



SUMMATIVE (FORMAL) ASSESSMENT (RESIT SEPTEMBER 2022): MODULE 3B

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

This is the **summative (formal) resit assessment** for **Module 3B** of this course. Please read the instructions 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.assessment3Bresit]**. An example would be something along the following lines: 202223-336.assessment3Bresit. **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. This assessment must be returned to David.Burdette@insol.org by e-mail no later than **23:00 (11 pm) BST (GMT +1) on Monday 26 September 2022**. When returning the assessment by e-mail, your e-mail must 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. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

Commented [DB1]: 35/50 = 70%

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

Commented [DB2]: 8/10

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. 1 mark**
- (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. 1 mark**

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. 1 mark

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. 1 mark
- (d) The company's auditor.

Question 1.5

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

- (a) Administration. 1 mark
- (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) GBP 500
- (b) GBP 750
- (c) GBP 1,000 1 mark
- (d) GBP 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. 1 mark
- (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.

1 mark

(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 [DB3]: 10/10

Question 2.1 [maximum 5 marks] 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?

[Answer: The following may bring an action:

(i) Under section 423 of the Insolvency Act 1986 the ("IA 1986") - pursuant to section 424 IA 1986, (1) An application for an order under section 423 shall not be made in relation to a transaction except- (a) in a case where the debtor has been made bankrupt or is a body corporate which is being wound up or is in administration, by the official receiver, by the trustee of the bankrupt's estate or the liquidator of the body corporate or (with the leave of

the court) by a victim of the transaction; (b) in a case where a victim of the transaction is bound by a voluntary arrangement approved under Part 1 or Part VIII of the IA 1986, by the supervisor of the voluntary arrangement or by any person (whether or not so bound) is such a victim; (2) An application made under any of the aforesaid paragraphs of subsection (1) is to be treated as made on behalf of every victim of the transaction.

(ii) Under section 6 of the Company Directors Disqualification Act 1986 ("CDDA 1986") - pursuant to section 7 (1) of the CDDA 1986, if it appears to the Secretary of State that it is expedient in the public interest that a disqualification order under section 6 should be made against any person, an application for the making of such an order against that person may be made - (a) by the Secretary of State, OR (b) if the Secretary of State so directs in the case of a person who is or has been a director of a company which is being (or has been) wound up by the court in England and Wales, by the official receiver.

(iii) Under section 246ZB IA 1986 - pursuant to section 246ZC of the IA 1986, section 215 applies for the purposes of an application under section 246ZA or 246ZB as it applies to the purposes of an application under section 213 but as if the reference in subsection (1) of section 215 to the liquidator was a reference to the administrator. In reference thereto, it will be the liquidator making the application.]

Question 2.2 [maximum 5 marks] 5 marks

List any **five (5)** of the debts which do not form part of the payment holiday under Part A1 of the Insolvency Act 1986 when a company is subject to a Moratorium.

[Answer: The following do not form part of the payment holiday under Part A1 of the IA 1986:

- (a) the monitor's remuneration or expenses;
- (b) goods or services supplied during the moratorium;
- (c) rent in respect of a period during the moratorium;
- (d) wages or salary arising under a contract of employment; and
- (e) redundancy payments.]

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

Commented [DB4]: 8/15

Question 3.1 [maximum 6 marks] 3 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?

[Answer: Yes, pursuant to sections 233 and 233A of the IA 1986 and section 233B as provided under section 14 of the Corporate Insolvency and Governance Act 2020 (the "CIGA"). In addition, section 15 of the CIGA, it provides for temporary exclusion for small suppliers as well.

The protection afforded under the IA 1986 and the CIGA essentially provides that any contractual terms or insolvency-related term in the supply agreement would not become effective if it requires repayment of outstanding debts as a condition to the continuation of the supply of certain essential supplies, entitle the supplier to terminate the supply, alter the terms of the supply or compel higher payments for continued supply.

To consider the protection of the supplier, however, section 233 permits a supplier to stipulate that the administrator must personally guarantee payment of charges in respect of the supply.

