



Chartered  
Institute  
of Credit  
Management

# **Legal Proceedings and Insolvency Question Paper, Answers and Examiner's Comments**

**Level 5 Diploma**

**January 2015**

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## **Legal Proceedings and Insolvency questions, answers and examiners' comments**

LEVEL 5 DIPLOMA IN CREDIT MANAGEMENT

**JANUARY 2015**

*Instructions to candidates*

Answer **COMPULSORY** questions 1 and 2 and any **THREE** other questions

All questions carry equal marks.

Time allowed: 3 hours

**You are reminded that, where appropriate, your answers should contain references to statutes and to case law.**

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*Generally, there were some encouraging responses to this paper which featured broad understanding of legal and insolvency issues affecting credit managers and which suggested a marginal improvement over recent examinations. There was also a noticeable preference towards the optional insolvency tasks this time.*

*However, there were too many disappointing submissions either featuring less than five informed question responses (suggesting limited understanding of the syllabus topics and/or poor examination time management), or which were largely undeveloped narratives based upon either general subject knowledge or basic study material information.*

*Developed responses are a requirement at this level firstly to reach pass standard and secondly to access the higher marks that are available for each question. Development involves responding directly to the task(s) set and scenarios given, showing sound understanding of the syllabus topics, and demonstrating analysis, evaluation, context, reasoning and interpretation as required by the task, or as pertinent within a structured response. Needless to say, as a law-based examination, responses should also contain appropriate reference to prevailing law.*

## COMPULSORY SECTION

Answer **both** questions in this section

1. You are Legal Collections Manager for a company. You receive Notice of Judgment Entered from the courts in relation to Ms Kirsten La'Gal, a barrister who owes your company £6,700. You have already ascertained that Ms La'Gal jointly owns her own property worth £237,000 and there are two charges registered against the property with one being a mortgage.

You have complied with the necessary rules in order to obtain a charge over the property however the final charging order hearing has been re-listed twice on the pre-text of allegations made by Ms La'Gal in relation to other unsecured and secured creditors.

Eventually you have your final charging order only to be notified that Ms La'Gal filed for her own bankruptcy the day after the granting of the final charge.

### TASK

- a) Demonstrate your understanding of the charging order process, including reference to what action is required where there are other charges against the property. (12 marks)
- b) What are the advantages of registering a charge and the options in insolvency available to a registered chargeholder? (5 marks)
- c) Critically assess the scenario above with special regard to the current status of the property and to Ms La'Gal's conduct, bearing in mind she is a barrister. (3 marks)
- (20 marks)

### Question aims

To test the candidate in relation to methods of enforcement in particular charging orders, holding security in the event of insolvency and holding a professional position when you are a bankrupt.

### Suggested answer

- a) Details of charging orders, their process, and reference to variations where other chargeholders exist, include:
- A charging order prevents the debtor from disposing of the property without paying off the judgment debt; if there is no equity in the property, the charging order will not prevent disposal of it;
  - Application under Practice Direction 73 is made to the court where judgment was obtained; two available forms used for charging order applications; Form N379 (Land) is appropriate here; application is made ex-parte on affidavit and includes evidence of property ownership;
  - The Court makes an order nisi (interim order) giving the debtor notice of the order and fixes a date for a court hearing to consider making the order absolute / final; on obtaining the order, it should be registered at the appropriate land registry as unregistered charges do not have to be settled; notification should be given to other secured creditors; the defendant is served with the order absolute;
  - Orders for sale following a final charge must be applied for by separate application to the court; if property is jointly owned the court is unlikely to make an order for sale as it would be unfair on the innocent party; that is likely to be the case here;

- Where an order for sale is granted the property must be sold for the best possible price; all other prior mortgages and charges already registered must be settled before the claimant's charge; if sale proceeds are insufficient to pay off all prior charges the claimant is responsible for paying them.

*Credit was given for appropriate and developed commentary about the charging order process. Wider discussion of fixed and floating charges was not required by this task.*

- b) Registering a charge makes the chargeholder a secured creditor and creates a stronger position in insolvency. The secured creditor has priority over unsecured creditors and those who registered a charge at a later date.

