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THE UNIVERSITY OF SYDNEY

FACULTY OF LAW

**EXAMINATION FOR THE GRADUATE DIPLOMA OF
CORPORATE SECURITIES AND FINANCE LAW; GRADUATE DIPLOMA IN
COMMERCIAL LAW; DOCTOR OF JURIDICAL STUDIES AND
MASTER OF LAWS**

DEBT FINANCING

JUNE 2005

TIME ALLOWED: 2 HOURS

Plus

READING TIME: 15 MINUTES

- **CANDIDATES ARE REQUIRED TO ANSWER ANY THREE (3) QUESTIONS.**
- **ALL QUESTIONS ARE OF EQUAL VALUE.**
- **THIS IS AN 'OPEN BOOK' EXAMINATION.**
- **ANSWER EACH QUESTION IN A SEPARATE BOOK.**
 - **YOU MUST WRITE THE QUESTION NUMBER ON THE FRONT OF EACH BOOK.**
 - **THIS EXAMINATION BOOKLET MUST NOT LEAVE THE EXAM ROOM.**

Question 1:

On 3 May 2004 Computus Pty Limited (C) placed an order with Blame Us Pty Limited (B) for \$1m of spare parts. Those parts were delivered on 10 August 2004 and payment was due on 15 September 2004. Payment was made when due.

On 30 July 2004, a second order was placed by C with B for \$2m of spare parts. Those parts were delivered on 25 October 2004 and payment was due on 30 November 2004.

On 10 November 2004, B discovered a manufacturing defect in most of the spare parts included in the first shipment and immediately tells C. After some investigation, the managing director of C sees you on 25 November 2005 and tells you that the consequence of the defect is that all of the spare parts included in the first shipment need to be recalled and destroyed.

There is no doubt that the second shipment is free from defect.

C wants to recover the following losses:

- The \$1.0m paid for the first shipment.
- Consequential losses including the cost of advertising and managing a recall of spare parts and damage to its business reputation and goodwill. C claims that these losses are \$3m (assume that this can be proved).

Consider:

1. Can C set off its claims against its obligation to pay for the second shipment?
2. Would it make any difference if:
 - a) A voluntary administrator was appointed to B on the day before you are consulted?
 - b) B is wound up in insolvency on the day before you are consulted?
 - c) The proposed Civil Procedure Bill was in force?

[Examination continues next page]

Question 2:

Member Pty Limited ("**Member**") buys and sells goods for Trader Pty Limited ("**Trader**") in accordance with a formal trading agreement. By a further agreement, Trader agrees to leave on deposit with Member gains made by Member on Trader's behalf, on the basis that Member pays interest. As the market starts to fall, Member requires some security as a condition of further dealing.

Meanwhile Trader gives its Bank a floating charge over all its assets (mostly real estate and chattels).

The next day Trader executes in favour of Member, in place of the deposit agreement, a fixed charge over the deposit, to secure all moneys owing by Trader to Member from time to time under the trading agreement. Member is not aware that Trader has given the floating charge to the Bank.

Notice of the floating charge is then lodged by the Bank for registration under the Corporations Act (within 45 days after the charge was created). The notice includes notice of a clause prohibiting the creation of other securities.

Three days after this, Member lodges the fixed charge for registration, but the notice under section 263(1) of the Corporations Act fails to indicate any prospective liability (for the purposes of this question, assume the deposit is a book debt).

Having become entitled to do so under its floating charge, the Bank appoints a receiver of Trader and at that time no money is payable by Trader to Member.

The following day, moneys become payable to Member as a result of trading by Trader in accordance with the original trading agreement.

1. As between Member's claim under the fixed charge and the Bank's claim under the floating charge, who has the prior claim to the deposit? (Consider briefly alternative views which may occur to you and set out briefly the steps in your analysis.) (80% of total marks)
2. Now assume that the fixed charge is never given to Member, ie Member relies only on the deposit agreement. Who has the prior claim to the deposit, Member or the Bank? (Consider briefly alternative views which may occur to you and set out briefly the steps in your analysis.) (20% of total marks)

Question 3:

Bankers Delight Limited (BDL) is persuaded by its investment bankers that its cost of capital would be reduced if it bought back some of its shares using the proceeds of a hybrid offer. After consulting with its tax and accounting advisors, BDL decides that the hybrid securities will be structured as debt for accounting and tax purposes. It is an open question whether these securities take the form of redeemable preference shares or debentures, both of which would be characterised as debt.

