INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
IN INTERNATIONAL INSOLVENCY LAW

SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3B

THE INSOLVENCY SYSTEM OF THE UNITED KINGDOM (ENGLAND AND WALES)

This is the **summative (formal) assessment** for **Module 3B** of this course and is compulsory for all candidates who **selected this module as one of their compulsory modules from Module 3**. Please read instruction 6.1 on the next page very carefully.

If you selected this module as **one of your elective modules**, please read instruction 6.2 on the next page very carefully.

The mark awarded for this assessment will determine your final mark for Module 3B. In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.

2. All assessments must be submitted electronically in MS Word format, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way**. **DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.

3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).

4. You must save this document using the following format: **[studentID.assessment3B]**. An example would be something along the following lines: 20222-514.assessment3B. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words "studentID" with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked**.

5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words**.

6.1 If you selected Module 3B as one of your **compulsory modules** (see the e-mail that was sent to you when your place on the course was confirmed), the final time and date for the submission of this assessment is **23:00 (11 pm) GMT on 1 March 2022**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2022. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.

6.2 If you selected Module 3B as one of your **elective modules** (see the e-mail that was sent to you when your place on the course was confirmed), you have a **choice** as to when you may submit this assessment. You may either submit the assessment by **23:00 (11 pm) GMT on 1 March 2022** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. If you elect to submit by 1 March 2022, you **may not** submit the assessment again by 31 July 2022 (for example, in order to achieve a higher mark).

7. Prior to being populated with your answers, this assessment consists of **7 pages**.

ANSWER ALL THE QUESTIONS

Commented [JL1]: 42 out of 50

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

Commented [JL2]: 9 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~~ A1 of the Insolvency Act 1986 to which creditors can consent without any application to the court?

Commented [JL3]: It is Part 1A

(a) 40 business days.

(b) One year and 20 business days.

(c) One year and 40 business days.

(d) One year.

Question 1.3

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

(a) The company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern.

(b) A compromise or arrangement is proposed between the company and its creditors, or any class of them, or its members, or any class of them.

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

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

Question 1.4

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

(a) The administrator.

(b) Any secured creditor with the benefit of a qualifying floating charge.

(c) The purchaser.

(d) The company's auditor.

Question 1.5

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

(a) Administration.

(b) Restructuring Plan.

(c) Scheme of Arrangement.

(d) Company Voluntary Arrangement.

Question 1.6

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

(a) £500

(b) £750

(c) £1,000

(d) £2,000

Question 1.7

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

(a) Wrongful trading.

(b) Breach of fiduciary duty.

(c) Being found guilty of an indictable offence in Great Britain.

(d) Being found guilty of an indictable offence overseas.

Question 1.8

The administrator is under a general duty to provide a statement for creditors' consideration setting out proposals for achieving the purpose of administration. He or she must obtain a creditors' decision on whether or not to approve the proposals **within how many weeks** of the date the company entered administration?

(a) 6

(b) 8

(c) 10

Commented [JL4]: c

(d) 12

Question 1.9

Which of the following statements is **incorrect**?

(a) An insolvency officeholder from an EU Member State will be automatically recognised by the courts in the UK whether the officeholder was appointed before or after Brexit.

(b) An insolvency officeholder from an EU Member State is automatically recognised by the courts in the UK if appointed before Brexit.

(c) An insolvency officeholder from an EU Member State appointed after Brexit may apply to a UK court for recognition under the Cross Border Insolvency Regulations.

(d) An insolvency officeholder from an EU Member State cannot apply to a UK court for recognition under section 426 of the Insolvency Act 1986.

Question 1.10

Under section 216 of the Insolvency Act 1986, a director of a company which has been wound up insolvent may not, unless an exception applies, be a director of a company that is known by a prohibited name **for what period of time**?

(a) 6 months.

(b) 12 months.

(c) 2 years.

(d) 5 years.

QUESTION 2 (direct questions) [10 marks]

Commented [JL5]: 10 out of 10

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 424 of the 1986 Act deals with standing to apply for an order under section 423. Section 424 makes different provision as to entitlement to challenge a transaction, depending on the company's arrangements in the insolvency. (1) Where the company is being wound up or is in administration. In that case, the official receiver, the liquidator, the administrator and (with permission of the court) any victim of the transaction, such as a creditor, may challenge the transaction. (2) Where a victim of the fraudulent transaction is bound by a CVA, the persons who may challenge the fraudulent transaction are the supervisor of the CVA or any victim of the fraudulent transaction (whether or not the victim is bound by the CVA). (3) Where neither of the foregoing scenarios applies, any victim of the fraudulent transaction may challenge it under section 423.

