



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]: 47/50 = 94% 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

(c) 10

(d) 12

Commented [WPA3]: C is correct

Question 1.9

Which of the following statements is incorrect?

(a) An insolvency officeholder from an EU Member State will be automatically recognised by the courts in the UK whether the officeholder was appointed before or after Brexit.

(b) An insolvency officeholder from an EU Member State is automatically recognised by the courts in the UK if appointed before Brexit.

(c) An insolvency officeholder from an EU Member State appointed after Brexit may apply to a UK court for recognition under the Cross Border Insolvency Regulations.

(d) An insolvency officeholder from an EU Member State cannot apply to a UK court for recognition under section 426 of the Insolvency Act 1986.

Question 1.10

Under section 216 of the Insolvency Act 1986, a director of a company which has been wound up insolvent may not, unless an exception applies, be a director of a company that is known by a prohibited name for what period of time?

(a) 6 months.

(b) 12 months.

(c) 2 years.

(d) 5 years.

QUESTION 2 (direct questions) [10 marks]

Commented [WPA4]: 9/10

Question 2.1 [maximum 5 marks]

Commented [WPA5]: 4/5 regarding s 6 only the SoS and the OR can bring an action. Section 16 refers to the ability of others to bring actions under other sections of the CDDA, not just s 6.

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?

Section 423 of the Insolvency Act 1986 pertains to setting attacking transactions designed to defraud creditors. Pursuant to s 424(1)(a) of the Insolvency Act 1986, the parties who may bring an action depends on the status of the debtor company. Where the debtor company is being wound up or is in administration, parties who may bring an action under s 423 include: (a) the liquidator; (b) the administrator; and (c) any victim of the transaction such as a creditor with the leave of the court. Pursuant to s 424(1)(b) of the Insolvency Act 1986, where a victim of the transaction is bound by a company voluntary arrangement ("CVA"), the parties who may bring an action under s 423 include: (a) the supervisor of the CVA; and (b) any victim of the transaction (whether bound by the CVA or not). Pursuant to s 424(1)(c) of the Insolvency Act 1986, in any other case, a victim of the transaction may bring an action under s 423.

Section 6 of the Company Directors Disqualification Act 1986 pertains to the disqualification of unfit directors, and deals specifically with findings of unfitness against directors of insolvency companies. The parties who may bring an application under the Company Directors Disqualification Act 1986 are circumscribed by s 16(4) of the Company Directors Disqualification Act 1986, and includes: (a) the Secretary of State; (b) the official receiver; (c) the Competition and Markets Authority; (d) the Liquidator; and (e) a specified regulator within the meaning of s 9E of the Company Directors Disqualification Act 1986.

Section 246ZB of the Insolvency Act 1986 renders directors of insolvency companies liable for wrongful trading and in certain circumstances, results in such directors being liable for some of the debts and liabilities of the company. Under s 246ZB(1) of the Insolvency Act 1986, it is provided that the administrator may make an application for the court to declare that a director is liable to make such contribution to the company's assets as the court thinks proper.

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.

A18(3) of the Insolvency Act 1986 prescribes the debts which do not fall within the ambit of pre-Moratorium debts for which a company has a payment holiday during a Moratorium. Five 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 include debts which consist of amounts payable in respect of: (a) the monitor's remuneration or expenses; (b) goods or services supplied during the Moratorium; (c) rent in respect of a period during the Moratorium; (d) wages or salary arising under a contract of employment; and (e) debts or other liabilities arising under a contract or other instrument involving financial services which is defined as including a contract consisting of lending, financial leasing or providing guarantees.

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

Commented [WPA7]: 14/15

Question 3.1 [maximum 6 marks]

Commented [WPAB]: 5/6 very good on ss 233 and 233A but little detail on 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?

