



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]: 50/50 = 100% a truly wonderful effort. Well done!

Commented [WPA2]: 10/10

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.***

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]

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Question 2.1 [maximum 5 marks]

Commented [WPA4]: 5/5

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?

With respect to section 423 of the Insolvency Act of 1986, an action to challenge a transaction intended to defraud creditors may be brought by the following persons. In case the company at issue is in the process of being wound up or is undergoing administration, the action can be brought by the official receiver, the administrator, the liquidator as well as, with leave of the court, any affected person by the transaction, including a debtor's creditor. In the event the affected person is involved in a company voluntary arrangement, the supervisor of the arrangement or any affected person by the transaction, either involved or not in the CVA, is entitled to attack the transaction. An action to challenge such a transaction may also be brought by an affected person by the transaction. As it can be understood, the applicant may not necessarily be an insolvency officeholder. However, usually, in an insolvency scenario, the persons making such an application are the administrator or the liquidator who submit the application "on behalf of" any affected person by the transaction.

With respect to section 6 of the Company Directors Disqualification Act of 1986, the persons who may make an application are as follows. In accordance with section 7 paragraph 1, the Secretary of State may make an application for a disqualification order of section 6 against any person if it considers such action appropriate for public interest purposes. An application for such an order can be also pursued by the official receiver in the event it has been directed by the Secretary of State to do so in the context of a former or current director of a company being in the process of a winding up proceeding or already wound up by the court in England and Wales.

With respect to section 246ZB ('Wrongful trading: administration') of the Insolvency Act of 1986, the person permitted to apply is the administrator. Indeed, the court may declare that a current or former director is liable for wrongful trading activities upon application of the administrator.

Question 2.2 [maximum 5 marks]

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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 Moratorium procedure involves a stay on any action concerning debts that have occurred before the establishment of the Moratorium. Nonetheless, it obligates the debtor company to be in a position to pay the debts as those as falling due during the period of the Moratorium. Section A18 of Chapter 4 explains that pre-Moratorium debts concern those debts that either have fallen due on a pre-Moratorium basis or that fall due within the period of the Moratorium. These debts are thus included in the company's 'payment holiday'. Five debts that do not form part of the payment holiday moratorium, pursuant to that section of the Insolvency Act of 1986, are as follows.

First of all, the stay on pre-Moratorium debts does not concern the remuneration of the monitor and relevant expenses. The monitor's function is to observe the affairs of the company in order to form an opinion as to the likelihood of the moratorium leading to the rescue of the business as a going concern. Section A18(7) explicitly states that the "monitor's remuneration or expenses" does not include remuneration in respect of anything done by a proposed monitor before the moratorium begins" (A18(7), Overview and construction of references to payment holidays, Chapter 4, Effects of Moratorium). Secondly, a stay on pre-moratorium debts does not concern any services or goods provided during the Moratorium period. This is presumably to secure the continuation of the business and its rescue. In addition, pre-moratorium debts falling within the 'payment holiday' consideration do not relate to any rent regarding any part of the Moratorium period. This is again to enable the uninterrupted continuation of the business and its rescue. Fourthly, other pre-Moratorium debts not falling within the spectrum of a payment holiday are linked to any salary(ies) and wages that occur in respect of an employment contract or contracts. For the purposes of this consideration, 'wages or salary' include amounts payable relating to holiday periods, absence periods through illness or other "good cause", amounts in lieu of holiday and contributions to an 'occupational pension scheme', as known in the United Kingdom. Lastly, redundancy payments are also excluded from any payment holiday. Redundancy payments refer to either the Employment Rights Act of 1996 (Part 11) or the Employment Rights Order of 1996 (Northern Ireland, Part 12). In connection with Parts 11 or 12, a redundancy payment may also refer to an individual agreeing to terminate the employment contract where he or she would have been eligible for redundancy payment under this part if he or she had been dismissed.

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

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Question 3.1 [maximum 6 marks]

Commented [WPA7]: 6/6 very 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?

