

TOTAL = 29.5/50  
59%



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.

Commented [FV2]: 0, correct answer is D

- (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.*

Commented [FV3]: 1, correct

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.*

Commented [FV4]: 0, correct answer is E

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.**

Commented [FV5]: 1, correct

(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?

(a) That the plan is fair and equitable to dissenting classes of creditors.

Commented [FV6]: 1, correct

(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.

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.**

Commented [FV7]: 1, correct

(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.

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]: 0, correct answer is E

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?

Setoff permits a creditor holding a claim against the debtor and, at the same time, owing money to the debtor to net out the two (or more) obligations.

The setoff is not permitted in many circumstances because setoff rights can improve the position of the creditor as compared to other unsecured creditors who do not have setoff rights because the creditor who exercises the setoff rights decreases its obligation to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the unsecured claim.

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?

A "priming lien" is a senior or equal to a pre-petition lien on estate property to secure post-petition financing.

The requirements that must be met for such a lien to be granted to secure DIP financing are: (i) financing could not be obtained on other terms, and (ii) the debtor must demonstrate that the interest of the secured creditor being primed is adequately protected.

Commented [FV12]: 2, correct

Question 2.3 [2 marks]

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

Two potential consequences of a violation of the automatic stay are:

1. The act taken in violation of the stay constitutes contempt of court and is void or voidable.
2. The violator may be sanctioned. Some of the sanctions are: payment of the debtors' attorneys' fees, requiring the violator to take affirmative acts to undo the effect of its violation, or daily fine to be paid to the court until the stay violation has been rectified.

Commented [FV13]: 2, correct

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?**

*In voting on a plan of reorganization, (i) an unimpaired class is deemed to accept the plan and (ii) a class that will receive nothing is deemed to reject the plan. Also, (iii) only impaired classes have the right to vote the plan.*

Commented [FV14]: 2, correct

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

Question 2.5 [3 marks]

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

- (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?

*(a) Preference avoidance is the cause of action that applies only to transfers made on account of antecedent debt. A preference is a transfer of the debtor's property made in a suspect period before the petition date. This transfer must be returned to the estate if it exceeds the amount the recipient would have received in a chapter 7 "Liquidation" had the transfer not been made.*

Commented [FV15]: 2, correct answer for b is also preference



(b) A constructive fraudulent conveyance requires that the debtor was insolvent (proved) at the time of the transfer. Also, in preference avoidance, the debtor is presumed to have been insolvent on and during the 90 days prior to the petition date.

(c) An actual fraudulent conveyance requires that the debtor be proven to have intended to frustrate creditors' recoveries. An actual fraudulent conveyance is proven by showing that the debtor made a transfer or incurred an obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted. Intent may be proven circumstantially, by reference to "badges of fraud" developed in state fraudulent transfer law.

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

Commented [la16]: 9.5/15

Question 3.1 [3 marks]

Commented [la17]: 2.5/3

**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.**

A bankruptcy court may enter a final order consistent with the US Constitution if is pronounced with respect to a core proceeding and the district court did not withdraw the reference of its jurisdiction to the bankruptcy court. Because district courts have exclusive jurisdiction to adjudicate a petition commencing bankruptcy proceedings, a bankruptcy court may exercise a district court's delegated authority to enter a final order on a motion challenging the validity of a petition.

Commented [la18]: Correct, 1/2 mark. The bankruptcy court may also enter a final order on a core proceeding with the consent of the parties.

Appeals from bankruptcy court decisions are heard by the district court for the district in which they sit. In certain circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Panel (BAP).

Commented [la19]: Correct, 1/2 mark

Commented [la20]: Correct, 1/2 mark

An order that resolves an entire dispute and therefore would be final for purposes of appeal may not be final in the constitutional sense if the parties have not consented to the bankruptcy court's jurisdiction. In that case, the order will be reviewed by the district court or BAP *de novo* all findings of fact and conclusions of law to which a party has objected.

Commented [la21]: Correct, 1 mark

Question 3.2 [3 marks]

Commented [la22]: 1/3

**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?**

The foreign representative in chapter 15 proceeding may not invoke Bankruptcy Code avoidance powers. Chapter 15 excludes from the rights granted to the foreign representative the use of avoidance powers provided by the Bankruptcy Code.

Commented [la23]: Correct, 1 mark

The other ways that the foreign representative can obtain equivalent relief is: (i) by exercising the avoiding actions that a domestic debtor or trustee would be able to use in the domestic jurisdiction; and (ii) relief granted on a discretionary basis, necessary to effectuate the purposes of chapter 15 and to protect the assets of the debtor or the interests of creditors.

Commented [la24]: Incorrect. The foreign representative may bring claims under applicable non-bankruptcy US or foreign law or by commencing a plenary proceeding under chapter 7 or 11

Question 3.3 [4 marks]

Commented [la25]: 1/4

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

The Federal Rules of Bankruptcy Procedure must be reviewed when preparing a filing for a bankruptcy court. The Federal Rules of Bankruptcy Procedure specify a number of schedules that are to be filed with the petition.

Commented [la26]: Correct, 1 mark. This question is about all filings in bankruptcy, not just the petition, so you should also look at the Federal Rules of Civil Procedure, the local rules of the bankruptcy court and the judge's personal practices.

