INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
IN INTERNATIONAL INSOLVENCY LAW

SUMMATIVE (FORMAL) ASSESSMENT: MODULE 8A

AUSTRALIA

This is the **summative (formal) assessment** for **Module 8A** of this course and must be submitted by all candidates who **selected this module as one of their elective modules**.

The mark awarded for this assessment will determine your final mark for Module 8A. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question (where this must be done is indicated under each question).

2. All assessments must be **submitted electronically in MS Word format**, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters – please do not change the document settings in any way. **DO NOT submit your assessment in PDF format** as it will be returned to you unmarked.

3. No limit has been set for the length of your answers to each question. More often than not, one fact / statement will earn one mark, but it is also possible that half marks are awarded (this should be clear from the context of the question, or in the context of the answer).

4. You must save this document using the following format: **[studentID.assessment8A]**. An example would be as follows 202122-336.assessment8A. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words "studentID" with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked**.

5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see paragraph 7 of the Course Handbook, specifically the information on pages 15 and 16, which deals with plagiarism and dishonesty in the submission of assessments. **Please note that plagiarism includes copying text from the guidance text and pasting it into your assessment as your answer**.

6. The final time and date for the submission of this assessment is **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. The assessment submission portal will close at 23:00 (11 pm) BST (GMT +1) on 31 July 2022. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.

7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

QUESTION 1 (multiple-choice questions) [10 marks in total]

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and mark your selection on the answer sheet by highlighting the relevant paragraph **in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

Select the correct answer:

If a creditor is dissatisfied with the bankruptcy trustee or liquidator's decision in respect of its proof of debt, the creditor may:

(a) apply to AFSA or ASIC for the decision to be reversed or varied.

(b) apply to the bankruptcy trustee or liquidator for the decision to be reversed or varied.

(c) bring court proceedings for a money judgment in respect of the debt.

(d) apply to the court for the decision to be reversed or varied. 1 mark

Question 1.2

Which of the following **is not** a collective insolvency process:

(a) Receivership. 1 mark

(b) Liquidation.

(c) Deed of company arrangement.

(d) Voluntary administration.

Question 1.3

Select the correct answer:

Which of the following insolvency procedures **requires** court involvement:

(a) creditors' scheme of arrangement. 1 mark

(b) deed of company arrangement.

(c) creditors' voluntary liquidation.

(d) voluntary administration.

(e) small company restructuring plan.

Question 1.4

Select the correct answer:

Newco Pty Ltd has three (3) employees and an annual turnover of AUD 950,000. It currently owes AUD 300,000 to its trade creditors and it has a AUD 800,000 secured loan from its bank. Which of these restructuring processes is Newco **ineligible** for?

(a) A voluntary administration followed by a deed of company arrangement.

(b) An informal restructuring with the agreement of creditors.

(c) A small business restructuring plan. 1 mark

(d) A deed of company arrangement.

Question 1.5

Select the correct answer:

Which of the following **is not** "divisible property" in a bankruptcy?

(a) Wages earned by the bankrupt.

(b) Fine art.

(c) Choses in action relating to the debtors' assets.

(d) The bankrupt's family home.

(e) Superannuation funds. 1 mark

Question 1.6

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

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

(b) The one-year period ending on the relation back day where the creditor had reasonable grounds for suspecting that the company was insolvent. 1 mark

(c) The four-year period ending on the relation back day where the creditor is a related entity of the company.

(d) The 10-year period ending on the relation back day where the transaction was entered into for a purpose that included defeating, delaying or interfering with the rights of creditors in the event of insolvency.

(e) After the relation back day but on or before the liquidator was appointed.

Question 1.7

Select the correct answer:

A company can only be placed into voluntary administration if:

(a) the directors declare that the company's liabilities exceed its assets.

(b) the creditors resolve that the company is unable to pay its debts as and when they fall due.

(c) a liquidator declares that the company is insolvent or likely to become insolvent.

