



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3B
THE INSOLVENCY SYSTEM OF THE UNITED KINGDOM
(ENGLAND AND WALES)

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

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

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

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

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

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in MS Word format, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
4. You must save this document using the following format: **[studentID.assessment3B]**. An example would be something along the following lines: 20222-514.assessment3B. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words "studentID" with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
- 6.1 If you selected Module 3B as one of your **compulsory modules** (see the e-mail that was sent to you when your place on the course was confirmed), the final time and date for the submission of this assessment is **23:00 (11 pm) GMT on 1 March 2022**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2022. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
- 6.2 If you selected Module 3B as one of your **elective modules** (see the e-mail that was sent to you when your place on the course was confirmed), you have a **choice** as to when you may submit this assessment. You may either submit the assessment by **23:00 (11 pm) GMT on 1 March 2022** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. If you elect to submit by 1 March 2022, you **may not** submit the assessment again by 31 July 2022 (for example, in order to achieve a higher mark).
7. Prior to being populated with your answers, this assessment consists of **7 pages**.

ANSWER ALL THE QUESTIONS

Commented [DJ1]: TOTAL: 47 OUT OF 50
Well Done!

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

Commented [DJ2]: 9 out of 10

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

Question 1.1

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

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

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

Question 1.2

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

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

Question 1.3

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

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

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

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

Question 1.4

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

- (a) The administrator.
- (b) Any secured creditor with the benefit of a qualifying floating charge.
- (c) The purchaser.
- (d) The company's auditor.

Question 1.5

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

- (a) Administration.
- (b) Restructuring Plan.
- (c) Scheme of Arrangement.
- (d) Company Voluntary Arrangement.

Question 1.6

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

- (a) £500
- (b) £750
- (c) £1,000
- (d) £2,000

Question 1.7

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

- (a) Wrongful trading.
- (b) Breach of fiduciary duty.

Commented [JL3]: b

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

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

Question 1.8

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

(a) 6

(b) 8

(c) 10

(d) 12

Question 1.9

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

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

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

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

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

Question 1.10

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

(a) 6 months.

(b) 12 months.

(c) 2 years.

(d) 5 years.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 5 marks]

Commented [DJ4]: 8 out of 10

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?

The following are the holders of an action under section 423 of the Insolvency Act 1986 ; (ii) section 6 of the Company Directors Disqualification Act 1986 ; and (iii) section 246ZB of the Insolvency Act 1986.

- **Section 6 of the Company Directors Disqualification Act 1986**

A liquidator and an administrator are empowered to investigate the affairs of the company and to discover any activity that may require further action. In exercise of these powers, the liquidator can bring an action on behalf of the company to sue a director who may have breached his duties to the company while it was a going concern. Likewise, the liquidator has a number of actions which he can bring against former directors or other persons whereby certain transactions can be attacked and set aside.

Similarly, the liquidator and administrator has a statutory duty to report directors who may be "unfit" to be directors under the Company Directors Disqualification Act 1986. Upon such a report, the Secretary of State may decide, on the basis of such a report, to take action against the directors whereby the court may disqualify them from being directors of companies and/or order them to compensate creditors who have suffered losses at the hands of the directors.

The court, for its part, must make a disqualification order against a person if the requirements of section 6 (findings of disqualification against directors of insolvent companies) or section 9A of that act (competition law infringements) are met.

Under section 6 of the CDDA, the court must make a disqualification order against a person where the following requirements are met:

1. that the person is or has been a director of a company that has at some time become insolvent (either while a director or subsequently); and
2. that his conduct as a director of such a company (either alone or in conjunction with his conduct as a director of one or more other foreign companies or undertakings) renders him unfit to participate in the management of a company.

Thus, it is the liquidator or administrator who is empowered to initiate the action contemplated in Section 6 of the Company Directors Disqualification Act 1986.

Commented [JL5]: Only the secretary of state r official receiver on instructions of the secretary of state.

- **Section 423 of the Insolvency Act 1986**

Under section 423 of the Act, transactions intended to defraud creditors may be attacked.

Such action may be initiated by the following:

1. Where the company is in liquidation or is in administration, the official receiver, the liquidator, the administrator and (with the court's permission) any victim of the transaction, such as a creditor ;
2. When a victim is bound by a CVA, the supervisor of the Company Voluntary Agreement (CVA) or any victim of the operation (whether or not linked to the CVA);
3. In any other case, by a victim of the operation.

