

TOTAL = 39.5/50
79%



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. [1]
- (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. [2]
- (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**[3] 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**[4] 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**[5] 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. |
[6]
- (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.
- (b) Creditors must have sufficient information about the debtor and the plan to make an informed voting decision. [7]
- (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. [8]
- (d) Both options (a) and (b).

(e) Both options (a) and (c).

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. []

[9]

(e) 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**?

- (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[10] process.
- (d) Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.
- (e) Authority for substantive consolidation comes from the Bankruptcy Code.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 (1 mark)

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

Setoff is a legal right that permits a creditor to offset a debt owed to them by a debtor with a claim against the creditor. This right can benefit the creditor by decreasing their obligation to the estate. However, setoff is limited in many cases to guarantee equitable treatment of creditors in bankruptcy proceedings. Setoff limitations include situations in which the[11] creditor's claim against the estate is rejected, the claim was acquired post-petition or within 90 days of the petition when the debtor was insolvent, or the creditor gains an unfair advantage through setoff compared to their position prior to the petition. These constraints are intended to avoid preferential treatment of specific creditors, ensure fair asset allocation, and uphold the principles of equality and integrity in bankruptcy proceedings.

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 special type of collateral utilized in Chapter 11 bankruptcy proceedings. It grants a new lender a security interest in the debtor's assets that supersedes previous liens held by other creditors. This enables the debtor to get critical debtor-in-possession (DIP) funding for business continuance, preservation, or reorganization purposes. However, issuing a priming lien is not without complications and needs achieving certain criteria:

- The debtor must demonstrate that securing funding is required for a successful restructuring. This often entails demonstrating that the DIP finance will permit continuing operations, protect assets, and facilitate a feasible restructuring strategy (Necessity)
- The debtor must demonstrate that they have exhausted all alternative possibilities for financing, such as unsecured loans or non-priming DIP finance. This shows that the lender providing the priming lien is the sole viable source of needed funds (Lack of Alternatives)
- The court must be satisfied that current lienholders' interests are sufficiently protected. This protection may include cash payouts, replacement liens, and assurances of a specific value for

the collateral. This guarantees that existing creditors are not subjected to excessive hardship as a result of the priming lien (Adequate Protection)

- The entire transaction, including loan term negotiation and priming lien issuance, [12] must be carried out in good faith and with fairness to all parties involved. (Good Faith and Fair Dealing)
- In the end, the court makes the final decision on whether to grant a priming lien. Before making a judgment, they will assess the possible benefits of the funding against the risk of harm to current creditors. (Court Approval)

Question 2.3 [2 marks]

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

- An act that violates the automatic stay is deemed contempt of court. This is applicable even if the action was made without knowledge of the bankruptcy filing. Contempt can result in sanctions against the violator, such as paying the debtor's attorney fees and requiring the violator to take affirmative efforts to reverse the effects of the violation. [13]
- Depending on the jurisdiction, activities committed in breach of the automatic stay are declared void or voidable. This means that any attempts to collect debts, enforce liens, or seize estate property in violation of the stay may be void. The particular outcome—whether an action is void or voidable—depends on the circuit in which the bankruptcy is proceeding, as there is a disagreement in interpretation among courts.

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?

- (i) Deemed to accept the plan: An unimpaired class is deemed to accept the plan. This includes classes where the plan leaves the holder's legal, equitable, and contractual rights unaltered, except in cases where the plan reverses contractual acceleration by curing any monetary default and compensating the holder for any damages.
- (ii) Deemed to reject the plan: A class that will receive nothing under the plan is deemed to reject the plan.
- (iii) Permitted to vote on the plan: Only impaired classes have the right to vote on the [14] plan. A class is considered impaired unless the plan leaves the holder's legal, equitable, and contractual rights unaltered.

For a class of creditors to accept a plan, a simple majority of the creditors in the class, holding at least two-thirds of the value of claims in the class, must vote in favor of the plan. For equity interests, two-thirds in the amount of interests must vote in favor .

