



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).**
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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]: 48/50 = 96% an excellent effort

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

Commented [WPA2]: 9/10

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.*

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*

Commented [WPA3]: B is correct

(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]

Question 2.1 [maximum 5 marks]

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?

Commented [WPA4]: 9/10

Commented [WPA5]: 4/5 the answers to ii) and iii) are not quite correct. Only the Secretary of State or the OR on the SoS's instructions can bring an action under s 6. Under s 246ZB only an administrator may bring an action. A liquidator cause of action is in s 214.

Section 423 of the Insolvency Act is designed to allow specified parties to attack transactions which are "designed to defraud creditors". The parties with standing under this section varies depending on the status of the company: where the company is in administration or being wound up, the official receiver, liquidator or administrator (as the case may be) can bring the action. In addition, any victim of the transaction (usually one of the defrauded creditors) can seek the Court's leave to bring the action. Where the company has a CVA in place and the victim is bound by that CVA, the action may be brought by either the supervisor of the CVA or any victim (whether or not subject to the CVA. In any other scenario, the victim of the transaction is the party with standing to bring the action under s423.

Section 6 of the Company Directors Disqualification Act deals with the disqualification of directors who are unfit to act in the context of a insolvent company. Such an order may be made on the application of the official receiver, administrator or liquidator.

Section 246ZB of the Insolvency Act deals with wrongful trading. In the context of an insolvent winding up, an application under this section may only be brought by the liquidator. However, the Small Business, Enterprise and Employment Act 2015 extended the wrongful trading doctrine to administration, such that the administrator of an insolvent company can now also make application under s246ZB.

Question 2.2 [maximum 5 marks]

Commented [WPA6]: 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.

Inter alia the following debts do not fall within the payment holiday provided under Part A1 of the Insolvency Act:

- *The Monitor's remuneration and expenses;*
- *Payment for any goods or services supplied during the moratorium period;*
- *Rent in respect of periods during the moratorium period;*
- *Wages and salaries arising under any contract of employment; and*
- *Any redundancy payments.*

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

Commented [WPA7]: 15/15

Question 3.1 [maximum 6 marks]

Commented [WPA8]: 6/6 good

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 continued supply of goods and services during the course of an administration, being an insolvency proceeding, is dealt with under ss233, 233A and 233B of the Insolvency Act.

Pursuant to s233A, the supply of "essential supplies", namely gas, electricity, water and communications services (which is widely defined to include for example point-of-sale technology, website hosting, data processing and storage, technical services and advice) may not be halted, made more expensive, or otherwise subject to different terms merely because the company has entered administration, on the basis of an *ipso facto* clause. Under s233, a supplier of these essential supplies cannot demand the repayment of arrears sums to continue to provide or to provide new supplies. However, the supplier can demand that the administrator personally guarantees any such outstanding sum.

Pursuant to s233B, the above provisions were extended to the supply of other goods and services as well. Under s233B, a supplier of almost any goods or services may not rely on a company going into administration or any other formal insolvency procedure to terminate an executory contract or "do any other thing" in respect of the contract. It should be noted that, like s233, this includes forcing a company to pay any pre-insolvency arrears. Unlike s233, however, a supplier under s233B (i.e. a supplier of anything other than the "essential supplies" to which s233 and s233A apply) cannot require the administrator to personally guarantee the pre-insolvency arrears. The only suppliers that are not subject to the provisions of s233B are those statutorily excepted, being banks, insurance houses, investment exchanges and clearing houses, electronic money institutions, securitisation companies and overseas companies with the same functions.

On this basis, an administrator can require the supplier of goods and services to continue to supply those goods and services during the administration, and the supplier is prevented by operation of the Insolvency Act from relying on an *ipso facto* clause to terminate provision of the relevant goods or services. Where the relevant goods or services are "essential supplies" within the meaning of s233, the administrator can be required by the supplier to personally guarantee any pre-insolvency arrears. In the case of all other services (save for the limited exceptions in s233B), the administrator cannot be required to give a personal guarantee in relation to pre-insolvency arrears.

Question 3.2 [maximum 9 marks]

Commented [WPA9]: 9/9 very good

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 first parties paid in a liquidation are the holders of fixed charges, if any. These fixed charges fall outside of the formal insolvency proceeding, and the chargeholders are paid from the proceeds of the sale of the asset over which they enjoy security.

The second tranche of payments is in relation to the expenses of the liquidation, including the costs of any security provided by the liquidator, any necessary disbursements incurred by the liquidator and the remuneration of the liquidator.

