

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.
- (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.**
- (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.**

Commented [FV4]: 1, correct

- (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.

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]: 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 in the context of bankruptcy allows a creditor holding a claim against the debtor, who also owes money to the debtor, to offset the two obligations. This means the creditor can reduce what it owes to the debtor by the amount the debtor owes to the creditor.

Commented [FV11]: 1, correct

Setoff is not permitted in many circumstances within bankruptcy proceedings because it can unfairly improve the position of one creditor at the expense of others.

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 lien that is granted to secure debtor-in-possession (DIP) financing which is senior to or equal to existing liens on the debtor's assets. For a court to grant a priming lien, the debtor must be unable to obtain post-petition financing on any other terms, and the court may grant a priming lien to secure this necessary financing. Furthermore, the debtor must demonstrate that the interests of the existing secured creditor, whose lien is being primed, are adequately protected.

Commented [FV12]: 2, correct

Adequate protection might involve providing the primed creditor with additional or replacement liens, cash payments, or other means to ensure that the primed creditor's position is not worsened by the grant of the priming lien. The requirement of adequate protection is designed to ensure that the senior creditor does not bear the risk of a decrease in the value of its security interest because of the debtor's use of the collateral to obtain new financing.

Question 2.3 [2 marks]

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

First, an act taken in violation of the automatic stay may constitute contempt of court, which can result in sanctions against the violator. This is the case even if the act was taken without notice of the filing of the petition.

Second, the act may be rendered void or voidable, a consequence depending on the circuit in which the bankruptcy is pending due to a circuit split on this issue.

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?

(i) A class of creditors is deemed to accept the plan if it is unimpaired, meaning their legal, equitable, and contractual rights are unaltered by the plan. An example is if a class whose debt acceleration has been reversed is deemed to accept the plan.

Commented [FV14]: 2, correct

(ii) A class that will receive nothing under the plan is deemed to reject the plan.

(iii) Only impaired classes, being classes whose claim or interest will be altered, are permitted to vote on the plan.

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 the claims in the class must vote in favor. For equity interest holders, 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?

Commented [FV15]: 3, correct

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

(a): Preferences

(b): Preferences

(c): Actual fraudulent conveyance.

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

Commented [la16]: 12.5/15

Question 3.1 [3 marks]

Commented [la17]: 2.5/3 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 may enter a final order consistent with the U.S. Constitution when it has the authority to do so, either by law or through the consent of the parties.

Commented [la18]: Partially correct, 1/2 mark, the matter must be a core proceeding exclusive to the Bankruptcy Code or consent to by the parties.

Appeals from bankruptcy court decisions are generally heard by the district court for the district in which the bankruptcy court sits. However, in some circuits, bankruptcy appeals can be heard by a Bankruptcy Appellate Panel (BAP) unless a party requests that the appeal be heard by the district court instead. Following the district court or BAP, there is an appeal of right to the circuit court of appeals. In rare circumstances, an appeal from a bankruptcy court may go directly to the court of appeals if the appeal involves a significant question of law or if immediate appeal may materially advance the case. The court of appeals has the discretion to accept such a case.

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Commented [la20]: Correct, 1/2 mark

The standard of review applied in appeals depends on whether the matter was a core proceeding and if the bankruptcy court had the authority to enter a final order. If the bankruptcy court had such authority, the district court or BAP reviews conclusions of law *de novo* and findings of fact for abuse of discretion. In contrast, if the ruling was in a non-core proceeding, or the bankruptcy court did not have authority to enter a final order, the district court or BAP reviews both findings of fact and conclusions of law *de novo*.

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Question 3.2 [3 marks]

Commented [la22]: 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?

In a Chapter 15 proceeding, a foreign representative may not invoke the Bankruptcy Code's avoidance powers, which include actions to avoid acts detrimental to creditors,

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such as preferences and fraudulent conveyances. Chapter 15 closely follows the Model Law in many aspects but specifically excludes the use of avoidance powers provided by the Bankruptcy Code to foreign representatives.

However, there are ways for a foreign representative to obtain equivalent relief. A foreign representative can commence a **plenary proceeding**, such as under Chapter 7 or Chapter 11, where the Bankruptcy Code's avoidance powers can be invoked. This can occur if such a proceeding was initiated by a debtor or its creditors before the involvement of the foreign representative, or the foreign representative may choose to commence a plenary proceeding under the Bankruptcy Code after recognition of the foreign proceeding under Chapter 15.

