



**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**

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

Commented [JL2]: 8 out of 10

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

**Question 1.1**

Please select the **most correct ending** to the following statement:

The Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021 restrict pre-pack sales which constitute a substantial disposal of the company's property to connected parties where the disposal occurs:

- (a) within 10 weeks of the commencement of the administration.
- (b) within 8 weeks of the commencement of the administration.**
- (c) within 4 weeks of the commencement of the administration.
- (d) on the day the company enters administration.

**Question 1.2**

What is the **maximum length** of a Moratorium under Part 1A of the Insolvency Act 1986 to which creditors can consent without any application to the court?

- (a) 40 business days.
- (b) One year and 20 business days.
- (c) One year and 40 business days.
- (d) One year.**

**Question 1.3**

Which of the following **is not** a requirement for a company that wishes to enter into a Restructuring Plan under Part 26A of the Companies Act 2006?

- (a) The company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern.
- (b) A compromise or arrangement is proposed between the company and its creditors, or any class of them, or its members, or any class of them.

(c) The purpose of the compromise or arrangement is to eliminate, reduce or prevent, or mitigate the effect of, any of the said financial difficulties.

(d) The company is, or is likely to become, unable to pay their debts, as defined under section 123 of the Insolvency Act 1986.

#### Question 1.4

In cases where the Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021 apply and an independent report from an Evaluator is obtained, the independent report must be obtained by whom?

- (a) The administrator.
- (b) Any secured creditor with the benefit of a qualifying floating charge.
- (c) The purchaser.
- (d) The company's auditor.

#### Question 1.5

Which one of the following **is not** a debtor-in-possession procedure?

- (a) Administration.
- (b) Restructuring Plan.
- (c) Scheme of Arrangement.
- (d) Company Voluntary Arrangement.

#### Question 1.6

A liquidator may pay dividends to small value creditors based upon the information contained within the company's statement of affairs or accounting records. In such circumstances, a creditor is deemed to have proved for the purposes of determination and payment of a dividend where the debt is **no greater than how much?**

- (a) £500
- (b) £750
- (c) £1,000
- (d) £2,000

#### Question 1.7

Which one of the following **is not**, in itself, a separate ground for disqualification of a director under the Company Directors Disqualification Act 1986?

- (a) Wrongful trading.
- (b) Breach of fiduciary duty.

Commented [JL3]: b

(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.

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## 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?

#### *Company Directors Disqualification Act 1986 (CDDA)*

Under section 7(1) of the CDDA, the Secretary of State may bring an application for a disqualification order<sup>1</sup>. In the case of an individual who has been a director of a company being or has been wound up, section 7(1)(b) of the CDDA provides that the Secretary of State may direct the Official Receiver to make such application. Upon satisfying the Court that the requirements for disqualification are established, the Court must make a disqualification order against the director.

#### *Insolvency Act 1986 (IA1986)*

As to section 423 of the IA1986, this section deals with transactions at an undervalue designed to put a debtor's assets beyond the reach of its creditors. The following have standing to bring an application under section 423:

- A victim of the transaction (normally a creditor of the company)<sup>2</sup>;
- With leave of the Court a liquidator or Official Receiver where the company is being wound up<sup>3</sup>;
- With leave of the Court an Administrator where the company has entered into Administration<sup>4</sup>; or
- By a Supervisor of a Company Voluntary Arrangement (**CVA**) or any victim of the transaction (secured or unsecured creditor regardless of whether the secured creditor is bound by the CVA)<sup>5</sup>

As to Section 246ZB of the IA1986, this section deals with claims against a director for wrongful trading where the director knew or should have known the company was insolvent or in the zone of insolvency. While directors owe fiduciary duties to act in the company's best interest, where a company is insolvent or in the zone of insolvency, the directors' duty is to act in the best interest of the creditors as a whole of the company. Section 246ZB(1) confers standing to an administrator of the company to bring such an application.

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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.

Historically, where a creditor of a company is required to make decisions within insolvency procedures, it was either by correspondence or by convening a physical meeting. These decisions include but are not limited to (i) the appointment of a liquidator; (ii) approve administration proposals; (iii) to remove an administrator; and (iv) agree to the remuneration

<sup>1</sup> Section 7(1)(a) of the CDDA

<sup>2</sup> IA 1986 §424(1)(a)

<sup>3</sup> IA 1986 §424(1)(a). In this context leave is required because following the making of a winding up order any individual actions against the company are stayed.

