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 202223-336.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 dealing 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 2023***. The assessment submission portal will close at 23:00 (11 pm) BST (GMT +1) on 31 July 2023. 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*** 9 pages**.**

ANSWER ALL THE QUESTIONS

Commented [BB1]: TOTAL = 34/50 (68%)

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

Commented [BB2]: Sub-total = 4 marks

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.

Question 1.2

Which of the following **is** a debtor-in-possession process?

(a) Small company restructuring.

(b) Bankruptcy.

(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.

(b) Deed of company arrangement.

(c) Creditors' voluntary liquidation.

(d) Voluntary administration.

(e) Small company restructuring.

Question 1.4

Commented [BB3]: The correct answer is (a)

Select the correct answer:

Newco Pty Ltd has three (3) employees and an annual turnover of AUD 950,000. It currently owes AUD 100,000 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 debt agreement under Part IX.

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

(c) A small company restructuring.

(d) A deed of company arrangement.

Question 1.5

Commented [BB4]: The correct answer is (e)

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.

Question 1.6

Commented [BB5]: The correct answer is (c)

Which of the following claims **are not provable** in a liquidation?

(a) Future debts

(b) Contingent claims

(c) Penalties or fines imposed by a court in respect of an offence against a law

(d) Claims for damages for personal injury

Question 1.7

Commented [BB6]: The correct answer is (d)

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.

Question 1.8

Commented [BB7]: The correct answer is (d)

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.

(e) is required to meet the priority claims of employees out of assets subject to a non-circulating security interest.

Question 1.9

Commented [BB8]: The correct answer is (e)

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.

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.

(c) Reducing the default bankruptcy period from three years to one year.

(d) A safe harbour from insolvent trading liability.

MULTIPLE CHOICE: 4/10

QUESTION 2 (direct questions) [10 marks]

Commented [BB9]: Sub-total = 5 marks

Question 2.1 [maximum 3 marks]

Name the five types of voidable transactions that can be reversed by a liquidator on application to the court, and explain whether it is a complete defence to each of these types of voidable transactions if the defendant proves that they were not aware that the company was insolvent at the time they entered into the transactions.

[Answer:

The five types of voidable transactions that can be reversed by a liquidator are:

1- **Unfair Preferential Payments:**

Definition: Payments made by the company to a creditor that result in that creditor receiving more than they would have received in the liquidation if the transaction had not occurred.

Complete Defence: A complete defence to an unfair preferential payment is the "Good Faith" defence. If the creditor can prove that they received the payment in good faith and had no reasonable grounds to suspect that the company was insolvent at the time of the payment, the transaction may not be voided.

2- **Uncommercial Transactions:**

Definition: Transactions entered into by the company with a party for little or no consideration, significantly less than the value of the consideration provided by the company.

Complete Defence: The "Good Faith" defence is also applicable to uncommercial transactions. If the recipient can demonstrate they acted in good faith and had no reasonable grounds to suspect the company's insolvency at the time of the transaction, it may not be voided.

3- Unfair Loans:

Definition: Transactions where the company incurred a debt to a creditor and, at the time of incurring the debt, there were reasonable grounds for suspecting that the company was insolvent or would become insolvent as a result.

Complete Defence: There is no specific complete defence available to unfair loans. The court will consider all relevant circumstances, including the creditor's knowledge of the company's financial position and whether they acted in good faith, in determining whether the loan should be voided.

4- Unfair Preferences to Related Entities:

Definition: Unfair preferences made to related entities of the company, which includes directors, shareholders, or other entities associated with the company.

Complete Defence: The "Good Faith" defence is applicable here as well. If the recipient can demonstrate they received the preference in good faith and had no reasonable grounds to suspect the company's insolvency at the time of the payment, the transaction may not be voided.

5- Transactions to Defeat Creditors:

Definition: Transactions entered into with the intention of preventing, hindering, or delaying the property from becoming available for the company's creditors.

Complete Defence: The "Good Faith" defence may apply to these transactions as well. If the recipient can prove that they acted in good faith and had no reasonable grounds to suspect the company's insolvency at the time of the transaction, it might not be voided.

In summary, the "Good Faith" defence can be a complete defence to several types of voidable transactions if the defendant can prove they were not aware or had no reasonable grounds to suspect that the company was insolvent at the time they entered into the transactions. However, the availability and applicability of this defence can depend on the specific circumstances of each case and how the court interprets the facts presented.]

QUESTION 2.1: 2/3

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?