For this action to succeed, section 423 of the Act has two requirements:

1. It is necessary to demonstrate that the company entered into a transaction with another person at a lower value (i.e. that the company has received no consideration or significantly less consideration than it has provided); and
2. It is necessary to show that the company entered into the transaction for the purpose of putting the assets beyond the reach of a person who is making, or may at some time make, a claim against the company, or otherwise prejudicing the interests of such person in connection with the claim he is making or may make.

It is worth noting that any person who is a victim of the transaction can make an application under this section. However, if the company is in liquidation or is subject to an administration, the liquidator or administrator will usually make the application. However, regardless of who makes the application, the application is considered to be made on behalf of all victims of the transaction.

- **Section 246ZB of the Insolvency Act 1986**

Sections 214 and 246ZB of the Act make directors of insolvent companies liable for wrongful trading, thus making them, in certain circumstances, liable for some of the company's debts and liabilities.

This action, **which can only be brought by the liquidator (not by a creditor or contributory)**, is intended to ensure that, when the directors become aware that an insolvent liquidation (or administration) is imminent, they do all they can to minimise the potential losses to the company's creditors.

Thus, under this section the court is empowered to declare that an administrator of a company in insolvent liquidation must make a contribution to the company's assets.

For this action to apply, the court must be satisfied that the following conditions are met:

1. That the company has gone into liquidation due to insolvency;
2. That at some time prior to the commencement of the company's liquidation, that person knew or ought to have come to the conclusion that there was no reasonable prospect of the company avoiding going into insolvency liquidation;
3. That at the time the person came to that conclusion or should have come to that conclusion, that person was a director of the company.

The burden of proof is on the liquidator to show that the director in question knew or ought to have known that there was no reasonable prospect of avoiding insolvency. Once this has been demonstrated, the burden of proof shifts to the director to show that what he did was to take all steps to minimise losses to **creditors**.

Commented [JL6]: S246ZB pertains to administration and thus the correct answer is administrator.

Commented [DJ7]: 3

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 decision of creditors in insolvency proceedings shall be taken by means of the tacit consent procedure or the qualified decision procedure.

- **The tacit consent procedure** allows a decision to be taken by notifying the creditors

of the intended decision and, if that decision is not effectively objected to, it is deemed to have been taken. The tacit consent procedure applies to any decision unless 10% of the creditors object before the date set for the tacit consent procedure to take effect. In the absence of the 10% objection, the deemed consent is effective.

Generally, presumed consent can be used for all management decisions (except for setting the basis for the director's remuneration).

- **Qualified decision:** Where tacit consent is effectively objected to or where the administrator decides not to use tacit consent, the decision shall instead be made by one of the five qualified decision procedures listed in the Rules at 15.3, namely:
 - a. Correspondence;
 - b. Electronic voting;
 - c. Virtual meeting;
 - d. Physical meeting; or
 - e. Any other decision-making procedure that allows all creditors entitled to participate in decision-making on an equal footing.

The decision date shall be set at the discretion of the administrator (called the convenor), but shall not be less than 14 days after the date of delivery of the **notice**.

Commented [DJ8]: 5

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

Commented [DJ9]: 15 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?

There are several standards by which an administrator can require suppliers of goods and services to continue to provide goods and services during the insolvency. These rules are:

- A supplier may not demand payment of outstanding debts to secure a new or continued supply to the company in administration. However, section 233 of the Act allows a supplier to stipulate that the administrator must personally guarantee the payment of expenses relating to the supply.
- A supplier of such services cannot generally invoke an "insolvency-related clause" in a supply contract that would otherwise entitle it to terminate the supply, modify the terms of the supply or force higher payments to continue the supply (section 233A).
- Clauses that allow the supplier of goods or services to terminate or "do anything else" in relation to that contract if the company enters into formal insolvency proceedings or administration are not permitted. Section 233B therefore prevents suppliers from terminating a supply in the event of insolvency or administration of the company, but it also prevents suppliers from making payment of pre-insolvency/administration arrears and making other changes to the contract, such as increasing prices, a condition of continuing the supply. However, the supplier may terminate the contract if the company or the insolvency office holder gives its consent or if, upon application to the court, the court considers that continuation of the contract would cause hardship to the supplier and authorises the termination.

Thus, there are different sections in the law that prohibit suppliers from terminating, ending, suspending, demanding payments and so on from a company going into administration. Therefore, under these provisions an administrator who wishes to continue the business of the company in administration can require suppliers of goods and services to continue to supply those goods and services during the administration.

