



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).
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- 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**.

Commented [DB1]: Please be more careful when inserting your student ID – you had written 356 instead of 365. Incorrect student ID's can cause huge issues for us on the course.

ANSWER ALL THE QUESTIONS

Commented [WPA2]: 42/50 = 84% - a very worthy effort

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

Commented [WPA3]: 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.

Commented [WPA4]: C is correct

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 [WPA5]: 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 [WPA6]: 9/10

Question 2.1 [maximum 5 marks]

Commented [WPA7]: 4/5 – 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?

[The following persons may bring an action under the following provisions:

- (i) Under **section 423 of the Insolvency Act 1986** which relates to transactions entered into at an undervalue; The following persons may bring an action:
 - (a) The Official Receiver, the Trustee of the bankrupt's estate or the Liquidator or the Administrator of the body corporate or (with the leave of the Court) a victim of the transaction, in a case where the debtor has been adjudged bankrupt or is a body corporate which is being wound up or in relation to which an administration Order is in force.¹
 - (b) The Supervisor of the voluntary arrangement or by any person who (whether or not so bound) is such a victim, in a case where a victim of the transaction is bound by a voluntary arrangement approved under Part 1 or Part VIII of the Act;² or
 - (c) By a Victim of the transaction, in any other case.³
- (ii) Under **section 6 of the Company Director's Disqualification Act, 1986** which relates to issues of disqualification of Directors of Insolvent Companies for wrongful or unfit conduct;
 - (a) By the Secretary of State in the public interest; or
 - (b) By the Official Receiver upon the direction of the secretary of state.⁴
- (iii) Under **section 246ZB of the Insolvency Act, 1986** which relates to issues of liabilities of directors of Insolvent Companies for wrongful trading;
 - (a) Only the Liquidator by virtue of section 214 of the Insolvency Act, 1986.^{5]}

Question 2.2 [maximum 5 marks]

Commented [WPA8]: 5/5

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

[The five (5) qualifying decision procedures by which creditors may make decisions in the context of an insolvent company are;

1. By correspondence;
2. By electronic voting;
3. By virtual meeting;
4. By physical meeting; or
5. By any other decision-making procedure which enables all creditors who are entitled to participate in the making of the decision to participate equally.^{6]}

¹ See, Section 424 (1) (a) of the Insolvency Act 1986.

² See, Section 424 (1) (b) of the Insolvency Act 1986.

³ See, Section 424 (1) (c) of the Insolvency Act 1986.

⁴ This can be found in Section 7 of the Company Directors Disqualification Act, 1986.

⁵ See, Section 214 (1) of the Insolvency Act 1986.

⁶ This can be found in Rule 15.3 of the Insolvency Rules 2016 SI 2016/1024 ("the Rules").

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

Commented [WPA9]: 14/15

Question 3.1 [maximum 6 marks]

Commented [WPA10]: 6/6 – there is a technical error towards the end in terms of which office holders are covered by each section but a generally very good answer

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?

[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. This is so because, the appointment of an administrator does not automatically terminate a company's executory contracts such as contracts of supply of goods and services. In addition, agreed terms in contracts of supply which normally provide for automatic termination were historically generally effective but recently have now become subject to increasing statutory exceptions which now largely make such automatic termination (or *ipso facto*) clauses void, upon the company entering into an Insolvency. For instance, administrator usually need to obtain or retain certain essential supplies under section 233 of the Insolvency Act, 1986 which applies to a supply of gas, electricity, water and communications services.⁷ Under the section, suppliers are not permitted to require payment of outstanding debts in order to secure a new or continued supply to the company in administration except the supplier had stipulated that the administrator must personally guarantee payment of charges in respect of the supply under the Act. In addition, the 1986 Act under section 233A also provided that a supplier of such services is generally unable to rely upon an "insolvency-related term" in a contract of supply which would otherwise entitle the supplier to terminate the supply, alter the terms of the supply or compel higher payments for continued supply.

