



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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Well Done!

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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]

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 (“**S423**”) relates to transactions defrauding creditors. In the following three situations, the parties listed below each situation can bring an action under S423:

- a) Company being wound up or in administration:
 1. The official receiver
 2. The liquidator
 3. The administrator
 4. Any victim of the transaction defrauding creditors, such as a creditor itself. It should be noted that the victim would require leave of the court to bring an action.
- b) Company bound by a Company Voluntary Arrangement (“**CVA**”):
 1. The supervisor of the CVA
 2. Any victim of the transaction defrauding creditors, such as a creditor itself. It should be noted that this is irrespective of whether the creditor is bound by the CVA.
- c) Any other case:
 1. Any victim of the transaction defrauding creditors, such as a creditor itself.

Section 6 of the Company Directors Disqualification Act 1986 (“**S6**”) relates to the disqualification of directors of insolvent companies for the reason of being found unfit. The following parties can bring an action under S6:

1. The liquidator
2. The administrator
3. The Secretary of State

Section 246ZB of the Insolvency Act 1986 (“**S246ZB**”) relates to the making of directors liable for wrongful trading. The following parties can bring an action under S246ZB:

1. The liquidator
2. The administrator

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Question 2.2 [maximum 5 marks]

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

The five qualifying decision procedures listed in the Insolvency Rules 2016, rule 15.3, are as follows:

1. Correspondence
2. Electronic voting
3. Virtual meeting
4. Physical meeting

5. Any other decision procedure that allows equal access and participation to creditors when making decisions

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It should be noted that creditors must receive at least 14 days' notice of any qualifying decision procedure.

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

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Question 3.1 [maximum 6 marks]

Can an administrator who wishes to continue to operate the business of the company in administration require suppliers of goods and services to continue to supply those goods and services during the administration?

Section 233 of the Insolvency Act 1986 ("the Act") ("S233") applies to a supply of essential goods and services during an administration. Essential goods and services include gas, electricity, water, and communication services. S233 prevents the suppliers of such essential goods and services from requiring payment of outstanding bills for the continuation of the supply. However, S233 does permit the essential supplier to require the administrator to personally guarantee payment of the requested goods or services.

However, contracts of such essential supplier may include terms that relate to the insolvency of a company which, upon the company entering into an insolvency procedure, would enable these suppliers to terminate the contract, alter the supply terms, or compel higher payments for the continuation of the contract. Section 233A of the Act ("S233A") prevents an essential supplier from enforcing such terms when a company enters into administration. Therefore, an administrator, in reliance to S233A, would not have to worry about essential suppliers relying on such contract terms to prevent the continuation of supply of goods and services.

S233A therefore added additional protection to administrators as it relates to essential suppliers on top of those provided for by S233. However, there were still some missing protections including that both sections only relate to essential suppliers and S233A permits the essential supplier to terminate the contract if payment of the continued supply was not made within 28 days of falling due.¹

Section 233B of the Act ("S233B") fills the gaps in S233 and S233A by extending the protections provided under S233 and S233A as it relates to administrators, and other office-holders, to all suppliers (with limited exceptions for certain financial services), not just essential suppliers. A unique provision of S233B is that a supplier will not be able to enforce a contract term based on a pre-insolvency event after the company has entered into administration.²

It should be noted that under S233B, an administrator will not be required to provide a personal guarantee for payment of outstanding bills as permitted in S233 and a supplier cannot terminate the supply of goods or services if such supplies are not paid within 28 days of falling due as permitted in S233A.³

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¹ Withers, Alexandra, "Losing the right to terminate supply: the impact of the Corporate Governance and Insolvency Act 2020", at <https://newcastle-bpcf.org.uk/2020/08/26/losing-the-right-to-terminate-supply-the-impact-of-the-corporate-governance-and-insolvency-act-2020/>, accessed 27 February 2022.

² *Ibid.*

³ Gallimore, Amy, "CIGA BITESIZE: TERMINATION OF SUPPLIES: ARE YOUR SUPPLIES ESSENTIAL OR PROTECTED, OR BOTH?", at <https://www.ashfords.co.uk/news-and-media/general/ciga-bitesize-termination-of-supplies-are-your-supplies-essential-or-protected-or-both>, accessed 27 February 2022.

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 are as follows:

1. Fixed charge holders
2. Expenses of winding up, including the liquidator's remuneration
3. Ordinary preferential creditors
4. Secondary preferential creditors
5. Floating charge holders
6. Unsecured creditors
7. Shareholders

I discuss each of these classes below.