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) Preferences. The cause of action that applies only to transfers made on account of antecedent debt is preferences. Preferences specifically involve transfers made to or for the benefit of a creditor, for an antecedent debt owed by the debtor before the transfer was made, while the debtor was insolvent, and made during the suspect period, enabling the creditor to receive more than it would have in a chapter 7 liquidation
 - (b) Constructive Fraudulent Conveyances. This cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer or became insolvent as a result of the transfer. Constructive fraudulent conveyances are shown by the debtor receiving less than a reasonably equivalent value in exchange for a transfer or incurrence of obligation, along with one of several additional factors, such as insolvency at the time of or resulting from the transaction
 - (c) Actual Fraudulent Conveyances. This cause of action requires that the debtor be proven to have intended to frustrate creditors' recoveries. Actual fraudulent conveyances are proven by showing that the debtor made a transfer or incurred an obligation with the actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted

QUESTION 3 [16] (essay-type questions) [15 marks in total]

Question 3.1 [17] [3 marks]

Describe the circumstances in which a bankruptcy court may enter a final order consistent with the US Constitution, who reviews appeals from bankruptcy court orders and how orders that are not constitutionally final are reviewed.

A bankruptcy court's ability to enter a final order is based on two key pillars:

- **Core Jurisdiction [18]**: The decision must address issues within the court's core jurisdiction, as defined by the Bankruptcy Code. These basic problems are critical to the efficient administration of bankruptcy estates and include issues such as claim allowance/disallowance, debt discharge, and estate property.
- **Finality**: The order must be final in the sense that it conclusively settles all legal issues and claims between the parties concerned in the specific case. It must leave the court with no more judicial action to take other than to enforce the decision.

Furthermore, bankruptcy courts can issue final orders in non-core processes provided the parties agree to the court's authority in that particular case. This permission eliminates any potential conflict with the Seventh Amendment's right to a jury trial in non-core subjects, allowing the bankruptcy court to rule conclusively.

Appeals from final orders granted by bankruptcy courts usually follow a two-tiered review process:

- District Courts[19] and Bankruptcy Appellate Panels (BAPs):[20] Depending on the circuit, appeals are initially directed to either the district court in which the bankruptcy court is located or to a Bankruptcy Appellate Panel (BAP) made up of experienced bankruptcy judges. BAPs provide an intermediate level of review before the district court.
- Circuit Courts of Appeals: After being evaluated by the district court or BAP, a further appeal can be brought to the circuit court of appeals, as long as the original decision was appealable as of right.

Orders that do not meet the criteria for finality, often originating from non-core processes, are subject to a distinct review process.

- District Court Review: In such circumstances, the bankruptcy court may make recommended findings of fact and conclusions of law[21]. The district court reviews these findings and conclusions de novo. This means that the district court takes a fresh look at the case without being bound by the bankruptcy court's decisions. This assures a thorough examination even if no final order is issued.

Question 3.2 [22][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?

In a chapter 15 proceeding, a foreign representative may not exercise the avoidance rights[23] granted by the Bankruptcy Code, including the avoidance of preferences and fraudulent conveyances.

There are two possibilities for the foreign representative to receive equivalent relief:

- To exercise the Bankruptcy Code's avoidance powers, file a plenary process under chapter 7 or 11.[24] This might be done by the debtor or its creditors before the involvement of the foreign representative, or by the foreign representative after the international process has been recognized under Chapter 15. The plenary process will be limited to the debtor's US assets and coordinated with the overseas proceeding.
- If the Bankruptcy Code's avoidance powers are insufficient or ineffective, seek redress under other applicable law[25]. This may involve utilizing laws that allow claims for constructive fraudulent conveyance or other related legislation that grant remedies like the Bankruptcy Code's avoidance powers.

Question 3.3[26] [4 marks]

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

- Federal Rules of Bankruptcy Procedure[27] (Bankruptcy Rules)
 - o These rules govern the procedures in bankruptcy proceedings, including the resolution of disputed issues in contested matters or adversary proceedings. They frequently mention the Federal Rules of Civil Procedure[28], which are especially relevant in litigation.

- **Local Rules of Procedure for the Bankruptcy Court** [29]
 - o Each bankruptcy court has its own set of local rules that specify specific filing methods, timelines, and other court-specific criteria. These guidelines are available on the bankruptcy court's website and must be followed to ensure compliance.
- **Personal Practices of the Bankruptcy Judge** [30]
 - o Individual bankruptcy judges may have their own practices or preferences for how matters should be presented and managed before them. These practices may include preferred working procedures and changes to filing deadlines. These practices, like the local regulations, are revised on a regular basis and made available on the bankruptcy court website.

Question 3.4 [31] [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?

In Delaware, directors of corporations have fiduciary duties of **loyalty** [32] and **care** [33] primarily to the **corporation** [34] and its **shareholders** [35]. The duty of loyalty requires directors to operate in the corporation's best interests, avoiding conflicts of interest and not acting for personal gain. The duty of care compels directors to make informed and deliberate judgments, with reasonable diligence and good faith. The business judgment rule shields directors from liability for errors in judgment, assuming that acts are conducted in good faith and based on reasonable knowledge. This protection is not applicable in circumstances of extreme negligence, when directors are not working independently, or when they are involved in transactions where their personal interests conflict with those of the corporation.