Commented [DJ10]: 6

Question 3.2 [maximum 9 marks]

Explain the order of priority of payments in a liquidation and explain the nature of the rights enjoyed by each class of creditor or expense.

The order of priority of payments in a settlement is as follows:

1. Those with fixed charge collateral will normally enforce their collateral irrespective of any formal insolvency. Recall that **fixed charge** collateral is posted on a particular asset or asset class.
2. Expenses (including remuneration of the office holder):

Under section 115 of the Act (and rules 6.42 and 7.108 of the Regulations), a number of expenses have priority over preferential creditors of the company, floating charge holders and unsecured creditors of the company.

The main expenses that take priority over these creditors and are paid in the following order of priority are detailed below:

- expenses incurred by the liquidator in preserving, realising or securing any of the assets of the company (including the conduct of any legal proceedings);
- the cost of any security provided by the liquidator;
- any amount paid to a person to assist in the preparation of a statement of accounts or the accounts;
- all necessary expenses of the liquidator in the course of the liquidation (including, for example, the expenses of the members of the liquidation committee);
- the remuneration of any person who has been engaged by the liquidator to perform any services for the company;
- the liquidator's remuneration (which is effectively subject to the same rules as apply to directors, including specifically the fee estimation regime where a time cost basis is adopted for the liquidator's fees);
- the amount of corporation tax on taxable capital gains accruing on the realisation of any assets of the company; and
- any other expenses that the liquidator may incur in the performance of his duties in the liquidation.
- It should be noted that the liquidator's own remuneration is behind a number of expense categories.

3. Preferential creditors

Once all liquidation expenses have been paid, the company's assets are used to pay preferential creditors (before any payments can be made to floating charge holders or unsecured creditors).

Preferential creditors in practice are limited to the reasonably modest claims of employees who are owed money by their insolvent employers and to some tax debts

owed to the government where the company has in fact acted as a tax collector for the government.

However, there are two types of preferential debts, ordinary and secondary.

- Ordinary preferential debts:
 - o They are paid before secondary preferential debts. Preferential debts, in their respective classes, rank equally with each other and are therefore reduced in equal proportion if the company's assets are insufficient to pay them all.
 - o The following debts are classified as ordinary preferential:
 - any sum owed on account on an employee's contribution to an occupational pension scheme, being contributions deducted from earnings of the company's employees paid in the period of four months prior to the commencement of the winding up;
 - any sum owed by the company on account of an employer's contribution to an occupational pension scheme in the period of 12 months before the relevant date;
 - remuneration owed by the company to a person who is or has been an employee of the debtor and is payable in respect of the whole or any part of the period of four months prior to the commencement of the winding up to a maximum total figure which is currently £800 (a figure that has remained unchanged since 1976);
 - any amounts owed by the company by way of accrued holiday remuneration in respect of any period of employment before the winding up;
 - claims for monies advanced to pay wages or holiday remuneration will rank as preferential.
 - levies on the production of coal and steel referred to in article 49 and article 50 of the European Coal and Steel Community Treaty (as there are very few independent producers of coal and steel remaining in the UK such preferential claims are extremely rare);
 - claims for so much of any amount which is ordered to be paid by the company under the Reserve Forces (Safeguard of Employment) Act 1985, and is so ordered in respect of a default made by the company in the discharge of its obligations under that Act (again such claims are extremely rare).
 - So much of any amount owed by the company in respect of an eligible deposit as does not exceed the compensation that would be payable in respect of the deposit under the Financial Services Compensation Scheme to the person or persons to whom the amount is owed.
- Secondary preferential debts
 - o They are paid after ordinary preferential debts.
 - o Secondary preferential debts are:
 - So much of any amount owed by the company to one or more eligible persons 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 to that person or those persons.
 - (10) 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. In addition to the above,

the UK has reintroduced a form of Crown preference for certain debts owed to the taxation authority (Her Majesty's Revenue and Customs):

- PAYE income tax deductions, national insurance deductions, VAT payments, Construction Industry Scheme deductions and student loan repayments.

4. Holders of floating charges (subject to section 176A):

The floating charges will then be paid. There may be more than one floating charge holder and, if that is the case, the priority between them usually depends on which floating charge was created first.

The liquidator (or administrator) is required to allocate a 'prescribed part' of the company's net assets to the satisfaction of unsecured debts and must not distribute any part of this prescribed part to a floating charge holder, except to the extent that it exceeds the amount necessary to satisfy all unsecured debts. For these purposes, 'net assets' is the amount of the company's assets that would otherwise be available to satisfy the debts of floating charge holders. It is therefore calculated after liquidation expenses and preferential debts have been paid.

