

TOTAL = 36/50
72%



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]: 0, correct answer is C

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.

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.

Commented [FV3]: 1, correct

(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.

Commented [FV4]: 1, correct

(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.

Commented [FV5]: 1, correct

(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?

(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.

Commented [FV6]: 1, correct

(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.

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.

Commented [FV7]: 1, correct

(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.

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]: 0. Correct answer is C

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?

ANSWER: **Setoff speaks to the scenario where a creditor both owes money to a debtor and has a claim against the debtor and the two or more obligations are netted out. It is not permitted because it would give that creditor an advantage compared to other unsecured creditors of the debtor as the creditor's obligation to the debtor would be decreased by the full amount that the debtor owes the creditor and the debtor would likely not pay the full amount to the said unsecured creditors.**

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?

ANSWER: **A priming lien is a form of lien on a debtor's property which will take priority or be over pre-petition liens and other secured lenders on a debtor's property. A priming lien is only available to a debtor when the debtor is unable to secure any other form of financing, in essence as a last resort.**

Commented [FV12]: 1.5. Full credit not given because it fails to mention the adequate protection requirement

Question 2.3 [2 marks]

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

ANSWER: **Any act which violates the automatic stay constitutes a contempt of the court's order and will void.**

Although relief from a stay can be granted to an interested party upon an application, an action taken which breaches the stay before this relief is granted will be punished by contempt sanctions. These sanctions can take the form of the party who has violated the stay being made to pay the debtor's attorneys' fees or requiring the violator to take actions to undo the effects of its violation.

Commented [FV13]: 1.5. Full credit not given because answer fails to mention that the act may be voidable depending on the circuit

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: **An unimpaired class of creditors are deemed to accept the plan. A class that will receive nothing is deemed to reject the plan and an impaired class of creditors has the right to vote.**

The voting power is structured to give the impaired classes the most voting power as they have the most to gain or to lose. A simple majority of two thirds of the value of the claims in the class or alternatively two thirds in the amount of interests in the class can approve the plan.

Commented [FV14]: 2, correct

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?

ANSWER: **A preference cause of action applies to transfers made because of debts that are pre-existing to the date of the petition.**

(b) Which cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer?

ANSWER: **A preference cause of action requires for the transfer to have been made while the debtor was insolvent.**

Commented [FV15]: 3, correct

(c) Which cause of action requires that the debtor be proven to have intended to frustrate creditors' recoveries?

ANSWER: **An actual fraudulent conveyance cause of action requires for the debtor to have been proven to have an intention to frustrate the creditors' recoveries by essentially hindering, delaying or defrauding an entity to which the debtor became indebted.**

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

Commented [la16]: 10/15 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.

ANSWER:

Important context under this question is to remember that bankruptcy courts are typically established by the federal legislation of the bankruptcy code as opposed to Article III of the US Constitution.

One of the main elements that a bankruptcy court must consider in whether it can enter a final order consistent with the US Constitution is whether the matter before it is a core or non-core matter. Bankruptcy courts may only review core proceedings. Some examples inter alia of core proceedings are orders in respect to obtaining credit, orders to turn over property of the estate, matters concerning the administration of the estate and determination of the validity, extent or priority of liens.

However, a bankruptcy court must ensure that even in core proceedings, it must make orders that do not invade the jurisdiction of Article III. In the case of *Stern v Marshall* 564 US 462 (2011), the Supreme Court stated that the bankruptcy's issuance of a final order over a state law claim was unconstitutional. Typically, the rule would be that the first judgment would be binding on the parties if there are parallel proceeding but even though the bankruptcy court's judgment was first, the district court's affirmation of the bankruptcy court's ruling was not first and the Supreme Court said that it would be unconstitutional for the bankruptcy court's ruling to bind the state court proceedings.

So, to answer the first part of this question, bankruptcy courts may enter a final order consistently with the constitution by essentially making a report and review which can then be reviewed by the district court. Alternatively, they may issue final orders only with the consent of the parties to the matter and bankruptcy rules requires parties to state in their pleadings whether they consent to this.

Commented [la18]: Partially correct, 1/2 mark, this is the standard when the bankruptcy court's order is not constitutionally final.

