INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
IN INTERNATIONAL INSOLVENCY LAW

SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3B

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

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

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

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

INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

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

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

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

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

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

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

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

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

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

ANSWER ALL THE QUESTIONS

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

Commented [DJ1]: TOTAL: 46 OUT OF 50
Well Done!

Commented [DJ2]: 8 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 [DJ3]: 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

Commented [DJ4]: c

(d) 12

Question 1.9

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

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

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

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

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

Question 1.10

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

(a) 6 months.

(b) 12 months.

(c) 2 years.

(d) 5 years.

QUESTION 2 (direct questions) [10 marks]

Commented [DJ5]: 9 out of 10

Question 2.1 [maximum 5 marks]

Who may bring an action under: (i) section 423 of the Insolvency Act 1986; (ii) section 6 of the Company Directors Disqualification Act 1986; and (iii) section 246ZB of the Insolvency Act 1986?

Under section 423 of the Insolvency Act 1986, an official receiver, liquidator, administrator, and (with leave of the court) any victim of the transaction such as a creditor, may bring an action to attack transactions which are designed to defraud creditors, where the company is in administration or being wound up. If the company is subject to a Company Voluntary Arrangement (CVA), the supervisor of a CVA (if the victim is bound by the terms of a CVA) or the victim of the transaction (whether bound by the CVA or not) may bring a section 423 action. Thirdly and in any other case, a victim of the transaction may bring section 423 actions.

The Secretary of State may bring an action under section 6 of the Company Directors Disqualification Act 1986 (CDDA).

Only a liquidator may bring an action under section 246ZB of the Insolvency Act 1986.

Commented [JL6]: As this section pertains to administration the correct answer is administrator.

Commented [DJ7]: 4

Question 2.2 [maximum 5 marks]

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

The five qualifying decision procedures set out in rule 15.3 of the Insolvency Rules 2016, by which creditors may make decisions in the context of an insolvent company, are:

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

For most decisions a majority in value of unsecured creditors in favour of any decision is sufficient for it to be passed.

Commented [DJ8]: 5

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

Commented [DJ9]: 14 out of 15

Question 3.1 [maximum 6 marks]

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

Generally, yes. Due to an increasing number of statutory exceptions making automatic termination (ipso facto) clauses void, an administrator can require suppliers of goods and services to continue to apply those goods and services during the administration, enabling the business to continue as a going concern.

One example of this is section 233 of the Insolvency Act 1986 (**Act**) which applies to supply of gas, electricity, water and communications services. The latter is broadly defined and includes point of sale terminals, computer hardware and software, information, advice and technical assistance, data storage and processing and website holding. Suppliers are not allowed to require payment of outstanding debts in order to secure new or continued supply to the company. However, they can stipulate that the administrator must personally guarantee payment of charges in respect of the supply. Supplementing this provision is section 233A which prevents a supplier of these services from relying on an "insolvency-related term" in a contract of supply which would otherwise entitle the supplier to terminate the supply, alter the terms of the supply or compel higher payments for continued supply.

The protection afforded by section 233 and 233A has been extended by the Corporate Insolvency and Governance Act 2020 (2020 Act) by importing section 233B into the Act which prohibits clauses allowing a supplier of goods or services to terminate or "do any other thing" in relation to the particular supply contract if the company enters a formal insolvency procedure. Therefore, this prohibition not only prevents a supplier terminating a contract for supply but also prevents them from making it a condition of continued supply that pre-insolvency arrears are paid and from making other changes to the contract, such as increasing prices.

Section 233B applies to administrations, as well as to companies which have entered a CVA, Moratorium or a Restructuring Plan. This has a far reaching effect because the prohibition on termination under section 233B applies to all suppliers (not just those stipulated in section 233 and 233A) with a limited number of exceptions, such as insurers, banks, electronic money institutions, recognized investment exchanges and clearing houses, securitization companies and overseas companies with corresponding functions.

However, a contract may still be terminated by a supplier restricted by section 233B only with the administrator's or office holder's consent or, on an application to the court. The court may grant permission for the termination if satisfied that the continuation of the contract would cause the supplier hardship.

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.

