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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 2024**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2024. 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 2024** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2024**. If you elect to submit by 1 March 2024, you **may not** submit the assessment again by 31 July 2024 (for example, in order to achieve a higher mark).

7. Prior to being populated with your answers, this assessment consists of **9 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 eight weeks of the commencement of the administration.
3. within four 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**

Section 426 of the Insolvency Act 1986 contains provisions for UK courts to provide assistance to overseas courts from certain listed jurisdictions. Which of the following is not a listed jurisdiction under section 426?

1. Malaysia.
2. Australia.
3. India.
4. Hong Kong.

**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 filing by a company’s directors of a Notice of Intention to Appoint an administrator produces a short-term moratorium on actions against the company which lasts for how long?

1. Five business days.
2. Twenty business days.
3. Ten days.
4. Three months.

**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 if the director has been a director of the company during which period prior to the insolvent liquidation?

1. Six months.
2. Five years.
3. Two years.
4. Twelve months.

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

**Question 2.1 [maximum 5 marks]**

Who may bring an action under: (i) section 245 of the Insolvency Act 1986, (ii) section 6 of the Company Directors Disqualification Act 1986, (iii) section 246ZB of the Insolvency Act 1986, and (iv) section 127 of the Insolvency Act 1986?

1. Pursuant to section 245 of the Insolvency Act 1986 (the **IA**), an action to seek to avoid a floating charge may be made by a liquidator or an administrator depending on whether the company is in liquidation or administration. The section allows the liquidator or administrator to challenge any floating charges that were created in the period prior to the liquidation or administration to prevent pre-existing unsecured creditors obtaining security shortly prior to liquidation / administration.[[1]](#footnote-1)
2. Pursuant to section 6 of the Company Directors Disqualification Act 1986 (the **CDDA**), the Official Receiver (initial Court appointed liquidator) may bring an action on the instructions of the Secretary of State for Business, Energy and Industrial Strategy. The action may seek orders for the director's disqualification from being involved in the management of a company for up to 15 years.[[2]](#footnote-2)
3. Pursuant to section 246ZB of the IA, a liquidator may bring an action against a director (or former director) for a declaration that a director of a company which is in insolvent liquidation should make a contribution to the company’s assets on the basis that they are liable for wrongful trading. The action cannot be brought by a creditor or contributory of the company. An administrator of a company in administration may bring a similar kind of claim with respect to fraudulent trading under section 246ZA of the IA.
4. Section 127 of the IA does not specify who may apply for to the Court to validate transactions that would otherwise be void following the commencement of winding up, however, practically speaking the application would be made by the company itself prior to any winding up order being made, or by the liquidator following their appointment. It is also possible for the application to be made by an interested party.

**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.

Five kinds of 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 include amounts payable with respect to:

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; and
5. redundancy payments.[[3]](#footnote-3)

**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?

This essay explains why in general an administrator who wishes to continue to operate the business of a company in administration can require suppliers of goods and services to continue to supply those goods and services during the administration. There are of course some exceptions which are also explained below.

Firstly, it is important to understand that a company's executory contracts are not automatically terminated upon an administrator's appointment. Contractual clauses which seek to achieve automatic termination upon certain events, such as insolvency, are known as *ipso facto* clauses. Historically, such clauses were generally effective, however, with the introduction of statutory measures, such clauses are less effective. By reference to the IA, the following sections explain some of these provisions.

Firstly, section 233 prevents suppliers of gas, electricity, water and communications services from requiring payment of outstanding debts before supplying new or continued services to a company in administration.[[4]](#footnote-4) Communication services include *"the supply of goods and services such as point of sale terminals, computer hardware and software, information, advice, and technical assistance, data storage and processing and website hosting"*.[[5]](#footnote-5) This section of the IA essentially recognises that these services are essential services that an administrator will need to obtain or retain in order to achieve a base level of operations. The IA does, however, still afford certain protections to suppliers of these services including that such a supplier may require the administrator to personally guarantee payment of charges in respect of a new supply.[[6]](#footnote-6)

Section 233A of the IA applies to the same above-mentioned essential service providers and generally restricts a provider from relying on a contractual term which would otherwise mean that the supplier could terminate the supply, alter the supply or enforce more stringent payment terms for the continued supply in the circumstance of an insolvency related event.[[7]](#footnote-7)

