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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?

Answer:

Setoff is a legal mechanism that allows parties to set aside mutual debts owed to each other, resulting in the cancellation of part or all of those debts. For example, if Party A owes $5,000 to Party B, and Party B owes $3,000 to Party A, setoff would allow Party A to deduct $3,000 from the amount owed to Party B, leaving a net amount of $2,000 owed by Party A to Party B.

Setoff is not permitted in many circumstances due to various legal and practical considerations:

**Equity and Fairness**.

**Bankruptcy and Insolvency**

**Contractual Provisions**

**Complexity and Uncertainty**

**Legal Requirements**

**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?

Answer:

A "priming lien" refers to a sort of security interest or lien that is granted to a lender in bankruptcy proceedings, which allows the lender to obtain priority over existing creditors' liens or interests in the debtor's assets. Priming liens are frequently connected with debtor-in-possession (DIP) financing, which is money provided to a debtor during bankruptcy proceedings to support its operations and facilitate its reorganization.

To obtain a priming lien to secure DIP financing, certain requirements must typically be met:

**Court Approval**

**Adequate Protection**

**Finding of Necessity**

**Good Faith and Best Interests**

**Compliance with Legal Requirements**

**Question 2.3 [2 marks]**

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

Answer:

An infringement of the automatic stay, which is a fundamental protection provided to debtors under U.S. bankruptcy law, can have important legal and financial residue. Here are two potential consequences:

**Contempt of Court and Sanctions:**

**Description:** The automatic stay is an injunction ordered by the court that immediately comes into action after the filing of a bankruptcy petition. The intentional violation of the automatic stay could be considered contempt of court.

**Consequence:** The court imposes penalties on the party violating the automatic stay. These penalties can include fines and, punitive damages. For instance, in the case of In re **Jove Engineering, Inc., 92 F.3d 1539 (11th Cir. 1996)**, the court awarded punitive damages for willful violations of the automatic stay.

**Damages to the Debtor:**

**Description:** Section 362(k) of the Bankruptcy Code specifically provides for damages in cases of persistent violations of the automatic stay. If a creditor knowingly and willfully violates the stay, the debtor is entitled to real damages.

**Consequence:** The debtor may recover actual damages, including costs and attorneys' fees, and in certain circumstances, punitive damages. For example, in **Sternberg v. Johnston, 595 F.3d 937 (9th Cir. 2010)**, the court acknowledged the debtor's right to recover attorneys' fees and other costs resulting from the stay violation.

These repercussions underscore the intensity with which bankruptcy courts treat the automatic stay and the protection it offers to debtors. Violating the automatic stay disrupts the orderly process of bankruptcy and frustrates the equitable treatment of creditors and debtors as intended by the Bankruptcy Code.

**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?

Answer:

In a Chapter 11 reorganization under the U.S. Bankruptcy Code, creditors are classified into different classes, and their rights to vote on a plan of reorganization are determined based on the treatment they receive under the plan. Here's how the voting works for different classes of creditors:

**(i) Deemed to Accept the Plan**

**Deemed to Accept:** Classes of creditors that are unimpaired by the plan are deemed to accept the plan.

**Unimpaired Class:** A class is considered unimpaired if the plan leaves unaltered the legal, equitable, and contractual rights of the creditors in that class.

**Legal Reference:** 11 U.S.C. § 1126(f).

**(ii) Deemed to Reject the Plan**

**Deemed to Reject:** Classes of creditors that receive no distribution or interest under the plan are deemed to reject the plan.

**Impaired Class with No Recovery:** A class is considered impaired and deemed to reject if its members will not receive or retain any property under the plan.

**Legal Reference:** 11 U.S.C. § 1126(g).

**(iii) Permitted to Vote on the Plan**

**Permitted to Vote:** Classes of creditors that are impaired by the plan and are entitled to receive some distribution under the plan are permitted to vote.

**Impaired Class:** A class is considered impaired if the plan alters the legal, equitable, or contractual rights of the creditors in that class.

