INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
IN INTERNATIONAL INSOLVENCY LAW

SUMMATIVE (FORMAL) ASSESSMENT: MODULE 5D

GUERNSEY

This is the **summative (formal) assessment** for **Module 5D** of this course and must be submitted by all candidates who **selected this module as one of their elective modules**.

The mark awarded for this assessment will determine your final mark for Module 5D. 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 **Microsoft Word format**, using a standard A4 size page and an 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.assessment5D]**. An example would be something along the following lines: 202122-336.assessment5D. **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. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.

7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

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

Commented [DJ1]: 10/10

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

Which one of the following statements **correctly describes** the Guernsey legal system?

(a) Guernsey is bound by decisions of the English Court of Appeal.

(b) UK legislation is directly applicable in Guernsey.

(c) Guernsey law is often influenced by the common law of other Commonwealth jurisdictions.

Commented [DJ2]: Correct

(d) Customary law in Guernsey cannot be altered by legislation.

Question 1.2

Which one of the following **is not** a fiduciary duty of a director?

(a) Exercise independent judgment.

(b) Avoid conflicts of interest.

(c) Act *bona fide* in the best interests of the company.

(d) Act with skill and care.

Commented [DJ3]: Correct

(e) Act for proper purposes.

Question 1.3

Which one of the following statements **is correct** in respect of the order of priorities in a liquidation in Guernsey?

(a) The *pari passu* principle affects the rights of secured creditors.

(b) Preferential debts come first in the order of priority.

(c) There is no preferential treatment given to employees.

(d) Debts in a certain class are given priority in relation to the time of their creation.

(e) Rent due to a landlord has priority among preferential debts.

Commented [DJ4]: Correct

Question 1.4

Which one of the following **is not** a standalone ground for the making of a compulsory winding up order as set out in the Companies Law?

(a) The company has is unable to pay a dividend to members.

(b) The company has failed to send its members a copy of its accounts or reports under specified provisions of the Companies Law.

(c) The company has, by special resolution, resolved to be wound up.

(d) The company suspends business for a year.

(e) The company is unable to pay its debts as they fall due

Question 1.5

Which one of the following statements about Schemes of Arrangement is **incorrect**?

(a) The process is broadly the same as that in the UK.

(b) At the Court-convened meeting of creditors / members, a majority in number representing not less than 50 per cent in value of the members present and voting must approve the scheme before it is sanctioned by the court.

(c) Notice of the meeting of the members of the company must be sent to each creditor or member.

(d) A scheme may be used in conjunction with an administration.

(e) A scheme could be used for restructuring.

Question 1.6

Which of the following types of security can be effectively taken over Guernsey **immovable property**?

(a) A fixed charge / mortgage.

(b) A lien.

(c) A *hypothèque* by way of bond.

(d) A security interest agreement.

(e) A floating charge.

Commented [DJ5]: Correct

Commented [DJ6]: Correct

Commented [DJ7]: Correct

Question 1.7

Which of the following **two statements are correct** in respect of compulsory liquidations?

(a) There is no statutory moratorium on creditors' claims.

Commented [DJ8]: Correct

(b) Once the winding-up procedure has commenced, any transfer of shares is valid for a period of 30 days without the need to seek approval from the liquidator.

(c) The company must not carry on any business upon the making of a compulsory winding-up order.

(d) The courts usually impose time frames for the length of liquidation.

(e) A company is dissolved at the start of the liquidation.

Question 1.8

Which one of the following parties **does not** have automatic statutory standing to make an application for an administration order in respect of a Guernsey company?

(a) A member.

(b) An incorporated cell company.

(c) A prospective creditor.

(d) A director.

(e) The Guernsey Registry.

Commented [DJ9]: Correct

Question 1.9

Which one of the following **is not** a ground for setting aside a judgment registered under the Reciprocal Enforcement Law?

(a) The enforcement of the judgment would be contrary to public policy in the home jurisdiction.

Commented [DJ10]: Correct

(b) The courts of the originating country did not have jurisdiction.

(c) The judgment debtor did not receive notice of the proceedings in sufficient time to enable him / her to defend the proceedings and he / she did not appear.

(d) The judgment was obtained by fraud.

