



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 2024**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2024. 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 2024** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2024**. If you elect to submit by 1 March 2024, you **may not** submit the assessment again by 31 July 2024 (for example, in order to achieve a higher mark).
7. Prior to being populated with your answers, this assessment consists of **9 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 eight weeks of the commencement of the administration.**
- (c) within four 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. [p.89]
- (b) Restructuring Plan.
- (c) Scheme of Arrangement.
- (d) Company Voluntary Arrangement.

Question 1.6

Section 426 of the Insolvency Act 1986 contains provisions for UK courts to provide assistance to overseas courts from certain listed jurisdictions. Which of the following is not a listed jurisdiction under section 426?

- (a) Malaysia.
- (b) Australia.
- (c) India.
- (d) Hong Kong.

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 filing by a company's directors of a Notice of Intention to Appoint an administrator produces a short-term moratorium on actions against the company which lasts for how long?

- (a) Five business days.
- (b) Twenty business days.
- (c) Ten days.
- (d) Three months.

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 if the director has been a director of the company during which period prior to the insolvent liquidation?

- (a) Six months.
- (b) Five years.
- (c) Two years.
- (d) Twelve months.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [maximum 5 marks]

Who may bring an action under: (i) section 245 of the Insolvency Act 1986, (ii) section 6 of the Company Directors Disqualification Act 1986, (iii) section 246ZB of the Insolvency Act 1986, and (iv) section 127 of the Insolvency Act 1986?

(i) Procedure under section 245 of the Insolvency Act 1986 (the "Act").

Section 245 of the Act specifically applies to floating charges and doesn't apply to other types of security. It applies when a company is in administration or liquidation. A floating charge is automatically invalid, to the extent that the criteria set out in section 245 of the Act are satisfied (i.e., the relevant time (section 245(3)(a) & (b) of the Act); the insolvency requirement within the meaning of section 123 of the Act (section 245(4) of the Act); or the "new" consideration exceptions (245(2)(a)-(c) of the Act)).

No application needs to be made by the office holder, at least theoretically. The office holder will customarily simply write to the floating charge holder, stating that the office holder believes the floating charge is invalid. This may prompt the floating charge holder to attempt to enforce the charge, in which case the office holder may take proceedings to prevent the floating charge holder from enforcing the security.

In practice, in all but the clearest cases, a determination whether or not a floating charge is valid or not under the application of section 245 of the Act may trigger litigation on the issue, often for a declaration as to the validity or otherwise of the charge, depending on who initiates the litigation. In this context, the following parties may bring an action under this section: (i) a Liquidator: if the company is in liquidation, the liquidator can take action to set aside transactions that were detrimental to the company's creditors; (ii) an Administrator: where the company is in administration, the administrator has the same powers as a liquidator and may bring an action under this section; and (iii) an Official Receiver: when the company is put compulsory liquidation, the court-appointed Official Receiver is also able to initiate proceedings under section 245 of the Act.

(ii) Section 6 of the Company Directors Disqualification Act 1986 (the "CDDA")

An application to the court where this qualification order will be made by the Secretary of State (in cases of voluntary winding up) or the official receiver (in compulsory winding up cases) on the instructions of the Secretary of States where the company in question has been wound up by the court (see section 7(1)(a) & (b) of the CDDA).

Section 6 of the CDDA gives the Secretary of State the ability to bring legal proceedings against a director, where they consider the court will be satisfied that the person concerned was a director of an insolvent company or it was dissolved without becoming insolvent and the director's conduct makes them a "*person unfit to be concerned in the management of a company*". The Insolvency Service may bring proceedings on behalf of the Secretary of State if the alleged unfit conduct falls within its remit, and it is instructed to do so. The majority of applications made by the Insolvency Service, on behalf of the Secretary of State, are made under section 6 of the CDDA.¹ The proceedings are usually brought by the Insolvency Service acting on behalf of the Secretary of State for Business and Trade.²

(iii) Section 246ZB of the Insolvency Act 1986

Section 246ZB of the Act pertains to wrongful trading during administration, and proceedings pursuant to this section are typically brought by the administrator of the company, if it appears that a person who is or has been a director of the company that has entered insolvent

¹ See paragraph 11 of [Company Directors Disqualification Act 1986 and failed companies - GOV.UK \(www.gov.uk\)](http://www.gov.uk)

² See paragraph 12 of [Company Directors Disqualification Act 1986 and failed companies - GOV.UK \(www.gov.uk\)](http://www.gov.uk)

administration knew or ought to have concluded that there was no reasonable prospect that the company would avoid entering insolvent administration (section 246ZB(2)(a)-(c)).

