



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]: 29/50 = 58%

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

Commented [WPA2]: 4/10

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.*

Commented [WPA3]: C is correct

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*

Commented [WPA4]: C is correct

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.**

Commented [WPA5]: B is correct

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 [WPA6]: C is correct

(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.

Commented [WPA7]: A is correct

(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.

Commented [WPA8]: D is correct

QUESTION 2 (direct questions) [10 marks]

Commented [WPA9]: 7/10

Question 2.1 [maximum 5 marks]

Commented [WPA10]: 2/5 the answer to (i) is incomplete and only an administrator can bring an action under s 246ZB

**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?**

*[Type your answer here]*

**(i) section 423 of the Insolvency Act 1986**

A Creditor or an affected person who is affected by a transaction below value may apply to the court for an order avoiding any transaction made at below the value of such transaction or protecting the interests of those affected by such a transaction.

**(ii) section 6 of the Company Directors Disqualification Act 1986**

CDDA 1986, s 6(1) states that '*proceedings may only be brought against a person whose conduct as a director is considered to make them unfit to be concerned in the management of a company*'.

Proceedings will be brought in the name of the Secretary of State, for voluntary winding up, or by the official receiver in compulsory winding up cases.<sup>1</sup>

**(iii) section 246ZB of the Insolvency Act 1986**

The burden of proof is on the liquidator to prove that the director knew or ought to have known that the company was in distress and there was no reasonable prospect of avoiding an insolvent liquidation. Upon proving same, the burden of proof shifts to the director to show that what he did was to take every step to minimize loss to creditors.<sup>2</sup>

Wrongful trading claims can only be brought by a liquidator / administrator or an assignee under IA 1986, ss 214 or 246ZB.<sup>3</sup>

Question 2.2 [maximum 5 marks]

Commented [WPA11]: 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.**

*[Type your answer here]*

<sup>1</sup> Directors' disqualification—pre-action protocol and considerations, Published by a LexisNexis Restructuring & Insolvency expert, Practice notes

<sup>2</sup> Guidance Text Model 3B Insolvency Systems of the United Kingdom (England and Wales) -Page 59

<sup>3</sup> Insolvency Act of 1986

In terms of Part A18 (2) are provisions which include restrictions on the enforcement of payments

Part A 18 (3) which makes reference to pre-moratorium debts where a company has a payment holiday during a moratorium which has fallen due before the moratorium or or that fall due during the moratorium, with the exception of the following:

1. the monitor's remuneration or expenses,
2. goods or services supplied during the moratorium,
3. rent in respect of a period during the moratorium,
4. wages or salary arising under a contract of employment,
5. redundancy payments, or debts or other liabilities arising under a contract or other instrument involving financial services.

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

Commented [WPA12]: 11/15

Question 3.1 [maximum 6 marks]

Commented [WPA13]: 4/6 a good answer on ss 233 and 233A but needed also to consider s 233B

***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?***

*[Type your answer here]*

The administrator acts as the company's agent and has a general power to do anything necessary or expedient for the management of the company's affairs, business and property. An administrator has the same general powers as the company and/or its directors.

An administrator acts with one or more of three statutory objectives in mind. Paragraph 3 of Schedule B1 of the Act lists the objectives .

- The first objective is to consider rescuing the company. If the administrator thinks that objective is not reasonably practicable (or thinks that a better result for the company's creditors as whole would be achieved by pursuing the second objective)
- he or she may move to the second objective, that of achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being placed into administration).



If the administrator thinks that the second objective is not reasonably practicable

- he or she may pursue the third objective, that of realizing property in order to make a distribution to one or more secured or preferential creditors (as long as he or she does not unnecessarily harm the interests of the creditors of the company as a whole).

In terms the Insolvency Act of 1986 schedule 1 (14) The administrator has the power to continue with the business.

If consideration has to been to the objectives and if the objective is to rescue the company and if the supplies are critical to the turnaround then in that event the administrator can then in terms of section 233 IA may request the continuation of the essential supply and the supplier cannot insist on the payment of any 'pre-appointment' charges outstanding as a condition to continuation. The supplier however may make it a condition that the office-holder personally guarantee the payment of any charges in respect of any period post-appointment (*section 233(2) IA*).

