



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]: 5 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.

Commented [JL3]: d

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.

Commented [JL4]: c

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 [JL5]: 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 [JL6]: 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.

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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?

Under Section 423 of the 1986 Act: where a company is being wound up or in administration, the administrator, liquidator or official receiver can bring an action in addition to any victim of a transaction that has alleged to have been based in fraud (but only with leave of the court). The supervisor of a CVA may also bring an action where a victim is bound by the CVA. A victim of a transaction where it is not a CVA or winding up may also bring an action.

Section 6 of the CDDA is the purview of the court. In terms of applications, these can only be brought by the Secretary of State for Business, Energy & Industrial Strategy (**SoS**), working within the Department for Business, Energy & Industrial Strategy. In practice, the functions of the SoS are carried out by the Insolvency Service.

Post 1 October 2015 (and the introduction of the Small Business, Enterprise and Employment act 2015, both liquidators and administrators can bring wrongful trading claims, subject to the transitional provisions. Prior to that date, only liquidators could do so.

Additionally, since that same date, a liquidator or administrator can, among other claims, assign wrongful trading claims to third parties. Prior to 1 October 2015, liquidators were prohibited from assigning wrongful trading claims, as confirmed by the Court of Appeal in the case of *Re Oasis Merchandising Services Limited* (in liquidation).

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Question 2.2 [maximum 5 marks]

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

The five qualifying decision procedures listed in the Insolvency Rules 2016 (r.15.3) are:

- i. Correspondence;
- ii. Electronic voting
- iii. Virtual meeting
- iv. Physical meeting
- v. Any other decision making procedure which enables all entitled creditors to participate in the making of the decision and to participate equally.

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

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Question 3.1 [maximum 6 marks]

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

The act of going into administration, or the appointment of an administrator does not render the company's contracts void, nor do executory contracts automatically terminate. Although contractual provisions may stipulate clauses for automatic termination, including the appointment of an administrator, these are now subject to increasing statutory exceptions

which prohibit *ipso facto* clauses, rendering automatic termination clauses void. In short, the administrator can require the continued supply of goods and services.

This is a result of the Enterprise Act 2002 (the **2002 Act**). This act has overhauled the administration process. Section 233 of the 2002 Act, provides that the supply of essential utilities such as gas, electricity, water and communications/telecoms are protected. The latter extends to POS devices, computer hardware, data storage, online hosting etc.

It is also the case that suppliers cannot require payment of outstanding debts prior to providing a new or continued service. It is however open to the supplier to stipulate that in such cases the administrator must personally guarantee payment of these services being supplied.

Section 233A removes the ability of a supplier to rely on a "insolvency-related term" as means of terminating the contract (or varying its terms unfavourably). This allows the administrator to ensure continued supply for the ongoing operation of the business.

Furthermore, and to the advantage of the administrator, the CIGA 2020 (adding section 233B to the 2002 Act) has enhanced and developed these protections for companies in insolvency by preventing the alteration or termination of a contract upon the company entering into a formal insolvency regime. Essentially the supplier is not in a position to do anything in respect of the contract upon the company being insolvent and an e.g. administrator appointed. Section 233B also precludes suppliers from making conditions of continued supply the arrears are brought up to date. In this case, only with the consent of the administrator would the contracts be able to be effectively terminated or where the supplier makes an application such that it can satisfy a court that the continuation of the contract would cause hardship.

The development of section 233B in tandem with sections 233 and 233A provide the administrators the necessary breathing space to operate the business without the looming threat of the cancellation/termination of essential services the company holds contracts for.

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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.

Qualifying floating charge holder - will ordinarily choose to appoint an administrator in enforcing its charge. Secured creditors equally will typically be dealt with prior to the company entering into liquidation via an administrator.

Expenses of the liquidation – the liquidators' expenses are given priority under section 115 of the Act, (and rules 6.42 and 7.108 of the Insolvency Rules). These rank above the company's preferential creditors, including holders of a floating charge (subject to the practical caveat outlined above). Within the expenses of the liquidation these fall in the following order of priority:

- i. Expenses of realising assets (including legal proceedings);
- ii. The cost of security provided by the liquidator;
- iii. Fees due in the preparation of statement of affairs or accounts;
- iv. Necessary disbursement in the courts of the winding up (e.g. the expenses of the liquidation committee);
- v. Remuneration of any person employed by the liquidator to perform a service for the company;
- vi. The remuneration of the liquidator;
- vii. Corporation tax on chargeable gain following the realization of any assets of the company; and

viii. Any other expenses properly associated with and incurred by the liquidator for the purpose of the winding up.

Preferential creditors – these are covered under section 386-387 of the Act. Following the expenses of the liquidation being fully paid, the assets of the company can then be used to pay the preferential creditors.

Preferential debts are split into ordinary and secondary, with ordinary debts being paid first. Preference debts among the respective categories rank *pari passu* and as such abate in equal proportion where there are insufficient assets to cover the debts.

The list of preferential debts is set out in Schedule 6 of the Act. These are not repeated here in full in the interests of brevity but include sums due to employees in connection with pension contributions, pay and holiday/sick pay. Debts listed in Schedule 6 at (9)-(11) are secondary preferential ranking behind the ordinary preferential debts. These include money owed in connection with an eligible deposit exceeding the companionate payable under the Financial Services Compensation Scheme and any PAYE, NI, VAT etc. deductions, all as fully set out in Schedule 6.

