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**SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3A**

**THE INSOLVENCY SYSTEM OF THE UNITED STATES**

This is the **summative (formal) assessment** for **Module 3A** 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 3A**. 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.assessment3A]**. An example would be something along the following lines: 202223-336.assessment3A. **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 “student number” 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**.

6.1If you selected Module 3A 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 3A 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**

Car Corp, incorporated and headquartered in Michigan, owes Parts Inc, incorporated and headquartered in Mexico, USD 10,000 on a past-due invoice for components used to build Car Corp vehicles. May Parts Inc file an involuntary petition to place Car Corp into chapter 11 bankruptcy proceedings?

(a) Yes, regardless of the circumstances.

(b) Yes, if Car Corp has fewer than 12 non-contingent, non-insider creditors.

(c) Yes, if other creditors owed at least USD 5,775 join in the petition.

(d) No, because Parts Inc does not know whether Car Corp is insolvent.

(e) No, because Parts Inc is not a US company.

**Question 1.2**

Answer this question with reference to the set of facts set out in question 1.1 above: Which of the following is likely to be a party in interest in the bankruptcy of Car Corp?

(a) A shareholder in Parts Inc, to which Car Corp is indebted.

(b) A journalist writing about Car Corp’s bankruptcy.

(c) A shareholder in Investment Corp, Car Corp’s parent company.

(d) A retired employee of Car Corp who receives payments from the company’s pension plan.

(e) A non-profit organization that advocates for companies like Car Corp to be held responsible for climate change

**Question 1.3**

Which of the following entities does not satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

(a) A foreign domiciled company that pays a US attorney a retainer.

(b) A company with several US bank accounts, but no physical presence in the United States.

(c) A company with US patents, but no physical presence in the United States.

(d) Options (a) to (c) above satisfy the minimum requirement for presence in the United States.

(e) None of the above (options (a) to (d)) satisfy the minimum requirement for presence in the United States.

**Question 1.4**

Who may serve as a foreign representative to seek recognition of a foreign proceeding under chapter 15?

(a) An officer of the debtor if it is a debtor-in-possession in the foreign proceeding.

(b) The board of directors of the debtor if it is a debtor-in-possession in the foreign proceeding.

(c) An insolvency professional appointed by the court overseeing the foreign proceeding.

(d) An insolvency professional appointed by a creditor where the foreign proceeding is an involuntary receivership.

(e) All of the above.

**Question 1.5**

Which of the following regarding executory contracts is **false**?

(a) A court will generally defer to a debtor’s business judgment regarding whether to assume or reject an executory contract.

(b) Executory contracts are clearly defined by the Bankruptcy Code.

(c) In the most common formulation, executory contracts are defined as those where both sides to a contract have material unperformed obligations.

(d) Chapter 11 debtors have greater flexibility than chapter 7 debtors on when they may assume, assign or reject an executory contract.

(e) Under the hypothetical test, a debtor cannot assume an executory contract if the debtor could not also assign the contract.

**Question 1.6**

Which of the following is not a requirement to confirm a “cramdown” plan?

1. That the plan is fair and equitable to dissenting classes of creditors.
2. Acceptance of the plan by at least one class of impaired, non-insider creditors.
3. Acceptance of the plan by all classes of secured creditors.
4. That the plan does not discriminate unfairly against dissenting classes of creditors.
5. That the dissenting creditors receive no less than they would under a liquidation scenario.

**Question 1.7**

Which of the following statements about “pre-packs” is false?

1. A pre-pack cannot be used if the debtor wishes to reject executory contracts.
2. Creditors must have sufficient information about the debtor and the plan to make an informed voting decision.
3. A pre-pack debtor may spend as little as a single day in bankruptcy.
4. The proposed plan of reorganization is submitted to the bankruptcy court together with the voluntary petition.
5. Creditors’ commitment to vote in favor of the plan may be memorialized in a restructuring support agreement.

**Question 1.8**

If a debtor rejects an executory trademark license agreement under which the debtor licenses its trademark to a manufacturer, which of the following is true:

1. The manufacturer has a claim for damages for breach of contract.
2. The manufacturer must immediately stop using the trademark.
3. The manufacturer can continue using the trademark for the remaining period of the license.
4. Both options (a) and (b).
5. Both options (a) and (c).

**Question 1.9**

Which of the following about 363 sales is false?