First of all, it should be noted that executory contracts are not terminated simultaneously with the appointment of the administrator. The situation that requires certain contracts to be maintained during the company's administration is indeed essential to the company and to the overall procedure.

Section 233 (Insolvency Act of 1986) regulates the supply of communication services, electricity, gas and water. The same section gives the opportunity to a supplier to specify that payment of charges concerning the supply should be personally guaranteed by the administrator. On their part, suppliers cannot oblige the company in administration to pay outstanding debts which would aim at ensuring a new supply or the continuation of a supply.

Pursuant to section 233A, the supplier of the aforementioned services is generally not permitted, through the existence of an "insolvency-related term", to modify the supply terms, terminate the supply or condition continued supply on increased payments upon the occurrence of the company's insolvency (section 233A, "Further protection of essential supplies", Insolvency Act of 1986).

In addition, section 233B, being an expansion of sections 233 and 233A, does not allow clauses that would enable the supplier of goods or services to terminate the supply contract or perform any other actions in that context if the company formally commences any insolvency process. This section, contrary to section 233, does not stipulate that a supplier may specify that payment of charges concerning the supply should be personally guaranteed by the administrator.

Equally, sections 233 and 233A of the Insolvency Act do not allow termination of supply contracts on behalf of suppliers linked to IT, utility and communication services if insolvency occurs.

Nevertheless, under section 233B termination of a supply contract can still occur either upon the company's or insolvency office holder's consent or upon satisfaction of the court, after an application, that the supplier would suffer adverse effects. Moreover, although section 233B expands the restriction regarding termination of contracts of supply to all suppliers in general, certain exceptions apply with respect to bank institutions, electronic money institutions, insurers, investment exchanges that have been recognized and clearing houses, securitisation companies as well as foreign companies performing relevant operations.

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 accordance with section 115 of the Insolvency Act as well as rules 6.42 and 7.108 of the Insolvency Rules 2016 (SI 2016/1024), priority in the context of liquidation is first of all accorded to particular expenses before preferential creditors, floating charge holders, unsecured creditors and shareholders.

In order of priority, expenses concerning the preservation, realization or return of assets to the insolvency estate by the liquidator, which also comprise the situation of conducting legal proceedings, are payable first. These are followed by: costs linked to security given by the liquidator; expenses regarding a person who assisted with preparing a statement of affairs or accounts; required disbursements incurred during the winding up period by the liquidator (e.g. such expenses could concern those borne by the creditor committee's members); any expense relating to a person employed by the liquidator so to undertake any company's services; the liquidator's remuneration;

Commented [WPAB]: 9/9 a very good answer again. Fixed charge holders may also have been mentioned but the answer is sufficiently convincing to justify full marks.

expenses linked to corporation tax referring to taxable capital gains resulting from the realization of an asset of the company; and other expenses attributable to the liquidator in the performance of his or her duties in connection with the liquidation. As it can be seen, the liquidator's remuneration is behind other expenses. It is important to also underscore that the same rules apply to the liquidator's remuneration as to the administrators, i.e. a time cost estimate regime for the liquidator's fees.

The next creditors' class to be satisfied is the one concerning preferential creditors (pursuant to sections 386 and 387 as well as section 175 of Schedule 6). This class comprises limited employees' claims and tax liabilities, among others. The protection to employees within the Employment Rights Act of 1996 offers a more extensive employee protection than the Insolvency Act of 1986. It should be also stressed that the Finance Act of 2020 (section 95) now includes outstanding tax to the Crown (Government) which, as part of the preferential creditors' class, had been previously abolished by the Enterprise Act of 2002. Secondary preferential debts are paid after ordinary preferential debts, which together form the two classes of preferential debts.

