



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]: 36/50 = 72% an interesting read with a number of intelligent and helpful observations. The identification of issues in Q4 prevents it being an even better grade but still a good effort

Commented [WPA2]: 7/10

Commented [WPA3]: D is correct

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 [WPA4]: 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

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**
- (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 [WPA6]: 10/10

Question 2.1 [maximum 5 marks]

Commented [WPA7]: 5/5 under s 6 the OR may also bring an action on the instructions of the Sec of State

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) **Broadly speaking, section 423 allows victims of a transaction meant to defraud creditors of an insolvent company to take a stand and attack the aforementioned transaction. Furthermore, status of the company determines if any other party can defend creditors' (i.e., victim's) interests. If the company is controlled by an external party (i.e., administrator, official receiver, liquidator) or supervised as part of a CVA arrangement, opens up opportunities for the said office holders/individuals to represent the victims' interests and bring actions**

against culpable parties. Victims generally do not need court approval to take action under Section 423, except if the company is being wound up or in liquidation.

- (ii) Secretary of State, providing they are satisfied that the historical conduct of a director of an insolvent or a dissolved company does not make them fit to manage an enterprise going forward, can bring legal proceedings against the said director. It is then up to the court to decide whether the standards of section 6 have been met and therefore warrant director disqualification. Most often it is the evidence of trading whilst insolvent, excessive directors' remuneration and allegations of fraud or preferential treatment of creditors that put the final nail in the coffin of former company directors.*
- (iii) Section 246ZB refers to wrongful trading undertaken by directors of a company that is currently in an insolvent administration. If the directors, upon becoming aware of the company's impending insolvency, did not take all appropriate measures to minimize losses, the administrator has the power to apply to the court for the directors to make a contribution to the company's assets. The court will evaluate the available facts and decide whether the directors knew (or ought to have known) that the company was heading for insolvency.*

One point to note is that based on personal experience with similar situations, director conduct would have to be both blatantly obvious and egregious, in order for any of the mentioned remedies to be effective. This is rarely the case since precise point for the commencement of a company's zone of insolvency is hard to define and proving that the directors acted negligently or fraudulently is not straightforward. Finally, even if directors' actions are proven to meet the court's criteria, enforcing any of those judgements becomes challenging if the directors are based outside the UK in a jurisdiction without an extradition treaty.

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.

As a result of the pandemic in 2020, Corporate Insolvency and Governance Act 2020 ("Act") introduced new Part A1 to the Insolvency Act 1986. Key distinguishing feature of the Act is the 20-day Moratorium which grants a company breathing space while a Monitor (a qualified insolvency practitioner) oversees the company's affairs. The Moratorium can further be extended for another 20 days without creditor consent, or up to 12 months with creditors' consent or an application to the Court.

However, the Moratorium does not provide leave from the following debts:

- a) Monitor's remuneration / expenses;**

- b) *Company's operating costs incurred during the course of the Moratorium (e.g., cost of goods sold, rent, salaries and wages); and*
- c) *Redundancy payments (to the extent that staff have been laid off).*

In addition, pre-Moratorium debts related to financial services contracts, that have come due either as principal or interest payments, must be paid.

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

Commented [WPA9]: 13/15

Question 3.1 [maximum 6 marks]

Commented [WPA10]: 5/6 a good answer which might have benefitted from a little more detailed explanation of 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?

Historically suppliers have been able to use various contract provisions such as termination or insolvency clauses to end the contractual relationship with a distressed customer, especially in instances where there are substantial amounts outstanding. Commercially, this may not always be the most optimal choice for the supplier given that the repayment of outstanding amounts hinges on the continued existence (or sufficient liquidity) of the debtor. Therefore the supplier and the debtor are often forced to sit down and renegotiate their terms in order to come up with revised conditions of supply (and potentially a reprofiled outstanding obligation). This is especially true with critical suppliers who can at times act like ransom creditors.

However, Section 233 allows the administrator to continue the flow of certain "essential supplies". Initially introduced in 1986, subsequently expanded in 2015 (233A) and most recently amended in 2020 (233B), this section makes it ever more difficult for suppliers to terminate contracts with insolvent counterparties.

- *Section 233 - introduced to cover essential supplies such as gas, electricity, water, communications and IT goods and services. IT goods and services specifically refer to supplies that enable or facilitate "anything to be done by electronic means". Furthermore, the supplier is prohibited from demanding pre-insolvency debts being settled as a condition of continued supply.*
- *Section 233A - expended section 233 to include potential termination of supply if a customer has entered administration or a CVA.*
- *Section 233B - precludes termination of supply if a customer has entered insolvency. Suppliers are also prohibited from "doing any other thing" based on customer insolvency, meaning that changing of customer's payment terms would be prohibited. Provision of financial services is exempted from Section 233B.*

The obvious downside of Section 233 (from the perspective of the office holder) is that the supplier may require a personal guarantee from the insolvency professional in order to continue the provision of services. On the one hand this is understandable, on the other it may be burdensome for the office holder in the performance of their duties, and could potentially jeopardize their rescue efforts.