An administrator who wishes to continue to operate the business of the company in administration may require suppliers of specific goods and services to continue to supply those goods and services during the administration pursuant to s 233 of the Insolvency Act 1986 (the "Insolvency Act"). Under s 233(1), s 233 applies where a company enters administration. Pursuant to s 233(2)(b), if a request is made by or with the concurrence of the administrator for the giving of any of the supplies mentioned in s 233(3) after the effective date, the supplier shall not make it a condition of the giving of the supply, or do anything which has the effect of making it a condition of the giving of the supply, that any outstanding charges in respect of a supply given to the company before the effective date are paid. In this regard, the "effective date" is defined under s 233(4) as whichever is applicable of the following dates: (a) the date on which the company entered administration; or (b) the date on which the administrative receiver was appointed (or, if he was appointed in succession to another administrative receiver, the date on which the first of his predecessors was appointed. However, under s 233(2)(a), the supplier may make it a condition of the giving of the supply that the office-holder personally guarantees the payment of any charges in respect of the supply.

The supplies prescribed under s 233(3)(f) of the Insolvency Act include supplies of goods and services mentioned in s 233(3A) by a person who carries on a business which includes giving such supplies, where the supply is for the purpose of enabling or facilitating anything to be done by electric means. In turn, s 233(3A) provides that the goods and services referred to in s 233(3)(f) are: (a) point of sale terminals; (b) computer hardware and software; (c) information, advice and technical assistance in connection with the use of information technology; (d) data storage and processing; and (e) website hosting.

The supplies of goods and services are further protected by s 233A of the Insolvency Act, which provides that an "insolvency-related" term of a contract for the supply of essential goods or services to a company ceases to have effect where a company enters administration (s 233A(1)(a)). Under s 233A(3) of the Insolvency Act, where an insolvency-related term of a contract ceases to have effect under s 233A, the supplier may only terminate the contract if the condition in s 233A(4) is met, and may only terminate the supply if the condition in s 233A(5) is met.

Finally, s 233B of the Insolvency Act applies to companies in administration by virtue of s 233B(1) read with s 233(2)(b). Section 233B(3) prohibits clauses which allow the supplier of goods or services to terminate or do any other thing in relation to the

contract for the supply of goods and services, if the company enters a formal insolvency procedure such as administration.

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 order of priority of payments in a liquidation are as follows: (1) secured creditors; (2) expenses of winding up, including the liquidator's remuneration; (3) preferential creditors; (4) floating charge holders; (5) unsecured creditors; and (6) shareholders. The nature of the rights enjoyed by each class of creditor or expense will be elaborated on in turn.

First, a secured creditor is a creditor of a debtor who has the benefit of some form of mortgage or charge over the assets of the debtor (eg, a fixed charge, which fixes or attaches to a particular asset or class of assets). When a company becomes insolvent, secured creditors may exercise their rights under the relevant security against the assets of the debtor ahead of other creditors.

Second, under s 115 of the Insolvency Act 1986 (the "Act"), the expenses of the winding up, including the liquidator's remuneration, will be paid out ahead of the company's preferential creditors, holders of floating charges and unsecured creditors. The main expenses covered under s 115 of the Act are as follows, and will be paid out in the following order:

- (1) expenses properly incurred by the liquidator in preserving, realizing or getting in any of the assets of the company, including the conduct of any legal proceedings;*
- (2) the cost of any security provided by the liquidator;*
- (3) any amount payable to a person to assist in the preparation of a statement of affairs or accounts;*
- (4) any disbursements by the liquidator which are necessary in the course of the winding up;*
- (5) the remuneration of any person whom the liquidator employs to perform any services for the company;*
- (6) the remuneration of the liquidator;*
- (7) the amount of any corporation tax on chargeable gains accruing on the realization of any asset of the company; and*
- (8) any other expenses chargeable by the liquidator in carrying out his/her functions in the winding up of the company.*

Third, under s 175 of the Act, preferential creditors will be paid out in priority to floating charge holders and unsecured creditors. Preferential creditors are defined under ss 386 and 387 of the Act, with reference Schedule 6 of the Act. The category of

preferential creditors largely comprises limited claims of employees and some taxation liabilities.

Moreover, there are two classes of preferential debts: ordinary preferential debts and secondary preferential debts. Ordinary preferential debts are paid before secondary preferential debts. Preferential debts, in their respective classes, rank equally amongst themselves and thus will abate in equal proportion if the company's assets are insufficient to pay all of them. Schedule 6 of the Act prescribes the following as categories of preferential debts. The following items are ordinary preferential debts.