5. Unsecured creditors

Afterwards, unsecured creditors, i.e. those who do not have any security or title to the assets, which will normally be ordinary commercial suppliers and tax liabilities that are not senior, will be paid.

6. Shareholders

If there are sufficient funds to pay all creditors (and interest on their debts), the surplus is distributed to the shareholders in accordance with the company's articles of association, which normally allow for a *pro rata* distribution of the shareholders' respective [shareholdings](#).

Commented [DJ11]: 9

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

Commented [DJ12]: 15 out of 15

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

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

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

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

liabilities and agreed to further payments, on a cash on delivery basis, for further supplies which amounted to further payment of £3,000 up to the date of the winding up order.

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

Using the facts above, answer the questions that follow.

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

Question 4.1 [maximum 5 marks]

The floating charge in favour of Stercus Bank plc;

The liquidator could initiate the following two actions against the floating charge granted to Stercus Bank. However, as will be indicated below neither of them would be likely to succeed:

1. **FIRST: Action against preference.**

Section 239 of the Act allows to override preferences that have been granted to a creditor shortly before entering into formal insolvency proceedings, in order to put such a creditor in a better position than others. This prevents, for example, attacking a security given to a creditor, or other assets of the company made available to the creditor, who previously only had priority as an unsecured creditor.

Thus, the fact that the company has given a floating guarantee to Stercus Bank, which according to the information provided was a fifth class creditor, would suggest in principle that the company is giving it a better position than the other creditors.

However, for this action to be successful, the following requirements must be met:

1. The company has entered into liquidation or administration: this first requirement is fulfilled as the company went into liquidation on 14 October 2021. In this regard, it is important to remember that a compulsory liquidation starts with the petition to the court.
2. The person alleged to have been preferred was, at the time of the transaction, a creditor of the company (or a guarantor or surety for any of the company's debts or obligations): in this respect, according to the information given, Stercus Bank was a financial creditor of the company, which did not have any preference or priority in the payment of its claim.
3. That the company has done or allowed something to be done which has had the effect of putting that person in a better position, in the event of the company going into insolvent liquidation, than the position he would have been in if that thing had not been done (i.e. the person has been preferred): for the specific case, the fact that the company has given him a floating charge improves Stercus Bank's position in the event of liquidation. This is because, as stated above in point 3.2 of this submission, floating charge creditors are paid first before unsecured creditors.
4. Society, in giving the preference, was influenced by the desire to produce the effect mentioned in (b) (the desire to prefer) in relation to the preferred person.
 - a. For this requirement it must be proven that the company must be influenced by a desire to place the preferential creditor in a position which, in the event of the company going into insolvent liquidation, is better than the position it would have been in if the preference had not been granted.
 - b. This requirement has been explained in case law, and it has been held that when the company was influenced solely by commercial considerations,

namely attempts to ensure the continuity of the company's business, there could be no intention to give preference.

- c. For example, in the Millett J. case it was held that the granting of the obligation was motivated, not by a desire to prefer the bank, but by a desire to avoid the enforcement of the overdraft and the continuation of the company's business activity.
 - d. In this case, according to the information provided, the pressure from its bank was not to improve its creditor status but to prevent the bank from demanding repayment of the company's loans. Therefore, this requirement would not be fulfilled.
5. The preference came at a relevant moment.
- a. The timing depends on whether or not the preference is given to a connected person (such as a director or an associate of such a director). If it is in favour of a connected person, for a preference to be actionable, it must have occurred in the two years prior to the commencement of the insolvency. If it is in favour of a person not connected with the company, for a preference to be actionable, it must have occurred within six months prior to the commencement of the insolvency.
 - b. In the present case, and according to the information provided, Stercus Bank is not a person related to the company. Therefore, in order for the preference to be actionable, it must have occurred six months prior to the commencement of the insolvency.
 - c. Therefore, this requirement is not fulfilled either, as the company started insolvency on 14 October 2021 (the date on which the application was made to the court) and the preference was granted in February 2021, i.e. 10 months before the start of insolvency.

In view of the above, the liquidator of the company would not be able to successfully initiate the cancellation of preferences.

2. **SECOND:** For its part, it could initiate a "**floating charge**" cancellation action, which, as will be seen below, would also have no chance of success.