Fixed Charge Holders

The liquidator cannot deal with any assets subject to a fixed charge without the consent of the fixed charge holder. The fixed charge holder has the authority to sell the asset or permit the liquidator to sell the asset on its behalf. The Fixed charge holder will receive all proceeds up to the outstanding amount due to it. Any shortfall due to the fixed charge holders will rank as unsecured if there are funds remaining after payment of the ordinary unsecured creditors.

Expenses of Winding Up

Section 115 of the Insolvency Act 1986 (“the Act”) covers point 2 above (i.e. expenses of winding up). According to Rule 6.42(4) of the Insolvency Rules 2016 (“the Rules”), the order of priority of the main expenses of a winding up are as follows⁴ – it should be noted that Rule 7.108 of the Rules also includes other expenses as it relates to that of the provisional liquidator and official receiver:⁵

- a) Expenses which are properly chargeable or incurred by the liquidator in preserving, realising or getting in any of the assets or otherwise in the preparation, conduct or assignment of any legal proceedings.
- b) The cost of any security provided by the liquidator.
- c) The remuneration of the special manager, if any.
- d) Any amount payable to a person employed or authorised to assist in the preparation of a statement of affairs or of accounts.
- e) The cost of employing a shorthand writer on the application of the liquidator.
- f) Any necessary disbursements by the liquidator in the course of the administration of the winding up including any expenses incurred by members of the liquidation committee.
- g) The remuneration of any person who has been employed by the liquidator to perform any services.
- h) The remuneration of the liquidator, up to an amount not exceeding that which is payable under Schedule 11 of the Rules.
- i) The amount of any corporation tax on chargeable gains accruing on the realisation of any asset.
- j) The balance of any remuneration due to the liquidator.

⁴ The Insolvency (England and Wales) Rules 2016, Rule 6.42.

<https://www.legislation.gov.uk/ukSI/2016/1024/article/6.42/made>

⁵ The Insolvency (England and Wales) Rules 2016, Rule 7.108.

<https://www.legislation.gov.uk/ukSI/2016/1024/article/7.108/made>

- k) Any other expenses properly chargeable by the liquidator in carrying out the liquidator's functions.

In respect of the expenses of winding up, it should be noted that the expenses are paid in order of priority. For example, if there are sufficient funds to only cover the expenses detailed in points a to g above, the remuneration of the liquidator (i.e. point h) would not be satisfied.

Ordinary Preferential Creditors

Section 386 of the Act covers point 3 above (i.e. ordinary preferential creditors) and states that the following preferential creditors, as listed under Schedule 6 of the Act, are ordinary preferential creditors:⁶

- a) Any sum owed on account of an employee's contribution to an occupational pension scheme within the period of four months immediately preceding the date of commencement of the liquidation.⁷
- b) Any sum owed on account of an employer's contribution to an occupational pension scheme within the period of 12 months immediately preceding the date of commencement of the liquidation.⁸
- c) Any outstanding remuneration due to an employee in respect of the period of four months immediately preceding the date of commencement of the liquidation.
- d) Any amount owed by way of accrued holiday remuneration in respect of any period of employment before the date of commencement of the liquidation.
- e) Any outstanding amount owed to a lender in respect of money advanced for the purpose of satisfying point c or d directly above.
- f) Any sums due as at the date of commencement of the liquidation in respect of levies on the production of coal and steel or any surcharge for delay.
- g) Any debt owed to the scheme manager of the Financial Services Compensation.
- h) So much of any amount owed as at the date of commencement of the liquidation in respect of an eligible deposit as does not exceed the compensation that would be payable in respect of the deposit under the Financial Services Compensation Scheme.

It should be noted that in respect of ordinary preferential creditors, each creditor ranking as such ranks equally and receives a *pari passu* distribution from the assets available after the payment of the expenses of winding up.

Secondary Preferential Creditors

Section 386 of the Act also covers point 4 above (i.e. secondary preferential creditors) and states that the following preferential creditors, as listed under Schedule 6 of the Act, are ordinary preferential creditors:⁹

- a) So much of any amount owed at the date of commencement of the liquidation 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 Services Compensation Scheme.
- b) An amount owed at the date of commencement of the liquidation 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 deposit if it had been made through a UK branch of that credit institution.
- c) Any amount owed at the date of commencement of the liquidation to the HMRC in respect of valued added tax or a relevant deduction.

