

TOTAL = 37.5/50
75%



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.**
- 6.1 **If 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.

Commented [FV1]: 1, correct

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.

1.

Commented [FV2]: 1, correct

(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?

Commented [FV3]: 1, correct

Commented [FV4]: 1, correct

- (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.

Commented [FV5]: 1, correct

Question 1.6

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

- (a) That the plan is fair and equitable to dissenting classes of creditors.
- (b) Acceptance of the plan by at least one class of impaired, non-insider creditors.
- (c) Acceptance of the plan by all classes of secured creditors.
- (d) That the plan does not discriminate unfairly against dissenting classes of creditors.
- (e) That the dissenting creditors receive no less than they would under a liquidation scenario.

Commented [FV6]: 1, correct

Question 1.7

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

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

Commented [FV7]: 1, correct

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:

- (a) The manufacturer has a claim for damages for breach of contract.*
- (b) The manufacturer must immediately stop using the trademark.*
- (c) The manufacturer can continue using the trademark for the remaining period of the license.*
- (d) Both options (a) and (b).*
- (e) Both options (a) and (c).*

Commented [FV8]: 1, correct

Question 1.9

Which of the following about 363 sales is false?

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

Commented [FV9]: 1, correct

Question 1.10

Which of the following regarding substantive consolidation is true?

- (a) *It respects the boundaries of corporate separateness.*
- (b) *If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.*
- (c) *It is the treatment of two or more creditors as a single creditor to simplify the claims process.*
- (d) *Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.*
- (e) *Authority for substantive consolidation comes from the Bankruptcy Code.*

Commented [FV10]: 1, correct

QUESTION 2 (direct questions) [10 marks]

Question 2.1 (1 mark)

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

Setoff permits a creditor holding a claim against the debtor and simultaneously owing money to the debtor to net off the two obligations.

Setoff is not permitted in many circumstances because it improves the creditor's position as compared to other unsecured creditors who are not owed money by the debtor because it decreases its obligation to the estate by the full amount owed by the debtor rather than the less amount the debtor would pay on the unsecured claims.

Commented [FV11]: 1, correct

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?

Priming lien is granted to lenders for post-petition financing which has priority in collateral over pre-petition secured lenders.

The debtor needs to show that the interests of secured creditors being primed are adequately protected.

Commented [FV12]: 1.5. Full credit not given because answer fails to note the priming lien will only be granted if DIP is not otherwise available.

Question 2.3 [2 marks]

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

An action taken in violation of the automatic stay constitutes contempt of court and is void or voidable (depending on the circuit the bankruptcy is pending) due to a circuit split on this issue).

Commented [FV13]: 1. While the answer mentions contempt, it should be clearer and mention sanctions as a possibility.

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?

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

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

Commented [FV14]: 2, correct

The impaired class of creditors is permitted to vote on the plan. It needs a simple majority of creditors in the class, holding at least two thirds of value of the claims in the class to approve the plan.

Question 2.5 [3 marks]

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

- (a) Which cause of action applies only to transfers made on account of antecedent debt?***
- (b) Which cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer?***
- (c) Which cause of action requires that the debtor be proven to have intended to frustrate creditors' recoveries?***

Commented [FV15]: 3, correct

(a) Preference claims (b) preference claims (c) actual fraudulent conveyances.

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

Commented [la16]: 14/15 marks

Question 3.1 [3 marks]

Commented [la17]: 2/3

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.

*The bankruptcy court may only enter a final order on **core proceedings** which are related to bankruptcy. These include but are not limited to: (1) matters concerning the administration of the estate; (2) order in respect to obtaining credit; (3) counterclaims*

Commented [la18]: Specifically, the core matter must either be exclusive to the Bankruptcy Code (such as a challenge to a petition) or the parties must consent to the bankruptcy code entering a final order.

by the estate against persons who filed claims against the estate; (4) proceedings to avoid fraudulent conveyances.

Usually, the **district court** reviews appeals from the bankruptcy court. In some circuits, bankruptcy appeals are heard by **Bankruptcy Appellate Panel (BAP)**, convened from judges of the bankruptcy court within the circuit. In those circuits, a party has the option to request that the appeal be heard by the district court instead.

If the ruling was in a core proceeding over which the bankruptcy court has authority (by law or by consent of the parties) to enter a final order, the district court or the BAP will review the conclusions of law de novo and review the findings of facts for abuse of discretion. If the ruling was in a non-core proceeding over which the bankruptcy court has no authority to enter a final order, the district court or the BAP will review de novo all findings of facts and conclusions of law to which a party has objected.

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 representative the use of **avoidance powers** provided by the Bankruptcy Code. This is limited to avoidance of preferences and fraudulent conveyances, but not pre-petition transactions.

The foreign representative may (1) **commence a plenary proceeding under Chapter 7 or Chapter 11** after the recognition of the foreign proceedings under Chapter 15 to obtain access to the avoidance powers under the Bankruptcy Code, or (2) **use non-bankruptcy law** to pursue avoidance powers under Chapter 15 proceedings.

