



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.**
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- 6.1 If you selected Module 3B as one of your **compulsory modules** (see the e-mail that was sent to you when your place on the course was confirmed), the final time and date for the submission of this assessment is **23:00 (11 pm) GMT on 1 March 2022**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2022. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
- 6.2 If you selected Module 3B as one of your **elective modules** (see the e-mail that was sent to you when your place on the course was confirmed), you have a **choice** as to when you may submit this assessment. You may either submit the assessment by **23:00 (11 pm) GMT on 1 March 2022** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. If you elect to submit by 1 March 2022, you **may not** submit the assessment again by 31 July 2022 (for example, in order to achieve a higher mark).
7. Prior to being populated with your answers, this assessment consists of **7 pages**.

ANSWER ALL THE QUESTIONS

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

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

Question 1.1

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

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

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

Question 1.2

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

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

Question 1.3

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

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

Commented [JL1]: 41 out of 50

The way in which you reference is not easy to understand and does not help anyone to follow the flow of your discussions. If you would like to provide authority as you go along, it is better to do so by citing the sources in footnotes so the reader can seamlessly read your thoughts.

Commented [JL2]: 8 out of 10

(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

Commented [JL4]: c

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]: 9 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?

Who may bring an action under: (i) section 423 of the Insolvency Act 1986

Ref:

INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 69-70.
Latham & Watkins, 2021.
Insolvency Act, 1986 (c.45 Section 424).

423 can be used in the English court to seek financial remedies and related relief, where a debtor has an obligation to pay the claimant but enters into a "transaction at an undervalue" to put assets beyond their reach or to prejudice the creditor's interests.

S. 423 is a powerful and flexible tool for creditors in both solvent and insolvent situations to reverse transactions that have prejudiced their interests

S.424- Those who may apply for an order under s. 423.

(1)An application for an order under section 423 shall not be made in relation to a transaction except—

(a) where the debtor has been made bankrupt or for a body corporate which is being wound up or is in administration by,

- I. the official receiver,
- II. the trustee of the bankrupt's estate
- III. the liquidator
- IV. administrator of the body corporate or
- V. with the leave of the court by a victim of the transaction;

(b)in a case where a victim of the transaction is bound by a voluntary arrangement approved under Part I or Part VIII of the Act, by the supervisor of the voluntary arrangement or by any person who (whether or not so bound) is such a victim; or

(c)in any other case, by a victim of the transaction.

(2)An application made under any of the paragraphs of (1) above is to be treated as made on behalf of every victim of the transaction.

Unlike section 238 of the Act, there are no time limits in respect of which the transaction must have been entered. The applicants need not be insolvency officeholders, nor does the company need to be insolvent or subject to insolvency proceedings.

Who may bring an action under: (ii) section 6 of the Company Directors Disqualification Act 1986;

Ref:

Company Directors Disqualification Act, 1986 (c. 46 Section 7)
INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 61-62.

Disqualification orders under section 6: applications and acceptance of undertakings are dealt in section 7 of the act:

1. If the Secretary of State feels that it is in the public interest that a disqualification order under section 6 should be made against any person, an application for the making of such an order against that person may be made by —

(a) the Secretary of State

(b) The Official Receiver - if the Secretary of State so directs for a person who is or has been a director of a company which is being or has been wound up by the court in England and Wales.

2. The application cannot be made after 3 years after which the company became insolvent other than by leave of court, against the person who is or was a director of the company.

If it appears to the Secretary of State that the conditions mentioned in section 6(1) are satisfied as respects any person who has offered to give him a disqualification undertaking, he may accept the undertaking if it appears to him that it is expedient in the public interest that he should do so (instead of applying, or proceeding with an application, for a disqualification order). This clause is generally applicable against directors for Trading while Insolvent.

Who may bring an action under: (iii) section 246ZB of the Insolvency Act 1986?

Ref:

Insolvency Act, 1986 (c. 45 Section 246ZB).
INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 58.

This provision is applicable for Wrongful Trading in administration.