- (1) any sum owed on account of an employee's contribution to an occupational pension scheme, being contributions deducted from the earnings of the company's employees paid in the period beginning four months from before the commencement of the winding up;*
- (2) any sum owed by the company on account of an employer's contribution to an occupational pension scheme paid in the period beginning 12 months before the relevant date (as defined under s 387 of the Act);*
- (3) remuneration owed by the company to a person who is or has been an employee of the company and is payable in respect of the whole or any part of the period of four months prior to the commencement of the winding up (up to a maximum of GBP 800);*
- (4) any amounts owed by the company by way of accrued holiday remuneration in respect of any period of employment before the winding up;*
- (5) levies on the production of coal and steel referred to in Articles 49 and 50 of the European Coal and Steel Community Treaty;*
- (6) claims for any amount ordered to be paid by the company under the Reserve Forces (Safeguard of Employment) Act 1985, and is so ordered in respect of a default made by the company in the discharge of its obligations under that act;*
- (7) any amount owed by the company in respect of an eligible deposit as does not exceed the compensation that would be payable in respect of the deposit under the Financial Services Compensation Scheme ("FSCS") to the person(s) whom the amount is owed;*

The following items are secondary preferential debts.

- (8) any amount owed by the company to eligible person(s) in respect of an eligible deposit as exceeds any compensation that would be payable in respect of the deposit under the FSCS to that person or those persons;*
- (9) an amount owed by the company to eligible person(s) in respect of a deposit that: (a) was made through a non-UK branch of a credit institution authorised by the competent authority of the UK; and (b) would have been an eligible deposit had it been made through a UK branch of that credit institution; and*
- (10) PAYE income deductions, national insurance deductions, VAT payments, Construction Industry Scheme deductions and student loan repayments.*

Fourth, floating charge holders will be paid after preferential creditors. Where there is more than one floating charge holder, priority between them usually depends on which floating charge was created first. Notably, before any payment may be made to

a floating charge holder, the liquidator must consider the applicability of s 176A of the Act, which applies to a company with a floating charge created on or after 15 September 2003 and which has gone into liquidation. If s 176A of the Act applies, under s 176A(2), the liquidator or administrator has a duty to make a prescribed part of the company's net property available for the satisfaction of unsecured debts and must not distribute any of this prescribed part to a floating charge holder except insofar as it is in excess of the amount required to satisfy all the unsecured debts. In this regard, the "net property" refers to the amount of the company's property which would otherwise be available for the satisfaction of debts owed to holders of floating charges. The "net property" is thus calculated after the liquidation expenses and preferential debts have been paid. A floating charge holder who has an outstanding unsecured balance owing to it cannot participate in the distribution of the prescribed part.

Where the net property of the company is GBP 10,000 or less, the "prescribed part" is 50% of that property. However, where the property is less than the prescribed minimum of GBP 10,000, and the liquidator or administrator is of the view that making a distribution to unsecured creditors would be disproportionate to the benefits, the duty to make the distribution of the prescribed part does not apply. Conversely, where the net property of the company exceeds GBP 10,000, the prescribed part is the sum of 50% of the first GBP 10,000 in value, in addition to 20% of the excess in value above the GBP 10,000, subject to a maximum amount of GBP 800,000.

Fifth, unsecured creditors will next be paid. Usually, once the expenses of the liquidation have been paid and distributions have been made to secured and preferential creditors, there is little to nothing left to pay to unsecured creditors.

*Finally, if there are sufficient funds to pay all the creditors with interest on their debts, any surplus will be distributed amongst the shareholders in accordance with the company's constitution, which will normally permit a *pro rata* distribution according to the shareholders' respective shareholdings.*

If the company had been subject to a Moratorium under Part A1 of the Act during the 12-week period prior to the commencement of the liquidation, that might cause the priority of debts in the subsequent liquidation may be different from the priority of debts which existed prior to the moratorium. In particular, Section 174A affords certain unsecured debts a form of super priority in the subsequent liquidation by providing that certain unpaid pre-moratorium or moratorium debts that do not form part of the payment holiday, for instance debts owed to employees or financial services debts, be paid in the subsequent liquidation in priority to the liquidator's fees and expenses. By way of illustration, if a director has not been paid for several months prior to a moratorium, and the subsequent rescue attempt is unsuccessful and the company enters liquidation, the pre-moratorium unsecured debts of the director will acquire super priority in the liquidation.