The two provisions of sections 233 and 233A of the IA, 1986 which were already significant in such regards of interfering with the substantive terms agreed by the parties when there is an insolvency procedure were however applied only to contracts for the provisions of "essential supplies" as earlier stated. However, by the emergence of the Corporate Insolvency and Governance Act, 2020, these protections for insolvent company were expanded through the introduction of section 233B of the Act. Clauses which allow the supplier of goods or services to terminate or "do any other thing" in relation to that contract if the company enters a formal insolvency procedure were prohibited under section 233B of the Act. A provision of a contract for the supply of goods or services to the company is of no effect when the company enters an insolvency procedure, if, under that provision the contract would terminate or the supplier would be entitled to terminate the contract or to "do any other thing" upon the company entering an insolvency procedure. The section does not only prevent suppliers from terminating a supply upon the company's insolvency but also prevent suppliers from making it a condition of continued supply that pre-insolvency arrears are paid and also from making other changes to the contract such as increasing prices.

Nevertheless, under section 233B, a contract may still be terminated by a supplier where the administrator or the company consents or, on application to the Court, where the court must be satisfied that the continuation of the contract would cause the supplier hardship, before permission for termination can be granted. Section 233B has been said to complement the existing sections 233 and 233A of the Act which, in almost the same terms, prohibit termination

⁷ The definition of communications services includes the supply of goods and services such as point of sale terminals, computer hardware and software, information, advice, and technical assistance, data storage and processing and website hosting. See, Module 3B Guidance Text, p 20.

by utility, communications and IT suppliers⁸. The section opens up the restriction on termination to all suppliers (with a limited number of exceptions, for example, insurers; banks; electronic money institutions; recognised investment exchanges and clearing houses; securitisation companies and overseas companies with corresponding functions).⁹ It is however to be noted that the three sections apply in administration and also where a company has entered into a CVA and a Moratorium or a Restructuring plan.

In conclusion, I reiterate and affirm that 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 administration based on the foregoing provisions of sections 233, 233A of the IA 1986 and 233B of CIGA 2020 respectively.]

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.

[The order of priority of payments in a liquidation refer to the process of distributing the realised assets of company in liquidation to the creditors of the company in accordance to a laid down order or preference under insolvency law. All insolvency systems across the world provided for priority to payment from redeemed asset in liquidation, even though, nearly each country has a different scheme, albeit of marginal difference in some cases¹⁰. Generally speaking, order of priority of payment depends on whether the payment is for secured creditor or unsecured creditor.

Secured Creditors may be broadly defined as the holder of rights over property which are obtained (or possibly retained) with a view to ensuring the payment of money due or the performance of some other obligation. The property over which security is taken is referred to as being "secured" or "collateralised".¹¹ In some countries, secured creditors are paid first after the cost of the Insolvency proceedings have been taken care of. Indeed, secured creditors can effectively opt out of the Insolvency proceedings and realise their secured property (collateral) separately.¹²

There is a distinction between secured claims- claims backed up by security interests and unsecured claims. Secured claims generally have priority over unsecured claims but the extent of this priority may vary.¹³ However, it has been argued that the reason for giving security creditors priority over unsecured creditors is because the former have chosen and bargained for property rights and priority in respect of the debtor's assets whereas the later have not.¹⁴ There may be, however, a certain proportion of secured property realisations claims set aside for the benefit of unsecured claimants.¹⁵

⁸ Idem.

⁹ Idem. These lenders will still be able to exercise termination and any rights upon insolvency of the debtor where such rights are permitted by the relevant loan documents.

¹⁰ Andrew Keay, Andre Boraine and David Burdette, "Preferential Debts in Corporate Insolvency": A Comparative Study, INSOL International Review p 167.

¹¹ Gerard McCormack, "Priorities and Fairness in Restructuring and Insolvency Law", Academic Paper, INSOL International, Nov 2021, p 5.

¹² Idem.

¹³ Idem.

¹⁴ Idem.

¹⁵ Idem: Under the UK law, a certain percentage of floating charge realisations is set aside for the benefit of unsecured creditors. The percentage is calculated by secondary legislation on a sliding scale, but subject to an overall ceiling of GBP 800,000. See, idem.

Commented [WPA11]: 8/9 – it not clear why the overseas jurisdictions have been included. There is one small technical error in citing social security contributions under Cat 4 of Sch 6. That apart a very good answer to the UK regime.