When a company is in administration and it appears (a) to (c) below apply to a person who is or has been a director of the company, the court on application of the administrator may declare that the person is to be liable to make such contribution to the company's assets as the court thinks proper;

(a) the company has entered insolvent administration

(b) At some time before the company went into administration the person knew or ought to have concluded that there was no reasonable prospect that the company would avoid entering insolvent administration or going into insolvent liquidation

(c) The person was director of the company at that time. The person can be a shadow director

Commented [JL6]: yes, but who initiates the action?

Commented [JL7]: 4

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.

Ref:

The Insolvency (England and Wales) Rules, 2016 (Part 15).

Farmer, 2022.

The Gazette, 2022.

INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 6, 25.

The decisions of creditors or contributories in corporate insolvency procedures must now be made by a Deemed Consent procedure or a Qualifying Decision procedure.

Deemed Consent Procedure:

Though this is not a qualifying decision procedure, it is used for approval of an administrators proposal by notifying the creditors of the intended decision. (generally, any proposal can use this process other than for the approval of the remuneration of the office holder). Unless objected to by creditors the proposal is deemed to have been approved. Minimum 10% creditors must object to the proposal. where this procedure cannot be used, or it has been objected to, or where the office holder does not want to use it, the Insolvency Rules 2016 have introduced the following qualifying decision procedures for collective decision making:

- Correspondence.
- Electronic voting

This includes any electronic system that enables a creditor to vote without the need to be physically attending at a particular location. The notice to creditors must explain how to use and access the system and include details of any login or password. The system must allow creditors to vote at any time until the decision date, and must not provide details of votes cast by other creditors.

- Virtual meetings

meeting where persons who are not invited or required to be physically present together at a location may participate in the meeting, and can be communicating directly with all the other participants in the meeting and voting (either directly or via a proxy holder). The notice to creditors must explain how to access the virtual meeting, and include details of any access code or password.

- Physical Meetings

As per s.246ZE(9) and s.379ZA(9) of the Insolvency Act 1986, physical meetings can now generally only be requested within five business days of the notice of the decision-making procedure, and only if made by:

- 10 per cent of creditors by number

- 10 per cent of creditors by value
- 10 individual creditors
- Any other decision-making procedure that enables creditors to participate equally.

Commented [JL8]: 5

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

Commented [JL9]: 14 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?

Ref:

Insolvency Act, 1986 (c. 45, Part VI, Section 233, 233A, 233B).
 INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 20.
 Carter, 2022.

For the continuation of operations of the business, the administrator can obtain/retain certain essential supplies.

Section 233 of the act allows the administrator to make a request to the suppliers for continuance of supplies.

The supplier may:

- Make it a condition that the office holder personally guarantee the payment of the charges in respect to the supply.
- Not make a condition or do anything to effect a condition that any outstanding charges prior to the effective date are to be paid prior to giving the supply.

The supplies concerned in this context are:

- gas
- Electricity
- Water
- Communications
- Services enabling or facilitating anything to be done by electronic means
 This includes the supply of goods and services e.g. point of sale terminals, computer hardware and software, information, advice, and technical assistance relate to Information technology, data storage and processing and website hosting.

Further, under section 233A a supplier of such services, generally, cannot rely upon an "insolvency-related term" in the contract of supply, to terminate or alter the terms of the supply or enforce higher payments for continued supply. This section gives protection for the business by preventing the suppliers for increase in prices or termination. This section only applies for supplies on or after 1 oct 2015.

Section 233B has been added to the act now. This now prohibits clauses in the contract, which the supplier would use to terminate or "do any other thing" in relation to that contract if the company enters a formal insolvency procedure. Hence, the clauses in the contract that the contract would terminate or entitle the supplier to use other options when the company enters an insolvency procedure is of no

effect. This clause also prevents suppliers to insist on payment of prior dues (pre- insolvency debts) as a pre-condition of supply or increase in price.

The sections also cover the on-sellers of utilities who are an intermediary to between the supplier of essential utilities and the insolvent business and supplies for the facilitation of anything to be done by electronic means. Though internet access is not mentioned in the act, broadband, email etc. will be caught under the IT related supplies. The insolvency professional can request for continuation and the supplier cannot insist on pre appointment charges to be paid.