In 2020, the Corporate Insolvency and Governance Act 2020 (the **2020 Act**), which has a debtor friendly rescue focus, expanded the protections that were available with respect to the above-mentioned essential services to other suppliers. The 2020 Act added section 233B to the IA which applies a much broader range of suppliers but excludes insurers; banks; electronic money institutions; recognised investment exchanges and clearing houses; securitisation companies; and overseas companies with corresponding functions, among others.[[8]](#footnote-8)

Section 233B prevents suppliers of goods and services from seeking to include clauses which allow them to terminate the supply (among other things) if the company being supplied to enters into an insolvency procedure. In essence, section 233B of the IA prevents suppliers from (a) terminating a supply upon an insolvency event; (b) making continued supply conditional upon payment of arrears; and (c) making any other contractual changes such as price increases.[[9]](#footnote-9)

Turing to the protections that are available to suppliers that are caught by section 233B of the IA, unlike section 233, it is not open to a supplier under section 233B to insist on a personal guarantee from the administrator in relation to payment for the goods and services. Executory contracts with such suppliers, may however, still be terminated in certain circumstances, including where the company or administrator agrees, or following court sanction if the supplier applies to court, and the court is satisfied that the continuation of the contract would cause the supplier hardship.[[10]](#footnote-10)

As it can be seen, the introduction and existence of these measures are debtor friendly and essentially recognise that in order for administration to succeed, particularly if the objective is to rescue the company, then continued trading can be necessary to achieve those goals.

**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?

This essay provides an overview of the order of priority of payments in a liquidation in the United Kingdon (the **UK**) with a focus on the nature of the rights enjoyed by each class of creditor or expense. It then examines how the order of priorities are impacted in circumstances where a company has been subject to a Moratorium under Part A1 of the IA during the 12-week period prior to the commencement of the liquidation.

By way of preliminary comment, it is worth noting that secured creditors (i.e. holders of fixed charges) are generally paid out first and outside of the formal insolvency process. Typically, the secured creditor will act on its right to sell the asset subject to the fixed charges and will seek to recoup any debt owed to it from that sale.[[11]](#footnote-11) Holders of floating charges do not have the same right and or treatment as fixed charge holders, however, in some circumstances a holder of a floating charge may seek to enforce its charge by appointing an administrator which typically prevents a liquidator from being appointed until the administration is completed.[[12]](#footnote-12) A floating charge holder may also simply consent to the appointment of a liquidator which allows the liquidator to realise the charged assets as part of the liquidation and pay out the floating charge holder according to the charge holder’s normal priority.[[13]](#footnote-13)

Turning now to the order of priority of payments within the formal insolvency process and taking each in turn.

Liquidation expenses

First, pursuant to section 115 of the IA and rules 6.42 and 7.108 of the Insolvency Rules 2016 SI 2016/1024 (the **Rules**), certain costs and expenses are prioritised over the preferential creditors, any holders of floating charges and unsecured creditors. In order of priority, those include:

*"(a) expenses that are properly incurred by the liquidator in preserving, realising or getting in any of the assets of the company (including the conduct of any legal proceedings);*

*(b) the cost of any security provided by the liquidator;*

*(c) any amount payable to a person to assist in the preparation of a statement of affairs or accounts;*

*(d) any necessary disbursements by the liquidator in the course of the winding up (including,*

*for example, any expenses incurred by members of the liquidation committee);*

*(e) the remuneration of any person who has been employed by the liquidator to perform any services for the company;*

*(f) the remuneration of the liquidator (which is subject to effectively the same rules as those which apply to administrators, specifically including the fees estimate regime where a time cost basis for the liquidator’s fees is adopted);*

*(g) the amount of any corporation tax on chargeable gains accruing on the realisation of any*

*asset of the company; and*

*(h) any other expenses properly chargeable by the liquidator in carrying out the liquidator's*

*functions in the winding up."*[[14]](#footnote-14)

Preferential creditors

Second in the order of priority are preferential creditors, as defined in sections 386, 387 and Schedule 6: section 175 of the IA. Preferential debts are split into two classes - ordinary and secondary. Ordinary preferential debts are prioritised over secondary preferential debts but preferential debts within each of those classes rank equally amongst themselves. The debts listed below at (9), (10) and (11) are defined as secondary preferential debts under section 386 of the IA.