However, administrators and liquidators can now (under section 118 of the Small Business, Enterprise and Employment Act 2015 ("SBEEA" 2015)) assign wrongful trading claims to a third party, including to creditors, as a way of raising funds for the insolvent estate and thereby, avoid the risk of litigation. The administrators' and liquidators' power to assign is derived from section 246ZD of the Act, which states that (emphasis added):

- 1) This section applies in the case of a company where—
 - a) the company enters **administration**, or
 - b) the company goes into liquidation;
 - c) and "the office-holder" means the **administrator** or the liquidator, as the case may be.
- 2) **The office-holder may assign a right of action (including the proceeds of an action) arising under any of the following—**
 - (a) section 213 or 246ZA (fraudulent trading);
 - (b) section 214 or 246ZB (wrongful trading);**
 - (c) section 238 (transactions at an undervalue (England and Wales));
 - (d) section 239 (preferences (England and Wales));
 - (e) section 242 (gratuitous alienations (Scotland));
 - (f) section 243 (unfair preferences (Scotland));
 - (g) section 244 (extortionate credit transactions)."³

(iv) Section 127 of the Insolvency Act 1986

The liquidator of the company. Section 217 of the Act allows a liquidator to claw back monies that were paid to recipients from the period of first presentation of the winding up petition up until the making of the winding up order. Pursuant to section 127 of the Act, any disposition of the company's property, transfer of shares, or alteration in the status of members after the commencement of the winding up is also deemed to be void, except to the extent the Court orders otherwise. While this provision, *inter alia*, does not explicitly apply in a voluntary winding up, a voluntary liquidator may apply to the Court under section 112 of the Act to ask the Court to apply any provision applicable to a compulsory winding up in the voluntary winding up.

One of the main goals of liquidation is to safeguard that company property, which it owns when the liquidation starts, is distributed to its creditors in accordance with the statutory order. The onset of a winding up does not affect the company's ownership of its property, but it does affect its powers of dealing with that property by limiting those significantly. In a compulsory winding up, section 127 of the Act avoids any disposition of property of the company made after the onset of winding up, to the extent that the court does not order otherwise. The onset date will be the date of the filing of the winding up petition, and thus the avoidance provision acts in a backdated manner. Habitually, a company which is subject to a winding up petition may carry on trading with the purpose of defending the petition. If it carries on trading and fails to defend the petition, the winding up order which may be made several months after the petition will avoid any dispositions of company property which have been made in the interim. The liquidator will often therefore take steps to enforce section 127 of the Act in order to retrieve company assets disposed of during the period between the presentation of the petition and the winding up order.

³ Pursuant to section 246ZC of the Act, 'Proceedings under section 246ZA or 246ZB', Section 215 of the Act applies for the purposes of an application under section 246ZA or 246ZB of the Act as it applies for the purposes of an application under section 213 of the Act but as if the reference in subsection (1) of section 215 of the Act to the liquidator was a reference to the administrator.

Question 2.2 [maximum 5 marks]

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.

Pre-Moratorium debts for which the company does not have a payment holiday include:

1. The monitor's remuneration or expenses;
2. goods or services supplied during the Moratorium;
3. rent in respect of a period during the Moratorium;
4. wages or salary arising under a contract of employment;
5. redundancy payments; or
6. debts or other liabilities arising under a contract or other instrument involving "financial services" which term is somewhat inexactly defined as including a contract consisting of lending, financial leasing or providing guarantees.

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

Question 3.1 [maximum 6 marks]

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?

To some extent, yes. The appointment of an administrator doesn't, for example, result in an automatic and/or immediate termination of a company's executory contracts. Historically, provisions in supply contracts that allow for immediate termination have been largely effective. However, these are now increasingly subject to statutory exceptions, which predominantly render such immediate termination or *ipso facto* clauses invalid.

An administrator often requires access to or retention of certain vital supplies. Section 233 of the Act pertains to the provision of gas, electricity, water, and communication services. The term 'communication services' encompasses the supply of goods and services such as point of sale terminals, computer hardware, software information, advice and technical assistance, data storage and processing, and website hosting. Suppliers are prohibited from demanding payment of outstanding debts to secure a new or continued supply to the company under administration. However, section 233 of the Act allows a supplier to require that the administrator personally guarantee payment of charges for the new supply.

Furthermore, under section 233A of the Act, a supplier of such services is generally unable to depend on an "insolvency-related term" in a supply contract which would otherwise allow the supplier to terminate the supply, modify the supply terms, or demand higher payments for continued supply.

The 2020 Act has extended these protections for an insolvent company by incorporating section 223B into the Act. Section 233B of the Act forbids clauses which permit the supplier of any goods or services to terminate or "do any other thing" in relation to the contract if the company initiates a formal insolvency procedure.

A clause of a contract for the supply of goods or services to the company becomes ineffective when the company enters an insolvency procedure, where, pursuant to the clause of the contract would terminate or the supplier would have the right to terminate the contract or to "do any other thing" upon the company entering into insolvency procedure. Section 233B of the Act not only prevents suppliers from terminating a supply upon the company's insolvency but also prevents suppliers from making it a condition of continued supply that pre-insolvency arrears are paid and from making other changes to the contract such as increasing prices.

Under section 233B of the Act, a supplier cannot demand a personal guarantee from the administrator as it can under section 233 of the Act.