Restriction of termination:

Suppliers cannot terminate the contracts based on contractual terms on the basis of business entering administration or voluntary arrangement unless:

The office holder agrees to the same or the company is unable to pay the charges for supplies incurred after the company entered administration or CVA within 28 days of due date.

The supplier can however apply to court for termination as this may be causing hardship to them.

The supplier can also terminate if the office holder personally does not guarantee payment of the charges within 14 days of the notice from the supplier

The protection under section 233 however is not absolute:

The supplier may rely on other insolvency related terms as far as they related to other insolvency procedures, other than CVA, administration or liquidation.

The supplier may be able to terminate the contract by relying on other (non-insolvency) contractual terms.

Suppliers may also use other conditions such as downgraded credit rating, upon the company going into insolvency procedures, to change payment conditions etc.

Commented [JL10]: 5
S 233B extends the provisions to all supplies

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.

Ref:

Insolvency Act, 1986 (c. 45, Schedule 6).

Insolvency Act, 1986 (c. 45, Part IV, Chapter VIII, "Preferential Debts")

Begbies Traynor Group, 2022.

Moore, 2022.

Distribution of assets | MyLawyer, 2022.

Order of creditor and contributory ranking on a debtor's insolvency | Practical Law, 2022.

INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 50-54.

Priority of payments to creditors in a liquidation can be summarized as below:

Principles involved-

- Payments follow the class of creditors based on priority
- Payments follow the waterfall effect based on the priority as per the statute i.e. balance money is available to the next class after the previous class with higher priority is paid in full.
- Pari Passu payments within each class

The ranking of the creditors as per the act is as follows:

1. Secured Creditors
2. Administrator/ Liquidator fees (Costs of Liquidation)
3. Preferential creditors
 - Secondary preferential debts (some HMRC taxes have been included in this category)
4. Secured creditors with a floating charge
5. Creditors with unsecured provable debts
6. Statutory interest
7. Creditors with non-provable debts
8. Unsecured Creditors (including all other HMRC debt)
9. Shareholders

- Secured Creditors

A creditor is secured if they hold a right to sell a specific property in which the debtor has an interest, in order to settle the particular debt which the debtor has failed to pay.

The secured creditor has this right even in a liquidation and basically stands outside the liquidation.

If the secured creditor decides to sell the property (they may authorize the liquidator to do so) and the proceeds of sale are:

- a) Higher than the debt- they must pay the excess amount to the liquidator for distribution to the other creditors
- b) Is less than the debt- they can lodge a claim against the company for the balance amount.

The secured creditor can give up their security so that the asset can be sold for the benefit of all creditors.

Ref:

INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 50.
 The Insolvency (England and Wales) Rules, 2016 (No. 1024, Part 6, Chapter 6 rule 6.42 and Part7, Chapter 14 rule 7.108).

- Administrator/ Liquidator fees (Costs of Liquidation)

The following costs and expenses are included under this head:

- a) Expenses incurred to preserve, realise or procure any assets of the company (Legal costs incurred are included).
- b) expenses properly incurred by the administrator in performing the administrator's functions;
- c) the costs of the applicant in the case where an administration order was made,;
- d) costs and expenses in connection with the making of the appointment of the administrator, otherwise, than by order of the court;
- e) Costs of security provided
- f) Amounts payable for preparation of the Statement of Accounts or to do up the accounts
- g) Services rendered by persons employed by the liquidator
- h) Remuneration of the liquidator
- i) Corporation tax on chargeable gains on realization of the assets

- Preferential creditors s 386, 387 and Schedule 6: section 175

Ref:

INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 52-53.
Moore, 2022.

Insolvency Act, 1986 (c. 45, Schedule 6).

Insolvency Act, 1986 (c. 45, Part IV, Chapter VIII, "Preferential Debts" Section 175).

Insolvency Act, 1986 (c. 45, Part XII, Section 386).

Preferential Debts

This is a general provision and gives guidance that:

In a winding up, the company's preferential debts shall be paid in priority to all other debts after the payment of—

- (a) any liabilities to which section 174A applies, and
- (b) expenses of the winding up.

