



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

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

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.**

Commented [WPA1]: 38/50 = 76% a generally strong performance

Commented [WPA2]: 10/10 excellent

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 under s 6 the SoS has the power to bring an action but does not have the power to disqualify directors as such

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?

(i) Under section 423 of the Insolvency Act 1986, various parties may attack certain actions that have the purpose of defrauding creditors depending upon whether the company is in Liquidation, Administrations or a CVA. In Liquidation or Administration, parties who may bring actions include, among others, the official receiver, the liquidator and the administrator, or, for example a creditor or other victims, the latter two, however, must have court approval for bringing such actions.

When a company is in CVA, and a victim is bound by the CVA, the CVA supervisor, and in a case a victim is bound or not by the CVA, the victim itself. In any other proceedings, a defraud victim affected by the transaction.

(ii) Under section 6 of the Company Directors Disqualification Act 1986, Liquidators and Administrators have a duty to report any directors they believe to be "unfit" to hold the position of a director under the CDDA. The Secretary of State upon review of such a report whether to take action against the director and the court has the power to disqualify directors pursuant to the CDDA.

(iii) Under section 246ZB of the Insolvency Act 1986 authorizes the Administrator when a company is in administration, to bring actions against former directors for "wrongful trading." Section 246ZA applies to "fraudulent trading." Although this remedy has historically been only available to liquidators when a company was in liquidation, the Small Business, Enterprise and Employment Act now addresses both for when a company is in Administration.

SOURCE THROUGHOUT THIS ASSESSMENT, UNLESS OTHERWISE INDICATED: Module B3 Guidance Text

Question 2.2 [maximum 5 marks]

Commented [WPA5]: 5/5 rent during the moratorium

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.

Under Part A1 of the Insolvency Act of 1986, the following 5 debts do not form part of the "Payment holiday," a so described restriction for a company in a moratorium to pay pre-petition debts. The company in Moratorium, however, must remain current on its post-petition obligations during the Moratorium. Excluded from the "payment holiday" are:

- (a) certain remuneration or expenses of the monitor;**
- (b) amounts for goods or services that were supplied during the Moratorium;**
- (c) certain rent payments;**
- (d) wages or salary due under employment agreements;**
- (e) redundancy payments; or**
- (f) certain debts or other liabilities related to "financial services."**

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

Commented [WPA6]: 10/15

Question 3.1 [maximum 6 marks]

Commented [WPA7]: 4/6 the answer is a little general and would benefit from considering in more detail the provisions found in ss 233, 233A and 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?

Generally, the commencement of an administration does not automatically terminate executory contracts and certain clauses oftentimes contained in such agreements, for example *ipso facto* clauses, have found to be inapplicable. As such, the contracts continue during the pendency of an administration in most cases absent certain exceptions. Section 233 of the Act also applies to supply contracts, including the supply of goods and services. The 2020 Act further, in Section 233B, prohibits a supplier to terminate, among other things, the contract in the event a company enters a formal insolvency proceeding. Unless the administrator consents to the termination of the contract, the supplier may not terminate it. In other words, and in response to this question, the administrator may require the supplier to continue under the contract. Importantly, the supplier must do so without requiring the payment of pre-petition arrears or any other conditions.

These requirements are very similar to the provisions regarding executory contracts included in the US Bankruptcy Code and under established case law in respect thereto.

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?

In a liquidation, the liquidator, when making distributions of proceeds, must follow a certain "waterfall" set forth in the Act. Pursuant to section 115 of the Act as well as Rules 6.42 and 7.108, certain creditors receive priority in distribution ahead of unsecured creditors and holders of floating charges, equity holders, among others. The Act contains a specific order the Liquidator must adhere to when making distributions.

Before any distribution may be made, however, a creditor must prove the legitimacy of its claim by submitting a proof of debt setting forth, with supporting documentation, why it is entitled to payment of a particular amount and priority.

The order of priority set forth in the Act provides as follows:

First must be paid any expenses in connection with the liquidation proceeding pursuant to section 115 of the Act and Rules 6.42 and 7.108.

After the expenses for the liquidation proceedings have been satisfied pursuant to the above, certain preferential creditors (ordinary and secondary) are next in line to receive a distribution ahead of floating charge holders and unsecured creditors.

This class of creditors consists, among others, of employees and taxing authorities, among others. Importantly, the Act prescribes limits to such claims.

Ordinary debts must be satisfied ahead of secondary debts and in each class, the debts must be satisfied proportionally if the assets of the company are insufficient to satisfy them all.

Commented [WPA8]: 6/9 a reasonable answer but again one which would have benefitted from further detail in places eg there is no mention or explanation of the s 176A prescribed part

Following the satisfaction of all of the above claims, as applicable, next in line to receiving a distribution of the company's assets are floating charge holders and unsecured creditors. Floating charge holders, if multiple, are paid pursuant to the ranking/timing of the creation of their liens.

Next in line are distributions to unsecured creditors; however, very often, they will not receive any distribution if the proceeds of the liquidation have already been distributed as described above. The same applies to shareholders who rank in the "waterfall" even below unsecured creditors. However, in cases with surpluses after all other distributions have been made, remaining proceeds will be distributed to shareholders pursuant the company constitution and pro rata.