It should be noted that pursuant to Section 233B, a supplier can still terminate a contract if the company or insolvency office holder consents, or an application to the court is satisfied that the continuation of the contract would cause hardship to the supplier and grants permission for termination.

Section 233B of the Act supplements sections 233 and 233A of the Act, which likewise forbid termination by utility communications and IT suppliers. Section 233B of the Act extends the restriction on termination to all other suppliers, with a few exceptions, such as insurers, banks, electronic money institutions, recognised investment exchanges and clearing houses, securitization companies and overseas companies with equivalent functions.

Sections 233A and 233B of the Act apply in administration and where a company enters a CVA. Section 323B of the Act additionally applies in circumstances where a company has entered into a moratorium; a restructuring plan; or liquidation. The inclusion of liquidation is somewhat surprising at first glance as it is not common for a company in liquidation to continue to trade a business. Although unusual, it is not impossible for a company in liquidation to continue its business, at least for a short period to ensure beneficial winding up of the company's assets.

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 general, the order of priority of payment in a liquidation is as follows:

1. First ranking claims - holders of fixed charges
2. Second ranking claims - moratorium debts and priority pre-moratorium debts
3. Third ranking claims - expenses of the insolvent estate
4. Fourth ranking claims - preferential creditors
5. Fifth ranking claims - the prescribed part
6. Sixth ranking claims - holders of floating charges
7. Seventh ranking claims - unsecured creditors
8. Eighth ranking claims - shareholders

1) Expenses

Pursuant to section 115 of the Act and Rules 6.42 and 7.108 of the Insolvency Rules 2016 (the "**Rules**"), a number of expenses are given priority to company's preferential creditors, any holders of floating charges, and company's unsecured creditors. After the payment of any liabilities to which section 174A of the Act applies i.e. the Moratorium debts, all expenses properly incurred in the winding up, including the remuneration of the liquidator, are payable out of the company's assets in priority to all other claims (section 115 of the Act and (Rules 6.42(1)), and all fees, costs, charges and other expenses incurred in the course of the winding up are to be treated as expenses of the winding up (Rules 6.42(2)). the expenses are payable in the following order of priority pursuant to Rules 6.42(4):

- a) expenses which are properly chargeable or incurred by the liquidator in preserving, realising or getting in any of the assets of the company or otherwise in the preparation, conduct or assignment of any legal proceedings, arbitration or other dispute resolution procedures, which the liquidator has power to bring in the liquidator's own name or

- bring or defend in the name of the company or in the preparation or conduct of any negotiations intended to lead or leading to a settlement or compromise of any legal action or dispute to which the proceedings or procedures relate;
- b) the cost of any security provided by the liquidator or special manager under the Act or the Rules;
 - c) the remuneration of the special manager (if any);
 - d) any amount payable to a person employed or authorised, under Chapter 2 of Part 6, to assist in the preparation of a statement of affairs or of accounts;
 - e) the costs of employing a shorthand writer on the application of the liquidator;
 - f) any necessary disbursements by the liquidator in the course of the administration of the winding up (including any expenses incurred by members of the liquidation committee or their representatives and allowed by the liquidator under rule 17.24, but not including any payment of corporation tax in circumstances referred to in sub-paragraph (i));
 - g) the remuneration or emoluments of any person who has been employed by the liquidator to perform any services for the company, as required or authorised by or under the Act or the Rules;
 - h) the remuneration of the liquidator, up to an amount not exceeding that which is payable under Schedule 11 (determination of insolvency office-holder's remuneration);
 - i) the amount of any corporation tax on chargeable gains accruing on the realisation of any asset of the company (irrespective of the person by whom the realisation is effected);
 - j) the balance, after payment of any sums due under sub-paragraph (h) above, of any remuneration due to the liquidator; and
 - k) any other expenses properly chargeable by the liquidator in carrying out the liquidator's functions in the winding up.
- 2) Preferential creditors as defined in Sections 386, 387 and Schedule 6: section 175 of the Act
- a) The preferential debts regime applies to all insolvency procedures under the Act. NB: administrators and administrative or other receivers must act in accordance with the preferential debt regime and that the terms of CVAs cannot alter the priority preferential creditors.
 - b) Once the liquidation expenses have been fully paid, the company's assets are then used to pay preferential creditors before any payment may be made to floating charge holders or to unsecured creditors. The category of preferential creditors largely comprises limited claims of employees and some taxation liabilities (and other types of liability). A characteristic of the statutory preferential debts regime has historically been that the remuneration of employees and later contributions to their pension schemes have been granted some priority. However, there are such claims have are subject to significant limitations. For the majority of insolvencies the statutory protection afforded to employees under the Employment Rights Act 1996 provides a far more wide-ranging protection for employees, which has led to scrutiny of the Act's retention of this historic employee protection provision.
 - c) Before 2002, the class of preferential creditors included a number of liabilities owed in respect of outstanding tax to the Crown i.e. the government. Although the Enterprise Act of 2002 abolished this Crown preference, it has by and large been reintroduced via section 95 of the Finance Act 2020.
 - d) Ordinary and secondary make up the two classes of preferential debts. Ordinary preferential debts are paid in priority to secondary preferential debts. Preferential debts in their respective classes rank *pari passu* between themselves and so abate in equal proportion if the company's assets are not enough to pay them all.
 - e) Schedule 6 of the Act lists the following debts as preferential:

