defeat creditors happens when the debtor's main purpose was to prevent, hinder or delay creditors from being paid. There is no specific time period to recover the action.

This type of transaction is not reversible when the assets are paid with the market value and the transferee did not know and could not reasonably have inferred either the transferor had the main purpose of defeating creditors or the transferor was insolvent / about to become insolvent at the time of transfer.

c) Preferential payment to creditors

The bankruptcy trustee is able to recover this transaction if it occurs six months prior to the presentation of petition and the debtor was insolvent at the time of the transfer and further preference was given to the creditor by priority or advantage over other creditors.

The transaction is not reversible if the creditor shows that it received the payment in good faith, in the ordinary course of business and in return for valuable consideration.

Further the bankruptcy trustee will not be able to recover the property if the original trustee has since transferred the property to a third party and the third party received the property in good faith and for market value.

Plus the defences for all voidables:

- 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?

Scope of the stay in relation to a corporate debtor under Australia's implementation of Article 20 of the Model Law is discussed under the Bankruptcy Act and Chapter 5 of the Corporation Act. Australian court in considering a recognition application it will consider what "the case requires", that is, whether the case requires the broader voluntary administration stay which affects secured creditors or the standard liquidation stay that affects only unsecured creditors. It is not a question of discretion but rather which stay should apply according to the nature of the proceeding. The correct stay to apply is determined by the nature of the proceeding and whether it is more analogous to an Australian voluntary administration or a liquidation. **What sort of proceedings would require a voluntary administration stay? Often likely to be rescue proceedings. Liquidation stay obviously best analogy where the foreign proceeding is a liquidation. But there are some foreign proceedings that do not fall neatly into either category.**

*In the case of The Rizzo-Bottiglieri-de Carlini Armatori decisions, the second notable feature is the court's determination of which type of Australian stay should apply under Article 20(2) of the Model Law. Justice Rares recognised the Italian fallimento proceeding as a foreign main proceeding. His Honour heard and rejected an argument that, because the moratorium in the Italian fallimento proceeding also affected secured creditors, the Australian moratorium that should be applied would be the voluntary administration moratorium because it also affects secured creditors. Instead, his Honour found that because the fallimento proceeding was analogous to a liquidation, only the liquidation moratorium should apply. **Not sure why you copied this passage directly from the Guidance Text here, but it has not affected your mark.***

2/3 marks

Question 2.3 [maximum 4 marks]

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

According to the Treasury Law Amendment Bill 2017, an 'ipso facto' clause is a provision that allows one party to terminate or modify the operation of a contract upon the occurrence of some specific insolvency related event, regardless of otherwise continued performance of the counterparty. The operation of these clauses can reduce the scope for a successful restructure or prevent the sale of the business as a going concern. This may reduce or eliminate returns in liquidation because they disrupt the businesses' contractual arrangement. Copied verbatim from the explanatory memorandum, but at least you got the definition right in the first sentence.

In a liquidation if the liquidator wishes to maintain an important supply contract for a period of time to facilitate the temporary conduct of the company's business pending a possible sale, the liquidator will not have the benefit of the ipso facto enforcement prohibition that applies during bankruptcy. The supplier or other contractor is generally able to terminate its contract with the company as soon as the company enters liquidation (assuming ipso facto rights have been incorporated in the contract). Cut and pasted from the learning guide.

From 1 July 2018, a moratorium on reliance on "ipso facto" contractual clauses triggered by the counterparty becoming subject to certain specified formal corporate insolvency events came into effect. On 1 January 2021, the scope of the moratorium was further amended to reflect the new restructuring regime in Part 5.3B of the Corporations Act. The ipso facto moratorium (or stay) means that there will be a stay on the enforcement of certain ipso facto contractual rights against companies the subject of any of the following insolvency regimes:

- a creditors' scheme of arrangement (including certain steps leading up to the scheme)
- a voluntary administration;
- areceivershipbutonlywherethereceiverisappointedoverthewholeorsubstantiallythewholeofthepropertyofthecompany;or
- a restructuring.