(d) the directors resolve that the company is insolvent or likely to become insolvent. 1 mark

Question 1.8

Select the correct answer:

A receiver:

(a) is an agent of the secured creditor that appointed the receiver.

(b) owes a duty of care to unsecured creditors.

(c) is an agent of the company and not of the secured creditor that appointed the receiver. 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.

9/10 marks

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 3 marks]

Name the three types of voidable transactions that can be reversed by a bankruptcy trustee and describe the circumstances in which such a transaction will not be reversible.

Transactions entered into by a company may be voidable under Part 5.7B of the Act if they are:

1) unfair preferences;
2) uncommercial transactions;
3) unreasonable director-related transactions;
4) unfair loans; or
5) circulating security interests.

Undervalued transactions, transfers to defeat creditors, and preferential payments to creditors are the three types of voidable transactions that can be reversed by a bankruptcy trustee.

Of the above, transactions that occurred within the relation back period and were transacted in good faith, in the ordinary course of business, and in the absence of notice of a creditors' petition or debtor's petition will not be reversible.

0/4 marks – this question was about personal bankruptcy not company liquidation

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?

When an Australian court is determining the scope of the stay in relation to a corporate debtor under Australia's implementation of Article 20 of the Model Law, it needs to consider what "the case requires", i.e. whether the case requires the (broader) voluntary administration stay (which affects secured creditors) or the (standard) liquidation stay that only affects a company's unsecured creditors.

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?

As noted in a Baker McKenzie article[1], "an ipso fact clause is a contractual provision that allows one party to the contract to terminate or modify the operation of the contract upon the occurrence of a specified insolvency related event". An example could be a landlord being able to terminate a lease upon it's tenants insolvency.

Notwithstanding this, there is a stay on ipso facto clauses being enforced upon the commencement of formal insolvency procedures – namely, the relevance of such clause in liquidations is that the ipso facto stay does not apply by virtue of the counterparty becoming subject to a liquidation (at least where this doesn't happen immediately upon the finalisation of an administration, creditors' scheme, or restructuring). This stay was implemented with effect from 1 July 2018

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, https://www.bakermckenzie.com/en/insight/publications/2020/03/ipso-facto-prohibition-australia#:~:text=An%20ipso%20facto%20clause%20is,in%20respect%20of%20another%20party.

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.

In Australian insolvency scenarios, historically, the primary focus has been on the protection of creditors' rights (to the exclusion of management and shareholders), resulting in it being a creditor-friendly jurisdiction. Some examples of Australia being a creditor-friendly jurisdiction are set out below:

- Secured creditors are able to enforce their rights during bankruptcy and liquidation processes
- Creditors who hold security over all/the majority of a company's property have the ability to appoint a receiver over the top of a voluntary liquidator
- There is risk for a severe insolvent trading liability for directors
- Similarly, there's a voidable transaction regime which allow for significant sums to be recovered for the benefit of creditors
- Most of its insolvency processes involve the appointment of an external administrator, as opposed to being debtor-in-possession processes

Notwithstanding the above, recent reforms have made Australia more of a debtor-friendly jurisdiction.

For example, in September 2017, changes were made to the Corporations Act 2001 ("CA"), giving directors a "safe harbour" from liabilities associated with insolvent trading, so as to allow a company to continue trading whilst an informal restructuring was implemented which was reasonably likely to lead to a "better outcome" for the company. Section 588GA(7) of the CA states that a "better outcome" for the company means an outcome that is better for the company than the immediate appointment of an administrator or liquidator of the company. This commenced on 19 September 2017 and was also introduced by the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017. Great.

Another recent reform that has made Australia more of a debtor-friendly jurisdiction relates to the position as regards enforcement of ipso facto clauses. As noted in my response to question 2.3, there is a stay on ipso facto clauses being enforced upon the commandment of formal corporate insolvency procedures. This stay was implemented with effect from 1 July 2018. In terms of personal insolvency, Australia takes an even stricter approach, rending ipso facto clauses void upon a person becoming bankrupt. Good

The most recent reform that has made Australia more of a debtor-friendly jurisdiction was enacted on 1 January 2021. With effect from this date, small business restructurings can be undertaken and debtor-in-possession process are now available via Schemes of Arragement. Whilst a qualified IP still needs to be appointed, these recent reforms have made Australia more of a debtor-friendly jurisdiction.