Whether an administrator is entitled to exercise these powers will depend on:

- (i) whether the supply falls within the scope of 'essential supplies' under section 233 IA; and
- (ii) the date the essential supply contract was entered into by the parties.

The type of supplies being essential supplies are listed in section 233(3) IA and consideration being given to the amendments made by The Insolvency - Protection of Essential Supplies Order 2015:

- Electricity
- Gas
- Water

The supply of communication services falls under section 233(3)(e) IA.

- Communications services
- Information Technology
- point of sale terminals;
- computer hardware and software;
- information, advice and technical assistance in connection with the use of information technology;
- data storage and processing; and
- website hosting.

The administrator should consider a due diligence with regards to contracts of these suppliers which may be subject to:

- date of the supply contract which may affect certain criteria of the terms and conditions;

- any non-insolvency related terms in the contract upon which the supplier may seek to rely to terminate the essential supply contract or exercise other rights;
- is there a single agreement for the provision of a wide variety of different services and they way this may impact the supplier's ability to terminate or increase prices , especially if individual supplies that fall outside of the essential supply regime and can the termination of these supplies affect the continued provision of the other essential supplies.
- The supplier being a foreign company, and is governed by a foreign law, the cross border aspect to be considered.

Administrators must notify essential suppliers of the administration and also to keep suppliers informed of intended future use of the essential goods / services and updated on any further changes in the supply needs of the business during the administration. These charges incurred under a contract continued at the discretion of the administrator will constitute as an administration expenses.

**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?***

*[Type your answer here]*

In terms of Section 115 of the Act and the rules 6.42 and 7.108 respectively of the Rules, there are expenses that are given priority over the company's preferential creditors, holders of floating charges, if any and the company's unsecured creditors.<sup>4</sup>

The main expenses which are payable in priority to those creditors and are payable in the following order of priority:

- expenses that are appropriately incurred by the liquidator in preserving, realizing any of the assets of the company ,including the conduct of any legal proceedings;
- the cost of the security provided by the liquidator;
- any amount payable to a person who assist in the preparation of a statement of affairs or accounts;
- the remuneration for services to the company to any person who has been employed by the liquidator, and including the remuneration of

<sup>4</sup> Guidance text – insolvency System of the United Kingdom (English and Wales) – Page 51

**Commented [WPA14]:** 7/9 generally a strong answer. It is not made clear how fixed charge holders are or are not dealt with in the liquidation. Section 176A needed to be explained.

the liquidator,

- any disbursements that may be necessary by the liquidator in the course of the winding up.

In terms of the Insolvency Act 1986, Creditors are ranked as follows:

1. Secured creditors with a fixed charge - Are often banks and other asset-based lenders who hold title over a business asset. In this instance the company loses the right to sell or trade the item. Assets typically covered by a fixed charge include property, plant, machinery, and vehicles. The asset can be sold by the charge-holder or liquidator to realize funds.
2. Preferential creditors- include employees entitled to arrears of wages up to a maximum of £800, and holiday pay.
3. Secondary preferential creditors In terms of the new legislation on 1 December 2020, HMRC moved up the order of priority from unsecured creditors to secondary preferential. There are certain specified HMRC debts which are included. These are:
  - Value Added Tax (VAT), and debts that relate to the following taxes:
  - Pay As You Earn (PAYE) Income Tax
  - Employee National Insurance contributions (NICs)
  - Student loan repayments
  - Construction Industry Scheme deductions

The above debts are only preferential if the insolvent business entered a formal insolvency procedure on or after 1 December 2020.

4. Secured creditors with a floating charge- assets that are subject to a floating charge often include stock, raw materials, work-in-progress, fixtures and fittings – basically any other assets not subject to a fixed charge. Assets of this type can be traded in the normal course of business. Floating charge creditors are entitled to receive a distribution from the amount remaining after the application of costs.
5. Unsecured creditors – are trade creditors, suppliers, customers, contractors, some staff claims, rent arrears and lease dilapidations, unsecured loans from banks and lenders, unsecured overdrafts, friend and family loans to the business, directors loan accounts that are in credit, and the shortfall on any fixed or floating charge.
6. Shareholders are the final group to be paid due to them having taken a business risk in providing money to the company, they are not entitled to a distribution until all other creditor groups have been paid.

