INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
IN INTERNATIONAL INSOLVENCY LAW

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.

(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) Section 245 of the Insolvency Act 1986:

This section applies only to floating charges and only where a company is in administration or liquidation. It is meant to prevent preexisting unsecured creditors from obtaining the security of a floating charge before the company enters insolvency, but not the lenders who are providing fresh funding and taking a new floating charge. In effect, under section 238(2), the "office-holder" (i.e., administrator or liquidator) would be the person bringing these charges to invalidate a floating charge, even if the underlying debt remains valid.

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

This is the most commonly used ground for disqualification of a director under the CDDA. Under section 7, the court is under a duty to disqualify any person as described in section 6 on an application the court by (1) the Secretary of State, or (2) per the Secretary of State's direction in respect of a director of a company wound up by the court of England and Wales, by the official receiver. The application must be made within three years of the insolvency or in the case of dissolution without insolvency, on the date on which the company was dissolved. It is common for section 6 cases to be based on evidence that the directors permitted a company to trade while insolvent, usually in the form of paying themselves excessive remuneration or engaging in fraud with friends and family members.

(iii) Section 246ZB of the Insolvency Act 1986

The administrator or liquidator of an insolvent company would be the person making an application to the court for a declaration regarding a director's wrongful trading and any contribution to the company's assets as may be required. However, the court must not make a declaration if it is satisfied that director (or former director) took every step with a view to minimizing the potential loss to the company's creditors, even if that person knew that there was no reasonable prospect that the company could avoid entering insolvent administration or liquidation. There are further provisions in ss 214-215 relating to how these declarations must be made and any further directions given by the court, including the legal test. These provisions are available in an insolvent administration or liquidation.

(iv) Section 127 of the Insolvency Act 1986

This section governs how any disposition of the company's property or change in members made after the commencement of a winding up is void unless so ordered by the court. It has no effect on the changes made by an administrator while a winding-up petition is suspended, and no effect as related to a moratorium under Part A1 with some exceptions. Generally, per s. 126, once a winding-up petition has been presented, the company, or any creditor or contributory may apply to the court for a stay of proceedings or alternatively apply to a court of competent jurisdiction to wind up the company and restrain further proceedings. This section is meant to counterbalance these provisions (along with the court's discretion to not find a disposition as void under a validation order), and ensure assets are retained and creditor rights are protected. They may even be applied in a voluntary winding up under s 112 if so applied for by a voluntary liquidator.

In deciding whether or not to exercise its discretion to permit dispositions, the court will have regard to six guidelines, including:

- A reluctance to depart from the typical *pari passu* distribution among creditors;

- Whether payments are likely to be sanctioned where necessary to ensure continued supplies to enable the company to continue trading (and where such continued trading is in the best interest of the creditors);
- Validation of transactions that do not diminish or that increase the value of the company's net assets;
- Whether the disposition is in good faith when parties are unaware that a petition has been presented, as long as it was likely to benefit creditors generally;
- If goods have been paid for on cash-on-delivery terms, the court will consider whether that payment will enable further supplies to be received and continue the business to the benefit of the company; and,
- The benefits of ordering a general continuance of trading instead of validating a particular disposition.

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.

When a debtor is contemplating an insolvency proceeding, it can use the debtor-in-possession procedure of reorganisation. The goal of a 20-day reorganisation moratorium or stay under Part A1 is to facilitate a rescue of the company and a return to profitable trading. The directors can apply for a payment holiday that allows it to postpone the payment of certain pre-moratorium debts and debts that fall due during the moratorium. This allows the directors to take some "breathing room" from creditors and to work with a monitor to review the company's affairs and assess the best path forward toward profitable trading, be it by way of a CVA, restructuring plan or arranging for an injection of new funds.

However, pursuant to section A18, certain pre-moratorium debts are not eligible to be part of the payment holiday, including:
- The monitor's remuneration or expenses
- Goods or services provided during the moratorium
- Rent (although a landlord cannot exercise a right of forfeiture during the moratorium)
- Wages or salary pursuant to an employment contract
- Redundancy or termination payments to eligible terminated employees
- Debts or liabilities arising under financial services contracts (as set out in Schedule ZA2 of Part A1)

These payable debts are important for the monitor to assess as it may form grounds of a termination of the moratorium under A38 if the monitor believes that the company cannot pay its pre-moratorium and moratorium debts as they have come due.

