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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: 202223-336.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 2023**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2023. 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 2023** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2023**. If you elect to submit by 1 March 2023, you **may not** submit the assessment again by 31 July 2023 (for example, in order to achieve a higher mark).

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

**ANSWER ALL THE QUESTIONS**

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

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

**Question 1.1**

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. GBP 500
2. GBP 750
3. GBP 1,000
4. GBP 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?

1. Section 424(1) of the Insolvency Act 1986 ("**IA**") provides that the following parties have the right to challenge transactions designed to defraud creditors and make an application under s.423 of the IA:
2. Where the company is being wound up, or in administration:
   1. Official Receiver;
   2. Liquidator;
   3. Administrator; or
   4. Victim of the relevant transaction (with the leave of the court).
3. Where a victim of the relevant transaction is bound by a company voluntary arrangement ("**CVA**"):
   1. Supervisor of the CVA;
   2. Any victim of the relevant transaction, whether or not they are bound by the CVA; or
   3. Any other victim of the relevant transaction.
4. Section 7(1) of the Company Directors Disqualification Act 1986 ("**CDDA**") provides that an application under s.6 of the DDA may be made:
5. Where it is considered to be expedient in the public interest that a disqualification order is made:
6. Secretary of State.
7. if the Secretary of State so directs in the case of a person who is or has been a director of a company which is being wound up by the court in England and Wales: by the official receiver.
8. Official Receiver.
9. Section 246ZB(1) of the IA provides that if, while a company is in administration, it appears that the "wrongful trading" criteria specified at subsection (2) of s.246ZB applies to a person who is or has been a director of the company, then the court, on the application of the administrator of the company, may declare that that person is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.

**Question 2.2 [maximum 5 marks]**

List any **five (5)** of the debts which do not form part of the payment holiday under Part A1 of the Insolvency Act 1986 when a company is subject to a Moratorium.

1. The monitor's remuneration or expenses;
2. Goods or services supplied during the moratorium;
3. Rent in respect of a period during the moratorium;
4. Wages or salary arising under a contract of employment;
5. Redundancy payments.

**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?

The appointment of an administrator does not automatically terminate a company's executory contracts. In practice, an administrator will frequently need to obtain or retain certain essential supplies. Section 233 of the IA applies to a supply of gas, electricity, water and communication services. "Communication services" includes the supply of goods and services such as POS terminals, computer hardware and software, information, advice, and technical assistance, data storage, and processing and website hosting.

Suppliers are not permitted to require payment of outstanding debts in order to secure a new or continued supply to the company in administration. However, s.233 of the IA permits a supplier to stipulate that the administrator personally guarantee the payment of charges in respect of the relevant supply.

Section 233A of the IA prevents a supplier of goods and services to the company in administration from relying on an "insolvency-related term" in a contract of supply which would otherwise entitle the supplier to terminate the supply of the relevant goods or services, alter the terms of the supply, or compel higher payments for continued supply *ipso facto* the company entering into administration.

The Corporate Insolvency and Governance Act 2020 ("**CIGA**") has further expanded such protections for financially distressed companies by adding s.233B to the IA. Section 233B prohibits clauses which allow the relevant supplier of goods and services to terminate or "do any other thing" in relation to that contract if the company enters a formal insolvency procedure, including administration.

Section 233B, therefore, prevents suppliers from terminating a supply upon the company's insolvency but also prevents suppliers from making it a condition of uninterrupted supply that pre-insolvency arrears are paid and from making other changes to the contract, such as increasing the price of the relevant supply.

However, a contract of supply may still be terminated by a supplier where a company or administrator consents, or on application to the court, the court is satisfied that the continuation of the contract would cause hardship to the supplier, and grants permission for the contract to be terminated.

**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. How would this priority change if the company had been subject to a Moratorium under Part A1 of the Insolvency Act 1986 during the 12 week period prior to the commencement of the liquidation?

The IA and the Insolvency Rules 2016 ("**Rules**") set out the order of distribution in liquidation, following the realisation of security by secured creditors (other than those with floating charges) for their benefit.

