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

Commented [WPA1]: 47/50 = 94% an excellent effort.

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

Commented [WPA2]: 10/10

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

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 [WPA3]: 10/10

Question 2.1 [maximum 5 marks]

Commented [WPA4]: 5/5

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 1986 relates to transactions defrauding creditors. Pursuant to this section, the following parties have the right to attack transactions which are designed to defraud creditors:

1. In the case of a company that is being wound up or is in administration, the official receiver, the liquidator, the administrator and (with the leave of the court) any victim of the transaction such as a creditor;
2. Where the victim is bound by a company voluntary arrangement ("**CVA**"), the supervisor of the CVA or any victim of the transaction (whether bound by the CVA or not); or
3. In any other case, by a victim of the transaction.

Section 6 of the Company Directors Disqualification Act 1986 is the most commonly used ground under that act to seek disqualification of a director. An application can be made by the Secretary of State or, if the Secretary of State so directs in the case of a person who is or has been a director of a company which is being or has been wound up by the court in England and Wales, by the official receiver. While the Court can make a disqualification order, it is also possible for the Secretary of State to accept a disqualification undertaking, which will have the same consequences as though a disqualification order had been made by the court.

Section 246ZB of the Insolvency Act 1986 deals with wrongful trading and can make directors of insolvent companies liable for wrongful trading, and thereby making them (in certain circumstances) liable for some of the debts and liabilities of the company. The Small Business, Enterprise and Employment Act 2015 introduced wrongful trading to administration under section 246ZB. It is therefore the administrator who can bring an action under this section.

Question 2.2 [maximum 5 marks]

Commented [WPA5]: 5/5

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

A decision of the creditors may be made by one of the following five qualifying decision procedures provided for the in the Insolvency Rules:

1. Electronic voting;
2. Virtual meeting;
3. Correspondence;
4. Physical meeting;
5. And other decision making procedure which enables all creditors who are entitled to participate in the making of the decision to participate equally.

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

Commented [WPA6]: 13/15

Question 3.1 [maximum 6 marks]

Commented [WPA7]: 6/6

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 appointment of an administrator does not automatically terminate a company's executory contracts. An administrator will often need to obtain or retain certain essential supplies. Section 233 of the Insolvency Act 1986 applies specifically to the supply of gas, electricity, water and communications services (which includes the supply of goods and services such as computer hardware and software, technical assistance, data storage etc.). Suppliers are not permitted to require payment of outstanding debts in order to secure a new or continued supply to the company in administration. Section 233 does, however, afford some protection to the supplier in that it permits a supplier to stipulate that the administrator must personally guarantee payment of charges in respect of the supply.

Furthermore, under Section 233A a supplier of such 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, compel higher payments for continued supply or alter the terms of the supply.

The Corporate Insolvency and Governance Act 2020 has expanded these protections for insolvent companies by the introduction of Section 233B, which 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 contract may still be terminated by a supplier under this section where the company or insolvency office holder (in this case the administrator) consents or, on application to the court, if the court is satisfied that the continuation of the contract would cause the supplier hardship and therefore grants permission for termination.

Section 233B is particularly helpful to an administrator in that it opens up the restriction on termination of contracts to all suppliers, with just a limited number of exceptions (such as banks, insurers etc.), and therefore goes beyond the essential supplies provided for in Sections 233 and 233A.

Question 3.2 [maximum 9 marks]

Commented [WPA8]: 7/9 a good answer but more detail on preferential debts and the prescribed part would have been helpful.

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.

Holders of fixed charges holders will usually be paid first outside of any formal insolvency.

Following that, pursuant to Section 115 of the Insolvency Act (and Rules 6.42 and 7.108), there are a number of expenses which are given priority over the company's preferential creditors, holders of floating charges and the company's unsecured creditors. The main expenses which are paid in priority to those creditors are as follows, and in the following order of priority:

1. Expenses properly incurred by the liquidator in preserving, realising or getting in any of the assets of the company (including in the conduct of any legal proceedings);
2. The cost of any security provided by the liquidator;
3. Any amount payable to a person who assisted in the preparation of the statement of affairs or accounts;
4. Any necessary disbursements by the liquidator during the course of the winding up (e.g. any expense incurred by members of the liquidation committee);
5. The remuneration of any person who was employed by the liquidator to perform any services for the company;

6. The remuneration of the liquidator;
7. The amount of any corporation tax on chargeable gains accruing on the realisation of any assets of the company; and
8. Any other expenses properly chargeable by the liquidator in carrying out the liquidator's functions in the winding up.