However, secured creditors cannot prove for their debts in insolvency as their primary redress is to realise their security, however they can waive their right to the security and prove in the insolvency.

The options available for a secured creditor are:

- Redeem the security, which realises the amount claimed and concludes matters
- Redeem the security and prove for any shortfall as an unsecured creditor
- Value and maintain the security if it is likely to realise the full claim value
- Value and maintain the security, and prove for any shortfall as an unsecured creditor
- Surrender the security and prove as an unsecured creditor for the full debt

- c) Assessment of the scenario and Ms La'Gal's conduct might highlight:

- her knowledge of the legal system which she may have used to delay the process;
- attempts to delay or defeat due process may be taken into account on a bankruptcy discharge application and the possibility of a longer bankruptcy period because of that;
- there may be a lack of equity or another problem regarding the house as otherwise she would have been better placed to sell this on her own terms;
- the bankruptcy adjudication now means she will not be permitted to continue to practice as a barrister;
- the usefulness of an existing charging order in a bankruptcy adjudication.

*Responses to this compulsory question on a particular method of enforcing a judgment and the early part of a post-insolvency process (topics central to the syllabus) were disappointing as less than a third of candidates scored 10 marks or more. There was confusion by some between a charging order (judgment enforcement) and fixed/floating charges (loan security), and few could offer charge-holder options in an insolvency. Insight into processes, practices and methodology relevant to the scenario are necessary in this type of task and are rewarded, whereas broad statements around the topic with no real focus or scenario attachment will receive very few marks.*

**Total 20 marks**

2. Unicorn Developments, a house building company, is owned and run by Jack Altrades. They owe your company, Candy Building Supplies, £27,500 in unpaid invoices and you are considering legal action for recovery. As Credit Controller of Candy you receive notification that Unicorn Developments is in compulsory liquidation.

While reading through the documentation, you note that 'The Bungalow' was commenced in June 2011 and scheduled for completion Feb 2013; however the actual build was not finished until Oct 2013. As yet it is still unsold. The slippage in completion resulted in a cost overrun of some £600,000, largely financed by Jack Altrades and trade creditors. The Director (Jack Altrades) states he hugely underestimated the build costs of the bungalow.

Consequently, liabilities significantly outweigh assets.

### **TASK**

- a) Summarise the different grounds for a Compulsory Winding-Up, making reference to relevant law, and possible outcomes in the winding-up in relation to 'The Bungalow'. (8 marks)
- b) Discuss what you know about 'wrongful trading'; what are your conclusions about Jack Altrades? (6 marks)
- c) As Credit Controller, what systems and warning signs should you be aware of in order to identify clients that may become insolvent? (6 marks)
- (20 marks)

### **Question aims**

To test the candidate in relation to Compulsory Winding Up, Directors duties in relation to wrongful trading and what steps a credit controller can take to minimise the bad debt situation.

### **Suggested answer**

- a) Where a company is unable to pay its debts, creditors may seek a court order for winding up the company (Section 122(1) Insolvency Act 1986). Grounds for a compulsory winding up include that:
- a company has failed to pay/secure/compound for a £750+ debt to the reasonable satisfaction of the creditor after being served with a statutory demand requiring payment within three weeks (s123(1))
  - execution on a judgment is returned fully or partly unsatisfied (s123(1))
  - inability to pay debts is proven to the satisfaction of the court (s123(1))
  - its liabilities exceed its assets (Balance Sheet Test) (s123(2))
  - it is unable to pay debts as and when they fall due (Liquidity Test) (s122(1))
  - it is just and equitable to do so (s122(1))
  - there is inordinate delay in the conduct of a voluntary arrangement (s122(1))
  - the company passes a Special Resolution to wind the company up (s122(1))
  - a public company not issued with a s761 Companies Act 2006 certificate (share capital requirements) and more than a year has passed since original registration (s122(1))
  - the number of shareholders/members falls below 2 (s124(2))
  - it is dormant for more than a year (s122(1))

As an asset in the winding-up, 'The Bungalow' would be sold for the highest price achievable with proceeds available to creditors as part of any surplus. However, any negative equity will impact adversely erode the possibility of a dividend to some or all classes of creditor.