The third tranche of payments is in respect of preferential creditors, being (i) employees who are owed money by the insolvent company and (ii) the government in respect of tax debts where the company has acted as tax collector for it. Preferential claims are heavily restricted, and are also sub-divided into ordinary and secondary preferential claims. Ordinary preferential claims include, for example, payments owing in relation to employee contributions to a pension scheme, employer contributions to a pension scheme, remuneration due to employees for the four months preceding liquidation (and capped at £800), and other debts as set out in Schedule 6 to the Insolvency Act. Once all of the ordinary preferential claims have been met, secondary preferential claims are paid. These consist of, for example, sums owed to eligible persons which exceed the sums that those eligible persons will recover under the Financial Services Compensation Scheme, PAYE deductions, VAT payments and student loan payments

The fourth tranche of payments is made to the holders of any floating charges, subject to statutory deductions, if any. Where there are multiple floating chargeholders, the usual rule is that the first-in-time charge prevails. The statutory deduction arises by operation of s176A of the Insolvency Act, and prevents a floating charge-holder from automatically "scooping the pot" and leaving nothing for the unsecured creditors. It applies to all charges created on or after 15 September 2003, where the chargor company has subsequently gone into liquidation or administration. Under s176A, the liquidator is required to reserve the "prescribed part" of the asset subject to the floating charge for the unsecured creditors: where the company's "net property" (i.e. what is available for distribution post-payment of expenses and preferential claims) is £10,000 or less, the liquidator must retain 50% of that sum as the prescribed part. Where the net property exceeds £10,000, the liquidator must retain 50% of the first £10,000 (i.e. £5,000) and 20% of the balance, subject to a maximum prescribed part of £800,000.

The fifth and final tranche of payments is made to the unsecured creditors, being all those creditors who do not enjoy any security, such as a charge, or any other preferential status under the insolvency Act. This class usually consists of trade creditors of the company, amongst others.

*In the event that the company is solvent, each of these five classes will be paid in full and the balance will be paid to the members in accordance with the company's articles of association or other constitutional documents. In the event that the company is insolvent, each tranche of creditor will be paid in full. Where there are insufficient funds available to meet the claims of an entire class, that class will take the proceeds of the liquidation *pari passu inter se*, that is to say in equal proportion within the class, and later classes get no return. Usually this *pari passu* distribution occurs amongst the unsecured creditors, but it may be the case that the company's assets only cover, for*

example, expenses and preferential payments in addition to fixed charge payments, which would mean that the floating chargeholders and unsecured creditors receive nothing.

Where the company was subject to a Moratorium in the 12 weeks before the liquidation commenced, the debts falling outside of the payment holiday pursuant to the Moratorium (as to which see Q2.2 above) which remain unpaid enjoy "super-priority" and are therefore paid ahead of the liquidator's own fees and expenses (pursuant to s174A of the Insolvency Act). There is however an exception to this rule in relation to accelerated debts, which do not enjoy the super-priority.

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

Commented [WPA10]: 15/15

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]

Commented [WPA11]: 5/5 very good

The floating charge in favour of Fretus Bank plc;

The granting of a floating charge in favour of Fretus Bank plc may be a preference within the meaning of s239 of the Insolvency Act, or may be subject to avoidance under s245 of the Insolvency Act.

Preference

A preference is a transaction which gives one creditor an advantage or places them in a preferential position compared to what their position otherwise would have been in an insolvency. Preferences are avoidable by the Court on the application of the liquidator, after the company has gone into liquidation. In order to succeed in having a preference avoided under s 239, the liquidator must show that (i) the person preferred was at the time of the transaction a creditor of the company or surety or guarantor of any of its debts; (ii) the person has been preferred (i.e. the company has done or suffered something that places the creditor in a better position in the event of insolvency than it otherwise would have been); (iii) in giving the preference, the company was influenced by a desire to prefer that creditor; and (iv) the preference was given at a relevant time.

In this instance, Fretus Bank is evidently a creditor of the Company, as it was owed loan repayments by the Company. Thus, the first limb of the s239 test is met. Fretus Bank does not appear to have held any security prior to the granting of the debenture in February 2022, but was granted a floating charge by way of the debenture. As such, the granting of the debenture improved Fretus Bank's position as it changed Fretus Bank from an unsecured creditor (paid last in the waterfall) to the holder of a floating charge (paid before all unsecured creditors, after only expenses and preferential debts). Thus, there is a very real possibility that by virtue of the debenture Fretus Bank stands to benefit upon the liquidation of the Company, in that it will be paid earlier and is therefore more likely to receive repayment of its full claim. Granting of a debenture is plainly a positive step taken by the company. On this basis, the second requirement is met.

In relation to the third requirement, the pressure exerted by Fretus Bank (i.e. demanding the floating charge in exchange for not calling in the loans) is relevant, but it will ultimately fall to the liquidator to prove that the Company was influenced by a desire to prefer Fretus Bank over its other creditors. This is so because there is no evidence that Fretus Bank is a connected party to the Company, which means that the liquidator does not benefit from the presumption that the company had the necessary intention.

The fourth requirement is in relation to the relevant time. As Fretus Bank is not a connected party to the Company, the relevant time is defined as the 6 months before the commencement of the insolvency (which is the filing of the petition, i.e. October 2022). Since the debenture was granted in February 2022, this is more than 6 months before the commencement of the liquidation in October 2022. Accordingly, the liquidator will not be able to have the debenture set aside on the basis of s239 of the Insolvency Act.

