

# LEGAL PROFESSION ADMISSION BOARD

MARCH 2009

INSOLVENCY

**TIME: Three Hours**

This paper consists of six questions.

Candidates are required to attempt any five questions.

No question is compulsory.

All questions are of equal value.

If a candidate answers more than the specified number of questions, only the first **5** questions attempted will be marked.

All questions may be answered in one examination booklet.

Each page of each answer must be numbered with the appropriate question number.

Candidates must indicate which questions they have answered on the front cover of the first examination booklet.

Candidates must write their answers clearly. Lack of legibility may lead to a delay in the candidate's results being given.

**Permitted Material:**

**This is an open book exam. Candidates may refer to any books and any printed or handwritten material they have brought with them.**

**As some instances of cheating and of bringing unauthorised material into the examination room have come to the attention of the Admission Board, candidates are warned that such conduct will result in instant expulsion from the examination and may result in exclusion from all further examinations.**

*This examination should not be relied on as a guide to the form or content of future examinations in this subject.*

### **Question 1**

On 1 January 2007 Nolira transferred his interest in his family home and a parcel of shares in BHP worth \$200,000 to his wife Veronica. Nolira then went into business as a superannuation consultant.

On 1 January 2008 Nolira absconded to Bolivia with trust funds of his clients and is wanted by the Federal Police. On the day of his departure he gave Veronica a satchel of diamonds worth \$250,000 for their wedding anniversary. Veronica then sold the family home for \$500,000 and used the proceeds to buy another parcel of shares in BHP taking her share holding to \$1 million.

On 1 July 2008 a creditor's petition was presented against Nolira and a sequestration order was subsequently made against his estate appointing a trustee in bankruptcy.

**Discuss whether the Trustee in Bankruptcy can claim any of the assets held by Veronica.**

**(20 marks)**

### **Question 2**

Francless operated a café bar in downtown Sydney that he leased from Cubbyhole Ltd. for \$2,000 per month. As at 1 January 2008 Francless was insolvent and was indebted to the Humane Bank Ltd. for \$20,000 under his overdraft. The Bank was threatening to dishonour cheques drawn by Francless under the overdraft.

On 2 January 2008 Francless entered into an arrangement with Humane Bank Ltd. whereby his overdraft limit would be increased to \$30,000 to meet cheques drawn by Francless in payment of rent to Cubbyhole Ltd. All other cheques would be dishonoured. Francless was required to bank all the takings of his business in permanent reduction of the overdraft with the Humane Bank Ltd.

On 1 February 2008 Francless purchased coffee beans for \$5,000 from Plantation Ltd. paying by cheque. His terms of trading with Plantation Ltd. provided that title to all coffee beans supplied would revert in Plantations Ltd. if the customer's cheque for payment was dishonoured. Francless then paid \$4,000 to Cubbyhole Ltd. by cheque to cover the rent until 1 April 2008. The cheque was honoured by Humane Bank Ltd.

On 1 March 2008 Francless went to Brazil to locate coffee bean exporters with favourable credit terms. Prior to his departure Francless deposited \$5,000 of the takings of the café bar with Humane Bank Ltd. While he was away the Humane Bank Ltd. dishonoured the cheque to Plantations Ltd. who then seized the coffee beans sold to Francless.

**(Question 2 continues)**

**(Question 2 continued)**

After hearing that his cheque was dishonoured Francless remained in Brazil and has not returned. The Humane Bank Ltd. is owed \$25,000 under its overdraft. Cubbyhole Ltd. obtained default judgment of \$2,000 in unpaid rent for April 2008 and has rescinded its lease with Francless.

- (a) Can Francless be made bankrupt on a creditor's petition presented on 1 July 2008?**
- (b) If so, when will the bankruptcy of Francless commence and what transactions, if any, will be void against his trustee in bankruptcy?**

**(20 marks)**

**Question 3**

Opportunities Pty. Ltd. was a corporate trustee with nominal assets and \$1 million in assets that were held on trust for the husbands of its directors Foxy and Jezebel. Foxy and Jezebel were the sole shareholders of Opportunities Pty. Ltd.

On 1 January 2007 Opportunities Pty. Ltd. purchased an asset called the Middle East Information Service from Foxy and Jezebel for \$850,000. Jezebel held a licence from the Beirut Tablet Ltd. a Lebanese newspaper, to receive its newswire on payment of \$100,000 per month. The licence was terminable on one month's notice. The acquisition of the Middle East Information Service by Opportunities Pty. Ltd. was achieved by Jezebel assigning her interest in the licence to Opportunities Pty. Ltd. who then indemnified Jezebel for her liability to pay licence fees to the Beirut Tablet Ltd. in a separate document.