- i) Any sum owed on account on an employee's contribution to an occupational pension scheme, being contributions deducted from earnings of the company's employees paid in the period of four months prior to the commencement of winding up. (Schedule 6, 8)
- ii) Any sum owed by the company on account of an employer's contribution to an occupational pension scheme in the period of 12 months before the relevant date.
- iii) Remuneration owed by the company to a person who is or has been an employee of the debtor 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 to a maximum total figure which is currently £800, a figure that has remained unchanged since 1976. (Schedule 6, 9)
- iv) Any amounts owed by the company by way of accrued holiday remuneration in respect of any period of employment before the winding up. Any remuneration payable by the company to a person in respect of a period of holiday or absence from work, through sickness or other good causes deemed to be wages. (Schedule 6, 10)
- v) Claims for monies advanced to pay wages on or holiday remuneration will rank as preferential. This provision is designed to protect lenders where their money has been used to pay wages or holiday remuneration of the employees of their customer and allows them to take up over the benefit which the employees would have had had the lender not made the monies available for the specific purpose of seeing them paid. (Schedule 6, 10)
- vi) Levies on the production of coal and steel, referred to in Article 49 and Article 50 of the European Coal and Steel Community Treaty. Given the paucity of independent producers of coal and steel in the UK these claims are now extremely rare. (Schedule 6, 15A)
- vii) Claims for salvage of any amount which is 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 the Act. Also these claims are extremely rare. (Schedule 6, 12)
- viii) More recently added preferential debts, such as so much of any amount owed by the company and respective and a legible deposit as does not exceed the compensation that would payable in respect of the deposit under the Financial Services Compensation Scheme to the person or persons to whom the amount is owed. (Schedule 6, 15B)
- ix) So much of any amount owed by the Company to one or more eligible persons in respect of an eligible deposit as exceeds any compensation that would be payable in respect of the deposit over the Financial Services Compensation Scheme to that person or those persons. (Schedule 6, 15BA)
- x) Amount owed by the company to one or more eligible persons in respect of a deposit that was made through a non-UK branch of a credit institution authorised by the competent authority of the UK; and would have been an eligible deposit if it had been made through a UK branch of that credit institution. (Schedule 6, 15BB)
- xi) In addition to the above, the UK has reintroduced a form of Crown preference for certain debts owed to taxation authorities, His Majesty's Revenue and Customs.
- xii) PAYE income tax deductions, National Insurance reductions, VAT payments, construction industry scheme deductions and student loan repayments.

The last three listed above are defined as secondary preferential debts under section 386 of the Act and are paid after the "ordinary" preferential debts, which includes all the other preferential debts noted above.

3) Floating charge holder and the "prescribed part"

- a) Where there is more than one floating charge holder, priority between them is usually determined by which floating charge was first created.

- b) Before any payment can be made to any floating charge holder, a liquidator must first consider the application of Section 176A of the Act, which applies to a company with floating charges created on or after 15 September 2003, and where the company has gone into liquidation or administration.
 - c) If the company's net property is
 - i) not greater than GBP 10,000, the prescribed part is 50% of that property. However, in such circumstances, where the property is less than the prescribed minimum of GBP 10,000, and the liquidator or administrator considers that making a distribution to unsecured creditors would be disproportionate to the benefits, then the duty to make this version of the prescribed part does not apply.
 - ii) if the company's net proceeds exceed GBP 10,000, the prescribed part is made up of the sum of 50% of the 1st GBP 10,000 in value, plus 20% of the excessive value above the GBP 10,000, subject to a maximum amount of the prescribed part of £800,000.
 - d) A floating charge holder, or indeed any secured creditor who may have an outstanding unsecured balance owing to it, is forbidden to participate in the distribution of the prescribed part.
- 4) Unsecured Creditors
- a) Creditors holding no security, frequently ordinary trade creditors, are paid out last in the statutory order. Regularly, after the expenses of the liquidation have been paid and distributions have been made to secure and preferential creditors, little or nothing is left to pay dividends to unsecured creditors.
- 5) Shareholders
- a) If sufficient funds to pay all the creditors an interest on their debts remain, any such surplus is distributed between the shareholders in accordance with the company's constitution, which will normally allow a distribution on a *pro rata* basis of the shareholders' respective shareholdings.

Subordination agreements whereby creditors agree between themselves to vary their priority, are valid since they do not affect the priority of other creditors; and simply act as a contractual agreement between two or more creditors.

[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?]