Question 3.2 [maximum 9 marks]

Commented [WPA11]: 8/9 a very good answer - perhaps a little more on s 176A would have been helpful

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?

Broadly speaking creditors can be split into secured and unsecured, with secured having first claim on debtor's assets (providing same assets have not been pledged multiple times to different parties!). Within secured creditors there is a further tier between fixed and floating charge, in that a fixed charge is over a specific asset of the debtor, with the creditor retaining full control over that asset until the indebtedness has been settled. Floating charge is generally over a pool of (substantially all of) company assets which are fungible (e.g., receivables) with the debtor retaining day-to-day control (with certain conditions) of the charged assets. Upon occurrence of an event of default, floating charge crystallizes and becomes a fixed charge.

Although unsecured creditors do not have direct control (or say) over the assets of the debtor, in case of an insolvency event they are authorized to appoint the office holder(s) that will oversee the debtor's affairs until the debts have been repaid (or the company is wound down). Also important to note that that secured creditors can become unsecured, to the extent that their asset coverage is not sufficient to repay the relevant debt in full.

Creditors with a fixed charge have absolute discretion to enforce on their security if the terms of repayment have not been honoured, and therefore they sit atop of the payment waterfall. Therefore, fixed charge creditors generally sit outside the bounds of any insolvency procedure, unless the office holder can convince them to give up their fixed charge in return for a more economically attractive proposition which will inevitably hinge on the future success (and turnaround) of the debtor. Considering banks are the typical fixed charge creditor, and are therefore not in the business of running or owning companies, the likelihood of a fixed charge being surrendered is minimal. Furthermore, it would be rare (e.g., in case of fraud) for a creditor with a fixed charge to be undersecured (i.e., value of asset with fix charge is less than the outstanding debt). However, if that were the case, the portion of debt that is not settled through the enforcement of the fixed charge would become part of unsecured pool of creditors.

Remaining assets (i.e., those excluding fixed charge assets) are then used to settle the debtor's obligations in the following order:

- i) *Expenses of the procedure (includes office holder's costs, legal fees, and any other expenses incurred as part of the process aimed at maximizing unsecured creditor recoveries);*
- ii) *Ordinary preferential creditors (Schedule 6) - rank pari-passu amongst each other (i.e., paid in equal proportion if they cannot be settled in full) and primarily relate to employee pension contributions, remuneration for the period covering four months prior to the start of the procedure (capped at GBP800 since 1976) and holiday pay.*
- iii) *Secondary preferential creditors (Section 386) - also rank pari-passu amongst each other and include items such as employee deposits, debts owed to HMRC, PAYE income tax deductions and VAT payments (amongst others).*
- iv) *Prescribed part (Section 176A) - applies to debtors with floating charge created on or after 15 September 2003. Considering the recoveries of unsecured creditor (usually locally businesses and suppliers of services to the distressed debtor) have typically been in the low single digits, primarily because the assets are "eaten up" by secured creditors (typically sophisticated financial institutions), prescribed part is meant to allocate a sliver of assets for unsecured creditors.*
- v) *Floating charge creditors - receive "net property" after the allocation of prescribed part.*
- vi) *Unsecured creditors - at the bottom of the totem pole, unlikely to recover any of their outstanding debts.*
- vii) *Members - unlikely to receive a dividend (otherwise they would have likely opted for a members voluntary liquidation). However if all the other creditors in the waterfall have been settled, any residual amounts are distributed to members in proportion to their respective shareholdings.*

However, if a company entered Moratorium (Part A1 of UKIA86) but failed to reorganize as a going concern within 12 weeks, and instead enters liquidation or administration, the priority of debts outlined above does not necessarily hold. Specifically, under Section 174A certain debts that are not subject to a payment holiday (e.g., debts to employees or financial institutions pre-Moratorium) are given preference over liquidator's fees and expenses.

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

Commented [WPA12]: 6/15

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;

"Give me a one-handed economist. All my economists say 'on the one hand...', then 'but on the other...'"

Harry Truman, 33rd US President

On the one hand the ruling by Millet J in the case Re MC Bacon Ltd. would not make this a preference transaction, given that the intention of the directors was to avoid immediate liquidation (which would have happened had Fretus Bank Plc. cut the line of credit). On the other hand, we could argue that the onset of insolvency was in July 2022 (when the company suffered cash flow issues and had to sell equipment to generate liquidity), which falls within the six-month time window for clawing back preferential transactions from unconnected parties. Finally, the liquidator could potentially pursue a wrongful trading claim (under Section 214 of UKIA 1986) against the directors given that the Company was clearly in dire straits, and all of their

Commented [WPA13]: 2/5 a reasonable answer on its own terms but the real issue was s 245

subsequent decisions seem to have made the unsecured creditors worse off. Taking into consideration the case facts (and how hard it is to prove a wrongful trading claim) it is most likely that the ruling by Millet J would stand and would therefore limit the liquidators' ability to claw back the security granted to Fretus Bank Plc.

