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

Commented [JL1]: TOTAL: 43 OUT OF 50
Well done!!

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

Commented [JL2]: 7 out of 10

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 [JL3]: d

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.

Commented [JL4]: c

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.

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.

Commented [JL5]: b

(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]

Commented [JL6]: 10 out of 10

Question 2.1 [maximum 6 marks]

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

[Cash flow insolvency happens the company is unable to pay its debts as they fall due. On the other hand, balance sheet insolvency happens when the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities. Hence, even if a company is able to meet its current liabilities, it

may still be viewed as insolvent on the 'balance sheet' test as it may have liabilities (including account being taken of the company's future and contingent liabilities) greater than it has assets. Section 123 of the *Insolvency Act* allows the use of either or both tests to establish that a company is unable to pay its debts, and thus, a sufficient justification for the court to make a winding up order.

Section 123(1)(e) of the Insolvency Act provides that a company is deemed unable to pay its debts 'if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.' What 'debts' are covered, however, has been problematic. For a long time, 'debts' was understood to cover only debts currently owed with no element of futurity. However, over time, this thinking changed. Recent cases show that courts may consider both debts currently owed and those which will become due in the reasonably near future. Lord Walker in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] UKSC 285 ('Eurosail'), for example, explained that the 'cash flow insolvency is concerned not simply with the petitioner's own presently-due debts, nor only with other presently-due debt owed by the company, but also with debts falling due from time to time in the reasonably near future.' Notably, 'what is reasonably near future…will depend on all circumstances, but especially on the nature of the company's business.' This shift in thinking has created uncertainty as where cash flow insolvency ends and balance sheet insolvency begins.

In *Eurosail*, the Supreme Court further explained that once the court looks beyond the reasonably near future, the 'cash flow' test falls away and the court instead looks to the 'balance sheet' test to compare the value of present assets with present, future and contingent liabilities. Future debts are debts which will definitely become payable at a specific future date, whilst contingent liabilities may or may not even become payable. There may be no problem in determining balance sheet insolvency when the company only has present liabilities. The problem arises, as Lord Walker admitted, in deciding how a court must discount future and contingent liabilities to take account of deferment and probability; thus, the process is 'very far from an exact test.' For example, in *Eurosail*, future liabilities may not be fully determined, based on the facts of the case, for another 30 years because the court could not be satisfied that there would eventually be a deficiency. For example, future profits are expected and these may be more than sufficient to enable the company to repay long-term loan when it falls due. Attempts to foresee the events of the next ten years would be 'entirely speculative…incapable of prediction with reasonable confidence.' The consequence of *Eurosail* is that creditors relying on debts falling payable in several years time or which are contingent will need overwhelmingly convincing evidence that those future or contingent debts make the company insolvent today.]

Commented [JL7]: 6

Question 2.2 [maximum 4 marks]

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

[The statutory moratorium or a stay which takes effect when a company enters administration has several elements. First, no resolution may be passed for the winding up of the company as well as no winding-up order may be made against the company. Second, no step may be taken to enforce security over the company's property. Likewise, no step may be taken to repossess goods in the company's possession under a hire-purchase agreement. Further, no legal process (including any legal proceedings or execution of any judgment) may be instituted or continued against the company. The exception to these three would be when the administrator or the court consents to such action. Third, a landlord may not exercise a right of forfeiture by peaceable re-entry in

relation to premises let to the company except with the consent of the administrator or the court. Fourth, no administrative receiver may be appointed. Notably, the moratorium is procedural in nature; thus, although the power to enforce rights is suspended, those rights are not extinguished.]

