



**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]

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.

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(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]**

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**Question 2.1 [maximum 5 marks]**

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

(i) Section 423 of the Insolvency Act 1986

The persons who may bring an action in respect of transactions defrauding creditors under section 423 of the Insolvency Act 1986 ("IA 1986") are set out in section 424 IA 1986 and are as follows –

- (A) in a case where the debtor has been made bankrupt, is being wound up or is in administration, the persons who may bring an action under section 423 IA 1986 are the official receiver, the trustee of the bankrupt's estate or the liquidator or administrator of the body corporate or (with the leave of the court) a victim of the transaction;
- (B) in a case where the victim of the transaction is bound by a corporate voluntary arrangement or an individual voluntary arrangement, the persons who may bring an action under section 423 IA 1986 are the supervisor of the voluntary arrangement or any victim of the transaction whether or not the victim is bound by the voluntary arrangement; or
- (C) in any other case, the person who may bring an action under section 423 IA 1986 is a victim of the transaction.

Subsection 424 IA 1986 further provides that any application under section 423 IA 1986 is to be treated as made on behalf of every victim of the transaction.

(ii) Section 6 of the Company Directors Disqualification Act 1986

If it appears to the Secretary of State that it is expedient in the public interest that a disqualification order under section 6 of the Company Directors Disqualification Act 1986 ("CDDA 1986") should be made against any person, an application for the making of the disqualification order may be made by –

- (A) the Secretary of State (section 7(1)(a) CDDA 1986); or
- (B) the official receiver, 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 (section 7(1)(b) CDDA 1986).

(iii) Section 246ZB of the Insolvency Act 1986

It is the administrator of a company who may bring an action for wrongful trading, under section 246ZB of the Insolvency Act 1986 ("IA 1986"), against the director of the company in administration. The following conditions must be satisfied for an action under section 246ZB IA 1986 –

- (A) the company has entered insolvent administration;

- (B) at some time before the company entered administration, the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid entering insolvent administration or going into insolvent liquidation; and
- (C) that at the time the director reached the conclusion or ought to have reached the conclusion in (B) above, the director was a director of the company.

Apart from the administrator, there is also another person who could bring an action under section 246ZB IA 1986. Pursuant to section 246ZD IA 1986, instead of bringing the action for wrongful trading under section 246ZB IA 1986 by himself or herself, the administrator may assign the right of action to a third party funder. The third party funder would then be entitled to bring the action for wrongful trading under section 246ZB IA 1986 against the director of the company in administration.

**Question 2.2 [maximum 5 marks]**

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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, as provided for in Rule 15.3 of the Insolvency (England and Wales) Rules 2016 (SI 2016/1024) ("Insolvency Rules 2016"), by which creditors may make decisions in the context of an insolvent company are –

- (a) correspondence;
- (b) electronic voting;
- (c) virtual meeting;
- (d) physical meeting; or
- (e) any 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]**

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**Question 3.1 [maximum 6 marks]**

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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 by virtue of the principles or provisions, and subject to the respective conditions, as set out below –

- (a) The administrator may rely on the general principle in law that entering into administration does not automatically terminate a company's executory contracts. If there are still obligations to be performed by the company and the counterpart under a contract, both parties must continue to perform their respective obligations even when the company is under administration;

- (b) In respect of essential goods or services, the administrator may rely upon sections 233 and 233A of the Insolvency Act 1986 ("IA 1986") to require the suppliers to continue to supply those goods and services during the administration.

#### Section 233 IA 1986

Section 233 IA 1986 provides the administrator with the right to request from the suppliers of –

- (i) gas;
- (ii) electricity;
- (iii) water;
- (iv) communications services; and
- (v) goods and services necessary for the purpose of enabling or facilitating anything to be done by electronic means such as point of sale terminals, computer hardware and software, information, advice and technical assistance in connection with the use of information technology, data storage and processing as well as website hosting,

to supply the supplies listed above after the effective date, that is, the date on which the company entered into administration.

Pursuant to subsection 233(2) IA 1986, if such a request for supplies is made by the administrator, the supplier can, as a condition for the giving of the supply, require the administrator to personally guarantee the payment of any charges in respect of the supply. However, the supplier cannot make it a condition of the giving of the supply, or do anything which has the effect of making it a condition of the giving of the supply, that any outstanding charges in respect of a supply given to the company before the effective date are paid.