- This avoidance is covered by section 245 of the Act, which applies only to floating charges, and not to any other type of security. This action arises where a company is in administration or liquidation and is intended to prevent pre-existing unsecured creditors from obtaining the security of a floating charge shortly before the company enters into formal insolvency proceedings. Where the person in whose favour the floating charge is constituted is not connected with the company, the relevant time is any time within the 12 month period prior to the commencement of the insolvency, but only if at the time of the constitution of the charge the company was unable to pay its debts (within the meaning of section 123 of the Act) or was unable to do so as a result of the transaction.
- In this way, it renders floating charges granted by a company at a given point in time ineffective, except to the extent that "new" consideration is provided for the charge. Thus, this action does not prevent lenders who are providing new financing to the company from taking a floating charge for that new financing.
- There are two main categories of "new" considerations set out in section 245 of the Act, which, if met, mean that the floating charge will not be invalid:
 - o The consideration must be paid at the same time as or after the creation of the lien.
 - o Floating charge is not invalidated to the extent that the consideration serves to release or reduce a debt of the company.

- If a floating charge falls within the scope of section 245, it is invalidated, except for the new consideration as discussed above. However, invalidity can only occur if the company goes into liquidation or administration. It does not invalidate anything that has been done under the authority of the vulnerable floating charge prior to the commencement of liquidation. Even if the floating charge is invalidated, the underlying debt remains valid.
- According to the information provided, I consider that the constitution of the floating charge can be considered as "new consideration" and therefore, it could not be invalidated. This is because Corfee Zero Limited, granted a debenture in favour of Stercus Bank plc in February 2021, and a floating charge was constituted on that new debenture over the whole of the company. Furthermore, the facts of the case do not indicate that the consideration was granted prior to the creation of the lien.

Commented [DJ13]: 5

Question 4.2 [maximum 6 marks]

The sale of the coffee roasting machines; and

The liquidator could bring one of the following actions against the coffee roasting machine sales transaction: (i) an action for misconduct; and (ii) an action for being an undervalued transaction.

1. FIRST: Action for misconduct:

- a. Under section 212, the court can examine the conduct of certain persons and whether there has been any wrongdoing or breach of duty in relation to a company in liquidation.
- b. From this examination, can order the restitution, the return or accounting of money or goods or the contribution of such a sum to the company as compensation.
- c. The successful action would allege that the offender "has applied, withheld or become liable for money or property of the company, or is guilty of prevarication or breach of any fiduciary or other duty".
- d. Thus, this action can be brought for breach of the duty (i) of care and skill (negligence), which is not a fiduciary action, but falls into the category of "other duties", (ii) as well as fiduciary duties such as acting in the best interests of the company and not acting where the director has a conflict of interest and duty. In circumstances where the company is insolvent (or about to become insolvent), if the directors continue to operate, the directors' duty shifts from being a duty to the company, having regard to what would be in the best interests of its members, to a duty to the company having regard to the interests of its creditors.
- e. Under section 212, an action may be brought against the following persons:
 - i. a former or current officer of the company (which would include directors);
 - ii. a former liquidator of the company;
 - iii. a receiver of the company; and any other person who is or has been involved, or has participated, in the promotion, formation or management of the company.
- f. In the case at hand, the liquidator could bring an action against Ann arguing that Ann breached a fiduciary duty by acting in a conflict of interest in the acquisition of the coffee roasting machines. This is because in this transaction she would see two conflicting interests: on the one hand, her interest as the buyer of the machines, whereby she would try to acquire the machines at a

lower price; and on the other hand, the interest of the company as the seller, to sell them at a similar value to the one at which she acquired them, so that she would not make a loss.

- g. Thus, having acquired the machines while also being a director of the company may imply that the company acted in a conflict of interest.
- h. In the event that Ms Ann is found to have acted in a conflict of interest, the Court may make i) an order for reimbursement or contribution; ii) disqualification of Ms Ann as a trustee; and iii) an order for compensation.

2. **SECOND:** For its part, the liquidator could initiate an action to attack the acquisition for being *undervalued*.