Question 3.3 [4 marks]

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

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

Question 3.4 [5 marks]

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

Under Delaware law, directors owe a fiduciary duty of **loyalty** to the corporation's best interests and a duty of **care** in educated decision making.

Commented [la19]: Correct, 1/2 mark

Commented [la20]: Correct, 1/2 mark

Commented [la21]: Correct, 1 mark

Commented [la22]: 3/3

Commented [la23]: Correct, 1 mark

Commented [la24]: Correct, 1 mark

Commented [la25]: Correct, 1 mark

Commented [la26]: 4/4

Commented [la27]: Correct, 1 mark

Commented [la28]: Correct, 1 mark

Commented [la29]: Correct, 1 mark

Commented [la30]: Correct, 1 mark

Commented [la31]: 5/5

Commented [la32]: Correct, 1 mark

Commented [la33]: Correct, 1 mark

Directors' duties are owed to the corporation and its shareholders, but not to the creditors in the ordinary course of business.

Commented [la34]: Correct, 1 mark

Commented [la35]: Correct, 1 mark

The Delaware Supreme Court has confirmed that even when the corporation is potentially or actually insolvent, directors owe their duties only to the corporation and its shareholders, but not to the creditors.

Commented [la36]: Correct, 1 mark

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

Commented [la37]: 5/15 marks

Question 4.1 [5 marks]

Commented [la38]: 1/5

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?

Lessors can commence an involuntary proceeding against iWork Ltd for the debt of unpaid rent under chapter 7 or 11 of the Bankruptcy Code if it can prove that iWork Ltd is generally not paying its debt as they become due.

In either proceeding, iWork Ltd can elect to reject the delinquent lease. If so, iWork Ltd will be in breach of the lease and the lessors can seek damages and their claims will be regarded as unsecured pre-petition claim in damages against the estate of iWork Ltd.

Commented [la39]: Correct, 1 mark, the lessor has an unsecured claim in damages for unpaid pre-petition rent. The lessor also has an administrative priority claim for rent for the period from the petition to the debtor's decision to assume or reject the lease and the debtor has 120 days to decide to assume or reject which may be extended a maximum of 90 days for cause. If the debtor assumes and then rejects the lease, the lessor has an administrative priority claim for 2 years' rent.

Commented [la40]: 2/5

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.

Skin Luxe's COMI is most likely to be France as it is where it is incorporated, and where it operates and manufactures its products. As such, the English scheme of arrangement will be regarded as a foreign non-main proceeding in a Chapter 15 recognition proceeding under the US Bankruptcy Code.

Commented [la41]: Correct, 1 mark, here the circumstances are unlikely to rebut the presumption that the COMI is in the place of incorporation. Since COMI is not in England, it cannot be recognized as a foreign main proceeding

Commented [la42]: Correct, 1 mark, the London boutique will be the necessary establishment in the jurisdiction of the foreign proceeding

For recognition under Chapter 15, the requirements are minimum. The foreign representative needs to prove that a foreign proceeding (i.e the English scheme of arrangement) with respect to Skin Luxe is pending and the foreign representative is empowered to act by the English proceeding.

Foreign proceeding is defined by the Bankruptcy Code as a "collective judicial or administrative proceeding in a foreign country ... under law relating to insolvency or adjustment of debt in which proceeding assets or affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of liquidation or reorganization". The English scheme of arrangements falls within this definition and will be granted recognition in the U.S as a foreign non-main proceeding.

Question 4.3 [5 marks]

Commented [la43]: 2/5

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?

Chapter 11 proceeding is a debtor friendly process under which the debtor will remain in possession. Speculation Inc may continue to operate in the ordinary course of business and may reorganize or liquidate.

Upon the filing of the petition, there will be a statutory automatic stay of creditor enforcement actions for pre-petition claims against Speculation Inc.

Commented [la44]: Correct, 1 mark

The impact of the intended chapter 11 petition is as follows:

- (i) The DOJ investigation will continue as it is a regulatory investigation which falls outside the automatic stay;
- (ii) The margin loan default will be subject to the automatic stay. The broker cannot enforce claims for those debts against Speculation Inc by issuing a proceeding in court;
- (iii) Speculation Inc can reject the delinquent lease, which means that it will be in breach of the lease and the lessor of the office space can seek damages which will be treated as unsecured pre-petition claims.

Commented [la45]: Correct, 1 mark

Commented [la46]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay so the broker can sell the collateral to pay down the loan.

Commented [la47]: The automatic stay protects the debtor from eviction proceedings on account of the unpaid pre-petition rent.

(iv) *The employee may continue her discrimination lawsuit as it is a claim under non-bankruptcy law that falls outside the rule of automatic stay of pre-petition claims.*

Commented [la48]: Incorrect, because this is a pre-petition claim for damages, this is stayed by the automatic stay

* End of Assessment *