(e) The enforcement of the judgment would be contrary to public policy in Guernsey.

Question 1.10

Which of the following statements is **incorrect** in respect of misfeasance / breach of fiduciary duty?

(a) The test for a breach of fiduciary duty is a subjective one.

(b) Any claim must be brought within three (3) years from the date of breach.

(c) The court may order the director to contribute towards the company's assets.

(d) It may arise where a director has breached their fiduciary duty towards the company.

(e) Any creditor of the company may apply to the court for an order against the director.

Commented [DJ11]: Correct

QUESTION 2 (direct questions) [10 marks]

Commented [DJ12]: 9/10

Question 2.1 [maximum 5 marks]

What are the most common forms of security granted over intangible movable assets in Guernsey? Explain what is required to ensure the security documents are valid and the consequences of failure to comply with any formalities.

Two of the most common forms of security granted over intangible movable assets are (1) security interests created under the Securities Interest (Guernsey) Law 1993 (**SI 1993**) or (2) the Law of Property (Miscellaneous Provisions) (Guernsey) Law 1979 (**PL 1979**). The formal requirements concerning the creation of a valid security interest will be discussed in turn below.

Commented [DJ13]: 1 mark

As regards SI 1993, a security interest under this law may be created over all immovable assets (save for a lease): *see Article 1(1)*. By way of example, security interests under the SI 1993 are generally created over the following types of collateral (i) shares in Guernsey companies; (ii) bank accounts; or (iii) policies of life insurance. A security interest may be created under the SI 1993 by any of the following methods: (a) where a secured party has possession of the asset under a security agreement; (b) where a secured party has title to the asset under a security agreement by way of assignment; or (c) where a secured party obtains control of an asset under a security agreement.

Commented [DJ14]: 1 mark

In all cases, it remains necessary for the parties to enter into a valid Guernsey Law security agreement. In that regard, such an agreement must meet the statutory requirements set out in Article 2(1)(a) – (f). Specifically, the security agreement must be:

- Evidenced in writing;
- Be dated;
- Identify the debtor and secured party;
- Be signed by the debtor;
- Contain provisions to expressly identify the assets in question sufficient enough to enable the identification at any time;
- Expressly set out the event or events of default by the debtor; and
- Contain provisions concerning the obligations of payment or performance to be secured by the debtor sufficient enough to enable it to be identified.

In addition to the statutory requirements identified above under Article 2(1)(a)-(f), a security agreement may contain any further provisions as may be agreed upon between the parties: *See Article 2(2)*.

Commented [DJ15]: 1 mark

Where a security interest is created by possession (i.e., over shares of a Guernsey registered company) under the security agreement, the secured party must take possession of the original share certificates subject to the agreement: *see Article 1 (3)*. Where security is taken by assignment, express notice must be given by the secured party to the person who assigned the rights would be able to claim: *see Article (1)(8)*. Thus, until the secured party gives such express notice, the security by assignment will not take effect.

A secured party who fails to comply with the express statutory requirements of the SI 1993 will not render the security void. However, as a consequence of the failure to comply with the statutory requirements, it will take the interest outside of the ambit of the SI 1993[1].

Commented [DJ16]: 1 mark

As regards LP 1979, this law concerns a set-off agreement and an assignment with a condition for re-assignment. The agreement which evidences the parties' agreement may be in writing or oral and express or implied. Under the agreement, the mutual dealings between the parties may be set off between them, and the balance of any debt due after set off is payable to the other party: *see Article 1 (1)*. The LP 1979 applies to the assignment of any debt or thing in action: *see Article 2(1),* and if such party is liable to the other after the set-off as mentioned above, he/she may commence an action in the Guernsey court for the payment of the same: *see Article 2(4).*

The parties will not create a valid assignment under the PL 1979 unless:

- The assignment is in writing and executed by the assignor: *see Article 2(2)(a)*; and
- Express written notice of the assignment has been served on the debtor or trustee from whom the assignor would have been able to claim the debt or thing in action: *see Article 2(2)(b)*.

Similar to the position under 1993, the failure to comply with the statutory requirements under the PL 1979 may not render the assignment void[2]. However, as a matter of best practice, it is best to comply with the statutory requirements rather than put the secured party's secured interest at risk.

