



**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?

- (i) An action under section 423 of the Insolvency Act 1986 may be brought by:
- A liquidator, administrator, the official receiver and any victim of a transaction designed to defraud creditors (with leave from the court, in instances where the company is being wound up or is in administration).
  - The supervisor of a CVA in instances where a victim of a transaction designed to defraud creditors is bound by that CVA.
  - a victim of transaction designed to defraud creditors, in any other case (not listed above).

A transaction designed to defraud creditors is one where the company entered into the transaction at an undervalue (ie the company received no consideration or received consideration significantly less than it provided initially). Essentially, any person who is a victim of such a transaction may bring an application under section 423.

- (ii) An action under section 6 of the Company Directors Disqualification Act 1986 (the "CDDA") may be brought in instances where the court is satisfied that:
- the person concerned is or has been a director of the company which has at the anytime become insolvent (either during his time as a director or subsequently); and
  - that his conduct as a director of that company makes him unfit to be concerned in the management of the company.

Pursuant to section 7 of the CDDA, such an action may be brought by the Secretary of State, or if the Secretary of State so directs in the case of a person who is or has been a director of a company which is being wound up by the court in England and Wales, by the official receiver.

- (iii) An action (for wrongful trading) under section 246ZB of the Insolvency Act 1986 may be brought by both liquidators and administrators (subject to the transitional provisions). Before 1 October 2015, only liquidators could bring such claims. A liquidator or administrator may also assign wrongful trading claims to third parties - this was confirmed in the *Re Totalbrand Limited* case<sup>1</sup>.

Commented [JL6]: 5

### 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.

1. Actual physical meeting of the creditors;
2. Electronic voting;
3. Correspondence;
4. Virtual meeting;

<sup>1</sup> *Re Totalbrand Ltd Cage Consultants Ltd v Iqbal and another* [2020] EWHC 2917 (Ch).

5. Any other decision making procedure which enables all creditors, who are entitled to participate, to participate equally in making the decision.<sup>2</sup>

A decision of the creditors may also be made by way of a "deemed consent procedure" which permits a decision to be made by notifying creditors of the intended decision and if that decision is not effectively objected to, it is deemed to have been made.

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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?

One of the main purposes of administration is to rescue the company so that it can continue trading as a going concern. This outcome is unachievable if the Company's supply agreements with its main suppliers cease to operate. If this happens it will be difficult for a company to continue trading as a going concern. Section 233 of the Insolvency Act of 1986 (the "Act") ensures that the essential services which the company needs in order to operate, will not cease simply because the company has entered into administration. Section 233 of the Act provides that if an administrator requests a current supplier of a company in administration to continue to supply certain essential services, the supplier: (a) may make the supply of the service subject to the administrator providing personal guarantees for the payment of any charges owing in respect of the service supplied, but (b) shall not make it a condition to continuing to supply the company with a service, that any outstanding charges which arose prior to the administration be paid off first. The services contemplated as under this section are:

- the supply of gas;
- the supply of water;
- the supply of electricity;
- the supply of communication services;
- a supply of goods or services by a person who carries on a business which includes giving such supplies, where the supply is for the purpose of enabling or facilitating anything to be done by electronic means (including goods and services such as (a) point of sale terminals; (b) computer hardware and software; (c) information, advice and technical assistance in connection with the use of information technology; (d) data storage and processing; (e) website hosting.

Section 233A takes the above a step further and provides further protection in respect to the supply of essential services during a company's administration. Section 233A of the Act provides that an "insolvency-related term" of a supply contract would cease to have effect if the company enters administration. These could include terms which provide for automatic termination of the contract should the company enter into administration or which change the terms of the supply under the contract while the company is under administration. However, these "insolvency related terms" do not cease to have effect to the extent that they provide for the contract or supply to terminate (or the right of the supplier to terminate the contract or supply) because the company becomes subject to an insolvency procedure other than administration, or because of an event that occurs after the company enters administration. Further, section 233B(3) of the Act, read together with subsections 4 and 5, provides that where an "insolvency-related term" has ceased to have effect, the supplier may still terminate

<sup>2</sup> Rule 15.3 of the Insolvency (England and Wales) Rules 2016.

the contract if (i) the administrator consents; (ii) the court grants permission (where the court is satisfied that the continuation of the contract would cause the supplier hardship); or (iii) any charges in respect of the supply that are incurred after the company entered into administration are not paid within 28 days from when they became due.<sup>3</sup> The supplier may also terminate the agreement/contract/supply where 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 the administrator does not give that guarantee within the period of 14 days from when notice is served.<sup>4</sup>