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 then in

that event the priority of debts in that subsequent liquidation may be different to the priority of debts which existed prior to the Moratorium.<sup>5</sup>

In terms of Section 174A of the Insolvency Act provides that certain unpaid debts which are not part of the payment holiday, eg. debts owed to employees or “financial services” debts, are paid in the liquidation, are priority to even the liquidator’s fees and expenses. This section affords certain unsecured debts a form of “super priority” in a subsequent liquidation. A director who did not get paid prior to a moratorium and that leads to a failed rescue and thereafter the company is liquidated the pre-moratorium unsecured debt of the Director will acquire “super priority” in the liquidation.

Also a pre-Moratorium bank debt, be it secured or un-secured which falls within the definition of “financial services”, will acquire such a “super priority”.

The exception of such “super priority” is when a pre-moratorium financial service debt is an accelerated debt, for example:

- it fell due by an acceleration clause; or
- when there is an early termination clause in the agreement.

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

Commented [WPA15]: 7/15

***Prior to going into compulsory liquidation on 23<sup>rd</sup> 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 14<sup>th</sup> 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.***

<sup>5</sup> Guidance text – insolvency System of the United Kingdom (English and Wales) – Page 39

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;**

*[Type your answer here]*

The security may be a Floating Charge which is said to float or hover above a class of assets until such time that it becomes fixed in nature when it is said to Crystallize. This means that the company is free to use these assets whilst they are trading in the normal course of business. It is only in the instance that the company faces financial difficulties, is put into liquidation or fails to repay back agreed amounts that the floating charge is then applied and crystallized to specific assets, in this case being 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, including any document executed by a company which creates or acknowledges a debt.

The debenture is a document that sets out the terms and conditions of a loans and further it provides clarity and security to lenders if the borrowing company becomes insolvent. Attaching a floating charge to the debenture offers further benefits, enabling the holder to rank above unsecured creditors when it comes to repayment.

Further, a floating charge usually gives the secured creditor the power to appoint and administrator who will take control of the charged assets and will attempt to realise them to pay off the secured creditor.

The power to appoint an administrator is available to the holder of a Qualifying Floating Charge (appointment of administrator without a court order, paragraph 14 of Schedule B 1)<sup>6</sup> which is a charge over the whole or substantially the whole of a company's property, both present and future. which will usually prevent a liquidator being appointed until the administration is completed. It is possible for such a charge holder to consent to the appointment of a liquidator rather than an administrator, in which case the liquidator may realize the charged assets as part of the liquidation and pay out the floating charge holder according to the charge holder's priority.

Before any payment can be made to any floating charge holder, the liquidator must first consider the application of section 176A of the Act. Section 176A applies to a company with a floating charge created on or after 15 September

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<sup>6</sup> Insolvency Act 1986

**Commented [WPA16]:** 2/5 the answer does not explain in any detail the possible causes of action available. Section 239 is not feasible due to the dates. Section 245 required a deeper analysis and application.

2003 and the company has gone into liquidation. In application to the above case where the prescribed part is the part of the proceeds that must be set aside and made available to satisfy unsecured debts on realizing assets covered by a floating charge.

The liquidator (or administrator) is under a duty to make a “prescribed part” of the company’s net property 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. For this purpose, “net property” is the amount of the company’s property which otherwise would be available for the satisfaction of debts of floating charge holders.

The principle of *pari passu* distribution is a fundamental principle in corporate insolvency ie. that all creditors of a certain class within the statutory scheme should be treated equally in the distribution.<sup>7</sup>

The bank, by its gained improvement of its position, will cause a detriment to the general body of creditors, thereby distorting the ‘equal treatment’ of all those within the general body of creditors. This may affect the proper distribution of the general pool of assets to the creditors.

Within the 12 months prior to the onset of insolvency and the company must be insolvent at the time or 2 years prior to the onset of insolvency where the floating charge holder is a connected person.<sup>8</sup>

In the above case the Company granted a debenture in favour of Fretus Bank plc in February 2022 and a compulsory Liquidation was entered into on 23 December 2022, some 10 months later, the test here is whether the company was solvent at the time they granted the debenture. If the company was solvent the debenture will by application of law crystallize, if not the liquidator will have to in terms of Section 239 of the IA 1986 to seek relief where that company has given a preference and certain conditions are met.