1. A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.
2. The debtor-in-possession must establish that the transaction is in the best interests of the estate as a whole.
3. In chapter 15 proceedings, a foreign court’s approval alone suffices for a 363 sale.
4. Debtors must carry out a robust marketing process for the sale.
5. A creditor’s lien on assets sold in a 363 sale attaches to the proceeds of the sale.

**Question 1.10**

Which of the following regarding substantive consolidation is true?

1. It respects the boundaries of corporate separateness.
2. If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.
3. It is the treatment of two or more creditors as a single creditor to simplify the claims process.
4. Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.
5. Authority for substantive consolidation comes from the Bankruptcy Code.

**QUESTION 2 (direct questions) [10 marks]**

**Question 2.1 (1 mark)**

What is setoff and why is it not permitted in many circumstances?

[Setoff allows a creditor who has a claim against the debtor, and who also owes money to the debtor, to net out the two (or more) obligations. Because setoff rights can enhance the position of the creditor in comparison to other unsecured creditors who are not owed money by the debtor (since it decreases the creditor's obligation to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the unsecured claim), setoff is not permitted in several circumstances:

(1)The creditor's claim against the estate is disallowed; (2)The creditor's claim against the estate was acquired post-petition or within the 90 days prior to the petition when the debtor was insolvent; (3)The creditor's obligation to the debtor was incurred within the 90 days prior to the petition when the debtor was insolvent for the purposes of exercising setoff rights; (4) The creditor improves its position by setoff compared to its position had setoff been exercised 90 days prior to the petition.

For these limitations, the debtor is presumed insolvent during the 90 days prior to the petition date, but the creditor can rebut this presumption. However, several transactions are exempted from these restrictions on setoff. The most significant of these are commodity, forward, security, repurchase, swap, and master netting contracts.]

**Question 2.2 [2 marks]**

What is a “priming lien” and what requirements must be met for such a lien to be granted to secure DIP financing?

[A "priming lien" is a type of security interest or lien that takes precedence over existing liens or encumbrances. It is commonly granted to a new lender in Debtor-In-Possession (DIP) financing. This gives them priority over existing creditors if bankruptcy occurs.

To be granted a priming lien, certain requirements must be met. For example: proving that existing lenders are adequately protected, and that the debtor has explored all other financing options ---- This means there is no other unencumbered estate property available for a lien and no encumbered estate property with an equity cushion available for a junior lien.]

**Question 2.3 [2 marks]**

What are two potential consequences of a violation of the automatic stay?

[The two potential consequences of violating the automatic stay are as follows:

(1) The violator might have to pay the debtor's attorney fees;

(2) The violator might be required to take affirmative actions to undo the effects of their violation.]

**Question 2.4 [2 marks]**

In voting on a plan of reorganization, which class(es) of creditors are (i) deemed to accept the plan, (ii) deemed to reject the plan and (iii) permitted to vote on the plan? What vote is necessary for a class of creditors to accept a plan?

[A class that is unimpaired is considered to have accepted the plan, while a class that receives nothing is viewed as having rejected the plan, and all the classes are permitted to vote on the plan. Additionally, at least one impaired class (excluding insiders) must vote in favor of the plan.]

**Question 2.5 [3 marks]**

Answer the following questions about preferences, actual fraudulent conveyances and constructive fraudulent conveyances:

1. Which cause of action applies only to transfers made on account of antecedent debt?
2. Which cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer?
3. Which cause of action requires that the debtor be proven to have intended to frustrate creditors’ recoveries?

[(a) Constructive fraudulent conveyances apply only to transfers made on account of antecedent debt.

(b) Constructive fraudulent conveyances require that the debtor be presumed or proven to have been insolvent at the time of the transfer.

(b) Actual fraudulent conveyances require that the debtor be proven to have intended to frustrate creditors’ recoveries.]

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

**Question 3.1 [3 marks]**

Describe the circumstances in which a bankruptcy court may enter a final order consistent with the US Constitution, who reviews appeals from bankruptcy court orders and how orders that are not constitutionally final are reviewed.

[(1) A bankruptcy court may enter a final order consistent with the US Constitution in “core” matters proceedings, and Core proceedings include, but are not limited to—

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

(C) counterclaims by the estate against persons filing claims against the estate;

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

(See 28 U.S. Code § 157 – Procedures（b)（2）

(2) who reviews appeals from bankruptcy court orders.

