



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: **[student number.assessment3B]**. An example would be something along the following lines: 202021IFU-314.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 “studentnumber” 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.**
- 6.1 If 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 2021**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2021. 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 2021** or by **23:00 (11 pm) BST on 31 July 2021**. If you elect to submit by 1 March 2021, you **may not** submit the assessment again by 31 July 2021 (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

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

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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

What is the initial period for a Moratorium under Part 1A of the Insolvency Act 1986 where the directors file relevant documents at court?

- (a) 20 days.
- (b) 20 business days.**
- (c) 40 days.
- (d) 40 business days.

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?

- (a) 40 business days.
- (b) One year and 20 business days.**
- (c) One year and 40 business days.
- (d) One year.

Commented [WA3]: d is the correct answer

Question 1.3

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

- (a) 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.
- (b) 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.
- (c) the purpose of the compromise or arrangement is to eliminate, reduce or prevent, or mitigate the effect of, any of the said financial difficulties.
- (d) 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

What percentage of creditors must approve a Scheme of Arrangement under Part 26 of the Companies Act 2006?

- (a) A majority in number and in value.
- (b) A majority in number and 50% or more in value.
- (c) A majority in number and 75% or more in value.
- (d) 75% or more in value.

Question 1.5

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

- (a) Administration.
- (b) Restructuring Plan.
- (c) Scheme of Arrangement.

(d) Company Voluntary Arrangement.

Commented [WA4]: a is the correct answer

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?

- (a) £500
- (b) £750
- (c) £1,000
- (d) £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?

- (a) Wrongful trading.
- (b) Breach of fiduciary duty.
- (c) Being found guilty of an indictable offence in Great Britain.
- (d) Being found guilty of an indictable offence overseas.

Question 1.8

The administrator is under a general duty to make a statement setting out proposals for achieving the purpose of administration. He or she must send out the statement of proposals as soon as reasonably practicable, and in any event within how many weeks of the date the company entered administration?

(a) 6

(b) 8

(c) 10

(d) 12

Question 1.9

Which of the following has the power to bring an action for wrongful trading under the Insolvency Act 1986?

(a) A monitor of a Moratorium.

(b) A supervisor of a Company Voluntary Arrangement.

(c) An administrator.

(d) An administrative receiver.

Question 1.10

Under section 176A of the Insolvency Act 1986, the prescribed part deducted from floating charge assets in favour of unsecured creditors is calculated as follows:

(a) 20% of the floating charge assets.

(b) 50% of the first £10,000 in value plus 20% of the excess in value above the £10,000 subject to a maximum amount of the prescribed part of £600,000.

(c) 20% of the first £50,000 in value plus 50% of the excess in value above the £50,000 subject to a maximum amount of prescribed part of £800,000.

(d) 50% of the first £10,000 in value plus 20% of the excess in value above the £10,000 subject to a maximum amount of prescribed part of £800,000.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 6 marks]

What is the difference between cash flow insolvency and balance sheet insolvency?

Cash flow insolvency is very simply where a company cannot pay its debts as and when they fall due. Conversely, balance sheet insolvency looks to the balance between a company's assets and liabilities. Where a company is in a position where its assets are lower than its liabilities, it will be deemed to be insolvent purely from the balance sheet test. It is however

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Commented [WA6]: 5/6 a good answer but some consideration of where the line is drawn between the two tests would have been helpful. I am not sure why your answer contains footnote markers.

possible however, that a company that is solvent from a cash flow perspective, could be considered to be insolvent under the balance sheet test.

The cash flow test, as set out in 123(1)(e) of the *Insolvency Act* requires the Court to be satisfied that the company will be unable to meet its debts as they fall due, however, this definition does not provide any temporal perspective. That is, at what point are the debts deemed to be due and payable, and how far into the future will the Court look to determine this form of solvency. As Lord Walker succinctly noted in *Eurosail*, the cash-flow test is not only concerned with the presently-due debt of the debtor, as well as presently due debt of the creditor (i.e what is owing to the creditor who has brought the petition) but also with the debts of the company that may fall due in the 'reasonably near future'.¹ The limitation of course of the cash-flow test was when a review of the company was required to extend beyond the reasonably near future (which is not defined and is arguably a particularly subjective timeframe) and it would only be prudent to determine solvency via the balance-sheet test.²

The balance sheet-test is based purely off an assessment of the value of current assets as well as the value of present, future and contingent liabilities. As the *Eurosail* decision highlights, the difficulty of the balance sheet test is confidently assessing that a company will eventually face a deficiency and would thus be insolvent in a number of years, when at the time of the assessment the company may have a deficiency but may, in due course trade out of such deficiency and be solvent.³ As such, any petitioner that is trying to rely on the balance sheet test to demonstrate an insolvent company would need to have considerably convincing evidence to demonstrate that the contingent liabilities or further future liabilities will be able to be enough to satisfy a court that the Company is insolvent at the time of the assessment, despite making an assessment whether there will be a reasonable expectation for the company to meet its future obligations.

