INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
IN INTERNATIONAL INSOLVENCY LAW

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

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

Commented [WPA1]: 40/50 = 80% a very good effort showing clear understanding

Commented [WPA2]: 9/10

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.

Commented [WPA3]: B is correct

(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

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.

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 [WPA4]: 8/10

Question 2.1 [maximum 5 marks]

Commented [WPA5]: 3/5 the answer to i) is not quite accurate and the answer to ii) is incorrect – Sec of State or official receiver have standing under s 6 not a liquidator

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?

Section 423 of the Insolvency Act includes provisions to pursue transactions that are designed to, or have, defrauded creditors. The parties able to attack a transaction under this section of the Act are: (1) the Official Receiver, the Administrator or the Liquidator (with the leave of the Court) and any victim of the transaction, where a company is being wound up, (2) the Supervisor, where the victim is bound by the CVA, (3) by the victim of the transaction in any other case – so long as the two requirements under Section 423 are satisfied. The two requirements are to show that the company entered into the transaction with another party at an undervalue in order to put assets beyond the reach of another person, thereby prejudicing the interests of other creditors.

Section 6 of the Company Directors Disqualification Act is most commonly used to seek the disqualification of a director and deal with the findings of breach of fiduciary duties, thereby rendering the director in question unfit. Under section 6, it is the Court which will make the disqualification order against an individual. The application and director conduct report would be made by the liquidator of the company.

Section 246ZB relates to wrongful trading, specifically in administrations, and it is the administrator that can bring action under this section subject to certain provisions. For wrongful trading to have occurred, it must be demonstrated that the director knew (or ought to have known) that there was no reasonable prospect that the company would avoid insolvency proceedings yet continued business anyway and also, that the director failed to take every step possible to minimise further potential loss to creditors. It is also important to note that if faced with the issue of lack of funding in the administration, the administrator can also assign a wrongful trading claim to a third party and this third party can then also bring action under this section.

Question 2.2 [maximum 5 marks]

Commented [WPA6]: 5/5

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

Section 246ZE(1) of the Act provides that a decision of the creditors may be considered using any qualifying decision procedure that the office holder thinks fit, except that it may not be made by a creditors' meeting unless such a meeting is requisitioned by the requisite majority of creditors. This being if requested by a minimum of any of 10% of the value of the creditors, 10% of the number of creditors or, 10 creditors.

The qualifying decision procedure is used for the decision of the creditors as an alternative to deemed consent (deemed consent being when the creditors are notifying of an intended decision and this is deemed acceptable on the basis of no objection – this method is appliable to most matters except for the basis of remuneration).

The five qualifying decision procedures used when deemed consent cannot be used are by correspondence, electronic voting, virtual meeting, physical meeting or any other decision making procedure which enables all creditors who are entitled to participate in the decision to

participate equally. The majority in value agreement would be required to approve the decision.

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

Commented [WPA7]: 12/15

Question 3.1 [maximum 6 marks]

Commented [WPA8]: 5/6 a good answer but it would have been helpful to explain explicitly the difference between s 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?

The answer is yes: an administrator who wishes to continue to operate the business of the company in administration can require suppliers of goods and services to continue to supply those goods and services during the administration. But certain restrictions and other terms apply.

An appointed administrator has the power to carry on the running of the business and often will do so to achieve a sale of the business as a going concern, if continuing to trade would serve to better protect the value of the business and therefore achieve a higher realisation.

In order to continue the running of the business, the administrator would still require the service providers on which the business relies, specifically essential supplies. Executory contracts are not automatically terminated upon the appointment of an administrator. In fact, even those supplier contracts which have automatic termination clauses built in, often find that such automatic termination clauses are void.

Section 233 of the Insolvency Act 1986 applies in this instance and is applicable to such essential services as communications, electricity, water and gas. Suppliers are required to "start a fresh" as at the date of appointment and are not permitted to demand the repayment of outstanding debts to secure continued supply to the company in administration. Such outstanding debts still rank as a claim in the administration estate.

However, under this section of the Act, the supplier is permitted to demand a personal guarantee from the administrator in respect of charges incurred from the date of appointment throughout the duration of the administration, thus, providing the supplier with the comfort and reassurance of no additional debt being incurred. It is also often the case in practice, that the appointed administrator would offer an undertaking to the supplier for services rendered from the date of appointment of the administrator.

More recently, the Corporate Insolvency & Governance Act, 2020 has further expanded these protective measures for the appointed administrator and the company in administration through the addition of Section 233B. This prohibits termination or obstructive actions of the supplier as regard to an existing contract upon the company entering into an insolvency procedure. It prevents supply being terminated, it prevents ongoing supply being withheld and it prevents contractual changes, such as a price increase. In the event a supplier does want to cease supplies, an application must be made to Court by the supplier and supplier hardship must be demonstrated, in order for the Court to grant permission to cease supply.