- Under section 238 of the Act, a liquidator (or administrator) may challenge a transaction entered into before the company goes into liquidation or administration where the transaction was entered into at a lower value.
- Under section 238, the liquidator or administrator must prove that the company:
 - o has given a gift to someone else;
 - o has entered into a transaction with another person on terms that provide for the company to receive no consideration; or
 - o has entered into a transaction with another person for a consideration that, at the date of the transaction, was, in money or monetary value, significantly less than the value, in money or monetary value, of the consideration provided by the company .
- To be attacked, the transaction must have taken place at a "relevant time", which is in the two-year period prior to the commencement of the liquidation or administration.
- Regardless of whether the transaction was entered into with a connected person, it is a prerequisite for liability under section 238 that, at the time the transaction was entered into, the company was unable to pay its debts as they fell due within the meaning of section 123 or became unable to pay its debts within the meaning of that section as a result of the transaction. However, in the case of a transaction with a connected person, it is presumed that the company was insolvent or became insolvent as a result of the transaction, unless the contrary is proved.
- If the respondent to an application satisfies the court that the transaction was entered into by the company in good faith and for the purpose of carrying on its business, and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company, then the court will not make an order under section 238 .
- If the court concludes that an undervalued transaction or a preference has taken place, it has the power to order that the situation be restored to the situation that would have been reached if the preference had not been given or the transaction had not taken place.
- However, section 241 offers protection to certain persons, as it provides that an order will not prejudice any interest in property which has been acquired from a person other than the company, and which has been acquired in good faith and for value.
- For the case at hand:
 - o The transaction was for significantly less money than the value at which the

company acquired the goods. This is because the company acquired the machines for £25,000 and sold them (only one year later) for £10,000.

- o The transaction took place three months before the winding-up petition. Therefore, the temporality requirement is fulfilled as the transaction took place in the two-year period prior to the commencement of the liquidation.
- o In this case the transaction was made with a related person, being a director of the company, so it is presumed that the company was insolvent or became insolvent as a result of the transaction, unless proven otherwise.
- o In the event that Ms Ann fails to show that the transaction was entered into by the company in good faith and for the purpose of carrying on its business, and that at the time it was entered into there were reasonable grounds to believe that the transaction would benefit the company, the court may order that the situation be restored to what it would have been had the transaction not been entered into. However, it is difficult for Ms Ann to prove such facts, given that by July 2021, the company had liquidity [problems](#).

Commented [DJ14]: 6

Question 4.3 [maximum 4 marks]

The payments to Beans and Leaves Ltd.

For this case, it is possible to bring an action under section 127 of the Act. However, as will be indicated below, this action has a number of requirements for success, which may be very difficult to satisfy in order to effectively attack the payments made to Beans and Leaves Ltd.

In a compulsory winding up, section 127 of the Act prevents any disposal of the company's assets made after the commencement of the winding up, unless the court orders otherwise. For this, it should be noted that the commencement date will be the date of filing of the winding-up petition.

Such a provision includes, for example, any payment of money, as well as assets that are sold or transferred.

In this way it would be possible to attack and annul the acts carried out from the time the liquidation was requested until the date on which the court actually granted such authorisation. This scenario includes the payments made in favour of Beans and Leaves Ltd. This is because these payments were made one month before the winding up order was made, i.e. on or about 23 November 2021. In this regard, it should be recalled that the winding-up petition was filed in October 2021. Therefore, the liquidation actually started in October, and therefore the said payments to Beans and Leaves were made when the company was already in judicial liquidation proceedings.

Notwithstanding the above, it is possible that a validation order may be sought in respect of such payments. In such a case, the court will make such a validation order if the circumstances indicate that the disposal was made for the benefit of the unsecured creditors' estate. In doing so, the court will take into account, inter alia, the following general guidelines:

1. Payments are likely to be validated where they are necessary to ensure continuity of supplies to enable the company to continue trading in cases where the court considers that continued trading was in the best interests of creditors;
2. Normally, transactions that do not decrease the net worth of the company (such as post-application transactions for their full value), increase the value of the company's assets or preserve assets from damage will be validated;

3. Where goods have been paid for against reimbursement, the court will consider the benefit to the business, including whether the payment will enable further supplies to be received and thus allow the business to continue.

Thus, if the transaction allows the company to continue operating, it will generally be validated. Conversely, if the transaction benefits only one creditor to the detriment of other unsecured creditors of the company, it will not be validated.

In this specific case, I consider that the Court could validate such an act (if requested) taking into account that the company made the payments in favour of Beans and Leaves Ltd , considering that the continuous supply of coffee beans was essential for the continuity of the company. Thus, it could be argued that without such a supply the company could cease to operate, which could result in further prejudice to all creditors.

On the other hand, it could also be argued, in favour of such payments, that cash on delivery payments were agreed with Beans and Leaves Ltd, with the sole intention of maintaining the supply of the payment, which is essential to the operation of the company.

Therefore, I consider that it would not be successful to attack such payments.

Commented [DJ15]: 4
Well done for identifying s 127 as being applicable!

*** End of Assessment ***