The main provision, s239 of the Insolvency Act 1986 (‘the Act’) has proved an effective weapon in a liquidator or administrator’s hand to deal with prohibiting preferences in the above.

S239 only permits applications to Court to be made in respect to an allegedly voidable preference that has occurred within the ‘relevant time’. ‘Relevant time’ breaks down into two mandatory preconditions - the preference must have occurred during the operative period; and while the company was in a state of insolvency.

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<sup>7</sup>Article – Understanding 239 Preference Under Insolvency Act 1986, Simon Hill, 30 January 2014

<sup>8</sup>Guidance text – insolvency System of the United Kingdom (English and Wales) – Page 91

The liquidator herein will be required to analyze these factors to be able to determine preference.

**Question 4.2 [maximum 6 marks]**

**Commented [WPA17]:** 5/6 not entirely relevant to the question asked but the discussion of s 238 is generally very sound.

**The sale of the marble cutting machines; and**

*[Type your answer here]*

*“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.”*

In order to determine a disposition the understanding thereof is required.

“Disposition of property” in terms of section 127 of the Act has been given a wide meaning:

- affect any payment of money
- assets being sold or transferred.
- where property ceases to be vested in a company in terms of a transaction, for example way of sale, gift, assignment, mortgage, charge, lease, loan or exchange.<sup>9</sup>

It can be seen here that the machine cease to vest in the company buy way of the sale.

Further to the above the relevant time in terms of S 238 and 239 is set out which clearly records different scenarios that could lead to the relevant time being determined for a transaction that was one at undervalue. In this case Section 240(1) (a) and Section 240 (3) (a) is applicable to determine the relevant time.<sup>10</sup> which is in the period of two years prior to the commencement of the liquidation.

The prerequisite of a liability under section 238 is that at a time the transaction was entered into, the company was either unable to pay its debts as they fell due as stated in S 123 or was unable to pay its debts due to this very transaction. This prerequisite stands whether the transaction is with a connected person or not. Where the transaction is with a connected person to the company, the company is presumed to be insolvent or became insolvent as a result of this transaction, unless proved otherwise. In this case it has been sold to a director.<sup>11</sup>

Apart from the factual matrix of this matter, a valuation will be required to demonstrate to the court the disposition and that was a transaction at undervalue, due to the fact that machine was purchased for GBP 25 000 and sold a year later for GBP 10 000 to the Director(connected party).

If the court, concludes that there has been a transaction at an undervalue and

<sup>9</sup> Guidance text – insolvency System of the United Kingdom (English and Wales) – Page 65

<sup>10</sup> Insolvency Act of 1986

<sup>11</sup> Guidance text – insolvency System of the United Kingdom (English and Wales) – Page 65

or a preference, the court would make an order restoring the position to what it would have been if the preference had not been given, or the transaction not entered.

If there is a presumption that the company was insolvent at the time of the transaction. This presumption is capable of being rebutted by evidence of solvency.

In the alternate and if the court be satisfied that the transaction was entered for the purpose of carrying on its business in the normal course and in good faith, and that at the time it 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.

Section 241 affords protection, to certain persons by which provides that an order shall not prejudice any interest in property which was acquired in good faith and for value, and such was acquired from a person other than the company.

Further to the above or as an alternative Section 246ZD of the Act and in particular S 246 ZD (1) (b) and S 246 ZD (2) (c) and (d) gives the liquidator the Power to Assign.

*In the two years prior to the onset of insolvency which in a liquidation will be the date of the petition for a compulsory liquidation The company must have been insolvent at the time (or it must have become insolvent due to the transaction).<sup>12</sup>*

In insolvency procedures such as liquidation involve the appointment of an insolvency office-holder whose primary duty is to get in the property of the company or individual, and realise the value of that property for the benefit of creditors. In some circumstances, this may be best achieved by an assignment which is dependent on the facts and the situation of the company.

A Liquidator may assign a cause of action because he has insufficient funds to pursue it on behalf of the estate.

He does not consider it to be worth pursuing on behalf of the estate in light of the prospects of success or recovery, the factual complexity or the time required to pursue litigation.

It is an effective way to realise value for the insolvent estate.

If there is a presumption that the company was insolvent at the time of the transaction. This presumption is capable of being rebutted by evidence of solvency.

If there is a presumption that the company was influenced by a desire to prefer the connected person which is capable of being rebutted by evidence to the contrary (in contrast to section 238, there is no presumption of insolvency).