Commented [JL8]: 4

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

Commented [JL9]: 13 out of 15

Question 3.1 [maximum 6 marks]

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

[The first major difference between a Part 26 Scheme of Arrangement and a Part 26A Restructuring Plan is in the percentage of votes required to approve the proposed scheme or plan. Under Part 26 of the *Companies Act 2006*, a company can enter into a scheme of arrangement which is binding on all its creditors. Voting by creditors is carried out by different classes of creditors – secured and unsecured – voting separately to approve the scheme. Creditors are allocated to a certain class based on the existing rights of the creditors and their rights as affected by the scheme. The court may order that meetings of creditors or classes of creditors and/or members (or classes of members) affected by the proposed scheme are summoned. Notably, each meeting (or class meeting) must approve the scheme by a simple majority in number and a majority of 75% or more in value of the creditors or members present and voting. After the meetings have approved the scheme, there is a second hearing. If the court sanctions the scheme at this hearing, it becomes binding on all the company's creditors or members. In contrast, in the case of a Part 26A Restructuring Plan, the court may sanction the proposed compromise or arrangement if the number representing 75% or more in value of the creditors or class of creditors, or members or class of members (as the case may be) agree on the terms of the Restructuring Plan. This differs to the Part 26 scheme which requires a majority in number as well as 75% or more in value of each class to approve the scheme.

The other main characteristic which distinguishes the Part 26A Restructuring Plan from the Plan 26 Scheme is the ability of the court to cramdown a dissenting class who does not approve the Restructuring Plan. In circumstances where one or more classes dissent, if Conditions A and B are met, the fact that the dissenting class has not agreed to the Restructuring Plan will not prevent the court from granting a sanction. Condition A is that the court is satisfied that, if sanctioned, none of the dissenting class would be any worse off than they would be in the event of the relevant alternative (which is usually a liquidation or administration). Condition B is that the compromise or arrangement has been agreed by 75% in value of at least one class of creditors or members, as the case may be, who would receive a payment or have a genuine economic interest in the company, in the event of the 'relevant alternative.' As long as Conditions A and B are met, one class of creditor can impose, via court order, the Restructuring Plan on all classes of creditors, even dissenting classes. In contrast, under Part 26 scheme, since all classes of creditors need to vote in favour, the rejection of a class of creditors will prevent the scheme being approved and the company is potentially left only with the option of liquidation. Under the Part 26 Scheme, the dissenting class of creditors cannot be crammed down.]

Commented [JL10]: 4
The requirement of financial distress was not discussed.

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.

[England and Wales have three or four approaches to cross-border insolvency proceedings. As such, three or four regimes could possibly apply to an overseas officeholder asking for recognition and assistance in the British courts.

First, companies with their centre of main interests (COMI) is within any European Union member state (apart from Denmark) are governed by the EU Regulation on Insolvency Proceedings (Recast) ('EIR (Recast)'). The approach under the EIR (Recast) is not to harmonise the various insolvency regimes within the EU but to provide rules for deciding which of the individual jurisdictions' insolvency regimes applies in a particular case. Hence, once COMI is identified, courts of such jurisdiction would have jurisdiction to commence main proceedings. The laws of the state where the company has its COMI would also govern the proceedings and will govern the process within the EU. Other EU jurisdictions will automatically recognise the proceedings and the officeholder will be able to exercise all his powers over assets situated within the EU member states. Particularly, appointment will be recognised automatically in all other EU states and the insolvency practitioner will be able to exercise all powers, subject to limited exceptions. However, if the company has an establishment in another EU member state, it is possible for secondary proceedings to be commenced in that member state and for assets belonging to the company in that other member state to be 'ring-fenced' for the benefit of creditors in that other member state.

Second, since the UK adopts the UNCITRAL Model Law on Cross Border Insolvency ('Model Law'), with only minor revisions, through the Cross Border Insolvency Regulation 2006 SI 3006/1030 (CBIR), such regime could also assist overseas officeholders asking for recognition and assistance in the court in England and Wales. However, unlike in the EIR, recognition of foreign insolvency proceedings under the Model Law is not automatic because it requires an application in the local court to gain recognition and relief. Furthermore, the Model Law does not determine the law applicable to the insolvency proceedings in all aspects, thus certain aspects of recognition (eg, exceptions to recognition) and assistance may be governed by the local law.