Commented [la19]: Correct, 1/2 mark, also the bankruptcy court may enter a final order on a core proceeding that is exclusive to the Bankruptcy Code such as a challenge to a petition.

The bankruptcy court also cannot proceed if there are substantial questions dealing with federal law other than the bankruptcy code and it the district court will typically withdraw its reference to bankruptcy court.

The second answer therefore is in part that appeals from bankruptcy court decisions are typically heard by the district court of the overarching district in which the bankruptcy court is in. In certain circuits, a panel called a Bankruptcy Appellate Panel made up of judges from bankruptcy courts in the circuit may hear the appeal. From

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Commented [la21]: Correct, 1/2 mark

there, further appeal goes to the circuit court of appeal. Matters may go directly to the circuit court of appeals in certain instances.

Orders that are not constitutionally final, that is the bankruptcy court either makes judgment on a non-core proceeding or did not have authority to make ruling on the proceeding, which are being appealed are heard de novo or freshly with reviews of all findings of fact and law which have been objected to by a party.

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?

ANSWER: The provisions of the Bankruptcy code which speak to avoidance actions, particularly for preferences and fraudulent conveyances, are not available for use by a foreign representative in a chapter 15 proceeding. It is notable that this is the one major distinction between Chapter 15 of the US Bankruptcy code and the Model Law, as many if not all of the other provisions of the Bankruptcy Code can be utilized by a foreign representative.

The US Courts have made clear however in the case of *re Condor Ins Ltd*, 601 F.3d 319, 329 (5th Cir 2010) that this provision is not to be interpreted to bar the foreign representative from an avenue to avoid pre-petition transactions by a debtor in full, and there are some alternative methods that can be utilized by a debtor in this regard

The foreign representative may be able to acquire equivalent relief through a plenary proceeding such as in chapter 7 or chapter 11. This can be done in one of two ways, either there was an action commenced before the involvement of the foreign representative or after recognition of the foreign proceeding which can grant the foreign representative relief or the foreign representative may commence such a plenary action himself.

If the foreign representative commences such a plenary action themselves, the scope of that plenary proceeding will be limited to the debtor's US assets only and will be coordinated alongside the foreign proceeding as per section 1528 of Chapter 11 of the Bankruptcy Code.

Question 3.3 [4 marks]

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

ANSWER: Bankruptcy Rules 1007 governs the time where forms and schedules associated with the filing of a petition are to be filed by a petitioner. There are particular forms and timelines that are important to bear in mind by any petitioner.

Commented [la22]: 2/3

Commented [la23]: Correct, 1 mark

Commented [la24]: Specifically, this permits the the foreign representative to use applicable US or foreign law to pursue avoidance actions

Commented [la25]: Correct, 1 mark

Commented [la26]: 1/4

Commented [la27]: Correct, 1 mark. This question is asking about any filing in bankruptcy court, not just the petition. You should also consult the Federal Rules of Civil Procedure, the court's local rules and the judge's personal practices

Bankruptcy Rule 2002 specifies that notice of the petition and the order which opens proceedings must be mailed to interested parties. Where notice by mail cannot be given, notice by publication may be authorized by the court.

If the filer is a debtor, the debtor must file certain schedules shortly after filing of the petition. If the petitioner is corporate debtor under chapter 7 or 11, the petitioner will be required to file schedules detailing real and personal property, secured creditors, unsecured creditors, executory contracts and unexpired leases and co-debtors.

A creditor must be mindful that in order to demand payment on a claim, it must file a proof of claim on or before the bar date which is specified by the Court. A claim for payment may be disallowed if it is filed after this date.

Question 3.4 [5 marks]

Commented [la28]: 5/5

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: **The Directors in Delaware owe duties to the corporation and its shareholders. The duty owed is a fiduciary one to act in the best interest of the corporation and a duty of care in educated decision making.**

Commented [la29]: Correct, 1 mark

Commented [la30]: Correct, 1 mark

Commented [la31]: Correct, 1 mark

Commented [la32]: Correct, 1 mark

Directors are protected from liability for errors in judgment by a rule called the business judgment rule which can only be rebutted by showing that a majority of the board in fact were not reasonably informed, did not honestly believe that the decision was in the corporation's best interest or were not acting in good faith.

Another exception to the business judgment rule is where a transaction is approved by a board majority that is not disinterested and independent or a controlling shareholder exists on both sides of the transaction.