Pursuant to Schedule 6 of the IA, the following debts are classed as preferential debts:

(1) sums owed on account of an employee’s contribution to an occupational pension scheme in the period of four months prior to the commencement of the winding up;

(2) sums 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 four-month period prior to the commencement of the winding up to a maximum of GBP 800;

(4) amounts owed by the company by way of accrued holiday remuneration;

(5) claims for monies advanced to pay wages or holiday remuneration;

(6) levies on the production of coal and steel pursuant to articles 49 and 50 of the European Coal and Steel Community Treaty;

(7) claims on any amount ordered to be paid by the company under the Reserve Forces (Safeguard of Employment) Act 1985;

(8) any amount owed 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 the amount is owed;

(9) 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 those persons;

(10) an amount owed by the company to one or more eligible persons in respect of a deposit that—

(a) was made through a non-UK branch of a credit institution authorised by the competent authority of the UK, and

(b) would have been an eligible deposit if it had been made through a UK branch of that

credit institution; and

(11) PAYE income tax deductions, national insurance deductions, VAT payments, Construction Industry Scheme deductions and student loan repayments.[[15]](#footnote-15)

Floating charge holders

Third in priority are any floating charge holders, with priority between them based on the order in which the floating charge was created first. However, before making any payment to a floating charge holder, the liquidator is obliged to consider section 176A of the IA and whether any of the floating charges were created on or after 15 September 2003. If there are, the liquidator is required to reserve a *“prescribed part”* of the company’s net property (assets available after payment of liquidation expenses and preferential debts) for the satisfaction of unsecured debts and must not distribute any of this prescribed part to a floating charge holder unless it exceeds the amount required to satisfy all the unsecured debts.

The amount of the "prescribed part" is calculated by reference to the amount of the company's available net property. If that does not exceed GBP 10,000, then the prescribed part is 50% of that property. However, the liquidator retains some discretion if the company's net property is less than GBP 10,000 and may decide not to make the distribution of the prescribed part if they consider that the distribution to unsecured creditors (over floating charge holders) would be disproportionate to the benefits.[[16]](#footnote-16) On the other hand, if the company’s net property exceeds GBP 10,000, the prescribed part is the sum of 50% of the first GBP 10,000 in value, plus 20% of the excess in value above the GBP 10,000, up to a maximum amount of GBP 800,000.[[17]](#footnote-17)

Following the High Court of England and Wales decision in *Thorniley v Harris* [2008] EWHC 124 (Ch), floating charge holders who have an outstanding unsecured balance owing to them are prohibited from participating in the distribution of the prescribed part. This decision and section 176A of the IA demonstrates the UK's desire to protect unsecured creditors to some extent and to ensure that floating charges are not used to complete detriment of unsecured creditors in a liquidation context.

Unsecured creditors

Fourth in priority are unsecured creditors who are typically ordinary trade creditors. It is not uncommon that after the liquidation expenses and distributions to secured and preferential creditors that there is little, or nothing left for unsecured creditors.[[18]](#footnote-18) This reality also reinforces the importance of rationale behind section 176A of the IA as described above which does require the liquidator to reserve some funds for unsecured creditors over floating charge holders if certain conditions are met.

Shareholders

Fifth in priority are shareholders, however, a distribution to shareholders will only occur if there are sufficient funds to pay all the creditors (and interest on their debts). Any payment to shareholders will be made in accordance with the company’s constitution, which typically will allow for a distribution pro rata as per the shareholders’ respective shareholding.

Modification to the order of priorities

Although the order of priorities is well established, there are some ways in which it can be modified. Firstly, creditors may agree between themselves to vary their priority. This is known as a subordination agreement and such an agreement can provide that certain funds will only be advanced on the condition that a certain priority is assured. These agreements will be valid as they do not affect the priority of other creditors.