Nevertheless, it is helpful to consider the elements required for an application under section 239 to be successful:

- a) Person that was alleged to have been preferred must have been a creditor of the company. Fretus Bank Plc. clearly was a creditor and would therefore pass this test;*
- b) Actions of the company directors had made the creditor better off relative to its original position, had the company gone into insolvent liquidation. Floating charge Fretus Bank Plc. was granted had made it a secured creditor. Without knowing the structure of the company's balance sheet it can be argued that it is not entirely clear whether this had made Fretus Bank Plc. better off overall, especially if major trade creditors had ROT clauses as part of their sales contracts;*
- c) The company was influenced by the desire to prefer the creditor in relation to other creditors. Following the ruling by Millet J in Re MC Bacon Ltd. numerous other decisions have held that the decision taken by the directors of the Company was done entirely with commercial considerations in mind and would thus fail this test; and*
- d) The preference was given at a relevant time. In this case it might be argued that the onset of insolvency was July 2022, given the Company would have probably failed the cash flow test at that point in time, and had to enter into a transaction at undervalue with a connected person. However, the actual winding-up petition was issued in October 2022, and could potentially stretch that time frame, causing this leg of the test to fail.*

Question 4.2 [maximum 6 marks]

The sale of the marble cutting machines; and

First of all the transaction with Ms. Perkins occurred within the two-year window prior to the commencement of the liquidation. Therefore it is a transaction that is subject to review and potential claw back by the liquidator under section 238 of UKIA 1986.

Second, the liquidator would need to prove that the transaction was entered into at a value that, at the time of the transaction, was significantly less than the consideration provided by the Company. In this instance we know that the two machines were bought for GBP25,000 the year prior, and were sold for GBP10,000 to Ms. Perkins. Without knowing any additional information it is hard to opine on this point given that

Commented [WPA14]: 4/6 again a reasonable answer but more detail is needed on the requisites of s 238 eg need for insolvency / connected party / presumption of insolvency / possible defence

in 2021 (and potentially through parts of 2022) there were substantial supply chain issues around the globe which pushed people to pay significant premia to receive their goods on time. It could be the case that the actual value of the two machines was only GBP12,500 at the time of purchase (excluding the scarcity premium). However, given that the Company directors did not conduct a market testing exercise (either by asking for independent bids to be submitted or by going to third party valuers) would suggest that this transaction is potentially open to attack by the liquidator.

Finally, the fact that the transaction was with a connected party would suggest that the Company was insolvent (unless proven otherwise). Furthermore, it is likely that the Company would have failed the cash flow test for insolvency purposes.

Therefore, if the liquidator is convinced that a) they can recover this asset from Ms. Perkins, b) that the subsequent asset disposal proceeds can at the very least cover the legal fees associated with this exercise, or c) that Ms. Perkins and other directors have sufficient funds to reimburse the Company for any loss of value, action under section 238 should be pursued. Otherwise, recoveries (if any) from Ms. Perkins, are likely to be eaten up by liquidators' and legal fees and will not benefit the estate.

In the alternative, actions against former Company directors under wrongful trading (sections 214 and 246ZB), can be explored, providing they have sufficient means to reimburse the estate for the loss of value. In this instance, given the transaction with a connected person (Ms. Perkins) insolvency can be presumed, and therefore the burden of proof would likely shift onto the former Company directors to demonstrate they have done everything in their power to minimize the potential loss to creditors, including disposing of the two machines to generate liquidity.

Question 4.3 [maximum 4 marks]

The payments to Hard and Fast Ltd.

It could be argued that Hard and Fast Ltd. are a ransom-creditor, that is crucial to continued operation of the Company, and therefore the former directors of the Company could not be faulted for either settling the outstanding debt in order to continue trading, nor agreeing to cash on delivery terms.

However, given that the company was already deemed insolvent (taking into consideration the machinery disposal to Ms. Perkins in July 2022), and that the settlement of outstanding debts of Hard and Fast Ltd. made other creditors worse off, the liquidator could potentially take actions against Ms. Perkins and other directors under sections 214 and 246ZB. Although not ideal, it may have been better for the directors to use one of the statutory options to restructure the Company's obligations, and at the very least ensure a better outcome for all of the Company's creditors.

Although the legal principles of following through with a wrongful trading claim against Ms. Perkins and other directors may be sound, commercially it would have to

Commented [WPA15]: 0/4 as the disposition was after the commencement of the winding up, s 214 is not available. The issue is covered by s 127.

be explored further (e.g., availability of assets), especially if any proceeds from recovery would first have to be used to settle legal and liquidator fees.

*** End of Assessment ***