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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?

Under specific circumstances, the Bankruptcy Code allows setoff rights derived from non-bankruptcy law to be exempted from avoidance as preferences. Setoff Parte superior do formulário

allows a creditor with a claim against the debtor, who also owes money to the debtor, to balance out the two obligations. Because setoff rights can improve the position of the creditor as compared to other unsecured creditors who are not owed money by the debtor because it decreases its 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 a number of circumstances, such as:

* If the creditor's claim against the estate is rejected.
* If the creditor's claim was acquired post-petition or within 90 days before the petition when the debtor was insolvent.
* If the creditor's debt to the debtor was incurred within 90 days before the petition when the debtor was insolvent.
* If the creditor benefits unfairly from setoff compared to their position 90 days before the petition.

During the 90 days before the petition date, the debtor is assumed to be insolvent unless proven otherwise by the creditor. Certain transactions, like commodity, forward, security, repurchase, swap, and master netting contracts, are exempt from these setoff restrictions.

**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" refers to a lien that holds a senior or equal position compared to a pre-petition lien on estate property to secure post-petition financing. The court may authorize a priming lien if the debtor is unable to secure DIP financing under any other conditions. Additionally, it is necessary for the debtor to demonstrate that the secured creditor's interests being primed are adequately safeguarded.

In Chapter 7, distributions are prioritized for holders of allowed unsecured claims following a detailed hierarchy. However, these distributions occur only after secured claims have been satisfied from their collateral. If a priming lien was issued for post-petition financing, that financing would take precedence in collateral over pre-petition secured lenders.

**Question 2.3 [2 marks]**

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

The "worldwide automatic stay" takes effect immediately upon the filing of a plenary petition in bankruptcy cases, allowing the debtor time to develop a restructuring plan, negotiate with creditors, and manage its assets in an organized manner, ultimately leading to the settlement of creditor claims based on the priorities outlined in the Bankruptcy Code.

Any action taken in violation of this stay, even if done without knowledge of the petition filing, is considered contempt of court and **may be void or voidable**, depending on the circuit where the bankruptcy case is pending, as there is a circuit split on this issue. However, parties involved may seek court permission to lift the stay either prospectively to allow an action or retroactively to validate a prior action that would otherwise violate the stay. Failure to obtain relief from the stay could result in contempt sanctions, including **payment of the debtor's attorneys' fees** and **requirements to undo the effects of the violation**. Recently, the US Supreme Court clarified that the stay only prohibits affirmative acts that alter the estate's property's status quo. Therefore, certain actions, such as the impoundment of a car before the debtor's bankruptcy filing, may remain in effect. In cases where the court is concerned about a violator's delay in rectifying the violation, it may impose coercive contempt sanctions, such as daily fines payable until the violation is resolved.

**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 of creditors that are not impaired by the plan (including one whose acceleration of debt has been reversed) are not allowed to reject the plan, therefore are deemed to accept it. On the other hand, a class that will receive nothing is deemed to reject the plan. A class of creditors approves the plan if a majority of the creditors in that class, holding at least two-thirds of the total value of claims, vote in favor. For equity interests, the plan is approved if at least two-thirds of the interests vote in favor. Thus, the balance of decision-making power lies with the impaired classes.

**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) Contemporaneous new value: In preference claims, a transfer cannot be avoided if the recipient provided the debtor with new value simultaneously. This defense requires more than just substituting a new obligation for an old one; it requires the provision of money, goods, services, or new credit. Essentially, this defense aligns with the requirement that the payment must be for an antecedent debt. Whether a transfer meets these criteria depends on the specific circumstances. If a security interest is involved, the time between the initial transaction and the perfection of the interest cannot exceed 30 days. However, transfers not related to security interests may still be considered non-contemporaneous, especially if they are part of a series of delayed transfers, which undermines the claim of being substantially contemporaneous.

b) Statutory liens: A state law lien established during the suspect period cannot be avoided as a preference. However, another provision of the Bankruptcy Code allows for the avoidance of such statutory liens under certain conditions, including if they are based on the debtor's insolvency, appointment of a custodian, financial condition, or petition for bankruptcy. Essentially, this section disregards state law liens that operate similarly to ipso facto clauses and could disrupt creditor priorities in bankruptcy.

c) Safe harbors for securities and commodities contracts: Certain types of payments cannot be avoided as preferences or fraudulent conveyances unless there is intent to defraud creditors. These include margin payments, settlement payments involving specific financial entities, transfers related to securities, commodity, forward, repo, and swap contracts, as well as those linked to master netting agreements. This exception aims to ensure stability and conclusiveness in financial market operations.

