



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]: 35/50 = 70% a generally good attempt with some lack of detail and accurate identification of issues in Q4.

Commented [WPA2]: 7/10

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.**

Commented [WPA3]: D is correct

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.*

Commented [WPA4]: A is correct

(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

Commented [WPA5]: C is correct

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 [WPA6]: 8/10

Question 2.1 [maximum 5 marks]

Commented [WPA7]: 3/5 Although the answer contains many accurate comments, the answer to (iii) is incorrect - only an administrator can bring an action under s 246ZB. The answer to (i) is reasonable but not specific as to exactly who can bring an action in what circumstances.

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. *Section 423 of the Insolvency Act deals with transaction defrauding creditors. This is a public policy principle which renders void any transaction which was conducted at undervalue and into which the company entered with a view to putting assets outside the reach of creditors or otherwise prejudice the interests of an affected person, usually a creditor. Action pursuant to this section may be brought even though the company is not insolvent or engaged in an insolvency proceeding. It need not be brought by an insolvency office holder (unless the company is in an insolvency proceeding) but can be brought by a victim of the fraud. Any action pursuant to this section is treated as an action on behalf of all victims.*

- ii. *Section 6 of Company Directors Disqualification Act was designed to protect the public and companies by laying down standards by which directors are expected to abide. The application can be brought by the Secretary of State or against any person who is likely to have contravened the provisions of the Act. With the permission of the Secretary of State, the Official Receiver may bring proceedings against a director of a company being wound up in England and Wales. The most common charge under this section is that the director caused the company to continue trading despite being aware that it was insolvent.*

- iii. *Section 246ZB of the Insolvency Act relates to wrongful trading on the part of a director. The section must be read in conjunction with section 214. In order to satisfy this section, it must be shown that (1) the company is in insolvent liquidation, (2) that prior to insolvent liquidation, the director knew or ought reasonably to have known that insolvent liquidation was unavoidable and (3) that conclusion was reached or ought to have been reached when the director was in office. This application can only be made by a liquidator.*

Question 2.2 [maximum 5 marks]

Commented [WPA8]: 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 debts which are not part of the payment holiday under Part A1 are set out section A18(3) and include:

1. **Goods and services supplied during the moratorium**
2. **Wages and salaries under employment contracts**
3. **Employee redundancy payments**
4. **Rent during the moratorium period**
5. **Debts or other liabilities in respect of financial services**

It should be noted that these debts are also accorded priority status where the company enters liquidation within 12 weeks of the end of the moratorium.

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

Commented [WPA9]: 12/15

Question 3.1 [maximum 6 marks]

Commented [WPA10]: 6/6 a very clear and complete answer

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?

The first point to note is that existing contracts between a company and its suppliers are not automatically terminated once an administrator has been appointed. The continuation of these contracts is dependent on the nature of the activity that the administrator intends to conduct in the administration, namely, whether he intends for the company to continue trading.

Secondly, this area of law has seen significant changes over the last decades - flowing from the global financial crisis in 2008 and the COVID pandemic in 2020. The result has been an attempt by Parliament to reduce the circumstances in which suppliers are entitled to terminate a contract with a company that goes into administration or another insolvency procedure and to provide for the continuation of a supply of goods and services in markedly different terms.

The effect has been that an administrator who wishes to continue trading and therefore, needs to secure the supply of certain necessary goods and services has the ability to do so as a result of the following:

- a. *Contractual terms which provide for the automatic termination or alteration of supply contracts with a company that enters administration have largely been neutered as per section 233 of the Insolvency Act by which suppliers are prohibited from requiring payment of outstanding debts in order to continue providing the listed services which include the supply of utilities (water, electricity, gas and telecommunication services) are concerned. The definitions of these services are very wide, particularly the telecommunications definitions which includes advisory services, website hosting and data storage and processing services. The expansive definitions reflect the importance of these goods and services to a company's daily operations.*
- b. *With the advent of sections 233A of the insolvency, suppliers can no longer rely on contractual terms which would otherwise have allowed them to terminate the supply or alter the terms on which that supply is made or compel higher payments in order for the supply to be maintained.*

c. *These restrictions were taken one step further with the introduction of section 233B which nullifies contractual clauses which allow the supplier to terminate the contract if the company enters a formal insolvency such as administration. The effect of these amendments and protections is to enable to companies to trade without having to put up additional security or pay higher prices simply based on the fact that they may be in a formal insolvency procedure. However, the administrator should note that pursuant to section 233 a supplier may require that he gives personal guarantee in respect of the supply of services which guarantee can be enforced in the event that the company in administration fails to pay.*

Further, a supplier may also apply to the court to release him from the contract on the basis that its continuation is causing him undue hardship. In those circumstances, it may be difficult to obtain an alternative supplier given the conditions identified above.

