



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3B
THE INSOLVENCY SYSTEM OF THE UNITED KINGDOM
(ENGLAND AND WALES)

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

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

The mark awarded for this assessment will determine your final mark for Module 3B. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in MS Word format, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
4. You must save this document using the following format: **[studentID.assessment3B]**. An example would be something along the following lines: 20222-514.assessment3B. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words "studentID" with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
- 6.1 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 2022**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2022. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
- 6.2 If you selected Module 3B as one of your **elective modules** (see the e-mail that was sent to you when your place on the course was confirmed), you have a **choice** as to when you may submit this assessment. You may either submit the assessment by **23:00 (11 pm) GMT on 1 March 2022** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. If you elect to submit by 1 March 2022, you **may not** submit the assessment again by 31 July 2022 (for example, in order to achieve a higher mark).
7. Prior to being populated with your answers, this assessment consists of **7 pages**.

ANSWER ALL THE QUESTIONS

Commented [WPA1]: 37/50 = 74% - a generally strong performance

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

Commented [WPA2]: 8/10

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

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:

- (a) within 10 weeks of the commencement of the administration.
- (b) **within 8 weeks of the commencement of the administration.**
- (c) within 4 weeks of the commencement of the administration.
- (d) 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?

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

- (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

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?

- (a) The administrator.
- (b) Any secured creditor with the benefit of a qualifying floating charge.
- (c) The purchaser.
- (d) The company's auditor.

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.

(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 provide a statement for creditors' consideration setting out proposals for achieving the purpose of administration. He or she must obtain a creditors' decision on whether or not to approve the proposals **within how many weeks** of the date the company entered administration?

(a) 6

(b) 8

(c) 10

(d) 12

Commented [WPA3]: C is correct

Question 1.9

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

(a) 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.

(b) An insolvency officeholder from an EU Member State is automatically recognised by the courts in the UK if appointed before Brexit.

(c) 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.

(d) An insolvency officeholder from an EU Member State cannot apply to a UK court for recognition under section 426 of the Insolvency Act 1986.

Commented [WPA4]: A is correct

Question 1.10

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

(a) 6 months.

(b) 12 months.

(c) 2 years.

(d) 5 years.

QUESTION 2 (direct questions) [10 marks]

Commented [WPA5]: 8/10

Question 2.1 [maximum 5 marks]

Commented [WPA6]: 3/5 – an action under s 6 may be brought by the Secretary of State or the Official Receiver. Only an administrator may bring an action under s 246ZB

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

- i. An action under section 423 of the Insolvency Act 1986 may be brought by:
 - a. where the company is being wound up or is in administration: the official receiver, the liquidator, the administrator and (with leave of court) any victim of the transaction such as a creditor;
 - b. where a victim is bound by a CVA: the supervisor of the CVA or any victim of the transaction (whether bound by the CVA or not);
 - c. in any other case: a victim of the transaction¹
- ii. An action under section 6 of the Company Directors Disqualification Act 1986 may be brought by a creditor or liquidator of the company.
- iii. An action under section 246ZB of the Insolvency Act 1986 can be brought by a liquidator or an administrator of the company.

Question 2.2 [maximum 5 marks]

Commented [WPA7]: 5/5

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

The five qualifying decision procedures are: (a) correspondence, (b) electronic voting, (c) virtual meeting, (d) physical meeting and (e) any other decision making procedure which enables all creditors who are entitled to participate in the making of the decision to participate equally²

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

Commented [WPA8]: 12/15

Question 3.1 [maximum 6 marks]

Commented [WPA9]: 5/6 a good answer but it does not make clear the distinction between ss 233, 233A and 233B.

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?

Section 233 of the Insolvency Act enables an administrator to require suppliers of gas, electricity, water and communications services (including point of sale terminals, computer hardware and software, information, advice, technical assistance, data storage and proceeding and website hosting) to continue providing those goods and services during administration.

Suppliers are not allowed to require payment of outstanding debts by the administrators in order to ensure a new or continued supply of the aforementioned goods and services to the company under administration, but section 233 does permit a supplier to stipulate that the administrator must personally guarantee payment of any charges in relation to the supply³.

¹ Foundation Certificate in Insolvency Law Guidance Text Module 3B paragraph 5.10.11.

² Insolvency Rules 2016, r.15.3; Foundation Certificate in Insolvency Law Guidance Text Module 3B paragraph 4.2.

³ Insolvency Act 1986 section 233; Foundation Certificate in Insolvency Law Guidance Text Module 3B paragraph 5.4.4.4.