To explain why the payment holiday does not apply to these debts, an overview of the restructuring/A1 moratorium process (as opposed to the moratorium in place during an administration) is beneficial. First, a monitor will be appointed to supervise whether the company meets eligibility requirements, who must also monitor on commencement and throughout the moratorium must assess whether it is likely that the moratorium will result in the rescue of the company as a going concern. A company is not eligible for a moratorium if it is already subject to an insolvency proceeding, a winding up petition is outstanding, it was already subject to a moratorium or insolvency procedure in the previous 12 months. Certain types of companies are ineligible because of their capital debt held over 10 million GBP, insurance companies, banks and other types of financial institutions and exchanges.

A debtor is eligible for a payment holiday under certain conditions, as the company may not always be unable to pay its debts at the time of insolvency proceedings. The procedure requires the company to be able to pay its debts as they come due during the moratorium in exchange for a stay on actions related to debts incurred before the moratorium. It does not prevent enforcement of creditor actions, but it does impose restrictions on enforcing debts subject to the eligible payment holiday/pre-moratorium debts. It is important to note that a payment holiday does not prevent financial creditors like banks or secured lenders from demanding payment during a moratorium, which likely triggers the end of the moratorium if the company is unable to pay. These and other super-priority debts are set out in section 174A of the Insolvency Act.

If the company cannot be rescued as a going concern and has to enter administration or liquidation within 12 weeks after the moratorium ends, the priority or debts payable changes. As a winding up continues, these pre-moratorium debts must also be paid out in priority to all fees except for the official receiver's fees or expenses for acting in its capacity during the winding up. Employment law requires that employment-related payments like wages, salary and redundancy or termination payments (where employees are eligible) that come due after the moratorium expires are preferential claims that come before the receiver's fees, as are financial services debts.

According to the Guidance for monitors published by the UK government on 26 June 2020, the company may make some payments in respect of pre-moratorium debts for which the company has a payment holiday, subject to certain limits. Total payments should not exceed the maximum limit set out in section A28, being the greater of £5,000 or 1% of the value of the unsecured debts owed by the company at the start of the moratorium. The monitor may give consent to the company to pay pre-moratorium debts for which the company has a payment holiday under section A18 above these limits, but only if the monitor thinks that it will support the rescue of the company as a going concern.

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?

Yes, an administrator has the power to continue to operate a business within certain boundaries. Administrative receivers historically had powers to keep a company carrying on business so that any floating charge that had attached to the company's entire undertaking could be realized through the sale of an operational entity instead of a piecemeal asset sale (which is typically what happens in liquidation). However, until legislative reforms came in the Enterprise Act 2002, administrative receivers did not prioritize the rescue of a company over the debenture holder's rights. Instead, under Schedule B1, an administrator can be appointed not only by the holder of a qualifying floating charge but also by way of company resolution or by board resolution out-of-court. An administrator appointment is advertised publicly so that all creditors are aware of the administration and the fact the company's directors are no longer managing the company.

The current administration regime carries on parts of this legacy by allowing a moratorium or stay against creditor actions so that the administrator can consider the best ways to rescue the company or to realise its assets. An administrator will receive a statement of affairs from the directors, prepare a proposal and ask creditors (both secured and unsecured) to vote on the plan in the hopes of obtaining majority approval for rescuing a company or realising the best possible value for its assets. In the interim, the administrator has the power to run the business to ensure that the assets retain value and that the company itself could be sold as a going concern if required. This is not always the case, for example, where a pre-packaged sale of the business is agreed shortly before the administrator is appointed, meaning that the administrator's duty is to execute the pre-packaged sale. In other situations, if a proposal is unsuccessful, the company may need to head straight into liquidation.

An administrator on appointment must take custody or control over all of the company's property to which it is entitled, including assets subject to security interests like fixed and floating charges, but not book debts assigned to another party. Assets subject to a fixed charge can be sold by the administrator with the consent of the charge holder or of the court. Goods subject to hire purchase or retention of title contracts generally will not belong to the company but the administrator can still ask the owner's for permission to sell or realise those assets (as part of the sale of the business as a going concern for example). The administrator bears no liability for the seizure or disposal of assets that are not company property unless it was negligent or lacked reasonable grounds to believe it was entitled to deal with such assets.

When it comes to executory contracts, an administrator's appointment does not automatically terminate these but rather the contracts that may be liable for automatic termination. The administrator needs to carefully consider which essential supplies need to be retained or continued to be provided to the company to ensure its existence continues, like utilities; communications services; office, computer or network technology; and related IT technical assistance. Under section 233, suppliers are not permitted to require payment of outstanding debts to continue supplying these goods or services to a company under administration, but they may take the administrator's personal guarantee for payment of these new charges.