Finally, pursuant to section 233B of the IA 1986, the supplier may not be compelled to continue the contract where on application to the court, the court is satisfied that the continuation of the contract would cause the supplier hardship, and the court grants permission for termination. In this situation, the supplier cannot be compelled by the liquidator.]

Full answer:

Terms in contracts of supply which provide for automatic termination have historically been generally effective but have now become subject to increasing statutory exceptions which largely make such automatic termination (or *ipso facto*) clauses void (1 mark). Section 233 of the Act applies to a supply of gas, electricity, water and communications services. Suppliers are not permitted to require payment of outstanding debts in order to secure a new or continued supply to the company in administration (1 mark). However, section 233 of the Act permits a supplier to stipulate that the administrator must personally guarantee payment of charges in respect of the supply (1 mark). Section 233A adds to this protection by preventing a supplier of such goods and service from relying upon 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 (1 mark). Section 233B extends the protections of section 233 and 233A to all suppliers (1 mark). Under section 233B a provision of a contract for the supply of goods or services to the company is of no effect when the company enters an insolvency procedure, if, under that provision the contract would terminate or the supplier would be entitled to terminate the contract or to "do any other thing" upon the company entering an insolvency procedure. Section 233B therefore prevents suppliers from terminating a supply upon the company's insolvency but also prevent suppliers 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 (1 mark).

Question 3.2 [maximum 9 marks] 5 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. How would this priority change if the company had been subject to a Moratorium under Part A1 of the Insolvency Act 1986 during the 12 week period prior to the commencement of the liquidation?

[Answer: The company's debts will be classified whether belonging to preferential debts (ordinary preferential debts or secondary preferential debts), or non-preferential debts as provided under the IA 1986 and The Insolvency (England and Wales) Rules 2016.

Pursuant to section 175, in a winding up the company's preferential debts shall be paid in priority to all other debts after the payment of (a) any liabilities to which priority on moratorium provisions under section 174A applies, (b) and expenses of the winding up. Rules 6.42 (for creditors voluntary liquidation) and 7.108 (for compulsory liquidation) provide that all fees, costs, charges and other expenses incurred in the course of the winding up are to be treated as expenses of the winding up.

If the company is subject to a Moratorium under Part A1 of the IA 1986 during the 12 week period prior to the commencement of the liquidation, it is essential to determine the date of the Moratorium to distinguish pre-Moratorium debts (those falling due before the Moratorium and those falling due during the Moratorium by reason of a pre-Moratorium obligation) and Moratorium debts. Generally, there is a stay on enforcement of pre-Moratorium debts for which a company has payment holiday during the period of Moratorium. When the company transitions from Moratorium to liquidation (as the company has not been rescued as a going concern), pursuant to section 174A, the unpaid unsecured pre-Moratorium debts are afforded "super priority" in a subsequent liquidation process.

Under section 115 of the IA 1986 and Rules 6.42 and 7.108, the following are the main expenses which are given priority over the company's preferential creditors, any holders of floating charges and the company's unsecured creditors:

- (a) expenses that are properly incurred by the liquidator in preserving, realising or getting in any of the assets of the company (including the conduct of any legal proceedings);
- (b) the cost of any security provided by the liquidator;
- (c) any amount payable to a person to assist in the preparation of a statement of affairs or accounts;
- (d) 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);
- (e) the remuneration of any person who has been employed by the liquidator to perform any services for the company;
- (f) remuneration of the liquidator (which is subject to effectively the same rules as those which apply to administrators, specifically including the fees estimate regime where a time costs basis for the liquidator's fees is adopted);
- (g) the amount of any corporation tax on chargeable gains accruing on the realization of any asset of the company; and
- (h) any other expenses properly chargeable by the liquidator in carrying the liquidator's functions in the winding up.

Once the payment of liabilities regarded as "super priority" and the winding up expenses have been paid, preferential creditors will accordingly be paid. Preferential debts are then classified as ordinary preferential debts or secondary preferential debts, which the former takes priority over the latter. Within their respective classes, the debts are rank equally

amongst themselves and so abate in equal proportion if the company's assets are insufficient to pay them all. Example of ordinary preferential debts is any sum owed on account on an employee's contribution to an occupational pension scheme and other employment-related payments, and example of a secondary preferential debt pertains to PAYE income tax deductions, national insurance deductions, VAT payments, construction industry scheme deductions and student loan repayments.