On the whole, for the reasons set out above, I agree with the statement "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." Great

The statement is not saying that Australia has switched from being a creditor-friendly jurisdiction to a debtor-friendly one, rather, that it is still pro-creditor, albeit that recent reforms are making things more friendly for debtors.

14/15 marks – this is a great response. You have summarised the prominent developments to shift Australia towards a debtor-friendly jurisdiction. This essay could have been strengthened by reference to the increase in creditors' procedural rights in the insolvency process. For example, the creditors' right to require IPs to provide information and the right to vote out IPs more easily.

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?

As noted above, Aussiebee owes AUD 12 million in taxes to the ATO, meaning that it is a creditor, however, revenue creditors such as the ATO is not entitled to prove in the Lyonessian liquidation of Aussiebee.

As stated at 7.2.2.2 of the Guidance Text, in the matter of Ackers v Deputy Commissioner of Taxation, "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." As regards the matter of Ackers v Deputy Commissioner of Taxation, "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 taxes 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, finding that the modification of the recognition orders was an appropriate way to ensure that the interests of the DCT as a creditor were accurately protected"

I note that NewYums Pty Ltd (NewYums) is wholly-owned, Australian-incorporated subsidiary of Aussiebee, that NewYums remains solvent, and that Aussiebee's shares in NewYums are worth AUD 20 million. In light of the above, being the case of Ackers v DCT, ATO will need to make an application to the Federal Court of Australia for recognition, under Article 22 of the Model Law. Similarly, when making such an application, the ATO should request that the Federal Court give it leave 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.

In addition, there may be grounds for claiming that Aussiebee's Centre of Main Interest ("COMI") is Australia, given that Aussiebee's board of directors is made up of six Australians, it employs 20 staff in Sydney, it's CEO is an Australian, as is its CFO who is also an Australian resident. Should this be the case, ATO could argue that its claim is due in Australia, given that it is Aussiebee's COMI. First, it could argue that the shares should not be put into the hands of the Lyonessian liquidator. Then, it could have applied to wind up Aussiebee as a foreign company carrying on business in Australia, and as you say it could have proved in that 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?

Voidable transactions

Transactions entered into by a company may be voidable under Part 5.7B of the Act if they are:

1) unfair preferences;
2) uncommercial transactions;
3) unreasonable director-related transactions;

4) unfair loans; or
5) circulating security interests.

Undervalued transactions, transfers to defeat creditors, and preferential payments to creditors are the three types of voidable transactions that can be reversed by a bankruptcy trustee.

Of the above, transactions that occurred within the relation back period and were transacted in good faith, in the ordinary course of business, and in the absence of notice of a creditors' petition or debtor's petition will not be reversible.

Voidable transactions - HGL

We note that the Perth plant had been operational for a year, suggesting that the loan may have been advanced by HGL to HA in October 2020. The loan agreement provides that the loan is repayable to HGL by HA by way of monthly instalments over a term of 5 years with the first payment due at the end of 2021.

In their capacity as directors of HGL, should HGL find itself in an insolvency procedure as a result of the position outlined, HGL and its directors may be subject to voidable transactions 2 – 3 by virtue of the loan being granted to HA. The loan could be considered an uncommercial transaction (given the extent of the credit terms), an unreasonable director-related transaction (given HA's insolvency and HA's directors being the same as HGL's) and an unfair loan (given the monies were advanced without security being sought). Interesting points that most students did not make

Ipso facto clause

As noted in a Baker McKenzie article[1], "an ipso fact clause is a contractual provision that allows one party to the contract to terminate or modify the operation of the contract upon the occurrence of a specified insolvency related event".

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, i.e. it contains an ipso facto clause.