Preferential creditors are next in line after all expenses have been paid in full. In practice this class of creditor is limited to reasonably modest claims from employees who are owed money by their insolvent employers and some taxation debts owed to the Government where the company has acted in effect as a tax collector for the Government. It has always been a characteristic of the statutory preferential debts regime that employees' remuneration (and later contribution to their pension schemes) has been given some priority. It should be noted that there are significant limits on such claims. The statutory protection afforded to employees under the Employment Rights Act 1996 provides a much more extensive protection for employees and it has been questioned why the Insolvency Act retains this much historic employee protection provision.

There are two classes of preferential debts, ordinary and secondary, with ordinary preferential debts being paid before secondary. Preferential debts rank equally amongst themselves in their respective classes. Schedule 6 of the Insolvency Act sets out the various types of preferential debt, which include any sum owed on account on an employee's contribution to an occupational pension scheme and any amounts owing by the company by way of accrued holiday remuneration in respect of any period of employment before the winding up.

In recent years, a number of additional preferential debts have been added to the regime which relate to payments which may have been made to those with deposits and where the financial institution holdings those deposits has become insolvent and compensation payments have been made by the Financial Services Compensation Scheme to those depositors. Certain of these debts are defined as secondary preferential debts under section 386 of the Act and are paid after "ordinary" preferential debts.

Once preferential creditors have been paid, floating charge holders will be paid. If there is more than one floating charge holder, priority between them usually turns upon which charge was created first. The liquidator is under a duty to make a prescribed part of 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.

Creditors with no security – i.e. unsecured creditors – are paid out last in the statutory order. These will commonly be ordinary trade suppliers and taxation liabilities which are not preferential. Often, 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 to unsecured creditors.

Finally, if the company is found ultimately to be solvent in that there is a surplus after payment of all its liabilities, that surplus will be returned to the members according to their rights under the company's constitution, which will normally permit a distribution pro rata the shareholders' respective shareholdings.

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

Commented [WPA9]: 14/15

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 [WPA10]: 4/5 a good answer but one which needed more detail on s 245 as s 239 is not going to help the liquidator (a point recognized by the answer)

The floating charge in favour of Stercus Bank plc;

There are two possibilities open to the liquidator to challenge the floating charge.

The floating charge in favour of Stercus Bank plc (the "**Bank**") was granted in February 2021, eight months before the creditors' winding up petition was issued. Liquidation is deemed to have commenced at that date of the petition, not the date of the winding up order (Section 129 of the Insolvency Act).

Section 239 of the Insolvency Act relates to preferences which may be avoided by the court on the application of the liquidator. The aim of Section 239 is to prevent a company, in the period leading up to entering a formal insolvency procedure, from placing one of its creditors in a better position than the others – for example, by giving security to a creditor who previously only had priority as an unsecured creditor. At first glance, the debenture in favour of the Bank granting a floating charge over the whole of the Company's undertaking in the months before the Company entered into insolvency appears to amount to a preference.

In order to succeed on an application under section 239 the liquidator must show that:

1. The person who was allegedly preferred was a creditor of the company at the time of the transaction;

2. Something was done by the company which had the effect of putting that person in a better position than he/she would have been in the event of the company going into insolvent liquidation;
3. The company was influenced by a desire to produce the effect at 2) above (i.e. a desire to prefer); and
4. The preference was given at a relevant time.

While it would appear that the present situation meets these requirements, there are two important factors to bear in mind. First, the timing of the transaction is relevant. For a preference to be actionable, it must have occurred within the two years prior to the onset of insolvency where the transaction was in favour of a connected person, or within the six months prior to the onset of insolvency where it was in favour of a person not connected to the company. As the Bank is not a connected person, the fact that the preference occurred earlier than the six months prior to the onset of insolvency means that it is not actionable.

Second, it must be shown that the Company was influenced by the desire to prefer the Bank. Although it is said that "under pressure from its bank" the Company granted the floating charge, in the leading case of MC Bacon Ltd. the court held that where a company is entirely dependent upon bank support for continued trading, such that if the debenture were not granted the bank would withdraw its support, and if the bank withdrew its support, the company would be forced into immediate liquidation, the granting of the debenture was motivated not by a desire to prefer the bank but by the desire to avoid the calling in of the overdraft and the continued trading of the company. The present case seems to be on all fours with MC Bacon, therefore – regardless of the timing issue- the liquidator would find it difficult to prove that the Company has a desire to prefer the Bank.

