

TOTAL = 39/50  
78%



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.

(d) **A retired employee of Car Corp who receives payments from the company's pension plan.**

Commented [FV2]: 1, correc

(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.**

Commented [FV4]: 1, correct

(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.**

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.
- (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.

Commented [FV5]: 1, correct

Question 1.6

Which of the following is not a requirement to confirm a "cramdown" plan?

- (a) That the plan is fair and equitable to dissenting classes of creditors.
- (b) Acceptance of the plan by at least one class of impaired, non-insider creditors.
- (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.

Commented [FV6]: 1, correct

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.
- (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.

Commented [FV7]: 1, correct

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?

Set off permits a creditor to net out a debt owed to the debtor, against a debt simultaneously owned to it by the debtor.

It is regulated with suspicion in an insolvency context because its exercise can improve (arguably unfairly) the position of a creditor vis-à-vis the other creditors. This is because the real value of the debt owed by the debtor will be less than its face value; thus, allowing a set off against the face value of the debtor's debt overcompensates the creditor in a set off.

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 superpriority security that is senior or equal to a pre-petition lien on property of the debtor, and is offered in exchange for post-petition financing.

To obtain court approval for a priming lien, the debtor must first show that it is unable to obtain credit otherwise, even if on an administrative priority basis, and second that it has adequately protected the interests of the existing lienholder notwithstanding the proposed priming lien. This usually requires the consideration of factors such as (a) a valuation of the subject property to assess the nature of the equity cushion, (b)

Commented [FV12]: 2, correct

*assessment of whether the property is eroding in value, (c) the nature of the payments proposed, and (d) whether the debtor has a reasonable prospect of reorganising.*

Question 2.3 [2 marks]

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

*Firstly, the act taken in violation of the stay is itself either void or voidable. Secondly, the person who made the decision to violate the stay despite being bound by it, may be liable for contempt of court.*

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?**

Commented [FV14]: 2, correct

*An unimpaired class is deemed to have accepted the plan.*

*A class that will receive nothing is deemed to reject the plan.*

*Only impaired classes have the right to vote on the plan.*

*A class of creditors is considered to have voted in acceptance of a plan if more than half in number and at least 2/3 in value of the claims in the class vote in favour of that plan.*

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?**

Commented [FV15]: 3, correct

(a) Preference

(b) Preference

(c) Actual fraudulent conveyance

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

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**Question 3.1** [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.**

*Under the Bankruptcy Code (28 USC 157), bankruptcy courts may make final orders in respect of a statutorily-defined list of "core" claims. For "non-core" proceedings, the court may only make recommendations and proposals (as to findings of fact and law) to the district court for consideration. However, since Stern v Marshall, an additional gloss has been added in that even statutorily core claims may not be amenable to final order by the bankruptcy court if it violates Art III jurisdiction, unless the litigants consent to such.*

*In most Circuits, appeals from bankruptcy courts are heard in the district court for the district in which the bankruptcy court sits. In the First, Sixth, Eighth, Ninth, and Tenth Circuits, appeals from bankruptcy courts are heard by a Bankruptcy Appellate Panel.*

*The orders that are not constitutionally final are mere recommendations on findings of fact and conclusions of law by a bankruptcy court, and are reviewed by the district court (or the BAP) on a de novo basis. The district court's decision is in turn reviewable by the Circuit court of appeal on a de novo basis for conclusions of law, and an abuse of discretion basis for findings of fact.*

**Question 3.2** [3 marks]

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

*Chapter 15 excludes from the powers of the foreign representative, the power to invoke the avoidance provisions under the Bankruptcy Code. General consensus construes this exclusion as referring to the Bankruptcy Code's provisions on preference and fraudulent conveyances.*

*Thus, to invoke the Code's preference and fraudulent conveyance powers, the foreign representative may choose to:*

- (1) If the circumstances permit, commence avoidance litigation in plenary proceedings (usually Chapter 7 or 11) commenced by another stakeholder (eg, the debtor or creditors prior to the involvement of the foreign representative); or*
- (2) Commence plenary proceedings under Chapter 7 or 11 himself/herself, which will be managed as concurrent proceedings with that in the representative's home jurisdiction (whether main or non-main).*

**Commented [la17]:** 2.5/3 marks

**Commented [la18]:** Correct, 1/2 mark, also core proceedings that are exclusive to the Bankruptcy Code may be finally resolved by the bankruptcy court.