Third,.section 426 of the Insolvency Act contains provisions for UK courts to provide assistance to overseas courts from certain listed jurisdictions (former British colonies) like Australia, Canada, Hong Kong, Ireland, Malaysia, New Zealand and South Africa. However, unlike in the EIR regime, recognition and determination of the 'assistance' to be given are discretionary. Significantly, UK courts may apply UK law or the law of the overseas territory in providing assistance.

Fourth, another possible regime is from the common law jurisdiction. However, the extent that common law may assist an overseas officeholder has dwindled down over the years. Initially, the principles of 'modified universalism' as contained in the Privy Council decision in *Cambridge Gas Transport Corp v The Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2006] UKPC 26, include (1) a domestic court has a common law power to assist a foreign insolvency officeholder; (2) a domestic court has a common law power to assist a foreign court by doing whatever it could have done in a domestic insolvency, including exercising any domestic statutory powers; and (3) a domestic court has jurisdiction over parties in an insolvency simply by virtue of its power to assist, and that the absence of jurisdiction *in rem* or *in personam* according to ordinary common law principles is not relevant. Notably, although the first principle remains intact, the extent of the ability of the common law to assist has been reduced significantly by subsequent decisions. The second principle has been held incorrect in *Singularis Holdings Ltd v PricewaterhouseCoopers* [2014] UKPC 39. As such, it appears that there remains little of 'modified universalism' in the common law which can assist an overseas officeholder.

The foregoing analysis is based on material which still does not take into account developments brought by Brexit.

Commented [JL11]: 9

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

Commented [JL12]: 13 out of 15

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.

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;

[Section 245 of the *Insolvency Act* renders a floating charge invalid given by a company at a relevant time, except to the extent that new consideration is provided for the change. The relevant period, depending on whether the person in whose favour the floating charge is created is connected with the company, would be two years (if connected person) or 12 months (if not connected person) prior to the onset of insolvency. In situations where the person who was granted the floating charge was not connected to the company, the relevant period of 12 months would apply only if at the time of the creation of the charge, the company was either unable to pay its debts or become unable to do so in consequence of the transaction. Here, Stercus Bank plc appears not to be connected to Cork-In Limited. Hence, the relevant period is 12 months. Furthermore, the floating charge over the whole of the company's undertaking was precisely made because Cork-In Limited would want to prevent Stercus Bank from demanding repayment of the company's loans. This is a good indicator that at the time the charge was created, Corn-In Limited was unable to pay its debts. Therefore, in this scenario, since Stercus Bank plc was granted a debenture containing a floating charge in January 2020, which is within the 'relevant period' (ie, November 2019 to November 2020), in a situation where Cork-In was unable to pay its debts to Stercus, section 245 would apply, thus rendering the floating charge invalid.

Furthermore, it appears that Stercuse did provide any new consideration, which could be a ground to avoid the invalidation of the floating charge. Here, the two main categories of 'new' consideration set out in section 245 of the Insolvency Act are not present. There was no money paid, or goods or services supplied, nor discharge or reduction of any debt to the company.]

Commented [JL13]: 5

Question 4.2 [maximum 5 marks]

The sale of the van; and

[Under section 238 of the *Insolvency Act*, a liquidator may attack a transaction which was entered prior to the company entering liquidation where the transaction was at an undervalue. Particularly, under section 238, the liquidator or administrator may attack a transaction if the company: (1) made a gift to another person; or (2) entered into a transaction with another person on terms that provided for the company to receive no consideration, or (3) 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's worth, of the consideration provided by the company. The transaction must have happened during the 'relevant period' which is the period of two years prior to the commencement of the liquidation or administration. In this case, liquidation happened in November 2020; thus, the relevant period would be the period from November 2018 to November 2020. Since, the sale of the van happened in June 2020, this was within the relevant period. Furthermore, the sale of the company van to Paul Watson, who was a director, was for £5000, when the van had been brought for £10,000 just a year before; thus the consideration was significantly less than the value provided by the company (situation #3) Nonetheless, since Paul is a director or a connected person to the company, liability would only attach under section 238 if at the time of the transaction, either the company was unable to pay its debts as they fell due within the meaning of that section 123 or became unable to pay its debts within the meaning of that section in consequence of the transaction. However, in such transactions with a connected person, the company is presumed insolvent or to have become insolvent as a result of the transaction, unless the contrary is proved. In this situation, with company already struggling financially in June 2020, the presumption about insolvency would be hard to rebut. Furthermore, the company may also have difficulty establishing that the transaction was done in good faith and for the purpose of carrying its business, and that at the time it did so there were reasonable grounds for believing the transaction would benefit the company. Hence, with the presumption still made to apply, the sale to Paul can be attacked. In such situation, the court has the overriding power to restore the position to what it would have been if the transaction at an undervalue (which is the case here) had not been entered.]