Question 2.2 [maximum 4 marks]

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List **four (4)** elements of the statutory moratorium imposed when a company enters administration.

No resolution may be passed for the winding up of the company;
No step may be taken to enforce security over the company's property except with the consent of the administrator or the permission of the Court;
No administrative receiver may be appointed; and
No legal process (including commencing new proceedings, or executing previous judgments) may be instituted against the company (or company property) except with the consent of the administrator or the permission of the Court.

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

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Question 3.1 [maximum 6 marks]

Commented [WA9]: 5/6 a good answer but needs to be clearer on how cram down operates

Explain the main differences between a Part 26 Scheme of Arrangement and a Part 26A Restructuring Plan.

There are a number of main differences between a Part 26 Scheme of Arrangement and a part 26A Restructuring Plan, leading to of course different circumstances where each option

¹ *BNY Corporate Trustee Services Ltd -v- Eurosail-UK 2—7-3BL Plc*, [2013] UKSC 28; [2013] 1 W.L.R. 1408 at [33], [37].

² *Ibid.*

³ *BNY Corporate Trustee Services Ltd -v- Eurosail-UK 2—7-3BL Plc*, [2013] UKSC 28; [2013] 1 W.L.R. 1408 at [49].

may be a better solution for a particular company, including based on the outcomes required from the process, and how the creditors or other stakeholders are going to act with respect to the process.

Eligibility

The first difference is the eligibility of companies to enter into a Part 26 or Part 26A. Unlike the Part 26, Part 26A is only available to a company which has encountered or is likely to encounter financial difficulties that will either affect, or are currently affecting the ability for the business to continue trading as a going concern. Further, it must be proven that the compromise or arrangement arising from the Part 26A process is between the and either it's creditors (or a class of creditors therein), or its members (or again, a class therein); and that the purpose of the compromise or arrangement is to either eliminate, reduce, prevent or mitigate part of the effect, of any of the said financial difficulties currently being encountered.

Conversely, a Part 26 is applicable to companies that are either solvent or insolvent, as the scheme is for creditors. Effectively, a company may enter into a Part 26 to effect a restructure of the company in circumstances where the company has a large asset base that is then able to actually fund the scheme.

Approval Process

The approval process between each of a Part 26 and Part 26A is also different. A Part 26 scheme requires the approval of 75% of the value of creditors to approve the Scheme, as well as the majority of stakeholders within each class of creditor to approve the scheme. Conversely, a Part 26A only requires the approval of 75% of the creditors in overall value.

Cram Down

Finally, a part 26A Plan allows for cram-down, even where not all of the creditors are able to agree with the restructuring plan that has been proposed, whereas a Part 26 Scheme has no such provision and as such a cram-down is not possible. A cram down under a part 26A plan requires the Court to be satisfied that none of the members would be worse off than under an alternative and that at least 75% (by value) of a class of creditor or members who hold either an economic interest, or would have otherwise received a payment, had voted in favour of the plan.

Question 3.2 [maximum 9 marks]

Explain the different ways in which overseas officeholders may be recognised and request the assistance of the court in England and Wales.

For a number of years, there have been four ways for an overseas officeholder to seek recognition of foreign proceedings and request the assistance of courts in England and Wales. These methods are the European Insolvency Regulation, Section 426 of the UK Insolvency Act, the Cross Border Insolvency Regulations (CBIR), or at common law based on the fundamental principles of comity. These various methods will be discussed in the below.

Firstly, and briefly, the European Insolvency Regulation (EIR) has previously provided assistance for officeholders across the European Union to easily and efficiently apply for recognition across all members of the EU (save for Denmark). Under the EIR, foreign proceedings were concerned with the Centre of Main Interests (COMI) of the Debtor company. Upon commencement of proceedings in the Country with the COMI, the applicable law would then be that of the COMI country. Effectively the EIR would then allow for automatic

Commented [WA10]: 9/9 a generally excellent answer but again there is a strange footnote marker

recognition of the proceedings across member states, including the UK meaning that recognition of a foreign officeholder was automatic. However, as a result of Brexit there have been a number of amendments to allow for recognition, as set out in *The Insolvency (Amendment) (EU Exit) Regulations 2019* and *The Insolvency (Amendment) (EU Exit) Regulations 2020*, which effectively provides some authority to the UK Courts to allow insolvency proceedings (following the exit date) where there is either a COMI of the UK, or the COMI is in the European Union but there is sufficient connection to the UK.