Ordinary preferential debts are as follows: a) any amount due in respect of contributions made by an employee to an occupational pension scheme, which are contributions deducted from the salaries of employees during the four-month period before the start of the winding up; b) any amount due by the company in respect of the contribution made by the employer to an occupational pension plan during the 12-month period prior to the relevant date; c) remuneration due by the company to a current or former employee of the debtor and payable for all or part of the four-month period preceding the start of the liquidation, subject to a maximum total amount, currently GBP 800; d) any amounts due by the debtor in respect of accrued holiday pay for any period of employment prior to liquidation (any remuneration relating to a holiday period or absence from work for illness or other just cause is considered wages); e) claims relating to sums advanced for the payment of wages or paid leave are given priority; f) levies on coal and steel production provided for in Articles 49 and 50 of the European Coal and Steel Community Treaty; g) claims relating to the portion of any amount which the debtor is required to pay under the Reserve Forces (Safeguard of Employment) Act of 1985 and which is so demanded as a result of the debtor's failure to perform its obligations under that Act; and, h) an amount the company owes regarding an eligible deposit that is no greater than the compensation that would be owed to the person or persons due the amount concerning the deposit under the Financial Services Compensation Scheme (hereinafter 'FSCS'). Secondary preferential debts are as follows: any amount the company owes to one or more persons in relation to an eligible deposit that is higher than any compensation that would be payable to that person or those persons in respect of the deposit under the FSCS; an amount the company owes to one or more persons regarding a deposit carried out via a credit institution's foreign branch, authorized by the UK competent authority, that would have been considered an eligible deposit had that been carried out by that credit institution's UK branch; and, lastly, income tax deductions known as 'PAYE', VAT amounts, national insurance deductions, deductions relating to Construction Industry Scheme and student loan reimbursements. In any case,

preferential claims in their respective categories (ordinary and secondary) enjoy the same rank among themselves and are therefore extinguished in equal proportion in the event of insufficient company assets to satisfy them all.

*The next class of creditors to be satisfied concerns floating charge holders. If, indeed, there are more than one floating charge holders the priority among them is determined by observing which charge was established first. In this context, the liquidator should examine whether section 176A applies, which concerns floating charges established on or after September 15, 2003, and companies having entered liquidation or administration. Interestingly, there is an obligation for the liquidator to establish the so-called "prescribed part", instituted on the net property of the company and intended to satisfy unsecured creditors. The liquidator is under a duty not to pay any amount from this prescribed part to floating charge holder(s) unless that amount is greater than the amount intended to satisfy the totality of unsecured creditors. In this regard, it is useful to clarify that net property concerns the sum of the property of the company that under other circumstances would be utilized for payment of floating charge holder(s). The net property amount is calculated after payment of expenses and preferential debts. If the net property is no greater than GBP 10,000 the prescribed part reaches 50% of the company's net property. If the net property is lower than the GBP 10,000 threshold, and if according to the liquidator carrying out a distribution to unsecured creditors would not be proportionate to the advantages, then the duty relating to the distribution of the prescribed part is not applicable. If the net property is greater than GBP 10,000, the prescribed part reaches 50% of the first GBP 10,000 and an amount calculated to 20% of the excess in value beyond GBP 10,000 is added. The prescribed part, in any event, should not exceed GBP 800,000. The distribution relating to the prescribed part remains a separate issue from the floating charge holder(s). In this light, any such holder or secured creditor who is eventually owed an outstanding unsecured amount is not allowed to participate in that prescribed part's distribution (*Thorniley v Harris* [2008] EWHC 124 (Ch)).*

Turning to the class of unsecured creditors, this class will be satisfied after the class of floating charge holders, as previously mentioned. Usually, funds are usually insufficient to distribute a dividend to this class of unsecured creditors.

Lastly, in the event of sufficient funds, any additional amount is shared proportionately ('pro rata') among the company's shareholders, pursuant to the constitution of the company.

In the context of a Moratorium under Part A1 of the Insolvency Act of 1986, the priority, indeed, would be different.

More specifically, in case the Moratorium procedure is not successful and the company enters administration or liquidation proceedings in the twelve weeks following the end of the Moratorium procedure, there would be substantial differentiations before and after the liquidation proceedings (in our case) in terms of priority. Pursuant to section 174A, specific pre-Moratorium or Moratorium debts that have not been paid,

and thus debts not in the context of a 'payment holiday' and unsecured in their nature, should be paid in priority. This situation is otherwise called 'super priority', as these amounts would be paid even prior to the expenses and fees of the liquidator. These specific debts include financial services debts or debts due to employees.