There are two types of Preferential debts:

Ordinary (these have priority over Secondary)

Secondary

Debts in each class rank equally amongst themselves and abate in equal proportion in case of insufficient assets

Ordinary preferential debts are more relevant when the company was an employer and includes employee claims and contributions.

- a) Sum owed on account of employee contributions to an occupational pension scheme, being the sums deducted from the employee for salary paid in the preceding 4 months of the commencement of liquidation
- b) Company contribution to an occupational pension scheme in the period 12 months prior to commencement of liquidation
- c) Remuneration which is unpaid to an employee in the preceding 4 months before commencement of winding up, capped at £800
- d) Amounts owed for accrued holiday remuneration for any period prior to winding up
- e) Claims for monies advanced to pay wages or holiday remuneration (This is to protect lenders who may have advanced sums
- f) Levies on production of coal and steel
- g) Claims under the Reserve Forces act 1985
- h) Any amount owed by the company for an eligible deposit, which does not exceed the compensation payable for the same under the financial Services Compensation Scheme. There is a cap £85000.

Other categories:

- i) CRAR (Commercial Rent Arrears Recovery) dues: these are also classified as preferential if creditor has exercised its claim in the preceding 3 months. However, creditor must pay the preferential dues before paying themselves
- j) Tort Victims: They have often been assigned a position of a preferential creditor

Secondary: These are paid after the ordinary class.

- k) Amount owed to a depositor in respect of an eligible deposit as exceeds any compensation that would be payable in respect of the deposit under the Financial Services Compensation Scheme

l) An amount owed by the company to one or more eligible persons in respect of a deposit that—

(a) was made through a non-UK branch of a credit institution authorised by the competent authority of the UK, and

(b) would have been an eligible deposit if it had been made through a UK branch of that credit institution.

Certain HMRC debts are included.

- m) PAYE income tax deductions
- n) National insurance deductions
- o) VAT payments
- p) Construction Industry scheme deductions
- q) Student loan repayments

INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp.53.-54
Insolvency Act, 1986 (c. 45, Part IV, Chapter VIII, section 176)

- Secured creditors with a floating charge
The floating charge is created over assets which are constantly changing due to the company's business activities. E.g. Stock in trade
They are paid after the Preferential debts. In case of more than 1 floating charge, then the priority is given to the floating charge created first
The Prescribed part: -
Before making any payment to the floating charge holder, the applicability of section 176A is to be reviewed. This applies to charges created on or after 15 Sept 2003. The liquidator is obligated to make a "Prescribed Part" retention of the company's net assets available for the satisfaction of unsecured debts. In this case the net property is calculated after the liquidation expenses and Preferential Debts have been paid.
Prescribed part Calculation:
 - 50% of first £10000
 - Plus 20% of the balance (excess above £10000) capped at £800000
 - If the value of net property is less than £10000 then the liquidator need not retain the prescribed part.
- A floating charge holder or any secured creditor who may have an outstanding unsecured balance owing to it, is not permitted to participate in the distribution of the prescribed part.

INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp.54.

- Unsecured Creditors (including all other HMRC debt)
These are creditors with no security but with provable debts. They are paid the last. They rank equally amongst themselves even though there may be some debts due to HMRC and service providers and will be paid in proportion to the funds available after all other classes of creditors. These are generally the trade creditors

Distribution of assets | MyLawyer, 2022.

- Statutory Interest:

Statutory interest is interest that accrues on provable debts after the commencement of the liquidation until the debt is paid.

- Non Provable debts:

These will include claims that have become statute barred and claims that did not arise from an obligation incurred prior to the date of the liquidation order. These debts also cannot be regarded as expenses of the liquidation because they did not originate from the liquidator's action.

INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp.54.

- Shareholders
If any money is left after paying all the creditors any surplus available will be distributed to the members of the company. This is generally pro-rata to the shareholders respective holdings.

Commented [JL11]: 9

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

Commented [JL12]: 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]

Ref:

Parry, Ayliffe & Shivji, 2018.

Avoiding invalid floating charges under section 245 of the Insolvency Act 1986 | Legal Guidance | LexisNexis, 2022.