*Higher credit was given for law-based responses and development of detail.*

b) 'Wrongful Trading' describes the situation where a company continues to trade during a period when one or more of its directors knew or ought to have concluded that insolvent liquidation of the company was unavoidable (s214(2) IA86) and they did not take every possible step to minimise potential losses to creditors (s214(3) IA86).

- Directors responsible for wrongful trading who can not show that they acted in creditors' interests may be ordered by the Court to make a financial contribution to company assets and, therefore, into the funds available for distribution to creditors (Re: Produce Marketing Consortium Ltd (1989)).
- A director will not escape potential liability if they are no longer a director at the time of the formal insolvency procedure (Re: Sherbourne Associates Ltd (1995)), or if they claim incompetence. What matters is that they were a director at the relevant time (s214(2)) and the general standard of competence is that of a reasonably diligent person in a similar role (s214(4)).
- Whilst courts will consider carefully the difference between wrongful trading and taking a measured and supported business risk (e.g. Re Hawkes Hill Publishing Co Ltd (2007)), directors can avoid liability under s214 by demonstrating the actions they personally took represented every possible step to minimise the potential loss to the company's creditors. Examples of potential appropriate actions include undertaking, or encouraging fellow directors to:
  - apply for an administration order
  - alert creditors to their position with a view to reaching an agreement with them
  - cease trading
  - attract new investment
  - trade out of insolvency where this is a realistic prospect
  - a combination of these and other actions.
- Since the company is now in insolvent liquidation, Jack will have to show the liquidator (and the Court, if necessary) that he was taking every reasonable step to minimise creditor losses during the period Feb-Oct 2013. The scenario is clear that he relied on creditors to support his business during that time, which suggests he was not. If there was a reasonable prospect that insolvent liquidation was not avoidable during the material time, Jack may well be ordered to make a personal contribution to his insolvent company's assets.

*Credit was given here for reasonable developed law-based responses regarding wrongful trading and Jack's situation.*

c) Discussions may include practical warning signs such as:

- Lack of engagement by the customer to approaches for payment;
- Deteriorating credit intelligence (status reports);
- Sudden changes in management and/or staff and/or directors' resignations;
- Sudden enthusiasm to increase spend;
- Raising of inappropriate number/quality of queries/disputes;
- Payment issues (broken promises/dishonoured cheques, direct debits, standing orders, etc.);

Systems include:

- Quality collection systems which bring together credit intelligence, ratings and limits, and history; recognise pre-action protocol requirements; constantly monitor internal and external customer performance; facilitate working practices such as CRIME in maintaining and reviewing different situations, etc.

*Credit was given for appropriate developed discussions on some of these matters.*

**Total 20 marks**

*Although central to the insolvency areas on the syllabus, only half of candidates achieved 10 marks or more in this second compulsory question. This is a task which required technical responses in defined areas on a scenario, and so broad discussions about winding-up in general, wrongful trading as a moral issue, or a 'by rote' reproduction of the CRIME mnemonic and its rhetorical prompts (e.g. 'C – Have we tried all collection means?') did not respond directly to the task.*

## OPTIONAL SECTION

### Answer any three questions

3. J Company Limited owes the company you work for, Reinnard Consumables Ltd, £3,500. Some invoices are overdue and some not yet due. You have been chasing payment of overdue sums, but although J Company Ltd has made several payment promises, so far nothing has been received.

Today you have been passed a letter from the joint nominee enclosing details of a proposed Company Voluntary Arrangement.

#### TASK

- a) Explain why a company might consider entering into a Company Voluntary Arrangement (CVA). (4 marks)
- b) Outline what should be contained in the letter and the enclosures which should accompany it. (8 marks)
- c) Discuss the typical contents of a CVA proposal and outline your opinion about Reinnard's expectation to recover the above debt. (8 marks)
- (20 marks)

#### Question aims

To test the candidates practical understanding of proposed company voluntary arrangements and their outcome.

#### Suggested answer

- a) For preservation of the business. Part 1 of the Insolvency Act 1986 sets out a procedure to enable companies to reach a compromise with the majority of their creditors which is then binding on all creditors.