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?

The overall purpose of the liquidation process is to call in all possible assets of the company with a view to ultimately settle all existing debts as far as the circumstances allow. Given the creditors are prevented from taking individual actions against the company, the role of the liquidator is even more important as he owes an obligation to the creditor to distribute the assets of the company according to law.

Once the liquidator has completed his realisation of the company's assets, he must then distribute in accordance with the statutory order.

The first payments that must be made are those relating to the liquidation itself including the liquidator's remuneration. This is a specific requirement of section 115 of the Insolvency Act and rules 6.42 and 7.108 of the Insolvency Rules. There is an internal order of priority which is as follows:

- 1. All expenses incurred by the liquidator in realising or preserving the company's assets;*
- 2. Costs of any security provided by the liquidator*
- 3. Fees incurred by persons who prepared statement of affairs*
- 4. Reasonable disbursements relating to the liquidation*
- 5. Remuneration of the liquidator's staff*
- 6. Remuneration of the liquidator himself*
- 7. Taxes*
- 8. Any other expenses*

Commented [WPA11]: 6/9 a generally very sound answer which would have benefitted from some further detail in places eg preferential creditor classes, s 176A prescribed part and moratorium debts with priority.

The second class of debts which must be satisfied is the preferential creditors. This class of creditors is found in all the various insolvency related procedures. This class of creditors is set out at Schedule 6 to the Insolvency Act and generally includes liabilities to the Crown and statutory bodies as well as any claims in relations to employees up to the applicable statutory limit. This class of creditors is divided into ordinary preferential debts which are paid first and secondary preferential debts which are paid next. All of these debts rank pari passu and as such in the event that the realized assets are insufficient to discharge them all, then they will all abate in equal proportions to reflect this.

The next class of creditors to be paid is the floating charge holders or secured creditors. Payment in this class is made in order of priority - usually the date on which the floating charge was created. An important caveat that must be followed is that unless the realised assets of the company are sufficient to discharge all the unsecured creditors' debts, then a portion of the amount otherwise payable must be withheld to satisfy them.

In the event that there are funds remaining, the next class of creditors to be paid are the unsecured creditors followed by shareholders who will then be paid on a pro rata basis relative to their shareholdings.

If the company had been subject to a moratorium during the 12 week period prior to the commencement of the liquidation, then the order of priority will be materially affected. Those post moratorium expenses will be given a priority ranking and must be paid ahead of all other expenses including the expenses the liquidation itself.

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

Commented [WPA12]: 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;

The main question that arises here is whether the liquidator is entitled to avoid the floating charge granted in favour of Fretus Bank plc. The liquidator is empowered pursuant to section 245 of the Insolvency Act to avoid floating charges granted by the company in liquidation once certain criteria have been met. It is generally accepted that this provision is designed to prevent pre-existing creditors from obtaining unfair advantage over other creditors in circumstances when the company shortly before a company enters insolvency. Whether a floating charge is liable to be set aside by the liquidator is dependent on several factors: (1) whether the Chargee is connected with the company; (2) whether new consideration is provided for the floating charge; and (3) the time period within which the charge was granted.

In this case, it has not been suggested that the Bank is connected with the company and as such the relevant period is twelve months from the entry into insolvency. As the company went into liquidation on 23 December 2022, the floating charge meets the timeframe since it was given less than twelve months prior to that.

The next requirement that has to be met is whether fresh consideration was provided for the floating charge. On the facts as has been presented, the answer to this question is not straightforward. However, it is likely that a good case for setting aside the floating charge exists. On the one hand, it may appear that fresh consideration was provided by the Bank in exchange for the floating charge. Given that consideration may come in the form of a forbearance to proceed with an act that a party would ordinarily have the right enforce, the Bank may argue that its decision to refrain from demanding repayment of its loans was fresh and valuable consideration for the grant of the charge. This may be an attractive argument, but it runs up against the clear words of section 245 which set out what amounts to new consideration.

