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**SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3B**

**THE INSOLVENCY SYSTEM OF THE UNITED KINGDOM**

**(ENGLAND AND WALES)**

This is the **summative (formal) assessment** for **Module 3B** of this course and is compulsory for all candidates who **selected this module as one of their compulsory modules from Module 3**. Please read instruction 6.1 on the next page very carefully.

If you selected this module as **one of your elective modules**, please read instruction 6.2 on the next page very carefully.

**The mark awarded for this assessment will determine your final mark for Module 3B**. 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.

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 the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).

4. You must save this document using the following format: **[studentID.assessment3B]**. An example would be something along the following lines: 20222-514.assessment3B. **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 the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words**.

6.1If you selected Module 3B as one of your **compulsory modules** (see the e-mail that was sent to you when your place on the course was confirmed), the final time and date for the submission of this assessment is **23:00 (11 pm) GMT on 1 March 2022**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2022. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.

6.2 If you selected Module 3B as one of your **elective modules** (see the e-mail that was sent to you when your place on the course was confirmed), you have a **choice** as to when you may submit this assessment. You may either submit the assessment by **23:00 (11 pm) GMT on 1 March 2022** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. If you elect to submit by 1 March 2022, you **may not** submit the assessment again by 31 July 2022 (for example, in order to achieve a higher mark).

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

Please select the **most correct ending** to the following statement:

The Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021 restrict pre-pack sales which constitute a substantial disposal of the company’s property to connected parties where the disposal occurs:

1. within 10 weeks of the commencement of the administration.
2. within 8 weeks of the commencement of the administration.
3. within 4 weeks of the commencement of the administration.
4. on the day the company enters administration.

**Question 1.2**

What is the **maximum length** of a Moratorium under Part 1A of the Insolvency Act 1986 to which creditors can consent without any application to the court?

1. 40 business days.
2. One year and 20 business days.
3. One year and 40 business days.
4. One year.

**Question 1.3**

Which of the following **is not** a requirement for a company that wishes to enter into a Restructuring Plan under Part 26A of the Companies Act 2006?

1. The company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern.
2. A compromise or arrangement is proposed between the company and its creditors, or any class of them, or its members, or any class of them.
3. The purpose of the compromise or arrangement is to eliminate, reduce or prevent, or mitigate the effect of, any of the said financial difficulties.
4. The company is, or is likely to become, unable to pay their debts, as defined under section 123 of the Insolvency Act 1986.

**Question 1.4**

In cases where the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 apply and an independent report from an Evaluator is obtained, the independent report must be obtained by whom?

1. The administrator.
2. Any secured creditor with the benefit of a qualifying floating charge.
3. The purchaser.
4. The company’s auditor.

**Question 1.5**

Which one of the following **is not** a debtor-in-possession procedure?

1. Administration.
2. Restructuring Plan.
3. Scheme of Arrangement.
4. Company Voluntary Arrangement.

**Question 1.6**

A liquidator may pay dividends to small value creditors based upon the information contained within the company’s statement of affairs or accounting records. In such circumstances, a creditor is deemed to have proved for the purposes of determination and payment of a dividend where the debt is **no greater than how much**?

1. £500
2. £750
3. £1,000
4. £2,000

**Question 1.7**

Which one of the following **is not**, in itself, a separate ground for disqualification of a director under the Company Directors Disqualification Act 1986?

1. Wrongful trading.
2. Breach of fiduciary duty.
3. Being found guilty of an indictable offence in Great Britain.
4. Being found guilty of an indictable offence overseas.

**Question 1.8**

The administrator is under a general duty to provide a statement for creditors’ consideration setting out proposals for achieving the purpose of administration. He or she must obtain a creditors’ decision on whether or not to approve the proposals **within how many weeks** of the date the company entered administration?

1. 6
2. 8
3. 10
4. 12

**Question 1.9**

Which of the following statements is **incorrect**?

1. An insolvency officeholder from an EU Member State will be automatically recognised by the courts in the UK whether the officeholder was appointed before or after Brexit.
2. An insolvency officeholder from an EU Member State is automatically recognised by the courts in the UK if appointed before Brexit.
3. An insolvency officeholder from an EU Member State appointed after Brexit may apply to a UK court for recognition under the Cross Border Insolvency Regulations.
4. An insolvency officeholder from an EU Member State cannot apply to a UK court for recognition under section 426 of the Insolvency Act 1986.

**Question 1.10**

Under section 216 of the Insolvency Act 1986, a director of a company which has been wound up insolvent may not, unless an exception applies, be a director of a company that is known by a prohibited name **for what period of time**?