The other main way that the order of priorities is modified is due to the application of the moratorium under Part A1 of the IA. The moratorium is a debtor-in-possession procedure, whereby the directors remain in control of the company, subject to the supervision of a monitor with the aim of rescuing the company as a going concern.[[19]](#footnote-19) However, if the company is not rescued as a going concern and rather enters administration or liquidation within 12 weeks of the end of the moratorium (initially 20 days but it can be extended), the order of priority of debts in the subsequent administration or liquidation can differ to the order which would have applied but for / prior to the moratorium. In particular, section 174A of the IA provides that certain unpaid pre-moratorium or moratorium debts such asdebts owed to employees or “financial services” debts (debts which are not part of the payment holiday during the moratorium), are paid in the subsequent liquidation, in priority to even the liquidator’s fees and expenses.[[20]](#footnote-20)

As a result, section 174A and the moratorium is effectively a mechanism which allows for certain unsecured debts to be granted a form of *“super priority”* in the event of a subsequent liquidation.[[21]](#footnote-21) This outcome is particularly desirable for unsecured creditors who may otherwise receive nothing in a liquidation due to the fact that they are ordinarily paid out last. Given that payments to Directors would be included, it may be seen that this is a motivator for the company's directors to seek to take steps to rescue the company before turning to liquidation.

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

Prior to going into compulsory liquidation on 28 February 2024, under pressure from its bank, Ambitus Bank plc, and in order to prevent it from demanding repayment of the company’s loans, Blazer Laser Limited (the Company), granted a debenture in favour of Ambitus Bank plc in June 2023. 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 13 January 2024.

Sometime in January 2023, as the Company continued to suffer cash flow problems, the directors approved the sale of two laser cutting machines to Angela Bannister (a director) for GBP 40,000 in cash. The machines had been bought for GBP 100,000 a year before.

A month before the winding up order was made, Angela Bannister received an email from Aluminium Alumini 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 metal was seen as essential by the Company, the board authorised a payment of GBP 20,000 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 8,000 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 Ambitus 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 Ambitus Bank plc;

The liquidator of the Company should be advised that they may take action to seek to avoid the floating charge pursuant to section 245 of the IA now that the Company is in liquidation. Section 245 is designed to prevent pre-existing unsecured creditors like Ambitus Bank plc from obtaining security of a floating charge shortly before a company enters into insolvency and allows a liquidator to challenge and seek to avoid such charges which may otherwise result in a higher priority when it comes to making any distributions in the liquidation.[[22]](#footnote-22)

The Company granted a debenture in favour of Ambitus Bank plc in June 2023 which contained a floating charge over the whole of the Company’s undertaking. The Company did this in circumstances where it was under pressure from Ambitus Bank plc and in order to prevent it from demanding repayment of its loans. There is no evidence that any new consideration was provided for the charge (see below).

The Company went into liquidation on 28 February 2024 following a creditor’s winding up petition which was issued on 13 January 2024. This meant that the floating charge was provided approximately seven months prior to the date of the petition which will mark the onset of insolvency in this compulsory liquidation.

Where the entity in whose favour the floating charge is created is not connected with the Company, the relevant time in which section 245 of the IA applies 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 the company was either unable to pay its debts within the meaning in section 123 of the IA or became unable to do so in consequence of the transaction.

In view of the above, the floating charge was provided in the relevant period, but more analysis will be required to determine if at the time of the creation of the charge the company was either unable to pay its debts within the meaning in section 123 of the IA or became unable to do so in consequence of the transaction. Based on the information that we do have to hand, we know that that the creditor's winding up petition which resulted in the winding up order was filed on 13 January 2024, creditors were threatening to stop supply in January 2024 and that the Company was experiencing some cash flow issues as early as January 2023.

Whether or not the Company was insolvent in January 2023 will come down to a further investigation and reference to sections 123(c) and (d) of the IA which says that a debtor company is insolvent if it is either unable to pay its debts as they fall due (cash flow insolvency); or proved to the satisfaction of the court that the value of the company’s assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities (balance sheet insolvency).[[23]](#footnote-23)

In other words, the Company will be balance sheet insolvent if the value of its assets is less than its liabilities (taking into account any future or contingent liabilities as well as its current liabilities and/or cash flow insolvent where it is unable to pay its debts as they fall due. With that in mind, the fact that the Company was experiencing some cash flow issues in January 2023 when it sold the laser cutters doesn’t necessarily mean that it was insolvent at that time because it may have still had a strong balance sheet at that time.[[24]](#footnote-24)

If Ambitus Bank plc was a connected person to the Company, then the relevant time period for the purpose of section 245 of the IA is any time within the period of two years prior to the onset of insolvency, however, there is no evidence that Ambitus Bank plc would meet the connected person test.