The Insolvency Act 2000 introduced a moratorium for small companies from 1 January 2003. A moratorium prevents any creditor from continuing or commencing proceedings against the creditor whilst it is in place, thus giving the CVA a better chance to be successful.

- b) The typical letter content and enclosures include:
- An introduction inviting you to attend a creditors' meeting, what the letter is about and why you have been sent it
  - The proposals that will be put to the meeting
  - The documents enclosed:
    - Formal notice of the creditors' meeting
    - Notice of claim forms
    - Proxy forms
    - A copy of the proposal
    - A copy of the company's statement of affairs
    - A copy of the joint/nominees report on the proposal
  - Any recommended suggestions and further information
  - Actions you need to consider taking.

c) Summary of proposal contents – Insolvency Rule 1.3

- Rationale – the reason why the CVA is desirable and why creditors should support it
- Statement of assets and liabilities (statement of affairs)
- Proposals regarding duration of the CVA, dates and amounts of distribution(s)
- Amount and basis of the nominee’s fees and the supervisor’s remuneration
- Whether the business is to continue to trade and what security/guarantees come from directors and others to support the CVA
- The name, address and the qualification of the supervisor, administrative matters including functions to be undertaken by the supervisor, the holding of funds methodology and the procedure adopted with surplus funds at the end of the CVA

*Credit was given for outline development of typical proposal content.*

In this scenario, Reinnard should seriously consider the CVA proposal and vote accordingly. Some CVAs (e.g. small dividend; long duration; dividend bands including 0%; etc.), are not realistic so the proposal and the statement of affairs needs scrutiny. Successful CVAs may lead to new profitable business after the scheme concludes, but the reality is that many CVA’s are unsuccessful and the company does end up in liquidation.

**Total 20 marks**

*Half of all candidates chose to tackle this optional question and, pleasingly, 75% of those scored 10 marks or more. It does follow though that, to achieve 10 marks, candidates required sound knowledge of the detail and practicalities of CVA proposals, especially in part b).*

4. You are Credit Controller for Barker Furniture Stores and have recently received Notice of Judgment against Mrs Dorothy Chang for the sum of £27,490. You have a meeting arranged with your Credit Manager to discuss the enforcement options available. In the meantime, you receive notice that the defendant has filed an application to set judgment aside, claiming that she has not seen the claim form because she has been away in Austria for the last eight weeks visiting her son.

Mrs Chang is 77 years old and claims that her daughter has already been in touch with your company and agreed a payment arrangement.

### TASK

- a) Outline the different types of judgment and, with specific reference to the above, identify which is the most likely type of judgment in this case. (12 marks)
- b) Discuss the term 'set aside judgment' referring your answer to the circumstances of Mrs Chang. (4 marks)
- c) Critically assess the above and give your proposal to obtain payment. (4 marks)
- (20 marks)

### Question aims

To test the candidate on different types of judgment and when they are applicable.

### Suggested answer

- a) • **Judgment in default** – 14 days to respond from date of service, if the claim is served by the claimant/process server then the certificate should be signed setting out the date on which service was effected or if the claim was served by the court they will send a notice of service to the claimant setting out the date the claim is deemed to have been served
- **Judgment after acknowledgment** – defendant completes and returns the acknowledgment indicating their intention to defend, in which case they must deliver a defence within 28 days of the date of service. If on 29<sup>th</sup> day no defence is received then the claimant may enter judgment in default of defence
  - **Judgment on defendant's offer** – where the defendant completes the form in the response pack making an admission and payment offer
  - **Judgment after part-payment** – after giving time for a defence to be received and taking account of the sums paid the claimant may enter judgment for the remaining balance
  - **Summary judgment** – when appropriate evidence is available, court may determine that it is applicable and this can speed up the legal process and prevent delaying tactics. It can be on the full amount or part of it.

In relation to the scenario, judgment in default would have been most likely, as Mrs Chang claims not to have seen the claim form and therefore could not have responded to it.