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<sup>12</sup> Insolvency Act of 1986



Question 4.3 [maximum 4 marks]

**The payments to Hard and Fast Ltd.**

[Type your answer here]

***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 Avoidance transactions are the financial deals done by a debtor, which put the creditors at a disadvantage or give preference to some creditors over others. A preference claim is brought by the liquidator against creditors paid within a certain period prior to the debtor filing for bankruptcy. These claims are sometimes referred to as "claw-back" claims.<sup>13</sup>

Section 239 of Act 1986 relates to preferences which may be avoided by the court on the application of a liquidator. This section has a number of defined terms in common with section 238 of the Act which enables a liquidator to obtain an order that may be available to the court under section 238 and 239 of the Act.

The purpose of section 239 of the Act is to prevent a company, from placing one of its creditors in a better position than others shortly before entering a formal insolvency procedure.

Some of the preferences that are prevented, eg. a payment in full or a higher dividend than expected as an unsecured creditor. This can open up to attack a security given to a creditor, or other property of the company made available to the creditor, who previously only had priority as an unsecured creditor.

Specifically to this matter in terms of Section 239(5) a court shall not make an order under this section in respect of a preference given to any person unless the company which gave the preference was influenced in deciding to give it by a desire to produce in relation to that person the effect mentioned in subsection (4)(b).<sup>14</sup>

The burden of proof in relation to each of the above matters normally rests with the officeholder. The test for a connected person being preferred is different

<sup>13</sup> Article – Understanding 239 Preference Under Insolvency Act 1986, Simon Hill, 30 January 2014

<sup>14</sup> Insolvency Act of 1986

**Commented [WPA18]:** 0/4 unfortunately, the answer misses the point of the question which is s 127. Section 239 cannot apply as the payments took place after the commencement of liquidation not in the period prior to the commencement.

and not relevant to this matter above as it was a supplier/creditor.

In order to determine the preference and what was done to “create” a preference, and the fact that pressure was applied by the creditor wherein Hard and Fast Ltd., the company’s key 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, and due to the fact that the continue supply of marble was essential to the company it is not relevant. Pressure should be considered relevant only to whether there is the requisite desire.

The relevant time within which a preference needs to have been given to come within section 239 of the Act is within the six months prior to the onset of insolvency if it is in favor of a person not connected to the company.

At the time the preference was given, either the company was unable to pay its debts as they fell due within the meaning of section 123 of the Act or became unable to pay its debts.

The need to show the company was influenced by a desire to prefer the creditor is the most difficult requirement to establish, wherein the company must have been influenced by the desire to put the preferred party should in the event of the company going into a liquidation, and would be better than the position he or she would have been in if the preference had not been given.

Millett J. in the case, *Re MC Bacon Ltd*<sup>15</sup> provided some guidance with regards to the meaning of the relevant desire where he drew a distinction between intention, which is an objective concept, and desire, a subjective one:

*“A man is taken to intend the necessary consequences of his actions [but a] man can choose the lesser of two evils without desiring either.” Therefore, an intention to grant security to a creditor necessarily involves an intention to prefer that creditor in the event of insolvency. However, even though the granting of the security must necessarily prefer the creditor in the event of insolvency this will not, by itself, amount to a desire to prefer.”*

Here the directors did not want to improve the banks position, but simply wished to continue trading.

In the subsequent case, it was been held there could be no desire to prefer where the company was influenced by commercial considerations only, which specifically attempts to ensure that the company continued trading.

In the above case and at face value of the facts provided it can be seen that the Board approved the payment so that the company could continue trading. What is not clear is at the time when the board made a decision to pay was S

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<sup>15</sup> [1990] BCC 78.

123 of the Act considered.

The desire to prefer is presumed unless the otherwise is shown, where the preference is given to a person connected with the company.

The presumption helpful and it is rare for an action to be brought under section 239 of the Act unless the person whom it is alleged has been preferred is a connected person, but in the above case it is a supplier.

Section 43(3) provides that a transaction will not qualify as preferential transaction if it is done in in the ordinary course of the business or financial affairs of the 'corporate debtor or the transferee.'<sup>16</sup>

**\* End of Assessment \***

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<sup>16</sup> Insolvency Act of 1986