Notwithstanding this, there is a stay on ipso facto clauses being enforced upon the commencement of formal insolvency procedures – namely, the relevance of such clause in liquidations is that the ipso facto stay does not apply by virtue of the counterparty becoming subject to a liquidation (at least where this doesn't happen immediately upon the finalisation of an administration, creditors' scheme, or restructuring). This stay was implemented with effect from 1 July 2018.

This stay results in the requirement for the loan to become automatically due and payable in full to fall away. Not in a liquidation, but it would in a voluntary administration.

1, https://www.bakermckenzie.com/en/insight/publications/2020/03/ipso-facto-prohibition-australia#:~:text=An%20ipso%20facto%20clause%20is,in%20respect%20of%20another%20party.

Voidable transactions – HA

We need to establish the value of the trucks upon the CBA loan being advanced.

Whilst it is unlikely that CBA would have advanced a sum greater than the trucks' value in order to purchase the same, if it did HA and its directors may be subject to voidable transactions 5 by virtue of circulating security interests.

Trucks

Given the trucks are subject to mortgages (notwithstanding the face these are not registered on the Personal Property Securities Register), CBA is able to enforce upon the same in its capacity as secured creditor.

As a method of enforcement, CBA may appoint a Receiver under the terms of its security, who would seek to realise the trucks outside the scope of a separate insolvency procedure.

Should CBA suffer a shortfall upon realising the trucks, it will have an unsecured claim against HA in respect of the balance. The issue to pick up about the security is that it is voidable in a voluntary administration or a liquidation because it was not registered on the PPSR.

HA's financial position

On 1 October 2020, the Supreme Court ordered HA pay AUD 4.6 million to BOR. Given the requirements and processes as regards making a claim through the courts, we can determine that HA is insolvent on at least a cash flow basis, as it is unable to pay its debts as and when the fall due.

Whilst we do not have visibility as regards the value of HA's assets, given the extent of its liabilities, it could well be insolvent on a balance sheet basis, too.

Trading whilst insolvent

In September 2017, changes were made to the Corporations Act 2001 ("CA"), giving directors a "safe harbour" from liabilities associated with insolvent trading, so as to allow a company to continue trading whilst an informal restructuring was implemented which was reasonably likely to lead to a "better outcome" for the company. Section 588GA(7) of the CA states that a "better outcome" for the company means an outcome that is better for the company than the immediate appointment of an administrator or liquidator of the company. This commenced on 19 September 2017 and was also introduced by the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017.

During the meeting in October 2021, the board of directors confirm that HA has been insolvent since the Supreme Court's judgement a year earlier (in October 2020).

As a result of this continuation of trade, HA incurred debts to trade creditors and borrowed AUD 5 million from its parent company HGL.

Given that the question does not make reference to any informal restructuring being put in place following the Supreme Court's judgement, the directors will not have the benefit of the "safe harbour" referred to above and as detailed in section 588GA of the CA. Well analysed.

The holding company HGL will also have insolvent trading liability (section 588V of the CA).

So what should the Board do? The Board should resolve to place HA into voluntary administration, resolving that it is insolvent or likely to become insolvent. They need to be aware that:

- The *ipso facto* clause in the loan agreement will not be triggered by entry into VA (but it will trigger once the company then goes into liquidation or a DOCA after the VA period).

- Immediately before HA enters voluntary administration, the mortgages over the trucks will vest in the voluntary administrator because CBA failed to register its security interests on the PPSR. Unperfected (ie unregistered) interests vest in the voluntary administrator immediately before the commencement of a voluntary administration (*Personal Property Securities Act*, s 267). The voluntary administration can then sell the trucks to create a fund to provide a return to unsecured creditors.

- 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.

Liquidation would be risky, because:

- HGL is exposed to holding company insolvent trading liability

- As directors of HA, they are personally exposed to insolvent trading liability. Exposure is for all debts incurred whilst insolvent.

3/6 marks

*** End of Assessment ***

39/50 in total