Floating charge holders – following preferential creditors, floating charge holders are entitled to rank next in priority – where two or more floating charges are in place, they will typically rank in order of which was created first. For floating charge holders the liquidator will make a "prescribed part" of the company's assets available for the satisfaction of unsecured debts and cannot distribute this to a floating charge holder unless the prescribed part exceeds the unsecured debts. Here the net property available is calculated after the liquidation expenses and preferential debts have been paid.

In cases where the net property of the company is less than £10,000 the prescribed part is 50% of that. This will not apply where the liquidator takes the view that the distribution to unsecured creditors would be disproportionate to the benefits.

In cases where the net property exceeds £10,000, the prescribed part is 50% of the first £10,000 plus 20% of the excess value above £10,000 up to a maximum of £800,000.

Floating charge holders (or secured creditors) with unsecured claims are not permitted to participate in the distribution of the prescribed part.

Unsecured Creditors – creditors who do not enjoy any form of preference or security over their debts are paid out last under the law. Ordinarily in a liquidation, once the above creditors and expenses have been paid there is seldom surplus funds to distribute for payment of unsecured claims and there will often be little or no dividends payable in partial satisfaction of unsecured claims in the liquidation.

Shareholders – in the unlikely event that unsecured claims are paid in full (including any applicable interest on their debts any excess assets of the company are distributed among its shareholders per the constitution of the company (typically, this will be *pro rata* between the respective shareholdings).

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

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

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Fixed charge holders?

Commented [JL14]: 10 out of 15

debenture in favour of Stercus Bank plc in February 2021. The debenture contained a floating charge over the whole of the Company's undertaking.

The winding up order followed a creditor's winding up petition issued on 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;

Under section 245 of the Insolvency Act, as the Company is in liquidation, the effect of section 245 is to prevent an otherwise unsecured creditor obtaining security over a company prior to it entering formal insolvency. In the case of Stercus the debenture containing the floating charge was granted on February 2021 with the company going into liquidation in December 2021 with the winding up petition issue on 14 October 2021.

Commented [JL15]: Applies to floating charges only.

As Stercus is not a connected person, the relevant time for the invalidity of the floating charge is 12 month (24 months for connected parties), where the Company is unable to pay its debts as defined under section 123 of the Act or becomes unable to do so by virtue of the transaction itself.

This will hinge on whether the Company is in that position. It appears, given the facts known that the Company may have been unable to pay its debts at the point when the floating charge was granted. This would render the floating charge invalid.

As this is in connection with existing loans the floating charge will be invalid. Had this been new funding Stercus could have taken a floating charge over the new loans.

The underlying debt remains valid, notwithstanding the invalidity of the floating charge.

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Question 4.2 [maximum 6 marks]

The sale of the coffee roasting machines; and

The sale of the coffee machines is a potential transaction at undervalue to a connected party under section 238 of the Act. A liquidator is at liberty to attack certain transactions entered into in the period before the company enters into a formal insolvency procedure. As the Company entered into liquidation on 23 December 2021, with the creditors' petition filed on 14 October 2021, the sale in July 2021 is potentially caught under this provision.

In this case the liquidator must show, pursuant to section 238 that at the date of the transaction the consideration paid for the coffee machines was significantly less than the value. In this case the coffee roasting machines are only a year old. It is unlikely their value will have depreciated by £15,000 in 12 months. As the transaction took place within 2 years it is caught by the provisions of section 238.

It is a requirement that the Company be unable to pay its debts as they fall due at the time the transaction was entered into. As the Company was suffering cash flow issues around this time it can be inferred that the Company was likely to fall into this category. Notwithstanding this, as the director, Ms. Young, is a connected person there is a presumption that the company is insolvent and it would be for her to establish otherwise.

In this instance, given the cash flow issues of the Company, it would be open to Ms. Young to argue that there were reasonable grounds for believing the transaction would benefit the Company, in this case to alleviate the short-term cash flow issues. Additional weight may be given to this as the decision was approved by the directors.

The liquidator will require to weigh up whether there was a reasonable belief that the transaction would benefit the Company and whether there is an argument to be made that Ms. Young (and by extension, the directors who approved the sale) were in fact acting in the interests of the Company.

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Question 4.3 [maximum 4 marks]

The payments to Beans and Leaves Ltd.

The payments to Beans and Leaves are under an executory contract in that both parties retain unperformed obligations.

As the Company has not entered into a formal insolvency yet the provisions of sections 233A and 233B of the Insolvency Act will not trigger. Suppliers are prohibited from relying on ipso facto clauses but only in the event that the Company is in an insolvency procedure. The Company is not in an insolvency procedure until the winding up order is granted. At the point of the creditors' petition, which the supplier may or may not be aware of, the Company was not in a formal insolvency procedure as the petition had yet to be determined.

As a result the provisions which prevent a supplier from, in effect, amending/varying/terminating the terms of the contract would not attach and the parties free to amend the terms as they see fit, within the confines of the original contract.

The transactions authorised by the directors to Beans & Leaves cannot be challenged on that basis.

Were it the case that the Company was in a formal insolvency procedure, then the variation of the terms would be invalid under section 233B as suppliers are prevented from "doing any other thing" upon the Company entering insolvency. Was this to be the case Beans & Leaves could not impose conditions in connection with the continuing supply of goods, albeit it would be open to them to apply to the court should such an arrangement cause them "hardship" a term which is undefined in the legislation.

*** End of Assessment ***

Commented [JL18]: 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 applies.