Commented [DJ17]: 1 mark – an excellent answer.

Question 2.2 [maximum 5 marks]

Guernsey's insolvency regime is often described as being "creditor-friendly". Identify key features of the various insolvency procedures available to companies that support this description.

Guernsey's insolvency regime has developed to be a creditor-friendly jurisdiction as an offshore financial institution. This can be seen from the following insolvency procedures available under Guernsey law.

First, under the compulsory winding up procedure, upon the court granting such an order, there is no automatic moratorium or stay on creditor claims against a company. Notwithstanding the lack of a stay, it is open to a creditor to apply to the court upon an application to wind up the company for an order to restrain any action or proceeding against the company[3].

Commented [DJ18]: 1 mark

[1] Module at [5.2.2.]
[2] Ibid.
[3] Module at [6.3.1.5]

Second, and similar to the procedure under the compulsory winding up process, in the context of a company's voluntary liquidation, there is also no statutory moratorium on creditors' claims on the making of a winding up order or passing of the resolution by the directors of the company to wind up[4]. In addition, the Companies (Guernsey) Law 2008 (**CL 2008**) confers standing to a creditor of the company to bring an application for the company subject to a voluntary winding up to be wound up under a court-supervised compulsory liquidation[5].

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Third, in Guernsey, a company can enter into a scheme of arrangement. The purpose of a scheme is to allow the company to restructure its debt and, upon the successful reorganization of its debt, continue as a going concern. There are two benefits to creditors under this procedure. First, in the absence of a company also being placed into administration, there is no statutory moratorium against creditor claims being commenced against the company pending the approval of the scheme by both the creditors and the Royal Court. Second, it may be more beneficial for the company to continue as a going concern because the return to the creditor in these circumstances will generally be more significant than in a liquidation scenario which will typically return pennies on the dollar.

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Finally, the Companies (Guernsey) Law 2008 (Insolvency) (Amendment) Ordinance 2020, Part XXIIIA confers jurisdiction on the Royal Court to wind up a foreign company that is not registered in Guernsey but either operates or has assets within the jurisdiction. This change to Guernsey's insolvency regime provides further protections to creditors, especially in light of Guernsey being an offshore financial center.

Commented [DJ21]: 1 mark – well picked p. The crucial missing point here is the administration moratorium in Guernsey and the fact that it excludes enforcement by secured creditors.

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

Commented [DJ22]: 11/15

Question 3.1 [maximum 7 marks]

A creditor wishes to register or enforce an English judgment in Guernsey. Explain whether this is possible and what the creditor would need to do. How would your answer differ if the officeholder sought to register or enforce a judgment from the USA?

In Guernsey, there are two mutually exclusive regimes for enforcing foreign judgments. The procedure applied in each case will be determined by the country that issued the judgment. Upon recognition, the foreign judgment will have the same effect as any judgment entered by the Royal Court and be capable of enforcement.

Statutory regime

The Judgment (Reciprocal Enforcement) (Guernsey) Law 1957 (the **Law**) applies to judgments issued by the courts of the reciprocating countries listed in the Judgments (Reciprocal Enforcement) Ordinance 1973. Under the Ordinance, judgments of the English Courts are capable of registration and enforcement in Guernsey. However, notably absent from this are judgments issued by US courts. Consequently, US court judgments may only be registered under the common law regime, which is discussed further below.

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Further to Article 3(2) of the Law, a judgment is capable of registration provided the following statutory requirements are met:

- The judgment is a final judgment between the parties: *see Article 3(2)(a)*; and
- The judgment is payable for a sum of money (and not a penalty or tax): *see Article 3(2)(b)*.

[4] Module at [6.3.2.3]
[5] Ibid; see also Article 405 CL 2008

A judgment will be deemed "final" notwithstanding that there may be an appeal pending or may be subject to an appeal pending in the original court: *see Article 3(3)*. Moreover, a foreign judgment issued by a reciprocating court must be registered within six years after the date of the judgment or after the date of the last judgment in the proceedings if there has been an appeal: *see Article 4(1)* of the Law.