Once the preferential creditors have been paid, and there are more assets left to be distributed, the floating charge holder will be paid. If there are more than one floating charge holder, priority between them usually turns upon which floating charge was created first. If there is any excess of assets after satisfying the claims of the floating charge holder, the liquidator is under duty to make the net property available for the satisfaction of the unsecured debts.

Once floating charge holders are paid, the unsecured creditors, often ordinary trade creditors, will be paid.

If fortunate enough to have residual assets left after paying all those creditors in the higher order, any surplus will then be distributed amongst the shareholders in accordance with the company's constitution, which will usually permit a distribution pro rata based on the shareholders' respective equity.

In summary, the order of priority of payments in liquidation shall be as follows:-

- (a) if there is moratorium under Part A1, payment of liabilities as provided under section 174A;
- (b) expenses of winding up;
- (c) ordinary preferential debts;
- (d) secondary preferential debts;
- (e) floating charge holder;
- (f) unsecured creditors; and
- (g) shareholders]

The answer:

The question requires a brief explanation of the rights of each type of creditor/expenses as well as getting the order correct - Fixed charges will be paid first unless assets subject to the fixed charge are realised by the liquidator in which case the liquidator's costs of realisation are paid first (**1 mark**); liquidator's costs and expenses (**1 mark**); preferential debts - ordinary and secondary (**2 marks**); floating charges subject to s 176A (**2 marks**); unsecured creditors (**1 mark**). Section 174A provides that certain unpaid pre-Moratorium or Moratorium debts, such as debts owed to employees or "financial services" debts, are paid in the subsequent liquidation, in priority to even the liquidator's fees and expenses (**2 marks**).

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

Commented [DB5]: 8/15

Prior to going into compulsory liquidation on 23rd December 2022, under pressure from its bank, Fretus Bank plc, and in order to prevent it from demanding repayment of the company's loans, Marbley Q Limited ("the Company"), granted a debenture in favour of Fretus Bank plc in February 2022. 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 2022.

In July 2022, as the Company continued to suffer cash flow problems, the directors approved the sale of two (2) marble cutting machines to Rita Perkins (a director) for GBP 10,000 in cash. The machines had been bought for GBP 25,000 a year before.

A month before the winding up order was made, Rita Perkins received an email from Hard and Fast 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 marble was seen as essential by the Company, the board authorised a payment of GBP 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 GBP 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 Fretus 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] 3 marks

The floating charge in favour of Fretus Bank plc;

[Answer: The liquidator has the following options: unfair preferences by a company pursuant to section 239 of IA 1986 and **section 245** of the IA 1986.

(A) The liquidator may bring a claim of unfair preferences, if Fretus Bank plc is a **connected person** considering. Pursuant to section 239 of the IA 1986, where a company has at any relevant time given a preference to any person, the office holder may apply to court for an order of preferences under section 239 of the IA 1986. The relevant period pertains to last 6 months (if connected) and 2 years (if connected). As the transaction took place on February, more than 6 months of the onset of the insolvency (December 2022), it is necessary for the liquidator to prove that connection. Otherwise, if Fretus is unconnected, the action for preferences pursuant to section 239 of the IA 1986 may not prosper. Pursuant to section 239(6), there is a presumption on the desire to prefer.

(B) The liquidator can apply to a court for a declaration of the floating charge in favour of Fretus Bank plc to be declared invalid or avoided pursuant to section 245 of the IA 1986 for lack of no new consideration, other than the pressure from the demanding repayment of the loan.

Under section 245 of the IA 1986, a floating charge on the company's undertaking or property created at a relevant time is invalid except to the extent of the aggregate of - (a) the value of so much of the consideration for the creation of the charge consists of money paid, or goods or services supplied, to the company at the same time as, or after, the creation of the charge; (b) 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; and (c) the amount of such interest (if any) as is payable on the amount falling within paragraph (a) or (b) in pursuance of any agreement under which the money was so paid, the goods or services were so supplied or the debt was so discharged or reduced.