Notably, creditors may diverge from the statutory regulated "waterfall" above by entering into a subordination agreements. Oftentimes lenders, prior to agreeing to provide financing to a company in need, may demand such an agreement in order to receive a higher priority. Such agreements do not alter the ranking among creditors who are not a party to the subordination agreement.

Moratorium under Part A1 of the Insolvency Act 1986 during the 12-week period prior to the commencement of the Liquidation

Even with good intentions to rescue a company, not all Moratoria succeed and a liquidation follows. In such a case, the distribution "waterfall" set forth in the Act and the Rules does not necessarily apply the in the same manner; it might be different. For example, certain payments that were not included in the "payment holiday," for example payments to employees, will be paid in a liquidation following a Moratorium even ahead of the fees for the liquidator. The same applies for directors that remained unpaid prior to a Moratorium, among others.

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

Commented [WPA9]: 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]

The floating charge in favour of Fretus Bank plc;

Importantly, and as applicable here, where a creditor filed the winding up petition on 14 October 2022, and the Court issued its winding up order on 23 December, 2022, the liquidation proceeding is deemed to have commenced on October 14, 2022. This is critical to the answers to all three questions related to this fact pattern.

The Floating Charge - granted in favor pf Fretus Bank in February 2022 (pre-petition)

Generally speaking, especially in Liquidation cases, the Liquidator has to carefully investigate, among other things, the conduct of the officers and directors during the time leading up to the Liquidation. Unfortunately, oftentimes, there is little to no money for the Liquidator to sue the appropriate party because of a lack of funding. Increasingly, liquidators use the help of certain litigation funding firms, third parties, who may then themselves sue to defendant(s).

1. The Liquidator might be able to bring a misfeasance action against the company for which section 212 provides now a summary procedure to simplify the process. The Liquidator could argue that the company in granting the floating charge breached various duties, including, but not limited to a breach of fiduciary duty. The fact pattern is unclear as to whether the directors and officers in February 2022 were already aware of the level of financial distress the company would soon be under. The defendants could argue in defense that they acted in the best interests of the company. If the court believes that the directors acted in fact honestly, it might relieve the defendant(s) of liability under section 1157 of the Company Act of 2006.

2. The Liquidator could possibly bring an action for "wrongful trading" under section 214 of the Act. Once directors become aware of the insolvency and that an action

Commented [WPA10]: 3/5 a very general answer lacking specific detail. Most of the suggested causes of action are not realistic eg the suggestion that the bank is a connected person for the purposes of s 239 is not likely and fails to consider the definition of a connected party. Section 245 is the only realistic option and although explained in outline, again there is a lack of detailed explanation and application.

might be looming or be inevitable, they have a duty to do anything in their power to minimize potential losses to the company. Assuming under the facts, the directors knew already of the looming insolvency, the Court might order them to make a contribution to the company. Before ordering such contribution, usually in the amount of the increased liability, the Court must be satisfied that certain requirements are met: (1) that liquidation has begun; (ii) that the person who made the decision was a director and that the director knew or should have known that a liquidation would not be avoidable.

Again, the fact pattern here is unclear as to what extent the company/directors knew of the looming insolvency. They acted under the pressure of the bank that demanded repayment, but the facts do not state any other details.

3. The Liquidator could possibly bring a preference/avoidance action against the Bank under section 239. The provision is aimed at preventing that one creditor will be preferred over another shortly before the commencement of proceedings. The section also applies to creditors who will receive a security even though they previously only enjoyed the status of an unsecured creditor.

Generally speaking, the burden of proof rests with the Liquidator as the office holder; however, in cases in which the preferred creditor is a connected person, a presumption applies in favor of the company that it was influenced by the creditor. Here, the Bank had previous dealings with Marbley as its lender and will therefore likely be found to be a connected person. The Bank, pursuant to the facts, exercised a good amount of pressure to get the company to grant the floating charge. However, such pressure is usually not relevant absent requisite desire. The issue of connectivity is, however, a decisive factor here because there are time limitation as to when a preference action might be pursued. The floating charge was granted in February 22, 2022 and the creditors filed a petition on 14 October 2022, about 8 months later. This is critical as the preferential transaction in connection with a connected person must have occurred within 2 years of the onset of the insolvency while a preferential transaction must have occurred within 6 months prior to the onset of insolvency. Should the Bank not constitute a connected person, the time to bring a preference action would have passed.

Assuming the bank will be found to be a connected person, the preference action could be brought by the Liquidator. The next issue, in connection therewith, would be for the liquidator to prove the company's desire to prefer the creditor.

4. The Liquidator might also bring an action under Section 245 of the Act that specifically applies to floating charges only. The section of the Act aims at preventing floating charges the company granted shortly prior to the commencement of the liquidation. The question is whether the granting of the floating charge 7 months prior to the petition can be considered "shortly" though. Whether the Bank would be determined to be a connected or unconnected person does not matter for this action as actions related to floating charges to unconnected person within 12 months prior to the insolvency proceeding if certain requirements have been met.