As previously mentioned, there is no evidence that Ambitus Bank plc provided any new consideration for the floating charge. This is important because section 245 of the IA provides that a floating charge will not be invalid if new consideration was provided. Based on the facts we are told that the floating charge was provided in respect of the Company's existing loans and to stop Ambitus Bank plc from requiring repayment. For completeness the two categories of new consideration that are set out in section 245 of the IA as not being capable of invalidating a floating charge are the value of so much of the consideration:

1. for the creation of the charge as consists of money paid, or goods or services supplied, to the company at the same time as, or after, the creation of the charge; and
2. as consists of the discharge or reduction, at the same time as, or after, the creation of the charge, of any debt of the company.[[25]](#footnote-25) This category also specifically provides that a floating charge is not to be invalidated to the extent of consideration by way of discharge or reduction of a debt of the company.

Based on the facts that we have to hand, the liquidator should be advised that neither of the "new consideration" conditions appear to be met. No money was paid, or goods or services supplied at the time of or after the creation of the charge and there was no deduction of any debt of the Company at the same time as or after the creation of the charge.

In the circumstances, it seems likely that the floating charge in favour of Ambitus Bank plc will be capable of being caught and invalidated pursuant to section 245. Ambitus Bank plc's debt will remain valid, but it means that it will rank as an ordinary unsecured creditor in the liquidation and will not enjoy any preferential status when it comes to payment of any distributions.

**Question 4.2 [maximum 6 marks]**

The sale of the laser cutting machines; and

Turning to the Company's sale of the laser cutting machines to a director, Angela Bannister for GBP 40,000 in cash after the machines had been bought for GBP 100,000 a year before, the liquidator should be advised that this transaction is also open to challenge on the basis that it is likely a transaction at undervalue.

Section 238 of the IA allows a liquidator (or administrator) to challenge a transaction which was entered prior to a company entering liquidation (or administration) where the transaction was at an undervalue.[[26]](#footnote-26)

Although there are three possible options under section 238, in the present case the liquidator will need to show that the Company entered into a transaction with another person for a consideration which, in money or money’s worth, was, at the date of the transaction, significantly less than the value, in money or money’s worth, of the consideration provided by the Company. Based on the fact that the laser cutting machines were worth GBP 100,000 in January 2022, it is highly unlikely that their value has reduced to GBP 40,000 in one year. Some further valuation information may be required such as the general life span of the machines and how much use they have had to make a final determination.

For the purposes of section 238, the transaction must have taken place at a “relevant time” being in the period of two years prior to the commencement of the liquidation (or administration). In this case, we know that the sale occurred in January 2023 which was one year prior to the filing of the creditor's winding-up petition, hence falling in the relevant period.

One of the prerequisites of liability under section 238 of the IA is that at the time of the transaction, the Company was unable pay its debts as they fell due within the meaning of section 123 of the IA or became unable to pay its debts as a result of the transaction. However, it is also important that the transaction was with a connected person, being one of the Company's Directors, Angela Bannister[[27]](#footnote-27) because where the transaction is with a connected person, the Company will be presumed to have been insolvent, or to have become insolvent as a result of the transaction, unless it can be proved otherwise.

In terms of whether the Company can prove that it wasn’t insolvent in January 2023, further information is needed to complete the assessment. In considering whether the Company is cash flow insolvent and unable to pay its debts as they fall due. The Court would look not only at the Company's current debts, but also debts falling due from time to time in the reasonably near future.[[28]](#footnote-28) The Court's decision in the leading case of *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] UKSC 285 establishes that once the consideration of the company’s financial condition requires the court to move on from the reasonably near future (of which the duration will vary depending upon the company’s individual circumstances) any attempt to apply the “cash-flow” test becomes merely speculative and it is at this point that a court must consider the “balance sheet” test, that is, whether a company’s assets outweigh its liabilities (which test includes a requirement to take account of future and contingent as well as current liabilities).[[29]](#footnote-29)