*Expenses of liquidation, including liquidator's remuneration*

Under s.115 of the IA and r.6.42 and 7.108 of the Insolvency Rules 2016, a number expenses are given priority over the company's preferential creditors, any holders of floating charges and unsecured creditors. The main expenses payable in priority are:

1. expenses properly incurred by the liquidator in ensuring the preservation, realisation or collection of any of the company's assets, including the conduct of 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 the liquidation;
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 any corporation tax on chargeable gains accruing on the realisation of any assets of the company; and
8. any other expenses properly chargeable by the liquidator in carrying out the liquidator's functions in the liquidation.

*Preferential creditors*

After expenses, the company’s preferential debts must be paid in accordance with s.175, s.386 and Schedule 6 of the IA. These debts are paid in priority to all other debts, including those secured by way of a floating charge. The most common ordinary preferential debts are contributions to occupational pension schemes and certain employee benefits, which are determined at the relevant date under s.387 of the IA. This will generally be the date of the liquidation order.

For insolvencies commenced from 1 January 2015, there are two categories of preferential debts:

1. ordinary preferential debts; and
2. secondary preferential debts.

Secondary preferential debts rank behind ordinary preferential debts. Within each category of preferential debts, the debts rank equally among themselves. Ordinary preferential debts include:

1. contributions to occupational pension schemes;
2. certain employee benefits;
3. levies on coal and steel production;
4. certain debts owed to the Financial Services Compensation Scheme ("**FSCS**"); and
5. deposits covered by the FSCS in such amount that does not exceed the compensation that would be payable in respect of the deposit under the FSCS (currently a limit of £85,000 for deposits).

Secondary preferential debts include so much of any amount owed in respect of an eligible deposit as exceeds any compensation that would be payable in respect of the deposit under the FSCS, and certain deposits made through a non-UK branch of an authorised credit institution.

Where the relevant date of insolvency falls on or after 1 December 2020, HMRC receives secondary preferential creditor treatment in respect of certain debts due to it – to include VAT, PAYE, employee National Insurance Contributions and student loan deductions.

Realisations from property subject to a fixed charge will be paid to the fixed charge holder (less the liquidator’s costs of realisation). Any charge that was originally a floating charge but has crystallised to become a fixed charge will be subordinated to preferential debts.

*Prescribed part and floating charge holders*

In accordance with s.175(2) of the IA, the liquidator should distribute to secured creditors pursuant to floating charges after preferential debts.

This reflects the rule that preferential debts – insofar as the assets of the company available for payment of general creditors are insufficient to meet them – rank in priority over the claims of holders of debentures secured by, or holders of, any floating charges created by the company and shall be paid accordingly out of any property comprised in or subject to that charge. Where there are sufficient funds available, then the assets subject to floating charges need not be used to discharge the claims of preferential creditors.

In relation to floating charges created on or after 15 September 2003, a certain part of the net proceeds from the realisation of the property covered by the floating charge must be set aside for distribution among the unsecured creditors – the "prescribed part" – under s.176A of the IA. At present, the prescribed sums are:

1. 50% of the value of property where that property’s value does not exceed £10,000; and
2. where the property’s value exceeds £10,000 in value, 50% of the first £10,000, thereafter 20% subject to a statutory cap – which is £600,000 where the company’s net property is available to be distributed to the holder of a floating charge created before 6 April 2020, and £800,000 where the floating charge was created on or after 6 April 2020. Where a post-6 April 2020 floating charge ranks *pari passu* or in priority to a pre-6 April 2020 floating charge, the cap is also £800,000.

*Unsecured creditors*

The category into which most creditors fall is unsecured creditors, which encompasses all debts which have not been granted some preference or security by charge. Regardless of when the debt was incurred, such debts abate rateably, just as with preferential debts. The liquidator will calculate what each creditor will receive as a dividend, i.e., so many pence in the pound.

*Other liabilities, deferred debts and sums due to members in their capacity as members*

The statutory priorities must be paid ahead of all other liabilities in a liquidation. There are also classes of deferred debts that are payable out of the assets remaining only after the ordinary unpreferred and unsecured debts of the company have been discharged in full.

Deferred debts include cases where payment of the debt of a partner-creditor must be postponed to those of other creditors of the company, thus making it a deferred debt in the liquidation. A special statutory rule under s.74(2)(f) also applies to a sum due any members in their character of members by way of dividends, profits or otherwise.