*Credit was available for outline discussions of these judgment types and for interpreting the scenario.*

- b) An application may be made to the court to have a judgment set aside. In relation to Mrs Chang's judgment (in default?), she asserts not to have seen the claim form. If a defendant makes an application to set aside judgment the court MUST do so if the judgment was wrongly entered against them and the defendant can prove this. For example where the incorrect address has been used or the claim never came to their attention. However the court MAY set aside judgment if it can be shown that the defendant made application to set aside judgment as soon as was reasonably practical, when they became aware of it and the defence has a reasonable prospect of success or raises an issue of public interest that ought to be tried.

The effect of setting aside a judgment means it is rescinded and the claim is re-heard.

- c) Mrs Chang has denied not knowing about the judgment, but has not denied owing the sum, so it is admitted. It is unlikely that the court will set aside the judgment as you could argue that her daughter has been 'taking care of things' whilst Mrs Chang was out of the country. You may therefore decide to progress with the claim as she has not denied it and the offer of a payment arrangement backs this up, in which case you could press for settlement in full and progress with enforcement action.

However, she does state that her daughter has *already* made a payment arrangement with your firm, so you need to follow this up with who was involved (if true) first and link the two together if it was a sensible proposal. You also might check again if any payments have already been made.

**Total 20 marks**

*This was a very unpopular question and furthermore, candidate responses to it were very poor. This examination concerns legal proceedings and this was a scenario-based task on a credit management / debt litigation situation regarding different types of court judgment, applications to set judgment aside and an opportunity to use practical skills to address credit-related problems. These should not be unexpected topic areas for examination and are hardly on the edge of the syllabus.*

*There is a worry therefore concerning how well candidates prepare themselves for this examination. For instance, lack of a credible response to Part c) suggests that Level 5 is not consistently being achieved by a candidate. Additionally, none of the task involved enforcement of the judgment in a wholesale way, so extended discussions on enforcement scored little, irrespective of their quality and accuracy of detail.*

*It may also be a prudent time to remind all candidates that whilst appropriate alternative on-task responses will always be given credit (although it is difficult to imagine obvious alternatives in this task), it is never an acceptable tactic to avoid the task set on the basis that one's own 'off-task' proposals are better.*

5. You work in the recoveries department at Pounds In and you have been tasked to review the judgments your company has been awarded against its non-paying customers and to make suggestions about the most appropriate enforcement action.

### **TASK**

For each of the following, suggest the appropriate enforcement action, describe it and explain why you believe it is the most appropriate.

- a) Chris is a 19 year old bar person. He works 5 nights a week on minimum wage; he lives at home with his parents and your judgment is for £253. (5 marks)
- b) Rebecca restores antique sewing machines. She is self employed and rents a lock up on the local industrial estate. The judgment debt is £1,378. (5 marks)
- c) Lexi lives alone in her own house that she bought with a mortgage 15 years ago. She works full time and has no dependants. The judgment debt is for £28,793. (5 marks)
- d) Denis is unemployed having been sacked for gross misconduct. The judgment debt is £109 and is one of several that he has. He is currently of no fixed abode and his employment prospects are grim. (5 marks)

(20 marks)

### **Question aims**

To test the candidates application of their knowledge of methods of enforcement for different debtor types

### **Suggested answer**

- a) Having knowledge of where he works and his employer consideration should be given to an Attachment of Earnings Order. Due to this being a relatively small value, plus he is unlikely to have assets to seize. Alternatively consideration could be given to a payment plan, whereby he agrees to make payments of an agreed amount each week/month.
- b) Given she is self employed then an Attachment of Earnings order is not applicable. There is a likelihood of some valuable assets in the form of antique sewing machines and maybe restoration equipment. The enforcement in this scenario therefore lends itself towards instructing a bailiff or enforcement agent in order to seize/take control of goods and sell them.
- c) Considering the amount of the judgment debt in this case the most appropriate method of enforcement would be a charging order. The debt is certainly large enough for this to be considered. If there is enough equity in the property an application could be made for an Order for Sale which should be successful given this is a large debt and there is no-one else living in the property.
- d) The court would probably assess that he can only afford to pay 50p a week, the administrative task of collecting this is probably not worth it. A repayment plan should be considered but not spend too much time on missed payments and with a probably write it off if he was to default.