In the liquidation waterfall for distributions**, expenses of winding up** (including the liquidator's remuneration) generally have the highest priority. Under section 115 of the Act (and rules 6.42 and 7.108 of the Rules) the main expenses, which are given priority over the company's preferential creditors, holders of floating charges and the unsecured creditors, are (in the order of priority) the following:

(i) expenses that are properly incurred by the liquidator in preserving, realizing or getting any of the assets of the company (including conducting legal proceedings);
(ii) the cost of any security provided by the liquidator;
(iii) any amount payable to a person to assist in the preparation of a statement of affairs or accounts;
(iv) any necessary disbursements by the liquidator in the course of the winding up (including, for example, any expenses incurred by members of the liquidation committee;
(v) remuneration of any person who has been employed by the liquidator to perform services for the company;
(vi) remuneration of the liquidator;

(vii) the amount of any corporation tax on chargeable gains accruing on the realization of any asset of the company;
(viii) any other expenses properly chargeable by the liquidator in carrying out the liquidator's functions in the winding up.

After expenses of the winding up are paid in full, the assets of the company will be used to pay **preferential creditors**, who are second in the distribution waterfall. Preferential creditors are defined in sections 386, 387 of the Act and section 175 of Schedule 6 of the Act and largely comprises limited claims of employees and some taxation liabilities. In respect of the former, there are significant limits on claims of employees under the Act. However, these limitations do are not in practice detrimental because the protection afforded by the Employment Rights Act 1996 is more extensive. In respect of tax liability to the Crown, although once abolished under the Enterprise Act 2002, it has been reintroduced to a large extent by section 95 of the Finance Act 2020. There are two classes of preferential debts, ordinary and secondary (ordinary being paid before secondary). In their respective classes, the preferential debts rank equally amongst themselves and so abate in equal proportion if the company's assets are insufficient to pay them all. The preferential debts listed in Schedule 6 of the Act largely relate to employment remuneration (limited to £800) and benefits (such as pension scheme contributions and accrued holiday remuneration, but also include levies on production of coal and steel, and any amounts owed under the Reserve Forces (Safeguard of Employment) Act 1985. In addition to the above, any amount owed by the company in respect of an eligible deposit where the financial institution holding the deposits becomes insolvent (which does not exceed the compensation that would be payable by the Financial Services Compensation Scheme (FSCS)), to depositors, are now also considered preferential debts. Secondary preferential debts (as defined under section 386 of the Act) include eligible deposits which exceeds any compensation that would be payable in respect of the deposit under the FSCS; amounts owed to eligible persons in respect of a deposit made through a non-UK branch of a credit institution that would have been eligible if it has been made through a UK branch; and certain debts owed to Her Majesty's Revenue and Customs. Finally another form of secondary preferential debts are PAYE income tax deductions, national insurance deductions, VAT payments, Construction Industry Scheme deductions and student loan repayments. It is important to note that the preferential debts regime applies to all insolvency procedures therefore administrators and administrative and other receivers must act in accordance with the regime, and the terms of CVAs cannot alter the priority of preferential creditors.

After payments for expenses and to preferential creditors, **floating charge holders** will be the next creditor to receive a distribution. If there is more than one floating charge holder, priority between them usually turns upon which charge was created first. Before payment can be made to any floating charge holder, the liquidator must first consider whether section 176A of the Act applies. This provision relates to floating charges made on or after 15 September 2003 and the company has gone into liquidation (or administration). If this section applies, a "prescribed part" of the company's net property must be made available for the satisfaction of unsecured debts and must not distribute any of this prescribed part to a floating charge holder except insofar as it is in excess of the amount required to satisfy all the unsecured debts. Net property for this purpose is the amount of the company's property which otherwise would be available for the satisfaction of debts of floating charge holders (i.e. after liquidation expenses and preferential debts have been satisfied). Where the company's net property does not exceed £10,000, the prescribed part is 50% of that property. However, if it is less than this amount and the liquidator or administrator considers that making a distribution to creditors would be disproportionate to the benefits, the duty to make a distribution of the prescribed part does not apply. Where the company's net property exceeds £10,000 in value, the prescribed part is 50% of the first £10,000 plus 20% of the excess above £10,000 subject to a maximum amount of the prescribed part of £800,000. The case of *Thorniley v Harris* [2008] EWHC 124 (Ch) held that a floating charge holder (or any secured creditor) who may have an outstanding unsecured balance owing to it, may not participate in the distribution of the prescribed part.