<sup>4</sup> IA1986 §424(1)(a)

<sup>5</sup> IA 1986 §424(1)(b)

of an officeholder. Following the enactment of section 246ZE of the IA1986, it is no longer necessary to hold a physical meeting except where 10% of the value or in number of creditors make a request to convene a meeting<sup>6</sup>. Otherwise, decisions by creditors are made by using either deemed consent procedures or qualifying decision procedures. Pursuant to rule 15.3<sup>7</sup>, a decision by creditors may be made by:

- Correspondence;
- Electronic voting;
- Electronic meeting; or
- Any other procedure which enables all creditors to participate in making the decision to do so.

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### 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?

The short answer is yes, **provided** that the administrator personally guarantees the payment of continued service upon the company being subject to an insolvency procedure or upon an application by the service provider; the Court determines that the provision of continued service would cause the supplier undue hardship.

Section 233 of the IA1986 permits an officeholder (i.e., administrator or liquidator) to request the continued supply of essential services within the meaning of the IA1986. The supplies that are covered by the IA1986 include:

- The supply of gas<sup>8</sup>;
- The supply of electricity<sup>9</sup>;
- The supply of water<sup>10</sup>;
- The supply of communications<sup>11</sup>; and
- The supply of goods and services to facilitate anything done by electronic means<sup>12</sup>.

Section 233(3A) of the IA1986 then goes on to define goods and services as:

- Point of sales terminals<sup>13</sup>;
- Computer hardware and software<sup>14</sup>;
- Information, advice, and technical assistance in connection with the use of information and technology<sup>15</sup>;
- Data storage and processing<sup>16</sup>; and

<sup>6</sup> IA1986 §246ZE (3)

<sup>7</sup> Insolvency (England & Wales) Rules 2016 (SI/2016/1024)

<sup>8</sup> IA1986 §233(3)(a)-(aa)

<sup>9</sup> IA1986 §233(3)(b)-(bb)

<sup>10</sup> IA1986 §233(3)(c)-(cc)

<sup>11</sup> IA1986 §233(3)(d)-(e)

<sup>12</sup> IA1986 §233(3)(f)

<sup>13</sup> IA1986 §233(3A)(a)

<sup>14</sup> IA1986 §233(3A)(b)

<sup>15</sup> IA1986 §233(3A)(c)

<sup>16</sup> IA1986 §233(3A)(d)

- Website hosting<sup>17</sup>.

Section 233A of the IA1986 aims to provide greater protections to financially distressed businesses by preventing suppliers of goods and services (as set out above) from relying on insolvency terms in their contracts<sup>18</sup>. In the absence of these provisions, a supplier of goods and services would be in a position to terminate the contract of supply or 'do any other thing' to the company upon the company being subject to an insolvency procedure.

Nevertheless, the supply of goods and services may still be terminated in circumstances where (i) the officeholder consents to the termination of the contract<sup>19</sup>; (ii) the Court grants permission for the termination of the contract<sup>20</sup> provided it is satisfied the continuation of the contract would cause the supplier undue hardship<sup>21</sup>; or (iii) any post-administration charges related to the supply of goods or services are not paid within 28 days after becoming due<sup>22</sup>.

Although suppliers are not permitted to demand payment of outstanding debts for the supply of new or continued service, this is subject to two express carve-outs:

- Upon the supplier giving written notice to the officeholder that services will be terminated unless the officeholder personally guarantees the payment of continued service upon the company entering insolvency procedure and the officeholder fails to give such notice within 14 days of receipt<sup>23</sup>; or
- This provision does not apply to any contracts entered into prior to 1 October 2015<sup>24</sup>.

The Corporate Insolvency and Governance Act 2020 (**CIGA**) extended the protections to insolvent companies by prohibiting the termination of contracts where the company enters into an insolvency procedure<sup>25</sup>. Similar to section 233A, a supplier of goods and services may terminate the contract (i) with the consent of the officeholder<sup>26</sup>; the company consents to the termination<sup>27</sup>; or (iii) the Court is satisfied that the continuation of the contract would cause the supplier undue hardship<sup>28</sup>. Further, the supplier is prohibited from taking any steps to demand as a condition for continued supply of services the satisfaction of pre-insolvency procedure debts<sup>29</sup>.