**Total 20 marks**

*Credit was given for any reasonable developed discussion appropriate to the individual scenarios, but it was surprising that with a one-third take-up, more candidates did not attempt these 'practical' tasks. Most of those that did scored more than 10 marks.*

*It is worth saying that 'reasonable' and 'appropriate' were important issues here – in Part d), for instance, the debt was £109 and the debtor was unemployed. Therefore, although it is 'possible' to apply for an order for information or to regularly review the debtor's financial status over the next 6 years, neither are practical because the costs involved outweigh the benefits, so are not reasonable suggestions with the debt value and debtor's situation in mind. It is not necessarily a matter of whether suggestions are 'correct' at Level 5, but whether they are 'realistic' alternatives.*

6. You are Senior Collector for Shed Base Ltd, a company that builds sheds and summerhouses to customers' specification. Shed Base recently took an order from Mr Antonio who has placed several orders with it in the past. Having a trading history with Mr Antonio, it was not felt necessary to ask for payment in advance. The summerhouse was delivered and erected. Mr Antonio gave a cheque to your delivery driver for £2,845; however this cheque bounced due to insufficient funds in the account. Your company has a policy to immediately commence legal proceedings where a cheque is dishonoured.

### TASK

- a) Detail what is meant by pre-action protocol and apply it to the scenario above. (10 marks)
- b) Demonstrate your understanding of 'the right to interest'. (6 marks)
- c) Given the information above, briefly explain whether or not Mr Antonio has a defence to your company's legal action, justifying your response. (4 marks)
- (20 marks)

### Question aims

To test the candidate in relation to pre-action protocols, the right to interest and defending an action

### Suggested answer

- a) Litigation should always be the last resort when all other practical methods of recovery have failed and all mutually resolvable disputes remedied. Occasionally, litigation is justifiably necessary to obtain a legal ruling to resolve an issue that can not be remedied between the parties, but this will relate to some aspect of services, contract, or other matter rather than debt collection itself. Whilst there are no set protocols for debt collection because they are believed to encourage legal action in this area, the approaches enshrined in other set protocols represent good practices within the credit industry. The pre-action protocol approach is looked for in commercial debt recovery and is a way of reducing the need for unnecessary litigation by following a number of prudent practices:

**Effective credit assessment** – at the start of the relationship with a new customer and ongoing through the relationship. There is little point in suing non-creditworthy defendants, especially if their credit-worth was not known at the time of agreeing services on a credit basis. Here, Mr Antonio is for all intents and purposes a cash customer. Although there is a trading history with Mr Antonio, moving from cash with order to allowing short-term credit is still a big step if no further checks were made beforehand.

**Terms of trade** – these must be clearly defined and agreed by the parties at the start of the contract and updated/reviewed during the course of it as necessary. Terms of trade for a 'cash' customer are not necessarily the same as those for a credit customer of known credit-worth because the risks are different. Customers who pay by cheque at the time of service leave the supplier at risk until the possibility of dishonour or non-encashment is past.

**Effective cash collection, dispute resolution and recording system** – a system that records all payment chasing activity with the customer, all responses, discussions and promises made, and all notifications of disputes and their resolution, that can be produced as evidence if required.

*The task called for an engaged response, so rhetorical reproduction of the CRIME mnemonic was not appropriate, although credit was given for applying its elements directly to the scenario.*

- b) The 'right to interest' in a non-payment scenario comes from the following sources:
- Contractual interest: agreed contract terms define the basis upon which interest may be charged where payments are late. The clause is subject to contract law and may have to, where necessary, pass the reasonableness test (Unfair Contract Terms Act 1977), or be shown not to be a penalty clause, for instance.
  - Statutory interest: Late Payment of Commercial Debts (Interest) Act 1998 as amended by the Late Payment of Commercial Debt Regulations 2002 provides the circumstances in which interest charges of 8% above Bank of England base rate, together with a 'collection costs' charge based on debt value, may be levied.
  - Statutory interest: County Courts Act 1984 or the Supreme Court Act 1981 provides the circumstances in which interest at 8% per annum can be added to legal claims and the continuing proceedings.
- c) There is no *prima facie* defence to a dishonoured cheque, as the funds for it to be honoured should be in place at the time it is drawn. Unless there is a genuine reason for the cheque to have bounced that is outside the control of Mr Antonio (e.g. incorrect dishonour by his bankers), then a claim founded upon the dishonour should be successful.