Section 233A excludes any "insolvency-related term" in a contract to supply goods and services, which would otherwise allow the supplier to terminate the supply of goods and services, increase price for continued supply or otherwise alter the terms of the contract⁴.

Section 233B prohibits clauses which purport to allow the supplier to terminate or "do any other thing" in relation to the supply contract, if the company in question enters a formal insolvency procedure⁵.

Notwithstanding the above provisions, which are designed to ensure that suppliers do not simply abandon supply contracts for insolvent companies or hike their prices in response or demand payment of arrears, a supply contract could potentially still be terminated by a supplier, if such termination is consented to by the administrator or the supplier makes and is successful in a court application for permission to terminate⁶.

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.

Section 115 of the Insolvency Act and rules 6.42 and 7.108 of the Insolvency Rules provide that a certain expenses are given priority over preferential creditors, holders of floating charges and unsecured creditors. The expenses are as follows, in order of priority:

- (i) Expenses incurred by the liquidator in preserving, realising or getting in assets of the company. This includes the conduct of any proceedings relating to such recovery.
- (ii) The cost of any security provided by the liquidator.
- (iii) Any amount payable to persons (usually accounting firms) to prepare a statement of account/statement of affairs of the company.
- (iv) Any necessary disbursements incurred by the liquidator in the course of winding up the company (for example, expenses incurred by members of the liquidation committee).
- (v) The remuneration of any person who has been employed/retained by the liquidator to perform any services for the company.
- (vi) The remuneration of the liquidator himself (which is subject to rule including the fees estimate regime, where a time cost basis for the liquidator's fees is used).
- (vii) Any corporate tax on chargeable gains accruing on the realisation of any company assets.
- (viii) Any other expenses properly chargeable by the liquidator in carrying out the liquidator's functions in the winding up.

Once the above expenses of the liquidation are paid up, the assets of the company are then used to pay preferential creditors. "Preferential creditors" usually includes employee claims (including their pension schemes) and some other tax liabilities. The Employment Rights Act 1996 provides more extensive protection for employees than the Insolvency Act, and there is some duplication between the two sets of provisions. In relation to tax liabilities, a number of liabilities owed to the Crown have been more recently reintroduced by section 95 of the Finance Act 2020.

Preferential debts are split into ordinary and secondary classes. Ordinary preferential debts are paid before secondary. Each class rank equally amongst themselves, so receive equal aggregate compensation, if there are not sufficient funds to pay them in full.

⁴ [ibid]

⁵ [ibid].

⁶ [ibid].

Commented [WPA10]: 7/9 good but the prescribed part is not defined and the priority of fixed charges is not explained.

Schedule 6 of the Insolvency Act lists preferential debts.

Once preferential creditors' claims have been settled. Residual funds are then used to pay holders of floating charges and then unsecured creditors. However, the liquidator is under a duty to make a "prescribed part" of the company's "net property" available to settle unsecured debts and must not distribute any of that prescribed part to floating charge holders unless it is in excess of what is need to satisfy all the unsecured debts. "Net property" is the amount of the company's property, which would have otherwise been available to satisfy the floating charge holders' debts. It is calculated after the liquidation expenses and preferential debts have been paid.

Subject to the "prescribed part" as defined above, unsecured creditors are paid last. Once the liquidation expenses and distributions are made to preferential and secured creditors, there is usually barely anything left in order to pay a dividend to unsecured creditors.

Finally, only if there are sufficient funds to pay all creditors including interest, any (unlikely) surplus is distributed amongst the shareholders in accordance with the company's memorandum and articles of association, which usually contain a term providing for a distribution pro rata the shareholders' respective shareholdings⁷.

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

Commented [WPA11]: 9/15

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

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

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

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

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

Using the facts above, answer the questions that follow.

⁷ Foundation Certificate in Insolvency Law Guidance Text Module 3B paragraph 5.9.5.

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 may apply here. It is aimed at preventing pre-existing unsecured creditors from obtaining the security of a floating charge in the relevant time period before the Company became insolvent.

Assuming Stercus Bank plc was an unsecured creditor unconnected to the Company, then the relevant time period would be 12 months prior to the onset of insolvency, if at the time the floating charge was created, the Company was already unable to pay its debts.