In Canada, under sections 136 to 147 of the Bankruptcy and Insolvency Act 1985 containing the statutory scheme that governs the ranking of claims, the order of priority of payments in liquidation is as follows;

- (a) Super priority claim¹⁶
- (b) Secured creditors
- (c) Preferred claims¹⁷
- (d) Unsecured creditors' claims
- (e) Shareholders claims

In the US Bankruptcy Code, order of priority payment is predicated on the absolute priority principle explained in detail by the US Supreme Court in the case of *Czyzewski v. Jevic Holding Corp.*¹⁸, where the Supreme Court said that the Bankruptcy Code sets forth a basic system of priority that ordinary determines the order in which the Court will distribute assets of the debtor's estate. Secured creditors are highest on the priority list in that they must receive the proceeds of the collateral that secures their debts. Special Classes of creditors, such as those that hold certain claims for taxes or wages, come next in a particular order followed by lower priority creditors, including general unsecured creditors. Equity holders are at the bottom of the priority list and they receive nothing until all previously listed creditors have been paid in full.¹⁹

Under the South African Insolvency Act 1936 applicable to corporate insolvency, the order of priority of payments is as follows²⁰

1. Secured Creditors²¹
2. Preferent Creditor and
3. Concurrent Creditors.

Preferent creditors are creditors whose claims are statutorily preferent in terms of the Insolvency Act. Concurrent creditors are creditors that have no form of security for their claims and are paid from the free residue of the estate after the secured and preferent creditors have been paid. It has been observed however, that the term "preferent creditor" refers to a creditor who has a right to receive payment before other creditors, and thus secured creditors are also preferent creditors. The term "preferent creditor" is however usually reserved for a creditor whose claim is not secured, but nevertheless ranks above the claims of concurrent creditors in terms of preference provided by the Insolvency Act under section 103 (that is, priority creditors)²². Any free residue of an estate is applied to pay execution cost²³, Liquidator's

¹⁶ These include: (a) claims for unpaid employee payroll tax deductions owed to the Canadian taxing authority (known as source deductions); (b) claims by suppliers for the return of goods supplied to the debtor company in the 30-day period prior to bankruptcy; (c) claims for up to CAD 2,000 for unpaid salary, wages, commissions and benefits for amounts paid by the federal government to employees under the Wage Earner Protection Program Act (WEPPA); and (d) amounts deducted and not remitted and for unpaid regularly scheduled contributions (that is, not special contributions or the underfunded liability itself) to a pension plan. See, Module 4C Guidance Text 2021/2022.

¹⁷ They include fees of the trustee and its legal counsel and claims for up to three months of arrears of rent and three months of future rent by landlord.

¹⁸ 137 S ct. 973 (2017).

¹⁹ Note, 10: See, 11 US C, Ss 725, 507 and 726 respectively.

²⁰ The order of priority in personal and corporate insolvency in South Africa is the same under the Act.

²¹ Secured creditors receive payment from the assets they hold as security while unsecured creditors (preferent and concurrent creditors) are paid from the free residue of the estate. See, Module 7D Guidance Text, p 27.

²² *Ibid*, p 28.

²³ Section 98 South Africa Insolvency Act 1936.

remuneration, amounts due to employees of the insolvent company and certain employee schemes and funds²⁴, statutory obligations²⁵ and income tax²⁶.

Under the United Kingdom, the order of priority of payment provided under the Insolvency Act, 1987 is as follows:

1. Expenses of Liquidation;
2. Preferential Creditors;
3. Floating Charge Holders;
4. Unsecured Creditors;
5. Shareholders.

1. Expenses of Liquidation refer to the expenses incurred by the Liquidator in the course of the liquidation of the insolvent company. These expenses include;
 - (a) Expenses that are properly incurred by the Liquidator in preserving, realising or getting in any of the assets of the company (including the conduct of any legal proceedings);
 - (b) The cost of any security provided by the Liquidator;
 - (c) Any amount payable to a person to assist in the preparation of a statement of affairs or account;
 - (d) Any necessary disbursements by the Liquidator in the course of the winding up (including, for example, any expenses incurred by members of the liquidation committee);
 - (e) The remuneration of any person who has been employed by the Liquidator to perform any services for the company;
 - (f) The remuneration of the Liquidator (which is subject to effectively the same rules as those which apply to administrators, specifically including the fees estimate regime where a time cost basis for the Liquidation's fees is adopted);
 - (g) The amount of any corporation tax on chargeable gains accruing on the realisation of any asset of the company; and
 - (h) Any other expenses properly chargeable by the Liquidator in carrying out the liquidator's functions in the winding up.²⁷
2. Preferential Creditors: After the full payment of the cost of liquidation, the assets of the company are then used to pay preferential creditors before payment to floating charge holders or unsecured creditors. The category of preferential creditors largely comprises limited claims of employees and some taxation liabilities including some other types of liability.²⁸ Preferential debts, in their respective classes, rank equally amongst themselves and so abate in equal proportion if the company's assets are insufficient to pay them all. The following categories of debts are listed as preferential under Schedule 6 of the 1986 Act:
 - (a) Contributions to Occupational Pension Scheme, etc.²⁹; This category refer to any sum owed by the company on account of an employer's contribution to an occupational pension scheme, being contributions deducted from earnings of the company's employees paid in the period of four months prior to the commencement of the winding up.