Cut and pasted from <https://www.bakermckenzie.com/-/media/files/insight/publications/2021/03/ipso-facto-29-march-2021.pdf>

For instance, in a case where a creditors' voluntary liquidation immediately follows a prior voluntary administration or attempt to negotiate a creditors' scheme of arrangement, in which case the ipso facto moratorium introduced as part of recent amendments to the Corporations Act will be invoked. However, while there will be a moratorium in that scenario, the ipso facto clause itself will not be void, unlike during bankruptcy. There are no special rules for the treatment of essential contracts (such as those relating to the provision of water, electricity and communication services). Cut and pasted from the Guidance Text

1/4 marks

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

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

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

Australia's restructuring and insolvency regime is largely protecting the rights and interests of creditors over debtors. The protection is given to the creditors during the pre insolvency and also

during the insolvency period. Under the creditors friendly law, the managers/debtors generally lose the control of the company for an administrator who represent the creditors' interest. These can be seen from the protection given under the Act as discussed below.

1. Insolvent trading:

when the company entered into an insolvent position, the directors of the insolvent company should act for the interest of the creditors as opposed to the shareholders. Under the Australian legislation the directors can be personally liable for such unlawful transaction or the court can impose civil penalty/criminal penalty over the director. Section 588G of the Corporation Act 2001 states the directors have duty to prevent the company from trading when its insolvent. The duty applies not only when the company is insolvent or would become insolvent but also when there are reasonable grounds for suspecting it's insolvent or would become insolvent. Furthermore, the liability can be found if the director is shown to be aware of reasonable grounds for suspecting this or when a reasonable person in a similar position in a similar company would have been aware of these reasonable grounds. Company directors need to, before incurring new debts, always check whether there are reasonable grounds for believing the company is insolvent or will become insolvent as a result of the new debt being incurred.

2. Treatment of securities.

One of the main characteristic of creditors friendly law is the particular treatment granted to securities.

The rights of secured creditors particularly those creditors with security over the whole or substantially the whole of a debtor's properties are well protected in the regime of insolvency. This is reflected in the rights and priority generally afforded to secured creditors regarding the enforcement and distribution of assets. A creditor can take security over a company's assets through fixed charges. In this, the company is unable to sell these assets without the creditor's consent.

Secured creditors with security over "substantially the whole of a company's property" are not bound by formal insolvency processes. For instance, the secured creditors are not subject to the stays on enforcement contained in the voluntary administration (under corporate rescue) and liquidation regimes. A liquidator cannot deal with or otherwise dispose of an asset that is subject to a security interest without the secured creditor's consent as the secured creditors stay outside of the liquidation so their security. Under the business rescue process, the restructuring agreements implemented by a deed of company arrangement (which follows a voluntary administration) are not binding on secured creditors

As for non-major secured creditors, as well as owners and lessors with enforcement rights, they can continue with enforcement action which has been commenced prior to the appointment of a voluntary administrator or which relates to perishable property, or otherwise with the consent of the court.

Ordinary unsecured creditors also have an active role in formal restructuring and insolvency processes. These unsecured creditors are given rights to receive information and participate at meetings that can determine the future of the debtor. One of the rights given to these unsecured creditors is they can form and be the committee of creditors. The role of the committee of creditors is to monitor, assist and advise the liquidator as representatives of the

general body of creditors. The committee may direct the liquidator as to the conduct of the liquidation and approve certain actions of the liquidator in place of the general body of creditors.

3. Treatment of priorities

Secured creditors and employees enjoy statutory priority in a distribution of assets and in some circumstances unsecured creditors can also place themselves in a position of protection. Secured creditors always have priority over non-circulating assets. In certain circumstances, secured creditors do not have first priority over 'circulating assets' (sometimes known as floating charge assets), such as stock and inventory. Unlike secured creditors, unsecured creditors are given no legal rights to priority, yet due to a particular relationship that may exist with a debtor, they can exercise that power to obtain payment and ensure future payments as a practical necessity to maximise value and keep the debtor business running. **Unfair preference law exists specifically to stop this from happening – creditors will only be paid for future supply, not past debts.**

The main objective of debtors' friendly laws is to privilege debt renegotiation and companies' reorganisation. These laws often maintain managers/debtors in position and give the breathing space for the managers/debtors to initiate the reorganisation plan. The aim of debtors friendly laws, is to minimize the social consequences of the financial distress by preserving employment and avoiding systemic risks. Even though creditors friendly laws have the advantage of avoiding ineffective reorganisations, yet the risk of undue or premature liquidations is bigger.