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S233B also extends the protections of 233 and 233A to ALL suppliers

### 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.

In a court-ordered, winding up the IA1986 and the Insolvency Rules 2016 provides a statutory priority for distributing assets out of the estate. Before turning to the order of priority, there are two general principles that apply to the distribution of these assets. First, higher classes of priority must be discharged in full before a lower category of priority will receive a distribution.

<sup>17</sup> IA1986 §233(3A)(f)

<sup>18</sup> IA1986 §233A(2)

<sup>19</sup> IA1986 §233A (4)(a)

<sup>20</sup> IA1986 §233A (4)(b)

<sup>21</sup> IA1986 §233A (4)

<sup>22</sup> IA1986 §233A (4)(c)

<sup>23</sup> IA1986 §233A(5)

<sup>24</sup> IA1986 §233A (10)

<sup>25</sup> IA1986 §233B

<sup>26</sup> IA1986 §233B(5)(a)

<sup>27</sup> IA1986 §233B(5)(b)

<sup>28</sup> IA1986 §233(5)(c)

<sup>29</sup> IA1986 §233B(7)



Second, if there are insufficient assets available for distribution to satisfy all of a debtor's liabilities in full, then the liabilities will be discharged ratably i.e., *par passu*.

Liabilities of a debtor are discharged in the following order of priority:

- Assets and expenses of the liquidation;
- Preferential Debts;
- Floating Charge Holders;
- Unsecured debts; and
- Any remaining surplus is distributed to the shareholders/contributors of the company.

Section 115 of the IA1986 provides that the expenses occasioned by and incidental to the winding are given priority over all other debts of a debtor. Although these expenses enjoy priority over other debts, the expenses rank in the following order of priority:

- Expenses incurred by realizing or securing assets of the company, including the conduct of litigation<sup>30</sup>;
- The cost of any security provided by a liquidator<sup>31</sup>;
- Amount payable to a person to assist in the preparation of the statement of affairs of the company<sup>32</sup>;
- Disbursements by a liquidator made during the currency of insolvency proceedings<sup>33</sup>;
- Remuneration of persons employed by the liquidator to perform services for the company<sup>34</sup>;
- Remuneration of the liquidator<sup>35</sup>;
- Amount of corporate tax payable on chargeable gains<sup>36</sup>; and
- Any other expenses chargeable by a liquidator carrying out the liquidator's functions<sup>37</sup>.

Upon satisfaction of the expenses of the liquidation, section 175(1) of the IA1986 provides that preferential debts shall be paid in priority to all other debts. Within this category, there are two different classes of preferential debts. Section 175(1A) provides that 'ordinary preferential debts' rank before 'secondary preferential debts' but equally amongst themselves. In the event that the ordinary preferential debts cannot be paid in full, then the debts will be paid ratably<sup>38</sup>. Similarly, secondary preferential debts rank equally amongst each other and are discharged ratably if the assets of the debtor are insufficient to pay them in full<sup>39</sup>.

Section 386 of the IA1986 refers to Schedule 6 of the IA1986, which ranks preferential debts in the following order of priority:

- Contributions to occupational pension schemes<sup>40</sup>;

<sup>30</sup> Insolvency Rules 2016, Rule 6.45(4)(a)

<sup>31</sup> Insolvency Rules 2016, Rule 6.45(4)(b)

<sup>32</sup> Insolvency Rules 2016, Rule 6.45(4)(d)

<sup>33</sup> Insolvency Rules 2016, Rule 6.45(4)(f)

<sup>34</sup> Insolvency Rules 2016, Rule 6.45(4)(g)

<sup>35</sup> Insolvency Rules 2016, Rule 6.45(4)(h)

<sup>36</sup> Insolvency Rules 2016, Rule 6.45(4)(i)

<sup>37</sup> Insolvency Rules 2016, Rule 6.45(4)(k)

<sup>38</sup> IA1986 s. 175(1A)

<sup>39</sup> IA1986 s. 175(1B)

<sup>40</sup> IA1986 Schedule 6, para 8

- Remuneration owed by the company to an individual who has been employed in whole or part of the period of 4 months before the company enters into liquidation<sup>41</sup>;
- Accrued holiday remuneration owed to an employee prior to the company entering liquidation<sup>42</sup>;
- Any sums owed in respect of money advanced for payment for remuneration or accrued holiday<sup>43</sup>;
- Any amounts ordered to be paid under the Reserve Forces (Safeguard of Employment) Act<sup>44</sup>;
- Levies on coal and steel production<sup>45</sup>;
- Debts owed to the Financial Services Compensation Scheme<sup>46</sup>; and
- Amounts owed to 'eligible persons' in respect of an eligible deposit as does not exceed amounts payable under the Financial Services Compensation Scheme<sup>47</sup>.