Commented [DJ24]: 1 mark

Process for Recognition

A party seeking to enforce an English Judgment under the Law must apply to the Royal Court. Article 1 of the Judgments (Reciprocal Enforcement) (Guernsey) Rules 1972 (the **Rules**) provides that such application may be made without notice to the judgment debtor on an *ex parte* basis. Should the judgment creditor proceed on this basis, such creditor is under a duty of full and frank disclosure of all material facts relevant to the application. The application for recognition of a foreign judgment must be supported by an affidavit that:

- Exhibits a certified copy of the Judgment: *see Article 2(1)(a)* of the Rules; and
- State to the best knowledge and belief of the deponent that:
    - The judgment creditor is entitled to enforce the judgment: *see Article 2(1)(b)(i) of the Rules*;
    - the judgment has not been satisfied in whole or in part on the date of the application: *see Article 2(1)(b)(ii)*;
    - at the date of the application, the judgment is capable of enforcement in the country of the original court: *Article 2(1)(b)(iii);*
    - The judgment, if registered, would not be capable of being set aside under the Law: *See Article 2(1)(b)(iv)*; and
    - The amount of interest on the judgment is specified at the time of registration: *see Article 2(c)* of the Rules.

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Upon making an order to register the foreign judgment, the court shall proscribe the period of time which the judgment debtor may make an application to set aside the registration of the judgment: *see Article 4* of the Rules. The Royal Court, upon making such order, may order the judgment creditor to provide security for costs for the registration application or any application to set aside the registration: *see Article 3* of the Rules. Whether security will be ordered is a matter of discretion.

The order for registering the foreign judgment must be personally served on the judgment debtor: see *Article 6* of the Rules. For judgment debtor's within the jurisdiction, such service must be effected by Her Majesty's Sergeant: *Article 6(1)(a)* of the Rules. For a debtor who resides outside of the jurisdiction, it will be necessary for the judgment creditors to obtain leave to serve the debtor outside the jurisdiction: *see Article 6(1)(b)* of the Rules.

Commented [DJ26]: 1 mark

In the absence of an application to set aside or extend the time to challenge the registration of the foreign judgment, the creditor must make a further application for leave to enforce the judgment: see *Article 9* of the Rules. Such application may be made on an ex parte basis. The application for leave to enforce the registered judgment must be supported by an affidavit that exhibits proof of service on the judgment debtor.

For judgments that fall within the common law regime (i.e., US Court judgments), a judgment creditor must issue fresh proceedings to obtain a domestic judgment, relying on the foreign judgment debt forming the cause of action. Generally, a judgment creditor will apply for summary judgment.

Commented [DJ27]: 1 mark

The Royal Court has enforced foreign judgments under common law principles provided:

- The defendant is resident in a foreign jurisdiction;
- The defendant selected the foreign jurisdiction in which the judgment was issued as the forum for dispute with the plaintiff
- The defendant voluntarily appeared in the foreign court or contracted to submit to its jurisdiction[6].

Question 3.2 [maximum 8 marks]

Write a short essay on the benefits of using Schemes of Arrangement over other forms of corporate rescue or winding up procedures?

Where a company has entered financial difficulties and is insolvent or in the 'zone of insolvency' apart from the formal insolvency procedures available under Guernsey law (i.e., liquidation or administration), the company may utilize a court-sanctioned arrangement between the company and its creditors (i.e., a scheme of arrangement). Depending on the facts of each case, a scheme of arrangement has advantages for both the company and the creditors of the company.

First, a scheme of arrangement is a rescue procedure that allows the company to compromise its debts with its creditors to continue as a going concern. Generally speaking, unlike a liquidation or administration, the process under a scheme of arrangement is likely to be a faster and more cost-efficient means for a creditor to realize its outstanding debt[7].

Second, a company entering into a formal insolvency process may be value destructive to the assets of the company. The knock-on effect of such value destruction means that the creditors likelihood of payment of a creditor's debt is further reduced.

Following on from the above point, creditors of a company will likely fare better than they would under a liquidation scenario. This is because the company's business will cease operation in a liquidation scenario, and a liquidator will generally sell the business and its assets in a piecemeal fashion. Under a scheme of the arrangement, the company's business will continue as a going concern, increasing the likelihood of a creditor realizing its compromised debt[8].

