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. Correct answer

(b) deed of company arrangement.

(c) creditors' voluntary liquidation.

(d) voluntary administration. 0 marks

(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. 0 marks

(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.

8/10 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.

There are three types of Voidable Transactions Provisions in the Bankruptcy Act, which are:

- Undervalued Transactions
- Transfers to Defeat Creditors
- Preferential Payment to Creditors 1 mark

In order to reverse these transactions, they need to be within the 'relation-back period'. This dates back from the earliest date of bankruptcy within a 6 month period from the presentation of the petition, for an involuntary bankruptcy. For voluntary bankruptcy, it will be the date of the petition. If the transactions are not within these time periods, they will not be reversed.

Furthermore, if the transactions are in the ordinary course of business and in good faith (in addition to the absence of notice of the petition), then they may not be reversible. 1 mark

Finally, if the individual transferring the property has subsequently transferred the property to another third party. This assumes that the third party received the assets/transaction for market value and in good faith. In the scenario, it will also not be reversible. 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?

Under Article 20, the scope of a stay is the same as in the Bankruptcy Act of Chapter 5 of the Corporations Act. 1 mark

The Court will consider whether a case requires a more broad voluntary administration. This stay will affect the secured creditors, or for a liquidation only the unsecured creditors. This will not be based on discretion but the nature of the proceedings. 1 mark

If there is a foreign proceeding, then a rescue procedure and stay in a voluntary administration would be best. However, when the foreign proceeding is a liquidation, the second would be best. 0.5 marks – the determining factor is not necessarily whether the foreign proceeding is technically a rescue procedure or liquidation in the foreign jurisdiction's eyes, but whether it is analogous of those proceedings from the perspective of Australian courts.

Questions to be considered for a stay are:

- The actions do not detriment the creditors
- Not further co-operation forms have been considered
- Model Law will prevail over the Bankruptcy Act and Corporation Act
- No requirement for reciprocity under the Model Law

2.5/3 marks

Question 2.3 [maximum 4 marks]

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

An *ipso facto* clause is a contractual clause used prior to a restructuring plan. The clause cannot be used as enforcement action until the restructuring has finished. However, the rights under the contract (or other type of agreement or arrangement) made after a company is in a restructuring process will not be stayed.

The provisions of the clause usually state that the contract is termination as a result of insolvency, bankruptcy or liquidation. It does also allow for the contract to be modified on specific terms, as a result of an insolvency event. Yes.

Examples could be a landlord's lease terminating if the tenant experiences an insolvency process. Or the termination of a loan agreement if a borrower experiences an insolvency process of applies for a scheme of arrangement.

Under the Corporations Act, there is a stay on any *ipso fact* clauses being enforced when ~~a substantial~~ insolvency process is entered into. No, only for certain specific insolvency processes. This usually includes Receiverships, Voluntary Administrations and Schemes of Arrangement.

A Court can extend or limit the stay or has discretion regarding the enforcement.

The question was about *ipso facto* clauses *in liquidations.* Liquidations do not get benefit of ipso facto protection. However, ipso facto clauses that are triggered by a prior voluntary administration or attempt to negotiate a creditors' scheme of arrangement continue to be subject to the moratorium during a subsequent liquidation.

1/4 marks

PRELIMINARY TOTAL: #/20

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.

Historically, Australia has been viewed as a creditor friendly jurisdiction due to creditors right being a primary focus during insolvency proceedings.

The majority of procedures under the Bankruptcy Act and Corporations Act result in an external administrator being appointed. The alternative to this would be a debtor-in-possession.

However, debtors in possession are now available in Schemes of Arrangement and small business restructurings. These were brought in on 1 January 2021, and show a more debtor-friendly approach to options. However, this still requires a qualified insolvency practitioner to be appointed.

Secured creditors also have the ability to enforce during Bankruptcy and Liquidation procedures. This allows creditors to still implement their rights and remove the moratorium effect of insolvency proceedings.

Furthermore, a majority creditor with secured of the majority, or all, of a company's property will have the ability to enforce a Receiver. The Receiver would then take priority over a previously appointed Voluntary Administrator. This allows the secured creditor to over ride Administration proceedings and to take control of the process to prioritise their security.

In addition, Australia also appears to have broad legislation for causes of action. The Insolvent Trading Liability for Directors, alongside the Voidable Transactions, both state that a substantial sum can be challenged for the creditors in the estate, resulting in a far better outcome for them.

Under the Insolvent Trading Liability, an IP could also claim from the Directors personally or against their D&O insurance policy, if debts have been incurred when insolvent. Furthermore, for Voidable Transaction, the period for transactions goes back a substantial number of years and there is no requirement to prove the conduct was intended to defeat the creditors.

However, the recent Corporate Voluntary Regime recently reformed the processes in order make the jurisdiction more balanced and debtor-friendly.

The Voluntary Administration has the main goal of continuing trade under the DOCA. Secondary, it attempts to carry on as much of trade as possible for an insolvent company, even if the whole company cannot be rescued.

On 1 July 2018, creditors were also stopped from being able to enforce against *ipso facto* rights which are based on a company becoming insolvent.

Furthermore, the Bankruptcy process has taken an even stricter view from 1 July 2018, by stating that all *ipso facto* clauses will become void when an individual is made bankrupt, bring a far more debtor-friendly approach.

Finally, in September 2017, there was a reform to the Corporations Act which gave Directors a safe harbour from liability for insolvent trading. As a result, Director could incur further debts

when insolvent, on the basis that it was in the process of creating an informal restructuring plan with the supervision of an insolvency expert.

As a result of these recent changes, Australia appears to be attempting a more balanced approach to insolvency proceedings and giving more rights to debtors. However, overall my view is that the underlying creditor-friendly legislation still exceeds the debtor-friendly changes, meaning that on balance, Australia still remains a creditor-friendly jurisdiction.