An idiosyncratic aspect of the Moratorium is that if the company is not rescued as a going concern, but instead goes into liquidation within 12 weeks of the Moratorium ending, the priority of debts in that subsequent liquidation may be different to the priority of debts which existed prior to the Moratorium. Pursuant to section 174A, certain unpaid pre-Moratorium or Moratorium debts, i.e., the debts that do not form part of the payment holiday, for example, debts owed to employees, or "financial services" debts are paid in the subsequent liquidation in priority to even the liquidator's fees and expenses. Section 174A of the Act therefore grants specific unsecured debts a form of "super priority" in a following liquidation. For instance, where a director has not received payment for months preceding a Moratorium, if the Moratorium ends in an unsuccessful rescue attempt and the company enters liquidation, the pre-Moratorium unsecured debt of the director will acquire super priority in the liquidation. Unsecured or secured pre-Moratorium bank debt falling within the definition of "financial services" will also acquire such a "super priority" although there is an exception which prevents such liabilities acquiring that kind of super priority where the debt is accelerated, in other words, any pre-moratorium financial services that which fell due by reason of the operation of, or exercise of rights under, an acceleration or early termination provision in the financial services contract.

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

Prior to going into compulsory liquidation on 28 February 2024, under pressure from its bank, Ambitus Bank plc, and in order to prevent it from demanding repayment of the company's loans, Blazer Laser Limited (the Company), granted a debenture in favour of Ambitus Bank plc in June 2023. 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 13 January 2024.

Sometime in January 2023, as the Company continued to suffer cash flow problems, the directors approved the sale of two laser cutting machines to Angela Bannister (a director) for GBP 40,000 in cash. The machines had been bought for GBP 100,000 a year before.

A month before the winding up order was made, Angela Bannister received an email from Aluminium Alumi 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 metal was seen as essential by the Company, the board authorised a payment of GBP 20,000 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 8,000 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 Ambitus Bank plc and the two subsequent transactions.

Using the facts above, answer the questions that follow.

Identify the relevant issues and statutory provisions and consider whether the liquidator may take any action in relation to:

Question 4.1 [maximum 5 marks]

The floating charge in favour of Ambitus Bank plc;

The relevant issue here for the liquidator to consider and take advice on is floating charge avoidance:

The debenture the Company granted in favour of Ambitus Bank PLC ("**Ambitus**") in June 2023 in order to prevent it from demanding repayment of the company's loans, which contained a floating charge over the whole of the Company's undertaking, may be caught by section 245 of the Act. This section applies only to floating charges, not any other type of security; and applies where a company is in liquidation, as is the case here, given that on the facts the Company went into compulsory liquidation on 28 February 2024, following a creditor's winding up petition issued on 13 January 2024.⁴ The provision is aimed at preventing pre-existing unsecured creditors obtaining the security of a floating charge shortly before the company enters a formal insolvency procedure. It also renders invalid floating charges given by a company at a relevant time, except to the extent that in substance that "new" consideration is provided for the floating charge. Whether the person in whose favour a floating charge is created is connected or not connected to the Company has an impact on the "relevant time" for the purposes of section 245 of the Act (see section 245(3)(a) & (b) with (c)&(d) of the Act).

⁴ NB: section 245 of the Act also where a company is in administration.

On the facts, we understand that Ambitus is the Company's bank and thus presumably the person in whose favour the floating charge was created is not connected to the Company. Where the person in whose favour the floating charges created is not connected with the Company, the relevant time is anytime within the period of 12 months prior to the onset of insolvency (section 245(3)(b) of the Act),⁵ but only if at the time of the creation of the charge, the Company was either unable to pay its debts (i.e., cash flow insolvency) or its liabilities exceeded its assets (i.e. balance sheet insolvency) within the meaning of section 123 of the Act, or became unable to do so in consequence of the transaction (section 245(4) of the Act). In liquidation, the onset of insolvency is the date on which the winding-up petition was presented to the court, in a compulsory liquidation (section 129 of the Act) – which on our facts is 13 January 2024. Thus, the floating charge created in June 2023 would fall within 12 months of the onset of the Company's insolvency (i.e., c. 6 months from the onset).

We further understand that sometime in January 2023 the Company continued to suffer cash flow problems. We require further information to determine whether the Company was cash flow insolvent at June 2023 within the meaning of section 123 of the Act; but if it was, then the floating charge will have been created at a relevant time when the Company was unable to pay its debts at the time the charge was created or became unable to pay its debts in consequence of the transaction under which the charge is created (section 245(4) of the Act).