The Bank would firstly need to show either that (1) money had actually been advanced to the company at the same time of or very shortly after the execution of the charge or (2) that the debts of the company had been reduced or discharge in exchange for

Commented [WPA13]: 4/5 a good answer but it would have been helpful to consider the actual statutory wording which applies to the consideration under s 245. The suggestion made, which is rightly dismissed, is intelligent but needed to be based more on the actual law.

charge. Neither of these appear to have happened based on the facts disclosed. A further question also arises as to whether the Bank could be said to have been put on notice that company was already insolvent or was shortly like to be so classified insofar as it was unable to pay its debts as they fell due under section 123. This would be a fair conclusion on the facts and would be a proper basis on which the floating charge was liable to be set aside.

It should also be noted that while the charge is set aside, the underlying debt still subsists.

Question 4.2 [maximum 6 marks]

The sale of the marble cutting machines; and

The Court is also empowered under section 423 to set aside transactions of that nature.

The applicable test of whether a transaction is voidable at the instance of the liquidator is (1) whether the transaction was made at an undervalue as defined in section 238 and (2) whether it can be said that the transaction complained of was primarily designed to place the company's property out of the reach of its creditors or otherwise prejudicing the interest of a creditor or other interested person.

Having regard to the applicable law and the facts disclosed, it appears that the sale of the marble cutting machines is voidable for the following reasons:

- a. *The transaction was made at time when the directors including the purchaser knew that the company was experiencing cash flow problems and was likely unable to pay its debts as they fell due.*
- b. *The fact that the machines were bought for GBP 25,000 less than a year before only to be sold at less than half that a year later shows that the transaction was at significant undervalue even when allowances for depreciation is made. This meets the definition of undervalue in section 238(2)*
- c. *It cannot be said, in all the circumstances that the transaction was done in commercial good faith since the lack of marble cutting machines would negatively impact the ability of the company to continue its business.*
- d. *Rather, it could be said that the purpose of the transaction was to deprive the creditors of potential assets which could be used to repay the debts held by them*
- e. *Rita would therefore be unable to avail herself of the protection of section 241 and the court is likely to make an order pursuant to 238 on the basis that it cannot be said that the transaction was made in good faith or in the course of doing business or that the directors reasonably believed that it would benefit the company*
- f. *It is important to note that the liquidator need not bring the claim himself as any victim of the action could do so, for example a creditor although leave of the court will be required.*

Commented [WPA14]: 3/6 The answer seems to conflate ss 238 and 423. The two actions are separate and need to be dealt with fully and separately. The s. 238 argument would appear to be far stronger on the facts and the answer does not deal fully with the s 238 requisites.

Question 4.3 [maximum 4 marks]

The payments to Hard and Fast Ltd.

Similar to the transactions likely to defraud creditors as prohibited under section 423 and general public policy, the answer to this question engages the anti-deprivation principle which provides that any transaction which is designed to or has the effect of depriving the creditors of valuable assets which could be used to for their benefit is liable to be voided by the liquidator.

This is a public policy principle which goes to the heart of the insolvency process: all assets of an insolvent company must be preserved for distribution among its lawful creditors and the law will rebuff any attempts by to remove assets which would otherwise have been available to the creditors for realisation and distribution.

In order to disapply the principle, it must be shown that the transaction was conducted in commercial good faith or on an arm's length basis: Belmont Park Investments PTY Ltd v BNY Corporate Trustee Services Ltd at paragraph 105. Once that defence is shown, then the party may avail itself of section 241 which shields a transaction which was executed in good faith and for good value. On the facts disclosed, there is no basis on which the transaction could be avoided. This is for the following reasons:

- a. The payment was not made to a person connected to the company so there is no inherent suspicion regarding its purpose.*
- b. The course of dealings between the company and hard and Fast Ltd show that it was purely a commercial relationship, and the payment was made in furtherance of that relationship.*
- c. The company received valuable consideration in the form of marble which it then used to continue its trading.*
- d. A failure by the directors to authorise the payment terms would most likely have negatively impacted the trading ability of the company and potentially hastened its fall into insolvency, there is therefore a good defence under section 238*
- e. In all of the circumstances, it could be said that the company and Hard and Fast Ltd acted in commercial good faith in relation to the transaction. It would therefore be able to avail itself of the protection of section 241*

* End of Assessment *

Commented [WPA15]: 1/4 although not really arguable, the answer does suggest an intelligent approach to the issue. The answer itself is far more straightforward - s 127 would make each disposition void subject to any possible validation by the courts.