The fourth and last category of creditor in the distribution waterfall are **unsecured creditors**. Such creditors, often ordinary trade creditors, are paid out once the expenses of the liquidation have been paid and distributions have been made to the secured and preferential creditors.

Finally, if there is anything left for distribution after the settling of the debts discussed above, any such surplus will be available for a distribution amongst **shareholders** prorated according to their respective shareholdings.

The priority and respective rights of each class of creditor cannot be altered. However, one exception to this is any agreement between creditors whereby the agree between themselves to vary their priority. This is known as a subordination agreement. Such agreements are valid because they alter only the priority of the creditors agreeing to be bound by the agreement and do not vary the priority of other classes of creditor.

Commented [DJ11]: Fixed charge holders? 8

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 floating charge may be caught by section 245 of the Act because it is a charge over the whole of the company's undertaking and no "new" consideration has been given to the Company in exchange for the creation of the charge.

It is said the company is under pressure from Stercus Bank plc, and that the charge was created in order to prevent it from demanding repayment of the company's loans. There is no indication that the company received either of the two main categories of "new" consideration that are set out in section 245 that would mean the charge would not be invalid. These two categories are (i) the value of so much of the consideration for the creation of the charge as consists of money paid, or goods or services supplied at the same time or after the charge was created; and (ii) the value of so much of that consideration as consists of the discharge or reduction, at the same time as or after the creation of the charge, of any debt of the company. There does not appear from the facts presented to have been any money, goods or services received by the company, or any reduction or discharge of the existing debt.

The charge was created in February 2021. For the floating charge to be avoided under section 245, the charge would have to be created any time within the 12 months prior to the onset of insolvency, but only if at the time of the creation of the charge, the company was either unable to pay its debts (within the meaning of section 123 of the Act) or became unable to do so in consequence of the transaction. It appears that the charge would have been created within the 12 months prior to the onset of insolvency, given that the winding up petition was issued in October 2021 and the winding up order made December 2021. However, it is not known on the facts presented whether the charge was created at a time when the company was either unable to pay its debts or became unable to do so in consequence of the transaction. Further details regarding the company's financial situation at the time and / or shortly thereafter the charge was created would be required in order to assess whether this requirement would be satisfied. However, if the floating charge is caught by section 245, it is rendered invalid. If invalid, it cannot be legally enforced and the liquidator would be able to reject or contest any enforcement of the invalid security.

Another potential course of action the liquidator could take is to apply to the court pursuant to section 239 of the Act for an order that the transaction is avoidable because it amounts to a preference. In order for such an application to succeed, the liquidator must show that:

Commented [JL13]: Not relevant based on the facts.

(a) the bank was at the time of the transaction, a creditor of the company;
(b) something was done or suffered to be done by the company which had the effect of putting the bank in a better position, in the event of the company going into insolvent liquidation, than the position it would have been in if that thing had not been done (that it has been preferred);
(c) the company was, in giving preference, influenced by a desire to produce the effect referred to in (b) above (desire to prefer) in relation to the bank; and
(d) the preference was given at the relevant time.

The burden of proof rests with the liquidator as the bank is not (on the facts presented) a connected party.

In relation to (a) noting that the bank was calling for repayment on the company's existing loans, it would be considered a creditor at the time the charge was created. In relation to (b) the creation of the charge in favour of the bank over all of the company's undertakings would mean that it would move up from its unsecured creditor status in the event of an insolvent liquidation to that of a secured creditor, thereby placing the bank in a better position that other creditors. Although the company appears to have been under pressure from the bank, this is not relevant. However, due to the improvement of the bank's position in the event of insolvency, it seems that the bank would be considered as having been preferred.