The recent corporate voluntary administration regime and some recent reforms to the corporate insolvency process have moved the objective from creditors to debtor's rights. These are discussed below.

1. The primary objective of the voluntary administration is to maximize the chance of an insolvent company, or as much as possible of its business, continuing in existence under the terms of a DOCA. Even though, the objective is towards debtors interest, the whole administration is under the supervision of a voluntary administrator and secured creditors rights are protected through out the whole process.
2. A small shift in favour of the debtor have recently been made with the introduction of the 'safe harbour' regime and the prohibition on the exercise of 'ipso facto' rights which provide greater protection to a debtor and its directors in situations of financial distress. Recent amendments include the Insolvency Law Reform Act 2016 which was introduced in February 2016 and had the effect of harmonising the procedures for corporate insolvency and personal bankruptcy in Australia.

The Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017 introduced a 'safe harbour' regime which provides directors of financially distressed companies with greater protection from laws that impose personal liability on the director for the debts incurred by the company while insolvent. Before the introduction of the safe harbour in Section 588GA of the Corporation Act, directors of a company would typically appoint a voluntary administrator at the first sign of financial trouble in an attempt to avoid personal liability for insolvent trading (by invoking the defence to liability under section 588(H)6 of the Corporation Act). The new safe harbour law is intended to strike a better balance between the protection of creditors and encouraging honest, diligent and competent directors to innovate and take reasonable risks

and the safe harbour focuses on the behaviour of directors in trying to turn their company around rather than just the solvency of the company and the precise timing of debts being incurred as has previously been the case. This change was introduced to encourage those company directors to remain in control of a business in financial difficulty and take reasonable steps to restructure and/or trade out of its difficulties.

The safe harbour provision also protect a holding company from liability resulting from debts incurred by a subsidiary where the directors of the subsidiary have the benefit of safe harbour and where the holding company took reasonable steps to ensure the directors of the subsidiary had the benefit of safe harbour.

Under the new safe harbour provision, the court may consider the following in determining whether a course of action is reasonably taken which is better for the company than the immediate appointment of an administrator or liquidator "Better Outcome":

- properly informed themselves of the company's financial position;
- taken appropriate steps to prevent any misconduct by officers or employees;
- taken appropriate steps to ensure the company is keeping appropriate financial records;
- obtained advice from an appropriately qualified expert that a restructuring plan should be adopted and is likely to lead to a better outcome for the company; and
- proceeded to develop and implement the restructuring plan in consultation with the expert adviser.

Under the section 588GA of the Corporation Act, the safe harbour only applies if :

- the debt incurred towards the proposed action for "Better Outcome"
- subject to the company continues to pay all employees entitlements as and when they fall due
- complies to all tax obligation.

3. In insolvency, based on the rights given under an Ipso facto clause the party may terminate or modify the contract. Such as the appointment of a voluntary administrator would inevitably cause creditors to invoke their ipso facto contractual rights or rights to enforce their security. This type of termination occur regardless of the debtor's company continues performance under the contract. This eventually reduce the success of formal corporate or business rescue under DOCA and destroy the enterprise value of a business entering formal administration or prevent sale of going concern. The new ipso facto moratorium which provides stay of the enforcement rights is likely to enhance the prospect of a company being resuscitated, or atleast business being preserved by way of a going concern sale, insofar as it will preserve a company's enterprise value while a voluntary administrator investigates the company's affairs, including whether a DOCA is feasible, before reporting to creditors. This safe harbour is intended to promote informal rescue without the need to resort to the formal procedures.

Further a successful restructuring ultimately depends on a change in the underlying anti-collectivist creditors enforcement culture which exists in Australia. The process is expected to take quite some time.

13/15 marks – this is strong response. You summarise a number of aspects of Australia's system which favour the rights of creditors over debtors, and vice versa. Your response could have been strengthened by mentioning a further development which has shifted towards a more debtor-friendly system, being the small company restructuring regime which is essentially a debtor-in-possession scheme with the advice of an insolvency practitioner. Further, you did not conclude on

whether or not you agree with the statement that Australia has become a more debtor-friendly jurisdiction.