A second option open to the liquidator would be under Section 245 of the Insolvency Act, which only applies to floating charges. Pursuant to this provision, where a company is in liquation pre-existing unsecured creditors are prevented from obtaining the security of a floating charge shortly before the company enters a formal insolvency procedure.

It does not prevent lenders who are providing fresh funding to the company from taking a floating charge for that new funding, but rather 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 granted is connected with the company, the relevant time is any time within the period of two years prior to the onset of insolvency. Where the person is not connected, the period is 12 months prior to the onset on insolvency. It would appear that the floating charge in favour of the Bank is caught by this section, as there is no evidence of "new" consideration being given for the charge and it occurred at the relevant time. The floating charge is therefore rendered invalid.

Question 4.2 [maximum 6 marks]

Commented [WPA11]: 6/6

The sale of the coffee roasting machines; and

This would appear to be a transaction at an undervalue which may be attacked by the liquidator (Section 238 of the Insolvency Act). The liquidator must show that the company:

1. Made a gift to another person, or
2. Entered into a transaction with another person on terms that provided for the company to receive no consideration, or
3. Entered into a transaction with another person for a consideration which was, at the date of the transaction, significantly less that the value of the consideration paid by the company.

In addition, in order to be attacked the transaction must have taken place at a relevant time – i.e. within the period of two years prior to the onset of the liquidation.

It is a prerequisite that at the time of the transaction, the company was either unable to pay its debts as they fell due within the meaning of section 123 of the Insolvency Act or became unable to pay its debts as a consequence of the transaction. Importantly, in the case of 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.

In the present case, a transaction was made between the Company and another person, Ann Young, for significantly less value that the roasting machines were bought for. The transaction happened in July 2021, well within the two year relevance period. Further, because Ann Young was a director of the company she was a connected person, therefore the presumption is that the Company was insolvent at the time, or became insolvent as a result of the transaction, unless it can be proved otherwise.

The liquidator is likely to be successful in challenging this transaction unless the respondent can 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 be for the benefit of the company. It appears that this may be a possible defence in this situation; at the time of the transaction the Company was continuing to suffer cash flow problems, so the directors may have taken the view that it would be beneficial to the Company to receive at least some cash for the roasting machines.

Question 4.3 [maximum 4 marks]

Commented [WPA12]: 4/4

The payments to Beans and Leaves Ltd.

The payments to Beans and Leaves Ltd. may be declared void by the Court unless it can be validated.

In a compulsory winding up, as in the present case, Section 127 of the Insolvency Act avoids any disposition of property of the company made after the commencement of winding up, unless the court otherwise orders.

The commencement date is taken to be the date of the presentation of the winding up petition, so the avoidance provision acts in a backdated manner. In the present case, the petition was issued on 14 October 2021 and the payments to Beans and Leaves Ltd. were made a month before the winding up order was made on 23 December 2021, therefore the payments are caught by section 127.

The words "disposition of property" in Section 127 have a wide meaning and affect any payment of money as well as assets being sold or transferred. Section 127 covers any type of transaction where property ceases to be vested in a company, such as by way of sale, gift, assignment, mortgage, charge, lease, loan or exchange. The payments to Beans and Leaves Ltd. clearly qualify as a "disposition of property".

However, the impact of Section 127 is not absolute. The court has a discretionary power to declare that dispositions shall not be void by way of a "validation order". Anyone applying for a validation order has the burden of proving the order should be made.

Where a company is trading, if transactions in the ordinary course of business which are entered into bona fide are not permitted, the parties interested in the assets of the company could be prejudiced. A validation order will only be made in respect of an insolvent company where the circumstances indicate that the disposition will be or has been made for the benefit of the general body of secured creditors. This will include a situation such as the present case where payments were made on supplies to enable to the company to fulfil a contract that appear to be profitable.

If the transaction allows the company to continue to trade, it will generally be validated. Payments are likely to be sanctioned where necessary to ensure continued supplies enabling the company to continue trading, in cases where the court considers that the continuance of trading was in the best interests of the creditors. Where goods have been paid for on terms of cash on delivery, as in the present case, the court will consider the benefit to the company including whether the payment will enable further supplies to be received and so the enable the business to continue.

Beans and Leaves Ltd. was a key supplier and therefore most likely essential to the company carrying on business, so it is likely that the court would validate the payments.

*** End of Assessment ***