**Legal Reference:** 11 U.S.C. § 1126(a).

Vote Necessary for a Class of Creditors to Accept a Plan

**Acceptance Requirement:** For a class of creditors to accept a plan, two criteria must be met:

**Numerosity Requirement:** At least two-thirds (2/3) in amount of the allowed claims of creditors in that class who have voted must vote to accept the plan.

**Majority Requirement:** More than one-half (1/2) in number of the allowed claims of creditors in that class who have voted must vote to accept the plan.

**Legal Reference:** 11 U.S.C. § 1126(c).

**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?

Answer:

(a) **Preferences**

**Legal Reference:** 11 U.S.C. § 547

**Explanation:** Transfers made in response to an antecedent debt are subject to a preference action. If a transfer was made to or for the benefit of a creditor during the debtor's insolvency, on account of an antecedent debt, within 90 days prior to the petition's filing (or within a year if the creditor was an insider), and if it allows the creditor to obtain a larger amount than it would have in a Chapter 7 liquidation, the trustee may be able to avoid it.

(b) **Preferences and Constructive Fraudulent Conveyances**

**Preferences:**

**Legal Reference:** 11 U.S.C. § 547(b)(3)

**Explanation:** It must be demonstrated that the debtor was insolvent at the time of the transfer in order to pursue a preference action. Throughout the ninety days prior to the bankruptcy filing, insolvency is assumed.

**Constructive Fraudulent Conveyances:**

**Legal Reference:** 11 U.S.C. § 548(a)(1)(B)

**Explanation:** In order to pursue a constructive fraudulent conveyance action, it must be demonstrated that the debtor was insolvent at the time of the transfer or that the transfer caused them to become insolvent, and that they received less than reasonably equivalent value in exchange for the transfer. **(c)** **Actual Fraudulent Conveyances**

**Legal Reference:** 11 U.S.C. § 548(a)(1)(A)

**Explanation:** Proof that the debtor made the transfer with the genuine intention to obstruct, delay, or deceive creditors is necessary to establish an actual fraudulent conveyance. Regardless of the debtor's solvency at the time of the transfer, the primary focus of this cause of action is the debtor's intention to obstruct creditors' recoveries. It is possible to demonstrate intent directly with evidence or indirectly through circumstantial evidence (fraudulent badges).

**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.

Answer:

**Circumstances in Which a Bankruptcy Court May Enter a Final Order**

A final order in "core proceedings" as defined by 28 U.S.C. § 157(b) may be entered by a bankruptcy court. Core proceedings are those that originate in a bankruptcy case or under Title 11 (the Bankruptcy Code). Examples include:

1) Matters Concerning the Administration of the Estate

2) Allowance or Disallowance of Claims Against the Estate

3) Counterclaims by the Estate Against Persons Filing Claims Against the Estate

4) Orders to Turn Over Property of the Estate

5) Proceedings to Determine, Avoid, or Recover Preferences or Fraudulent Transfers

**Who Reviews Appeals from Bankruptcy Court Orders**

Appeals from bankruptcy court orders are typically reviewed by:

**District Courts:** The initial stage of the bankruptcy court orders appeal process. Both final and interlocutory orders from bankruptcy courts are subject to review by district courts.

**Bankruptcy Appellate Panels (BAPs):** BAPs act as a district courts' and bankruptcy courts' intermediate appellate tribunal in some jurisdictions. Judges of bankruptcy courts who hear appeals of bankruptcy court rulings make up these panels.

**Courts of Appeals:** The appropriate U.S. Court of Appeals hears appeals from district court or BAP rulings.

**Supreme Court of the United States:** The Supreme Court may hear appeals from the Courts of Appeals, but doing so is optional and needs a writ of certiorari.

**Review of Orders That Are Not Constitutionally Final**

The process is as follows for orders that are not constitutionally final, like "Stern claims" or other cases where the bankruptcy court is not constitutionally authorized to make a final ruling follows:

**Proposed Findings of Fact and Conclusions of Law:** The bankruptcy court issues proposed findings and conclusions instead of a final order.