The Court could find the floating charge valid to the extent it provides "new" consideration.

Section 245 sets forth two main categories of "new consideration" pursuant to, if satisfied, the court would not invalidate the floating charge.

Notably, the floating charge can only found to be invalid if the company goes into liquidation, which the company under the facts of the case here did. Therefore, anything in connection with the floating charge that occurred prior to commencement of the liquidation is not invalidated and the debt remains valid.

Question 4.2 [maximum 6 marks]

This incidence occurred in July 2022, prior to the petition date of 14 October 2022. Pursuant to the facts, the company, including Ms. Perkins, was already aware of the financially distressed situation of the company. In cases of compulsory liquidation, the Liquidator acts as an officer of the court and has various duties, including, but not limited to, investigating acts of former officers and directors. He or she must take a close look at whether, among other things, misfeasance or other wrongdoing occurred leading up the insolvency proceeding. These investigations often lead to actions taken by the Liquidator for various forms of breach of duty.

Here, the directors approved the sale of the machines shortly before the Petition Date and Director Perkins purchased the machines, likely under market value. The Liquidator might be able to bring a misfeasance action against the company for which section 212 provides now a summary procedure to simplify the process. If successful in his/her action against the directors, the court might enter an order for repayment or contribution. However, the directors, in their defense, might argue that they acted in the best interest of the company as they attempted to approve its cash flow. Section 1157 of the Companies Act 2006 allows the court to relieve a director of its liability for certain duty breaches, among other things, if all the circumstances considered lead the Court to hold that the director should be relieved of its liability.

2. Further, the disposition of the machines might be void unless the Court validates the sale pursuant to section 127. Although the company is still the rightful owner of the machines, upon the commencement of a liquidation, the creditors are entitled to a distribution, so the power of the company to deal with its own property differs now from prior to the commencement of the liquidation. As stated above, the commencement date under the facts is 14 October 2022 when the creditor filed the petition. As such, the disposition of the machines occurred during the pendency of the liquidation. Importantly, the Court has discretion in deciding whether a certain transaction should be void. The directors could apply for a "validation order" to have the court declare the transaction not to be void. If the court, among other things, finds that the disposition was made for the general good of all creditors, it might grant the order.

Under the facts of the case, this is questionable, however, as the machines have been sold for much less than what they were purchased for only the year prior. As explained in the Guidance Text, courts normally validate transactions that increase the value of the company's assets, but actions that harm, will not be validated. Combined with the

Commented [WPA11]: 1/6 again there is poor identification of issues - s 127 cannot apply as the transaction occurred prior to the commencement of the winding up. Section 238 is a viable cause of action but the consideration of s 238 is far too thin.

important concept of pari passu, the Court here is likely to deny a validation order if pursued by the company. The concern of the directors and their intent to help with the cash flow will likely not be sufficient to convince the court to rule in their favor.

3. The Liquidator may also challenge the transaction under section 238 of the Act, because the transaction at issue occurred prior to the commencement of the petition in July 2022, and the transaction was for a significantly less value than what the company had originally been paying for.

Question 4.3 [maximum 4 marks]

Commented [WPA12]: 4/4 - the grade here takes into account the earlier discussion of s 127.

The payments to Hard and Fast Ltd.

As described in detail elsewhere in this assessment, suppliers are not allowed to terminate contracts in the event an insolvency proceedings is commenced, even though a particular contract might provide to the contrary. Initially, these protections were only applicable to Administration proceedings. However, the 2020 Act expanded these protections with the inclusion/implementation of section 233B of the Act to other insolvency proceedings; however liquidations are not among them.

However, the Liquidator might bring an action similar to the action with respect to the machines against the directors above. However, if the directors move for a validation order, here, in contrast to the machines, the Court might grant the order under section 127. As explained above, under section 127, any disposition of property made after the commencement is void, unless otherwise ordered.

Here, the directors determined that Hard and Fast is essential to the Company's ongoing operations. The Court might find that the directors acted in good faith in connection with this transaction. Further, according to the Guidelines provided in the Guidance Text, the Court would likely take into consideration that the continued supply from Hard and Fast allowed the company to continue operating in the ordinary course, therefore validating the disposition. Of course, if Hard and Fast was the only creditor who received payments like the ones explained, the Court might nevertheless find that Hard & Fast was treated unequal to other trade creditors, if any, and therefore deny the validation order.

RESPONSE TO 4.1, 4.2, and 4.3

The Court might also find the directors unfit under the Company Directors Disqualification Act 1986 (CDDA). The regime contained in the CDDA aims at protecting the public from wrongdoing by directors and raising the standard in connection with the behaviour of directors. Section 6 of the CDDA is most commonly the ground upon which a disqualification order is sought. The section is based on directors' wrongful trading while the company is insolvent, but also applies in situations of fraud or allegations of preferential treatment of creditors.

Commented [WPA13]: This is not an action the liquidator can bring

As explained above, the above transactions subject the directors to a disqualification charge. More fact and evidence would be needed to determine the likelihood of such a finding, however.

*** End of Assessment ***