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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 is a principle which would (if permissible) allow a creditor holding a claim against the debtor and simultaneously owing money to the debtor to net out the two (or more) obligations. If this creditor elected to setoff its claims, their position would be improved as compared to other unsecured creditors of the debtor, and is therefore preferential (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). It is therefore not permitted in a number of circumstances.

**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 lien on property which is senior to, or has the same priority as, existing liens on the estate property, provided in order to secure post-petition financing. In the context of DIP (debtor-in-possession) financing under Chapter 11 of US bankruptcy, a priming lien allows a lender to secure new financing with a lien that takes precedence over the claims of existing creditors. A priming lien can be granted by the Court is financing cannot be obtained on any other terms. The debtor must also demonstrate that the interest of the secured creditor being primed is adequately protected.

**Question 2.3 [2 marks]**

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

Any act taken in violation of the automatic stay, which comes into effect immediately on the filing of any plenary petition under the US Bankruptcy Code, constitutes a contempt of Court and is void or voidable (the distinction depends on the circuit in which the bankruptcy is pending, due to a current division in the US circuit Courts on this issue). These consequences apply even if the act is taken without notice of the filing of the petition.

**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?

Deemed to accept the plan: an unimpaired class of creditors (including one whose acceleration of debt has been reversed) is deemed to accept the plan.

Deemed to reject the plan: any class that will receive nothing in any proposed reorganization is deemed to reject the plan.

Permitted to vote on the plan: all impaired classes of creditors (subject to the cramdown rules)

In order for a class of creditors to accept a plan a simple majority of the creditors in that class, holding at least two-thirds of the value of claims in the class, vote in favour (or, for equity interests, if two-thirds in amount of interests vote in favour).

**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) the elements of a preference claim are (i) a transfer of an interest of the debtor in property (ii) to or for the benefit of a creditor, (iii) for or on account of an antecedent debt owed by the debtor before such transfer was made, (iv) made while the debtor was insolvent, (v) made during the suspect period and (vi) that enables the creditor to receive more than it would have in a chapter 7 liquidation. Consequently, the cause of action which applies only to transfers made on account of antecedent debt is **preferences**.

(b) an actual fraudulent conveyance is proven by showing that the debtor made a transfer or incurred an obligation "*with actual intent to hinder, delay or defraud any entity to which the debtor was or became … indebted"*. As actual intent is required, the cause of action that requires a debtor to have been proven to have intended to frustrate creditors' recoveries is **actual fraudulent conveyance**.

(c) **a constructive fraudulent conveyance** requires the debtor to be presumed or proven to have been insolvent at the time of the transfer (amongst other requirements).

**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.

As US bankruptcy judges are appointed by Courts of Appeal, they have limited jurisdiction to enter final orders. In order to be consistent with the US Constitution, a bankruptcy court can therefore make a final order on core bankruptcy issues, as defined in the United States Bankruptcy Code (US Code paragraph 157), which do not invade Article III jurisdiction (see Stern v Marshall 564 US 462 (2011)).. In relation to non-core proceedings, the bankruptcy court may hear the proceedings (if they are sufficiently related to a bankruptcy proceeding) but cannot make a final determination.

Generally, appeals from bankruptcy court decisions are heard by the district court for the distract in which they sit, although in certain circulates bankruptcy appeals are heard by a Bankruptcy Appellate Panel.

If a bankruptcy Court ruling was in a noncore proceeding, or the bankruptcy court did not have authority to enter a final order, the district court or Bankruptcy Appellate Panel re-reviews (de novo) all findings of fact and conclusions of law to which a party is objected. The order of a district court or Bankruptcy Appellate Panel is reviewed by a circuit court of appeal *de novo* as to conclusions of law and for abuse of discretion for 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?