Section 233B of the Act, which was introduced by the Corporate Insolvency & Governance Act 2020, creates further restrictions on the actions that a supplier of goods or services can take in the event of insolvency of its client, being the company who has been placed under administration. This section limits the operation of an automatic termination of the contract or the supply or any other thing, when a company (as client of the supplier) becomes subject to an insolvency process, in this case administration. This section also restricts the suppliers' ability, by varying the terms of their supply, to make the supply of goods/subject to the payment of any arrears outstanding. Section 233B Act does not apply to suppliers who are financial institutions such as banks, insurers and electronic investment exchanges (whether as customer or as supplier). - Financial contracts (such as contracts for lending, financial leasing or providing guarantees), contracts for securities, commodities, futures/forwards, swaps, and inter-bank borrowing of three months or less are also excluded.

Should the supply agreement contain a clause whereby the supply or the contract itself may be terminated by the supplier due to an event which occurred prior to the start of the insolvency period or administration, and that entitlement arises before the start of the insolvency period, then Section 233B(4) of the Act prevents the supplier from relying on this event.

Section 233B of the Act differs in many respects to Section 233A of the Act in that it applies to a broader set of insolvency procedures than those particularised in Section 233A and it also covers more than just essential supplies. One example is that Section 233A does not provide for the ability of suppliers to require an administrator (or other such insolvency officeholder as the case may be) to personally guarantee the payment of any future supply.<sup>5</sup>

Based on the above it would seem that an administrator who wishes to continue to operate the business of the company in administration can require suppliers of certain goods and services to continue to supply those goods and services during the administration. However this is limited to certain goods and services (those which are essential as listed above) and subject to rights and remedies available to suppliers (in particular those circumstances which allows a supplier to terminate the contracts where certain conditions are met).

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<sup>3</sup> Section 233B(4)

<sup>4</sup> Section 233B(5)

<sup>5</sup> <https://www.lexology.com/library/detail.aspx?g=750dd93b-effa-416f-967d-79bb7b7d9490> "Insolvent customer? Supplier beware!" D Steinberg and L Trott, Stevens & Bolton LLP dated 3 July 2020, accessed 25 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 Insolvency Act of 1986 (the "Act") prescribes a statutory order which needs to be followed when making distributions to creditors involved in the liquidation of a company. In summary, the hierarchy/order of creditors is as follows:

1. Fixed charge holders.
  2. Liquidators' fees and expenses.
  3. Preferred creditors.
  4. Floating charge holders.
  5. Unsecured creditors.
  6. Interest incurred on all unsecured debts post-liquidation.
  7. Shareholders.
1. Secured creditors with a fixed charge are lenders (usually banks) who hold title over a commercial asset. Such assets may include a company's property, plant, machinery, and vehicles. The fixed charge holder, is able to sell the secured asset to recoup the money owed to it. Typically the assets which are subject to a fixed charge are fundamental to a company's business operations, and unlikely to be sold in the normal course of events. However in a liquidation, subject to the terms of the charge agreement, the asset can only be sold by liquidator to realise funds, but the charge holder will rank first when payments are made.
2. Liquidators fee and expenses - These fees includes all fees and expenses of the insolvency proceedings, including the insolvency practitioner's fees.
- These expenses can include payments to company employees or successful victims of a wrongful action claim. An insolvent company's employees are entitled to arrears of wages up to a maximum of £800, and holiday pay upon liquidation of the company.
3. Preferential Debtors - The Deposit Guarantee Scheme Regulations 2015 amended the Act and included section 386 which categorized debts owed to the Financial Services Compensation Scheme ("**Scheme**") as a preferential debt. In the case of deposits, depositors protected by the Scheme are also considered preferential creditors (since 31 December 2014) so long as the amounts owed to them do not exceed the compensation they are entitled to under the Scheme and this amount is capped at £85,000.<sup>6</sup> Insurance or direct policyholders only have a priority status within the class of unsecured creditors.<sup>7</sup>

Pursuant to the Insolvency Act 1986 (HMRC Debts: Priority on Insolvency) Regulations 2020 and from 1 December 2020, certain debts owed to the HMRC were classified as secondary preferential debts. These debts are to be paid in a liquidation above unsecured creditors. These debts include:

- Value Added Tax, and debts that relate to the following taxes;
- Pay As You Earn Income Tax;
- Employee National Insurance contributions;
- Student loan repayments; and
- Construction Industry Scheme deductions.