As regards directors, a scheme may also be more attractive to the company's directors. A scheme of arrangement is a debtor in possession process. Thus, the directors will remain in control of the company. If the requisite number of creditors approve and the Royal Court sanctions the scheme, the directors will avoid both (i) an investigation into the affairs of the company; and (ii) avoid personal liability against a liquidator bringing personal claims against the directors for wrongful and fraudulent trading (if such are found to exist)[9].

If a scheme of arrangement is used in conjunction with administration, this will afford the directors some breathing space to reach a compromise with its creditors. This is because the company will have the benefit of the automatic moratorium against creditors taking action against the company without leave of the Royal Court. While this prevents unsecured creditors from taking enforcement action, the moratorium will not prevent the secured creditors or creditors with a set off from enforcing those rights.

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

Commented [DJ28]: 2 marks

Commented [DJ29]: 1 mark

Commented [DJ30]: 1 mark

Commented [DJ31]: 1 mark

Commented [DJ32]: 1 mark. A good answer. Would have liked to see some development of the concept by reference to the ability to bind all creditors or members in a class.

Commented [DJ33]: 15/15

[6] Module at [8.2].
[7] Module at [6.5.2]
[8] Ibid.
[9] Ibid.

Pam and Jim have been asked to consider taking an appointment as insolvency officeholders over Munder & Difflin Limited (M & D), a Guernsey incorporated company specialising in selling office supplies. Michael and Dwight were the company's only members and directors.

For the last 18 months, the company has been experiencing financial difficulties as a result of the implementation of an expensive online sales platform which failed to deliver the promised increase in sales and profitability.

The platform was designed and built by Scranton Software Limited (Scranton), a company registered in England. Scranton invoiced M & D in the sum of £250,000 three (3) months ago. Scranton is owned by Ryan (Michael's son).

Following the failed launch of the website, it was obvious that M & D had cash flow issues in that it could not meet its day to day liabilites and that insolvency was inevitable. Michael and Dwight thought it would be a good idea to get cash quickly injected back into the company and took out a short term loan from a friend, Toby. The loan was primarily used to discharge the debt to Scranton.

The company now has no cash or liquid assets and cannot pay its major supplier that is owed £500,000. It also cannot meet this month's salaries, rent and other trade debts.

It is, however, understood that a small tweak to the sales platform could very easily return D & M to profitability if it can be protected from action by its creditors.

Jim and Pam have been approached by Michael to help navigate the crisis. Dwight has absconded to his farm in Scotland, taking with him various items of company property and valuable information.

Help Jim and Pam to advise on the following issues:

(a) The formal insolvency proceedings available to M & D under Guernsey law and the most appropriate course to follow in the circumstances. Your answer should draw support for your conclusion from the facts set out above.

(b) What, if any, potential claims the insolvency officeholders may wish to investigate following their appointment. For these purposes, you may assume that M & D will ultimately be placed into compulsory liquidation.

(c) How Jim and Pam could seek assistance overseas in dealing with Dwight.

4(a)

Under Guernsey law, the following procedures are available to an insolvent company or a company in the zone of insolvency: (1) voluntary liquidation; (2) compulsory liquidation; (3) administration; and (4) a scheme of arrangement. It should be noted that a scheme is not a formal insolvency procedure but is available to a company that may be capable of rescue.

As a compulsory or voluntary liquidation will result in the dissolution of M&D, the rescue procedures should be considered where it is possible for M&D to continue as a going concern. The available facts show that a slight tweak of M&D's online sales platform could return the company to profitability. Thus, if the company can get some breathing space to reorganize its debts, a corporate rescue procedure should be adopted as it will likely result in a far better return to the creditors of M&D.

Commented [DJ34]: 1 mark

If used in conjunction with administration, the scheme procedure will trigger an automatic statutory moratorium for creditor claims being commenced or continued without leave of the court. As Toby and/or the trade supplier do not appear to be secured creditors, who would be in a position to enforce their rights, no action can be taken against the company. During this period, M&D could attempt to negotiate a compromise with the trade supplier and Toby. The benefit to Toby and the trade supplier should be self-evident, as M&D does not have any liquid or cash assets, and the piecemeal sale of the business and/or assets will likely return pennies on the dollar in an insolvency scenario. M&D returning to profitability and continuing as a viable business will significantly increase the likelihood of the trade supplier and Toby receiving a greater return. It also follows that Michael and Dwight, in an insolvency scenario, are unlikely to receive a distribution of any surplus.