Chapter 15 excludes from the rights granted to foreign representatives the use of the avoidance powers provided by the Bankruptcy Code (see US Bankruptcy Code paragraph 1521(a)(7)), although this has been widely interpreted to apply to the use of the Bankruptcy Code's powers of avoidance of preferences and fraudulent conveyances.

The foreign representative can invoke the Bankruptcy Code's avoidance powers in a plenary proceeding such as Chapter 7 or Chapter 11. Such plenary proceedings could have been commenced by a debtor (or its creditors, dependent on the Chapter) prior to involvement of the foreign representative, and avoidance powers may therefore already exist. The foreign representative may also choose to commence plenary Chapter 7 or 11 proceedings under the Bankruptcy Code following recognition of the foreign proceeding under Chapter 15. If this option is pursued by the foreign representative, the plenary proceeding would be limited to the debtor's US assets and would be coordinated with the foreign proceeding (see US Bankruptcy Code paragraph 1528)).

**Question 3.3 [4 marks]**

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

* US Bankruptcy Code
* Federal Rules of Bankruptcy Procedure (and, by reference, the Federal Rules of Civil Procedure)
* The local rules of the relevant bankruptcy court and the judge's personal practices

To the extent that you are not practicing regularly in any given jurisdiction, it is advisable to consult with a local practitioner for any advice on unwritten local 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?

Directors of Delaware corporations owe limited fiduciary duties, but owe:

(a) a fiduciary duty of loyalty to the corporation's best interest; and

(b) a duty of care in educated decision-making (and, under the business judgment rule, there is a rebuttable presumption that he board of directors have acted in good faith on the basis of reasonable information).

These duties are owed to the corporation and its shareholders, even if the corporation is potentially or actually insolvent, pursuant to the rules of the Delaware Supreme Court. Thus, even where the corporation is insolvent, the board of directors may pursue (in good faith) strategies to maximise the value of the corporation (Trenwick AM Litig Trust v Ernst & Young LLP 906, A.2D 168 (Del Ch 2006)). There is, therefore, no equivalent under US law of the concepts of 'wrongful trading' or 'deepening insolvency'.

**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?

In a scenario where iWork Ltd voluntarily files for bankruptcy in the US, as a result of its decline in revenues, lessors of office space to a bankrupt tenant would be granted various protections under the US Bankruptcy Code, such that they would receive payment for the leased space.

Firstly, a worldwide automatic stay would come into effect immediately upon iWork filing a petition (US Bankruptcy Code paragraph 363). This is designed to give iWork time to formulate a restructuring plan which could culminate in payments being made to lessors. Alternatively, iWork's lessors, as estate creditors, could submit a lift-stay or relief from stay motion, and submit there is a lack of adequate protection of their interest in the property of the estate (as the value of the property may decline during the course of proceedings and result in them, as interested parties, making a less than full recovery). If the Court determines that adequate protection is lacking, the lessor creditors could pursue iWork for the "indubitable equivalent" of the value of their interests that may otherwise be lost through, for example, periodic cash payments from iWork. If the adequate protection awarded by the court proves to be insufficient, any lessors' shortfall would be given administrative expense priority.

Further, As lessors of office space owed pre-petition rent by iWork, all lessors would be entitled to file claims in iWork's bankruptcy. Under paragraph 507(a)(7) of the US Bankruptcy Code, unpaid rent obligations incurred by the debtor for the period following the filing of the bankruptcy petition (post-petition debt) would be categorized as administrative expenses. These administrative expenses have priority over other claims made against iWork's estate.

As the US Bankruptcy Code reflects a debtor-friendly approach, iWork has the ability to assume, reject, or assign executory contracts. iWork's leases of office space are assignable executory contracts and, as such, iWork could elect to assume it under the 'hypothetical test'. If iWork does assume the leases, iWork must cure defaults (i.e. pay the unpaid rent) and give the lessor counterparties sufficient assurances of future performance (US Bankruptcy Code paragraph 365(b)(1)). If iWork rejects the leases, the lessor's claims for unpaid rent owing would become a pre-petition claim against the iWork estate.