<sup>6</sup> [https://www.cms-lawnow.com/ealerts/2015/03/an-insolvency-lawyers-guide-to-the-financial-services-compensation-scheme?cc\\_lang=en](https://www.cms-lawnow.com/ealerts/2015/03/an-insolvency-lawyers-guide-to-the-financial-services-compensation-scheme?cc_lang=en) "An Insolvency Lawyer's Guide to the Financial Services Compensation Scheme" by R Lowe, CMS Law dated 26 March 2015, accessed 19 February 2022.

<sup>7</sup> <https://www.fscs.org.uk/about-us/funding/recoveries/>

This means that the HMRC may be treated as preferred creditor, albeit secondary, only where the above secondary preferential debts exist when a company on or after 1 December 2020 begins insolvency proceedings. For any other taxes to be paid to the HMRC, the HMRC will remain an unsecured creditor.

The concept of a secondary preferential debt was introduced by the Banks and Building Societies (Depositor Preference and Priorities) Order 2014 which came into force on 1 January 2015 and amended the Act at section 175. This Order provides that 'ordinary preferential debts' rank equally among themselves and shall be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions. The amended section goes further and provides that 'secondary preferential debts' rank equally among themselves after the ordinary preferential debts and shall be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions. This section creates a sub-ranking of preferential debts amongst preferential creditors.

After ordinary preferential creditors have been paid, secondary preferential creditors will be paid. These include, as already mentioned, the HMRC in certain instances, depositors for amounts exceeding the £85,000 cap, and eligible depositors that made deposits with an authorised credit institution but with a branch located outside of the European Economic Area.<sup>8</sup>

4. Floating charge holders are the next to be paid after preferential creditors. A floating charge may be held over a variety of assets for example stock, raw materials, cash, fixtures and fittings etc. If there are multiple floating charge holders, the order of preference in payment between them is usually based on which floating charge was created first in time. Section 176A of the Act applies where a floating charge relates to property of a company which has gone into liquidation. This section provides that the liquidator (a) shall make a prescribed part of the company's net property available for the satisfaction of unsecured debts, and (b) shall not distribute that part to the proprietor of a floating charge except in so far as it exceeds the amount required for the satisfaction of unsecured debts. Essentially, this means that the liquidator is required to determine and "set aside", so to speak, a prescribed part of the Company's net property in order to satisfy the unsecured debts. This prescribed part cannot be used to pay the holders of a floating charge unless it is in excess of the unsecured creditors' claims. Section 176A only applies to floating charges created on or after 15 September 2003
5. Unsecured creditors are as the name indicates those creditors with no security and usually comprise unsecured loans from banks and lenders, trade creditors, customers, suppliers, contractors, unsecured overdrafts, rent and lease payments or maintenance, directors loan accounts, friend and family loans to the business, and any shortfall on any fixed or floating charge.<sup>9</sup>
6. Subject to remaining funds be available for distribution, statutory interest will then become on insolvency debts.
7. Shareholders are the final group of creditors to be paid in the company's distribution of assets on liquidation. The reason behind this is that as they have taken a commercial risk in providing money to the company, they should not be entitled to a distribution until all the

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<sup>8</sup> Supra note 4 above.

<sup>9</sup> <https://www.begbies-traynorgroup.com/articles/insolvency/who-gets-paid-first-when-a-company-goes-into-liquidation> "Order of payment priority for creditors during company liquidation" by Jonathan Munnery, Begbies Traynor Group dated 24 January 2021 accessed on 19 February 2022.

other creditor groups have been paid. It's the same reasoning for why shareholders are entitled to receive dividends or profits from the company should it be **successful**.

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

Commented [JL11]: 10 out of 15

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]**

The floating charge in favour of Stercus Bank plc;

Stercus Bank plc (the "Bank") as the holder of a floating charge shall in the liquidation of the Company rank in priority to unsecured creditors, but after preferential creditors for purposes of distributions made to the Company's creditors. However, where a creditor obtains security (be it in the form of a floating charge or otherwise) from a company shortly before it enters into insolvency proceedings, this can amount to floating charge avoidance under section 245 of the Insolvency Act 1986 (the "Act"). If it is found that the floating charge was entered into for the wrong reasons in order to put the creditor in a more favourable position right before a company goes into liquidation, the liquidator may have the floating charge set aside in terms of section 245 and be declared invalid. This invalidity can only arise in instances where the company goes into liquidation or administration, as the case may be. Not all floating charges created at a time shortly before insolvency proceedings will be invalid, they have to be created

"at the relevant time". Section 245(3) provides that the time at which a floating charge is created by a company is a relevant time for the purposes of this section if the charge is created:

- in the case of a charge which is created in favour of a person who is connected with the company, at a time in the period of 2 years ending with the onset of insolvency; or
- in the case of a charge which is created in favour of any other person, at a time in the period of 12 months ending with the onset of insolvency (but only if at the time of the creation of the charge, the company was either unable to pay its debts or became unable to do in consequence of this transaction).