⁶ Insolvency Act 1986, Schedule 6. <https://www.legislation.gov.uk/ukpga/1986/45/schedule/6>

⁷ Pension Schemes Act 1993, Schedule 4. <https://www.legislation.gov.uk/ukpga/1993/48/schedule/4/enacted>

⁸ *Ibid.*

⁹ Insolvency Act 1986, Schedule 6. <https://www.legislation.gov.uk/ukpga/1986/45/schedule/6>

It should be noted that, as with ordinary preferential creditors, each secondary preferential creditor ranks equally and receives a *pari passu* distribution from assets available after payment of the ordinary preferential debts. It should also be noted that the secondary preferential debts due to the HMRC are only treated as such for liquidations commencing on or after 1 December 2020.¹⁰

Floating Charge Holders

If there are assets subject to a floating charge as at the date of commencement of the liquidation, the floating charge holders automatically have authority over such assets. As with fixed charge holders, the liquidator cannot deal with the floating charge assets (i.e. sell them) without the consent of the floating charge holders. In the event that there is more than one floating charge holder, the priority of payment is usually dictated by the date of creation of the floating charges.

When calculating funds available for payment to the floating charge holders, the liquidator must refer to Section 176A of the Act which states that:¹¹

- a) The liquidator shall make a prescribed part of the company's net property available for the satisfaction of unsecured creditors.
- b) Any shortfall due to the floating charge holder as a result of the prescribed part will not be satisfied until unsecured creditors are satisfied in full.
- c) The company's net property is the amount of assets subject to a floating charge.

The prescribed part only relates to floating charges created on or after 15 September 2003. Therefore, floating charge holders in respect of a floating charge created before 15 September 2003 would receive no deduction relating to the prescribed part when calculating the distribution amount due.¹²

The prescribed part is calculated as:¹³

- a) 50% of the first £10,000 of the company's net property.
- b) If the net property exceeds £10,000, 20% of such amount up to a maximum amount of £800,000.¹⁴

It should be noted that pursuant to Subsection 3 of Section 176A of the Act, if the net property does not exceed £10,000 and the liquidator thinks that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits, the prescribed part does not apply.¹⁵

¹⁰ Munnery, Jonathan. "Order of payment priority for creditors during company liquidation", at <https://www.begbies-traynorgroup.com/articles/insolvency/who-gets-paid-first-when-a-company-goes-into-liquidation>, accessed 27 February 2022.

¹¹ Insolvency Act 1986, Section 176A. <https://www.legislation.gov.uk/ukpga/1986/45/section/176A>

¹² Martin-Royle, Claire, "Floating charges –not necessarily what they say on the tin", at <https://www.jonesday.com/files/Publication/60ba3b1a-58b3-42de-ab3d-c2d628af566c/Presentation/PublicationAttachment/2f2c219d-6313-4f63-b93f-c70b9d3582a2/IHL157%20p73-75.pdf>, accessed 27 February 2022.

¹³ Munnery, Jonathan. "Order of payment priority for creditors during company liquidation", at <https://www.begbies-traynorgroup.com/articles/insolvency/who-gets-paid-first-when-a-company-goes-into-liquidation>, accessed 27 February 2022.

¹⁴ Martin-Royle, Claire, "Floating charges –not necessarily what they say on the tin", at <https://www.jonesday.com/files/Publication/60ba3b1a-58b3-42de-ab3d-c2d628af566c/Presentation/PublicationAttachment/2f2c219d-6313-4f63-b93f-c70b9d3582a2/IHL157%20p73-75.pdf>, accessed 27 February 2022.

¹⁵ Insolvency Act 1986, Section 176A. <https://www.legislation.gov.uk/ukpga/1986/45/section/176A>

Unsecured Creditors

Creditors with no security or those who do not rank as preferential creditors receive a distribution if there are funds remaining after payment of winding up expenses, preferential debts, and/or in respect of the prescribed part.

It should be noted that if there are funds remaining after payment of the unsecured debts, payment will be made in partial or full satisfaction of the shortfall due to the fixed and floating charge holders. Any admissible interest due on the unsecured debts would then be satisfied.

Shareholders

After payment of unsecured creditors, if there are any funds remaining, the shareholders of the company would receive payment usually in proportion to the shareholders' percentage interest in the company.