**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.

Provided that the foreign representative for the English scheme of arrangement can establish that a foreign court or administrative proceeding with respect to the debtor is pending (i.e. the English scheme of arrangement), and that they are empowered to act by the proceeding, the English scheme of arrangement could be granted recognition under US Chapter 15 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"* (US Bankruptcy Code, paragraph 101(23)). Following In re Global Cord Blood Corp (Case no. 22011347, DSJ, 2022, WL 17478530) the foreign representative would have to establish that the English scheme of arrangement has not been commenced solely for the purposes of investigation and instead relates to the adjustment of debt.

From the above fact-pattern, Skin Luxe's centre of main interest appears to be in France, as its principal place of business, although the centre of main interests would need to be assessed as at the date of the US Chapter 15 petition following Bear Stearns (374 BR 122). Consequently Skin Luxe's English scheme of arrangement could not be recognised under US Chapter 15 proceeding as a foreign main proceeding. Instead, it would be capable of recognition under Chapter 15 as a foreign non main proceeding, as Skin Luxe has an establishment in England (via its boutiques in London) such that it carried out non-transitory economic activity in England prior to the commencement of (future) Chapter 15 proceedings.

**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?

If Speculation Inc were to file a Chapter 11 petition:

DOJ investigation: as criminal proceedings the DOJ's investigation would not be impacted by the worldwide automatic stay on any proceedings against the debtor or its property, as a statutory exception to the US Bankruptcy Code which, instead, provides the debtor with a temporary reprieve from civil actions to encourage the restructuring of debts. The Department of Justice would retain its authority to investigate and prosecute alleged criminal activity irrespective of Speculation Inc's status.

Margin loan default: as a result of the worldwide automatic stay imposed following the filing of a Chapter 11 petition, the broker would not be able to bring enforcement action against Speculation Inc. (and any existing enforcement action would be stayed). This stay would provide Speculation Inc. with some breathing room to formulate a restructuring plan, and would not (for example) permit the broker to unilaterally sell the shares held as collateral. Unless a trustee is appointed, which requires a high threshold for a creditor or another party in interest to be met, Speculation Inc would continue its ordinary course of business operations as a debtor in possession. Such operations may, for example, result in repayments being made to remedy the default. Alternatively, Speculation Inc would propose a reorganization plan within 120 days from the petition (see US Bankruptcy Code paragraph 1121) to address its debts (i.e. including the debt owed following its default on the margin loan). This reorganization plan must then be approved by the Court and accepted by Speculation Inc's creditors, including the broker.

Lease: as with the margin loan default, the worldwide automatic stay imposed following the filing of the Chapter 11 petition would temporarily halt Speculation Inc's landlord's ability to take any legal action (including eviction proceedings, unless the lease has expired) against Speculation Inc. for past rental payments. However, during the bankruptcy process, Speculation Inc. remains responsible for payment of rent. As a lease is an executory contract, Speculation Inc has the option to assume or reject its lease in the Chapter 11 process. If Speculation Inc chooses to assume the lease, it must cure any existing defaults, i.e. make payments of unpaid rent, and provide adequate assurance as to its ability to make rental payments in future to the landlord. If Speculation Inc chooses to reject the lease, if it cannot afford to maintain it, the historic (i.e. overdue) rental payments would be classes as a pre-petition claim by the landlord.

Employment discrimination claim: as above, the worldwide automatic stay imposed by filing the Chapter 11 petition would temporarily pause the civil suit and the former employee would not be able to take further legal action against Speculation Inc. Under paragraph 501 of the US Bankruptcy Code the former employee would need to file a proof of claim with the bankruptcy court, who would have jurisdiction to determine the issue as a core matter, to continue to assert her claim for damages and, if accepted, potentially receive a distribution from the estate's assets.

**\* End of Assessment \***