Applying the balance sheet test to the Company's present liabilities is simple. However, taking into account future contingencies is much harder. In *Eurosail* the Court found that this was far from an exact process. When taking account of future (and contingent) liabilities, some discounting is required due to the long-term nature of some loans or other liabilities. Future profits must also be taken into consideration.[[30]](#footnote-30)

As a result of the challenges with the balance sheet test, overwhelmingly convincing evidence would be required to disprove the presumption that the Company was insolvent in January 2023. Much more information would be needed about the Company's potential future financial position, but at this point we know that the transaction itself will notably impact the Company's balance sheet by reducing its assets by GBP 60,000. The fact that it also sold the machines for cash may also be relevant especially if the Company had a loan to purchase the machines in the first place.

The Court is also prevented from making an order under section 238 if the Company can satisfy the Court that it sold the laser machines in good faith and for the purpose of carrying on its business, and that there were reasonable grounds for believing that the transaction would benefit the Company.[[31]](#footnote-31) The Company may be able to rely on the fact that it needed the cash in order to continue operations and genuinely considered that the sale would lead to better results for the Company in the future if it were able to continue. However, this seems a bit of a stretch when presumably the Company will be limited in its operations with less machines.

If the Court concludes that the sale of the laser machines was a transaction at an undervalue, then it will make an order restoring the position to what it would have been if the transaction had not occurred.

**Question 4.3 [maximum 4 marks]**

The payments to Aluminium Alumini Ltd.

Similar to the above transactions, the liquidator should be advised that the payments to Aluminium Alumini Ltd (**AAL**) may be avoided on the basis that they are preferences (although there are significant challenges which are explained below) or void because they were not validated.

Section 239 of the IA precludes a company from doing anything that would place one of its creditors in a better position than other creditors shortly before entering a formal insolvency procedure. It is open to the liquidator to apply to the Court to avoid the payments now that the winding-up order has been made and the Company is in liquidation. The liquidator will need to establish that:

1. AAL was, at the time of the transaction, a creditor of the company. This may be established based on the contract between AAL and the Company and with further evidence of AAL's demands for payment and refusal to continue supply unless paid for outstanding debts and for future supply to be on a cash on delivery basis.
2. Something was done by the Company which had the effect of putting AAL in a better position, in the event of the Company going into insolvent liquidation, than the position they would have been in if that thing had not been done. This factor may be established by evidence that the Company did in fact pay the GBP 20,000 to AAL to cover existing liabilities and also advanced GBP 8,000 for orders up to the date of the winding up order. Both of these payments put AAL in a better position that it would have otherwise been in because it has received full payment as opposed to waiting in line with other unsecured creditors and being paid on a *pari passu* basis after payment of preferential debts etc.
3. The Company was, in giving the preference, influenced by a desire to prefer AAL. We are told that the Company considered that a continued supply of metal was seen as essential by the Company. This will be the most difficult factor for the liquidator to establish because the Company may be able to show that it didn’t have a desire to prefer AAL, but simply saw the supply of metal as being crucial to its survival. The pressure that was being applied by AAL on the Company is not relevant to the analysis.[[32]](#footnote-32) In case law following the leading English decision of *Re MC Bacon Ltd* [1990] BCC 78 *"it has been held that where the company was influenced solely by commercial considerations, specifically attempts to ensure that the company continued trading, there could be no desire to prefer."[[33]](#footnote-33)* Based on the facts to hand, it appears that this will be a valid defence for the Company which felt that the supply of metal was crucial for its ongoing commercial operations.
4. The preference was given at a relevant time. On the basis that AAL is not connected to the Company, the preference must have occurred within six months prior to the onset of insolvency. As the Company is in compulsory liquidation, the onset of insolvency will be the date of the petition on 13 January 2024 meaning that the payments had to occur in the six months prior to that date. This factor may also cause some problems for the liquidator because we know that the winding up order was made on 28 February 2024 and AAL's demand was approximately one month prior to that date with the payments coming later. In the circumstances the payments may not have occurred in the relevant period.