Generally, bankruptcy court decisions are appealed to the district court in their respective district. In some circuits, these appeals are handled by a Bankruptcy Appellate Panel (BAP), which comprises bankruptcy court judges from within the circuit. The appealing party, however, can request the district court to hear the appeal instead in these circuits.

An appeal of right can be made to the circuit court of appeals from either the district court or BAP, assuming the initial order allows for such an appeal. Exceptionally, an appeal from a bankruptcy court may directly reach the court of appeals. This happens if the bankruptcy court or district court certifies that the appeal either raises a legal question with no controlling decision from the circuit or the US Supreme Court, requires resolution of conflicting controlling decisions, or an immediate appeal could significantly advance the case. The court of appeals has the discretion to accept a case that has been certified in this manner.

(3) How orders that are not constitutionally final are reviewed?

Answer: If the ruling was in a core proceeding, where the bankruptcy court had authority (either by law or by the parties' consent) to issue a final order, the district court or Bankruptcy Appellate Panel (BAP) reviews conclusions of law de novo and findings of fact for abuse of discretion. This is because the bankruptcy court had a greater opportunity to weigh the evidence. If the ruling was in a non-core proceeding or if the bankruptcy court did not have authority to issue a final order, the district court or BAP reviews all findings of fact and conclusions of law de novo, but only if a party has objected. The district court or BAP's order is reviewed by a circuit court of appeal de novo for conclusions of law and for abuse of discretion regarding findings of fact.]

**Question 3.2 [3 marks]**

What provisions of the Bankruptcy Code may not be invoked by a foreign representative in a chapter 15 proceeding? What are two ways that the foreign representative can obtain equivalent relief?

[(1) It's important to note that an "Automatic Stay" may not be invoked by a foreign representative in a Chapter 15 proceeding. However,

(2) The stay can be invoked in two ways: it arises either upon the petition for recognition of a foreign main proceeding is granted and is limited to the debtor's property within the US jurisdiction, or the Bankruptcy Court could grant a stay or other assistance on an interim basis pending recognition or following recognition of a non-main proceeding.]

**Question 3.3 [4 marks]**

What rules should one review when preparing a filing for a bankruptcy court?

[ When preparing a filing for a bankruptcy court, we should review the rules as follows:

(1) the Bankruptcy Rules, (2) the Federal Rules of Civil Procedure, (3) the local rules of the bankruptcy court, and (4) the judge’s personal practices.]

**Question 3.4 [5 marks]**

What fiduciary duties do directors of Delaware corporations owe and to whom are the duties owed in the ordinary course of business? To whom are duties owed when the corporation is potentially or actually insolvent?

[(1) Directors of Delaware corporations owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care in educated decision-making. However, the business judgment rule protects directors from liability for errors in judgment. This rule assumes that directors have acted in good faith, based on reasonable information. This assumption can only be reversed by proving that the majority of the board was not adequately informed, didn't genuinely believe their decision was in the corporation's best interest or acted dishonestly. Unless this assumption is reversed, the directors will not be held accountable unless there is proof of gross negligence. Furthermore, a corporation's certificate of incorporation can excuse directors from liability for breaching the duty of care, but not the duty of loyalty.

The business judgment rule does not apply when the majority of the board approving a transaction lacks impartiality and independence, or when a controlling shareholder is involved in both sides of the transaction. In these situations, the transaction will be void unless it meets the entire fairness standard.

(2) In general, directors owe their duties to the corporation and its shareholders, not its creditors.

(3) When the corporation is potentially insolvent, and shareholders might not receive anything in bankruptcy, directors owe their duties to the corporation and its shareholders. Even if a company is operating "in the zone of insolvency" or when it is insolvent, the Delaware Supreme Court has clarified that directors are not obligated to creditors.

 However, when insolvency occurs, creditors gain the ability to assert derivative claims on behalf of the corporation for directors' breaches of fiduciary duties. This is because the directors' duties are to the corporation and all of its residual claimants, which, after insolvency, include the creditors.]

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

**Question 4.1 [5 marks]**

iWork Ltd leases office space from office building owners and sublets the space to small businesses. Due to the increases in the numbers of businesses operating remotely, iWork Ltd has suffered a decline in revenues. As a result, it has failed to pay rent on some of its office space leases. What protections does the Bankruptcy Code provide to lessors of office space to iWork Ltd?

[If iWork Ltd filed a petition, lessors of office space are affected because the Code authorizes a trustee or debtor to assume or reject a lease of real or personal property within certain periods.