Secondly, s426 of the Insolvency Act provides the framework for UK Courts to provide assistance to other U.K Courts as well as to the insolvency courts of countries (as defined in the Act, these are 'relevant countries' and this is not a blank obligation to any country). A number of countries are currently listed including South Africa, Australia, Hong Kong, New Zealand and Canada. Whilst the decision to grant assistance under s 426 is entirely within the discretion of the Court, the general position is that the court should provide the requested assistance unless it would be improper for the Court to do so.

The Cross-Border Insolvency provisions are based on the UNCITRAL Model Law on cross-Border Insolvency and as such the general provisions relating to the Model Law exist within the UK as a result of this legislation. It is interesting to note that in adopting the Model Law, the UK has not placed any limits on the an inbound application, meaning that any insolvency practitioner from any overseas jurisdiction can make an application in the UK for recognition and assistance, and any such application can be directly made by the insolvency practitioner. Further, foreign insolvency practitioners are provided with further opportunities to engage with and participate in any debtor's British insolvency processes.

Finally, the UK common law allows for applications to be made to the Court for recognition. Naturally, this approach has changed over time, but the approach was initially for the court to adhere to the discretion of their power to recognise foreign officeholders as if the application had been made under s.426 as discussed above. Initially, the UK approach allowed for such recognition to be granted, there were 3 main principles that governed this approach – being that a domestic court had the power under the common law to assist a foreign insolvency officeholder, a domestic court has the common law power to assist a foreign court to do whatever the Court would have otherwise done in a local proceeding, and a domestic court has jurisdiction over parties in an insolvency procedure by virtue of this common law power (even if the parties are otherwise outside of the jurisdiction that the domestic court would have otherwise had).⁴ The current UK Common Law approach is significantly limited, so much so that in the event of recognition of a foreign officeholder requiring assistance, should utilise one of the above methods over and above the common law.

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

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Prior to going into liquidation in November 2020, under pressure from its bank, Stercus Bank plc, and in order to prevent it from demanding repayment of the company's loans, Cork-In Limited granted a debenture in favour of Stercus Bank plc in January 2020. The debenture contained a floating charge over the whole of the company's undertaking.

In June 2020, as the company continued to struggle, the directors approved the sale of a company delivery van to Paul Watson (a director) for £5,000 in cash. The van had been bought for £10,000 a year before.

⁴ *Cambridge Gas Transport Corp v The Official Committee of Unsecured Creditors of Navigator Holdings PLC* [2006] UKPC 26, [22] per Lord Hoffman.

A month before the company went into liquidation, Paul Watson received an irate phone call from one of the company's key suppliers, Gary's Grapes Limited. The supplier demanded immediate payment of all sums owing to it (even those invoices that had not become payable). Fearing being cut off by the supplier, Paul arranged for a cheque for the full amount to be sent that day.

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;

After the preferential creditors have been paid, the next creditor(s) to be paid are the holders of any floating charge. Firstly however, the liquidator will need to have ensured that they have complied with section 176A of the Insolvency Act, which is a duty that the liquidator must comply with and have set aside sufficient money/assets to pay the unsecured debts, out of what is called the net property.⁵ For the purposes of s 176A of the Act, the net property then provides a certain amount of money that would otherwise be available for the satisfaction of debts and is calculated after the costs of liquidation and any other preferential debts. Given that the assets have not been disclosed, it is hard to know the exact amount covered by the floating charge.

Given that the charge was granted to an entity not connected with the company, the relevant period for determination is 12 months prior to the liquidation.⁶ Further, it must be proven that as a result of the granting the floating charge the company became unable to pay debts, or that as at the time that the charge was granted, the company was unable to pay the debts then the floating charge is valid.⁷

Therefore, the floating charge would in fact remain valid if it could be proven that the company was unable to pay its debts as and when they fell due or became unable to do so as a result of the floating charge. It is possible that the floating charge did not have this effect, but given that the company was in financial trouble it is likely that this was the case.

However, in the event that the floating charge is able to be avoided by the liquidator, it is important to note that the debt itself that gave rise to the floating charge remains valid.

Question 4.2 [maximum 5 marks]

The sale of the van; and

⁵ *Insolvency Act 1986* s176(2).

⁶ *Insolvency Act 1986* s245(3)(b).

⁷ *Insolvency Act 1986* s245(4).

Commented [WA12]: 2/5 there is some confusion between s 176A and s 245. More detail on s 245 was required. Again there are some aberrant footnote markers.

