

TOTAL = 38/50  
76%



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]: 0, correct answer is D, but 3 answers chosen

**(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.**

Commented [FV4]: 1, correct

**(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.

Commented [FV5]: 1, correct

**(b) Executory contracts are clearly defined by the Bankruptcy Code.**

(c) In the most common formulation, executory contracts are defined as those where both sides to a contract have material unperformed obligations.

(d) Chapter 11 debtors have greater flexibility than chapter 7 debtors on when they may assume, assign or reject an executory contract.

(e) Under the hypothetical test, a debtor cannot assume an executory contract if the debtor could not also assign the contract.

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.**

(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, but 2 answers were selected

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 is the process of netting the position when a creditor has both a claim against a debtor and also owes money to the debtor - the claim and the debt will be set off against each other to arrive at a net position. However, setoff is not permitted in many circumstances because it can improve the position of the creditor as compared to other 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?

A priming lien is a lien over estate property which has priority or is equal to any pre-petition liens, and may be issued (by the court) to lenders (who become secured creditors) when providing new money in a restructuring scenario. The debtor must demonstrate that the interest of the lender being primed is adequately protected.

Commented [FV12]: 1.5. Full credit not given because answer did not state that priming is only granted when there is no alternative financing.

Question 2.3 [2 marks]

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

A violation constitutes contempt of court and actions taken in violation will be void or voidable (depending on the circuit).

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?**

*A single class of impaired creditors can vote to accept the plan by a simple majority, effectively cramming down the other creditors. An unimpaired class are deemed to accept the plan, and a class that will receive nothing is deemed to reject the plan. A simple majority is at least two-thirds of the creditors in the class holding the value of claims / equity interests (as relevant).*

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?**
- (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

(b) constructive fraudulent conveyances

(c) fraudulent conveyances

Commented [FV15]: 1.5; answer for b is preference. answer for c is actual fraudulent transfer (partial credit given for c)

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

Commented [la16]: 14/15 marks

Question 3.1 [3 marks]

Commented [la17]: 3/3 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.**

*As a result of the US Supreme Court ruling in the case of Stern v Marshall, a bankruptcy court may only issue a final order consistent with the constitution when: (i) the parties agree that the bankruptcy court can issue a final order (by stating as such in their pleadings, as required by the Bankruptcy Rules); and (ii) if the District Court delegates a matter to the Bankruptcy Court (and that delegation is not withdrawn), the Bankruptcy Court can enter a final judgment on a motion challenging the validity of a petition.*

Commented [la18]: Correct, 1/2 mark

Commented [la19]: Correct, 1/2 mark



In general, appeals from Bankruptcy Court orders are heard by the relevant District Court, however in circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Panel. In rare circumstances, bankruptcy appeals may go directly to the relevant court of appeal.

Commented [la20]: Correct, 1/2 mark

Commented [la21]: Correct, 1/2 mark

Orders that are not constitutionally final (i.e. where the Bankruptcy Court issues a report or recommendation) are reviewed by the District Court. If the District Court issues a final order based on that recommendation, the recommendation effectively becomes final (such as was historically the position with 'non-core' proceedings).

Commented [la22]: Correct, 1 mark

Question 3.2 [3 marks]

Commented [la23]: 2/3 marks

What provisions of the Bankruptcy Code may not be invoked by a foreign representative in a chapter 15 proceeding? What are two ways that the foreign representative can obtain equivalent relief?

Chapter 15 proceedings may not be invoked as against certain persons, e.g. persons who may not be subject to Chapter 7 proceedings / US citizens eligible to be debtors under Chapter 13 / entities subject to proceedings under SIPA.

A foreign representative cannot invoke the Bankruptcy Code avoidance powers other than in plenary Chapter 7 or 11 proceedings. The relevant provision (based on Article 23 of the UNCITRAL Model Law on Cross Border Insolvency (MLCBI)) has been widely interpreted to apply only to powers of avoidance of preferences and fraudulent conveyances, and not to avoidance of pre-petition transactions. One way to obtain relief equivalent to avoidance powers would be to invoke such plenary proceedings (under Chapter 7 or 11). Another (less common) way to seek equivalent relief is for the foreign representative to commence a plenary proceeding under the Bankruptcy Code after recognition of the foreign proceeding under Chapter 15, although in those circumstances, the scope of the plenary proceeding would be limited to the debtor's US assets.