#### Section 233A IA 1986

Subsection 233A(1) IA 1986 provides that an insolvency-related term of a contract for the supply of essential goods or services i.e. a contract for the supply mentioned in paragraphs (b)(i) to b(v) above, ceases to have effect if the company enters into administration.

Such insolvency-related term may be in the form of provisions that – (i) provide for the contract or supply to be automatically terminated or any other thing to automatically take place because the company enters administration; (ii) entitle the supplier to terminate the contract or supply or do any other thing because the company enters administration; or (iii) entitle the supplier to terminate the contract or supply because of an event that occurred before the company enters administration (subsection 233A(8) IA 1986). By the words "any other thing", subsection 233A(8) IA 1986 not only makes clauses that provide for automatic termination upon a company entering into administration ineffective, but also makes ineffective clauses that allow the supplier to take any other action simply because of the administration, for example, altering the terms of the supply or compelling higher payments for continued supply.<sup>1</sup>

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<sup>1</sup> Professor Peter A Walton, *Foundation Certificate in International Insolvency Law, Module 3B Guidance Text, Insolvency System of the United Kingdom (England and Wales), 2021/2022* (INSOL International 2021), page 20



Where an insolvency-related term ceases to have effect by virtue of subsection 233A(1) IA 1986, by virtue of subsection 233A(3) IA 1986, the supplier of essential goods and services may only terminate –

- (i) the contract for supply if –
  - (A) the administrator consents to the termination;
  - (B) the court grants permission for the termination. The court may only grant such permission if it is satisfied that the continuation of the contract would cause the supplier hardship; or
  - (C) any charges in respect of supply incurred after the company entered administration are not paid within a period of 28 days from the day on which the payment became due (subsection 233A(4) IA 1986); and
- (ii) the supply if –
  - (A) the supplier gives written notice to the administrator that the supply will be terminated unless the administrator personally guarantees the payment of any charges in respect of the continuation of the supply after the company entered administration; and
  - (B) the administrator does not give that guarantee within the period of 14 days beginning with the day the notice is received; and
- (c) apart from essential goods and services, the administrator may also require the continued supply of other goods and services (save for supplies by institutions as set out in Schedule 4ZZA of the IA 1986) by relying on section 233B IA 1986.

Pursuant to subsection 233B(3) IA 1986, provisions of a contract for the supply of goods or services which provide that because the company enters into administration, –

- (i) the contract or the supply under the contract would terminate, or any other thing would take place; or
- (ii) the supplier would be entitled to terminate the contract or the supply, or to do any other thing,

will cease to have effect when the company becomes subject to administration. Similar to subsection 233A(8) IA 1986, by the words “any other thing”, subsection 233B(3) IA 1986 not only makes clauses that provide for automatic termination upon a company entering into administration ineffective, but also makes ineffective clauses that allow the supplier to take any other action simply because of the administration, for example, making other changes to the contract such as increasing prices.<sup>2</sup>

Notwithstanding subsection 233B(3) IA 1986, where a provision of a contract ceases to have effect under that subsection, the supplier may terminate the contract pursuant to subsection 233B(5) IA 1986 if either –

- (i) the administrator consents to the termination; or
- (ii) the court is satisfied that the continuation of the contract would cause the supplier hardship and grants permission for the termination.

Pursuant to subsection 233B(7) IA 1986, the supplier is not allowed to require payment of outstanding charges in respect of supplies to the company made before the administration, as a condition for supply of goods and services after the administration.

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<sup>2</sup> Professor Peter A Walton, *Foundation Certificate in International Insolvency Law, Module 3B Guidance Text, Insolvency System of the United Kingdom (England and Wales), 2021/2022* (INSOL International 2021), page 20

### Question 3.2 [maximum 9 marks]

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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.

Creditors holding a fixed charge over particular assets of a company in liquidation have the right to deal with the assets outside of the liquidation, save that, if there is any surplus from the realisation of the assets after satisfying the debt due to the creditor, the creditor must pay over the surplus to the liquidator and the surplus will form part of the pool of assets of the company available for the benefit of the general creditors of the company. If the realisation of the asset that is subject to the fixed charge does not fully satisfy the debt owing to the secured creditor, the creditor may file a proof with the liquidator for the remainder of the debt owing to it. Such amount will be an unsecured debt and the creditor will rank as an unsecured creditor for that portion of the debt.