Practically, amounts due to a director who has not been paid before the Moratorium for months will be deemed as super priority in the subsequent liquidation. In addition, a secured or unsecured pre-Moratorium bank debt in the context of the definition of financial services will also be considered a super priority. There is an exception in that context in respect of any pre-Moratorium financial services debt that has become due as a result of the application or exercise of rights under an acceleration or early termination clause pursuant to the financial services contract.

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

Commented [WPA9]: 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 [WPA10]: 5/5 very good

The floating charge in favour of Fretus Bank plc;

In accordance with the facts of the case, Marbley Q Limited (hereinafter 'the Company') granted a debenture containing a floating charge over the undertaking of the Company in its entirety in favour of Fretus Bank plc. This action occurred in February 2022. In October 2022, a winding up petition on behalf of a creditor was presented and in December 2022 the Company entered compulsory liquidation (compulsory winding up).

The procedures of a compulsory winding up are regulated by Part IV of the Insolvency Act of 1986 (Winding Up of Companies Registered under the Companies Acts). Pursuant to section 124 of the Act, a petition may be presented, inter alia, by a creditor.

The floating charge concerns the entirety of the company's present and future property and comprises the right to carry on the business activity. It is worth mentioning that in case the holder (in our case, Fretus Bank plc) would be holding a qualifying floating charge, then that holder would have, upon the insolvency of the debtor, the right to appoint an administrator that would take control of and realize the charged assets to satisfy the secured creditor (see also section 176A that enables debenture holders to appoint, out-of-court or through the court, an administrator; this particularity applies to a company in liquidation and in case the floating charge has been created on or after September 15, 2003). We assume for the present purposes that this is not the case.

Under these circumstances, the liquidator in the case at hand could explore the possibility of avoiding the floating charge. Indeed, according to section 245 of the Insolvency Act of 1986, where a company is undergoing administration or liquidation proceedings, it is possible to circumvent the situation of a previously unsecured creditor acquiring a floating charge soon before the commencement of a formal insolvency procedure. This does not prevent, however, the acquisition of a floating charge in the context of providing 'fresh funding' to the debtor company. In the event the 'holder' of the floating charge is connected with the company, the two-year period before the commencement of insolvency should be examined. If the 'holder' is not a connected person, the period that should be examined is the 12-month period prior to insolvency. This whole consideration is valid in case the company is unable to pay its debts pursuant to section 123 of the Insolvency Act or became unable to pay its debts as a result of the granting of the floating charge.

*Pursuant to section 245 of the Insolvency Act, there are two exemptions to the invalidation of a floating charge. Firstly, if the value of the new consideration regarding the establishment of the charge relates to amounts paid, goods or services provided to the company upon or after creation of the charge, then the floating charge will not be invalidated. As supported by jurisprudence, any delay between the payments and the execution of the charge should be "minimal" (see *Re Shoe Lace Ltd* [1993] BCC 609), in the light of an agreement to execute the charge after payments to the company are made (the latter leading to the formal execution of the charge).*

*Equally, the floating charge will not be invalidated in the context of a reduction or discharge of any company's debt. This reduction or discharge should take place upon or after the creation of the floating charge. That being said, a consideration concerning payments made by directors to the company for a particular purpose, to the directors' benefit, to assist them in discharging their personal liability under guarantees, is not covered by the exemption (see *Re Fairway Magazines* [1992] BCC 924). It is supported that the consideration would not be invalidated if the amounts were transferred directly to the bank and not to the company to repay the bank.*

In case the liquidator is successful in invalidating the floating charge under section 245, it should be noted that the underlying debt continues to be valid. In addition, the avoidance of such a charge does not involve anything done before the initiation of the administration or liquidation proceedings.