In the circumstances where there are going to be significant challenges to seek to avoid these payments to AAL on the basis that they are preferences pursuant to section 239 of the AAL, the liquidator should be advised that the payments may be invalidated on the basis that they were made after the presentation of the winding-up petition on 13 January 2024 and prior to the winding-up order being made on 28 February 2024 but were not validated pursuant to section 127 of the IA.

Section 127 of the IA avoids any disposition of property of the Company made after the commencement of winding up, unless the court otherwise orders.[[34]](#footnote-34) Based on the facts there is no evidence that the Company applied to the Court to seek a validation order pursuant to section 127 of the IA with respect to either the payment of GBP 20,000 to AAL to cover existing liabilities or for the GBP 8,000 for cash on delivery orders. In those circumstances and now that a winding-up order has been made, it is open to the liquidator to take steps to enforce section 127 in order to retrieve payments that were made during the period between the petition and the winding-up order.[[35]](#footnote-35)

However, AAL may still seek to validate the payments and can apply under section 127 of the IA. The Court has a wide discretion in determining whether a validation order should be made, and it will be up to AAL to prove that the payments should be validated. AAL will likely rely on the fact that the payments were necessary to ensure continued supplies of metal which enabled the company to continue trading and that that was in the best interests of creditors.[[36]](#footnote-36) The Court will also consider the fact that GDP 8,000 worth of goods were paid for on terms of cash on delivery and the benefit that this provided to the Company and whether it did in fact enable further supplies to be received and so enable the business to continue. If the Court finds that the continued trading did result in a better outcome for creditors, then the payments may be validated. However, if the liquidator can establish that there was no greater benefit aside from to AAL, then the payments are more likely to be voided.

**\* End of Assessment \***

1. Module 3B Guidance Text, Insolvency System of the United Kingdom (England and Wales) 2023 / 2024 (**Guidance Text**), pages 70 – 71. [↑](#footnote-ref-1)
2. Guidance Text, page 7. [↑](#footnote-ref-2)
3. Guidance Text, page 38. [↑](#footnote-ref-3)
4. Guidance Text, page 20. [↑](#footnote-ref-4)
5. Ibid. [↑](#footnote-ref-5)
6. Ibid. [↑](#footnote-ref-6)
7. Ibid. [↑](#footnote-ref-7)
8. Guidance Text, page 21. [↑](#footnote-ref-8)
9. Guidance Text, Page 21. [↑](#footnote-ref-9)
10. Ibid. [↑](#footnote-ref-10)
11. Guidance Text, page 51. [↑](#footnote-ref-11)
12. Guidance Text, page 51. [↑](#footnote-ref-12)
13. Ibid. [↑](#footnote-ref-13)
14. Guidance Text, pages 51 – 52. [↑](#footnote-ref-14)
15. Guidance Text, pages 52 - 53 [↑](#footnote-ref-15)
16. Guidance Text, page 55. [↑](#footnote-ref-16)
17. Ibid. [↑](#footnote-ref-17)
18. Ibid. [↑](#footnote-ref-18)
19. Guidance Text, page 36. [↑](#footnote-ref-19)
20. Guidance Text, page 39. [↑](#footnote-ref-20)
21. Ibid. [↑](#footnote-ref-21)
22. Guidance Text, pages 70 – 71. [↑](#footnote-ref-22)
23. Sections 123(c) and (d) of the IA; Guidance Text, page 4. [↑](#footnote-ref-23)
24. Guidance Text, page 4. [↑](#footnote-ref-24)
25. Guidance Text, page 70. [↑](#footnote-ref-25)
26. Guidance Text, page 67. [↑](#footnote-ref-26)
27. Guidance Text, page 60. [↑](#footnote-ref-27)
28. *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] UKSC 285. [↑](#footnote-ref-28)
29. Guidance Text, page 49. [↑](#footnote-ref-29)
30. Guidance Text, page 49. [↑](#footnote-ref-30)
31. Guidance Text, page 67. [↑](#footnote-ref-31)
32. Guidance text, pages 68 – 69. [↑](#footnote-ref-32)
33. Guidance test, page 69. [↑](#footnote-ref-33)
34. Guidance Text, page 65. [↑](#footnote-ref-34)
35. Ibid. [↑](#footnote-ref-35)
36. Guidance Text, page 66. [↑](#footnote-ref-36)