**Total 20 marks**

*Whilst every candidate responded to this question, only one fifth scored 10 or more marks. Development of the response was required here also, particularly in Part b) which needed a display of coherent and detailed commentary, so lists of 'random' facts to do with interest did not score well. For Part c), a remarkable number of candidates seemed completely unaware there was no legal defence to a dishonoured cheque, although many highlighted that pre-action protocol approaches had not been sympathetically followed. Credit was also given to candidates who acknowledged that the policy on dishonoured cheques was very strict, but recommended that it was worth giving Mr Antonio a very short window to redeem the situation with a 'guaranteed' payment, so as to avoid legal action and further costs (which is sympathetically a protocol approach).*

7. Define what you understand by the term 'Antecedent Transactions' and give a detailed analysis of this area of insolvency law. (20 marks)

**Question aims**

To test the candidates knowledge in relation to antecedent transactions

**Suggested answer**

**Antecedent transactions**

These are transactions entered into by an insolvent debtor that have the effect of considerably reducing the value of the assets available to the creditors. These often include assets that have been sold to relatives or an associated company for a much reduced price or ensuring settlement of their bills over those of other creditors. Where this is evident to the liquidator or trustee, the transactions can be reversed by application to the court, thus increasing the value of the estate. The three main types of antecedent transactions are preference, transactions at an undervalue and extortionate credit transactions.

**Reversal of transactions**

If the court sees fit it may make an order to restore the position to what it would have been prior to the transaction being entered into. The court has express power to order the third party to pay money into the estate that represent the benefit received; for example, pay the difference between the amount paid and the market value at the time of the transaction or to require the property to be returned to the trustee or liquidator.

**Transactions at an undervalue**

These are transactions entered into by the debtor within a relevant time before insolvency which were for a price less than the full economic value at the time of the transaction. This is appropriate to both individuals and companies, but there are differences in relation to the relevant time scales of interest:

Type of antecedent transaction	Insolvency Act section covering the transaction itself	Insolvency Act section covering the time limit	Relevant Time
Undervalue	Individual s. 339	341 (1)	5 years
	Corporate s. 238	240 (1)	2 years

**Preferences**

This is where a creditor has been paid in a favourable manner over other creditors (for example, if the debtor knows of their likely insolvency, but pays a significant sum to a relative), in an attempt to avoid losses for that creditor and potentially benefiting them over the other creditors.

The court may make reversal orders under sections 239 and 340 providing that:

- Prior to the issue of the petition the debtor has done something which has the effect of putting a creditor/guarantor/surety in a better position than they would otherwise be in if bankruptcy / winding up occurs
- In giving the preference the debtor was influenced by a desire to put the creditor/guarantor/surety in a better position.

Where the preference was given to a connected person then it is assumed that the debtor was motivated by a desire to put them in that better position.

Type of antecedent transaction	Insolvency Act section covering the transaction itself	Insolvency Act section covering the time limit	Relevant Time
Preference	Individual s. 340	341 (1)	6 months *
	Corporate s. 239	240 (1)	6 months

\*This period extends to 2 years where the preferred creditor is an associate of the debtor

### **Extortionate Credit Transactions**

A transaction entered into by the bankrupt or insolvent company can be reviewed where grossly exorbitant payments are required or gross contravention of the ordinary principles of fair dealing is evident. The relevant time period is three years before the bankruptcy or winding-up order (rather than before the presentation of a petition as for other antecedent transactions).

Type of antecedent transaction	Insolvency Act section covering the transaction itself	Insolvency Act section covering the time limit	Relevant Time
Extortionate credit transaction	Individual s. 343	343	3 years
	Corporate s. 244	244	3 years

Credit Managers need to be aware of preferences as monies received from a debtor may subsequently be reclaimed, unless the credit manager can show that the payment was made due to pressure they put on for the debt to be paid.