[Answer:

Australia's implementation of Article 20 of the UNCITRAL Model Law on Cross-Border Insolvency deals with the "effects of a stay of proceedings against the debtor." The purpose of the stay is to provide protection to a corporate debtor involved in foreign insolvency proceedings, so that the assets and affairs of the debtor are not subject to multiple, potentially conflicting legal actions in different jurisdictions.

The scope of the stay in relation to a corporate debtor is determined by the court based on the specific circumstances of each case and the objectives of the Model Law.

Generally, the court will consider the following factors:

1- **Recognition of Foreign Insolvency Proceedings**: The court will determine whether the foreign insolvency proceedings are eligible for recognition under the Model Law. If the foreign proceedings are eligible, the court may grant the stay to give effect to the recognition and ensure a coordinated and orderly process.

2- **Duration of the Stay**: The court may specify the duration of the stay, which can vary depending on the stage of the foreign insolvency proceedings and the objectives to be achieved. The stay may be temporary or indefinite, depending on the circumstances.

3- **Extent of the Stay**: The court will determine the extent of the stay, which may include staying legal actions, enforcement proceedings, or the exercise of certain rights against the debtor or its assets.

4- **Exceptions and Limitations**: The court may consider exceptions or limitations to the stay, allowing certain legal actions to proceed if they are essential to protect the rights of a party or to prevent potential harm to the interests of the debtor, its creditors, or other stakeholders.

5- **Coordinating with the Foreign Court:** The court will take into account the principles of cooperation and comity between jurisdictions to coordinate the proceedings with the foreign court where the insolvency proceedings are taking place.

6- **Protection of Local Interests**: The court may consider the impact of the stay on local creditors and stakeholders and may take measures to ensure that local interests are adequately protected.

Overall, the court's determination of the scope of the stay is aimed at promoting efficient and effective cross-border insolvency cooperation while safeguarding the interests of all relevant parties involved in the insolvency proceedings. The court's decision will be based on the principles of fairness, reasonableness, and the overarching objectives of the Model Law.]

QUESTION 2.2: 1/3

Question 2.3 [maximum 4 marks]

What are the differences between liquidations and small company liquidations?

[Answer:

Liquidations and small company liquidations are both insolvency processes, but they have some key differences in terms of eligibility criteria, scope, and regulatory requirements.

Here are the main differences between the two:

1- <u>Eligibility Criteria:</u>

Liquidations: Liquidation, also known as "voluntary winding-up" or "creditors' voluntary liquidation," is a formal insolvency process available to all types of companies, regardless of their size. It can be initiated voluntarily by the company's shareholders or directors, or it can be forced upon the company by its creditors through a court process called "compulsory liquidation."

Small Company Liquidations: The term "small company liquidation" is not commonly used to describe a specific insolvency process. However, in Australia, there are specific restructuring and liquidation regimes designed for small companies with liabilities of AUD 1 million or less, known as "Small Business Restructuring" and "Simplified Liquidation," respectively. These processes are available only to eligible small companies that meet certain criteria related to size and eligibility for simplified insolvency procedures.

2- **Process Complexity and Cost:**

Liquidations: Traditional liquidations can be complex and involve extensive legal and administrative procedures, which can result in higher costs and longer timeframes for larger companies.

Small Company Liquidations: The small business restructuring and simplified liquidation regimes in Australia aim to streamline and reduce the regulatory burden for financially distressed small companies. The process is intended to be simpler and more cost-effective for small companies with fewer assets and creditors.

3- **Administrator's Role:**

Liquidations: In a traditional liquidation, an independent liquidator is appointed to take control of the company's affairs, realize its assets, and distribute the proceeds to creditors in a prescribed order of priority.

Small Company Liquidations: In the Small Business Restructuring process, a small company's directors remain in control of the company while developing a restructuring plan with the assistance of a restructuring practitioner. In the Simplified Liquidation process, a simplified liquidator is appointed to wind up the company's affairs with a reduced regulatory framework.

4- **Objectives:**

Liquidations: The primary objective of a traditional liquidation is to wind up the company's affairs, realize its assets, and distribute the proceeds among creditors according to the statutory order of priority. The company will cease to exist after the liquidation process is completed.

Small Company Liquidations: The Small Business Restructuring process aims to provide eligible small companies with an opportunity to restructure their affairs and debts with the aim of continuing the business and avoiding liquidation. Simplified Liquidation is designed to provide a quicker and less expensive winding-up process for small companies with minimal assets and creditors.]

QUESTION 2.3: 2/4

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

Commented [BB10]: Sub-total = 15 marks

"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.

[Answer:

Historically, Australia's insolvency and restructuring options have been perceived as creditor-friendly, prioritizing the protection of creditor rights and maximizing creditor recovery.