Parry, Rebecca, 2018.

Cooper, 2022.

Insolvency Act, 1986 (c. 45, Part VI, Section 245).

The floating charge in favour of Stercus Bank Plc:

In this case the liquidator can act to void the charge given in favour of Stercus Bank Plc, vide section 245 of the act.

Sec 245 of the act deals with floating charges and not any other type of security. This section declares certain floating charges automatically invalid, if they were created within a specific time before the commencement of an administration or winding up of the chargor.

This section only applies in the context of liquidation and administration and is aimed at preventing pre-existing unsecured creditors obtaining the security of a floating charge shortly before a company enters formal insolvency procedure.

If lenders are providing fresh funding to the company, this section does not prevent the lenders from taking a floating charge. Floating charges are rendered invalid, given by the company at a relevant time, except the extent the 'new consideration' is provided for the charge.

Relevant time:

If the person in whose favour the charge is created, is connected with the company, the relevant time is, within the period of two years, prior to the onset of insolvency. If the person is not connected with the company, the relevant time is any time within 12 months prior to the onset of insolvency. The condition being that at the time of creation of charge, the company was unable to pay its debts or become unable to pay its debts in consequence of the transaction.

The fact that the charge was given under pressure from, Stercus Bank plc, and in order to prevent it from demanding repayment of the company's loans, satisfies the condition that the company was unable to pay its debts at the time of giving the charge. (sec 245 (4) (a))

Sec 245 provides that below 2 main categories of new consideration is satisfied, the charge will not be invalidated. The satisfaction of the below categories of "new" consideration as per section 245 of the Act, will mean that the floating charge will not be invalid:

1. the value equal to 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.

The consideration must be given, at the same time, on or after the creation of the charge.

Where an agreement is made to execute a charge, followed by payments made to the company, followed in turn by the formal execution of the charge, any delay between the making of the payments and the execution of the charge must be minimal.

2. 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.

This category, specifically provides that a floating charge is not to be invalidated to the extent of consideration by way of discharge or reduction of a debt of the company

3. The amount of interest (if any) payable on the above 2 categories.

Hence, the liquidator, in this case can invalidate the charge as:

1. the charge was created in Feb 2021. This is within the 12 month period by which the charge can be invalidated as the winding up of the company happened on 23rd dec 2021 and the petition itself was issued on 14th Oct 2021. This falls within the relevant time period for “ person not connected to the company” as per section 245 (3) (b). The liquidator can invalidate the charge for the benefit of all creditors under section 245 of the insolvency act 1986 as this condition is satisfied.
2. The floating charge, if, caught under the section 245, other than the new consideration as discussed above, it is rendered invalid. It is important to note that the charge was created on old dues and that Stercus Plc did not give any new monies and no consideration was used to settle old dues or discharge any debt, thereby excluding the concession in sec 245 (2).
3. The invalidity can only arise, in the event that the company goes into liquidation or administration. In this case the company had been wound up within 12 months of the charge being created and therefore satisfying the clause under sec 245 4(a) (was unable to pay its debts at the time of creation of charge)and 5 (d) (where the winding up petition was filed within the 12 month period)

Commented [JL13]: 5

Question 4.2 [maximum 6 marks]

Ref:

Transactions at an Undervalue and Defrauding Creditors | Mercer & Hole, 2022.
Stone, 2022.
Insolvency Act, 1986 (c. 45, Part VI, Section 212, 213, 214,238, 240,249).

The sale of the coffee roasting machines:

Transactions defrauding creditors

In this case the liquidator Can attack the transaction as it can be considered that the machines sold were at an undervalue under section 238. The machines were bought only a year back, the normal depreciation of the assets would be between 10 to 20%. Hence the value of the assets would range beteeen £20,000 to £22,500. The assets were sold to one of the directors for £10,000, hence this transaction can be caught under sec 238 of the act.