²⁴ Idem.

²⁵ Idem, s 99.

²⁶ Idem, s. 101

²⁷ See, Section 115 of the Insolvency Act, 1986 and Rules 6.42 and 7.108 of the 2006 Rules. It can however be observed under the provision that the Liquidator's own remuneration lies behind a number of categories of expenses.

²⁸ It should be noted however, that there are two classes of preferential debts, ordinary and secondary. Ordinary preferential debts are paid before secondary preferential debts.

²⁹ See, Sch. 6 Category 4 pursuant to section 386 of the 1986 Act; Sch. 3 of the Social Security Pension Act, 1975.

- (b) Social Security Contributions;³⁰ This category of debts refers to any sum owed by the company on account of an employer's contribution to an occupational pension scheme in the period of 12 months before the relevant date.³¹
- (c) Remuneration of Employees;³² This category refer to remuneration owed by the company to a person who is or has been an employee of the debtor and is payable in respect of the whole or any part of the period of four months prior to the commencement of the winding up to a maximum total figure which is currently 800 pounds.
- (d) Amount owed by the company by way of accrued holiday remuneration in respect of any period of employment before the winding up;³³
- (e) Claims for monies advanced to pay wages or holiday remuneration will rank as preferential.³⁴ This provision is designed to protect lenders where their money has been used to pay wages or holiday remuneration of the employees of their customer, and allows them to take over the benefit which the employees would have had, had the lender not made the monies available for the specific purpose of seeing them paid.³⁵
- (f) Levies on production of coal and steel referred to in Articles 49 and 50 of the European Coal and Steel Community Treaty.³⁶
- (g) Claims for so much of any amount which is ordered to be paid by the company under the Reserve Forces (safeguard of Employment) Act 1985, and is so ordered in respect of a default made by the company in the discharge of its obligations under that Act.
- (h) So much of any amount owed by the company in respect of an eligible deposit as does not exceed the compensation that would be payable in respect of the deposit under the financial Service Compensation Scheme to the person or persons to whom the amount is owed.
- (i) So much of any amount owed by the company to one or more eligible persons in respect of an eligible deposit as exceeds any compensation that would be payable in respect of the deposit under the Financial Scheme Compensation scheme to that person or those persons.
- (j) An amount owed by the company to one or more eligible persons in respect of a deposit that- was made through a non UK branch of a credit institution authorised by the competent authority of the UK, and would have been an eligible if it had been made through a UK branch of that credit institution.
- (k) PAYE income tax deductions, National insurance deductions, VAT payments, construction industry scheme deductions and students loan repayments.³⁷

3. Floating Charge Holder and the "prescribed part": Upon the preferential creditors been fully paid, the next creditor to be paid will be any floating charge holder. And where there is more than one floating charge holder, priority between them usually turns upon which floating charge was created first. However, before any payment can be made to

³⁰ See, Sch. 6 Category 4, *idem*.

³¹ Relevant date is the date set out under Section 387 of the 1986 Act and refers to the date which determines the existence and amount of a preferential debt under sch. 6 of the Insolvency Act.

³² See, Sch. 6 Category 5, *ibid*.

³³ Section 10, *idem*. It should be noted that any remuneration payable by the company to a person in respect of a period of holiday or absence from work through sickness or other good cause, is deemed to be wages. See, Module 3B Guidance text, p 52.

³⁴ Section 11, *idem*.

³⁵ See, Module 3B Guidance text, p 52.

³⁶ *Idem*.