Under section 7 of the CDDA, an application under section 6 of the CDDA may be made by the Secretary of State or, if the SoS so directs where a company is being or has been wound up, by the official receiver.

Under section 246ZB of the 1986 Act, introduced by the Small Business, Enterprise and Employment Act 2015, an administrator (subsection 246ZB(1)) may make an application to the court for a declaration that a person is liable to make a contribution to the company's assets by reason of wrongful trading.

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.

Rule 15.3 of the Insolvency Rules 2016 lists the following qualifying decision procedures:

(a) correspondence;
(b) electronic voting;
(c) virtual meeting;
(d) physical meeting; or
(e) any other decision making procedure which enables all creditors who are entitled to participate in the making of the decision to participate equally.

Commented [JL7]: 5

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

Commented [JL8]: 13 out of 15

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?

Whether the administrator can require the supplier to continue trading with the insolvent company will depend on (1) the service or product supplied and (2) the nature of the contract.

Sections 233 and 233A of the 1986 Act prevents suppliers of the services listed therein from terminating supply agreements upon the purchaser entering administration or making future supply conditional on payment of past liabilities. These services include utilities and communications services (including the IT hardware and services listed in section 233(3A)).

For services not covered by section 233, whether the administrator can require a supplier to continue to trade with the company will depend on whether the contract is an ongoing one. If so, the supplier will not be permitted to unilaterally terminate the contract. Section 233B of the 1986 Act, introduced by the Corporate Insolvency and Governance Act 2020, negates "ipso facto clauses" in contracts, which entitle the supplier to terminate or alter the terms of supply (including varying the price) in the event of the purchaser's insolvency. But where the supply contract has already been discharged by performance in full before the insolvency, the administrator cannot force the supplier to make a new contract with the company. To do so would be contrary to the doctrine that the parties are the masters of their own contractual fate.

Commented [JL9]: 4
Some elements missing
Is the supplier allowed to request settlement of outstanding debts?
Personal guarantee by the Administrator.

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.

When a company enters liquidation, it may be in possession of chattels whose legal title belongs to a third party. A good example of a commercial arrangement where the lender of property retains legal title is a hire purchase contract for a vehicle or machinery, or a retention of title supply contract. Under a hire purchase agreement, legal title remains with the creditor until the debtor has performed the agreement (usually by paying all the hire instalments). Because legal title does not vest in the debtor where the agreement remains incomplete, such assets do not form part of the insolvent estate for the liquidation. Creditors under an incomplete hire purchase contract would therefore be first in line in a liquidation, since (subject to the terms of the HPA) they may be entitled to take possession of their property. A debt factor or other receivables financier is in a similar position, because the book debts have been sold to the factor and therefore belong to the factoring company. They fall outside the insolvent estate.

Aside from the special position of a creditor who holds the legal title to an asset in the possession of the debtor, there is a strict priority for payment of creditors.

First come creditors whose interest is secured by a fixed charge. A fixed charge is a security over a specific asset, whether real or personal property. A mortgage is probably the most common example of a fixed charge, but many companies will rent their commercial space and may not have a mortgage.

Next in line are creditors with a statutory "super priority". These include employee wage and salary claims under employment contracts which have been adopted by the administrator, and debts or liabilities arising under contracts entered into by the company acting through the administrator. There is a strong public policy justification behind the super priority, as it gives third parties confidence that they will not be at a disadvantage if they continue to work for or trade with the company during the administration. In this way, it is an important facilitator of the legislative objective of promoting corporate rescue.

After the super priority creditors come other expenses and fees incurred by the administrator. These must be paid in the order listed in Rule 3.51 of the Insolvency Rules 2016.

Next in line are statutory preferential creditors. This class includes employees with unpaid wages and salaries (including pension contributions and holiday pay) which predate the

appointment of the administrator (subsequent wage and salary claims would likely be made under an adopted employment contract and therefore attract super priority, above). Remuneration claims are capped at a relatively modest sum of £800 per employee and limited to a period of 4 months prior to the administrator's appointment, although employment law provides more extensive remedies for unpaid employees. The other main creditor in this class is HMRC. This is known as the Crown preference. HMRC enjoyed the Crown preference until 2003, when it was abolished by the Enterprise Act 2002, but the preference was reintroduced on 1 December 2020 by the Finance Act 2020. The Crown preference does not apply to all taxes. It bites on those taxes (known as Source Taxes) which are collected by the business as agent for HMRC, specifically VAT, PAYE, income tax, NICs and (if applicable) Construction Scheme Industry deductions. Within preferential creditors, debts are ranked as ordinary and secondary. Employee claims are ordinary, whereas Crown preference claims are secondary (section 386 of the 1986 Act).