Commented [la24]: Correct, 1 mark

Commented [la25]: Correct, 1 mark. Alternatively, the foreign representative may bring equivalent claims under applicable US or foreign law.

Question 3.3 [4 marks]

Commented [la26]: 4/4 marks

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

Federal Rules of Bankruptcy Procedure;

Federal Rules of Civil Procedure;

The local bankruptcy court's rules of procedure; and

Judge's personal practices (published on the bankruptcy court's website).

Commented [la27]: Correct, 1 mark

Commented [la28]: Correct, 1 mark

Commented [la29]: Correct, 1 mark

Commented [la30]: Correct, 1 mark

Question 3.4 [5 marks]

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?

Directors of Delaware corporations owe fiduciary duties of **loyalty** to the corporation's best interests and in **educated decision-making**. Delaware directors are protected (in the absence of gross negligence) from liability for errors of judgment by the 'business judgment rule' (the presumption of which can be rebutted). The duties of care are owed to the **corporation and its shareholders**, not to creditors. This position is **unchanged if the corporation is actually or potentially insolvent**, and the Delaware Supreme Court has confirmed this position, stating that there is no concept of wrongful trading / deepening insolvency.

Commented [la32]: Correct, 1 mark

Commented [la33]: Correct, 1 mark, often called the duty of care

Commented [la34]: Correct, 1 mark

Commented [la35]: Correct, 1 mark

Commented [la36]: Correct, 1 mark

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

Commented [la37]: 9/15 marks

**Question 4.1** [5 marks]

Commented [la38]: 1.5/5 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?**

*I have assumed, for the purposes of this answer, that Subchapter V of Chapter 11 is not relevant.*

*On the basis that iWork Ltd has failed to pay rent under certain leases in the amount of at least USD16,750 (subject change / update at the time of filing), the Bankruptcy Code provides, subject to certain requirements, the lessor with the ability to petition for the involuntary bankruptcy of iWork Ltd under Chapters 7 or 11 of the Bankruptcy Code. In order to qualify as a petitioning creditor, the lessor must have a claim against iWork Ltd which is non-contingent and undisputed. If iWork Ltd has less than 12 creditors, iWork Ltd can petition alone. However, I note that filing a petition for iWork Ltd's bankruptcy is proactive, rather than protective. In terms of protection, the US Bankruptcy Code is very much pro-debtor.*

*Pursuant to the Bankruptcy Code, the **lessor's pre-petition claim for unpaid rent will be considered a secured claim** (up to the value of any deposit / collateral) for the purposes of distribution, however the lessor cannot use the deposit as setoff against the unpaid rent. However, **post-petition rent that falls due are considered 'administrative expenses'** under the Bankruptcy Code<sup>1</sup> and are entitled to priority over unsecured claims.*

Commented [la39]: Incorrect, the claim would be treated as a general unsecured claim

Commented [la40]: Correct, 1 mark

*An unexpired lease is an executory contract (where there are material unperformed obligations on both sides) and accordingly, the debtor (iWork Ltd) (in Chapter 11 proceedings) / the trustee (in Chapter 7 proceedings) has the ability to assume or reject or assume and assign burdensome contracts (which would likely include the leases,*

<sup>1</sup> "Lease Defaults and Restructuring: The Impact of Bankruptcy on Commercial Landlords and Tenants", Michael J. Riela, February 1, 2021 <https://businesslawtoday.org/2021/02/lease-defaults-restructuring-impact-bankruptcy-commercial-landlords-tenants/> (accessed on 23 February 2024)

although it must vacate if the lease is rejected). Until iWork Ltd / the trustee decides whether to assume or reject, "Section 365(d)(3) of the Bankruptcy Code requires a tenant to perform all post-petition obligations under the lease"<sup>2</sup> and accordingly, the lessor's "collection of post-petition rental payments does not violate the automatic stay",<sup>3</sup> although payment deadlines that arise during the first 60 days of proceedings may be extended by the court.