Commented [DJ35]: 1 mark

A scheme would also benefit Michael and Dwight as the directors of M&D. Indeed; such a procedure would prevent a liquidator investigating the affairs of M&D from bringing claims personally against them. As discussed in more detail at 4(b) below, Michael and Dwight may be liable for giving a preference, wrongful trading, and/or misfeasance.

Commented [DJ36]: 1 mark

Under this procedure, an application to the Royal Court must be made to convene a creditors/members meeting. Notice must be provided by way of a statement that sets out the scheme proposal: *Article 108 of the CL 2008*. Further to Article 110, if a majority in number representing 75% of the value of the members or class of creditors approve the proposed scheme, then an application may be made to the Royal Court to sanction the scheme.

In considering the sanction application, the Royal Court will have regard to:

- The majority is acting in good faith in the interests of the creditors or class of creditors it professes to represent: *Article 110(2)(a)*;
- The different interests of creditors and members are such that they should be treated as belonging to a different class: *Article 110(2)(b)*; and
- The scheme is such that an independent and honest person would approve[10].

On the facts, the latter requirement is likely to be satisfied as a liquidation will result in a zero return to the creditors of M&D. If the Royal Court sanctions the scheme, it will become binding on all creditors as well as the company: *Article 110(4)*.

Commented [DJ37]: 1 mark

Alternatively, if it appears to Pam and Jim that it will not be possible to reorganize M&D's debt under a scheme or arrangement, then placing M&D into administration with a view to selling the company should be considered. This is because it may be possible to find a willing buyer of M&D as the infrastructure requires a slight tweak before making a profit. Such a sale will likely provide a better return to the creditors of M&D.

Commented [DJ38]: 1 mark

Suppose either of these options is not viable. In that case, the company must be placed into liquidation (whether by the company or a creditor under compulsory liquidation or voluntarily by special resolution). In this case, the M&D will cease to carry on business, and a liquidator will be appointed to secure the assets of the company and investigate the company's affairs. As mentioned above and discussed below, this will put Michael and Dwight at risk of claims being made by a liquidator to claw back the reference or personal liability for how they conducted the business affairs.

4(b)

Based on M&D's financial difficulties, Pam and Jim may consider making an application to set aside the payment of GBP 250,000 to Scranton Software Limited as a preference. Article

[10] Module at [6.5.2.2]

424(1) of the CL 2008 confers standing for a liquidator to apply to the Royal Court for an order under this section.

A transaction will be a preference if:

- The person who received the preference was a creditor of the company: *Article 424(2)(a)(i)*;
- The effect of the preference is to put the creditor in a better position than it would have been in the event the company entered liquidation: *Article 424(2)(a)(ii);*
- The preference was given in six months ending with the date of the application for the compulsory winding up of the company: *Article 424(1)* as read with Article 424(2)(b)(i);
- At the time of the preference, the company was unable to pay its debts within the meaning of Article 407: *Article 424(3)(a)*; and
- In giving the preference, the company was influenced by a desire to prefer a creditor: *Article 424(3)(b)*.

Commented [DJ39]: 1 mark

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

At all times, Scranton was a trade creditor of M&D. As a trade creditor, upon a winding up order being made by the Royal Court, it would have been an unsecured creditor. After distributions were made to priority creditors, Scranton would have been entitled to receive a *pari passu* distribution if there were any remaining assets. Bearing in mind that M&D has no cash or liquid assets, there is likely no possibility of Scranton receiving any distribution in a liquidation scenario. Accordingly, receiving GBP 250,000 before the onset of liquidation puts Scranton in a better position than it otherwise would have been upon M&D entering liquidation. As to whether the preference was given within the relevant time, if Pam & Jim bring an action within the next 3 months, said payment will have been made within the relevant time. The look-back period is extended to 2 years where the "person" given the preference is connected with the company: *see Article 424(6)* CL 2008. For the purposes of this section, such person is deemed to be a "connected person" where such person has a connection with that person and the company. In this case, Scranton is beneficially owned by Ryan, Michael (one of M&D's directors) son and likely will be a "connected person" for the purposes of CL 2008.