The aforesaid section also provides that the relevant time would be a period of 2 years ending with the onset of insolvency, if created in favour of a connected person with the company, or otherwise to any person within a period of 12 months. In the instant case, the onset of liquidation is 23 December 2022 while the floating charge is created on February 2022. It is immaterial whether connected person or not as the period falls well within either 12 months or 2 years.

On the value of the floating charge to be avoided, it will be the entire amount of the floating, except when new consideration is received then the value up to the extent of the new consideration will remain valid.

It is also worth noting that the old debt remains valid, but the effect of the declaration of the invalidity of the floating charge is that the old debt will become unsecured debt, which will therefore follow the ranks provided for unsecured creditors in the order of priority of payments during liquidation.]

Question 4.2 [maximum 6 marks] 3 marks

The sale of the marble cutting machines; and

[Answer: The liquidator may bring a claim to restore any loss of value to the company pursuant to section 238 of the IA 1986. In addition, the liquidator may brought an action for transaction defrauding creditors pursuant to section 423 of the IA 1986.

Section 238 (2) of the IA 1986 provides that where a company has at a relevant time entered into a transaction with any person at an undervalue, the office holder may apply to court for an order of declaring the transaction at an undervalue. Section 238(3) provides that the court shall, on such an application, make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction. Pursuant to section 234(4)(b), a company enters into a transaction with a person at an undervalue if

the person enters into a transaction with that person for a consideration that value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company. The relevant time will be 2 years regardless of connected or unconnected person. In the instant case, the transaction took place on July, which is within the relevant time, and the acquisition cost of the machines was GBP25,000 and the consideration provided by Rita is only GBP10,000, an amount significantly lower than the acquisition cost. Insolvency at the time of the transaction is presumed, but otherwise as indicated in the facts that the company continues to suffer cash flow problems.

With regard to the action for defrauding creditors, if it can be proven that the intention or the purpose of the transaction was to put the assets beyond the reach of creditors, including future creditors, or otherwise to prejudice their interests. Pursuant to section 423 (1)(c) of the IA 1986, a person enters into a transaction at an under value with another person if he enters into a transaction with the other for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by himself. On relevant time, there is no limit required on defrauding creditors.]

Question 4.3 [maximum 4 marks] 2 marks

The payments to Hard and Fast Ltd.

[Answer: the liquidator may bring a claim pursuant to section 239 of the IA 1986 to prevent a creditor obtaining improper advantage over the other creditors.

Section 239(2) provides that where the company has at a relevant time (6 months for unconnected and 2 years to connected person) given preference to any person, the office-holder (that includes liquidator) may apply to the court for an order of preferences under section 239. Section 239(4) provides that a company gives preference to a person if (a) that person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities; and (b) the company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done. Section 239(3) provides that the court, on such application, make an order as it thinks fit for restoring the position to what it would have been if the company had not given that preference.

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

In the instant case, (a) Hard and Fast Ltd is a creditor of the company; (b) the board approval on the payment of GBP8,000 to cover existing liabilities, agreement to pay on cash basis,

further payment of GBP3,000 had the effect of putting Hard and Fast Ltd in a better position than the position it would have been in if these payments/actions had not been done), and this was done within the relevant time, being within 6 months or 2 years of the onset of the liquidation order. The liquidator will have to prove that there was a desire to prefer, if Hard and Fast Ltd is not connected person, but desire to prefer is presumed if Hard and Fast Ltd is a connected person.]

Full answer:

Section 127 of the Insolvency Act 1986 avoids any disposition of property of the company made after the commencement of winding up, unless the court otherwise orders (1 mark). The commencement date will be the date of the presentation of the petition to wind up not the date of the winding up order so the avoidance provision acts in a backdated manner (1 mark). On facts, prima facie void but court may validate - need to explain how the court approaches such a discretion - The court will be reluctant to depart from the basic principle of *pari passu* distribution among creditors in order to validate payments or transfers made in relation to pre-liquidation transactions where the effect is to give a preference to a pre-liquidation creditor over other creditors - 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 (1 mark). Unlikely to validate payments for past supplies but may well do so for cash on delivery supplies (1 mark)

*** End of Assessment ***