The key features that contributed to this creditor-friendly approach include:

1- **Liquidation as a Primary Option**: Liquidation, both voluntary and compulsory, has been the predominant option for financially distressed companies. The primary objective of liquidation is to wind up the company's affairs, realize its assets, and distribute the proceeds to creditors in a prescribed order of priority.

2- **Strict Enforcement of Insolvent Trading:** Directors faced personal liability for insolvent trading, incentivizing them to place the company into liquidation promptly upon financial distress. This deterrent effect aimed to prevent directors from incurring further debts when the company was unable to meet its obligations.

3- **Voidable Transaction Provisions:** Australia's insolvency laws allowed liquidators to avoid certain transactions made by the company leading up to insolvency. Voidable transactions, such as preferential payments, uncommercial transactions, and unfair loans, could be reversed to enhance creditor recovery.

4- **Creditor Control in Voluntary Administration:** During voluntary administration, creditors had significant control over the process. They could vote on the appointment of an administrator, approve a deed of company arrangement, or decide to place the company into liquidation.

5- **Emphasis on Creditor Interests in Schemes of Arrangement**: Schemes of arrangement required creditor approval and court sanction, emphasizing creditor interests in the process. Creditors had the right to vote on the proposed arrangement and its terms.

While this creditor-friendly approach aimed to protect creditor interests, it sometimes led to the premature liquidation of potentially viable businesses. The focus on liquidation often meant that companies with restructuring potential were not adequately encouraged or supported to explore alternatives.

Recent insolvency and restructuring reforms in Australia have indeed introduced debtor-friendly provisions, seeking to encourage business rehabilitation and provide more options for financially distressed companies to explore restructuring alternatives. These reforms have shifted the focus from immediate liquidation to promoting viable business rescue and debtor rehabilitation.

Some key factors contributing to Australia becoming more debtor-friendly include:

1- **Safe Harbour Provisions:** The introduction of safe harbour provisions in 2017 shields directors from personal liability for insolvent trading if they develop a restructuring plan that is reasonably likely to achieve a better outcome for the company and its creditors. This encourages directors to continue trading a financially distressed company and explore restructuring options without the fear of personal liability.

2- **Ipso Facto Reforms:** The ipso facto reforms, implemented in 2018, restrict the enforcement of certain contractual rights triggered by insolvency events. This prevents

counterparties from terminating contracts solely based on the company's financial distress, providing breathing space for the debtor to restructure its affairs and continue operating.

3- **Small Business Restructuring and Simplified Liquidation**: Australia introduced tailored processes for small businesses, namely the Small Business Restructuring and Simplified Liquidation, in 2021. These regimes streamline the insolvency procedures for small companies with reduced regulatory burdens, facilitating their recovery or winding-up in a cost-effective manner.

4- **Temporary Moratorium during Voluntary Administration and Schemes of Arrangement:** The implementation of a temporary moratorium on enforcing certain contractual rights during voluntary administration and schemes of arrangement protects debtors during the restructuring phase. This prevents creditors from terminating contracts solely based on the company's financial distress and allows for a more orderly restructuring process.

5- **Debtor-in-Possession Elements:** The recent reforms have incorporated debtor-in-possession elements into insolvency proceedings, allowing debtors to remain in control of their businesses during restructuring efforts. For instance, the Small Business Restructuring process allows eligible small companies' directors to retain control while developing a restructuring plan.

6- **Focus on Business Rehabilitation:** The shift towards debtor-friendly provisions reflects a recognition of the economic and social importance of preserving viable businesses and protecting jobs. The reforms aim to support debtor rehabilitation and potentially save businesses that have the potential to recover with appropriate restructuring measures.

While recent reforms have made Australia more debtor-friendly, it is essential to acknowledge that creditor protections have not been eliminated. Creditors still retain priority in the distribution of assets, and mechanisms to challenge voidable transactions remain in place. The reforms aim to strike a better balance between debtor protection and creditor rights, promoting a more efficient and equitable insolvency regime.

Recent reforms have sought to strike a better balance between creditor and debtor interests. The introduction of safe harbour provisions and ipso facto reforms provided directors with protection from insolvent trading liability and prevented the termination of contracts triggered by insolvency events. These reforms aimed to encourage directors to explore restructuring options rather than resorting to immediate liquidation.

Additionally, the Small Business Restructuring process and Simplified Liquidation introduced specific procedures for small companies with reduced regulatory burdens, providing more debtor-friendly options for financial distress. The introduction of a temporary moratorium on enforcing certain contractual rights during voluntary administration and schemes of arrangement further protected debtors during the restructuring phase.