Similarly, under section 233A, a supplier cannot rely upon any term in the contract that would otherwise allow for termination of a contract with a company in insolvency proceedings. Section 233B also prohibits a supplier from requiring previous debts to be paid before continuing to provide services or goods. The companies subject to section 233B are broader than 233A and include all other suppliers, with some exceptions for insurers, banks and other financial institutions. However, a supplier may still terminate its contract where the company or administrator consents, or where it applies to the court for permission and demonstrates that continued performance would cause the supplier hardship.

The same is true of employees: contracts are not automatically terminated because of an administration and they retain their contractual and statutory rights. An employee still retains their statutory right to redundancy and termination compensation, along with wage arrears payable, except in limited cases where the company cannot pay these amounts. In the event that an employee is kept on for 14 days after the administrator's appointment, their contract is deemed to be adopted and any wages, salary, holiday/sick pay or other benefits due then have super priority over all other creditors, including the administrator's own fees and any secured or unsecured creditors. However, any employee owed money relating to services rendered before the administration is paid out a maximum of GBP 800 in advance, and to a limit of four months prior to the appointment. A further protection to the operation of the business and security or employees caught in the transition is that any employment contracts will survive and be enforceable with a buyer of the company as a new employer.

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?

The usual order of priority of payments in a liquidation is set out in the Insolvency Act 1986:

- Section 115 and Rules 6.4.2 and 7.108: Certain expenses relating to the liquidation including the liquidator's fees in preserving realising or receiving any assets of the company, including conducting legal proceedings;
    - Costs of security provided by the liquidator;
    - Amounts payable to a person assisting with the statement of affairs or accounts;
    - Necessary disbursements incurred during the winding up, including for the liquidation committee;
    - Remuneration for any person the liquidator hires to provide services for the company;
    - The liquidator's own remuneration (subject to a specific fees-estimate regime);
    - Corporate tax or gains tax accrued by realising the company's assets; and
    - Other liquidator's expenses of the winding-up.
- Sections 386, 387 and Sched. 6, section 175: Preferential or secured creditors (applicable to all insolvency proceedings):
    - Employees' rights (although employees receive greater rights to remuneration under the Employment Rights Act 1996, as is explained below):
        - Compensation for contributions to the occupational pension scheme;
        - Remuneration owed to an employee for the four months before the winding up to a maximum of GBP 800;
        - Sick, holiday or accrued leave payments;
    - Coal and steel production levies (rare);
    - Reserve Forces levies (rare);
    - Amounts held as eligible deposits as does not exceed compensation payable in respect of a deposit (eg under the Financial Services Compensation Scheme);
    - Secondary preferential debts:
        - The same as the previous item except for the amounts that do exceed the compensation payable;
        - Other deposits that would be eligible; and
        - PAYE income tax deductions and other national payment deductions; and
    - Taxation authorities (i.e., the Crown, via the Finance Act 2020, section 95)
- Section 176A: Floating charge holders
    - Priority among floating charge holders usually turns upon which floating charge was created first;
- Unsecured creditors with no security (see below on "prescribed part" taken from floating charge creditors' portions)
- If any funds remain after creditors and interest are paid, the amounts may then be distributed to the company's shareholders *pro rata*

Before a creditor can be ranked in priority or vote as among the other creditors on decisions, it must submit a proof of debt ("POD") to the liquidator. The POD must capture all debts owed prior to the start of liquidation, or which became payable after liquidation began but were incurred because of prior obligations, or contingent future debts (which may be discounted). Creditors with small-value claims under GBP 1,000 may receive dividends based

on the company's records. The liquidator may accept the creditor's POD in whole, reject parts of it or reject it entirely. Creditors may be grouped into two voting categories of secured and unsecured or other groups that make sense in the circumstances.

Each class of creditors receives certain rights. For example, as set out in previous answers, employees retain several protections under the Employment Rights Act to remuneration of unpaid wages, salary, holiday/vacation pay and other benefits, and also to termination or redundancy pay, in priority to all other creditors. This super-priority of employment rights is granted the highest preference because of the importance of worker's rights of fair compensation even in the face of a company's insolvency.

Preferential creditors are also classed as ordinary or secondary, with the ordinary preferential creditors being paid before the secondary preferential creditors, but also abate in equal proportion as among these subgroups if the company's assets are not sufficient to pay them all.