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

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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, Coffee 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]

The floating charge in favour of Stercus Bank plc;

The liquidator should refer to Section 245 of the Insolvency Act 1986 ("**S245**") which relates to the avoidance of certain floating charges in the context of liquidations and provides that any

floating charge created within a specified period of the onset of insolvency is void except to the extent that value is provided to the company at the same time as, or after, the creation of the charge.¹⁶

S245(3) defines the specified period as being within 2 years of the onset of insolvency where charges are granted in favour of a connected person or within 12 months of the onset of insolvency where charges are granted in favour of any other person. In the instance of a person who is not connected to the company, there is an additional requirement pursuant to S245(4) that the company be unable to pay its debts or becomes unable to pay its debts in consequence of the transaction under which the charge was granted. In the context of liquidations, the onset of insolvency is defined as the date of commencement of the liquidation.¹⁷

Section 249 of the Act states that a person is connected with a company if, amongst other things, he (or she) is a director of the company.¹⁸ In this case, Stercus Bank plc (“**Stercus**”) would not be considered a connected party.

The two main scenarios which would be considered as the new provision of value in exchange for the charge pursuant to S245(2) are:¹⁹

- a) 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; and,
- b) 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.

As Stercus is not a connected party, the relevant time to take into consideration would be 12 months within the date of commencement of the liquidation. The liquidation commenced on 14 October 2021 and the charge was granted in February 2021; as the charge was granted within 12 months of the commencement of liquidation, the timing requirement is satisfied. Based on the facts of the case, no new consideration was provided at the same time as, or after, the creation of the charge.

In addition, based on the facts of the case, it appears that the Company was unable to pay its debts. This conclusion is based on the fact that the Company granted the floating charge to prevent Stercus from demanding repayment of the Company’s loans suggesting that it was, at the time, unable to pay such loans. Given that all requirements of S245 appear to have been met, the floating charge would be deemed invalid.

The liquidator should take note that S245 is automatic and that even though the floating charge, in this case, is invalid, the loans due to Stercus remain valid. The difference is that the loans due to Stercus would be treated as unsecured debt rather than debt subject to a floating charge.

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¹⁶ Parry, Rebecca, “Avoidance of Floating Charges (Insolvency Act 1986, Section 245: Corporate Insolvency Only)”, at <https://oxford.universitypressscholarship.com/view/10.1093/oso/9780198793403.001.0001/isbn-9780198793403-book-part-21>, accessed 28 February 2022.

¹⁷ Insolvency Act 1986, Section 245. <https://www.legislation.gov.uk/ukpga/1986/45/section/245>

¹⁸ Insolvency Act 1986, Section 249. <https://www.legislation.gov.uk/ukpga/1986/45/section/249>

¹⁹ Insolvency Act 1986, Section 245. <https://www.legislation.gov.uk/ukpga/1986/45/section/245>

Question 4.2 [maximum 6 marks]

The sale of the coffee roasting machines; and

In respect of the coffee roasting machines, the liquidator should refer to Section 238 of the Act (“S238”) which covers transactions considered to be completed at an undervalue and states that such a transaction includes one where the company receives a consideration, the value of which is significantly less than the value of the consideration provided by the company.²⁰

For the transaction to be considered as one at an undervalue, Section 240 of the Act (“S240”) states that the transaction must have been completed within 2 years prior to the commencement of the liquidation.²¹ The sale of the coffee roasting machines was completed in July 2021 and the Company was placed into compulsory liquidator on 23 December 2021. Therefore, the transaction satisfies this requirement.

S240 further provides that in general, a pre-requisite for a transaction to be considered one at an undervalue is for the company to, at the time of the transaction, be unable to pay its debts or become unable to pay its debts in consequence of the transaction. However, in instances where the transaction was conducted with a connected person, it is presumed that the company was unable to pay its debts at the time of the transaction.²²

Section 249 of the Act states that a person is connected with a company if, amongst other things, he (or she) is a director of the company.²³ In this case, the coffee roasting machines were sold to Ann Young, a director of the company. Therefore, Ann is considered a connected party and the presumption of insolvency requirement would be met.