Commented [WA13]: 4/5 generally sound but no explanation and application of the issue around the recipient being a connected person

Ostensibly, the sale of the van could be construed as a transaction at undervalue, which can be set aside by the liquidator. Pursuant to section 238(2), the liquidator is able to apply to the Court for an order, if at a relevant time, being 2 years prior to the commencement of the liquidation;⁸ the company entered into a transaction with any person at undervalue. The intent of any order from the court with respect to an undervalue transaction is to seek to place the company back in the position it would have been in, if not for that transaction.⁹

To demonstrate that the transaction has been completed at an undervalue, the liquidator must be able to demonstrate that the company either has made the a gift to that person, or has entered into the transaction with that person which results in the Company receiving no consideration;¹⁰ or the company enters into that transaction with that person and the consideration received by the Company is, at the time of the transaction, significantly less than that the value that should have been provided for that transaction.¹¹ A defence to any such transaction however is that the company could have entered into the transaction in good faith and for the purpose of carrying on the business of the company,¹² and that there were reasonable grounds at the time of the transaction for believing that the transaction would actually benefit the company.¹³

Firstly, the liquidator would be able to demonstrate that the transaction was within the relevant time, as it was only 6 months prior to the liquidation commencing. To then satisfy the court, that the transaction was at undervalue, and the company should be restored back to it's prior position (but for that transaction), an analysis of the estimated value of the van at the time that the company entered into the transaction would need to be completed. On a general assumption, it is unlikely that the van would have depreciated by 50% in the year since the acquisition of the van. Further, any defence is unlikely to succeed as the director, who would have the control and authority to enter into the transaction would be unable to satisfy the Court that the transaction was in good faith and for the purpose of carrying on its business or would benefit the company, given how severely undervalued this transaction appears to prima facie be. Further, it is likely that such a loss of an asset for undervalue consideration could have led to the Company being in the position of being unable to pay its debts.

Question 4.3 [maximum 5 marks]

The payment to Gary's Grapes Ltd.

The payment to Gary's Grapes could be considered as a preference or preferential payment. The purpose of the operation of these provisions is to prevent a company that is about to enter into liquidation (or formal insolvency procedure) from making payments to a creditor to place that creditor in a better position than it would have been under any insolvency procedure, and better than other creditors.¹⁴ Generally, the burden of proof for preferences is with the liquidator, unless the transaction is with a person who is otherwise connected with the company, then they must rebut the presumption that it was a preferential payment.

To satisfy the court that the payment was a preference, the Liquidator must demonstrate that that payment was within the relevant period,¹⁵ the receiver of the payment was either a

⁸ *Insolvency Act 1986* s240(1)(a).

⁹ *Insolvency Act 1986* s238(3).

¹⁰ *Insolvency Act 1986* s238(4)(a).

¹¹ *Insolvency Act 1986* s238(4)(b).

¹² *Insolvency Act 1986* s238(5)(a).

¹³ *Insolvency Act 1986* s238(5)(b).

¹⁴ *Insolvency Act 1986* s239(4).

¹⁵ *Insolvency Act 1986* s239(2).

Commented [WA14]: 5/5 a very good answer but again one with stray footnote markers

creditor, or a surety or guarantor for debts (or a liability);¹⁶ the company has either done anything or has 'suffered' anything by virtue of putting that person in a better position than it would have been under any insolvency procedure, and better than other creditors.¹⁷ It is also a prerequisite that the company was unable to pay debts as and when they fell due or become unable to pay debts as and when they fell due by virtue of the payment.¹⁸ Further, the liquidator has a higher threshold to demonstrate that the making of the payment was influenced by the desire to place the creditor in a better position.¹⁹

In terms of this scenario, the liquidator has the burden of proof and would be able to demonstrate that the payment was made within the relevant period, as the payment was made one month prior to liquidation, and that the Gary's Grapes Ltd was a creditor, and that the payment put Gary's Grapes in a better position than it would have been through the insolvency process. It is also possible, depending on the actual value of the payment that the full payment to Gary's Grapes resulted in the company entering into the insolvency process and becoming unable to pay its debts.

However, it would be difficult to demonstrate that the company was influenced by Gary's Grapes to place them in a better position than liquidation. Given that Gary's Grapes was a key supplier to the company, and as stated above, the company wanted to keep Gary's Grapes happy, as an argument would likely be mounted that if the supplier was still providing to the company, the directors may have thought that maintaining this commercial relationship would assist the company. Conversely, an argument could also be made with the view that the full payment of the outstanding money to Gary's Grapes was in fact a preference purely because the company was only motivated to make the payment to avoid entering into the insolvency process.²⁰

*** End of Assessment ***

¹⁶ *Insolvency Act 1986* s239(4)(a).

¹⁷ *Insolvency Act 1986* s239(4)(b).

¹⁸ *Insolvency Act 1986* s123.

¹⁹ *Insolvency Act 1986* s239(5).

²⁰ *RE MC Bacon Ltd* [1990] BCC 78.