1. 6 months.
2. 12 months.
3. 2 years.
4. 5 years.

**QUESTION 2 (direct questions) [10 marks]**

**Question 2.1 [maximum 5 marks]**

Who may bring an action under: (i) section 423 of the Insolvency Act 1986; (ii) section 6 of the Company Directors Disqualification Act 1986; and (iii) section 246ZB of the Insolvency Act 1986?

*Standing under section 423 of the Insolvency Act*

Under section 423 of the Insolvency Act 1986, any of the following persons may bring an action for attack transactions which are designed to defraud creditors:

1. Where the company is being wound up or in administration then the action can be brought by the official receiver, the liquidator or the administrator. Additionally, the victim of the transaction (such as a creditor) may obtain leave of the court to bring an action;
2. Where a victim is bound by a company voluntary agreement, then the supervisor of the SVA or any victim of the transaction may bring the action; or
3. In any other case, the victim of the transaction may bring the action.

St*anding under Section 6 of the Company Directors Disqualification Act 1986*

Where he/she considers or has received a report from a liquidator or administrator that a director of an insolvent company was and/or is unfit, then The Secretary of State may bring an action.

*Standing under section 246ZB of the Insolvency Act 1986*

A liquidator has standing to bring a claim against a director of the company for wrongful trading. He/she may

**Question 2.2 [maximum 5 marks]**

List the **five (5)** qualifying decision procedures by which creditors may make decisions in the context of an insolvent company.

Where the deemed consent procedure cannot be used, creditors may make a decision in the context of an insolvent company through any one of the five qualifying decision procedures outlined in Insolvency Rules 2016, r 15.3. These procedures are:

1. Correspondence;
2. Electronic Voting;
3. Virtual Meeting;
4. Physical Meeting; or
5. Any other decision making procedure which enables all creditors who are entitled to participate in the making of the decision to participate equally

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

**Question 3.1** **[maximum 6 marks**]

Can an administrator who wishes to continue to operate the business of the company in administration require suppliers of goods and services to continue to supply those goods and services during the administration?

An administrator can require suppliers of goods and services pursuant to an executory contract to continue to supply those goods and services during the administration in accordance with section 233 of the Insolvency Act. This is important as the administrator may need to retain certain essential supplies.

The relevant section to consider if the administrator wishes to continue to engage with the suppliers of the company are sections 233, 233A and 233B. however, these provisions only apply where the company has entered CVA, a moratorium or restructuring plan.

Section 233, provides that the administrator may request of a supplier that it continues to supply certain goods and services after the company enters administration. The supplier of those services may make it a condition of the giving of the supply that the administrator personally guarantees the payment of any charges in respect of the supply. However, the supplier shall not make it a condition of the giving of the supply, or do anything which has the effect of making it a condition of the giving of the supply, that any outstanding charges in respect of a supply given to the company before the administration’s effective date are paid.

The services covered by section 233 are however limited to electricity, gas, water and communication services such as point of sale terminals, computer hardware and software, information and advice and technical assistance, data storage and processing and web hosting.

As for section 233A of the Insolvency Act, the administrator may rely upon this provision if it wishes to continue a supply contract which contains insolvency related terms. Under section 233A, a supplier of the kinds of services mentioned under section 233, is generable unable to rely on “insolvency-related terms” in the supply contract which would entitle the supple to bring the contract to an end or alter the terms on which it supplied its services or require a higher payment for continuing its services. In essence, those terms generally cease to have effect upon the company entering into administration and the administrator may therefore continue the contract.

However, section 233A also provides that an insolvency-related term does not cease to have effect to the extent that—

(a)it provides for the contract or the supply to terminate, or any other thing to take place, because the company becomes subject to an insolvency procedure other than administration or a voluntary arrangement;

(b)it entitles a supplier to terminate the contract or the supply, or do any other thing, because the company becomes subject to an insolvency procedure other than administration or a voluntary arrangement; or

(c)it entitles a supplier to terminate the contract or the supply because of an event that occurs, or may occur, after the company enters administration or the voluntary arrangement takes effect.

The 2020 Act also introduced section 233B which provides that a provision of a supply contract ceases to have effect when the company becomes subject to the relevant insolvency procedure if and to the extent that, under the provision— (a)the contract or the supply would terminate, or any other thing would take place, because the company becomes subject to the relevant insolvency procedure, or (b)the supplier would be entitled to terminate the contract or the supply, or to do any other thing, because the company becomes subject to the relevant insolvency procedure.