After preferential creditors come floating charge holders. These creditors are holders of a security which is not fixed over a particular asset but is instead a charge against the company's present and future undertakings, e.g. a charge over present and future book debts. Because it is the undertaking which is charged, rather than a specific asset, the security includes management powers. Historically this enabled the holder of a floating charge to appoint an administrative receiver, although this is now a rare occurrence following the abolition of that enforcement right in respect of securities registered at Companies House prior to 15 September 2003 by the Enterprise Act 2002. Section 176A(2) of the Insolvency Act 1986 requires the liquidator to make a prescribed part of the company's net property available for the satisfaction of unsecured debts, depending on the company's net asset position. To that end, a liquidator might apply a haircut to the floating charge creditors to ensure that some funds are left over to pay unsecured claims.

Finally, unsecured creditors are at the back of the queue. These are ordinary creditors whose claims are neither reinforced by security nor given a statutory preference. Often these creditors will be trade suppliers of the insolvent company or, in the case of a smaller company, they may include the business owner in a personal capacity, or his family or friends, who have lent money to the company without taking security.

If any money is left over after all liabilities have been paid off (i.e. if the company was solvent), the surplus will be distributed to the shareholders.

Commented [JL10]: 9

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

Commented [JL11]: 10 out of 15

Prior to going into compulsory liquidation on 23rd December 2021, under pressure from its bank, Stercus Bank plc, and in order to prevent it from demanding repayment of the company's loans, Corfee Zero Limited ("the Company"), granted a debenture in favour of Stercus Bank plc in February 2021. The debenture contained a floating charge over the whole of the Company's undertaking.

The winding up order followed a creditor's winding up petition issued on 14th October 2021.

In July 2021, as the Company continued to suffer cash flow problems, the directors approved the sale of 5 coffee roasting machines to Ann Young (a director) for £10,000 in cash. The machines had been bought for £25,000 a year before.

A month before the winding up order was made, Ann Young received an email from Beans and Leaves Ltd, one of the Company's key suppliers. The supplier demanded immediate payment of all sums owing to it and informed the Company that further supplies would only be made on a cash on delivery basis. As the continued supply of coffee beans was seen as essential by the Company, the board authorised a payment of £8,000 to cover existing liabilities and agreed to further payments, on a cash on delivery basis, for further supplies which amounted to further payment of £3,000 up to the date of the winding up order.

The liquidator has asked for advice whether any action may be taken in respect of the floating charge in favour of Stercus Bank plc and the two subsequent transactions.

Using the facts above, answer the questions that follow.

Identify the relevant issues and statutory provisions and consider whether the liquidator may take any action in relation to:

Question 4.1 [maximum 5 marks]

The floating charge in favour of Stercus Bank plc;

The two central issues which arise in relation to the floating charge are: (1) was it a preference which is open to challenge under section 239 of the 1986 Act; and (2) is it an avoidable under section 245 of the 1986 Act?

Granting Stercus Bank a floating charge might appear at first sight to prefer the Bank, compared with the position the Bank would have been in as an unsecured creditor. But a challenge under section 239 would face a number of difficulties. Firstly, whilst the Company must have intended to prefer the Bank by granting it a debenture, it is far from clear on the limited evidence provided in the question that the Company desired to prefer the Bank (section 239(5)). On the facts provided, the opposite seems to be the case; the Bank demanded the debenture as a condition of not calling in its debt in February 2021. While the evidence is limited, it seems most likely that the Company granted the debenture in order to prevent the Bank calling in the Company's debt in February and potentially triggering an insolvency. That may fall within the reasoning of *Re MC Bacon Ltd* [1990] B.C.C. 78 as an intention, not a desire, to prefer and therefore not a preference within section 239. Secondly, the Bank appears to be unconnected to the Company (save the creditor-debtor relationship). If that is correct, then the debenture agreement would fall outside the relevant period of 6 months prior to the onset of insolvency. The onset of insolvency is defined in section 240(3)(e) as the date of commencement of the winding up; in this case, 23 December 2021. On this basis also, the debenture agreement would fall outside section 239.

Commented [JL12]: Correct, preference not possible due to time and desire.