A floating charge created at a relevant time will be valid only to the extent of the value of ("new") consideration provided to the company at the same time or after the creation of the charge. The following two main categories of "new" consideration (plus a category of interest on such consideration) set out in section 245(2)(a)-(c) of the Act, which, if satisfied, entail the floating charge will not be invalid:

- 1) Money paid, or goods or services supplied, to the company at the same time as, or after, the creation of the charge.
 - a) Not only must the consideration be provided at the same time or after the creation of the charge, it must also be given specifically in respect of the grant of that charge. Where the agreement is made to execute a charge, followed by payments made to the company, followed then by the formal execution of the charge, any delay between the making of the payments and the execution of the charge must be minimal, such as the time to take a coffee-break; where there is doubt about whether the two take place "at the same time", the floating charge will not be invalid in respect of that loan if the interval between (in the case of the making of a loan) payment to the company of monies and execution by the company of the charge is "so short that it can be regarded as minimal and payment and execution can be regarded as contemporaneous" (see *Re Shoe Lace Ltd* [1993] BCC 609). This category does not appear applicable to our fact pattern.
- 2) Discharge or reduction of any debt of the company at the same time or after the creation of the charge.
 - a) The requirement for new consideration is a requirement of new consideration paid or supplied to the company, and not to any other person. *Re Fairways Magazines Ltd* [1992] BCC 924 is an example of a situation where a company granted a floating charge which was held to be invalid because the money was not paid to the company itself – a charge granted by a company to a director was held to be invalid because the director paid the money direct to the company's bank (where the bank applied the

⁵ Cf. Where the person in whose favour the floating charges created is connected with the Company, the relevant time is anytime within the period of 2 years prior to the onset of insolvency (section 245(3)(a) of the Act), and so on the facts, the floating charge created in favour of Ambitus would most likely be caught by section 245 of the Act, subject to the consideration and insolvency requirements under this section.

sums against the company's overdraft): the money therefore never became available to the company.⁶

An effect of the consideration requirement is that a floating charge may be partly valid (as regards the consideration for the creation of the charge) and partly invalid (if it also purports to secure other monies or liabilities) under section 245 of the Act. The partial invalidity of the charge does not of on its own affect the provability, as an unsecured claim, of any amount not effectively secured.

A floating charge over a company's property will be invalid under section 245 of the Act if, *inter alia*, the floating charge was given in exchange only for prior consideration, for example, to secure loans previously made. For a floating charge to be free of the risk of invalidity under section 245 of the Act in the context of loan of financing transactions, the charge must have been granted before or at the same time as the consideration for it is given.

If the floating charge is caught by section 245 of the Act, then, save to the extent of any new consideration under the two categories in section 245(2)(a)-(c) of the Act, it is rendered invalid. Invalidity can arise because the Company is in (compulsory) liquidation. Our facts appear to be distinguishable from *Fairway Magazines*, and thus the floating charge in favour of Ambitus may fall within the second category above and not be rendered invalid and avoidable by section 245 of the Act. However, even if the floating charge were invalidated, the underlying loan repayments owed by the Company to its bank may remain valid.

It should also be noted that the floating charge holder, Ambitus, would rank third in order of priority of payment after expenses and preferential creditors (as defined in sections 386, 387, and Schedule 6; section 175 of the Act).

Question 4.2 [maximum 6 marks]

The sale of the laser cutting machines; and

The relevant issue here for the liquidator to consider and take advice on is a potential transaction at undervalue:

The issue here is that the Company's director's approval around January 2023 of the sale of the 2 laser cutting machines (bought for GBP 100,000 a year before the sale) to Angela Bannister (a director of the Company) for GBP 40,000 in cash is a transaction at undervalue (the "**Sale**"). As such, the Company's liquidator may attack the Sale which was entered shortly prior the Company entered formal insolvency if the transaction was at under value (pursuant to section 238 of the Act). This section applies to the Company because it has gone into liquidation (section 238(1)(b) of the Act).

Of the requirements under section 238 of the Act which the liquidator must demonstrate to attack the Sale, and apply to the court to ask it to set aside, or make another appropriate order in relation to, the transaction at an undervalue, the following appear most applicable on our facts:

- 1) the company enters into a transaction with that 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).

⁶ Commentators have suggested that the charge may have been found valid if the director had relied on section 245(2)(b) (discharge or reduction of debt of the company) rather than section 245(2)(a) (money paid). (See [PLC Note on Avoidance of floating charges in corporate insolvency](#)).

- a) The Sale would appear to fall within the widely defined concept of "transaction". However, the principal difficulty here would lay in deciding whether the consideration, which represents 60% discount on the purchasing price of the laser cutting machines a year before the Sale, received by the Company is, in money or money's worth, significantly less than the consideration provided by the Company; and specifically involve questions of valuation, taking into account depreciation and other issues related to the machines.
- 2) The transaction was entered into during the two years before the onset of insolvency (i.e., the "relevant time").
 - a) Where the company has at a relevant time (defined in section 240 of the Act) entered into a transaction with any person at an undervalue, the office-holder may apply to the court for an order under this section (section 238(2) of the Act).
- 3) The company was unable to pay its debts at the time of the transaction or became unable to pay its debts as a result of the transaction (i.e., the insolvency requirement) (section 240(2) of the Act).
- 4) Bannister is a director of the Company and thus a connected person (Section 249(2)(a) of the Act).
 - a) Irrespective of whether the Sale was made with a connected person, it is a requisite requirement of liability under section 238 of the Act that, at the time the Sale was entered into, either the Company was unable to pay its debts as they fell due within the meaning of Section 123 of the Act or became unable to pay its debts within the meaning of the same section in consequence of the transaction.
 - b) Where the transaction was made with a connected person, as is the case on our facts, there is a rebuttable presumption that the Company was insolvent at the time, unless it can be shown otherwise (section 240(2) of the Act).
 - c) As noted above, we would require further information to determine the solvency of the Company at the time of or in consequence of the Sale, in January 2023 when we understand the Company was continuing to suffer cash flow problems.
- 5) An application to court challenging the Sale as a transaction at an undervalue would have to comply with the requirements of Rule 1.35 Insolvency Rules 2016; and should be made in the name of the office-holder, in the capacity, in our case, as liquidator of the Company.
- 6) We would need to warn the liquidator of the defence to a transaction at an undervalue claim available to the director(s) of the Company at section 238(5) of the Act; namely, that the court will not make an order under section 238 of the Act in respect of a transaction at an undervalue 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.