Section 386(1B) of the IA1986 then goes on to provide that the following debts are 'secondary preferential debts within the meaning of the IA1986:

- Amounts owed to 'eligible persons' in respect of an eligible deposit as exceeds amounts payable under the Financial Services Compensation Scheme<sup>48</sup>;
- Amounts owed by a company to an 'eligible person' in respect of a deposit (i) through a non-UK branch of a credit institution authorized by a competent UK authority; and (ii) would have been eligible if it had been made through a UK branch of that credit institution<sup>49</sup>;
- Certain HMRC debts<sup>50</sup>.

If there are assets remaining for distribution, the next category of priority is floating charge holders. Section 176A of the IA1986 provides that the proscribed part of a company's 'net property' shall be available for distribution to the company's unsecured creditors. As a consequence, floating charge holders are paid the balance of proceeds realized from the sale of any charged assets.

The next category of priority deals with unsecured secured creditors. The distribution to unsecured creditors will be distributed on a *pari passu* basis.

In the event that the insolvent estate has sufficient funds to pay all the debtor's liabilities, any remaining surplus is distributed amongst the company's shareholders/contributories in accordance with the company's constitutional documents.

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

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

<sup>41</sup> IA1986 Schedule 6, para 9

<sup>42</sup> IA1986 Schedule 6, para 10

<sup>43</sup> IA1986 Schedule 6, para 11

<sup>44</sup> IA1986 Schedule 6, para 12

<sup>45</sup> IA1986 Schedule 6, para 15A

<sup>46</sup> IA 1986, Schedule 6 para 15AA

<sup>47</sup> IA1986 Schedule 6, para 15B

<sup>48</sup> IA1986, Schedule 6, para 15BA

<sup>49</sup> IA1986, Schedule 6, para 15BB

<sup>50</sup> IA1986, Schedule 6, para 15D

**Commented [JL10]:** Fixed charge holders? Position of Floating Charge Holders low on detail.  
7

**Commented [JL11]:** 11 out of 15

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:**

As a preliminary point, it may be possible to bring a misfeasance claim against the directors of Corfee Zero Limited (**CZL**) for entering into the questionable transactions. If successful, the liquidator may seek an order for repayment or contribution from the directors. This money will be returned to the insolvency estate and be available for distribution to the creditors of CZL.

In order to be liable for misfeasance, it must be shown that the former officers of CZL misapplied, retained any money or property of CZL, or breached their fiduciary duty or other duty concerning the company<sup>51</sup>. It is well established that a company director owes a fiduciary duty to act in the best interest of a company. However, in circumstances where a company is insolvent or in the zone of insolvency (as is the case here), the directors' duty shifts, and a director must act in the best interests of the creditors of the company as a whole.

If it can be shown that in February 2021, CZL was in the zone of insolvency, then on its face, the grant of a floating charge over the entire undertaking of CZL to Stercus Bank plc (**Bank**) does not appear to be in the best interests of CZL's creditors as a whole.

The position is even stronger in respect of the sale of the coffee roasting machines. First, the directors of CZL owed a fiduciary duty to act in the best interests of the company. Moreover, Ann Young owed a duty not to act where there is a conflict of interest. It is difficult to see how the sale of CZL's most significant asset for a pittance was in the best interest of the company. This is especially so where the company financial position was dire.

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<sup>51</sup> IA1986 §212(1)

Even if this transaction could be shown to be in the best interest of CZL, as indicated above, if in July 2021 CZL was in the zone of insolvency (which appears to be the case on account of its continued cash flow problem), then the directors would have to demonstrate that said transaction was in the best interest of CZL's creditors as a whole.

In respect of the payments to Beans and Leaves Ltd (**Beans**), if it can be shown that CZL was insolvent or in the zone of insolvency, then similar to above, it is difficult to see how said transaction was in the best interest of CZL's creditors as a whole. This is because the £8,000 payment to Beans which may otherwise been available to the creditors of CVL, was paid potentially as a preference to Beans.

It should be noted that under section 1157 of the Companies Act 2006, the Court may excuse the breach where it is satisfied that the director acted honestly and reasonably.