When a corporation is solvent, these obligations are owed to both the corporation and its shareholders. However, the legal environment shifts when a corporation goes insolvent or enters the "zone of insolvency." Despite this shift in financial position, the Delaware Supreme Court has established that **directors do not have direct fiduciary duties to creditors, even if the corporation is insolvent or nearing insolvency.** [36] Instead, directors' primary responsibility remain focused on the corporation and its shareholders, rather than creditors. Delaware law does not recognize the concepts of "wrongful trading" or "deepening insolvency" as grounds for director responsibility.

QUESTION 4 [37] (fact-based application-type question) [15 marks in total]

Question 4.1 [38] [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?

Protections are designed to balance the interests of debtors and creditors while also providing tools for lessors to preserve their rights and assets during bankruptcy proceedings.

- Automatic Stay: When a debtor files for bankruptcy, all collection operations, including eviction proceedings, are temporarily halted.
- Lease Assumption or Rejection^[39]: Allows the debtor to choose whether to renew or terminate unexpired leases, which affects future rent payments.
- Adequate Protection: Lessors might seek protection if the value of their property is jeopardized due to the debtor's occupancy during bankruptcy.^[40]
- Administrative Rent Claims: Rent incurred after filing for bankruptcy is treated as an administrative expense and is paid first.^[41]
- Lease Termination Clauses: Enforceable clauses may allow lessors to terminate leases under certain circumstances, such as bankruptcy filings or defaults.^[42]

Question 4.2^[43] [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.

- Foreign Main Proceeding
 - o The primary avenue for recognition hinges on Skin Luxe's center of main interests (COMI). Given its incorporation and principal place of business in France, the COMI is likely located there.^[44] As Chapter 15 prioritizes the main insolvency proceeding, the English scheme, despite addressing the bonds, might not qualify as a foreign main proceeding in the US courts.^[45]
- Foreign Non-Main Proceeding
 - o However, a potential alternative exists. Chapter 15 also recognizes foreign non-main proceedings, applicable to situations where the debtor's COMI lies outside the US but has an "establishment" within its borders.^[46] This establishment signifies a location where the debtor conducts substantial and ongoing economic activity relevant to the restructuring, potentially involving personnel, assets, or activities related to the bond scheme. If Skin Luxe possesses such an establishment in England, the path towards recognition as a foreign non-main proceeding becomes a possibility.^[47]
- Recognition Requirements and Challenges
 - o Recognizing the English scheme under Chapter 15 is dependent on two major factors: comparable administration and public policy compliance. The scheme's administration must demonstrably resemble US bankruptcy proceedings in terms of fairness and creditor protection, and its recognition cannot contradict established US public policy. Additionally, potential hurdles include procedural discrepancies

between the scheme and US bankruptcy procedures, and disparate treatment of creditors compared to Chapter 11 protections.

Question 4.3 [48] [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 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 Chapter 11 filing would provide Speculation Inc a short relief from some activities by creditors and litigants, enabling it to concentrate on restructuring its debts and operations. However, it would not shield the corporation from current criminal probes. Speculation Inc would have to navigate the complexities of bankruptcy processes to handle its financial and legal issues comprehensively.

- (i) The automatic stay arising from a Chapter 11 filing [49] does not affect criminal procedures, including investigations. As a result, the DOJ's investigation into whether Speculation Inc's trading performance was due to illegal insider knowledge will continue undisturbed by the bankruptcy filing. [50]
- (ii) Margin Loan Default: The automatic stay prevents the broker from defaulting on the loan and selling the collateralized shares [51]. This allows Speculation Inc to handle the margin loan default through its reorganization plan, maybe negotiating new conditions that are viable given its financial restructuring.
- (iii) Delinquent Lease: The automatic stay prevents the landlord from evicting or collecting unpaid rent from Speculation Inc. [52] Under Chapter 11, Speculation Inc can either accept or reject the lease. Assuming the lease would necessitate correcting any defaults and continuing to make payments under the lease conditions, whereas rejecting the lease would allow Speculation Inc to exit the property but may result in a claim for damages from the landlord for the lease rejection.
- (iv) Employment Discrimination Lawsuit: Filing would result in an automatic stay, delaying proceedings. This would allow Speculation Inc to potentially resolve the litigation as part of its Chapter 11 reorganization, maybe through a bankruptcy court-approved settlement [53].

*** End of Assessment ***