*Interest*

s.189(2) of the IA provides that where there is a surplus remaining after the payment of all debts that have been proved, the first call on the surplus is for the payment of interest on those debts in relation to the period post-liquidation.

*Postponed debts*

From 6 April 2017, r 14.2(4) of the Rules provides for certain postponed debts that are not provable except at a time when all other claims of creditors in insolvency proceedings have been paid in full with interest under s.189(2) of the IA.

*Members*

If there is a surplus remaining after all of the distribution categories set out above, it is divided between and returned to the company’s contributories. A contributory cannot recover anything until they have fully paid any obligations as a contributory to the company in accordance with the rule in *Cherry -v- Boultbee*.

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If the relevant company had been the subject of a moratorium under Part A1 of the IA in the 12-week period prior to the commencement of liquidation, then any moratorium debts and ‘priority pre-moratorium debts’ – for which the company did not have a payment holiday during the moratorium, but which were not paid – will have priority over all other claims.

Therefore, where such a liquidation occurs, any prescribed fees or expenses of the Official Receiver or liquidator acting in any capacity in relation to the company will rank first, followed by moratorium debts and priority pre-moratorium debts as defined in s.174A of the IA – as introduced by Schedule 3, para. 13 of CIGA.

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

Prior to going into compulsory liquidation on 23rd December 2022, under pressure from its bank, Fretus Bank plc, and in order to prevent it from demanding repayment of the company’s loans, Marbley Q Limited (“the Company”), granted a debenture in favour of Fretus Bank plc in February 2022. 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 2022.

In July 2022, as the Company continued to suffer cash flow problems, the directors approved the sale of two (2) marble cutting machines to Rita Perkins (a director) for GBP 10,000 in cash. The machines had been bought for GBP 25,000 a year before.

A month before the winding up order was made, Rita Perkins received an email from Hard and Fast 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 marble was seen as essential by the Company, the board authorised a payment of GBP 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 GBP 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 Fretus 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 Fretus Bank plc;

Section 239 of the IA opens to attack the floating charge granted to Fretus Bank plc ("**Fretus**") by Marble Q Limited ("**MQ**") with the legislative provision's purpose being to prevent a company from placing one of its creditors in a better position than others shortly before the company enters a formal insolvency procedure such as compulsory liquidation.

An application by the liquidator under s.239 is likely to succeed since the liquidator will be able to establish that:

1. Fretus was, at the time of the granting of the floating charge over the whole of MQ's undertaking, a creditor of MQ by virtue of the extant indebtedness created by the loans;
2. MQ granted a debenture containing the floating charge to Fretus thereby placing Fretus in a better position in the event of MQ entering insolvent liquidation than Fretus would otherwise have been in;
3. MQ was, in giving the preference to Fretus, influenced by a desire to produce the effect of (b) above (desire to prefer) in relation to Fretus; and
4. the preference was given at a relevant time – that is, it occurred within the two years prior to the onset of insolvency of MQ.

Section 245 of the IA applies only to floating charges and is aimed at preventing pre-existing unsecured creditors obtaining the security of a floating charge shortly before a company enters a formal insolvency procedure such as liquidation. It renders floating charges invalid where they are given by a company at a relevant time. The relevant time in respect of the floating charge given by MQ to Fretus is any time within the period of 12 months prior to the onset of insolvency, but only if at the time of the creation of the charge MQ was either unable to pay its debts (within the meaning of s.123 of the IA) or became unable to do so in consequence of the transaction.

There was no new consideration provided for the charge as per s.245 of the IA. As such, there are good grounds for the liquidator applying to set aside the floating charge provided to Fretus by MQ.

**Question 4.2 [maximum 6 marks]**

The sale of the marble cutting machines; and

The sale of the marble cutting machines to Rita Perkins is open to attack by a liquidator under s.238 of the IA since it was entered into prior to MQ entering liquidation and was at a significant undervalue – some 20% of what MQ had paid for the machines only a year earlier notwithstanding there would be depreciation to factor in.