Opportunities Pty. Ltd. sold units in the trust that valued the Middle East Information Service at \$1 million and did not disclose the termination clause in the licence or its indemnity of Jezebel. Capital Printers were owed \$50,000 by Opportunities Pty. Ltd. for printing the prospectuses for distribution to the public. Only \$100,000 was received from investors who took up units in the trust.

On 1 January 2008 Opportunities Pty. Ltd. paid \$100,000 to Commercial Leases Pty. Ltd. in annual rent and became insolvent. It could no longer indemnify Jezebel for the licence payments to Beirut Tablet Ltd. who gave notice of termination of the licence to Jezebel. Jezebel paid \$500,000 into a separate account in the name of her husband. Foxy resigned as a director and received a \$500,000 severance payment. She used the money to take over the licence from Beirut Tablet Ltd.

**(Question 3 continues)**

**(Question 3 continued)**

On 1 March 2008 Capital Printers Ltd. made an application to wind up Opportunities Pty. Ltd. A provisional liquidator was appointed who spent \$50,000 obtaining an injunction freezing \$500,000 in the account of Jezebel's husband. The unit holders are demanding return of their money on the basis that the prospectus did not disclose the licence fees on the Middle East Information Service.

**On 1 June 2008 a liquidator was appointed over Opportunities Ltd. Advise the liquidator on the winding up of Opportunities Pty. Ltd.**

**(20 marks)**

**Question 4**

Incarcerations Ltd. was a company whose directors Strict and Stern obtained a contract for Incarcerations Ltd. with the government to run a prison for convicted criminals. Incarcerations Ltd. obtained finance by issuing zero coupon bonds for \$1 million with no interest and maturing over three years with \$3 million repayable on the maturity date. The bonds were secured over the proceeds of sale of walking sticks made in the prison workshop.

Incarcerations Ltd. entered into a third party insurance policy for personal injury and property damage paying premiums of \$10,000 per month to Risk Insurance Ltd. It funded the policy by selling license plates manufactured by prisoners in the prison factory to Edson Automobiles Ltd. Prisoners wore clothing manufactured by Industrial Clothing Ltd. who were owed \$20,000 for uniforms supplied.

Strict developed a gambling problem and fell into debt. He began accepting bribes from relatives of inmates for the granting of special privileges. Incarceration Ltd. also failed to pay its insurance premiums to Risk Ltd. because Strict had used the money to fund his gambling debts. Prisoners working in the factory were forced to work excessive hours to increase the profits of Incarcerated Ltd. enabling Strict to fund his gambling addiction.

On 1 January 2008 inmates rioted and lit fires that spread to adjacent properties. Many inmates suffered personal injuries when the riot was forcibly suppressed by Stern. As a result of the uninsured liabilities incurred to the owners of the adjacent properties and the prisoners for personal injuries Incarceration Ltd. was insolvent.

**(Question 4 continues)**

**(Question 4 continued)**

On 10 January 2008 Stern directed Edson Automobiles Ltd. to pay \$ 20,000 that it owed to Incarcerated Ltd. directly to Industrial Clothing Ltd. Stern appropriated the walking sticks manufactured in the prison workshop to sell on the open market. Incarcerated Pty. Ltd. failed to pay \$ 50,000 to its accountants A.C.E for keeping its books and prison staff went on strike when their wages were not paid.

On 1 March 2008 an application was made to wind up Incarceration Ltd. in insolvency. This put Incarcerated Pty. Ltd. into default under its bond issue and \$3 million became automatically payable to the bond holders. The government terminated its contract with Incarcerated Pty. Ltd. and moved all the prisoners to a different prison.

**On 1 June 2008 a liquidator was appointed over Incarcerated Pty. Ltd. Advise the liquidator on what actions may be taken to benefit the creditors in the winding up of Incarcerated Pty. Ltd.**

**(20 marks)**

**Question 5**

“The onus of proving sufficiency of assets lies on the respondent. It is not sufficient for the respondent simply to establish that he has assets which exceed his liabilities in value. It must also be established that the assets are available to be realised and that they are capable of ready realization. If a debtor is able to pay his or her debts, but is recalcitrant, the creditors may resort to other remedies, such as execution against property and garnishee proceedings, but not to sequestration. Bankruptcy is not a proceeding designed for the recovery of debts” (Hely J in *Australia & New Zealand Banking Group Pty. Ltd. v Foyster* [2000] FCA 400 at para.17).

**Discuss with reference to section 52 of the Bankruptcy Act.**

**(20 marks)**

**Question 6**

By section 459 C (2) (a) of the Corporations Act a company is presumed to be insolvent if it fails to comply with a statutory demand as defined by section 459 F of the Corporations Act.

**Explain the policies and procedures that provide the context for the operation of the statutory presumption including its utility in the making of winding up orders for insolvent companies.**

**(20 marks)**

**END OF PAPER**