**Total 20 marks**

*Less than half of candidates attempted this question, but a good number of those that did had a sound understanding of this area of insolvency law. Developed, law-based discussions on the nature and types of antecedent transactions, the powers to investigate them and the remedies available, were given the greater mark rewards. Some credit was also given for any practical credit management insight in this area.*

8. You are Credit Manager for a firm of solicitors; one of your clients, an individual, owes the firm £124,000 for legal services provided. The debt is now six months past your payment terms. This is largely because the client has raised several queries, including wanting a full time breakdown and an itemised list of expenses. All the information was sent to the client four weeks ago but payment has so far not been received, despite numerous telephone calls and email chasers. The solicitor that did the work is not at all happy and is not concerned about preserving the relationship with the client.

Your Chief Executive now wants to progress the matter by taking a harder line and has asked what options are available.

### **TASK**

Prepare a report to the Chief Executive with the above scenario in mind which:

- a) Discusses the nature, available formats and content of a Statutory Demand. (8 marks)
- b) Includes various options for a debtor who receives a Statutory Demand. (3 marks)
- c) Explains any advantages and disadvantages to the creditor in the use of a Statutory Demand in this situation. (4 marks)
- d) Recommends a specific further course of action following unsuccessful issue here of a Statutory Demand, justifying the choice and highlighting any potential drawbacks of such further action. (5 marks)

(20 marks)

### **Question aims**

To test the candidates understanding of the use of statutory demands and bankruptcy petitions and the advantages/disadvantages associated with them.

### **Suggested answer**

- a) The demand must be in one of the following formats:
  - Form 6.1 – for a liquidated sum payable immediately
  - Form 6.2 – for a liquidated sum payable immediately after a judgment order of court
  - Form 6.3 – for a debt payable at a future date.

The demand must contain the following:

- Debtors name and address
  - Creditors name and address
  - Amount and details of the debt
  - Time limits applicable for response to the demand.
- b) On receipt of a properly raised demand the debtor has three options
    - To pay the debt in full
    - To negotiate a payment proposal to settle the debt
    - To offer some form of security.

*Please note these responses are not the same as the options for a debtor receiving a County Court claim, which is not an alternative response to this task.*

c) The advantages of a statutory demand include:

- cost efficiency compared to other procedures
- giving the debtor one last opportunity to settle the debt
- ensuring the debtor knows you are serious and will wait no longer for settlement of the debt
- often encourages the debtor to negotiate a payment arrangement.

*Credit was available for any appropriate disadvantages to the use of a statutory demand, which were not 'opposites' of advantages and were realistic (so not, for instance, that they can be set aside).*

However, the creditor must take all reasonable steps to bring the demand to the debtor's attention and therefore it is preferable to serve personally although service by postal service is allowed.

But Section 268 of the Insolvency Act 1986 states that a creditor may issue a petition if he has served on the debtor a statutory demand requiring the debtor to pay the debt and three weeks have passed since the demand without payment from the debtor.

**d)** Following service of the demand, if the client does not settle the amount in full or at least make contact with acceptable proposals for settlement, then the matter should be progressed to the issue of a bankruptcy petition. However, unless the debtor has valuable assets in their estate, it is not likely that all debts will be paid in full, or bankruptcy avoided. A disadvantage of a petition is the cost involved as the fee and deposit payable on the issue of the petition can be quite high. Also, once the petition is issued the creditor may lose control of the process as, even if the creditor has been paid, other creditors become aware of the petition and may take it over. This could result in any funds the creditor received having to be paid to the trustee in bankruptcy for the benefit of all creditors. Even then, any preferential creditors may significantly reduce or absorb any distribution to unsecured creditors.

**Total 20 marks**

*Three-quarters of candidates attempted this question and, on the whole, responses were well-thought out and appropriate to a written report to a chief executive, with most achieving 10 or more marks. However, some candidates did not respond in a report as required and broad discussions of enforcement options in Part d) were not appropriate because there is not a judgment to enforce.*

*Nevertheless, it was good to be able to award higher marks for this popular question.*

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