As the relevant period and presumption of insolvency requirements would be met pursuant to S240, the liquidator would be in a position to attack the transaction. Given that the coffee roasting machines were sold for £10,000 but were purchased for £25,000 just a year before, on face value it would appear that the transaction would qualify as one at an undervalue. Pursuant to S238(3), if the court is in agreement, it shall make an order as it thinks fit restoring the position to what it would have been if the Company had not entered into that transaction.²⁴

However, the liquidator should keep in mind that Ann, pursuant to S238(5), would be able to make submissions to the court in an attempt to satisfy it that the transaction was entered into in good faith, for the purpose of carrying on the Company’s business, and there were reasonable grounds to believe the transaction would benefit the Company. If Ann is able to successfully argue these points, the court would not make an order in respect of a transaction at an undervalue.²⁵

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Question 4.3 [maximum 4 marks]

The payments to Beans and Leaves Ltd.

The liquidator should refer to Section 239 of the Act (“S239”) which relates to preferences and states that a company gives a preference to a person if that person is one of the company’s creditors and the company does anything or suffers anything to be done which has

²⁰ Insolvency Act 1986, Section 238. <https://www.legislation.gov.uk/ukpga/1986/45/section/238>

²¹ Insolvency Act 1986, Section 240. <https://www.legislation.gov.uk/ukpga/1986/45/section/240>

²² *Ibid.*

²³ Insolvency Act 1986, Section 249. <https://www.legislation.gov.uk/ukpga/1986/45/section/249>

²⁴ Insolvency Act 1986, Section 238. <https://www.legislation.gov.uk/ukpga/1986/45/section/238>

²⁵ *Ibid.*

the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done. In addition, S239 requires the liquidator to show that the company was influenced in deciding to give the preference by a desire to produce in relation to the creditor in question; the desire to prefer is presumed if the creditor in question is a connected person.²⁶

For the transaction to be considered a preference, S240 states that the preference must have been conducted within 2 years of the commencement of the liquidation if made with a connected person and otherwise, within 6 months of the commencement of the liquidation.²⁷

S240 further provides that in general, a pre-requisite for a transaction to be considered a preference is for the company to, at the time of the transaction, be unable to pay its debts or become unable to pay its debts in consequence of the transaction. However, in instances where the transaction was conducted with a connected person, it is presumed that the company was unable to pay its debts at the time of the transaction.²⁸

Section 249 of the Act defines a connected person as a director or shadow director or associate of such director or shadow director, or an associate of the company.²⁹ In this case, Beans and Leaves Ltd (“BLL”) would not be considered a connected party. However, the payments were conducted within six months of the commencement of the liquidation so the timing requirement would be met pursuant to S240.

The burden of proof would be on the liquidator to show that the intention of the Company was to prefer BLL, which would be the most difficult to prove. To illustrate this difficulty, the pressure exerted by BLL in respect of the demand for immediate payment and altering the payments terms to a cash on delivery basis will not be relevant unless the desire to prefer can be proven.

In *Re MC Bacon Ltd*, the liquidator applied to court to have a debenture set aside as a preference. It was noted that the bank required the debenture over the company’s fixed and floating assets in exchange for its continued financial support. At the time, the company was insolvent and if the bank were to withdraw its support, the company would be forced into liquidation. The presiding judge noted that in deciding to grant the debenture to the bank, the directors’ desire was to avoid going into liquidation and to continue trading; the directors were not found to have a desire to improve the bank’s position as a creditor prior to liquidation. As such, the debenture was not set aside.³⁰

This case illustrates the extreme difficulty in establishing a “desire” to prefer as required by S239. This is even more difficult when dealing with arms-length transactions as the burden of proof is on the liquidator and there is no presumption of desire as there is with connected party transactions. In this case, given that BLL is not a connected party and on face value it appears that the decision to make the payments was for the purpose of preventing liquidation and to continue trading, the liquidator should understand that it is unlikely for a court to set the payments aside as preferences.

*** End of Assessment ***

²⁶ Insolvency Act 1986, Section 239. <https://www.legislation.gov.uk/ukpga/1986/45/section/239>

²⁷ Insolvency Act 1986, Section 240. <https://www.legislation.gov.uk/ukpga/1986/45/section/240>

²⁸ *Ibid.*

²⁹ Insolvency Act 1986, Section 249. <https://www.legislation.gov.uk/ukpga/1986/45/section/249>

³⁰ Quo, Shirley, “*Insolvency Law: A Comparative Analysis of the Preference Tests in the Hong Kong Special Administrative Region (HKSAR) and Australia*”, at https://www.monash.edu/data/assets/pdf_file/0007/896695/working-paper-9.pdf, accessed 28 February 2022.

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Refer to p 64 in the Guidance Text.
This scenario deals with a disposition after the commencement of the company’s insolvency proceeding.
Therefore, s 127 and not s 239 applies.