**De Novo Review by District Court:** Reviewing the proposed findings and conclusions de novo means that the district court looks at the case from the beginning and doesn't take the bankruptcy court's rulings into account. After reviewing the record and the suggested findings and conclusions, the district court issues a final order or judgment.

**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?

**Provisions of the Bankruptcy Code That May Not Be Invoked by a Foreign Representative in a Chapter 15 Proceeding**

Chapter 15 of the United States Bankruptcy Code pertains to cases of cross-border insolvency and places particular restrictions on the authority of a foreign representative. Interestingly, in a Chapter 15 proceeding, the foreign representative is not permitted to use certain Bankruptcy Code provisions that are typically available in a full bankruptcy case under other chapters (e.g., Chapter 7 or Chapter 11). Some of these provisions include:

1. **Avoidance Powers (11 U.S.C. §§ 547, 548, 549)**:

**Preferences (11 U.S.C. § 547)**: The capacity to stay away from transfers of preference made prior to filing for bankruptcy.

**Fraudulent Transfers (11 U.S.C. § 548)**: The authority to prevent transfers made for less than fairly equivalent value or with the intention of impeding, delaying, or defrauding creditors.

**Post-petition Transfers (11 U.S.C. § 549)**: The authority to avoid unauthorized post-petition transfers.

**Automatic Stay (11 U.S.C. § 362)**:

Chapter 15 can offer remedies akin to the automatic stay, the specific automatic stay clauses are not immediately activated upon the foreign proceeding's recognition.

**Ways for a Foreign Representative to Obtain Equivalent Relief**

Despite these limitations, a foreign representative has mechanisms to obtain equivalent relief through Chapter 15:

1. **Granting of Additional Relief by the Court (11 U.S.C. § 1521)**:

Upon acknowledgment of a foreign main or nonmain proceeding, the court is authorized to provide any suitable remedy required to safeguard the debtor's assets or creditors' interests. This comfort may consist of:

**Staying execution against the debtor's assets** (11 U.S.C. § 1521(a)(1)).

**Suspending the right to transfer, encumber, or otherwise dispose of any assets of the debtor** (11 U.S.C. § 1521(a)(3)).

**Providing for the examination of witnesses, the taking of evidence, or the delivery of information concerning the debtor’s assets, affairs, rights, obligations, or liabilities** (11 U.S.C. § 1521(a)(4)).

**Entrusting the administration or realization of all or part of the debtor's U.S. assets to the foreign representative** (11 U.S.C. § 1521(a)(5)).

1. **Recognition of Foreign Main Proceeding (11 U.S.C. § 1520)**:

Similar to the automatic stay, the following automatic reliefs are applicable upon recognition of a foreign main proceeding:

**Automatic stay of actions against the debtor and the debtor's property in the United States** (11 U.S.C. § 1520(a)(1)).

**Automatic stay against the transfer, encumbrance, or disposal of any assets of the debtor within the territorial jurisdiction of the United States** (11 U.S.C. § 1520(a)(2)).

The purpose of these provisions is to preserve the debtor's assets and the status quo during the duration of the foreign insolvency procedure.

**Conclusion**

In a Chapter 15 proceeding, a foreign representative cannot directly invoke certain provisions of the Bankruptcy Code, such as those relating to avoidance actions and the automatic stay. However, they can seek equivalent relief through court-granted measures under 11 U.S.C. § 1521 and the automatic effects of recognizing a foreign main proceeding under 11 U.S.C. § 1520. This framework ensures that the interests of creditors and the debtor's estate are protected in cross-border insolvency cases.

**Question 3.3 [4 marks]**

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

Answer:

The following legal regulations and guidelines must be carefully reviewed and followed when preparing a bankruptcy court filing in order to guarantee that the submission is correct, comprehensive, and compliant with the law:

**Federal Rules of Bankruptcy Procedure**

1. **Rule 1001-1002**: General Provisions and Commencement of Case.
2. **Rule 1007**: Lists, Schedules, Statements, and Other Documents; Time Limits.
3. **Rule 3001-3003**: Proof of Claims and Interests, and Filing Requirements.
4. **Rule 4001-4004**: Relief from the Automatic Stay, the Discharge of Debts, and Other Proceedings.