**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.

In circumstances where a bankruptcy court lacks constitutional authority, it can still enter final orders in core proceedings. This can be achieved by providing a report and recommendation for review by the district court, following procedures similar to non-core proceedings. Alternatively, with the consent of the parties, bankruptcy judges may issue final orders themselves. Bankruptcy Rules now mandate litigants to specify whether they consent to final orders or judgment by the bankruptcy court. If a district court determines that a bankruptcy court lacked jurisdiction to issue a final order, it may treat the order as proposed findings of fact and conclusions of law.

Appeals from bankruptcy court decisions are typically heard by the district court in the respective district. However, in some circuits, appeals are heard by a Bankruptcy Appellate Panel (BAP) comprising bankruptcy court judges from within the circuit. Parties in these circuits have the option to choose the district court for their appeal. Appeals from the district court or BAP can then be further appealed to the circuit court of appeals, provided there was an initial right to appeal. In exceptional cases, an appeal from a bankruptcy court may bypass the district court and go directly to the court of appeals if the bankruptcy or district court certifies that the case raises a novel legal question, resolves conflicting decisions, or if immediate appeal would significantly advance the case. The court of appeals has discretion to accept cases certified in this manner.

When the decision below occurs in a core proceeding where the bankruptcy court had authority to issue a final order, either by law or by the parties' agreement, the district court or BAP conducts a de novo review of legal conclusions and examines factual findings for signs of abuse of discretion, recognizing the bankruptcy court's extensive opportunity to evaluate evidence. However, if the decision pertained to a noncore proceeding or the bankruptcy court lacked authority to issue a final order, the district court or BAP conducts a de novo review of all contested findings of fact and legal conclusions. The decision of the district court or BAP is then subject to de novo review by the circuit court of appeal for legal conclusions and for potential abuse of discretion regarding factual findings.

**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?

Chapter 15 of the bankruptcy law closely mirrors the Model Law but excludes foreign representatives from using avoidance powers provided by the Bankruptcy Code. However, this exclusion is generally interpreted to apply only to preferences and fraudulent conveyances, not precluding foreign representatives from seeking to avoid pre-petition transactions under other US or foreign laws. Foreign representatives can invoke Bankruptcy Code avoidance powers only in plenary proceedings such as Chapter 7 or 11, either initiated before their involvement or after recognition of the foreign proceeding under Chapter 15. In such cases, the scope is limited to the debtor's US assets and coordinated with the foreign proceeding. Plenary proceedings may be initiated to access Bankruptcy Code's avoiding powers when other laws' relief is inadequate.

**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, it's essential to review several sets of rules:

* **Bankruptcy Rules**: These are the specific rules governing bankruptcy proceedings, including procedures, forms, and requirements for filings.
* **Federal Rules of Civil Procedure**: Although bankruptcy is a separate legal field, certain aspects of civil procedure may apply, especially in matters related to service of process, discovery, and evidence.
* **Local Rules of the Bankruptcy Court**: Each bankruptcy court may have its own local rules that supplement the Bankruptcy Rules and provide additional guidance specific to that jurisdiction.

Also, understanding the preferences and procedures of the presiding judge can be crucial for ensuring compliance and efficiency in the courtroom. Finally, if you're not regularly practicing in the jurisdiction, seeking advice from local practitioners can provide valuable insights into any unwritten local practices or nuances of the court's procedures.

**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?

In Delaware, directors of corporations owe fiduciary duties primarily to the corporation and its shareholders. These duties include a duty of loyalty, requiring directors to act in the corporation's best interests, and a duty of care, mandating informed decision-making.