It is the underlying policy of the act to treat all unsecured creditors equally and fairly. The act allows certain transactions which occurred before the onset of formal insolvency to be attacked under sec 238 of the act. the liquidator can attack the transaction if it is at an undervalue, where the transaction by the company:

1. Was made as a gift to another person
2. Was on such terms where the company receives no consideration
3. Was entered into with another person for a consideration which in money or money's worth, was at the date of transaction, significantly less than the value in money or money's worth of the consideration provided by the

Relevant time: Sec 240 (1) (a)

The transaction at an undervalue given to a person who is connected with the company, at a time period of 2 years ending with the onset of insolvency (In this case as per sec 240(3) (e), the date of commencement of winding up)

Sec 240 (1) (b) in the case of a preference which is not such a transaction and is not so given, at a time in the period of 6 months ending with the onset of insolvency.
In either case the machines were sold in the relevant time.

Also under sec 240(2), when the company enters into a transaction at an undervalue, at time as mentioned in 240(1)(a), the time is not a relevant time for purposes of sec 238 unless the company

1. Is not able to pay its debts at that time within the meaning of sec 123 of the act
2. Becomes unable to pay its debts within the meaning of the section in consequence of the transaction.

The requirements of this sub section are presumed to be met unless shown to the contrary in relation to any transactions at an undervalue entered into, by the company, with a person connected with the company. Section 249 (a) defines "connected" with a company, as the person, if he is a director or shadow director or an associate of the director or shadow director of the company.

So in a nutshell; all the relevant clauses in sec 238 are satisfied for the liquidator to attack this transaction as:

Sec 238 (3)

The value of transaction is lower than the depreciated value and there is no valuation done to ascertain the same.

Sec 240(2)(a)

The company has sold the assets to alleviate its cash flow position indicating that the company's finances are stressed or unable to pay its debts at that time and also sec 240 (1) (a), 240 (2), 249 (a)

Sold to a director who is a connected person, hence the issue of relevant time is addressed.

Commented [JL14]: No, the issue of inability to pay debt or illiquidity consequently is dealt with.

Directors position under sec 238:

The directors may take refuge under sec 238(5) and claim that it a necessary act, in good faith for continuity of business. However, this can be negated as the transaction is with out valuation and to a connected person of the company. It may be advisable for the liquidator to get a valuation report to augment the argument of undervalue.

Section 212 Summary remedy against delinquent directors, liquidators, etc

The court may, on the application of the official receiver or the liquidator, or of any creditor or contributory, examine into the conduct of the person falling within subsection (1) and compel him—

(a) to repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or

(b) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just.

This includes an action where the wrongdoer may have "misapplied, retained or become accountable for money or property of the company, or [is] guilty of misfeasance or breach of any fiduciary or other duty".

This will include an action for the breach of the duty or care and skill (negligence) as well as fiduciary duties wherein the director has to act in the best interests of the company and not to act where the director has a conflict of interest and duty.

In the case where the company is insolvent (or is close to insolvent), continuation of trading, the duty of the directors shifts from one owed to the company, taking into account what would be in the best interests of its members, to one owed to the company taking into account the interests of its creditors.

Hence any actions to dissipate the assets of the company to the benefit of another person (in this case another director, which is a conflict of interest) but not for all creditors can be caught under this provision.

The following sections of the act are also available to the liquidator, wherein the directors have not acted in the best interests of the creditors and had full knowledge that the company is not in a position to pay its debts in the near future. Any such act can be penalised by the court.

Section 213 Fraudulent trading (INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 59).

The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper.

Section 214 Wrongful trading (INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 58.)

(1) if in the course of the winding up of a company it appears that subsection (2) of this section applies in relation to a person who is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.

The liquidator also has the option to also attack under sec 15A of the CDDA and request a compensation order to make a payment to specific creditors or contribute to assets of the company where the conduct of directors caused loss to one or more creditor. This route may not be granted if the liquidator has taken other course of action.

While it will be an argument to also attack under Section 423 of the act, where there is no time limit for the transaction to be attacked and where

1. There is evidence of the transaction being at an undervalue
2. Putting the assets beyond the reach of the person making the claim or

3. Prejudicing the interests of such a person in relation to the claim which he is making or can make.

The burden under this case is high on the claimant to prove that the intention of the transaction was to defraud the creditors.