The above is true even in cases of insolvency. In the case of *Trenwick Am Litig Trust v Ernst & Young, LLP, 906 F.2d 168 (Del Ch 2006)* establishes there no obligation on the directors to liquidate or cease operation. The Directors in such cases can explore strategies to maximize the value of the corporation. There is no duty owed to creditors and therefore no concept of wrongful trading or deepening insolvency.

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

Commented [la34]: 9/15

Question 4.1 [5 marks]

Commented [la35]: 2/5

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?

ANSWER: Section 375 of the Bankruptcy code allows for executory contracts (contracts with materially unperformed obligations on both sides) to be accepted or rejected by a debtor or also assigned.

This presents avenues for the lessors to iWork Ltd to be protected.

A lease is a form of executory contract. That means that there are three possible pathways under the Bankruptcy Code:

- iWork Ltd has the option of rejecting the lease contract which would give the lessors to iWork Ltd an unsecured pre-petition claim in damages;
- if iWork Ltd takes the option of accepting the lease contract, all defaults would have to be cured and the lessors would have to be given sufficient assurances of iWork Ltd future performance of the lease contract. If iWork Ltd then breaches this agreement, the damages due to the lessor become a post-petition administrative expense of the estate.
- The lease of office space is assignable under the bankruptcy code. Therefore, iWork Ltd can have its obligation assigned to a third party. This third party would then give the lessors adequate assurances of future performance.

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 COMI of Skin Luxe is in France. Its principal place of business or headquarters or management are in France and this seems to be where its primary assets in terms of its manufacturing and development technologies and facilities.

Therefore, only foreign proceedings from France under Chapter 15 of the Bankruptcy Code could constitute foreign main proceedings.

The evidence presented about the operations of Skin Luxe in the United Kingdom suggest that its operations in the United Kingdom are more than merely transitory.

Commented [la36]: Work only has 120 days to decide whether to assume or reject the leases. This period can be extended by 90 days for cause, but not further without lessor consent. iWork must pay rent as an administrative expense for the period prior to rejection of a lease.

Commented [la37]: Correct, 1 mark

Commented [la38]: Correct, 1 mark, this an administrative priority claim for 2 years' rent

Commented [la39]: 4/5

Commented [la40]: Correct, 1 mark, on these facts the presumption favor of the jurisdiction of incorporation is unlikely to be rebutted.

Commented [la41]: Correct, 1 mark

This is because they own physical boutiques in London, United Kingdom which indicates some aspect of long-term presence if not permanence as well as conducting further economic activity through bonds which are governed by English Law.

Commented [la42]: Correct, 1 mark

So, the English scheme of arrangement would be recognized under Chapter 15 of the bankruptcy code but as a foreign non-main proceeding.

Commented [la43]: Correct, 1 mark

Question 4.3 [5 marks]

Commented [la44]: 3/5

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?

ANSWER:

Any protection that may be granted by virtue of an automatic stay upon filing of a chapter 11 plenary petition has the exception of inter alia criminal proceedings and regulatory investigations of which the DOJ investigation would be the latter. Therefore, the DOJ 's investigation against Speculation Inc would not be impacted and could continue.

Commented [la45]: Correct, 1 mark

Commented [la46]: Correct, 1 mark

ii. Even though there is a default in the loan, the automatic stay which comes into effect on the filing of the Chapter 11 plenary petition will have the effect of barring any act to obtain possession or control of property of the estate, or the enforcement of a lien against the property of an estate. Therefore, even though Speculation Inc. has defaulted on its loan, its broker cannot enforce its security over shares owned by Speculation Inc.

Commented [la47]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay so the broker can sell the shares to reduce the balance of the loan

iii. When a plenary petition is filed under Chapter 11 of the Bankruptcy code, there is an automatic stay which comes into force and is very broad. One of the areas affected by this stay is pre-petition litigation of which the employment discrimination claim would be one.

Therefore this employment discrimination claim would be stayed until Speculation Inc completes its restructuring plan, negotiates with creditors etc in accordance with the priorities in the Bankruptcy Code.

Commented [la48]: Correct, 1 mark, also the automatic stay would prevent any eviction action on account of the unpaid pre-petition rent

* End of Assessment *