It is also important to note that previously, the rules on executory contracts was limited only to the essential services noted at the start of this question answer. Section 233B expands this limitation by being applicable to all suppliers, with only a limited number of noted exceptions.

Question 3.2 [maximum 9 marks]

Commented [WPA9]: 7/9 a good answer but it needed to explain in more detail the categories of preferential creditors and how s 176A operates.

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.

The order of priority of payments is set out under Section 115 of the Insolvency Act and also under Rule 6.42 and Rule 7.108 of the Insolvency Rules. It should be noted here that whilst the Act contains the primary law, the Rules provide more practice related detail, which includes this waterfall priority of payment structure.

To begin with the fixed charge holder, assets typically included with a fixed charge include property, machinery or vehicles. Fixed charge holders are always paid first and often outside of the formal insolvency process.

There are certain expenses deemed payable in priority to creditors, creditors including the company's preferential creditors, floating charge holders and unsecured creditors. A number of these expenses also hold priority over the liquidator's own remuneration, though the fees of the liquidator can be drawn prior to payment to creditors.

To summarise, Rule 6.42 states "all fees, costs, charges and other expenses incurred in the course of the winding up are to be treated as expenses of the winding up". The expenses that are payable, in order of priority, include, but are not limited to:

- Expenses that are properly incurred by the liquidators in preserving or realising the assets of the company;
- The cost of any security provided by the liquidator;
- Any necessary disbursements of the liquidator; and
- The remuneration of the liquidator.

Note: there are others not listed – these are just examples.

In a liquidation, secured creditors with a fixed charge rank with the highest priority, followed by the fees of the liquidator, followed by preferential creditors, followed by floating charge holders, following by unsecured creditors, finally, followed by the shareholders. Each class of creditor, with the exception of 'prescribed part', must be paid in full before funds are allocated to the next.

It is also important to note that any prescribed part expenses are payable from the prescribed part ringfenced fund. The prescribed part is the part of the property/asset realisation pot, that a liquidator must reserve for unsecured creditors under Section 176A of the Insolvency Act, which would otherwise have been available to satisfy claims secured by a floating charge.

Once the expenses of the liquidation have been paid in full, preferential creditors are next in order of priority and are set out under Schedule 6 of the Act. Preferential creditors are mainly employees or labour related claims but for procedures from 2020 onwards also includes H M Revenue & Customs (albeit with secondary preferential creditor status). Employees are entitled to arrears of wages up to a maximum of £800, and holiday pay. It should also be noted that only certain HMRC debts are included.

After the preferential claims have been settled in full, any surplus funds filter down to pay the floating charge holder. It is at this point that the aforementioned prescribed part ring fenced fund would be sectioned out, as per Section 176A of the Insolvency Act. In the event of there being more than one floating charge holder, the one which was creates earliest gets priority.

Next are unsecured creditors. Unsecured creditors hold no security and are often referred to as trade creditors, as they are usually just that: trade creditors. Very often, by the time the

funds have come this far down the waterfall, there are insufficient funds to pay unsecured creditors in full and, therefore, any unsecured creditors with a valid and admitted proof of debt would get paid a dividend of a p/£ distribution. Unsecured creditors can also include claims from the secured creditor in respect of any shortfall and employee claims, to the extent they do not rank as preferential.

In the event that there have been sufficient realisations in the estate to pay unsecured creditors in full, bearing in mind that when being paid in full, unsecured creditors are also entitled to be paid statutory interest on their claims, then any surplus is distributed amongst the shareholders of the company, on a pro rata basis on their respective shareholdings, in accordance with the constitution of the company. Shareholders are not entitled to any payment until all other creditor groups have been paid.

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

Commented [WPA10]: 11/15

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.

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]

Commented [WPA11]: 5/5

The floating charge in favour of Stercus Bank plc;

According to the information provided, the Company granted a debenture in favour of Stercus Bank Plc (the **Bank**) in February 2021, 10 months prior to the Company entering into liquidation. Section 245 of the Insolvency Act declares certain floating charges automatically invalid if they were created within a specific time before the commencement of a winding up, subject to certain exceptions. We must consider the relevant timeframe and exceptions, to determine whether they apply. It is important to note that even if the floating charge is deemed invalid, the underlying debt on which it is based is not – this can still be claimed for in the liquidation as an unsecured debt.

My assumption in this case is that the Bank is not a connected party, therefore, the relevant time is within the period of 12 months prior to the onset of insolvency (but only if the Company was unable to pay its debts at the time of the transaction). Given the indication of pressures and 'avoidance' of demanding repayment of loans (together with the subsequent transactions shortly thereafter involving the coffee roasting machines and coffee beans), then I would assume this was the case.