³⁷The debts listed above at point (i), (j) and (k) are defined as Secondary preferential debts under section 386 of the Act and are paid after the "ordinary" preferential debts which includes all the other preferential debts explained. See, Module 3B Guidance text.

any floating charge holder, the Liquidator must first consider the application of section 176A of the Act. Section 176A applies to a company with a floating charge created on or after 15 September, 2003 and the company has gone into liquidation (or administration). The Liquidator (or administrator) is under a duty to make a "prescribed part" of the company's net property available for the satisfaction of unsecured debts and must not distribute any of this prescribed part to a floating charge holder except insofar as it is in excess of the amount required to satisfy all the unsecured debts. For this purpose, "net property" is the amount of the company's property which otherwise would be available for the satisfaction of debts of floating charge holders. It is thus calculated after the liquidation expenses and preferential debts have been paid.

Where the company's net property does not exceed 10,000 pounds, the prescribed part is 50% of that property. However, where the property is less than the "prescribed minimum" of 10,000 pounds and the Liquidator (or administrator) thinks that making a distribution to unsecured creditors would be disproportionate to the benefits, then the duty to make the distribution of the prescribed part does not apply.

Where the company's net property exceeds 10,000 pounds, the prescribed part is the sum of 50% of the first 10,000 pounds in value, plus 20% of the excess in value above the 10,000 pounds subject to a maximum amount of the prescribed part of 800,000 pounds.

Note that, a floating charge holder (or indeed any secured creditor), who may have an outstanding unsecured balance owing to it, is not permitted to participate in the distribution of the prescribed part.³⁸

4. Unsecured Creditors: These are creditors without security and usually ordinary trade creditors. They are paid last in the statutory order. Mostly, once the expenses of the liquidation have been paid and distributions have been made to secured and preferential creditors, there is little or nothing left to pay dividend to unsecured creditors.
5. Shareholders: If there are sufficient funds to pay all the Creditors (and interest on their debts) any surplus is distributed amongst the shareholders according to the company's constitution, which will normally permit a distribution *pro rata* the shareholders' respective shareholding.³⁹

On the nature of the rights enjoyed by each class of creditors or expense, they are as follows:

1. Expenses of liquidation; They enjoy the rights of statutory preference or priority over all other class of debts or expense. They must be paid before the preferential creditors and any other creditors are paid⁴⁰.
2. Preferential Creditors; These creditors enjoy the rights of full payment after the cost of liquidation has been paid. These creditors rights are statutorily protected and the Liquidator is under obligation to accord priority to them with respect to the proceeds from the estate of the debtor company after the cost of expenses has been paid.
3. Floating Charge Holders; They rank in priority to the unsecured creditors and also enjoy the rights and remedies of enforcement enjoyed by security holders. Their

³⁸ See, Thorniley V. Harris (2008) EWHC 124 (ch): Module 3B Guidance text, p 54.

³⁹ See, Module 3B Guidance text, *ibid*.

⁴⁰ In South Africa Insolvency system, the expenses of liquidation is categorised under the preferent creditor and has a statutory right subject to the priority of the secured creditors.

ranking in the order of priority of payment is after the preferential creditors⁴¹. They can also generally take control of the company's assets, the subject of the charge and sell them as mortgagee or a receiver and apply the proceeds against the amount owed. They also have the right to challenge the Liquidator's remuneration by making a court application where they feel it is too high. The floating charge holders also have the right to appoint a different Liquidator if not comfortable with the appointed Liquidator.

4. Unsecured Creditors; This category of creditors have the right to request for a meeting by a number of them constituting 10% in terms of value, number or individual creditors. They also have the right to vote on the appointment of liquidator during a Creditors' Voluntary Liquidation even after, the shareholders had appointed a liquidator. They also have the right to form a creditor's liquidation committee which usually consists of between three and five members to oversee the liquidation process on behalf of unsecured creditors as a group. They can also monitor the Liquidator's action during the liquidation process and be entitled to claim their reasonable travel expenses. This class of creditor also have the right to claim return, or reimbursement of goods in the debtor company possession which are belonging to them. They can also claim interest on the debt up to the date of liquidation in certain circumstances especially where the said interest charge was stated within the initial contract. They also have the right of appeal should the Liquidator refused to pay them⁴².]

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

Commented [WPA12]: 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.

⁴¹ In some jurisdiction, the floating charge holders are referred to as the secured creditors. E.g, in Canada, they ranked second in the order of priority of payment.