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 Lyonesian. 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 Lyonesian 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 Lyonesian 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 Lyonesian liquidation.

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

Based on the information provided it is noted that the liquidator of Lyonessee have applied to the federal court of Australia for recognition of the Lyonesian liquidation as foreign main proceeding and for the order entrusting Aussiebee's assets to the liquidator of Lyonessee.

Where it necessary to protect the assets of the debtor or the interest of the creditors, the court may grant the necessary reliefs sought by the Lyonesian liquidator once the liquidation of Lyonessee is recognised as foreign proceeding, whether main or non-main. The relief which can be granted upon recognition of the foreign proceeding are discussed under the Article 19 of the Model Law.

In this case, the liquidator of Lyonessee have asked order for the realised proceed from the sale of Aussiebee's shares in NewYums which are worth AUD 20 million to be distributed to her. At the same time it also noted Aussiebee owes AUD 12 million in taxes in Australia, payable to the Australian Taxation Office (ATO). By granting this order the ATO will not be able to recover his claim, as a debt payable to a foreign revenue creditor is not admissible to proof in Lyonesian. As such before granting the relief under Article 19 of the Model Law, the court must entrust that the interest of the creditors in Australia are adequately protected.

The ATO may apply to the court under the Article 22 of the UNCITRAL Model Law which allows the court to modify the effect of recognising the foreign winding up proceeding so as to ensure adequate protection of creditors' interests. ATO can file an application seeking modification of the recognition orders to issue statutory notices and take other recovery action, including action to obtain payment of the tax debt on a *pari passu* basis from the assets in Australia.

This was discussed further in *Ackers v Deputy Commissioner of Taxation*. **Correct.**

The following is cut and pasted from the learning guide: The decision of the Full Court of the Federal Court of Australia concerned the application of Article 22 of the Model Law whereby the court must be satisfied that the interests of the creditors are “adequately protected” when granting relief under Article 19. In this case, the Cayman Islands liquidation of a Cayman Islands registered company had been recognised as a foreign main proceeding in Australia. The foreign representatives wished to remit approximately AUD 7 million, being the proceeds of sale of the Australian assets of the company, from Australia to the Cayman Islands for distribution there as part of the Cayman Islands liquidation. The company owed over AUD 83 million in tax and penalties in Australia. A debt payable to a foreign revenue creditor is not admissible to proof in a Cayman Islands liquidation (nor is such a debt admissible to proof in an Australian liquidation).

On the application of the Deputy Commissioner of Taxation (DCT), the Federal Court modified the recognition orders, giving leave to the DCT to take steps to enforce its claim in Australia, expressly for the purpose of recovering an amount up to the *pari passu* amount the ATO would have received if they were entitled to prove for the tax debt as an unsecured creditor in the foreign main proceeding. On appeal, the Full Court upheld the decision, and the Full Federal court held that:

- there was nothing in the Model Law which imported foreign insolvency law into Australia so that domestic tax debts could not be recovered
- There was no legislative or common law basis which destroyed the rights of the DCT to seek leave to proceed against the company in liquidation or to employ his enforcement rights under tax legislation
- When granting or modifying relief under the Model Law, the Court must ensure that the interest of local creditors are protected, and
- The primary judge had not misapplied the exercise of discretion by making the modification orders because to have found otherwise would have meant that the DCT's rights as a local creditor would have been transformed into a foreign creditor and that as the primary judge permitted the DCT to recover only a *pari passu* entitlement, the principles of fairness between all creditors was upheld.

The Full Federal Court's decision and the subsequent dismissal of the special leave application provided a precedent that Australian Courts have the power to make orders under the Model Law to protect the Commissioner's ability to recover revenue liabilities from assets located in Australia in circumstances where the revenue liability would not be admitted in a foreign liquidation.

You did not pick up the other main issue arising on the facts. The ATO should intervene on the recognition application, arguing that the COMI of Aussiebee is Australia, not Lyonesse, and so the assets of Aussiebee should not be entrusted to the Lyonesse 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?

Based on the provided information it is noted that there are several issues surrounding the management of HA which the directors of HA should be aware. The issues are discussed below.