It is worth nothing that if the person/entity who has been granted the floating charge is connected to the Company, then the relevant time is 2 years.

Before taking any action, however, the liquidator must consider whether "new" consideration applies. We know that the first category of "new" consideration does not apply, as no money was paid or goods/services applied. However, it would need to be investigated whether category 2 would apply. Category 2 consists of a discharge or reduction in the Company's debt. If this applies, then the floating charge is not to be invalidated. We do not have enough information in the question to categorically consider this and more questions should be asked – whilst it would not appear to be the case, this is an key consideration to be made.

If the floating charge granted to the Bank is deemed to be caught under Section 245 of the Act, then it is rendered invalid and cannot be enforced.

Question 4.2 [maximum 6 marks]

Commented [WPA12]: 6/6

The sale of the coffee roasting machines; and

The coffee roasting machines were sold to a director of the company for £15,000 less than the purchase price only 12 months later. The director is considered a connected party. It is safe to assume that any depreciation in value of the coffee machines would not have amounted to over half of the purchase price, given the relatively short period of time that passed. Therefore, this is considered a transaction at an undervalue. Section 238 of the Act can be used by the liquidator to commence legal proceedings for compensation in respect of this transaction.

Under Section 238 of the Act, the appointed liquidator is entitled to attack this transaction, as the liquidator can show that the company, as quoted from the Act, "entered into a transaction with another person for a consideration which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company". It can also be demonstrated that the transaction took place within the "relevant time" – the three months being within the period of two years prior to the commencement of the liquidation.

In addition, it states in the question that the transaction occurred as a result of the Company suffering cash flow problems. Whether or not these cash flow problems meant the Company was unable to pay its debts as and when they fell due, therefore, deemed insolvent per Section 123 of the Insolvency Act is unknown however, this prerequisite is actually irrelevant in this

case as the transaction was with a connected person, meaning the Company is presumed to have been cash flow insolvent unless the contrary is proved.

The only way the Company could defend any action taken against it by the liquidator is if it could satisfy the Court that the transaction was entered into for the purpose of carrying on its business and for the benefit of the Court. Whilst this could be true as the coffee roasting machines form a key part of the business, it still may not be accepted that they were sold at such a low value.

Should the Court conclude that this was a transaction at an undervalue, it shall make an Order to restore the position to what it would have been had the transaction not been entered into.

Question 4.3 [maximum 4 marks]

Commented [WPA13]: 0/4 – unfortunately the issue is misidentified – it cannot be s 239 as the winding up has already commenced – it can only involve s 127

The payments to Beans and Leaves Ltd.

The payment to Beans and Leaves Ltd constitutes a preference payment, pursuant to Section 239 of the Act, having placed it, as a creditor, in a better position than others shortly prior to entering into compulsory liquidation – and, when the directors of the Company knew (or ought to have known) it was in financial difficulty.

Per the stipulations of Section 239 of the Act, it can be demonstrated that Beans and Leaves were a creditor of the Company at the time of the transaction, as they were a key supplier who not only previously supplied the Company but also based the settlement of its debt on the future supply of the coffee beans.

In addition, it can be demonstrated that Beans and Leaves were put in a better position at the time of the Company entering into liquidation. Had the transaction not occurred, Beans and Leaves would have been an unsecured creditor proving a claim in the sum of £8,000 (assuming all future supply ceased, as threatened, and no further coffee beans were delivered to the Company). However, as a result of the transaction, Beans and Leaves were only a creditor as at the date of appointment in the sum of £3,000 – a £5,000 'gain' for the creditor as a result of the transaction.

The desire to prefer can also be demonstrated. Beans and Leaves threatened to cease the supply of coffee beans. What matters here is that the threat itself is not relevant. The directors considered coffee beans an essential supply and, therefore, entered into the transaction to result in the above – Beans and Leaves being put in a better position to others, in order that the Company could keep their ongoing supply of coffee beans.

And finally, the transaction was entered into only a month before the winding up order was made, well within the relevant time to be considered a preference payment under Section 239 of the Act, the relevant time frame being six months for a non-connected party.

It is for the Liquidator to prove each stipulation of a preference payment are met, which can be adequately done in this case, giving sufficient grounds to pursue a claim. The risk associated with such a claim would be if the Court considered that the Company entered into the transaction with a commercial mindset, specifically so the Company could continue to trade (i.e. because there could be no coffee, with no coffee beans). If the Judge took the same view as demonstrated in the case provided by Millet J. in *Re MC Bacon Ltd*, then there could be no desire to prefer.

*** End of Assessment ***