Question 3.4 [5 marks]

Commented [la27]: 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?

Directors of Delaware corporations owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care in educated decision-making. They are protected from liability for errors of judgment by the business judgment rule. Under the business judgment rule, the board of directors is presumed to have acted in good faith on the basis of reasonable information. Nevertheless, this presumption can be rebutted. Unless the presumption is rebutted, the directors will not be liable in the absence of a showing of gross negligence.

Commented [la28]: Correct, 1 mark

Commented [la29]: Correct, 1 mark

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

Commented [la30]: Correct, 1 mark

Commented [la31]: Correct, 1 mark

When the corporation is potentially or actually insolvent, Directors' duties are still owed to the corporation and its shareholders, not to creditors. The Delaware Supreme Court has established that directors do not owe duties to creditors when a company is operating "in the zone of insolvency", or indeed is actually insolvent.

Commented [la32]: Correct, 1 mark

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

Commented [la33]: 5/15 marks

Question 4.1 [5 marks]

Commented [la34]: 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?

As protection, if iWork Ltd initiates a bankruptcy proceedings under the Bankruptcy Code, the rent can be paid as an administrative expense because is actual and necessary to preserve the state.

**Commented [la35]:** Correct, 1 mark, this is true for post-petition rent. The pre-petition unpaid rent is a general unsecured claim.

In Chapter 11, unexpired leases become property of the bankruptcy estate. This allows the debtor to decide whether to assume or reject the lease. If assumed, the lease remains in effect and the tenant must promptly remedy all outstanding defaults owed to landlord.

**Commented [la36]:** The debtor has a 120 day deadline to assume or reject, with a maximum extension of 90 days for cause.

In case of Chapter 7 Liquidation and if iWork Ltd rejects the lease contract, the claim of the lessor is a priority unsecured claim because with respect to a non-residential lease of real property that was assumed and subsequently rejected, two years of lease payments from the later of the date of rejection of the lease or turnover of the property, are priority unsecured claim.

**Commented [la37]:** Correct, 1 mark

**Question 4.2** [5 marks]

**Commented [la38]:** 1/5

Skin Luxe is incorporated and has a principal place of business in France where it develops and manufactures high end skincare products. Skin Luxe sells its skin care products through its own boutiques in many international cities, including Paris, Las Vegas, London and Hong Kong. Skin Luxe's English law-governed bonds are due to mature in one year, but it is unable to repay or refinance them. Skin Luxe is considering using an English scheme of arrangement to restructure the bonds.

Discuss whether the English scheme of arrangement could be granted recognition under US chapter 15 as a foreign main or foreign non-main proceeding.

The English scheme of arrangement can be recognized under US chapter 15 if the requirements are met. The requirements are: the foreign representative must establish that a foreign court or administrative proceeding with respect to the debtor is pending and that the foreign representative is empowered to act by the proceeding.

In the case of Skin Luxe, the English scheme of arrangement will be recognized as foreign main proceeding, because is the one commenced in the debtor's center of main interests (COMI).

**Commented [la39]:** Correct, 1 mark, this is correct as a matter of when foreign main recognition is appropriate. However, here, Skin Luxe's COMI is likely to be France as these facts are unlikely to rebut the presumption that the COMI is in the jurisdiction of incorporation. Therefore foreign main recognition is not available. The proceedings can be recognized as a foreign non-main proceeding because the boutique in London is the necessary establishment in the jurisdiction.

**Question 4.3** [5 marks]

**Commented [la40]:** 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 gender bias.

**What would be the effect of a chapter 11 petition being filed by Speculation Inc on each of (i) the DOJ investigation, (ii) margin loan default; (iii) the delinquent lease and (iv) the employment discrimination lawsuit?**

**The effect of a chapter 11 petition being filed by Speculation Inc will be:**

- (i) **Regarding DOJ investigation: regulatory investigations are statutory exceptions to the stay, so the DOJ investigation will continue against Speculation Inc, who will not be protected in this matter.**
- (ii) **Regarding the margin loan default: the broker, because of the default, can not enforce the collateral against property of the estate, because the Bankruptcy Code specifically prohibits the enforcement of liens against property of the state. The broker must verify its claim and become a party to the reorganization proceeding in order to receive payment of its claim according to the plan approved in the proceeding.**
- (iii) **Regarding the delinquent lease: In Chapter 11, unexpired leases become property of the bankruptcy estate. This allows the debtor to decide whether to assume or reject the lease. If assumed, the lease remains in effect and Speculation Inc must promptly remedy all outstanding defaults owed to landlord.**
- (iv) **Regarding the employment discrimination lawsuit: Speculation Inc will be protected by the stay and the lawsuit will be suspended. This, because the Bankruptcy Code specifically prohibits litigation on pre-petition claims.**

**Commented [la41]:** The filing of the petition will bring the automatic stay into effect.

**Commented [la42]:** Correct, 1 mark

**Commented [la43]:** Incorrect, the margin loan is a securities contract that is exempt from the automatic stay so the broker can liquidate the collateral to pay down the loan.

**Commented [la44]:** The automatic stay will prevent any action to evict the debtor for unpaid rent.

**Commented [la45]:** Correct, 1 mark

**\* End of Assessment \***