**Local Bankruptcy Court Rules**

Local rules that may provide additional or different requirements from federal rules apply to each bankruptcy court. Examining the particular local regulations for the jurisdiction where the filing will take place is crucial.

**Bankruptcy Code (Title 11 of the United States Code)**

1. **Chapter 7**: Liquidation.
2. **Chapter 11**: Reorganization.
3. **Chapter 13**: Individual Debt Adjustment.
4. Understanding the relevant chapter under which the bankruptcy is filed is essential, as each chapter has specific provisions and requirements.

**Official Bankruptcy Forms**

Official forms are available on the United States Courts website and must be used when filing for bankruptcy. Make sure all required forms are accurately filled out:

1. **Voluntary Petition for Individuals Filing for Bankruptcy (Form 101)**.
2. **Schedules of Assets and Liabilities (Forms 106A-J)**.
3. **Statement of Financial Affairs (Form 107)**.
4. **Chapter-specific forms, such as Chapter 13 Plan (Form 113)**.

**Credit Counseling and Debtor Education Requirements**

1. **Credit Counseling**: Must be completed within 180 days before filing.
2. **Debtor Education**: Must be completed after filing but before discharge.

**Means Test Calculation**

Necessary to ascertain eligibility based on income for Chapter 7 filings.

**Filing Fees and Fee Waivers**

Know the procedure for requesting a fee waiver, if any, as well as the necessary filing fees.

**Deadlines**

It's crucial to follow the deadlines for submitting different kinds of documentation. Deadline violations may result in the case being dismissed.

**Automatic Stay Provisions**

Recognize the automatic stay that is imposed upon filing and how it affects the actions of creditors.

**Disclosure Requirements**

It is necessary to disclose all assets, liabilities, income, and expenses in full and accurately.

**Noticing Requirements**

Proper notice must be given to all creditors and interested parties.

**Bankruptcy Trustee**

Recognize the trustee in bankruptcy and your obligation to work with them.

**Court Procedures and Etiquette**

Learn about the court's protocols, such as the conduct of hearings, the filing of motions, and proper court etiquette.

**Recent Case Law**

Examine recent case law to learn how courts are interpreting and implementing statutes and rules pertaining to bankruptcy.

**Ethical Considerations**

Ensure compliance with ethical standards and professional conduct rules.

**Practical Steps:**

1. **Gather and Organize Financial Information**: Gather all of your financial records, such as bank statements, tax returns, pay stubs, and asset and debt lists.
2. **Complete Credit Counseling**: Get a certificate from a credit counseling organization that has been authorized.
3. **Fill Out the Required Forms**: Complete all necessary forms accurately and thoroughly.
4. **File the Petition**: Pay the necessary fees and turn in the bankruptcy petition and all supporting documentation to the court.
5. **Attend the 341 Meeting**: Attend the creditors' meeting so that the trustee and other creditors can question you about your finances and bankruptcy paperwork.

By diligently reviewing and adhering to these legal rules and guidelines, one can ensure a smoother bankruptcy filing process and avoid potential legal pitfalls.

**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?

Answer:

In Delaware, corporate directors owe fiduciary duties to the corporation and its shareholders. These duties include:

**1. Duty of Care**

• In comparable situations, directors are required to behave with the caution that one of reasonable caution would exercise. This entails exercising due diligence and making well-informed decisions prior to acting on behalf of the company.

**2. Duty of Loyalty**

• Directors must avoid conflicts of interest and self-dealing by acting honestly and in the corporation's best interests. They shouldn't take advantage of their position to further their own interests at the expense of the company or its investors.

**3. Duty of Good Faith**

• Directors are required to uphold the law and their obligations with honesty and integrity. This obligation is frequently seen as a part of the care and loyalty obligations.

