



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: 202223-336.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 2023. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2023. 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 2023 or by 23:00 (11 pm) BST (GMT +1) on 31 July 2023. If you elect to submit by 1 March 2023, you may not**

submit the assessment again by 31 July 2023 (for example, in order to achieve a higher mark).

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

ANSWER ALL THE QUESTIONS

Commented [WPA1]: 42/50 = 84% an excellent effort

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

Commented [WPA2]: 10/10 excellent

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) GBP 500
- (b) GBP 750
- (c) GBP 1,000**
- (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.**
- (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]

Commented [WPA3]: 10/10

Question 2.1 [maximum 5 marks]

Commented [WPA4]: 5/5

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?

First of all, section 423 of the Insolvency Act 1986 allows the following parties to attack transactions which allegedly defraud creditors:

(i) When the company is being liquidated or is in administration, the action may be filled by the official receiver, the liquidator, the administrator and (with the leave of the court) any victim of the transaction such as a creditor;

(ii) where a victim is bound by a company voluntary arrangement (CVA), the action may be filled by the supervisor of the CVA or any victim of the transaction (whether bound by the CVA or not); or

(iii) in any other situation, by the victim of the transaction.

Secondly, the disqualification of directors, foreseen in section 6 of the Company Directors Disqualification Act 1986, aims to protect the public against the wrongdoing directors so as to assist in raising the standards of behaviour of directors. The Secretary of State may bring this action.

Finally, section 246ZB of the Insolvency Act 1986 is the legal basis for making directors of insolvent companies liable for wrongful trading. If this happens, in certain circumstances, the directors may be liable for some of the debts and liabilities of the company. The administrator may bring this action.

Question 2.2 [maximum 5 marks]

Commented [WPA5]: 5/5

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.

The Moratorium provides a stay on actions in relation to debts incurred before the Moratorium. The payment holiday restricts the company on paying most of its pre-Moratorium debts. The stay doesn't apply to debts incurred during the Moratorium. Thus, the stay applies only to pre-Moratorium debts, except in so far as they consist of amounts payable in respect of:

- (i) the remuneration or the expenses of the monitor;*
- (ii) goods or services supplied during the Moratorium period;*
- (iii) rent in respect of a period during the Moratorium;*
- (iv) salary of wages due to a contract of employment; or*
- (v) redundancy payments.*

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

Commented [WPA6]: 10/15

Question 3.1 [maximum 6 marks]

Commented [WPA7]: 4/6 a good answer but it is only of limited assistance to quote legislative provisions without explanation and application to the question asked. A little more detailed explanation would have been helpful in places.

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 speaking, the answer is yes.

First of all is important to keep in mind that the appointment of an administrator does not automatically terminate the company's executory contracts. This means that, in principle, the company's contracts remain valid and in force. Some agreements have automatic termination clauses (ipso facto clauses) which provide that if the company enters into administration, the agreement is automatically terminated. Although these clauses have historically been generally effective, nowadays there are some statutory exceptions which largely make such automatic termination clauses void.

Section 233 of the Act applies to a supply of gas, electricity, water and communications services and prohibit suppliers to require payment of outstanding debts in order to secure a new or continued supply to the company in administration. On the other hand, the administrator must guarantee payment of charges in respect of the supply.

Furthermore, section 233A sets further protection of essential supplies. For example, "(1) An insolvency-related term of a contract for the supply of essential goods or services to a company ceases to have effect if (a) the company enters administration, or (b) a voluntary arrangement approved under Part 1 takes effect in relation to the company".

Besides, Section 233A also sets that: "(2) An insolvency-related term of a contract does not cease to have effect by virtue of subsection (1) to the extent that (a) it provides for the contract or the supply to terminate, or any other thing to take place, because the company becomes subject to an insolvency procedure other than administration or a voluntary arrangement; (b) it entitles a supplier to terminate the contract or the supply, or do any other thing, because the company becomes subject to an insolvency procedure other than administration or a voluntary arrangement; or (c) it entitles a supplier to terminate the contract or the supply because of an event that occurs, or may occur, after the company enters administration or the voluntary arrangement takes effect".

Finally, the 2020 Act created a new section 233B which prohibits clauses which allow the supplier of goods or services to terminate or "do any other thing" in relation to that contract if the company enters a formal insolvency procedure. In other words, the law protects the company which enters into an administration so that it avoids the termination of important contracts to the company keep operating.

Section 233B also prohibits 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. In other others, the supplier cannot take advantage from the company financial crisis to continue supply goods and services.

Section 233B restricts the termination to all other suppliers, but there are important exceptions, like insurers and banks contracts. That's why the answer to this question is generally yes and not simply yes in any circumstance.

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. 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?