1. The monetary judgment obtained by the joint venture partner (BOR) for a sum of AUD4.6mil against HA. The proceeding was commenced on July 2020 and a judgement was obtained in October 2020. Despite the judgement granted against HA, HA have continued operation knowing that they will not be able to settle the judgement sum.
2. Unsecured Loan from HGL for AUD30mil which become becomes automatically due and payable in full if HA enters into any formal insolvency or restructuring process in Australia
3. 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.

By doing the above activities the directors could have allowed the company to incur liability whilst its insolvent. Section 588G of the Corporation Act discuss the Insolvent trading provision. There are various penalties and consequences for insolvent trading, including civil penalties, compensation proceedings and criminal charges. The directors will be liable for insolvent trading where:

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

The Corporations Act provides some statutory defences for directors. However, directors may find it difficult to rely on these if they have not taken steps to stay informed about the company's financial position. The defences are as follows: **None of these appear relevant on the facts**

- there are reasonable grounds to expect solvency;
- there is a reasonable expectation of solvency based on information provided by a competent and reliable person fulfilling a responsibility to provide that information;
- a director did not take part in the management of a company because of illness or some other good reason; or
- a director took all reasonable steps to prevent the company from incurring the relevant debt, including by appointing a voluntary administrator

The holding company, HGL, can also be liable for the insolvent trading.

Civil penalties

Contravening the insolvent trading provisions of the Corporations Act can result in civil penalties against directors, including pecuniary penalties of up to \$200,000.

The civil penalties are just a small add on. The real liability for insolvent trading is that the director/holding company is personally liable for all of the debts that the company incurred whilst insolvent.

Compensation proceedings

Compensation proceedings for amounts lost by creditors can be initiated by ASIC, a liquidator or a creditor against a director personally. A compensation order can be made in addition to civil penalties.

Compensation payments are potentially unlimited and could lead to the personal bankruptcy of directors. The personal bankruptcy of a director disqualifies that director from continuing as a director or managing a company.

Criminal charges

If dishonesty is found to be a factor in insolvent trading, a director may also be subject to criminal charges (which can lead to a fine of up to 2,000 penalty units or imprisonment for up to five years, or both). Being found guilty of the criminal offence of insolvent trading will also lead to a director's disqualification.

It also worth highlighting here the new provision introduced in September 2017 called "safe harbour". This safe harbour provision provides directors of financially distressed companies with greater protection from laws that impose personal liability on the director for the debts incurred by the company while insolvent. As long the directors are able to prove that the debt incurred was for better outcome as opposed placing the company in liquidation or under administration, the safe harbour provision will apply.

What is the option available for HA:

The facts gathered on HA are as follow:

- HA is insolvent
- No funding available for HA's operation
- Exercise to refinancing of HA's debts have failed
- The joint venture contract was terminated
- No future business contracts leading to no viable business plan
- Perth re-refining plant's profit is not sufficient to maintain the plant
- loan from the Commonwealth Bank of Australia (CBA) is secured by mortgages over the three trucks. The mortgages are not registered on the Personal Property Securities Register. (PPSR)

The directors shall not allow the company to incur further debt. Unless it is possible to restructure, refinance or obtain equity funding to recapitalise the company. Since the directors of HA have exhausted all possibilities for refinancing HA's debts, the option left for the director is to wind up the company and appoint a liquidator. **What about voluntary administration?**

The purpose of liquidation of an insolvent company is to have an independent registered liquidator take control of the company so its affairs can be wound up in an orderly and fair way to benefit its creditors.

As for the loan from CBA which is secured by mortgages over the 3 trucks are noted not registered under the PPSR. In Australia, securities interest should be registered either in the relevant state land registry (for mortgages) or on the national PPSR (for all other security interests). Such failure, will result in loss of the security in insolvency hence, CBA will not be able to enforce its rights and fall under unsecured creditors. Any proceeds from the liquidation will be distributed pari-passu to the unsecured creditors. **Good, well spotted.**

Voluntary administration, followed by a DOCA, would be a far better outcome than a liquidation.

3.5/6 marks

TOTAL MARKS: 36.5/50

*** End of Assessment ***