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;

In relation to the floating charge granted in February 2022 in favour of Fretus Bank plc ("Fretus") over the whole of the Company's undertaking, there are two possible actions that the liquidator may take:

- (1) an action to avoid the floating charge; and*
- (2) an action in unfair preference.*

Avoidance of the floating charge

Pursuant to s 245(2) of the Insolvency Act 1986 (the "Act"), a floating charge on the company's undertaking or property created at a relevant time is invalid except to the extent of the aggregate of:

- (a) *The value of so much of the consideration for the creation of the charge as consists of money paid, or goods or services supplied, to the company at the same time as, or after, the creation of the charge. This consideration must be given at the same time as or after the charge is created. Where an agreement is made to execute a charge followed by payments to the company, followed in turn by the formal execution of the charge, any delay between the making of the payments and the execution of the charge must be minimal (Re Shoe Lace Ltd [1993] BCC 609).*
- (b) *The value of so much of that consideration as consists of the discharge or reduction, at the same time as, or after, the creation of the charge, of any debt of the company. It has been suggested that consideration by way of payments by directors to the company for a specific purpose which was for the benefit of the directors, in helping to release their personal liability under guarantees, were not within the exemption in s 245 (Re Fairway Magazines [1992] BCC 924). However, this category specifically provides that a floating charge is not to be invalidated to the extent of consideration by way of discharge or reduction of a debt of the company.*
- (c) *The amount of such interest (if any) as is payable on the amount falling within paragraph (a) or (b) in pursuance of any agreement under which the money was so paid, the goods or services were so supplied or the debt was so discharged or reduced.*

The "relevant time" for the purposes of s 245 depends on whether the person in whose favour the floating charge is created is connected with the company. Under s 245(3), the "relevant time" is: (a) the period of 2 years ending with the onset of insolvency for a charge created in favour of a person connected with the company; and (b) the period of 12 months ending with the onset of insolvency for a charge created in favour of any other person, but only if at the time the charge was created the company was either unable to pay its debts within the meaning of s 123 of the Act or became unable to do so in consequence of the transaction. Section 129 of the Act in turn provides that the winding up of a company by the court is deemed to commence at the time of the presentation of the petition for winding up, which is 14 October 2022.

In the present case, there is no indication that any fresh consideration was provided by Fretus for the floating charge over the Company's entire undertaking. In particular, while the creation of the floating charge did prevent Fretus from demanding repayment of the Company's loans, it did not discharge or reduce the loan. Neither was any consideration in the form of money, goods or services given to the company for the creation of the floating charge.

Furthermore, there is nothing to suggest that Fretus was a connected person with respect to the Company. Hence, the relevant time would be 12 months. Here, the floating charge, which was created in February 2022, was created within the relevant time of 12 months before the petition for winding up was filed on 14 October 2022. However, the only difficulty is that it is unclear if the company was unable to pay its debts within the meaning of s 123 of the Act or became unable to do so because of the

creation of the floating charge. Therefore, more information is required to determine if the floating charge can be avoided.

Unfair preference

Another way in which the floating charge may be set aside is as an unfair preference. An application may only be made under s 239 of the Act if the company has gone into liquidation or administration.

Under s 239(2), where the company has at the relevant time given a preference to any person, the office-holder may apply to the court for an order under s 239. Under s 239(3), the court shall make such order as it thinks fit for restoring the position to what would have been if the company had not given that preference.

First, whether or not the preference was given to a connected person, it is a prerequisite under s 239 of the act that at the time the preference was given, either the company was unable to pay its debts as they fell due within the meaning of s 123 of the Act or became unable to pay its debts within the meaning of s 123 in consequence of the preference. There is insufficient evidence here to conclude that at the time of the creation of the floating charge, Fretus was unable to pay its debts or became unable to do so as a consequence of the floating charge being created.