As a floating charge, it is possible that the debenture agreement might be avoidable under section 245. Again, however, the transaction appears to fall outside the relevant period as defined by section 245(3). This is because, although the time frame is 12 months prior to the onset of insolvency and the transaction prima facie falls within that period, subsection (4) provides that the "relevant time" only applies if, at the time of making the debenture agreement the Company was unable to pay its debts within the meaning of section 123, or became unable to do so in consequence of the debenture transaction. Although it seems likely that the Bank would have sought security because it was concerned about the Company's financial position, there is little evidence to support the conclusion that the Company was insolvent in February

2021 in the facts provided. On that basis, I conclude that the debenture transaction falls outside section 245 and is not open to challenge under the 1986 Act.

Commented [JL13]: 4
A more detailed exposition of the requirements of s 245 would have been beneficial.
Some elements missing therefore.

Question 4.2 [maximum 6 marks]

The sale of the coffee roasting machines; and

The three issues which arise for consideration in relation to the coffee machine sale are (1) transaction at an undervalue under section 238 of the 1986 Act; (2) the linked issue of a transaction to defraud creditors under section 423; and (3) a breach of Ann's director's duties which might make her liable to account to the Company.

The coffee machine sale could be a transaction at an undervalue if the sale was at significantly less than the market value on the date of the sale. This is a difficult question to answer, because in any "fire sale" situation, a seller expects to lower the sale price. Even taking that into account, a discount of 60% on the price a year before seems open to question. The liquidator would need to obtain evidence of the value of the machines in July 2021. If the discount to Ann was significant (which has been established in other cases where a discount of 20% was applied) then the sale could be open to challenge. The sale falls within the relevant period of 2 years prior to the commencement of the liquidation. One area of uncertainty is whether the liquidator could establish that, at the time of the sale, the Company was unable to pay its debts within section 123 or the Company became insolvent as a result of the transaction. On the information provided in the question, that seems open to question, because the winding up petition was not presented until 14 October 2021. Since Ann is a director, however, and therefore a person connected with the Company, it will be presumed that one of these criteria was met at the time of the transaction unless Ann can prove the contrary. Ann may be able to defend the transaction under section 238(5) – a transaction in good faith for the purpose of carrying on the Company's business, with reasonable grounds for believing it would benefit the Company. To say anything more on this defence would be speculative.

The second issue, which is closely linked to the first, is a transaction to defraud creditors, which is challengeable under section 423 where the liquidator can establish a transaction at an undervalue and the transaction was entered into for the purpose of either putting assets beyond the reach of the Company's creditors or otherwise prejudicing them. There is no evidence in the facts provided to suggest that this is the case.

The third issue is a breach of Ann's fiduciary duties. Again, there is little to go on in terms of facts, but if, for example, Ann had quickly sold on the machines at a significant profit, she could be liable to account to the Company for that profit, depending on the facts.

Commented [JL14]: 6

Question 4.3 [maximum 4 marks]

The payments to Beans and Leaves Ltd.

The £8,000 payment to Beans and Leaves (B&L) could be a preference which could be clawed back under section 239 (see above). As it was only a month before the insolvency, it would be within the relevant time. The central issue on that challenge would likely be whether there was desire, as opposed to an intention, to prefer. That is a fact-sensitive question and there is little evidence in the question to assist with its determination, but it seems more likely that there was a desire to obtain further supplies of coffee beans rather than to prefer B&L.

Whether B&L was entitled to renegotiate payment terms to cash on delivery would depend on the nature of the supply contract. It seems most likely that each delivery was an individual contract, since the quantities required by the Company month to month could be expected to vary considerably. If each supply contract was a new contract, then there would be no impediment to requiring cash on delivery and that is the approach one would expect a supplier to a company on the brink of insolvency to take. If, contrary to the foregoing, it was a long-term supply contract with prescribed pricing, payment terms and quantities, then section 233B(3)(b) would arise for consideration. Section 233B could prevent B&L from renegotiating the supply contract. However that section is focussed on ipso facto clauses. The facts provided in the question make no mention of any such clause. Moreover, section 233B operates in relation to clauses triggered by or exercisable upon an insolvency event. So far as I understand, the renegotiation occurred a month before the relevant insolvency event in this case – the commencement of liquidation on 23 December 2021. It is therefore difficult to see how section 233B would apply on the facts of this case and, if the £8,000 payment and renegotiation is not a preference (which seems unlikely), it appears to be above challenge.

Commented [JL15]: 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 ***