⁴² This is possible after having a compromise with the Liquidator and the Liquidator failed to abide by the agreement.

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 [WPA13]: 5/5

The floating charge in favour of Stercus Bank plc;

[The relevant issue with respect to this question is whether the Liquidator upon appointment has power to bring action against persons where by certain transactions may be attacked and reversed in order to swell the assets available to the Liquidator in attempt to make a distribution to creditors of the company. In this circumstance, prevention of pre-existing unsecured creditors obtaining the security of a floating charge shortly before a company enters a formal insolvency procedure.

The issue is regulated by the provision of Section 245 of the Insolvency Act, 1986. This section applies only to floating charges, and not any other type of security. The provision applies where a company is in administration or liquidation and aimed at preventing pre-existing unsecured creditors obtaining the security of a floating charge shortly before a company enters a formal insolvency procedure. It, however, does not prevent lenders who are providing fresh funding to the company from taking a floating charge for that new funding but, renders invalid floating charges given by a company at a relevant time, except to the extent that "new" consideration is provided for the charge.

Where the person in whose favour the floating charge is created is connected with the company, the relevant time is any time within the period of two years prior to the onset of insolvency. However, where the person in whose favour the floating charge is created is not connected with the company, the relevant time is any time within the period of 12 months prior to the onset of insolvency, but only if at the time of the creation of the charge the company was either unable to pay its debts (within the meaning in section 123 of the Act) or became unable to do so in consequence of the transaction.

It should be noted that there are two main categories of "new" consideration set out in section 245 of the Act, which, if satisfied mean the floating charge will not be invalid;

(1) The value of so much of the consideration for the creation of the charge as consists of money paid, or goods or services supplied, to the company at the same time as or after the creation of the charge. Where an agreement is made to execute a charge, followed by payments made to the company, followed in turn by the formal execution of the Charge, any delay between the making of the payments and the execution of the charge must be minimal, such as the time to take a coffee-break⁴³.

(2) The value of so much of that consideration as consists of the discharge or reduction, at the same time as, or after, the creation of the charge, of any debt of the company. In *Re Fairway Magazines*, it was suggested that consideration by way of payments by directors, in helping to release their personal liability under guarantees, were not within the exemption in section 245. This category, however specifically provides that a floating charge is not to be invalidated

⁴³ Module 3B Guidance Text, p 69: *Re Shoe Lace Ltd*, 1993/BCC 609.

to the extent of consideration by way of discharge or reduction of a debt of the bank, rather than to the company for the purpose of repaying the bank, the payments would have fallen within the category.⁴⁴

However, where the floating charge is caught by section 245 of the Act, except to the extent of the said new consideration, it is rendered invalid, and the invalidity can only arise in the event that the company goes into liquidation or administration. It does not however invalidate anything done under the authority of the vulnerable floating charge prior to the commencement of the winding up. While the floating charge is invalidated, the underlying debt remains valid.

Applying the relevant facts to this issue, it can be said that Starcus Bank Plc is an unsecured creditor to Corfee Zero Limited (the company). This is because, by the facts available, the loans granted to the company by Starcus Bank Plc upon which the company under pressure granted the debenture to the Bank containing the floating charge over the whole of the company's undertaking were not secured by any security.

It can also be gleaned from the relevant facts that Starcus Bank Plc (the Bank) is not a connected person to the company under section 245 of the Act and by the facts, the transaction was done between February 2021 and 23rd December, 2021 which is within 12 months before the entering of liquidation by the company on 23rd December, 2021.

Furthermore, the relevant facts on this issue, do not fall within the exception provided under section 245 of the Insolvency Act, 1986 with respect to the said new consideration upon which, if, a floating charge is created pre- Insolvency can be validated.

In the circumstance, the Liquidator can take relevant action by applying to the court for an order to invalidate the floating charge granted to Starcus Bank Plc over the whole of the company's undertaking. See, Section 245 of the Insolvency Act, 1986.]

Question 4.2 [maximum 6 marks]

Commented [WPA14]: 6/6

The sale of the coffee roasting machines; and

[The relevant issue in the sale of the coffee roasting machines is whether a company's transactions made with a person at undervalue at a relevant time of the company entering into administration or liquidation can be challenged by a Liquidator upon appointment. The Statutory provision on this issue can be found in Section 238 of the Insolvency Act, 1986.