**Ordinary Course of Business**

These fiduciary duties are primarily owed to the corporation and its shareholders in the regular course of business. When making business decisions, directors should put the interests of the shareholders first, working to maximize shareholder value.

**Potential or Actual Insolvency**

Fiduciary duties of directors change when a corporation becomes insolvent, either permanently or temporarily. As per Delaware law:

1. **Potential Insolvency ("Zone of Insolvency")**

A director's fiduciary duties are still primarily to the corporation and its shareholders when the company is in the "zone of insolvency." Nevertheless, given that the company's financial stability is in jeopardy, they should also take creditors' interests into account.

1. **Actual Insolvency**

The directors' fiduciary duties extend to the corporation's creditors in the event that the corporation is insolvent. This change acknowledges that creditors now hold the remaining claims to the company's assets. In order to avoid taking any actions that would make it more difficult for the company to pay its debts, the duties of care, loyalty, and good faith now have to take the interests of creditors into account.**Conclusion**

* **Ordinary Course of Business**: Fiduciary duties of care, loyalty, and good faith are owed to the corporation and its shareholders.
* **Potential Insolvency**: Fiduciary duties are primarily owed to the corporation and its shareholders but should also consider the interests of creditors.
* **Actual Insolvency**: Fiduciary duties are owed to the corporation, and the interests of creditors must be taken into account, as creditors become the primary concern.

**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?

Answer:

Lessors of office space, such as those leasing to iWork Ltd., are safeguarded by the Bankruptcy Code in a number of ways when a lessee files for bankruptcy. These rights are primarily delineated in 11 U.S.C. § 365, which addresses the acceptance and rejection of executory contracts and unexpired leases. The pertinent protections for lessors are as follows:

**1. Automatic Stay (11 U.S.C. § 362)**

* Following the filing of a bankruptcy petition, an automatic stay is imposed in compliance with 11 U.S.C. § 362(a). This stay stops any and all attempts to collect from the debtor, including eviction procedures. Lessors are forbidden from initiating eviction procedures or other collection actions while the bankruptcy case is pending, despite the fact that iWork Ltd receives temporary relief from this.Following the filing of a bankruptcy petition, an automatic stay is imposed in compliance with 11 U.S.C. § 362(a). This stay stops any and all attempts to collect from the debtor, including eviction procedures. While the bankruptcy case is pending, lessors are not allowed to initiate eviction procedures or other collection actions, even though iWork Ltd is temporarily relieved of this obligation.

**2. Assumption or Rejection of Leases (11 U.S.C. § 365)**

* **Decision to Assume or Reject**: Under 11 U.S.C. § 365(d)(4), iWork Ltd., as the debtor, is required to determine, within 120 days of the relief order, whether to accept or reject its unexpired leases of nonresidential real property. There is a 90-day maximum extension period for good reason, and any additional extensions will need the lessor's approval.
* **Cure and Compensation Requirements**: In the event that iWork Ltd decides to take over a lease, it will have to comply with 11 U.S.C. § 365(b)(1)(A) and (B), which requires it to: compensate for any actual financial loss resulting from the default, cure any default or provide adequate assurance of prompt cure; and provide adequate assurance of future performance under the lease as required by 11 U.S.C. § 365(b)(1)(C).
* **Rejection of Leases**: In the event that iWork Ltd decides to reject a lease, 11 U.S.C. § 365(g)(1) states that this rejection is considered a breach of the lease as of the date of the bankruptcy filing. Subsequently, the lessor may bring a claim for breach-related damages, subject to the cap on damages for lease rejection under 11 U.S.C. § 502(b)(6).

**3. Administrative Expense Priority (11 U.S.C. § 503(b)(1))**

* **Post-Petition Rent**: Rent accumulated from the date of bankruptcy filing until the lease is accepted or rejected is deemed an administrative expense under 11 U.S.C. § 503(b)(1)(A). Under 11 U.S.C. § 507(a)(2), administrative expenses take precedence over most other claims, so the lessor is compensated for the use and occupancy of the premises during the bankruptcy proceedings.