Additionally, section 233B also provides that where a provision of a contract entitles the supplier to terminate the contract or the supply because of an event occurring before the start of the insolvency period, and the entitlement arises before the start of that period, the entitlement may not be exercised during that period.

The language of section 233B opens up the restriction on terminating supply contracts not just those in section 233A. However, the section does provide for a limited number of exceptions such as insurers, banks, electronic money institutions, recognised investment exchanges and clearing houses, securitisation of companies; overseas and corresponding funds.

Having regard to sections 233, 233A and 233B, it is therefore clear that an administrator can require suppliers of certain goods and services to continue their supply during administration, but this is subject to the kind of service to be supplied, the terms of the contract, among other things..

**Question 3.2 [maximum 9 marks]**

Explain the order of priority of payments in a liquidation and explain the nature of the rights enjoyed by each class of creditor or expense.

The order of priority is as follows:

1. The expenses of the winding up of the company, including the liquidator’s expenses;
2. Preferential creditors;
3. Floating charge holders and the “prescribed part”
4. Unsecured creditors;
5. Shareholders.

In respect of the nature of the rights enjoyed by each of the classes above:

The expenses associated with the winding up takes top priority. This is governed by section 115. However, even within this top priority, there is an order of priority of payments. The order of priority of payments is as follow:

* 1. Expenses properly incurred by the liquidator in preserving, realising or getting any of the assets including legal proceedings;
	2. The cost of any security provided by the liquidator;
	3. Any amount payable to a person to assist in the preparation of a statement of affairs or accounts;
	4. Any necessary disbursements by the liquidator in the course of winding up
	5. The remuneration of any person employed by the liquidator to perform any services for the company;
	6. The remuneration of the liquidator;
	7. The amount of corporation tax on chargeable gains accruing on the realising of any assets of the company;
	8. Any other expenses properly chargeable by the liquidator in carrying out the functions in the winding up.

It is clear from the priority of payment of the main expenses of the winding up of the company, that the costs/expenses associated with recovering or preserving assets take precedence over the liquidator’s own remuneration.

Preferential creditors are second in general in terms of priority, and will be entitled to payment once the expenses of the liquidation have been paid in full. The preferential creditor class will include for example, claims of employees of the company for remuneration and sums owed on account of an employee/employer’s contribution to a pension scheme. The statutory debt regime will offer some priority to remuneration of employees and contribution to their pension schemes. The statutory protection offered to employees pursuant to the Employment Rights Act of 1996 provides extensive protection for employees. The preferential creditors class may also include and some taxation liabilities for outstanding taxes due to the Crown. Despite the Enterprise Act 2002 abolishing the Crown’s preference, it was largely reintroduced by the Finance Act 2020 through section 95.

The preferential class may be split into two categories: ordinary or secondary. The former category is paid before the latter. Pursuant to Schedule 6 of the Insolvency Act, ordinary preferential debts include:

* + 1. Any sum owed on account on an employee’s contribution to an occupational pension scheme in the period of 12 months before the relevant date;
		2. Any sum owed by the company on account of an employer’s contribution to an occupational pension scheme in the period of 12 months before the relevant date;
		3. Remuneration owed by the company to a person who is or has been an employee of the debtor and is payable in respect of the whole or any part of the period of four months prior to the commencement of the winding up to a maximum total figure which is currently €800
		4. Any amounts owed by the company by way of accrued holiday remuneration in respect of any period of employment before winding up
		5. Claims for monies advanced to pay wages or holiday remuneration;
		6. Levies on the production of coal and steel referred to in article 49 and article 50
		7. Claims for so much of any amount which is ordered to the paid by the company under the Reserve Forces (Safeguard of Employment) Act;

Pursuant to section 386 (and Schedule 6) the following are secondary preferential debts.

* + - 1. So much of any amount by the company in respect of an eligible deposit as does not exceed the compensation that would be payable in respect of the deposit under the Financial Services Compensation Scheme to the person or persons to whom it is owed.
			2. So much any amount owed by the company to one or more eligible persons in respect of an eligible deposit as exceeds any compensation that would be payable in respect of the deposit under the Financial Services Compensation Scheme to that person or to those persons
			3. An amount owed by the company to one or more eligible person in respect of a deposit that- (i) Was made through a non-UK branch of a credit institution authorized by the competent authority of the UK, and (ii) Would have been eligible deposit if it had been made through a UK branch of that credit union. and
		1. PAYE income tax deductions, national insurance deductions, VAT payments, Construction Industry Scheme deductions and student loan payments.