The "onset of insolvency" for purposes of the above is the date of the commencement of the winding up.

Based on the above set of facts, the Bank is connected with the Company as it is the Company's corporate bank and would be privy to certain financial information of the Company, including whether it was likely to become insolvent. Accordingly, the relevant time requirement under section 245 is met as the floating charge was created in February of the same year that the Company entered into liquidation proceedings. It appears that the floating charge in the above set of facts meets the requirements of section 245 and the liquidator may bring an action for the floating charge to be declared invalid. The floating charge was entered into within the relevant time and the Company shortly thereafter entered into liquidation.

The only exceptions to the invalidation of a floating charge on a company's undertaking or property created at a relevant time is where the aggregate of:

- (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,
- (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, and
- (c) the amount of such interest (if any) as is payable on the amount falling within paragraph (a) or (b) 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.

Commented [JL12]: 5

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

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

Based on the set of facts the main issue present with the actions of the directors of the Company and the sale of coffee machines is the fact that the coffee machines were sold for less than what they cost a year before could amount to a transaction at undervalue if it meets the requirements of section 238 of the Insolvency Act 1986 (the "Act").

The main action based on the facts which may be brought by the liquidator is one of a "transaction at an undervalue" under section 238 where the company has entered into liquidation. The liquidator will need to prove that the Company: i) made a gift to another person or otherwise entered into a transaction with another person on terms that provides for the company to receive no consideration; or ii) entered into a transaction with another person for a consideration which in money or money's worth, was at the date of the transaction, significantly less than the value, in money or money's worth, of the consideration provided by the company. The transactions above need to have taken place at the "relevant time" as defined by section 240 of the Act in order to be actionable as a "transaction at an undervalue"

under section 238. Relevant time in the case of a transaction at an undervalue is "at a time in the period of 2 years ending with the onset of insolvency".

On finding that the requirements under section 238 are met, the court may make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction.

Based on the facts set out above, the Company appears to meet the requirements of section 238 in that the coffee machines were sold for consideration that was less than their value, based on what the Company bought them for a year earlier, and this sale of the coffee machines took place at the relevant time within the meaning of section 240 having taken place two months before the compulsory winding up petition was made. With respect to the above, the liquidator may approach the court on the basis of section 238 for an order restoring the position of the company to what it would have been had the Company not sold the coffee machines to Ann.

Despite the above, there is a statutory defence which can be raised against an order under this section, and the Company would need to satisfy the court that:

- (a) the Company entered into the transaction in good faith and for the purpose of carrying on its business, and
- (b) at the time it did so there were reasonable grounds for believing that the transaction would benefit the Company.

**Commented [JL13]:** 5  
Effect of a connected party sale.

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

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

This is a situation of wrongful trading where the directors of the Company ought to have known that the liquidation of the Company was inevitable and accordingly have taken every step necessary to minimise the potential loss to the Company's creditors. In terms of section 214 and section 246ZB of the Insolvency Act 1986 (the "Act"), wrongful trading is a statutory offence and if a director is found to be guilty of this offence, may be liable for some of the debts of the company. As soon as a director a company knows (or out to know) that there is no reasonable prospect of the company avoiding an insolvent liquidation (or insolvent administration, in relation to business conducted on or after 1 October 2015), the director has a duty to take every step which a reasonably diligent person would take to minimise any potential loss to the company's creditors. If it appears to the court that after the company has gone into insolvent liquidation that a director has failed to comply with this duty, the director may be ordered by the court to make such contribution to the company's assets as the court deems proper.

Based on the above set of facts the directors of the Company, the directors were aware that insolvent liquidation was inevitable as the creditor's had already petitioned the court for the Company compulsory winding up at the time when the directors negotiated and approved a change in the terms of supply with Beans and Leaves Ltd. The new terms of supply, being to pay off the arrear debts owed to the Supplier and to pay upfront before each new supply of coffee beans, directly increased the liabilities of the Company by continuing to trade with Supplier. These payments can also be seen as being in detriment to the other creditors in the Company who would have a preference on liquidation. Accordingly the liquidator can apply to court with a claim for wrongful trading against the directors of the Company and should the court find the directors of the Company to have engaged in wrongful trading, may order that the directors compensate the Company in an amount usually in line with the increase of liabilities at the time. The statutory defence that the directors once they knew or out to know

that the insolvent winding up of the Company was inevitable, took every reasonable step to mitigate the potential loss to the Company's creditors is clearly not available to the directors in this matter. The directors in fact aggravated the loss suffered by the company.

**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 \***