Commented [DJ40]: 1 mark

Commented [DJ41]: 1 mark

Based on the available facts, it is highly likely that M&D was unable to pay its debts within the meaning of Article 207 (i.e., balance sheet insolvent). This is because M&D failed to meet its day-to-day liabilities, required further capital injection to make the 'preference' payment to Scranton, and the company has no cash or liquid assets.

Finally, on the evidence, it must be shown that the company was influenced by a desire to prefer a creditor. If, as indicated above, Scranton is a 'connected person,' there is a presumption that the company has been influenced by a desire to give the preference: *Article 424(6)(b)*. If I am wrong, and Scranton is not a connected party, the facts need to be considered to determine whether this is satisfied. Here, Scranton had cash flow difficulties, and insolvency was inevitable. More importantly, M&D took out a short-term loan primarily used to discharge its liability to Scranton in the face of its imminent insolvency.

Commented [DJ42]: 1 mark

If a preference has been given, the court has broad powers to make any order it thinks fit, including requiring any person in receipt of the benefit to repay the same to the liquidator: *Article 424(4)(d)*.

It may also be possible to bring a misfeasance claim against either/or both Michael and Dwight. If successful, the liquidator may seek an order for repayment or contribution from the directors. This money will be returned to the insolvent estate and available for distribution to the creditors of M&D. To be liable for misfeasance, it must be shown that the former directors

appropriated or misapplied any of the company's assets: *Article 422(1)(a)*, or has been guilty of any misfeasance or breach of fiduciary duty in relation to the company: *Article 422(1)(c)*. As regards Michael and Dwight, it is well established that a company director owes a fiduciary duty to act in the company's best interests. However, when a company is insolvent or in the zone of insolvency (as is the case here), a director's duty shifts and the director must act in the best interests of M&D's creditors.

Commented [DJ43]: 1 mark

Insofar as it can be established that following the launch of the website, insolvency was inevitable, then on its face, the creation of further debt (i.e., by taking a loan) and the subsequent payment to Scranton does not appear to be in the best interests of M&D's creditors as a whole.

Commented [DJ44]: 1 mark

Separately, Dwight, having retained property of M&D, may be vulnerable to a misfeasance claim being made against him.

Subject to Jim and Pam's investigations into M&D's affairs, the last potential claim that may be made against Michael and Dwight is for wrongful trading. Under Article 434(1), a director may be liable for wrongful trading if:

- The company has gone into insolvent liquidation: *Article 434(2)(a)*;
- Before the commencement of the winding up, the director knew or should have known that there was no reasonable prospect that the company would not avoid going into insolvent liquidation: *Article 434(2)(b)*; and
- The person was a company director; *Article 434(2)(c)*.

Commented [DJ45]: 1 mark

Michael and Dwight could avoid liability if it could be established that they took every step to minimize the potential loss to the company's creditors. As indicated above, following the launch of M&D's website, it became clear to Michael and Dwight that due to cash flow problems, insolvency was inevitable. In response, the directors caused the company to incur further indebtedness to discharge the debt due to Scranton. Instead of applying the funds to tweak the sales platform to return the company to profitability, it discharged the debt owing to Scranton. On the face of it, such action does not appear to be an action that minimizes the potential loss to the creditors of M&D. If the Royal Court is satisfied that the directors have wrongfully traded, then Michael and Dwight may be liable to contribute to the assets of M&D.

Commented [DJ46]: 1 mark

4(c)

Pam and Jim may apply for assistance from the English High Court under section 426 of the Insolvency Act 1986 (the **Insolvency Act**). Such an application is commenced in Royal Court for the issue of a letter of request to the High Court. Subsection (5) of 426 of the Insolvency Act provides that in relation to the matters subject to the request, the law applicable to such request may be applicable in either jurisdiction.

Commented [DJ47]: 1 mark

In this case, Pam and Jim should seek the examination and production of documents under section 198 of the Insolvency Act. Article 198 provides that the Court may direct the examination of any person for the time being in Scotland in respect of the affairs and dealings of the company for an oral examination and production of the company's books and records.

Commented [DJ48]: 1 mark

This was generally an excellent answer particularly regarding the potential claims.

*** End of Assessment ***

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