Stercus Bank plc, therefore, would be prevented by section 245 from relying on the floating charge, as section 245 renders such floating charges invalid. We are told that the floating charge was granted to prevent the calling in of an existing loan made to the Company, therefore there is no question of the floating charge having been granted in relation to "new" consideration. If the floating charge had been given in relation to new consideration, it would have probably remained valid.⁸

Question 4.2 [maximum 6 marks]

The sale of the coffee roasting machines; and

The pre-liquidation sale of the coffee roasting machines to a director of the Company for \$10,000, when those machines were purchased just a year before for \$25,000, appears to be a transaction at undervalue involving parties connected to the Company. This is a reasonable assumption, as while some depreciation would be justifiable (particularly if the machines were bought "new" and are being sold "second-hand"), it is unlikely the coffee roasting machines have devalued their price by over 50% in just a year on any reasonable basis.

This transaction runs afoul of the anti-deprivation rule, which operates to prevent an insolvent estate from being deprived of an asset which should otherwise be preserved for the benefit of the creditors. As a matter of public policy, parties are not permitted to agree to transactions which deprive a subsequently insolvent party of assets. The deprivation must be triggered by the insolvency, which we are told it is, as the Company was having cash flow problems and the sale at undervalue was agreed to get some cash in. There is no "bona fide" defence to the transaction, as it involved a director of the Company as purchaser.

Potential claim:

Section 238 of the Insolvency Act provides that the liquidator must show that the Company:

- (i) Made a gift to another person; or
- (ii) 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.

⁸ Foundation Certificate in Insolvency Law Guidance Text Module 3B paragraph 5.10.10; 5.10.11; 5.10.12.

Commented [WPA12]: 3/5 correct as far as it goes but more detailed explanation and application of s 245 would have been helpful.

Commented [WPA13]: 6/6 a good answer on s 238 – the anti deprivation rule would not apply here.

In terms of relevant time period, the transaction must have taken place in the period of two years prior to the commencement of the liquidation.⁹ The transaction described is comfortably within that period (July 2021 to October 2021).

As the transaction in question was with a director of the Company, i.e. a connected person, the Company is presumed to have been insolvent or to have become insolvent as a result of the transaction, unless the contrary can be proved.

If a section 238 claim is brought by the liquidator against the directors and succeeds, the court can make an order restoring the Company to the position it would have been in if the transaction had not been entered into.

It appears that the liquidators have good grounds for a section 238 claim.

Alternative potential claim:

Section 423 of the Insolvency Act provides that:

- (i) It is necessary to show that the Company entered into a transaction with another person at an undervalue (which is defined as the Company having received no or significantly less consideration than it has provided); and
- (ii) It is necessary to show that the Company entered into the transaction for the purpose of putting assets beyond the reach of a person who is making, or may at some time make, a claim against the Company, or of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make.

There is a good argument that the transaction in question was one at an undervalue. In relation to the second limb of the section 423 test. The transaction occurred before the Company entered into compulsory liquidation, and during a period when the directors of the Company would have well been aware of the Company's near-insolvency. If the directors were aware of this but approved the transaction in order to ensure the Company put certain assets out of reach, then a section 423 claim may be made out and can be brought by the liquidator against the (former) directors.¹⁰

Question 4.3 [maximum 4 marks]

The payments to Beans and Leaves Ltd.

Beans and Leaves Ltd. demanded payment of arrears and demanded upfront payment as a new condition of continued supply from the Company. The directors of the Company, who were aware that the Company was near insolvent, acceded to these claims and caused sums to be paid out to the supplier. This is a potential case of wrongful trading, which is provided for in sections 214 and 246ZB of the Insolvency Act. The section aims to minimise the potential losses to the company's creditors. Under section 214 the court must be satisfied that:

- (i) The Company has gone into insolvent liquidation.
- (ii) At some point before the commencement of the winding up of the Company, that person knew or ought to have concluded that there was no reasonable prospect that the Company would avoid going into insolvent liquidation; and
- (iii) That at the time the person reached that conclusion or ought to have reached that conclusion that person was a director of the Company.

We are told that the directors, being aware of the Company's financial position, saw the supply of beans as essential and tried to keep the Company operating by agreeing to pay the supplier as demanded. The directors would have a defence if they could argue that there was still a reasonable prospect of avoiding liquidation provided the supply of beans was continued. The

⁹ Foundation Certificate in Insolvency Law Guidance Text Module 3B paragraph 5.10.3

¹⁰ [ibid]

Commented [WPA14]: 0/4 – s 214 cannot apply on the facts as the liquidation has already started – s 127 is the relevant law here.

only other defence available to the directors is if they can prove that they took every step with a view to minimising the potential loss to the Company's creditors.¹¹

*** End of Assessment ***

¹¹ [ibid].