In this particular case even though the company was unable to pay its debts at the time of transaction and there is no valuation report to support the lower price transaction, but the fact that, the company documented its intention that the machines were sold to alleviate cash flow, the issue of intention to defraud or put the assets beyond the creditors will be difficult to prove.

Commented [JL15]: 5

Question 4.3 [maximum 4 marks]

The payments to Beans and Leaves Ltd.

Ref:

Steven, 2022.

Hill, 2022.

Insolvency Act, 1986 (c. 45, Part VI, Section 239,240,241).

Section 239, 240, 241

Section 239 of the act addresses preference and is designed, so that circumvention of the pari-passu principle is avoided.

A "preference" occurs when a company pays a specific creditor or group of creditors and hence puts that creditor in a "better off" position than the other creditors, before going into a formal insolvency.

To qualify under this section the basic criteria that must be satisfied, for preference, under the act are:

1. That person who has been preferred was, at the time of the transaction, a creditor of the company or a surety or guarantor for any of the company's debts.
2. The company does anything or suffers anything to be done which has the effect of putting that person into a position which in the event the company goes into liquidation will be better than the position he would have been if the thing had not been done.
3. The company in giving the preference was influenced by a desire to produce the effect referred to in (2) in relation to the person preferred.
4. The preference was given at a relevant time.

In this particular case:

- a) The preferred person is a creditor of the company.
- b) The company paid old dues to a single creditor above other creditors putting the creditor in a better position compared to others, who did not get the same treatment. Importantly, the company was served with a winding up petition and it was the fiduciary duty of the

directors to act in the interest of all creditors and not do anything to create a preference or dissipate assets meant for all creditors. The directors were fully aware that the company will be going into liquidation and that the payment of old dues of £8000 will put the creditor in a better off position. Further, they agreed with the creditor to supply on a cash basis to avoid creating a new debt, to the detriment of other creditors.

- c) The desire in this case was to ensure that this creditor was better off, even though a winding up petition was served and to continue the business activity though liquidation was impending. In case no petition was there, the desire to avoid winding up also is considered as a desire
- d) The relevant time was the commencement of winding up proceedings and this transaction happened post this event.

In determining whether the thing done amounts to a preference, the fact that pressure was applied by the creditor (whether in requiring the company to do something, or in preventing the company from stopping the creditor exercising a self-help remedy) is not relevant. Pressure should be considered relevant only to whether there is the requisite desire.

In the MC Bacon Ltd case, case Millett J found that, where the company was entirely dependent upon bank support for continued trading, such that if the debenture were not granted the bank would withdraw its support, and where, if the bank withdrew its support, the company would be forced into immediate liquidation, the granting of the debenture was motivated, not by a desire to prefer the bank, but by the desire to avoid the calling in of the overdraft and the continuation of trading by the company (INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 67-68), BCC 78 (1990)

Section 214 Wrongful Trading (INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 58-59).

The liquidator also has recourse under section 214 as in this case the BOD has resolved to proceed with the transaction, knowing very well the existence of the winding up petition and also that the company had no reasonable prospect of avoiding to go into liquidation. They have proceeded with trading even in the insolvent position. This has caused damage to the other creditors and the directors can be attacked to compensate the losses.

Section 212 Summary remedy against delinquent directors, liquidators, etc (INSOL INTERNATIONAL, 2021, "Module 3B Guidance Text", pp. 57).

The court may, on the application of the official receiver or the liquidator, or of any creditor or contributory, examine into the conduct of the person falling within subsection (1) and compel him—

(a) to repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or

(b) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just.

This includes an action where the wrongdoer may have “misapplied, retained or become accountable for money or property of the company, or is guilty of misfeasance or breach of any fiduciary or other duty”.

This will include an action for the breach of the duty or care and skill (negligence) as well as fiduciary duties wherein the director has to act in the best interests of the company and not to act where the director has a conflict of interest and duty.

In the case where the company is insolvent (or is close to insolvent), continuation of trading, the duty of the directors shifts from one owed to the company, taking into account what would be in the best interests of its members, to one owed to the company taking into account the interests of its creditors.

Commented [JL16]: 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 ***

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