Pursuant to s 239(4) of the Act, a company gives a preference to a person if the following are satisfied.

- (a) That person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities, at the time of the transaction. This is clearly satisfied since Fretus was a creditor of the Company at the time of the creation of the floating charge.
- (b) The company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done. This requirement is likely satisfied since the granting of the floating charge to Fretus would put Fretus in a better position vis-à-vis the company's unsecured creditors.

In addition, it must be shown that:

- (c) The company in giving the preference was influenced by a desire to produce the effect referred to in (b) above, *ie*, the prefer the person preferred.
- (d) The preference was given at the relevant time.

In relation to requirement (c), the case of *Re MC Bacon Ltd* [1990] BCC 78 is instructive. In that case, a distinction was drawn between intention (an objective concept) and desire (a subjective concept). In other words, an intention to grant security to a creditor necessarily involves an *objective intention* to prefer that creditor in the event of insolvency. However, this does not, by itself, amount to a desire to prefer. In subsequent decisions, it was held that where a company is influenced solely by commercial considerations, in particular to ensure that the company continued

trading, there could be no desire to prefer. Moreover, where the preference is given to a person connected with the company, the desire to prefer is presumed, unless the contrary is established. On the facts, there is no evidence to suggest that Fretus is connected with the Company. Moreover, it is stated that the floating charge was created to prevent Fretus from demanding repayment of the Company's loans. Hence, the floating charge was likely given for a commercial reason, and a desire to prefer likely cannot be established.

In relation to requirement (d), given that there is no evidence that Fretus is connected with the Company, the s 240(1)(b) of the Act provides that the "relevant time" is the period of 6 months ending with the onset of insolvency. In turn, the onset of insolvency is defined under s 240(3)(e) as the date of commencement of winding up. Section 129 of the Act in turn provides that the winding up of a company by the court is deemed to commence at the time of the presentation of the petition for winding up, which is 14 October 2022. Here, the floating charge, being given on February 2022, was not given within 6 months of 14 October 2022 when the Company went into compulsory liquidation. Hence, the floating charge cannot be set aside as an unfair preference.

Question 4.2 [maximum 6 marks]

Commented [WPA12]: 6/6 very good

The sale of the marble cutting machines; and

In relation to the sale of the marble cutting machines, the liquidator could take out an action to set aside the transaction for being an undervalue transaction as the machines were purchased for GBP 25,000 but sold at GBP 10,000.

Pursuant to s 238(1) of the Act, the section only applies where the company goes into liquidation, which is satisfied in this case.

Pursuant to s 238(2) of the Act, where the company has, at a relevant time (as defined in s 240) entered into a transaction with any person or at an undervalue, the office-holder may apply to the court for an order under s 238, and the court shall, under s 238(3), make such an order as it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction.

First, whether or not the transaction was with a connected person, it is a pre-requisite of liability under s 238 that at the time the transaction was entered into, the company was either unable to pay its debts as they fell due within the meaning of 123 of the Act or became unable to pay its debts within the meaning of s 123 of the Act as a consequence of the transaction. In the case of a transaction with a connected person, it is presumed that the company was insolvent, or became insolvent as a result of the transaction, unless proven otherwise. Here, the transaction involved Rita Perkins ("Perkins"), a director of the Company, who is likely to be a connected person in relation to the Company. Hence, it would be presumed that the Company was insolvent at the time of, or became insolvent as a result of, the transaction.

Section 240, which defines the “relevant time” for s 238, provides that the relevant time is, where the transaction involves a person connected with the company, the period of 2 years ending with the onset of insolvency. In turn, the onset of insolvency is defined under s 240(3)(e) as the date of commencement of winding up. Section 129 of the Act in turn provides that the winding up of a company by the court is deemed to commence at the time of the presentation of the petition for winding up, which is 14 October 2022. As mentioned above, as the transaction involved Perkins, who is a connected person in relation to the company, the relevant time would be 2 years. It is clear that the transaction occurred within 2 years of 14 October 2022.