**4. Cap on Rejection Damages (11 U.S.C. § 502(b)(6))**

* The lessor's claim for damages is limited by 11 U.S.C. § 502(b)(6) in the event that iWork Ltd rejects the lease. The statute limits the claim to 15% of the remaining lease term or one year's rent, but not more than three years. According to precedent set by decisions like In re El Toro Materials Co., Inc., 504 F.3d 978 (9th Cir. 2007), this clause is intended to lessen the effect of significant lease rejection claims on the debtor's estate.

**5. Adequate Assurance of Future Performance (11 U.S.C. § 365(b)(1)(C))**

* In the event that iWork Ltd decides to take over the lease, it will need to guarantee future performance to the extent required by 11 U.S.C. § 365(b)(1)(C). This entails proving to the lessor that it can continue to fulfill its end of the lease, which may involve supplying financial statements, letters of credit, or other security measures to guarantee continued compliance.

**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.

Answer:

The requirements under U.S. Bankruptcy Code Chapter 15 must be examined in relation to Skin Luxe's circumstances in order to ascertain whether an English scheme of arrangement could be recognized under U.S. Chapter 15 as a foreign main or foreign non-main proceeding.

**Chapter 15 Recognition of Foreign Proceedings**

The U.S. Bankruptcy Code's Chapter 15 gives American courts the authority to acknowledge and support bankruptcy proceedings that are taking place abroad. One of two designations for a foreign proceeding is "foreign main proceeding" or "foreign non-main proceeding."

* **Foreign Main Proceeding**: Classified as a foreign proceeding pending in the nation where the debtor has its center of main interests (COMI) under 11 U.S.C. § 1502(4).
* **Foreign Non-Main Proceeding**: Defined as a foreign proceeding pending in a nation where the debtor has an establishment, or any location of operations where the debtor engages in a non-transitory economic activity using labor, goods, or services, under 11 U.S.C. § 1502(5).

**Requirements for Recognition**

Under 11 U.S.C. § 1517, the court shall grant recognition if:

1. According to section 1502, the foreign proceeding is a foreign main or non-main proceeding.
2. The foreign representative applying for recognition is a person or body.
3. The petition meets the requirements of section 1515.

**Application to Skin Luxe**

1. **Foreign Main Proceeding**:
   * **COMI Analysis**: Unless there is evidence to the contrary, the COMI is typically assumed to be the debtor's registered office (11 U.S.C. § 1516(c)). The principal place of business and registered office of Skin Luxe are located in France. However, it must be demonstrated that the UK is the COMI for the purposes of the scheme if the English scheme of arrangement is to be regarded as a proceeding in the UK.
   * In order for Skin Luxe's English scheme to be accepted as a foreign main proceeding, it must be shown that its COMI is located in the United Kingdom. If the majority of operations, management, and decision-making take place in France, this could be difficult. The principal assets, principal operations, headquarters location, and the location of control and direction administration are all important considerations. It seems improbable that the UK will be included in the COMI if these are predominantly in France.

**Foreign Non-Main Proceeding**:

* + **Establishment in the UK**: Skin Luxe needs to demonstrate that it has a presence in the UK in order for this to be accepted as a foreign non-main proceeding. The location where the debtor carries out non-transitory economic activities is called an establishment. London is one of the international cities where Skin Luxe has boutiques. The London boutique may meet the establishment requirement if it engages in significant economic activity and business operations.
  + However, merely having sales outlets or boutiques may not suffice without significant operations or administrative functions in the UK. Courts will consider the nature and extent of operations in London.

**Case Law and Practical Considerations**

* **Case Law**: Courts have varied in their interpretation of COMI and establishment. In **In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122 (Bankr. S.D.N.Y. 2007)**, the court emphasized the importance of the location of the main interests and control. In **In re SPhinX, Ltd., 351 B.R. 103 (Bankr. S.D.N.Y. 2006)**, the court analyzed the presence of an establishment based on the scope of operations.
* **Practical Considerations**: Skin Luxe needs to present strong proof of its business operations in the UK. Documentation of the business operations carried out at its London boutique, the purpose and importance of its UK operations, and the extent of its economic presence there are a few examples of what this could include.