The burden of proof in relation to both points above would be for the director(s) of the Company / respondents to the transaction at an undervalue claim to justify the Sale.

- 7) If the court were to conclude that there has been a transaction at an undervalue or a preference, it has the overruling power to make an order restoring the position to what it would have been if the Company had not entered into that Sale (section 238(3) of the Act).
- 8) The protections afforded to certain persons/third parties under section 241 of the Act do not appear to apply on the facts.

- 9) In conclusion, subject to the director(s) of the Company mounting a successful defence on the ground of good faith and that the Sale would benefit the Company, it appears on the facts that the ingredients for the liquidator to successfully attack the Sale at undervalue under section 238 of the Act are present.
- 10) The liquidator may also be advised that s/he can now (pursuant to section 118 of SBEEA) assign transaction at undervalue claims to a third party as a way of raising funds for the insolvent estate and thereby, avoid the risk of litigation (section 246ZD of the Act).

Question 4.3 [maximum 4 marks]

The payments to Aluminium Alumini Ltd.

A month before the winding up order was made, that is around end of January 2024, Angela Bannister received an email from Aluminium Alumini 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 metal was seen as essential by the Company, the board authorised a payment of GBP 20,000 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 8,000 up to the date of the winding up order on/around 28 February 2024.

The relevant issue here for the liquidator to consider and take advice on are (i) preference (section 239 of the Act) and/or (ii) disposition void unless validated (section 127 of the Act):

The liquidator can apply to the court to set aside the potential preference, i.e. the Company board authorized payments of (i) GBP 20,000 to cover existing liabilities and (ii) further payments, on a cash on delivery basis, for further supplies which amounted to an additional of GBP 8,000 up to the date of the winding up order on/around 28 February 2024, to Aluminium Alumini Ltd ("**Alumini**"), pursuant to section 239(1) of the Act. Section 239 of the Act adopts a number of defined terms also adopted in section 238 of the Act, and is aimed at preventing a company shortly before entering formal insolvency from placing one of its creditors in a more advantageous position than others.

The liquidator will be able to make an application as the Company has gone into (compulsory) liquidation on 28 February 2024. To succeed on an application pursuant to section 239 of the Act, the liquidator will have to satisfy (on our facts) the court that:

- 1) Alumini is a creditor (section 239(4)(a) of the Act), which it appears to be.
- 2) The Company does anything (or suffers anything to be done) which has the effect of putting Alumini into a position which, in the event of the Company going into insolvent liquidation, will be better than the position that Alumini would have been in if that thing had not been done (section 239(4)(b) of the Act).
 - a) Arguably, the Company board authorised payments of GBP 28,000 (cover existing liabilities and further payments, on a cash on delivery basis, for further supplies up to the date of the winding up order) put Alumini in a better position than if payments had not been made.
- 3) The Company was influenced in deciding to give the preference by a desire to prefer the Alumini and produce the effect referred to in section 239(4)(b) of the Act in relation to Alumini (section 239(5) of the Act).
 - a) This need to show the Company was influenced by a desire to prefer Alumini is the most difficult requirement to establish. The leading case in this context, *Re MC Bacon Ltd* [1990] BCC 78, provides guidance on the meaning of the relevant desire, drawing distinction between "intention", which is an objective concept, and "desire", which is a

subjective concept. Subsequent decisions held that where a company was influenced solely by commercial considerations, specifically attempts to ensure that the company continued trading, there could be no desire to prefer.

- b) In this context, as the continued supply of metal was seen as essential by the Company, payments to its key supplier, Alumini, to ensure future supplies, may be proven to have been commercially justified in order to keep the Company trading if (for instance) a rescue transaction was in reasonable prospect – such circumstances may mean that there is no desire to prefer.
 - c) The fact that Alumini 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 may well amount to pressure. However, the fact Alumini as a creditor applied pressure on the Company is not relevant in determining whether the Company's payments to Alumini amount to a preference.
- 4) The Company gave the preference to Alumini at a relevant time. The relevant time is determined by reference to section 240 of the Act (section 239(2) of the Act):
- a) in the case of a transaction at an undervalue or of a preference which is given to a person who is connected with the company (otherwise than by reason only of being its employee), at a time in the period of 2 years ending with the onset of insolvency,
 - b) in the case of a preference which is not such a transaction and is not so given, at a time in the period of 6 months ending with the onset of insolvency (section 240(a)&(b) of the Act).