Although unsecured debts rank below floating charges, the liquidator must hold a "prescribed part" of the company's net assets that would otherwise go to the floating charge holder aside to satisfy unsecured claims. The liquidator must not distribute that amount to a floating charge holder except where the amount is in excess of the amount required to satisfy all unsecured debts or where it is disproportionate if under the prescribed minimum of GBP 10,000. Where a company's net property exceeds GBP 10,000, the prescribed part is 50% of that property toward unsecured creditors, then 20% of the excess up to a maximum of GBP 800,000. Unsecured creditors thus have some rights to see marginal amounts repaid on their debts, at the expense of floating charge holders.

The priority of creditors in the repayment waterfall changes if a moratorium happens in 12-week period pre-liquidation. If the company is not rescued as a going concern, then as the moratorium end, the priority of the debts above will change per section 174A. Certain unpaid pre-moratorium debts that were not part of the payment holiday are then paid in super priority to even the liquidator's fees:

- The monitor's remuneration or expenses
- Goods or services provided during the moratorium
- Rent (although a landlord cannot exercise a right of forfeiture during the moratorium)
- Wages or salary pursuant to an employment contract
- Redundancy or termination payments to eligible terminated employees
- Debts or liabilities arising under financial services contracts (as set out in Schedule ZA2 of Part A1)

This allows certain unsecured debts like unsecured bank debts under "financial services" to take priority, although there is an exception that prevents super priority where the deb has been accelerated or subject to early termination provisions. Overall, it is incredibly important for creditors to ensure that their claims are adequately categorized and appropriately classed so that they do not miss out on the appropriate rights and levels of reimbursement and compensation by the company.

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 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.

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 first step that the liquidator must take before dealing with the floating charge is to assess the validity of the floating charge and when it was taken on, as there may be scope under the Insolvency Act 1986, section 245 to avoid the floating charge over the entire Company and leave it as an unsecured debt. First, the relevant assessment period is any time in the previous one year before the onset of insolvency, as the Bank in whose favour the floating charge was created was not connected with the Company. The Company granted the debenture in June 2023 and a winding up petition was issued on 13 January 2024, so the floating charge falls within the subject period.

The relevant circumstance is also important, as it appears from the facts described above that the Company was not able to pay its debts within the meaning of Section 123 of the Act. Under section 123(2), a company is deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities. As such, the liquidator will need to look at the Company's solvency at the time of the debenture to see whether it was insolvent. From the facts above, it was probably unable to pay its debts at the time the Bank was considering making formal repayment demands.

Section 245 then requires an analysis of whether fresh/additional consideration was provided. The Company granted the floating charge over its entire business undertaking to prevent the Bank from demanding repayment of the company's loans. The Bank did not

provide anything further like a new loan after the debenture was created. This would render the floating charge invalid as the Bank did not have anything further to give as consideration except for its forbearance, either at the time or shortly after, as per section 245(2). A floating charge is invalid where all it does is secure repayment of currently owed funds.

Even if the floating charge is found to be invalid, the underlying debt that the Company previous owed to the Bank remains valid and will join the ranks of unsecured creditors further down the priority list of repayment. As it seems like there was no debt connected to the floating charge, the other prior Bank debts would have to be analysed separately.

Question 4.2 [maximum 6 marks]
The sale of the laser cutting machines; and

The liquidator would have to investigate the validity of the director's transaction as being wrongful trading under Sections 214 and 246ZB of the Act or the alternative fraudulent trading under Sections 213 and 246ZA of the Act. It could also be investigated as a transaction at undervalue under Section 238.

Wrongful trading provisions ensure that the director of a company in insolvent liquidation meets her fiduciary duty to act in the best interests of the corporation, meaning that she must do everything possible to minimise the potential losses to the company and thus its creditors. The court has discretion to declare, at the liquidator's application, that the director is liable to make a contribution back to the Company's assets if it is satisfied that:

- The company is in liquidation,
- The person making the transaction knew or ought to have known before the winding-up that the Company had no reasonable prospect of paying its debts or avoiding insolvency, and
- The person was a director of the company.

This transaction has the earmarks of wrongful trading because that the Company's directors allowed the Company to sell another director (Ms Bannister) valuable equipment at undervalue not long before the company became insolvent. The two laser cutting machines were purchased for GBP 100,000 and within a year were resold for GBP 60,000 less. On these facts, this sale deprives the Company of the full value of its assets that may be available on liquidation for the benefit of its creditors. The transaction was made by a person connected with the Company and the insolvency of the company at the time is presumed unless shown otherwise.