The next creditor in terms of priority will be floating charge holders. Where there are more than one floating charge holder, priority will be given to the one created first in time.

Section 176A of the Insolvency Act is applicable to companies in liquidation with a floating charge created on or after 15 September 2003. The liquidator must make a prescribed part of the company’s net property available for satisfying unsecured debts and cannot distribute any of this prescribed part to a floating charge holder except where it exceeds the value of all unsecured debts. If the net property is less of 10,000 pound sterling then the prescribed part will be 50%, however, where the liquidator is of the opinion that the distribution to unsecured creditors would be disproportionate, then the prescribed part will not apply. Where the net property is in excess of 10,000 pounds, the prescribed part is 50% of the first 10K plus 20% of the excess, subject to a maximum prescribed part of 80,000 pounds.

The next in priority is unsecured creditors. In most cases, there is little or no money left to pay these persons. The same is true in terms of shareholders. Shareholders will be paid according to the company’s constitution, which in most cases is based on a pro rata basis.

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

Prior to going into compulsory liquidation on 23rd December 2021, under pressure from its bank, Stercus Bank plc, and in order to prevent it from demanding repayment of the company’s loans, Corfee Zero Limited (“the Company”), granted a debenture in favour of Stercus Bank plc in February 2021. The debenture contained a floating charge over the whole of the Company’s undertaking.

The winding up order followed a creditor’s winding up petition issued on 14th October 2021.

In July 2021, as the Company continued to suffer cash flow problems, the directors approved the sale of 5 coffee roasting machines to Ann Young (a director) for £10,000 in cash. The machines had been bought for £25,000 a year before.

A month before the winding up order was made, Ann Young received an email from Beans and Leaves Ltd, one of the Company’s key suppliers. The supplier demanded immediate payment of all sums owing to it and informed the Company that further supplies would only be made on a cash on delivery basis. As the continued supply of coffee beans was seen as essential by the Company, the board authorised a payment of £8,000 to cover existing liabilities and agreed to further payments, on a cash on delivery basis, for further supplies which amounted to further payment of £3,000 up to the date of the winding up order.

The liquidator has asked for advice whether any action may be taken in respect of the floating charge in favour of Stercus Bank plc and the two subsequent transactions.

**Using the facts above, answer the questions that follow**.

**Identify the relevant issues and statutory provisions and consider whether the liquidator may take any action in relation to:**

**Question 4.1 [maximum 5 marks]**

The floating charge in favour of Stercus Bank plc;

**Answer**

The issue in relation to the floating charge is whether the floating charge granted to in favour of Stercus Bank plc in February 2021, a few months before the Company entered formal insolvency proceedings, can be avoided?

The applicable law to this issue is section 245 of the Insolvency Act. This provision applies where the company (in liquidation or administration) enters into a floating charge at or close to the company being put in liquidation. The provision is intended to prevent a pre-existing creditor unsecured creditor from obtaining a floating charge shortly before an insolvent company enters formal liquidation procedures.

According to section 245(3), where the person or entity in whose favour the company granted the floating charge is connected to the company, the relevant time to be considered by the court is 2 years prior to the commencement of the insolvency procedure.

Additionally, section 245(3) also provides that where the person is not connected to the company, the relevant period is 12 months prior to the insolvency procedure. However, section 245(4) provides that this 12 months period only applies if at the time of the creation of the floating charge, the company was unable to pay its debts (within the definition of section 123) or became unable to pay its debts as a consequence of the transaction.

The floating charge will be invalid under section 245, unless and to the extent that “new” consideration was provided. When assessing this new consideration, one may look at factors such as:

1. The value of so much of the consideration for the creation of the charge as consists of money, or goods or services to the company at the time or after the creation of the floating charge; and
2. The value of so much of that consideration as consists of the discharge or reduction, at the same time or after the creation of the floating charge, of any debt of the company. In the leading authority of Re Fairway Magazines, however, it was said that the floating charge will not be invalidated, however, to the extent the consideration was for a discharge or reduction of a debt of the company.

There is nothing in the facts to suggest that Stercus Bank plc is connected to the company. The floating charge was created in February 2021, less than 12 months after the Company was put in compulsory liquidation (on 23 December 2021). Therefore the floating charge may be deemed invalid if there was no new consideration for it.

On the facts, the Company granted the debenture with a floating charge in order the bank from demanding repayment of the Company’s loans. Based upon the authority of Re Fairway Magazine, one has to consider whether this is new consideration – that is, whether the floating charge was granted to discharge the company from the loan.