In the case at hand, the Company is undergoing compulsory liquidation proceedings and the situation does not involve any sort of 'fresh money' being provided to the Company. Rather, it entails the granting of a floating charge over the whole of the Company's undertaking after being pressured by its bank, Fretus Bank plc. The bank seems not to be connected with the Company and, thus, the relevant period under scrutiny should be the 12-month period. The granting of the charge took place in February 2022 and the winding up proceeding commenced in December 2022. Moreover, the Company gives the impression of being unable to pay its debts as, in accordance with the given facts, there was a certain unwillingness on behalf of the Company to repay the bank's loans (" [...] in order to prevent it from demanding repayment of the Company's loans"). The granting of the floating charge does not seem to involve any money paid, goods or services provided to the Company or any reduction or discharge of any debt upon or after the creation of the charge. Therefore, the liquidator of Marbley Q Limited may pursue the opportunity given by section 245 in terms of avoidance of the floating charge granted to Fretus Bank plc.

Question 4.2 [maximum 6 marks]

The sale of the marble cutting machines; and

In this context, there are several remedies that the liquidator should explore.

Pursuant to section 238, the liquidator or administrator may challenge a transaction made at an undervalue concluded before the company enters administration or liquidation proceedings. The liquidator must demonstrate either that a gift was made to a person or that a transaction was concluded in such a way that the company received no consideration or that a transaction was made where the company gave a higher consideration compared to what it received. The time limit in view of such an application under section 238 is two years before the commencement of the liquidation (or administration). However, as one can understand, a proper evaluation of what the company has received with what it has provided may be a difficult

Commented [WPA11]: 6/6 again a very good answer which considers both the likely and the unlikely possible actions.

undertaking. Moreover, under section 238 there is a prerequisite of liability that upon conclusion of the transaction the company, pursuant to section 123, either became unable to pay its debts as a result of that transaction or was already unable to pay its debts. In the event of a transaction with a connected person (e.g. the company's management), and unless otherwise proven, there is a presumption that the company was insolvent or that it became insolvent as a result of that transaction. The respondent in such a case may convince the court that the transaction was made for the purpose of benefiting the company and on the basis of good faith and of continuing the business. The consequence of a successful challenge of the transaction is that the court "revives" the parties' situation as that was before the transaction was concluded. In any case, an order should not harm an interest in property obtained by a person, especially where the transaction has been made "in good faith and for value" for the company (see section 241, Insolvency Act of 1986).

Pursuant to section 423 of the Insolvency Act, the liquidator could attack a transaction intended to defraud creditors in the event the company (is in administration or) is undergoing winding up proceedings. For the action to be successful, the liquidator should demonstrate that the company received a lower consideration or no consideration of what it has furnished. This essentially refers to transactions concluded at an undervalue (section 238 of the Insolvency Act of 1986). In addition, the liquidator must prove that the transaction was intended either to harm the interests of a person who is in the process of making a claim or will make a claim against the company, or to 'keep assets out' of the hands of persons that are in the process of making such claim or will eventually make a claim against the company. A considerable advantage of this remedy concerns the absence of any time limit. A particular transaction could have been entered into years prior to the commencement of the liquidation proceeding. Interestingly, transactions in the form of gifts made to connected parties, such as the company's management, would also fall under section 423 of the Act, especially if assets are intended to be kept for a "difficult" situation. The company is deemed to be the victim of the transaction and in the context of a liquidation (compulsory winding up) proceeding the liquidator will be applying on behalf of the victim.

*The anti-deprivation rule avoids transactions that aim at 'depriving' the insolvency estate from an asset or assets that would be available for creditors. The rule centres on contractual terms that would dispossess the debtor, who would subsequently enter formal insolvency proceedings, from assets. Usually, this anti-deprivation rule is not applicable if the event has not been set off by an insolvency procedure. Moreover, there is uncertainty among courts as regards the consideration of whether an agreed clause is triggered by the commencement of a formal procedure or by the debtor's insolvency (see Eugenio Vaccari, *The normative and Jural meanings of the anti-deprivation principle vis-à-vis freedom of contract*, Wiley, INSOL International (2021)).*

Concerning the anti-deprivation principle, in the case at hand there is no indication that a deprivation is set off by the insolvency proceeding, except that "the Company continued to suffer cash flow problems". In any event, the case is not linked to the

existence or the consideration of clauses, *ipso facto* or other agreed terms, intended to deprive a subsequently insolvent party of property that would be at the disposal of creditors.