In order to assume a lease, pursuant to Section 565(b)(1), iWork Ltd / the trustee must cure / provide adequate assurance that the trustee will promptly cure, such default (e.g. rental arrears) / compensate for such and provides adequate assurance of timely future performance under the lease. If iWork Ltd fails to pay rent in a timely manner going forward, the lessor may seek relief from the automatic stay and seek to evict iWork Ltd or pursue any other remedies available to it. Time periods ascribed to both iWork Ltd/ the trustee / the lessor under the Section 565 of the Bankruptcy Code must be adhered to.

**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.**

In principle, an English scheme of arrangement could be granted recognition under Chapter 15 as a foreign main or non-main proceeding. The key difference being that a foreign main proceeding attracts a greater scope of relief than a non-main proceeding. For the scheme of arrangement to be considered a main proceeding, Skin Luxe's COMI should be in the same jurisdiction as the scheme, i.e. England. However, Skin Luxe is incorporated and has a principal place of business in France. 'COMI' is not a concept familiar to US law, which considers domicile, principal place of business, and location of assets in determining jurisdiction and venue, however when determining a debtor's COMI for the purposes of main/non-main proceeding classification, the presumption is that the debtor's COMI is presumed to be its place of incorporation. This presumption is which is rebuttable, however based on the facts, including that Skin Luxe develops and manufactures its products in France, my view is that a US court would likely consider Skin Luxe's COMI to be in France. I note that the US court will determine a relevant entity's COMI at the time of determining the recognition application. However, it is arguable that Skin Luxe has an 'establishment' (defined in the MLCBI as "any place of operations where the debtor carries out a non-transitory

<sup>2</sup> Ibid

<sup>3</sup> Ibid

**Commented [la41]:** Partially correct, 1/2 mark, in a chapter 11 proceeding, the deadline is 120 days, subject to a maximum 90 day extension for cause, to assume or reject the lease. If the debtor assumes and then rejects the lease, it must pay 2 years' rent as an administrative expense.

**Commented [la42]:** 5/5 marks

**Commented [la43]:** Correct, 1 mark

**Commented [la44]:** Correct, 1 mark

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

*economic activity with human means and goods or services”, however is not defined in the US Bankruptcy Code) in England given that it sells its products in locations including London. On the basis that Skin Luxe is considered to have an establishment in England, the scheme could be recognized under Chapter 15 as a foreign non-main proceeding which would mean that Chapter 15 recognition of the English scheme is still possible, however the scope of relief offered would not be quite as wide as for a foreign main proceeding.*

Commented [la46]: Correct, 1 mark

Commented [la47]: Correct, 1 mark

Question 4.3 [5 marks]

Commented [la48]: 2.5/5 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 effect of a chapter 11 petition being filed by Speculation Inc on each of the matters referred to above would be, in summary, as follows:**

- (i) **The DOJ investigation:** *the automatic stay of proceedings afforded to Speculation Inc pursuant to Chapter 11 proceedings would not prevent the DOJ from continuing with its investigation and does not provide protection from criminal action, however any legal action that the DOJ wished to commence would be stayed. In respect of legal actions, the DOJ could seek permission of the court to lift the stay.*
- (ii) **Margin loan default:** *the automatic stay of proceedings afforded to Speculation Inc pursuant to Chapter 11 proceedings means that collections thereunder would be stayed.*
- (iii) **The delinquent lease:** *Under Chapter 11 proceedings, Speculation Inc has the ability to assume or reject or assume and assign the lease. However, until Speculation Inc decides whether to assume or reject the lease Section 365(d)(3) of the Bankruptcy Code requires it to pay rent. If Speculation Inc opts to assume the lease, it must cure all default and pay the rent going forward. If it opts to reject, it must vacate the premises.*
- (iv) **The employment discrimination lawsuit:** *The lawsuit would be stayed under the automatic stay of proceedings afforded to Speculation Inc pursuant to Chapter 11 proceedings.*

Commented [la49]: Correct, 1 mark

Commented [la50]: Partially correct, 1/2 mark, any proceeding by the DOJ would be exempt from the stay

Commented [la51]: Incorrect, the margin loan is a securities contract that is exempt from the stay so the broker can sell the shares notwithstanding the bankruptcy filing.

Commented [la52]: The debtor would be protected from an action for eviction based on unpaid pre-petition rent.

Commented [la53]: Correct, 1 mark

\* End of Assessment \*