In conclusion, the recent insolvency and restructuring reforms in Australia have introduced debtor-friendly provisions, encouraging business rehabilitation, and offering more options for financially distressed companies to explore restructuring alternatives. The shift from a creditor-centric approach to a more balanced approach recognizes the need to support viable businesses and preserve economic value while ensuring the protection of creditor interests.]

15/15 marks – this is a very strong essay. It identifies the main features of Australia's insolvency regime which make it creditor-friendly, and identifies the recent reforms and

processes which may be described as more debtor-friendly. The author addresses the procedural rights of creditors which give them significant control over the insolvency process (eg rights to vote for appointment and removal of IPs). The author analyses the effects of the new reforms (eg encouraging directors to try restructuring without the risk of insolvent trading liability hanging over their head).

QUESTION 4 (fact-based application-type question) [15 marks in total]

Commented [BB11]: Sub-total = 6 marks

Question 4.1 [maximum 8 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 in both Sydney and in Lyonesse. Its warehouses are only in Sydney. Aussiebee regularly sells its chocolates all over the world, with orders received in Lyonesse and shipped from the Sydney 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 under the *Cross-Border Insolvency Act 2008*, 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?

[Answer:

As the advisor to the ATO (Australian Taxation Office) in this cross-border insolvency scenario involving Aussiebee and NewYums, it's crucial to consider the appropriate steps to protect the ATO's position. Since the Lyonessian liquidator has been appointed and has sought recognition in Australia, the ATO should take the following actions:

1- **Engage Legal Counsel**: The ATO should engage legal counsel experienced in cross-border insolvency matters to represent its interests effectively. The counsel can provide advice on the applicable laws and regulations in both Lyonesse and Australia, ensuring that the ATO's rights are protected throughout the process.

2- **Assess Proof of Debt**: While revenue creditors such as the ATO are not entitled to prove in the Lyonessian liquidation, the ATO should assess its proof of debt claim in the Australian insolvency of Aussiebee. As Aussiebee owes AUD 12 million in taxes in Australia, the ATO can file a proof of debt claim in the Australian proceedings to assert its claim as a creditor. This may give the ATO a better chance of receiving payment from any Australian assets of Aussiebee.

3- **Monitor Realization of Assets**: As the liquidator seeks to realize assets, including Aussiebee's shares in NewYums worth AUD 20 million, the ATO should closely monitor the process to ensure that the liquidator takes appropriate steps to maximize the value of these assets for the benefit of creditors, including the ATO.

4- **Assert Priority Status**: Although revenue creditors may not be entitled to prove in the Lyonessian liquidation, the ATO should assert its priority status as a revenue creditor in the Australian insolvency. In Australia, certain tax debts are given priority in insolvency proceedings, and the ATO should ensure that its priority claim is recognized in the Australian proceedings.

5- **Seek to Participate in the Recognition Process**: The ATO should seek to participate in the recognition process before the Federal Court of Australia. While revenue creditors may not be entitled to prove in the Lyonessian liquidation, the recognition process can still impact the ATO's position in the Australian proceedings.

6- **Engage with the Lyonessian Liquidator:** The ATO should also engage with the Lyonessian liquidator to understand the scope of the assets and liabilities of Aussiebee in Lyonesse. This can help the ATO assess the potential dividend or recovery it may receive from the Lyonessian liquidation.

7- **Consider Cross-Border Cooperation:** The ATO should consider engaging with relevant authorities in Lyonesse to ensure effective cross-border cooperation. This may involve coordinating with the Lyonessian liquidator and authorities to share relevant information and coordinate actions.

8- **Explore Australian Insolvency Options:** If necessary, the ATO should explore insolvency options in Australia to pursue its claim for the unpaid taxes. This could involve commencing separate insolvency proceedings in Australia or filing a proof of debt in the Lyonessian liquidation to preserve its rights.

9- **Fulfill Reporting Obligations:** The ATO must ensure compliance with all reporting obligations, both to the taxpayers and the relevant regulatory authorities. Transparent communication about the status of the tax debt and the insolvency process is essential.

In summary, to protect or improve its position in the cross-border insolvency of Aussiebee, the ATO should assess its proof of debt claim, engage legal counsel, monitor the realization of assets, assert its priority status as a revenue creditor in the Australian insolvency, and actively participate in the recognition process. Effective communication and cooperation with relevant parties in both Lyonesse and Australia are critical to safeguard the ATO's interests throughout the insolvency proceedings.]

