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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 refers to an arrangement where a debtor reduces his debt owed to a creditor with any amount which the creditor simultaneously owes to the debtor. It is not permitted in many circumstances because it improves the position of that particular creditor over other unsecured creditors.

**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 granted by court to lenders as part of the “Debtor in Possession” financing which grants the said lender a priority that is senior or equal to a pre-existing lien that was made pre-petition.

In order for such lien to be granted, the debtor must satisfy the requirements under **Section 364(d) of the Bankruptcy Code**, i.e.

1. The debtor is unable to obtain financing without offering a priming lien as an incentive; and

2. The debtor must show that there are adequate protections of the interest of the existing lien holders.

**Question 2.3 [2 marks]**

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

The two potential consequences are as follows:

1. The action may amount to a contempt of court; and

2. The action taken may be void or voidable.

**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?

1. An unimpaired class of creditors is deemed to accept the plan

2. A class of creditors that will receive nothing is deemed to reject the plan

3. An impaired class of creditors is permitted to vote on the plan.

A simple majority of a particular class of creditors holding at least two-thirds of the value of claims is necessary to approve a reorganization 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?

In respect of (a) – Preference

In respect of (b) – Constructive fraudulent conveyance

In respect of (c) – Actual fraudulent conveyance

**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.

A bankruptcy court may enter a final order consistent with the US Constitution by either issuing a report or recommendation for review by the district court, or when parties consent to such final order being made by the bankruptcy court.

Any appeals against a bankruptcy court order will be reviewed by the relevant district courts. However, in certain circuits, appeals are reviewed by a Bankruptcy Appellate Panel instead.

For orders that are not constitutionally final, it may only be reviewed with leave of the appellate court.

**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?

A foreign representative may not invoke the provisions under the Bankruptcy Code relating to avoidance actions.

In order for a foreign representative to obtain equivalent relief, he can do so in the following 2 ways:

a. When there is a plenary Chapter 7 or 11 proceedings commenced by a debtor or creditor prior to the involvement of the foreign representative; or

b. The foreign representative commences the plenary Chapter 7 or 11 proceedings under the Bankruptcy Code after recognition of the foreign proceedings under Chapter 15.

**Question 3.3 [4 marks]**

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

When preparing a filing at the bankruptcy court, one must ensure the following:

1. That the petition must be accompanied by a schedule disclosing all its assets including property, executory contracts, unexpired leases of real and personal property, as well as identifying its liabilities including identifying its secured and 20 largest unsecured creditors.

2. That the disclosure of information in the schedules would not violate any contractual or other confidentiality obligations. In this respect, one must confer with the US Trustees on the appropriate measures.

**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 owe a fiduciary duty to the corporation.

2. This duty includes a duty of loyalty whereby the best interests of the corporation take precedence over any other interests of the directors.

3. Another duty is the duty of care in educated decision-making whereby the directors must act with care which an ordinary, careful and prudent person would take in similar circumstances.

4. When a corporation is potentially or actually insolvent, a director owes a duty to the corporation and shareholders.

5. They do not owe any duties to creditors pursuant to Delaware Supreme Court’s decision in ***North Am Catholic Educational Programming Foundation v Gheewalla***

**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?

Assuming the leases are unexpired, lessors of office space may have the protection under Section 365(d)(4) of the Bankruptcy Code whereby the unexpired lease of the office space (which is a non-residential property) which iWork Ltd is the lessee shall be deemed rejected unless iWork Ltd assumes the unexpired lease within 120 days after the date of order for relief.

In such a case, iWork Ltd must immediately surrender the office space to the lessors.

A further protection provided to lessors is that the lessors’ written consent must be obtained if iWork Ltd seeks to apply for an extension beyond the 1st 90 days extension which iWork Ltd may apply pursuant to Section 365(d)(4)(B)(i) of the Bankruptcy Code.

Another form of protection provided to lessors is the ability for lessors to apply for a lift or relief from any automatic stay of proceedings arising from a Chapter 7 or Chapter 11 proceeding on the basis that there is a lack of adequate protection of an interest in property of the estate (Section 362(d) of the Bankruptcy Code). The lessors would have to show that the value of the property may decline during the course of the bankruptcy proceedings, and this would result in the lessors making less than a full recovery.

**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 could be granted recognition in the US as a **foreign main proceeding**. This is because the scheme of arrangement is just to restructure the bonds and not all assets / liabilities of Skin Luxe. The bonds are governed by English laws and thus English law (and in particular the “Rule in Gibbs”) will apply to the scheme of arrangement.

It is also likely that a majority of Skin Luxe’s creditors that may be affected are located in the UK. This is because they may be creditors based in the UK who insisted on the bonds to be governed by English law.

The fact that Skin Luxe is incorporated and has a principal place of business in France does not mean that France is Skin Luxe’s center of main interest (“**COMI**”) for the present application for recognition in the US. This is because its place of incorporation and principal place of business have little to do with the English law-governed bonds. In this respect, the presumption of France being Skin Luxe’s COMI by virtue of its place of incorporation, is rebutted.

**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?

The filing of a Chapter 11 petition will trigger an automatic worldwide stay of legal proceedings against Speculation Inc.

However, in so far as the DOJ investigation, such investigation will not be stayed. This is because the automatic worldwide stay does not operate against any regulatory investigation (Section 362(b) of the Bankruptcy Code).

In so far as the margin loan default is concerned, the broker will not be to commence any litigation to recover its losses arising from the default. Neither will the broker be able to enforce the securities over the shares which Speculation Inc provided as collateral. Any action taken by the broker may be an act of contempt in court and the action may be void or voidable.

In so far as the delinquent lease, the lessor may not be able to commence any litigation to recover any pre-petition unpaid rent. However, it is allowed to exercise its right to obtain possession of its property if the lease has expired. This is because the automatic stay does not operate against such right pursuant to Section 362(d)(10) of the Bankruptcy Code).

In so far as the employment discrimination lawsuit, that would also be stayed as a result of the Chapter 11 petition. This is because the lawsuit is likely to involve pre-petition claims.

**\* End of Assessment \***