Directors are generally protected from liability for errors of judgment by the business judgment rule, which presumes that they acted in good faith and with reasonable information. This presumption can only be overcome by showing gross negligence or breaches of fiduciary duty. Directors may also be shielded from liability for breaches of the duty of care by the corporation's certificate of incorporation.

However, the business judgment rule does not apply if a transaction is approved by a board majority that is not disinterested and independent, or if a controlling shareholder is involved in the transaction. In such cases, the entire fairness standard must be satisfied for the transaction to be valid. Importantly, directors' duties are owed solely to the corporation and its shareholders, not to creditors, even in circumstances where the corporation is potentially or actually insolvent.

The Delaware Supreme Court has clarified that directors do not owe duties to creditors when a company is operating in the "zone of insolvency" or is insolvent. Therefore, concepts like "wrongful trading" or "deepening insolvency" do not have equivalent legal standing under US law.

**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?

The Bankruptcy Code offers protections to office space lessors when tenants such as iWork Ltd file for bankruptcy. One crucial safeguard is the automatic stay, which pauses ongoing legal actions and debt collection efforts against the debtor, including eviction proceedings. This pause allows the debtor time to restructure its affairs and propose a repayment plan. Furthermore, under Section 365 of the Bankruptcy Code, a debtor in bankruptcy can choose to assume or reject existing leases. If iWork Ltd opts to assume its office space leases, it must address any outstanding defaults, such as unpaid rent, and assure future performance. Should iWork Ltd reject the leases, lessors can seek damages for resulting losses, including unpaid rent. Additionally, office space lessors might hold priority claims for unpaid rent during the bankruptcy proceedings, depending on the lease's specifics. However, the payment of these claims relies on available funds and the hierarchy of other claims in the bankruptcy case. Overall, the Bankruptcy Code strives to balance the interests of debtors and creditors, including office space lessors, by providing mechanisms for resolving lease agreements in bankruptcy proceedings.

**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.

The English scheme of arrangement may be eligible for recognition under US Chapter 15 as either a foreign main or foreign non-main proceeding, depending on specific criteria.

If Skin Luxe's center of main interests (COMI) is established to be in France, where its primary business activities are conducted, the English scheme of arrangement would likely be categorized as a foreign non-main proceeding under Chapter 15. In this scenario, Skin Luxe's primary bankruptcy proceedings would take place in France, and the English scheme of arrangement would be acknowledged as a secondary process in the US.

However, if Skin Luxe's COMI is determined to be in England, where it plans to use the scheme of arrangement for bond restructuring, the English scheme could be classified as a foreign main proceeding under Chapter 15. Here, Skin Luxe's principal insolvency proceedings would occur in England, and the scheme of arrangement would be recognized as the primary bankruptcy procedure in the US.

Ultimately, the designation of the English scheme of arrangement as a foreign main or foreign non-main proceeding under Chapter 15 hinges on factors such as Skin Luxe's COMI, the location of its main business operations, and the specifics of the restructuring endeavor.

**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?

In summary, filing for Chapter 11 bankruptcy would impact various aspects for Speculation Inc:

* **DOJ Investigation**: While bankruptcy doesn't halt the DOJ investigation, it could lead to a stay in related civil and criminal proceedings. However, the DOJ could continue its investigation, potentially resulting in criminal charges.
* **Margin Loan Default**: Chapter 11 would trigger an automatic stay, pausing collection efforts and allowing negotiation of new loan terms. This could include reducing debt or extending repayment.
* **Delinquent Lease Payments**: Similar to the margin loan default, the automatic stay would provide an opportunity to renegotiate lease terms with the landlord, possibly resulting in reduced rent or lease restructuring.
* **Discrimination Lawsuit**: Bankruptcy doesn't automatically dismiss the lawsuit, but could lead to a delay in civil proceedings. Lawsuit outcomes would depend on bankruptcy court decisions and any settlements reached during Chapter 11.

Overall, Chapter 11 bankruptcy offers Speculation Inc a chance to address financial challenges and restructure its operations and debts, with outcomes depending on negotiations, court decisions, and ongoing investigations and litigation.

**\* End of Assessment \***