The order of priority of other payments are determined by statute, that is, the Insolvency Act 1986 ("IA 1986") and the Insolvency Rules 2016. The order of priority of payments is as follows

- (a) firstly, will be the payment of the winding up expenses (section 175 IA 1986), including the remuneration of the liquidator (section 115 IA 1986). Within this category, the winding up expenses for a creditors' voluntary winding up are paid in the order of priority as set out in Rule 6.42 of the Insolvency Rules 2016 and the winding up expenses for a winding up by the court are paid in the order of priority as set out in Rule 7.108 of the Insolvency Rules 2016;
- (b) secondly, will be payment of preferential debts (section 175 IA 1986). The preferential debts are listed in Schedule 6 IA 1986 (section 386 IA 1986). Preferential debts can be divided into two (2) classes, that is, ordinary preferential debts (preferential debts listed in paragraphs 8 to 15B of Schedule 6, IA 1986) and secondary preferential debts (preferential debts listed in paragraph 15BA, 15BB or 15D of Schedule 6, IA 1986). Each class of preferential debts rank equally among themselves and will abate in equal proportions if the assets of the company are insufficient to pay the debts in full. Ordinary preferential debts will be paid before secondary preferential debts;
- (c) thirdly, would be payment of debts to floating charge holders. Where there is more than one floating charge holder, priority between them will depend on which floating charge was created first.

Where the floating charge was created on or after 15 September 2003, the liquidator must consider section 176A IA 1986 before making payment to any floating charge holder. Section 176A IA 1986 requires the liquidator to make a prescribed part of the company's net property (amount of the company's property which would be available for satisfaction of claims to floating charge holders) available for the satisfaction of unsecured debts. If the prescribed part exceeds the amount required to satisfy all unsecured debts, the liquidator may pay the excess amount to the floating charge holders. Where the realisation of assets subject to a fixed or floating charge are insufficient to satisfy the debts of the charge holder, the charge holder will be entitled to proof for the shortfall, as an unsecured debt, in the liquidation. The High Court in *Thorniley & Anor v HM Revenue & Customs & Anor*<sup>3</sup> held that the prescribed part under section 176A may not be used to satisfy the shortfall to the fixed or floating charge holder.

<sup>3</sup> [2008] EWHC 124 (Ch)

The liquidator will not be required to reserve a prescribed part of the company's net property for unsecured debts under section 176A IA 1986 in the event the company's net property is less than £10,000 and the liquidator thinks that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits;

- (d) fourthly, would be payment of debts owing to unsecured creditors; and
- (e) lastly, in the event there is a surplus in the assets of the company after paying all of the creditors and the interests on their debts, the surplus will be distributed amongst the shareholders of the company according to the company's constitution.

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

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Prior to going into compulsory liquidation on 23<sup>rd</sup> 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 14<sup>th</sup> 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;

Where the Company has at a relevant time given a preference to any person, section 239 of the Insolvency Act 1968 ("IA 1968") provides that the liquidator may make an application to

court for an order as the court thinks fit for restoring the position to what it would have been if the company had not given that preference.

In order to succeed in an action under section 239 IA 1986 against Stercus Bank plc (“Stercus”) in respect of the debenture granted in favour of Stercus, the liquidator must show, amongst others, that the preference i.e. the debenture was given at a relevant time. Stercus is not a person who is connected to the Company. Hence, the relevant time for purposes of section 239 IA 1986 would be in the period of six (6) months before the commencement of the winding up (subsection 240(1) IA 1986 read together with subsection 240(3) IA 1986). The winding up of a company is deemed to commence at the time of the presentation of the petition for winding up (subsection 129(2) IA 1986).

The debenture in favour of Stercus was granted in February 2021 and the creditors winding up petition was issued on 14 October 2021. This would be more than six (6) months before the commencement of the winding up. Therefore, the preference was not given at a relevant time for purposes of section 239 IA 1986. Hence, the liquidator would not be able to rely on section 239 IA 1986 to challenge the floating charge given by the Company in favour of Stercus.