By Section 238 of the Insolvency Act, 1986, a Liquidator (or administrator) may attack a transaction which was entered prior to the company entering liquidation or administration where the transaction was at an undervalue. An undervalue transaction with respect to the provision of section 238 of the Act is a transaction if;

- a. The company makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration, or
- b. The company enters into a transaction with that person for a consideration the value of 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.⁴⁵

By the said section, the Liquidator or administrator must prove that the company;

⁴⁴ Idem.

⁴⁵ See, Section 238 (4) (a) and (b) of the Insolvency Act, 1986.

1. Made a gift to another person; or
2. Enters 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 or money's worth, of the consideration provided by the company⁴⁶.

For the transaction to be successfully challenged, the transaction must also have taken place at a "relevant time" which is in the period of two years prior to the commencement of the liquidation or administration whether or not the transaction was for a connected person⁴⁷ and at the time the transaction was entered into, either the company was unable to pay its debts as they fell due within the meaning of section 123 or became unable to pay its debts within the meaning of that section in consequence of the transaction.⁴⁸ In the case of a transaction with 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 is proved.⁴⁹

If, however, the respondent to an application satisfy the court that the transaction was entered into by the company in good faith and for the purpose of carrying on its business, and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company, then the court shall not make an Order under section 238.⁵⁰

It is important to note that the overriding power of the court however, if it concludes that there has been a transaction at an undervalue or a preference, is to make an order restoring the position to what it would have been if the preference had not been given, or the transaction not entered.⁵¹

However, by Section 241 of the Act, protection is afforded to certain persons under which the section provides that an Order shall not prejudice any interest in property which was acquired from a person other than the company, and which was acquired in good faith and for value.⁵²

Applying the relevant facts on this question to this issue and the provision of the Act on same, it can be said that, the transaction of the sale of the coffee roasting machines in July, 2021 was made to a connected person (Ann-Young- a director of the company) when the company was unable to pay its debts as they fell due within the meaning of section 123 of the IA 1986. The inability of the company to pay its debts as they fell due can be deduced from the failure of the company to redeem its obligations of repayment of the company's loans to Stercus Bank Plc in February 2021 resulting to the Bank being granted debenture containing the floating charge over the whole of the company's undertaking to avoid a repayment of the loan demand by the Bank.

Also, the relevant facts revealed that the transaction of July, 2021 was executed at undervalue of the sum of 10,000 pounds for the 5 coffee roasting machines which were bought a year before at the sum of 25,000 pounds prior to the company entering liquidation on 23rd December, 2021 within the relevant period of two years when such nature of transaction can be challenged under section 238 of the IA 1986. Furthermore, the relevant facts revealed that the sale of the 5 coffee roasting machine to Ann-Young (a director of the company) at

⁴⁶ Module 3B Guidance Text, p 66.

⁴⁷ See, Section 240 (1) (a) of the Insolvency Act, 1986.

⁴⁸ See, Section 240 (2), *ibid*.

⁴⁹ See, note 38.

⁵⁰ See, Section 238 (5), *ibid*.

⁵¹ See, Section 239 (3) *ibid*; Guidance Text, *ibid*.

⁵² See, Module 3B Guidance Text, *ibid*.

undervalue also resulted to the company becoming insolvent as can be seen from the company's inability to pay the company's key suppliers resulting to the email of Beans and Leaves Ltd, one of the key supplier a month before the winding up Order was made on 23rd December, 2021. The difference in value of 15,000 pounds, may have assisted the company to meet some financial obligations that could have prevented the company going into liquidation at the said date. Also, the transaction can be said to have been made in bad faith and also does not enjoy the protection afforded in Section 241 of the IA because the 5 coffee roasting machines were acquired from the company and not from a person.

Based on the foregoing, the Liquidator should however apply for an Order of court mandating Ann Young, to pay the difference in value of the 5 coffee roasting machines. The difference in value with respect to the sale of the 5 coffee roasting machines at undervalue can by Order of court be repaid to the company by Ann- Young by virtue of Section 239 (3) of the IA 1986. Yes, an action of recovery of the difference in sale at undervalue of the company's assets to a connected person (a director-Ann Young) can be brought to recover the sum of 15,000 pounds being the outstanding value sum in the sale of the 5 coffee roasting machines transaction.]

Question 4.3 [maximum 4 marks]

The payments to Beans and Leaves Ltd.