However, the Bankruptcy Code attempts to protect lessors during the time before a trustee or debtor assumes or rejects a lease. With respect to a lease of nonresidential real property, section 365(d)(3) provides that:

(3) The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period. This subsection shall not be deemed to affect the trustee’s obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor’s rights under such lease or under this title.

section 365(d)(4)(A) provides that:

(A)Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—

(i)the date that is 120 days after the date of the order for relief; or

(ii)the date of the entry of an order confirming a plan.

See 11 U.S.C. §§ 365(d)(2); 365(d)(3); 365(d)(4)(A).

So that, lessors of office space to iWork Ltd may extend the time for performance of any such obligation after the date of the order for relief.]

**Question 4.2 [5 marks]**

Skin Luxe is incorporated and has a principal place of business in France where it develops and manufactures high end skincare products. Skin Luxe sells its skin care products through its own boutiques in many international cities, including Paris, Las Vegas, London and Hong Kong. Skin Luxe’s English law-governed bonds are due to mature in one year, but it is unable to repay or refinance them. Skin Luxe is considering using an English scheme of arrangement to restructure the bonds.

Discuss whether the English scheme of arrangement could be granted recognition under US chapter 15 as a foreign main or foreign non-main proceeding.

[(1) The requirements for recognition are minimal: the foreign representative must demonstrate that a foreign court or administrative proceeding involving the debtor is ongoing, and that they are authorized to act by this proceeding. There is no need for a foreign proceeding to resemble a US bankruptcy case. The Bankruptcy Code defines a foreign proceeding as "a collective judicial or administrative proceeding in a foreign country... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation."

According to the definition, English schemes of arrangement could be granted recognition under US Chapter 15.

In addition, a proceeding fulfilling these requirements may be denied recognition or assistance if it is manifestly contrary to US public policy. However, this exception is quite limited.

(2) The proceedings commenced in the debtor's center of main interests (COMI) are Foreign main proceedings. The relevant factors about the COMI are “the location of headquarters, management, primary assets, and a majority of debtor's creditors or a majority of the creditors that will be affected by the relief requested by the foreign representative...”

Since Skin Luxe is incorporated and develops and manufactures high-end skin care products in France, Skin Luxe’s COMI should be in France instead of England.

So with all that, Skin Luxe’s English schemes of arrangement could be granted recognition under US Chapter 15 as a foreign non-main proceeding.

By the way, the main point of contention that may arise at the recognition stage is determining whether the foreign proceedings are 'foreign main' or 'foreign non-main.' This distinction determines the scope of relief available to the debtor after recognition.]

**Question 4.3 [5 marks]**

Speculation Inc is engaged in day-trading stocks from leased office space with two employees. It funds its trading through a margin loan from its broker, where the shares it purchases are held as collateral. For a while, Speculation Inc was very successful in trading, and the US Department of Justice (DOJ) has announced an investigation into whether its success was due to illegally trading on insider information. More recently, Speculation Inc has had serious trading losses, causing its broker to declare a default on the margin loan. It also has fallen behind on its rent, and has been sued in civil suit by a former employee alleging she was fired due to due to gender bias.

What would be the effect of a chapter 11 petition being filed by Speculation Inc on each of (i) the DOJ investigation, (ii) margin loan default; (iii) the delinquent lease and (iv) the employment discrimination lawsuit?

[When Speculation Inc files a Chapter 11 petition, the "automatic stay" from Section 362 of the Bankruptcy Code takes effect immediately. This halts nearly all actions and proceedings against the debtor and their property. It provides the debtor the necessary breathing room to create a restructuring plan, negotiate with creditors, and orderly assess the value of their assets. Ultimately, this process leads to the payment of creditor claims, following the priorities set by the Bankruptcy Code. The scope of the automatic stay is exceptionally broad, and the Bankruptcy Code explicitly prohibits:

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

See 11 U.S. Code § 362 - Automatic stay (a) (1)(3)(4)

With all this being said, the effects are as follows:

(ii) for a margin loan default, its broker couldn't take any action against Speculation Inc. and the shares it purchases are held as collateral.

(iii) the landlord couldn't take any action against Speculation Inc. for a delinquent lease.

(iv) the employment discrimination lawsuit will be operated as a stay.

However, the stay is subject to certain statutory exceptions as follows: criminal proceedings;

regulatory investigations;... See Module 3A Guidance Text, p23.

Therefore, (i) the DOJ investigation will continue.]

**\* End of Assessment \***