#### **Question 4.1 [maximum 5 marks]**

**The floating charge in favour of Stercus Bank plc;**

A floating charge granted in favour of the Bank is an antecedent transaction and liable to set aside. The floating charge granted by CZL may be set-aside pursuant to section 245 of the IA1986, provided certain statutory requirements are met.

The purpose of section 245 is to prevent a company from creating a floating charge for existing liabilities without receiving any consideration. Under section 245 of the IA1986, a floating charge granted over a company's property will be invalid if:

- The floating charge was created for no consideration<sup>52</sup>;
- It was created in favour of a person not connected to the company within one year prior to the company's insolvency<sup>53</sup>;
- At the time the floating charge is created, the company was unable to pay its debts within the meaning of section 123 of the IA1986 (i.e., cash flow or balance sheet insolvent)<sup>54</sup>.

In this case, CVL created a floating charge in favour of the Bank over the Bank's whole undertaking within the 1 year look-back period in February 2021 for no consideration. On the basis that CVL acceded to the Bank's demand for repayment of the company's loan, it can be inferred that CVL was unable to pay its debts [cash flow insolvent]. As a consequence, the floating charge satisfies the requirements of section 245 and is therefore invalid. Prior to bringing a court application, it would be prudent to first write to the Bank to advise it that the floating charge is invalid. In the event that the Bank fails to respond or takes any steps to enforce the security, an application should promptly be made for a declaration that the floating charge is invalid.

Commented [JL12]: 5

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

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

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<sup>52</sup> FN

<sup>53</sup> IA1986 §245(3)(b)

<sup>54</sup> IA1986 §245(4)(a)

As to the sale of the coffee roasting machines, this antecedent transaction may be set aside as a transaction at an undervalue (s. 238 IA1986) or a transaction to defraud creditors (s. 423 IA1986).

Section 238 confers standing on the officeholder to make an application to set aside a transaction at an undervalue when said company enters liquidation<sup>55</sup>. In the context of this case, a liquidator must demonstrate that:

- The company enters into a transaction with that person for a consideration the value of which, in money or money's worth is significantly less than the value in money or money's worth of the consideration provided by the company<sup>56</sup>;
- In the case of a transaction at an undervalue, the relevant look-back period for a person connected to the company is a period of 2 years ending with the onset of insolvency<sup>57</sup>.

Section 240<sup>58</sup> of the IA1986 then goes on to state that:

*"where a company enters into a transaction at an undervalue that time is not a relevant time for the purpose of section 238 unless the company:*  
(a) *Is at that time unable to pay its debts within the meaning of section 123 of the IA1986 (i.e., cash flow or balance sheet insolvent); or*  
(b) *Becomes unable to pay its debts within the meaning of that section in consequence of the transaction or purchase."*

However, for the purposes of this section, there is a rebuttable presumption that the company is unable to pay its debts where the company with a connected person enters into the transaction. Thus, the burden shifts to the company to demonstrate that it was able to pay its debts at the time of the transaction.

If the Court is satisfied the company carried out the transaction at an undervalue, it may make an order to restore the position to what it would have been at the time had the company not entered into the transaction<sup>59</sup>. Section 238 IA1986 makes clear that a court will not make an order where it is satisfied that:

- The company entered into the transaction in good faith for the purpose of carrying on business<sup>60</sup>; and
- At the time of the transaction, there were reasonable grounds for believing that the questionable transaction would benefit the company<sup>61</sup>.

In the context of this case, even accounting for depreciation of the coffee makers on its face, the consideration received in the sum of £10,000 appears to be at an undervalue. Further, Ann Young, as a director of CZL, is a connected person. Therefore, the purported transaction on July 2021 is within the look-back period of 2 years as set out in section 240(1)(a). On this basis, the liquidator could bring an application under section 238 to attack this transaction.

Alternatively, upon obtaining leave of the Court, it is open to attack this transaction as a transaction to defraud creditors. Under section 423, a court will set aside a transaction if:

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<sup>55</sup> IA1986 §238(1)

<sup>56</sup> IA1986 §238 (4)(b)

<sup>57</sup> IA1986 §240(1)(a)

<sup>58</sup> IA1986 §240(2)

<sup>59</sup> IA1986 §238 (3)

<sup>60</sup> IA1986 § 238(5)(a)

<sup>61</sup> IA1986 238(5)(6)

- A company enters into a transaction with another for a consideration, the value of which in money or money's worth is significantly less than the value in money or money's worth of the consideration provided by himself<sup>62</sup>.