The floating charge did not discharge the debt to the bank. Nor did it reduce it. Therefore, there was no new consideration. There is also no evidence of value of so much of the consideration for the creation of the charge (money, or goods or services to the company) at the time or after the creation of the floating charge. The floating charge was only granted as a comfort to the Bank (a prior creditor) in circumstances where the company had been experiencing problems paying its debts (the loan to the bank). No new consideration was provided. The floating charge simply came about based on pressures from the bank.

On this basis, the liquidation may consider to avoid the floating charge under section 245.

 The transaction may also be avoided under section 239. That section deals with preferences granted to a creditor shortly before the formal insolvency procedure begins. For example, it can be used to invalidate a security given to a previously unsecured creditor. To succeed, the liquidator will need to show that (i) the bank was a creditor of the Company prior to entering into the charge (ii) something was done by the Company which had the effect of putting the bank in a better position in event the company went into liquidation and (iii) the Company was, in giving the preference, influenced by the desire to produce the preference in relation to the bank (Re MC Bacon Ltd case per Millet J). These elements are satisfied here. The bank was (presumably) an unsecured creditor, having loaned money to the Company, and the Company created a floating charge giving the bank a preference above other unsecured creditors. The preference was the desired effect of the charge – as this was needed in order or the bank not to require the Company (which had been facing financial difficulties) to repay the loan.

Therefore, while the pressure applied by the bank to the Company for it to do something in relation to the loan may not be relevant by itself, the fact is that the liquidator may be able to make out a section 239 action for the floating charge to be set aside.

**Question 4.2 [maximum 6 marks]**

The sale of the coffee roasting machines; and

The issue is whether the transaction was undervalued?

Section 238 allows for undervalued transactions to be set aside. Transactions is broadly defined by the provision and includes a gift, agreement or arrangement.

Section 238 requires that at the time the transaction was entered into, the Company was unable to pay its debts as they fall due within the meaning of section 123 or became unable to pay its debts in consequence of the transaction. Where the transaction was with a connected person, it is presumed, unless proven otherwise, that the Company was insolvent.

The five coffee roasting machines were sold at an undervalue price to Ann Young, who was at all material times a director, and was thus connected to the Company. The Company is therefore presumed insolvent. There is likely no evidence to the contrary, as it seems the Company had been having financial problems even before the transaction.

However, Ann may argue that the transaction was entered into by the Company in good faith and for the purpose of carrying on its business, and that at the time of the sale of the coffee roasting machines, she entered into the transaction reasonably on the grounds that the transaction would benefit the Company.

While she may argue that she was acting on the grounds that the sale would benefit the financially struggling Company, this may, however, be an unsuccessful defence. Ann would have known that the machines had been bought for £25,000 a year before and that the sale for £10,000 was grossly undervalued. Additionally, Ann would have been aware that the creditors had made an application for winding up on 14 October 2021. Yet, only one month later (and one month before the winding up order was granted) she entered into the grossly undervalued contract with the Company. This suggests she was not acting in the best interest of the Company – but instead she wanted to acquire the machines at a significantly reduced price.

The liquidation may therefore apply to set aside the transaction under section 238.

**Question 4.3 [maximum 4 marks]**

The payments to Beans and Leaves Ltd.

The issue here is whether Beans and Leaves Ltd could vary the terms of the supply contract?

The 2020 Act introduced section 233B which deals with contracts that supply goods and services. Subsection (7) of section 233B provides that the supplier shall not make it a condition of any supply of goods and services after the time when the company becomes subject to the relevant insolvency procedure, or do anything which has the effect of making it a condition of such a supply, that any outstanding charges in respect of a supply made to the company before that time are paid.

Subsection (8) further provides that “the insolvency period”, in relation to a relevant insolvency procedure, means the period beginning when the company becomes subject to the relevant insolvency procedure.

Section 129(2) provides that upon the winding up order being granted, the liquidation of the company is deemed to commence at the date of the petition, and not the date of the winding up order.

Since the creditors’ winding up petition was made on 14 October 2021, that is the relevant period for the purposes of section 233B.

A month before the winding up order Beans and Leaves demanded immediate payment of all sums owing to it and informed the Company that further supplies would only be made on a cash on delivery basis. This was essentially the imposition of a condition for the supply of services to the company, requiring that any outstanding charges in respect of the supply of beans to the Company before that time are paid in full.

Although this condition was implemented before the winding up order, the effect of section 129 is that the liquidation procedure commenced on 14 October 2021, prior to the introduction of the condition. The condition is therefore invalid and the liquidation may take action in this respect.

**\* End of Assessment \***