Commented [JL14]: 5

Question 4.3 [maximum 5 marks]

The payment to Gary's Grapes Ltd.

[Section 239 of the *Insolvency Act* allows preferences created by the company, shortly before a formal insolvency procedure, to be avoided by the court on the application of the liquidator. Particularly, section 239 prevents a company, shortly before entering a formal insolvency procedure, from placing one of its creditors in a better position than others. It prevents such preferences such as a payment in full where the creditor could have expected only a dividend as an unsecured creditor. To succeed on an application under section 239, the liquidator should establish: (1) the person whom it is alleged has been preferred was, at the time of the transaction, a creditor of the company (or a surety or guarantor for any of the company's debts or liabilities); (2) something was done, or suffered to be done, by the

company which had the effect of putting that person in a better position, in the event of the company going into insolvent liquidation, than the position he or she would been in if that thing had not been done (that is, that the person has been preferred); (3) the company was, in giving preference, influenced by a desire to produce the effect referred to in (2) above (the desire to prefer) in relation to person preferred; and (4) the preference was given at a relevant time, which would depend on whether the person preferred is connected or not to the company. Notably, for a preference to be actionable, it must have occurred within the two years prior to the onset of the insolvency (if in favour of a connected person) or within the six months prior to the onset of insolvency (if in favour of a person not connected to the company). In this situation, Gary Grapes Limited is not connected to the company; thus, the relevant period would be 6 months.

Applying the requirements of section 239 to the situation, one can argue that requirement 1 is satisfied because Gary Grapes Limited is a creditor of Cork-In Limited. Requirement 2 is also satisfied because Gary Grapes was made into a better position compared to the other unsecured creditors because of the earlier full payment made in its favour. If not for the full payment, Gary Grapes would need to wait and share with the dividends out of the entire estate or property of Cork-In Limited. Most likely, Gary Grapes in this situation, would have received less than the full amount owed by Cork-In Limited. Requirement 3 is also satisfied because the company was explicitly motivated to produce the effect under requirement 2. Since Gary Grapes demanded immediate full payment of all sums owing to it, Cork-In succumbed to its demands knowing fully well that the payment in full would put Gary Grapes in a better position compared to the other suppliers given the dismal financial situation that the company was already experiencing. This intention to prefer is further supported by the fact that Cork-In would not want to be cut-off by the Gary Grapes, which is a key supplier of the company, unless the full payment is made. However, a possible defence to this argument would be for the company to argue that it was motivated solely by commercial considerations, specifically attempts to ensure that the company continued trading. This argument however may be rebutted because here, although Gary Grapes is a key supplier, the company was not entirely dependent on Gary Grapes and could have relied on other equally important suppliers. However, it chose to favour Gary Grapes to appease its demands, and as such, the company has created a preference in favour of Gary Grapes. Lastly, requirement 4 is satisfied because the preference was created a month before the company went into liquidation which is within the relevant period of 6 months before the onset of insolvency.

Commented [JL15]: Was the intention to prefer them and place them in a better position or rather to maintain the supply of goods?

Unlikely that intention to prefer can be proven.

Given that the 4 requirements are satisfied, section 239 of the *Insolvency Act* is satisfied; thus the preference created in favour of Gary Grapes may be avoided. The court may therefore order the return of the full payment, and Gary Grapes may need to wait for the distribution of shares in the net estate of Cork-In Limited.]

Commented [JL16]: 3

*** End of Assessment ***