As above, in liquidation, the onset of insolvency is the date on which the winding-up petition was presented to the court, in a compulsory liquidation (section 129 of the Act); in our case 13 January 2024.

Hence, irrespective of whether Alumini is deemed a connected person or not, the preference made a month before the insolvency petition on 13 January 2024 and continuing to the date of the winding up order on 28 February 2024, would fall within 2 years or 6 months of the onset of insolvency.

- 5) Irrespective of whether the preference was given to a connected person or not, a prerequisite of liability pursuant to section 239 of the Act is that at the time the preference was given, the company either was unable to pay its debts as they fell due, or became unable to service its debts in consequence of the preference, within the meaning of section 123 of the Act.

In relation to each of the above requirement limbs, the burden of proof normally rests with the officeholder, i.e., the liquidator in our case. However, pursuant to section 239(6) of the Act, a company which has given a preference to a person connected with the company (otherwise than by reason only of being its employee) at the time the preference was given is presumed, unless the contrary is shown, to have been influenced in deciding to give it by such a desire as is mentioned in subsection 239(5) of the Act; and thus shifting the burden onto the connected person to rebut that presumption. This does not appear to be the case on our facts, but we would need more information to determine whether Alumini, which is described as one of the Company's key suppliers, was connected for the purposes of this section. While this presumption can often times be very helpful, the liquidator should be warned that rarely an action is mounted under section 239 of the Act unless the person whom it is alleged has been preferred is a connected person (effectively reversing the burden of proof back onto the officeholder, in our case the liquidator).

As noted further above, Section 233B of the Act (which, *inter alia*, applies to company's in liquidation (section 233B(2)(e) of the Act) not only prevents suppliers from terminating a supply upon the company's insolvency but also prevents suppliers from making it a condition of

continued supply that pre-insolvency arrears are paid and from making other changes to the contract such as increasing prices – and thus appears to apply here on our facts, at the very least in respect of the further payments demanded by Alumini from the Company, on a cash on delivery basis, for further supplies which amounted to further payment of GBP 8,000 from the date the winding up petition was presented (i.e., 13 January 2024) up to the date of the winding up order on/around 28 February 2024 (i.e. “the insolvency period” pursuant to section 233B(8)(e) of the **Act**).

The liquidator should also be advised that s/he can now (pursuant to section 118 of SBEEA) assign preference claims to a third party as a way of raising funds for the insolvent estate and thereby, avoid the risk of litigation (section 246ZD of the Act).

Lastly, as noted above, section 217 of the Act would allow our liquidator in a compulsory winding up to claw back monies that were paid to the Supplier from the period of first presentation of the winding up petition (i.e., the onset date of 13 January 2024) up until the making of the winding up order (i.e., around 28 February 2024), and thus the avoidance provision acts in a backdated manner. Pursuant to section 127 of the Act, any disposition of the Company's property, transfer of shares, or alteration in the status of members after the commencement of the winding up is also deemed to be void, except to the extent the Court orders otherwise (section 127(1) of the Act). As noted before, the onset of a winding up does not affect the company's ownership of its property, but it does affect its powers of dealing with that property by limiting those significantly. Habitually, a company which is subject to a winding up petition may carry on trading with the purpose of defending the petition. If the Company in our fact matrix carries on trading and fails to defend the petition, the winding up order which was made a month after the petition will avoid any dispositions of company property which have been made in the interim, potentially including the payment made to the Alumini. The liquidator should be advised therefore to take steps to enforce section 127 of the Act in order to retrieve Company assets disposed of during the period between the presentation of the petition and the winding up order. The liquidator, like anyone applying to court for a validation order has the burden of proving that the order should be granted. Amongst the general guidelines the court will consider when deciding whether or not to permit dispositions, pertinent to our facts are:

- a) Payments are likely to be sanctioned by the court if they were necessary to safeguard continued supply of metal which was seen as essential by the Company and that enabled the Company to continue trading (to the extent that the court would consider that the continuance of the Company trading was in the best interests of creditors;
- b) Circumstances where the Company paid for Alumini's goods on terms of cash on delivery, the court will consider the benefit to the Company, including whether the Company's payments enable further supplies to be received and its business to continue to operate.

On our facts, the Court may decide to grant a validation order in respect of further payments, on a cash on delivery basis, for further supplies amounting to an additional GBP 8,000 up to the date of the winding up order, if it deems it allowed the Company to continue trading; but may refuse to grant a validation order in respect of the payment of GBP 20,000 to cover existing liabilities, if such disposition is deemed to only benefit Alumini to the detriment of other unsecured creditors of the Company.

*** End of Assessment ***