BDL approaches Flavour of the Month Lawyers (FML) which between 1998 and 2000 were experts in advising technology companies on their IPOs and have recently established a niche practice in hybrid securities. FML are presented with the following facts:

- BDL's constitution provides for preference shares to be issued, but gives directors discretion to determine key terms of issue. Notably, the constitution states that the preference shares have a right to receive a dividend at a rate and on a basis decided by directors. Further, directors have the ability to determine whether or not dividends will be cumulative;
- BDL, which has been listed continuously for more than 12 months, wishes to do a short form disclosure document in order to save costs and expedite the preparation and issue of the disclosure document;
- If the hybrid securities take the form of debentures as defined in section 9 of the Corporations Act, BDL would insist that they be termed debentures in any disclosure document. FML are told that, if debentures are issued, they will be unsecured;
- BDL is not keen on the idea of using a third party to act as trustee for debenture holders under section 283AA of the Corporations Act. If a trustee is required, FML are told, BDL would prefer to use one of its subsidiaries to fill that role.

Based on the facts outlined above, in your opinion, are preference shares or debentures more suitable for BDL? (70% of total marks)

Describe briefly some of the key features of the disclosure document which would need to be prepared in relation to the securities you have identified as being appropriate for BDL's purposes. (20% of total marks)

Assuming that investors have the right to require the conversion of the hybrid securities into shares in BDL (as an alternative to receiving cash on redemption) advise whether any approvals would be required by BDL before proceeding with the hybrid offer under the ASX Listing Rules given that BDL has in the last 11 months already placed close to 15% of the number of ordinary shares to raise further capital. (10% of total marks)

[Examination continues next page]

Question 4:

ABC Limited ("**ABC**") is the holding company in a group of companies. There are seven subsidiary companies, all wholly owned by ABC.

ABC has borrowed \$150,000,000 from X Bank.

ABC has also borrowed \$100,000,000 through an issue of debt notes to various US institutions under a Noteholder Agreement.

ABC has lent \$50,000,000 to one of its subsidiaries, Junior Pty Limited.

Another subsidiary of ABC, Baby Pty Limited ("**Baby**") has lent \$20,000,000 to ABC by way of a 5 year interest only term loan.

All loans and debts mentioned above are unsecured.

X Bank has a guarantee from Baby for the debts of ABC. The terms of the guarantee state that Baby is prevented from proving in the winding up and liquidation of ABC or any other company in the group in respect of debts or other money payable to Baby unless:

- (a) All money actually or contingently owed by ABC to X Bank at the relevant time has been fully repaid; or
- (b) X Bank requests Baby to prove for the debt or money payable, in which case Baby must do so and will hold all amounts received in respect of that proof on trust for X Bank.

Baby has also given a guarantee to the US Noteholders in respect of the money owed to them by ABC under the debt notes. The guarantee does not however have a provision in it similar to the one mentioned above.

A liquidator is appointed to ABC and all 7 subsidiaries, including Baby. X Bank requests that Baby prove in the liquidation of ABC in respect of the \$20,000,000 debt owed to it by ABC.

You are retained by the liquidator of ABC and the other group companies. Please advise him/her of how the proof of debt lodged by Baby at the request of X Bank should be treated and how any proceeds payable in respect of that proof of debt should be dispersed or treated.

You should assume that Australian law governs all issues and that the liquidation occurs in Australia under Australian law.

Question 5:

Please note: Students attempting this question must answer (a) to (d) inclusive. Each part of the question is worth 25% of the total mark.

- a. Briefly compare and contrast the main features of the voluntary administration regime under Part 5.3A of the Corporations Act with Chapter 11 under the US Bankruptcy Code.
- b. Discuss any 3 recommendations for reform to Part 5.3A of the Corporations Act which have been made by the Corporations and Markets Advisory Committee in its recent report on rehabilitating large and complex enterprises in financial difficulties.
- c. Mr Winter was appointed voluntary administrator of Refrigeration Systems Pty Ltd (**RSPL**) on 1 October 2004 by resolution of its board. Due to an error by one of Mr Winter's staff, the second meeting of creditors is convened on 22 October 2004 to be held on 27 October 2004. Advise Mr Winter.
- d. One of RSPL's major creditors is XYZ Pty Ltd (**XYZ**) which is a supplier of motors to RSPL. Those motors are supplied on credit terms which include a retention of title clause that specifies that XYZ retains title in the motors until it receives payment of all monies owed to it. Mr Winter receives a demand from XYZ's lawyers for delivery up of the motors on the basis that they remain the property of XYZ. Advise Mr Winter.

[End of Examination]