**Conclusion**

* **Foreign Main Proceeding**: Given that Skin Luxe appears to have its principal place of business and its COMI in France, it is unlikely that the English scheme of arrangement would be recognized as a foreign main proceeding.
* **Foreign Non-Main Proceeding**: Should Skin Luxe be able to prove that its London boutique qualifies as an establishment, then recognition as a foreign non-main proceeding becomes greater likely. To do this, it would be necessary to demonstrate that the boutique conducts substantial, ongoing economic activity.

Ultimately, Skin Luxe’s ability to obtain recognition under U.S. Chapter 15 will depend on the specific facts and evidence demonstrating the nature of its operations in the UK.

**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?

Answer:

Speculation Inc. would automatically and procedurally affect a number of ongoing matters, such as the DOJ investigation, margin loan default, delinquent lease, and employment discrimination lawsuit, if it filed a Chapter 11 bankruptcy petition. Below is a breakdown of each:

**(i) DOJ Investigation**

* **Automatic Stay**: The filing of a Chapter 11 petition typically results in an automatic stay on the majority of lawsuits and proceedings against the debtor under 11 U.S.C. § 362(a). However, criminal proceedings are not covered by this stay.
* **Effect on Investigation**: The bankruptcy filing would not halt the DOJ's investigation into Speculation Inc.'s possible illegal insider trading. According to 11 U.S.C. § 362(b)(1), there are exceptions to the automatic stay for criminal investigations and proceedings. As a result, the DOJ can carry on without interruption with its investigation and any ensuing prosecution.

**(ii) Margin Loan Default**

* **Automatic Stay**: The default of the margin loan would be subject to the automatic stay under 11 U.S.C. § 362(a). All attempts at collection, including the broker's attempt to collect on the margin loan or seize collateral, are suspended by this stay.
* **Effect on Collateral**: According to 11 U.S.C. §541, the shares used as security for the margin loan are a part of the bankruptcy estate. It would be against the law for the broker to sell these shares without first requesting that the bankruptcy court lift the automatic stay.
* **Reorganization**: Speculation Inc. may submit a plan to reorganize its debts, including the margin loan, in the Chapter 11 proceeding. This could entail renegotiating the loan's terms or securing additional funding to pay the broker back.

**(iii) Delinquent Lease**

* **Automatic Stay**: The automatic stay prohibits the landlord from pursuing eviction or collecting past-due rent in relation to the delinquent lease.
* **Assumption or Rejection of Lease**: It is within Speculation Inc's rights to accept or reject its unexpired lease under 11 U.S.C. § 365(a). In order to take over the lease, it needs to resolve any defaults and offer sufficient guarantees for future performance (11 U.S.C. § 365(b)(1)).
* **Rejection of Lease**: If the lease is rejected, 11 U.S.C. § 365(g) states that the rejection is deemed a breach that becomes effective immediately prior to the bankruptcy petition's filing date. After that, the landlord may pursue damages, up to the cap on damages for lease rejection (11 U.S.C. § 502(b)(6)).

**(iv) Employment Discrimination Lawsuit**

* **Automatic Stay**: Regarding the employment discrimination lawsuit, 11 U.S.C. § 362(a) would impose an automatic stay. This implies that the former employee's civil lawsuit, which claimed gender discrimination, would be dropped.
* **Proof of Claim**: In the bankruptcy case, the former worker may submit a proof of claim for any damages claimed in the lawsuit. After that, the bankruptcy court will decide how the reorganization plan handles this claim.
* **Potential Lifting of Stay**: In order to pursue the lawsuit, the ex-employee may ask the bankruptcy court to lift the automatic stay. According to 11 U.S.C. § 362(d)), the court may decide to grant such relief for "cause".

**\* End of Assessment \***