At the same time, the possibility of making an application under section 423 should be also observed. The Company itself approved the sale of the two marble cutting machines to a director of the Company, Rita Perkins, for a considerably reduced price of GBP 10,000. These machines had been purchased by the Company one year before for GBP 25,000. However, although the situation of the absence of a time limit is advantageous, the liquidator will have to prove the intention of the Company to 'defraud creditors', which includes either that the Company aimed at keeping the marble cutting machines out of the reach of creditors (who were in the process of making or may make an application in the future) or that the Company aimed at harming the interests of such creditors.

With respect to section 238 (transactions at undervalue), the Company sold to a director, Rita Perkins, the two marble cutting machines for a reduced price of GBP 10,000 in July 2022, before the Company entered compulsory liquidation in December 2022. The transaction falls within the two-year time limit. The rebuttable presumption that the Company became unable to pay its debts as a result of that transaction with a connected person or was already unable to pay its debts, is an interesting element of this remedy. The connected person, in this context, would be one of the directors of the Company, Rita Perkins. This remedy seems to be the most relevant for the present purposes.

On another note, it is useful to underscore that the liquidator may have the possibility, under section 212 of the Insolvency Act (1986), to bring an action for misfeasance with regard to any misfeasance or breach of duty concerning the Company undergoing liquidation proceedings. In such a case, the court may order the wrongdoer "(a) to repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or (b) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just" (section 212 (3), Insolvency Act of 1986). The wrongdoer is believed to have "misapplied or retained, or become accountable for, any money or other property of the company, or [is] guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company" (section 212 (1), Insolvency Act of 1986). More specifically, the liquidator may pursue an action against the directors for breach of fiduciary duties in particular with respect to the duty to act in the company's best interests with reference to the transaction regarding the two marble cutting machines. This action may not be successful in cases where the court considers the reasonable and honest conduct of a director and where an exception should be made. In any case, this section establishes a simplified procedure for causes of actions against directors that could have been carried out by the company before the commencement of the compulsory winding-up.

Question 4.3 [maximum 4 marks]

Commented [WPA12]: 4/4 the s 127 discussion is convincing. The time limit of s 239 precludes it as a preference must occur before the commencement of winding up. Section 239 and s 127 are mutually exclusive.

The payments to Hard and Fast Ltd.

As regards the payments to Hard and Fast Ltd., the liquidator could examine the following possibilities.

*Under section 239 (Insolvency Act of 1986), a liquidator's main purpose would be to avoid transactions through which the intent was to prefer a specific creditor right before the commencement of a formal insolvency proceeding. It must be demonstrated that the person given the preference was a creditor of the company, that a specific action directed at that creditor was carried out by the company in such a way that the effect of that action is deemed an amelioration of the creditor's position in view of the insolvency of that company, that the debtor company was guided by a 'desire' to prefer that creditor and that the preference was acquired within a specific time limit (six months before the commencement of liquidation proceedings in the case of a non-connected person). It is required that the company, at the time the transaction was made, was either not in a position to pay its debts or became unable as a result of that preference, pursuant to section 123 of the Insolvency Act (1986). Interestingly, it should be noted that any form of pressure by the creditor to the debtor is not considered. At the same time, the most complex element to determine is the fact that the debtor company was "influenced by a desire" to prefer that creditor (section 239, Insolvency Act of 1986; see also *Re MC Bacon Ltd.* [1990] BCC 78). Through the years, UK jurisprudence has demonstrated that no such desire to improve the position of a particular creditor can be established where there is a mere willingness on behalf of the company to continue trade in the context of purely commercial-driven considerations.*