The liquidator would be able to show – under s.238 of the IA – that MQ entered into the transaction with Rita Perkins for a consideration which, in money or money's worth, was, at the date of the transaction in July 2022, significantly less than the value, in money or money's worth, of the consideration provided by MQ. The transaction is also comfortably within the prescribed two-year period prior to the commencement of the liquidation in December 2022.

On an application under s.238, the Court has the power to order, if it finds that the sale of the marble cutting machines to Rita Perkins was a transaction at an undervalue, that the position is restored to the position as if the transaction was not entered and order Rita Perkins to make restitution to MQ accordingly.

The transaction is also open to attack by the liquidator under s.423 of the IA as a transaction designed to defraud creditors of MQ since the liquidator will be able to show that (i) MQ entered into the transaction with Rita Perkins at an undervalue; and (ii) MQ entered into the transaction in July 2022 which prejudiced the interests of a person who is making, or may at some point make, a claim against MQ (i.e., a creditor).

The transaction is also open to attack via a claim in misfeasance under s.212 of the IA due to the breach of duty by Rita Perkins and the other board members in resolving to authorise the transaction in the first place. Since MQ was in the 'zone of insolvency' at the time of the transaction, the duty owed by Rita Perkins and the other directors shifted from one owed to MQ, taking into account what would be in the best interests of its members, to one owed to MQ's creditors. The liquidator is likely to succeed on an application under s.212 and ought to seek an order for repayment or contribution to the insolvent estate of MQ to be applied in the order of distribution to creditors in the normal course.

Rita Perkins and the rest of MQ's board are also susceptible to disqualification as directors under the Company Directors Disqualification Act 1986 ("**CDDA**") per s.4 (breach of duty), s.8 (unfit to be concerned in the management of a company) and s.10 (if the Court declares that Rita Perkins and/or the rest of MQ's board is liable to make a contribution to MQ's assets).

As well as facing disqualification as a director, Rita Perkins and the rest of MQ's board may be made subject to a compensation order to specified creditors of MQ or make a contribution to MQ's insolvent estate if the liquidator can establish that the transaction selling the marble cutting machines caused loss to one or more creditors.

**Question 4.3 [maximum 4 marks]**

The payments to Hard and Fast Ltd.

The payments to Hard and Fast Ltd ("**H&F**") are open to attack by the liquidator under s.214 and s.246ZB of the IA, which make directors of insolvent companies liable for wrongful trading, and thereby making them, in certain circumstances, liable for some of the debts and liabilities of the company.

Given that Rita Perkins and the rest of the MQ board authorised the payment of £8,000 to H&F a month prior to the compulsory liquidation and caused MQ to incur a further liability of £3,000 to H&F as at the date of the liquidation, they have rendered themselves liable to the court's discretion, on the application by the liquidator, in being ordered to contribute to MQ's assets in at least the sum of £3,000 paid to H&F at a time when MQ was clearly insolvent and the prospect of insolvent liquidation was glaringly apparent.

Wrongful trading is aimed at ensuring that, when directors become aware that an insolvent liquidation is in prospect, they do everything possible to minimise the potential losses to the company's creditors. The liquidator will be able to establish wrongful trading has occurred here given that:

1. MQ went into insolvent liquidation on 23 December 2022;
2. At some point before the commencement of the liquidation of MQ, Rita Perkins and the other board members knew, or ought to have known, that there was a reasonable prospect of MQ going into insolvent liquidation – especially given its financial struggles and the stay of execution negotiated with Fretus in February 2022; and
3. At the time Rita Perkins and the rest of MQ's board reached that conclusion, or ought to have reached it, she and the other board members were *ipso facto* directors of MQ.

Rita Perkins and the other directors of MQ will not be able to avail of the statutory defence under s.214 of the IA since they failed to take "every step" to minimise the potential losses to MQ's creditors, nor be entitled to relief from liability for breach of duty under s.1157 of the Companies Act 2006, which is not available in cases of wrongful trading.

Rita Perkins and the other board members may also be ordered to compensate the company for the £8,000 paid to H&F for the outstanding liabilities at a relevant time – just one month before the liquidation – if the liquidator considers it to be a voidable transaction, especially since it prejudices MQ's other creditors as to their potential recovery in the liquidation and H&F's apparent status as merely an unsecured creditor of MQ.

**\* End of Assessment \***