However , pressure should be considered relevant only when considering criteria (c), whether there was a desire to prefer, which is often the most difficult to establish. It seems that the charge was created due to pressure the company. However it was also created in order to avoid the bank demanding repaying of the company's existing loans, which might not amount

to a desire to prefer for the purposes of section 239. In *Re MC Bacon Ltd*.[1], a distinction was drawn between intention, which is an objective concept, and desire, which is a subjective one. Applying the analysis in this case to the present set of facts, whereas the charge created in favour of the bank amounts to an intention to prefer that creditor in the event of insolvency, it may not, by itself, amount to a desire to prefer. In *Re MC Bacon*, Millet J found that where a company was entirely dependent upon bank support to continue trading, such that if security was not granted, the bank would withdraw its support and if this happened, the company would be forced into immediate liquidation, the grant of security was motivated not by desire to prefer the bank but by the desire to avoid the calling in of the overdraft (in that case) and continuation of trading. Subsequent decisions have confirmed that where a company is influenced solely by commercial considerations, in particular, to ensure the continuation of trading, this will not amount to a desire to prefer. Therefore, if the liquidator cannot show that the pressure the company was under or there are other factors which demonstrate a desire to prefer the bank, the application may fail to meet criteria (c). However, we do not know enough about what would happen in the event the bank demanded repayment and in order to come to a conclusion on this point, further details would be needed in relation to the overall financial circumstances of the company and the extent to which it relied on the bank's financing to continue trading.

Finally, in relation to (d) the relevant time for an unconnected party is 6 months prior to the onset of insolvency, and that at the time the preference was given, either the company was unable to pay its debts as they fell due[2] or became unable to pay its debts in consequence of the preference. Again, we would need further details about when the company was unable to pay its debts as they fell due in order to ascertain whether the charge created was made at the relevant time. It would seem possible on the facts given the company if it could not (as opposed to did not want to) repay the debts owed to the bank. We would also need greater certainty that the onset of insolvency was by September 2021 (although from the facts pertaining to the sale of the coffee machines, that the company was suffering from cash flow problems in July 2021, this could be possible).

If the court is satisfied that the floating charge is a preference for the purposes of section 239, the court can make an order restoring the position to what it would have been had the preference not been given.

Commented [DJ14]: 5

Question 4.2 [maximum 6 marks]

The sale of the coffee roasting machines; and

[1] [1990] BCC 78

[2] Within the meaning of section 123 of the Act, under the cash flow insolvency test

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.

The sale of the 5 coffee roasting machines for £10,000 in July 2021 to a director of the company, Ann Young, presents a number of issues. It is said the machines had been bought for £25,000 each (£125,000 in total) a year prior. This transaction may be capable of being challenged by the liquidator pursuant to section 238 of the Act, as a transaction at an undervalue.

Under section 238, the liquidator must show that the company: (i) made a gift to another person or (ii) entered into a transaction with another person on terms that provided for the company to receive no consideration; or (iii) entered into a transaction with another person for a consideration which, in money or money's worth, was, at the date of the transaction, significantly less than the value, in money or money's worth, of the consideration provided by the company.

The sale of the coffee roasting machines may fall within the third category if the amount paid by Ann Young is significantly less than the value of the machines. However, it can sometimes be difficult to establish that the consideration received by the company is significantly less than the consideration provided by the company. Such difficulties arise from practical issues with valuation. Therefore, a valuation of the present day value of the coffee roasting machines may need to show that the consideration received by the company is significantly less than the value of the coffee roasting machines. Difficulties with valuation and other practical difficulties inherent in section 238 applications were recognised in the case of *Phillips v Brewin Dolphin Bell Lawrie Ltd*[3]. In this case, the consideration may be capable of being shown as significant less than the value of the coffee roasting machines, noting that the amount that they were purchased for only a year prior was more than ten times the consideration received by the company.

To succeed in attacking this transaction, the transaction must have taken place at a "relevant time", which is in the period of two years prior to the commencement of the liquidation. The commencement of the liquidation is the date that the winding up petition was issued[4], therefore 14 October 2021. The transaction took place in July, so 3 months prior. Therefore, prima facie, the transaction will have taken place at the relevant time for the purposes of section 238.

Where the sale is to a person not connected with the company, it would also be necessary to show that the company was unable to pay its debts as they fell due within the meaning of section 123 of the Act[5] or became unable to pay its debts in consequence of the transaction. However, where the sale is to a connected person (as is the case here), the company is presumed to have been insolvent or to have been insolvent as a result of the transaction, unless the contrary is proved. This is a presumption which the director will have the burden of rebutting.