3/8 marks – this answer does not engage with the substantive law of the Module. It provides high-level strategic advice. The answer ought to have advised the ATO to challenge the recognition proceedings on the basis that AussieBee's COMI is actually Australia and not Lyonesse. There were significant facts in the question which would have supported this argument. Additionally, the answer ought to have advised the ATO to enforce its claim to receive a pari passu amount equivalent to that which AussieBee would have received if it was an unsecured creditor in the Lyonessian proceedings (*Ackers v Deputy Commissioner of Taxation*).

Question 4.2 [maximum 7 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.

A competitor has recently approached HA with an attractive offer to purchase the 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?

[Answer:

As the advisor to the Board of directors of HGL and HA, it is essential to address the financial predicament of HA and the potential implications for both companies. The main issues to consider are HA's insolvency, the unsecured loan from a major shareholder, the secured loan from CBA, the damages owed to BOR, and the offer to purchase the Perth re-refining plant. Here are the key steps and considerations for the Board:

1- **HA's Insolvency:** The Board needs to acknowledge and accept that HA has been insolvent since the judgment was handed down in October 2020. Continuing to trade while insolvent exposes the directors to potential personal liability for company debts

incurred during this period. Therefore, the Board should act responsibly to protect the interests of creditors and stakeholders.

2- **Unsecured Loan from Major Shareholder:** The major shareholder of HGL has provided an unsecured loan of AUD 30 million to fund the Perth re-refining plant. As per the loan agreement, the loan becomes automatically due and payable in full if HA enters into any formal insolvency or restructuring process. This puts HA in a vulnerable position, as any insolvency proceeding may trigger the repayment of the loan, potentially exacerbating HA's financial difficulties.

3- **Secured Loan from CBA:** HA obtained a AUD 3 million loan from CBA, which is secured by mortgages over the three trucks. The mortgages, however, are not registered on the Personal Property Securities Register. This omission may affect the priority of CBA's security interest in the event of insolvency. The Board should seek legal advice to understand the consequences of this oversight and the implications for CBA's rights in a potential insolvency scenario.

4- **Damages Owed to BOR:** HA has been ordered to pay AUD 4.6 million in damages to BOR following the failed joint venture. This debt adds to HA's financial burden and raises concerns about its ability to meet its obligations to BOR and other creditors.

5- **Attractive Offer to Purchase Perth Plant:** A competitor's offer to purchase the Perth re-refining plant provides an opportunity to generate funds and potentially alleviate HA's financial strain. The Board should carefully evaluate the offer and assess whether the sale would yield sufficient funds to meet its outstanding liabilities and provide any surplus funds for distribution to creditors.

Based on the information provided, it appears that HA's financial situation is unsustainable, and the Board has exhausted all possibilities for refinancing its debts. Therefore, my advice to the Board would be as follows:

1- **Voluntary Administration**: Given HA's insolvency and the inability to secure further funding or refinancing, the Board should consider placing HA into voluntary administration. This will provide HA with a moratorium on creditor actions, allowing time to assess its options and negotiate with creditors.

2- **Evaluate the Competitor's Offer:** The Board should thoroughly assess the competitor's offer to purchase the Perth re-refining plant. If the offer is financially viable and would generate sufficient funds to cover HA's outstanding liabilities, it may be a favorable option.

3- **Engage with Creditors:** The Board should engage in negotiations with creditors, including BOR, CBA, and the major shareholder providing the unsecured loan. Negotiating with creditors in good faith may lead to mutually agreeable solutions to address HA's financial obligations.

4- **Seek Legal and Financial Advice:** Given the complexities of HA's financial situation, the Board should seek legal and financial advice from professionals with expertise in insolvency and corporate restructuring. This will ensure that the Board makes well-informed decisions that protect the interests of all stakeholders involved.

5- **Consider Liquidation:** If voluntary administration is not a viable option or fails to yield positive outcomes, the Board may need to consider appointing a liquidator to wind up HA's affairs and distribute its assets to creditors in an orderly manner.

6- **Comply with Director's Duties:** The Board must be aware of and comply with their director's duties, including the duty to act in the best interests of the company and its creditors once insolvency is evident.

7- **Communicate with HGL:** The Board of HGL should be kept informed of the developments with HA and any potential implications for the broader group. Open communication and collaboration between the two companies are crucial during this challenging period.

In conclusion, the Board of HGL and HA faces significant challenges due to HA's insolvency and financial predicament. Engaging in voluntary administration, evaluating the offer to purchase the Perth plant, and engaging with creditors are essential steps to address the situation. Seeking professional advice and adhering to director's duties are paramount to protect the interests of all stakeholders and navigate through this difficult period effectively.]

QUESTION 4.2: 3/7

*** End of Assessment ***