13/15 marks – a very good response. You come to a conclusion which is supported by logic and evidence. You touched on a number of the aspects of the Australian system which favour the rights of creditors over debtors, and vice versa. You could have strengthened your response by indicating whether each aspect of Australia's system favoured creditors or debtors and explain how so.

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?

Based on the information available, ATO is a creditor of Aussiebee which is in Liquidation. The Liquidator will make attempts to realise the assets of NewYums, which will then be distributed to creditors.

On the assumption that the Liquidator is able to realise the shareholder in NewYums, ATO would receive an unsecured dividend distribution after the costs of the Liquidation, any secured creditors and any preferential creditors have been paid. This is likely to not be a full return on their debt.

However, there is also the issue that the ATO is currently not entitled to prove in a Lyonessian liquidation. Therefore, as the liquidation of Aussiebee is based in Lyonessian, the claim would

not be valid for dividend purposes and the Liquidator would reject the claim on adjudication. Therefore, it is key that the ATO seek recognition of their Australian claim in Lyonessian.

In order to seek recognition, the ATO will need to make an application to the Federal Court of Australia under Article 22 of the Model Law. The Court will be required to ensure that all creditors have their interests adequately protected under Article 19 of the Model Law.

The ATO should apply to the Court to seek for modified recognition orders. The modification should allow the ATO to enforce it's claim in Australia, to receive dividend distributions on a *pari passu* basis. This should also state that the amount that ATO are able to prove for is equal to the sum if the ATO had been an unsecured creditor in the foreign main proceedings. Good

The ATO should rely in the case law of *Ackers V Deputy Commission of Taxation*¸ which was successful in the first instance Court in Australia and also heard on appeal. The appeal held that the first instance court was correct to modify the recognition order to ensure that the DCT's interests as a creditor were protected. Correct.

The Australian Courts have not considered the discretion under Article 25 of the Model Law, therefore Article 21 of the Model Law appears to be the appropriate legislation to rely upon in these circumstances. Yes.

Furthermore, based on Aussiebee and NewYums sharing a board of Directors and offices, the jurisdiction of Australia appears to be appropriate in the circumstances. ATO could argue that the tax claim was due in Australia due to the COMI of the Aussiebee being in that jurisdiction. Well spotted.

The COMI will define where a business is located. This appears that NewYums and Aussiebee could reasonably be argued to have COMI in Australia based on the location of manufacturing, the location of offices, the same Board of Directors and where staff are located.

On the basis, the ATO could also seek to have the claim recognised in Australia in the circumstances. Almost right: if the ATO could establish that Aussiebee's COMI is in Australia, not Lyonesse, then the ATO would have a stronger argument that the shares in NewYums should not be remitted to the Lyonessian liquidator. If they succeeded in that argument, they could then apply to have Aussiebee wound up here and an Australian liquidator appointed who would recognise the ATO's claim and could sell the NewYums shares to provide a return to creditors in the Australian liquidation.

8/9 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 information available, HA is insolvent as it is unable to pay it's debts as and when they fall due. It would also appear that it's liabilities exceed it's assets, however the full figures are not available to confirm this.

Upon becoming aware that HA was insolvent, the Directors obligations changed from being to the Shareholders, to the Creditors of HA. It would have been in best interest to seek advise and potentially cease trading at that time.

As a result of continuing to trade, HA has incurred additional debts of $5m, with little profit. Therefore, the Directors may be personally liable yes or liable under their D&O insurance also yes for these sums. Under the Insolvent Trading Liability, an IP could also claim from the Directors personally or against their D&O insurance policy, if debts have been incurred when insolvent. Furthermore, for Voidable Transaction, the period for transactions goes back a substantial number of years and there is no requirement to prove the conduct was intended to defeat the creditors.Insolvent trading isn't a voidable transaction, so this last sentence is not right. The holding company HGL will also be liable for insolvent trading.

This was reduced on 1 January 2021, however HA had become insolvent before then, therefore the Directors will not be fully covered by the reforms to the legislation and may still be liable. Particularly, on the basis that the Directors openly admit they were insolvent since October 2020.

It would appear that the Trucks have little realisable value as a result of the secured loan. The secured creditor may enforce against these assets, or will be entitled to the realisations under their security. If there is a shortfall on the security, the CBA will have an unsecured claim

against HA for the balance. In voluntary administration or liquidation, the security is invalid because it was not registered.

The BOR will become and unsecured creditor in any insolvency proceedings commenced by HA, as there does not appear to be any evidence to suggest that their debt has any security. As there is a judgment, it will likely be accepted during any adjudication process.

Finally, for the second Oil Refinery, the loan given by HG is only unsecured. As a result, they will not have any priority when the assets of HA are realised. There does appear to be an *ipso facto* clause, however this will not be valid after proceedings have commenced given the proceedings are post 1 January 2021. Ipso facto clauses can still operate in liquidations, but not voluntary administrations.

Based on the information, HA could consider a Voluntary Administration as the second Oil Refinery may be profitable. This would allow them to sell that part of the business and create realisations for the creditors. This would allow any remaining assets to be sold separately to conclude the process, preserving the value of the assets and creating a better return for creditors. Good, this is the best solution.

Alternatively, if the second Oil Refinery is not profitable, then HA will need to consider Voluntary Liquidation proceedings to close the business. This will allow all the assets to be sold on a break up basis and sold in the order of priority. They can still use voluntary administration.

Based on the information, the Directors should take advice and proceed urgently, so not to exacerbate the losses incurred whilst insolvent any further.

What happens after the voluntary administration, though? It must then go into either liquidation or a DOCA. As you say, they should try to sell the business:

- 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 ***

TOTAL MARKS: 40.5/50