*There is an order of priority of payments foreseen in the law. Creditors are divided into classes and the payment of a certain class is only made when there is the full payment of the higher classes. Creditors of a certain class are equally treated. This is the *Par Condicio Creditorum* (equal treatment among the creditors of the same class).*

Generally, the priority of payments in liquidation obeys the following order:

(i) First of all are paid the expenses of winding up, including the liquidator's remuneration (section 115 of the Act). A number of expenses are given priority over the company's preferential creditors, any holders of floating charges and the company's unsecured creditors. In this super preferential group there are, for instance, expenses that are properly incurred by the liquidator in preserving the assets and the cost of any security provided by the liquidator;

(ii) Secondly are paid the preferential creditors, as defined in sections 386, 387 and Schedule 6: section 175. There are two classes of preferential debts, ordinary and secondary. Ordinary preferential debts are paid before secondary preferential debts. Schedule 6 of the Act list the preferential debts, which includes, for example, money owed to the employees, levies on the production of coal and steel referred to in article 49 and article 50 of the European Coal and Steel Community Treaty, claims for so much of any amount which is ordered to be paid by the company under the Reserve Forces, among many other situations. A fixed charge is also a kind of secured creditor;

(iii) After, are paid the floating charge holder and the "prescribed part". Credits secured by floating charge will be paid according to the time of the constitution and with the exception of the part not paid in result of the prescribed part. Section 176A of the Act applies when the floating charge is created on or after 15 September 2003 and the company has gone into liquidation (or administration). In this case, the liquidator (or administrator) has to make a "prescribed part" of the company's net property available for the satisfaction of unsecured debts. Besides, the liquidator

Commented [WPA8]: 6/9 another generally good answer but some points needed some further detail. Par condicio creditorum does not appear to apply to expenses. There is no explanation of secondary preferential charges. The reference to fixed charges is not explained and does not make sense in the context of preferential creditors. Some detail on s 176A would have been helpful.

or the administrator shall 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;

(iv) Afterwards are paid the unsecured creditors, which are those with no security, like ordinary suppliers;

(v) finally, if there is any asset left (in other words: if all the creditors were fully paid), any surplus is distributed to the shareholders.

However, it must be pointed out that there is a peculiarity of the Moratorium in the case that the company is not rescued as a going concern but instead enters administration or liquidation within 12 weeks of the end of the Moratorium. In this situation, the priority of debts in that subsequent administration or liquidation may be different to the priority of debts which existed prior to the Moratorium. According to Section 174A the pre-Moratorium debts are paid in the subsequent liquidation, in priority to even the liquidator's fees and expenses. This is a super priority rule foreseen in Section 174A to certain unsecured debts in a subsequent liquidation.

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

Commented [WPA9]: 12/15

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]

The floating charge in favour of Fretus Bank plc;

The liquidator can make null and void the floating charge, based on Section 245 of the Act. The Insolvency Act has some rules concerning agreements made some time before the beginning of the insolvency proceeding. The idea is to preserve the equality among creditors avoiding certain transactions made in the suspect period.

Thus, Section 245 of the Act applies when a company is in administration or liquidation and the provision is aimed at preventing pre-existing unsecured creditors obtaining the security of a floating charge shortly before a company enters a formal insolvency procedure. It doesn't forbid the company from taking a floating charge for new funding (new money), but to upgrade an unsecured creditor to a secured creditor. According to Section 245 (2) of the Act:

*"(2) Subject as follows, 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 as 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".*

Given this is not a connect party transaction, the relevant time (suspect period) is 12 months prior to the onset of insolvency. It must be pointed out that at the time of the creation of the charge the company was unable to pay its debts (section 123 of the Act).

In this specific case, the floating charge was created to give the bank a new guarantee over an existing credit in less than 12 months prior to the onset of insolvency. This new guarantee can be voided based on section 245 of the Act to preserve the equal treatment among the company's creditors.

Question 4.2 [maximum 6 marks]

Commented [WPA10]: 4/5 a good answer but again some explanation and application of the quoted legislation would have been helpful.

Commented [WPA11]: 5/6 some further explanation and analysis of certain points would have assisted eg applying the undervalue rules to the facts

The sale of the marble cutting machines; and

This is a transaction at undervalue, because the original sale was made for GBP 25,000 just a year before and the same machines were resold for only GBP 10,000. The Insolvency Law aims to treat all unsecured creditors fairly and equally. Hence, the Act permits certain transactions which were entered into shortly before the company entered formal insolvency to be open to attack. This is a connect party transaction (related party transaction) and the relevant time (suspect period) is two years prior to the onset of insolvency. It must be pointed out that the company was insolvent at the time.

Under section 238 of the Act, a liquidator may attack an undervalue transaction which was entered prior to the company entering liquidation. The liquidator must prove that "the company enters into a transaction with that person 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 the company" (Section 238 (4) (b) of the Act).

The Insolvency Law also demands that "at the time the transaction was entered into, either 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 in consequence of the transaction" (Section 240) (2)). Given that this is a transaction with a connect party, there is a presumption to the company is insolvent.

Nevertheless, Rita Perkins (the director) may defend the validity of the transaction if she proves that "that the company which entered into the transaction did so in good faith and for the purpose of carrying on its business, and at the time it did so there were reasonable grounds for believing that the transaction would benefit the company" (Section 238 (5) ("a" and "b)).

Question 4.3 [maximum 4 marks]

Commented [WPA12]: 3/4 a reasonable answer but needed to consider validation under s 127 too.

The payments to Hard and Fast Ltd.

These payments requested by Hard and Fast Ltd are not valid.

Section 233B prohibits 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. In other others, the supplier cannot take advantage from the company financial crisis to continue supply goods and services. Thus, Hard and Fast Ltd cannot demand the payment of pre-insolvency debts.

Besides, Section 127 states that in "a winding up by the court, any disposition of the company's property, and any transfer of shares, or alteration in the status of the

company's members, made after the commencement of the winding up is, unless the court otherwise orders, void".

Thus, the payments requested by Hard and Fast Ltd are not valid.

*** End of Assessment ***