An alternative for the liquidator to potentially challenge the floating charge in favour of Stercus would be section 245 IA 1986. Pursuant to subsection 245(2) IA 1986, a floating charge on the Company’s undertaking created at a relevant time is invalid except to the extent of the aggregate of the value of any “new” consideration granted by Stercus to the Company. In order to succeed in an action under section 245 IA 1986, the liquidator must show that –

- (a) the floating charge on the Company’s undertaking was created at a relevant time. Stercus is not a person who is connected to the Company. Hence, the relevant time for purposes of subsection 245(2) IA 1986 would be in the period of twelve (12) months before the commencement of the winding up (subsection 245(3) IA 1986 read together with subsection 245(5) IA 1986). The winding up of a company is deemed to commence at the time of the presentation of the petition for winding up (subsection 129(2) IA 1986)

The floating charge in favour of Stercus was created in February 2021 and the creditors winding up petition was issued on 14 October 2021. This would fall in the period of twelve (12) months before the commencement of the winding up. Hence, the floating charge in favour of Stercus was created at a relevant time for purposes of section 245 IA 1986;

- (b) since Stercus is not a person who is connected to the Company, the requirements in subsection 245(4) IA 1986 have to be satisfied. In this regard, the liquidator must show either that the Company was at the relevant time unable to pay its debts within the meaning of section 123 IA 1986 or becomes unable to pay its debts within the meaning of section 123 IA 1986 as a consequence of the transaction under which the floating charge is created.

The facts of the case state that the Company granted the floating charge to Stercus in order to prevent Stercus from demanding repayment of the Company’s loans. This would indicate that at the time of granting of the floating charge in February 2021 i.e. the relevant time, the Company was unable to pay its debts as they fall due within the meaning of subsection 123(1)(e) IA 1986. Hence, the requirement in subsection 245(4) IA 1986 would be satisfied; and

- (c) there is no “new” consideration given by Stercus for the creation of the floating charge. Pursuant to subsection 245(2) IA 1986, a floating charge on the Company’s

undertaking created at a relevant time is invalid except to the extent of the aggregate of –

- (i) the value of so much of the consideration for the creation of the floating 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;
- (ii) 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 floating charge, of any debt of the Company; and
- (iii) the amount of such interest (if any) as is payable on the amount falling within paragraph (i) or (ii) above in pursuance of any agreement under which the money was so paid, the goods or services were so supplied or the debt was so discharged or reduced.

The facts of the case do not indicate that Stercus gave any “new” consideration to the Company for the creation of the floating charge. There were no new loans granted by Stercus nor was there any reduction in the loans already granted by Stercus to the Company.

Since all of the requirements under section 245 IA 1986 have been satisfied, the floating charge granted by the Company in favour of Stercus would be invalid.

#### **Question 4.2 [maximum 6 marks]**

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#### **The sale of the coffee roasting machines; and**

Where the Company has at a relevant time entered into a transaction with any person at an undervalue, section 238 of the Insolvency Act 1986 (“IA 1986”) provides that the liquidator may make an application to court for an order as the court thinks fit for restoring the position to what it would have been if the company had not entered into that transaction.

In order to succeed in an action against Ann Young under section 238 IA 1986 for the sale of the coffee roasting machines, the liquidator must show that –

- (a) the transaction i.e. the sale of the coffee roasting machines was entered into at a relevant time. Since Ann Young is a director of the Company, she is a person who is connected to the Company. The relevant time for purposes of section 238 IA 1986 would be in the period of two (2) years before the commencement of the winding up (subsection 240(1) IA 1986 read together with subsection 240(3) IA 1986). The winding up of a company is deemed to commence at the time of the presentation of the petition for winding up (subsection 129(2) IA 1986).

The sale of the coffee roasting machines to Ann Young was in July 2021 and the creditors winding up petition was issued on 14 October 2021. This would fall in the period of two (2) years before the commencement of the winding up. Hence, the transaction was entered into at the relevant time;

- (b) either that the Company was at the relevant time unable to pay its debts within the meaning of section 123 IA 1986 or becomes unable to pay its debts within the meaning of section 123 IA 1986 as a consequence of the transaction (subsection 240(2) IA 1986). However, in a transaction at an undervalue which is entered into by the Company with a person who is connected to the Company, there is a rebuttable presumption that the requirements in subsection 240(2) IA 1986 are satisfied.

Since Ann Young is a director of the Company i.e. a person who is connected to the Company, there will be a presumption that the requirements in subsection 240(2) IA 1986 have been satisfied, unless Ann Young can prove to the contrary. The facts of the case state that the transaction was made when the Company continued to suffer cash flow problems. This would satisfy the requirement of the Company being unable to pay its debts under subsection 123(1)(e) IA 1986. Hence, it is unlikely for Ann Young to be able to rebut the presumption in subsection 240(2) IA 1986 and the requirements would be satisfied; and

- (c) the transaction was at an undervalue. Pursuant to subsection 238(4) IA 1986, a transaction entered into by the Company with Ann Young would be at an undervalue if the price paid by Ann Young to the Company for the coffee roasting machines is significantly less than the value of the coffee roasting machines provided by the Company to Ann Young.