[The relevant issue in this question is whether a supplier of goods and services based on the relevant facts, can demand payment of outstanding pre-insolvency debts or invoices as a condition for continuing supply and whether the said supplier can alter the terms of contract midway upon the company entering liquidation.

The relevant law with respect to the issue can be found in the combined provisions of Sections 233, 233A and 233B of the Insolvency Act, 1986.

The Insolvency Act, 1986, consequent upon the need to obtain or retain certain essential supplies when a company enters Insolvency, provided under Section 233 of the Act restrictions of gas and other sundry matters suppliers from demanding or requiring payment of outstanding debts to secure a new or continued supply to the company in administration or liquidation. The Section however, permits a supplier to stipulate that the Administrator should personally guarantee payment of charges with respect to the supply.

Furthermore, under Section 233A of the Insolvency Act 1986, a supplier of the said goods and services is generally unable to rely upon an "insolvency-related term" in a contract of supply which would otherwise entitle the supplier to terminate the supply, alter the terms of the supply or compel higher payments for continued supply.

Similarly, the Corporate Insolvency and Governance Act (CIGA) 2020 further expanded the provisions of sections 233 and 233A above by the insertion or addition of Section 233B to the Insolvency Act by virtue of Section 14 of CIGA. This section prohibits clauses which allow the supplier of goods or services to terminate or "do any other thing" in relation to that contract, if the company enters a formal insolvency procedure. The section also prevents supplier from terminating a supply upon the company's insolvency or prevent supplier from making it a condition of continued supply that pre-insolvency arrears are paid and making other changes to the contract such as increasing prices.

Under Section 233B, a contract may still be terminated by a supplier where the company or insolvency office holder consents, or on application to the court, the court is satisfied that the continuation of the contract would cause the supplier hardship, and grants permission for

Commented [WPA15]: 0/4 unfortunately, the issue is misidentified. The payment has been made and the supply made. The issue is covered by s 127.

termination. Section 233B complements the existing Sections 233 and 233A of the Insolvency Act 1986 which, in similar terms, prohibit termination by Utility, Communications and IT suppliers. Section 233B has been said opens up the restriction on termination to all suppliers; recognised investment exchanges and clearing houses; securitization companies; and overseas companies with corresponding functions⁵³.

The summary of the relevant provisions of the law relating to this issue is that by the combined provisions of Sections 233, 233A and 233B of the Insolvency Act 1986, a supplier cannot demand payment of outstanding pre-insolvency invoices as a condition of continuing supply.

Now, in relation to the relevant facts of this question, the payments to Beans and Leaves Ltd of the sum of 8000 Pounds authorised by the Company consequent upon the email sent to Ann Young by Beans and Leaves Ltd, a month before the winding up Order was made, was a payment made in contravention of the provisions of Sections 233, 233A and 233B of the Insolvency Act 1986. The relevant facts reveal that Beans and Leaves Ltd is a supplier of Coffee beans to the Company, goods seen as essential to the Company which was under insolvency at the material time of the receipt of the email of Beans and Leaves Ltd by Ann Young demanding immediate payment of all sums owing to it and also informing the Company that further supplies would only be made on a cash on delivery basis. The email sent a month before the winding up order was sent on 23rd of December, 2021 was a demand of payment by Beans and Leaves Ltd of outstanding pre-insolvency invoices as a condition of continuing supply of coffee beans an essential goods to the Company, contrary to the provisions of Section 233B of the Act.

Furthermore, the information to the company via email that further supplies would only be made on a cash on delivery basis was alteration of the terms of the supply of the coffee beans to the company during the insolvency contrary to Section 233A of the Insolvency Act, 1986.

Based on the above circumstances, the Liquidator may take an action to recover the payments to Beans and Leaves Ltd of the sum of 8000 pounds covering the existing liabilities and the sum of 3000 pounds paid up-to the date of the winding up Order which was on a cash on delivery basis⁵⁴.]

*** End of Assessment ***

⁵³ Certain entities are excluded and will not be subject to the provision where they themselves are in distress or where they are supplier to a business in distress. These excluded entities listed in the Act are predominantly financial services. See, Ali Shalchi, Corporate Insolvency and Governance Act, 2020, House of Commons Library, 5 October, 2021.

⁵⁴ See, Sections 233, 233A and 233B of the Insolvency Act, 1986.