S245 floating charges

Section 245 of the Insolvency Act applies only to floating charges, and operates to prevent a previously unsecured creditor gaining security and this improving its position by way of a floating charge before insolvency. There are exceptions to this rule where the floating charge is granted for new consideration (e.g. a fresh line of credit being made available) but that does not appear to be the position in relation to Fretus Bank as there is no indication of new consideration being given in February 2022. As such, the floating charge granted by way of the debenture is susceptible to be avoided on the application of the liquidator in accordance with s245.

To have the floating charge avoided, the liquidator will have to prove that (i) the floating charge was granted in the 12 months before the onset of insolvency (because Fretus Bank is not a connected party, as discussed above) and (ii) at the time of the grant of the charge, the Company was unable to pay its debts within the meaning of s123, or it became unable to do so as a result of the granting of the charge.

In relation to (i), this requirement is plainly met as the commencement of insolvency will be October 2022, i.e. the date on which the petition was filed. As such, any floating charge granted after October 2021 is vulnerable under s245. The Fretus Bank floating charge was granted in February 2022, so falls within that window.

In relation to requirement (ii), it seems likely that the liquidator will be able to show that the Company was unable to pay its debts, or became so unable on the basis of the charge, because it is evident that the Company had other creditors and was in financial difficulties at that time. Provided that this can be proven (e.g. with reference to the Company's management accounts or annual financials), the liquidator will be able to have the floating charge set aside under s245 and Fretus Bank will 'revert' to its status as an unsecured creditor.

Question 4.2 [maximum 6 marks]

Commented [WPA12]: 6/6 very good

The sale of the marble cutting machines; and

The sale of the marble cutting machines to Ms Perkins may amount to a sale at an undervalue, which is dealt with under s 238 of the Insolvency Act. To succeed in having the sale set aside as a transaction at an undervalue, the liquidator must show that (i) the transaction was a gift, or for no consideration to the Company, or for consideration which in money or money's worth was significantly less than the value of the consideration provided by the Company; (ii) the transaction took place at a relevant time, which is the two years before the commencement of the liquidation; and (iii) the Company was, at the time of the transaction, unable to pay its debts as they fell due within the meaning of s123, or became unable to do so as a result of the transaction.

In relation to the first requirement, the machines were purchased by the Company one year before the sale for £25,000, but were sold to Ms Perkins for just £10,000. The liquidator will be required to prove the value of the machines at the transaction date, but it seems unlikely that the machines would have lost well over half of their value in just one year. As such, it is likely that the liquidator will be able to satisfy the Court that the consideration received by the Company (£10,000) was significantly less than the value in money's worth of the consideration received by Ms Perkins (the machines). A sale is plainly a "transaction" within the meaning of this requirement as well.

As to the second requirement, the sale took place in July 2022, three months before the petition as presented. This is well within the two year period and this requirements is therefore met.

In relation to the third requirement, it seems likely given the Company's precarious financial position that the Company was or became unable to pay its debts as required. However, given that Ms Perkins is a director of the Company, she is a connected person to the Company. The liquidator therefore benefits from a presumption that this requirement is met. This means that, rather than the liquidator bearing the burden of proving compliance with this requirement, this is presumed unless the contrary can be proven.

On this basis, it seems likely that the Court would set aside the sale to Ms Perkins as a transaction at an undervalue, on the application of the liquidator.

It should be borne in mind that a defence is available to Ms Perkins if she can show that the transaction was entered into in good faith by the company, for the purpose of carrying on its business and with reasonable grounds to believe at the time that the transaction would benefit the Company. However, given that the transaction was expressly entered into because of the Company's ongoing cash flow issues, it seems unlikely that this defence would be available as it cannot realistically be maintained that such a sale was for the purpose of carrying on its business.

Question 4.3 [maximum 4 marks]

Commented [WPA13]: 4/4 very good again

The payments to Hard and Fast Ltd.

Given that the Hard and Fast payment took place after the petition had been presented, albeit before the order was made, the transactions for £8,000 and £3,000 stand to be avoided under s127 of the Insolvency Act, which provides that all dispositions of property after the commencement of winding up (i.e. the date of presentation of the petition) are void unless otherwise ordered by the Court. In this instance, the payments to Hard and Fast would constitute dispositions of property since they are payments of money away from the Company.

The payments are therefore invalid, unless Hard and Fast applies for a validation order in respect of them. It should be noted that the Court has a discretion to grant such an

*order. Factors to be considered in relation to this discretion include the Court's desire to adhere to the *pari passu* principle, as well as the benefit received by the Company in return for the payment (especially where payment on delivery allows the Company to continue trading, where this is in the best interest of the creditors).*

The general rule is that payments which allow the Company to continue trading will be validated; however, the Court has refused such orders where to do so would be to prefer one creditor over the other unsecured creditors. As such, if a validation application is made, the outcome is likely to turn on the facts relating to the Company's trading position post-payments (since the payments were made for the continued supply of marble, which is essential to the business) and the position of the other creditors relative to Hard and Fast.

*** End of Assessment ***