A court will only make this order if it is satisfied that the purpose of the transaction was *"to put the assets beyond the reach of the person making it or may make some claim against it"*<sup>63</sup>. Upon satisfying these requirements, the Court may make an order to restore the position to what it would have been had the transaction not been entered into<sup>64</sup>.

The primary difference between sections 423 and 238 is that:

- (i) a victim (typically a creditor) has standing under section 423. However, in practice a liquidator, if the company is being wound up will bring the application on the creditors behalf. As mentioned above, a liquidator make also bring an application if given leave to do so by the Court; and
- (ii) There is no look-back period under section 423, and this application may be brought regardless of whether the company is in liquidation.

Turning to the facts of this case, the transaction on its face plainly appears to be at an undervalue for the reasons set out above. In these circumstances, the transaction does not appear to have any rational commercial basis other than to put the coffee makers beyond the reach of CZL's creditors.

In light of the foregoing, it would be open to the liquidator to make an application under either section 238 or 423. Based on the circumstances of this case, with a view towards dealing with the matter in a cost-efficient and timely manner, I would suggest that the liquidator attack the transaction as a transaction at an undervalue pursuant to section 238 of the IA1986.

Commented [JL13]: 6

### Question 4.3 [maximum 4 marks]

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

As to the payments to Beans, this antecedent transaction is also liable to be set aside as a preference. Section 239(1) of the IA1986 confers standing for a liquidator to apply to the Court for an order under this section.

As a preliminary point, if there are insufficient funds of the company for the liquidators to pursue the claim but the liquidator needs to have recourse to the company's property subject to a floating charge, the liquidator will need to obtain the consent of the floating charge holder to fund the litigation expense<sup>65</sup>.

A transaction will be a preference provided that:

- The person who received the preference was a creditor of the company<sup>66</sup>;

<sup>62</sup> IA1986 §423(1)(c)

<sup>63</sup> IA1986 §423(3)(a)

<sup>64</sup> IA1986 §423(2)(a)

<sup>65</sup> Rule 6.45 Insolvency (England & Wales) Rules 2016 (SI/2016/1024)

<sup>66</sup> IA1986 §239(4)(a)

- The effect of the preference is to put that creditor in a better position than it would have been in the event the company entered liquidation<sup>67</sup>
- The preference was given in the period of six months ending within the onset of insolvency<sup>68</sup>
- At the time of the preference the company was unable to pay its debts within the meaning of section 123 of the IA1986 (i.e., cash flow or balance sheet insolvent)<sup>69</sup>.
- In giving the preference the company was influenced by a desire to prefer the creditor<sup>70</sup>.

Below I will set out these requirements within the context of the facts of this case in turn.

At all times, Beans was a key supplier, thus a trade creditor of CZL. As a trade creditor, upon a winding-up order being made by the Court, it would have been an unsecured creditor of the company. After distributions made to priority creditors, if there were any remaining assets, Beans would have received a pari passu distribution. Accordingly, receipt of £8,000 prior to the onset of liquidation put Beans in a better position than it otherwise would have been upon CZL entering liquidation. As to whether the preference was given within the 'relevant time,' the CZL entered liquidation on 23 December 2021. Upon review of CZL's records, these payments were made in September 2021 i.e., within the relevant time.

Having disposed of the CZL's only significant asset (i.e., the roasting machines) previously purchased for £25,000, it is possible that CVL was balance sheet insolvent (i.e., liabilities are greater than assets). Further or alternatively, given CZL's inability to repay its loans suggests that CZL was cash flow insolvent.

Finally, it must be shown on the evidence that the company was influenced with a desire to prefer a creditor. In determining this issue, the Court will apply a subjective test. On the facts, CZL was influenced to make the payments to ensure the continued supply of goods to keep the business operational. While it is arguable that this constitutes a desire to prefer a creditor, the authorities illustrate that this may be insufficient to establish a desire to prefer a creditor. In *Re MC Bacon Ltd [1990] BCC 78*, the Court found that the company's payment to avoid a bank from calling in an overdraft was not a desire to prefer creditors.

Although there is a small risk that the Court may find this transaction is not a preference – it would be open to the liquidator to bring the proceedings to set aside this [transaction](#).

**Commented [JL14]: 0**  
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.

**\* End of Assessment \***

<sup>67</sup> IA1986 §239(4)(b)

<sup>68</sup> IA1986 §240(1)(c)

<sup>69</sup> IA1986 §240(2)(a)

<sup>70</sup> IA1986 §239(6)