Pursuant to s 238(4), for the purposes of s 238, a company enters into a transaction with a person at an undervalue if:

- (a) the company makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration; or*
- (b) the company enters into a transaction with a person for a consideration the value of which, in money or money’s worth, is significantly less than the value, in money or money’s worth, of the consideration provided by the company.*

Section 238(4)(b) of the Act is likely satisfied since the Company had agreed to sell the marble cutting machines to Perkins for 10,000 GBP, even though they had been purchased for GBP 25,000 just a year before.

However, under s 240(5), the court shall not make an order under s 238 if it is satisfied that:

- (a) the company which entered into the transaction did so in good faith and for the purpose of carrying on its business; and*
- (b) at the time it did so, there were reasonable grounds for believing that the transaction would benefit the company.*

Here, it is provided that the directors had approved the sale of the marble cutting machines to Perkins to alleviate its cash flow problems. Thus, there is a case for arguing that the Company had entered into the transaction in good faith and for the purposes of carrying on its business. Moreover, there were certainly reasonable grounds for believing that the sale would benefit the Company, since it would give the company much needed cash flow. While the difference in the price the machines were bought for and the price the machines were sold for is quite large (GBP 15,000), that could be attributed to the wear and tear sustained by the machines over a year. However, more information is needed for such a conclusion to be safely drawn.

Question 4.3 [maximum 4 marks]

Commented [WPA13]: 4/4 very good again

The payments to Hard and Fast Ltd.

The liquidator may apply to set aside the payments to Hard and Fast LTD (“HFL”) as it was a disposition of the Company’s property made after the commencement of winding up. In particular, pursuant to s 127 of the Act, in a winding up by the Court, any disposition of the company’s property and any transfer of shares, or alteration on the status of the company’s members, made after the commencement of the winding up is, unless the court otherwise orders, void. Moreover, the words “disposition of the company’s property” in s 127 are accorded a wide meaning and include any payment of money. Thus, that would most likely include the payments made to HFL.

In this regard, s 129 of the Act provides that the winding up of a company by the court is deemed to commence at the time of the presentation of the petition for winding up, which is 14 October 2022 in the present case. Here, the winding up order was made on 23 December 2022, and the payments were made a month before that in November 2022. Hence, the payments were technically made after the commencement of the Company’s winding up.

*However, the impact of s 127 is not absolute, and the court has a discretionary power to declare that dispositions shall not be void through a validation order. An applicant for a validation order has the burden of proving why the order should be made. The rationale underlying this discretion is that if transactions entered into *bona fide* in the order course of business are not permitted, the parties interested in the assets of the company could be prejudiced. In determining whether or not to permit dispositions, the court will consider the following among other considerations:*

- (a) The court is generally reluctant to depart from the basic principle of *pari passu* distribution among creditors, and would not validate a payment where its effect would be to give a preference to a creditor over other creditors.*
- (b) Payments are likely to be sanctioned where necessary to ensure continued supplies enabling the company to continue trading, in cases where the court considers that it would be in the best interests of creditors for the company to continue trading. Thus, where payments are made honestly and in the ordinary course of business for the benefit of the company, such as the payment on supplies to enable the company to fulfil a contract that seems profitable, the payment is likely to be authorised. Transactions which allow a company to continue to trade will generally be validated.*
- (c) Where goods have been paid for on terms of cash on delivery, the court will consider the benefit to the company, including whether the payment will enable further supplies to be received and so enable the business to continue.*

In the present case, the Company had decided to pay HFL as HFL had demanded immediate payments of all sums owing to it and informed the company that further supplies would only be made on a cash on delivery basis. It is provided that HFL was one of the Company’s key suppliers, and the continued supply of marble was regarded as essential to the Company’s business. Thus, the payments to HFL were likely necessary for the Company to continue trading, and were made honestly and in the ordinary course of business for the benefit of the company. The continued trading of the company would also likely be beneficial to the creditors of the company by

maximising the Company's assets. Thus, if the Company applies or had applied for a validation order to validate the payments made to HFL, that would likely be granted and the liquidator would likely not be able to set aside those payments as being a void disposition of the Company's assets after the commencement of winding up.

*** End of Assessment ***