The facts of the case state that the Company sold the coffee roasting machines to Ann Young for £10,000. This is less than half of the price of £25,000 which the Company paid a year ago for purchasing the machines. Even taking into account the depreciation in the value of the coffee roasting machines which would have been in use at the Company for one (1) year, it is unlikely that the court will find that the value of the coffee roasting machines at the time of sale to Ann Young is less than half of the initial purchase price. Hence, it is likely that the court will consider that the price of £10,000 paid by Ann Young for the coffee roasting machines is significantly less than the value of the coffee roasting machines provided by the Company to Ann Young. Therefore, the requirement of the transaction being at an undervalue would also be satisfied.

Even where the liquidator shows that all of the requirements stated above have been satisfied, the court will not grant an order under section 238 IA 1986 if it is satisfied that the Company entered into the transaction in good faith and for the purpose of carrying on its business and that at the time the Company did so there were reasonable grounds for believing that the transaction would benefit the Company. The facts of the case state that the coffee roasting machines were sold to Ann Young for £10,000 cash when the Company was suffering from cash flow problems. In this regard, it could be argued that the Company genuinely needed the £10,000 cash. If it can be shown that the sale of the coffee roasting machines to Ann Young was done in good faith, the £10,000 cash paid by Ann Young was necessary for the carrying on of the Company's business and the Company had reasonable grounds for believing the transaction would benefit the Company, then the court would not make an order under section 238 IA 1986. Otherwise, the court would make an order under section 238 IA 1986 to restore the position to what it would have been if the Company had not entered into the transaction with Ann Young. The court will take into consideration the factors stated in section 241 IA 1986 in making any such order.

#### **Question 4.3 [maximum 4 marks]**

Commented [WPA13]: 4/4

##### **The payments to Beans and Leaves Ltd.**

Pursuant to section 127 of the Insolvency Act 1986 ("IA 1986"), any disposition of the Company's property made after the commencement of the winding up is, unless the court otherwise orders, void. The winding up of a company is deemed to commence at the time of the presentation of the petition for winding up (subsection 129(2) IA 1986).

In the case of the Company, the winding up is deemed to have commenced on 14 October 2021 when the creditor's winding up petition was issued. Any disposition of property, including

payment of monies made after 14 October 2021 would be void pursuant to section 127 IA 1986, unless the court otherwise orders.

The payments to Beans and Leaves Ltd (“Beans”) was made from the period of one (1) month before the winding up order up until the winding up order, that is after the commencement of the winding up. Hence, the payments to Beans would amount to a disposition of the Company’s property made after the commencement of the winding up and pursuant to section 127 IA 1986, such payments would be void unless the court otherwise orders. The liquidator may therefore take the necessary action for the recovery of the payments made to Beans.

However, Beans may make an application to court for a validation order to declare that the payments shall not be void. The court may grant a validation order in respect of the payments where the circumstances indicate that the payments have been made for the benefit of the general body of unsecured creditors of the Company. The court may take into account the following factors in deciding whether the payments to Beans should be void or valid –

- (a) payments to Beans would in effect give Beans a preference over other creditors of the Company. This would depart from the principle of *pari passu* distribution among creditors;
- (b) from the facts, it appears that the Company is in the business of selling coffee. The supply of coffee beans would therefore be necessary for the Company to continue trading. Where it can be shown that the continuance of trading by the Company was in the best interests of its creditors, payments to Beans for the continued supply of coffee beans are likely to be validated by the court; and
- (c) Beans had made it a condition for further supply of coffee beans that payment should be on cash on delivery basis. Similar to the factor in paragraph (b) above, the court will consider the benefit to the company of payments on a cash on delivery basis to Beans for further supplies to enable the Company’s business to continue, provided continuing business is in the interests of the creditors of the Company.

Generally, the court will validate payments that are made honestly, in the ordinary course of business and for the benefit of the Company such as payments on supplies to the Company that appear to be profitable and for transactions that allow the Company to continue to trade. Since the payments to Beans was for supply of coffee beans that are essential for the company to continue to trade, it is likely that the court would validate the payments made by the Company to Beans.

**\* End of Assessment \***