*Under section 127 (Insolvency Act of 1986), transactions made by the debtor company in a compulsory winding up proceeding may be avoided when this disposal of property was carried out right after the commencement of the formal proceeding. The court is vested with a discretionary power to validate those transactions ('validation order') only where considerations of a transaction concluded in *bona fide* and of transactions entered into in favour of all unsecured creditors are relevant. Any party in interest applying for a validation order has the burden of proof. It is important to note that the commencement date is considered to be the date of the filing of the petition for a winding up procedure. Usually, companies intend to defend the winding up petition and, thus, on that basis, they continue trading. Failure to defend the petition will result in the avoidance of all the transactions that took place during that period until the winding up order.*

*In this respect, the court attaches particular importance to the following considerations: the *pari passu* principle, which aims to avoid creating a preferential situation for certain creditors prior to liquidation to the detriment of other creditors in the liquidation proceeding; the continuation of the business to the extent that it would be beneficial to the creditors; the fact that the transactions at issue do not reduce the debtor company's net assets, but on the contrary increase their value and protect*

them; ignorance by the parties to the transaction (which should in any case be in *bona fide*, made during the ordinary course of business and pursued to the benefit of the creditors) of the filing of the winding up petition; and the benefit to the debtor company, such as any additional supplies to be provided to it and enabling the continuation of its business, where "cash on delivery" terms have been agreed for the payment of goods. Regardless of whether to validate or not a transaction, the court can generally permit the continuation of trading for the debtor company. Generally speaking, the continuation of the trading of the business, especially where the contract seemed to be beneficial to the company, honesty in payments and the overall benefit to the debtor company are elements that will usually result in the validation of a transaction.

In the present case, Hard and Fast Ltd demanded, one month prior to the winding up order of December 2022, immediate payment of all outstanding amounts, informing the debtor Company that further supplies would be provided on a 'cash on delivery' basis. The directors of the Company permitted the payment of the current liabilities amounting to GBP 8,000, while GBP 3,000 were utilized, on a cash on delivery basis, for additional supplies delivered by Hard and Fast Ltd to the Company until the winding up order date of 23rd December 2022.

As per the action under section 239, since the payments from the Company to Hard and Fast Ltd were made a month before the winding up order, and, thus, during the six-month period for non-connected persons, the relevant time frame is certainly present. Nevertheless, this option does not seem compatible with the case at hand as, except for the specific difficulty in proving that the Company was guided by a desire to favour a specific creditor, the mere willingness of the Company to continue trading taking into account purely commercial considerations can also not support the fact that the debtor Company was influenced by a desire to prefer a particular creditor, and in our case, Hard and Fast Ltd. At the same time, as Hard and Fast Ltd. "demanded immediate payment" and, therefore, exercised, one could say, some sort of pressure, that pressure is not taken into consideration for avoiding such a transaction under section 239.

As per section 127, the Company is undergoing winding up proceedings and these payments were made between the petition of 14 October 2022 for a winding up procedure and the winding up order of 23 December 2022. All the aforementioned considerations to be observed by the court in its determination on whether to validate or not a transaction during that period tend to indicate that the transactions could be validated. Notwithstanding the protection of the general *pari passu* principle, the continued supply of marble was deemed essential for the Company, especially with regard to the continuation of trading. Moreover, these transactions may translate into a further increase in the Company's assets indeed due to the continuation of its business activity. In addition, there is no indication in the present case that the Company was informed of the winding up petition. Finally, the Company has agreed to be further supplied with marble on 'cash on delivery' terms (especially as regards the second payment of GBP 3,000) which, as previously mentioned, are viewed as

promoting the future supply of goods to the Company and thus the continuation of the business activity for the benefit of creditors.

From the aforementioned analysis, it may be concluded that, even under section 127, the payments made to Hard and Fast Ltd. may be validated mostly because of the important considerations of continuing the business activity to the benefit of both the debtor and creditors in the winding up procedure. This, nevertheless, does not mean that the transactions won't be rendered void, by application of section 127, and won't remain so at least until a validation order is issued, eventually.

*** End of Assessment ***