The defence available to wrongful trading is that the directors took every step with a view to minimising the potential loss to the company's creditors as soon as they knew or ought to have known the company was insolvent. The liquidator must prove that the director(s) knew there was no prospect of avoiding liquidation. Once this happens, the director(s) may present why they believe their action was taken as part of their duty to take every step possible to minimise loss to creditors. Section 214(4) indicates that the circumstances for claiming the statutory defence include three conditions: the facts a director ought to have known, the conclusions they ought to have reached and the steps that they ought to have taken. The standard is that of a) an objective test of a reasonable person who had general knowledge, skill and experience as expected of a director or person carrying out the same functions for the company and b) a subjective assessment as based on the general knowledge, skill and experience of that director. Directors of smaller entities are held to a lower standard on (b) than those who manage large, sophisticated entities and so Ms Bannister or the other directors approving the sale could possibly be held to that standard.

Similarly, the defence for a transaction at undervalue or for a preference is that the transaction was made in good faith and for the purpose of carrying on the company's business, with reasonable grounds to believe that it would benefit the company at the time.

For example, an exception would be if there was some legitimate purpose to the transaction at undervalue, for example, by changing the way that value for the used laser cutters was assessed. If laser cutting technology had experienced a massive shift similar to generative AI where the lasers had greatly devalued over the course of one year, or if some out-of-warranty damage was sustained to the machines that made them worthless to anyone outside of those with intimate knowledge of the machinery (i.e., sold for scrap). There is also an argument that in January 2023, the directors knew the Company was having financial difficulties, but it was not yet incapable of avoiding insolvent liquidation. This argument could be made on the basis that it was not until after the Bank threatened to demand payment of its loans six months later in June 2023 against the Company's entire undertaking that the Company was truly on its way to insolvency and had no reasonable prospect of avoiding liquidation.

If the Ms Bannister was not successful, she or the other directors approving the sale would be ordered to contribute an amount to the Company to make up for the decision to continue trade and accruing liabilities to the Company once they knew or ought to have known it was insolvent.

If the liquidator decided to approach the sale from the perspective of fraudulent trading, the higher standard of intent to defraud creditors or any other person, or business carried on with any other fraudulent purpose would have to be met. The liquidator would have to show that the directors approved the sale because they were knowing parties to Ms Bannister's fraud and that the act must amount to a real moral blame. It seems unlikely that the liquidator would be successful on the present facts as described above, but if the court finds the director liable for fraudulent trading, it may order a contribution by that person to the company's assets in the same way as for wrongful trading. There could be a criminal penalty under s 993 of the Companies Act 2006, but again, this would be at a much higher standard.

Question 4.3 [maximum 4 marks]
The payments to Aluminium Alumini Ltd.

The Company appears to have made a payment to Aluminium Alumini Ltd (AAL) and entered ongoing agreements as of 28 January 2024 for cash-on-delivery payments up to the date of the winding-up order as part of its attempt to keep the Company operational, since AAL's supplies were considered essential.

The liquidator should review this transaction and its grounds, as it may be possible that it is a disposition void unless validated under Section 127, since the agreements and payments were made after the winding-up petition was presented (i.e., the petition was presented on 13 January 2024, this agreement was made by 28 January 2024 and the winding-up order was made on 28 February 2024). The definition of disposition of property is very broad and includes payment of money. However, the court has jurisdiction to declare that the disposition is not void and is valid as a *bona fide* transaction according to the following guidelines:

- The court will consider whether the payment was made as a preference to a pre-liquidation creditor over other creditors (so the GBP 20,000 payment could be void, but the ongoing payments may not be);
- The payments are likely to be sanctioned as valid where necessary to ensure continued supplies for trading of the company where such continued operation is in

the best interests of creditors (which validity seems likely to succeed if AAL is providing key supplies);

- Transactions that do not diminish company's net assets and which would increase the value of its assets or preserve other assets from harm will be validated;
- If the parties are not aware that a petition is presented and made a disposition in good faith (not likely here as the parties knew there was a petition in place which spurred the AAL demand – again the GBP 20,000 payment could be invalidated on this basis);
- Where goods have been paid for on terms of cash on delivery, the court considers whether such payment will be to the company's benefit and enable further supplies to be received and business to continue (which seems likely to be valid as a reason); and
- The court can consider general continuance of trading over and above a separate disposition validation.

Overall, if the payment was made honestly and in the ordinary course of business, for the benefit of the company and to keep the company operational, it is likely to be found to be valid. It is a challenging decision because one creditor is potentially being prioritised to the detriment of other creditors, but AAL is providing key or essential supplies and so the question is whether any alternatives could have been taken.

*** End of Assessment ***