In the context of a plenary proceeding, the scope of action is limited to the debtor's assets within the United States and will be coordinated with the foreign proceeding. This approach allows a foreign representative to access the Bankruptcy Code's avoiding powers where **relief under other applicable law** is unsatisfactory, such as where the statute of limitations has expired, or the applicable law does not permit claims for constructive fraudulent conveyance.

Question 3.3 [4 marks]

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

When preparing a filing for a bankruptcy court, one should review the following rules:

1. **Federal Rules of Bankruptcy Procedure** (the Bankruptcy Rules): **These rules govern procedures in bankruptcy proceedings and often incorporate by reference the Federal Rules of Civil Procedure, especially regarding litigation of disputed issues in contested matters or adversary proceedings.**
2. **Local rules of procedure**: **Each bankruptcy court will have its own local rules of procedure.**

Although not rules per se, it would be prudent to also refer to the following:

3. Forms for common bankruptcy filings: **It is mandatory to use official forms for common bankruptcy filings where applicable.**
4. **Personal practices issued by each judge**: **Judges may issue personal practices that are periodically updated, which can also modify deadlines for filing and responding to pleadings.**

Question 3.4 [5 marks]

Commented [la24]: Correct, 1 mark

Commented [la25]: Conversely, the foreign representative can bring similar claims under applicable US or foreign law

Commented [la26]: 3/4 marks

Commented [la27]: Correct, 1 mark

Commented [la28]: These should also be reviewed

Commented [la29]: Correct, 1 mark

Commented [la30]: Correct, 1 mark

Commented [la31]: 5/5 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 the ordinary course of business, directors of Delaware corporations owe fiduciary duties to the corporation and its shareholders. These duties include:

1. Duty of **Loyalty**: *Directors must act in the best interest of the corporation and not allow personal interests to prevail over the interests of the corporation.*
2. Duty of **Care**: *Directors must make decisions with an educated and informed basis, acting in a manner they reasonably believe to be in the best interests of the corporation.*

When the corporation is potentially insolvent or actually insolvent, the directors' duties are still owed to the corporation and its shareholders, not to the creditors. The Delaware Supreme Court has established that even in the zone of insolvency or actual insolvency, there is no shift in the directors' fiduciary duties to creditors, thereby rejecting any notion of "wrongful trading" or "deepening insolvency" under U.S. law.

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

Question 4.1 [5 marks]

iWork Ltd leases office space from office building owners and sublets the space to small businesses. Due to the increases in the numbers of businesses operating remotely, iWork Ltd has suffered a decline in revenues. As a result, it has failed to pay rent on some of its office space leases. What protections does the Bankruptcy Code provide to lessors of office space to iWork Ltd?

The Bankruptcy Code provides certain protections to lessors of office space in the event of a tenant's bankruptcy.

A lessor can request that the automatic stay be lifted if it can demonstrate a lack of adequate protection of its interest in the leased property. This is particularly relevant where the property's value may decline during the bankruptcy proceedings, potentially resulting in the lessor recovering less than it is owed. If the court finds that adequate protection is lacking, the debtor can prevent the stay from being lifted by providing the "indubitable equivalent" of the value that may otherwise be lost, which can include periodic cash payments or the grant of replacement liens on unencumbered estate property. If the court-ordered adequate protection later proves to be insufficient, the shortfall is given administrative expense priority.

A lessor can also request for a stay to be lifted if the debtor has no equity in the property and the property is not necessary for reorganization. In a Chapter 7 case, this ground for lifting the stay is typically not contested, as reorganization is not the goal.

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Commented [la33]: Correct, 1 mark

Commented [la34]: Correct, 1 mark

Commented [la35]: Correct, 1 mark

Commented [la36]: Correct, 1 mark

Commented [la37]: 9/15 marks

Commented [la38]: 1/5 marks

Commented [la39]: Correct, 1 mark. Also the debtor has a 120 day deadline to assume or reject the lease, subject to a 90 day extension for cause, and no further extension without consent of the landlord. Prior to assumption or rejection, the debtor must pay rent as an administrative expense and, if the debtor assumes and then rejects a lease, it must pay 2 years' rent as an administrative expense. Also, the landlord has an unsecured claim for unpaid pre-petition rent.