It must be noted that a defence is available if it can be established that the transaction was entered into by the company in good faith and for the purpose of carrying on business, and that at the time if did so there were reasonable grounds for believing that the transaction would benefit the company, then the court shall not make an order under section 238. There is also protection available under section 241 of the Act which provides that an order shall not

[3] [2001] UKHL 2
[4] Section 129 of the Act
[5] See s.123, cash flow insolvency test

prejudice any interest in property which was acquired other than a company, and which was acquired in good faith and for value.

If a court determining an application is satisfied that section 238 is engaged and the transaction was at an undervalue, it can make an order restoring the position to what it would have been if the transaction had not been entered into. An order may be made by the court for Ann Young to return the coffee roasting machines or that she contributes an amount to reflect the value of the coffee roasting machines to the estate.

Commented [DJ15]: 6

Question 4.3 [maximum 4 marks]

The payments to Beans and Leaves Ltd.

The board's approval of the payment of £8,000 to cover existing liabilities and agreement to make 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, may be capable of being declared void by the court on an application by the liquidator under section 127 of the Act. These payments may be dispositions which fall within section 127 because they were made following the commencement of the winding up, which is when the petition was issued (October 2021). As the company failed to defend the petition and the winding up order was made in December 2021, and the payments fall within the wide definition of "disposition of property", they may be deemed void by the court.

The court's power under this section is discretionary and the court may determine not to declare the disposition void and instead, validate the disposition if the court is satisfied that the disposition has been made for the benefit of the general body of unsecured creditors. In determining whether or not to permit dispositions, the court will consider 6 general guidelines which are listed below and the facts applied:

(1) the court will be reluctant to depart from *pari passu* distribution in order to validate the payments made pre-liquidation where the effect is to give a preference to a pre-liquidation creditor. In this case, the payments were made prior to the winding up order but following commencement of the winding up. The first payment, for existing debt, would give a preference to Beans and Leaves Ltd as a pre-liquidation creditor over other creditors;

(2) the court is likely to sanction where necessary to ensure continued supplies enabling the company to continue trading in cases where the court considers that the continuance of trading was in the best interests of creditors. Although it is understood that the company deemed the continued supply as essential, it is not known whether this decision will be deemed to be in the best interests of creditors, as it is not known whether making these payments to ensure continued supply would have meant continued trading such that insolvency could have been avoided. From the facts it seems the company financial health has been suffering for some time, and so it may be that the court considers the decision to make these payments to ensure supply was continued, was not in the best interests of creditors.

(3) Payments which do not diminish the company's net assets (such as post-petition transactions for full value), which increase the value of the company's assets or preserve assets from harm, will normally be validated. The payments reduced the company's net assets and it is not known whether the continued trading for a further one month (resulting from the continued supply) would have increased the company's net assets.

(4) Where the parties are unaware that a petition had been presented and so the disposition was in good faith and in the ordinary course of business, the transaction is likely to be sanctioned as long as it is to be for the benefit of creditors generally. It is not known whether or when the company was made aware of the petition, and while the payments were perhaps made in the ordinary course of business, it does not seem as though they would be for the benefit of creditors generally unless the continued trading generated more revenue than the cost of the payments, which could be passed on to stakeholders to benefit from in the liquidation.

(5) where goods have been paid for on terms of cash on delivery the court will consider the benefit to the company including whether the payment will enable further supplies to be received and so enable the business to continue. This appears to have been the situation here with respect to the payment of £3000.

(6) the court can not only authorize or validate a particular disposition, but also authorise a general continuance of trading. Given that the winding up order had, by December, been made, this is unlikely.

This is a finely balanced situation because although the payments may have been made honestly, in the ordinary course of business and for the benefit of the company to enable it to continue trading, doing so would require the payments to fulfil a contract that appeared to be profitable. It is not known whether this was the case here. If the fulfilment of any contract or trading continuation was not profitable, then the payments are likely to be considered to benefit only one creditor (Beans and Leaves) to the detriment of other unsecured creditors, in which case the court may refuse to make a validation order rendering the payments void.

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*** End of Assessment ***