In a Chapter 11 case, however, the debtor must demonstrate that there is a reasonable prospect of reorganization within a reasonable time to avoid the stay being lifted.

Question 4.2 [5 marks]

Commented [la40]: 4/5 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.

An English scheme of arrangement could potentially be granted recognition under US Chapter 15 as either a foreign main or foreign non-main proceeding. Chapter 15 of the Bankruptcy Code defines a foreign proceeding as "a collective judicial or administrative proceeding in a foreign country... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation". Under this definition, various proceedings, including English schemes of arrangement, have been granted recognition in the past.

Whether the proceeding is recognized as a foreign main proceeding or a foreign non-main proceeding depends on factors such as the center of main interests (COMI) and whether there is an establishment in the foreign jurisdiction. A foreign main proceeding is one that is commenced in the country where the debtor has its COMI, while a foreign non-main proceeding requires the debtor to have an establishment—a place where it carries out non-transitory economic activity—in the jurisdiction.

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Commented [la42]: Correct, 1 mark

In this connection, Skin Luxe's COMI is likely to be determined to be in France as its principal place of business is based in France and is also incorporated in France. A company-debtor's COMI is presumptively its place of incorporation. Thus, the English scheme of arrangement would likely be recognized as a foreign non-main proceeding. Recognition of the English scheme of arrangement as a non-main proceeding means that the scope of relief available to Skin Luxe under Chapter 15 is less broad than if the scheme had been recognized as a foreign main proceeding.

Commented [la43]: Correct, 1 mark

Commented [la44]: Correct, 1 mark

Commented [la45]: Specifically, the boutique in London permits the English proceedings to be recognized as foreign non-main.

Question 4.3 [5 marks]

Commented [la46]: 4/5 marks

Speculation Inc is engaged in day-trading stocks from leased office space with two employees. It funds its trading through a margin loan from its broker, where the shares

it purchases are held as collateral. For a while, Speculation Inc was very successful in trading, and the US Department of Justice (DOJ) has announced an investigation into whether its success was due to illegally trading on insider information. More recently, Speculation Inc has had serious trading losses, causing its broker to declare a default on the margin loan. It also has fallen behind on its rent, and has been sued in civil suit by a former employee alleging she was fired due to due to gender bias.

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

The filing of a Chapter 11 petition by Speculation Inc would have the following effects:

1. DOJ Investigation: **The automatic stay imposed by a Chapter 11 filing typically does not affect ongoing criminal investigations by the DOJ. The automatic stay is designed to halt civil proceedings and creditor actions against the debtor's property and does not extend to criminal proceedings.**
2. Margin Loan Default: **The automatic stay would halt the broker's actions to enforce the default on the margin loan. This means that while the Chapter 11 case is active, the broker could not seize the shares held as collateral without obtaining relief from the stay from the bankruptcy court. For the secured creditor's interest in the margin loan, the Bankruptcy Code requires that the interest of the secured creditor be adequately protected if their collateral is to be used for obtaining post-petition financing or if they are to be otherwise affected by the reorganization.**
3. Delinquent Lease: **The lessor would be prohibited from evicting Speculation Inc for non-payment of rent or otherwise acting to obtain possession of the leased property without court permission. However, lessors have special rights under the Bankruptcy Code, and the stay in the case of a lease can be more limited than with other types of debt (see Question 4.1 above).**
4. Employment Discrimination Lawsuit: **The automatic stay would halt the prosecution of a civil employment discrimination lawsuit against Speculation Inc. The former employee would be prevented from proceeding with the lawsuit and would have to file a claim in the bankruptcy proceeding instead. However, if the lawsuit involves a claim for discrimination involving a governmental agency under prevailing regulations, the automatic stay might not apply, and the action could proceed despite the bankruptcy, as the Bankruptcy Code exempts from the stay the commencement or continuation of actions by governmental units to enforce such police or regulatory powers.**

Commented [la47]: Correct, 1 mark

Commented [la48]: Correct, 1 mark

Commented [la49]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay, so the broker can sell the shares despite the bankruptcy filing

Commented [la50]: Correct, 1 mark

Commented [la51]: Correct, 1 mark

* End of Assessment *