**Commented [la19]:** Correct, 1/2 mark

**Commented [la20]:** Correct, 1/2 mark

**Commented [la21]:** Correct, 1 mark

**Commented [la22]:** 2/3 marks

**Commented [la23]:** Correct, 1 mark

**Commented [la24]:** Correct, 1 mark; also the foreign representative may pursue equivalent claims under applicable US and foreign law

Question 3.3 [4 marks]

Commented [la25]: 4/4 marks

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

One should review the **Federal Rules of Bankruptcy Procedure**, the **Federal Rules of Civil Procedure** (which is often incorporated by reference in the Bankruptcy rules), the **local rules of the bankruptcy court**, and the **judge's personal practices**.

Commented [la26]: Correct, 1 mark

Commented [la27]: Correct, 1 mark

Commented [la28]: Correct, 1 mark

Commented [la29]: Correct, 1 mark

Commented [la30]: 5/5 marks

Question 3.4 [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?**

These directors usually owe a fiduciary duty of **loyalty** (which includes, for instance, the rule to act in the corporate's best interests, the rule against undisclosed conflicts of interests, and the rule against secret profits) as well as a duty of **care**.

Commented [la31]: Correct, 1 mark

Commented [la32]: Correct, 1 mark

In the ordinary course of business, these duties are owed to the **corporations** themselves as well as the **shareholders** of the company.

Commented [la33]: Correct, 1 mark

Commented [la34]: Correct, 1 mark

Under the business judgment rule, directors are presumed to have acted in good faith and on the basis of reasonable information. They will thus not be liable absent a showing of gross negligence. However, if it is shown that a majority of the board were in fact not reasonably informed, or did not honestly believe that their decision was in the corporate's best interests, or were not acting in good faith, then the presumption can be rebutted.

Even in a situation of potential or actual insolvency, the position in Delaware is that the fiduciary duties of the directors remain owed to the corporation and its shareholders, rather than any creditor or the creditors as a collective. This is contrary to the position in most Commonwealth jurisdictions including the UK and Singapore, and creates a narrower scope of director liability.

Commented [la35]: Correct, 1 mark

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

Commented [la36]: 7.5/15

Question 4.1 [5 marks]

Commented [la37]: 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 first question the lessors should consider is what protective action iWork is likely to take.

Likely, iWork's management would wish to retain control over the company (and prevent suits and investigations against themselves) and would therefore choose Chapter 11 to restructure its liabilities. By filing this, an automatic moratorium / stay comes into effect. The lessors will be precluded from commencing or continuing any of their claims against iWork. The Bankruptcy Code permits the lessors to seek relief from the stay, although this is difficult to obtain in practice especially in relation to land where valuations are relatively stable and ascertainable.

**Commented [la38]:** The lessors will have an unsecured claim in bankruptcy for the unpaid pre-petition rent.

Once iWork is within the Chapter 11 framework, it will likely use its bargaining power to reject some of its less profitable leases and renegotiate the remaining to secure a more profitable land bank and more favorable financial terms. Lessors - especially those who are unsecured - should be prepared for a difficult negotiation, and should make suitable concessions such that iWork will not be incentivized to reject the lease on the basis that it is burdensome or unprofitable, in which case the lessor will retain possession of the land but have its unpaid lease treated as general unsecured claim.

**Commented [la39]:** The lessors have some leverage because the debtor has only 120 days to assume or reject, subject to a maximum 90 day extension for cause, and no further extension without lessor consent. Also, if the debtor assume and then rejects a lease, the lessor has an administrative claim for 2 years' rent.

Significant creditors can also consider offering DIP financing such as a priming lien on terms that will allow that lessor to roll up their otherwise unsecured debt into a secured loan.

If Chapter 11 is filed soon, lessors should not feel concerned about the post-petition rent as that is entitled to priority. Indeed, depending on the lessor's view of the economic conditions, some lessors might feel that rentals (even if discounted) are better than vacancy, whereas some lessors with greater confidence in the market may wish to take its space back as soon as possible.

**Commented [la40]:** Correct, 1 mark

**Question 4.2** [5 marks]

**Commented [la41]:** 3/5 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.**

*There is almost no question that the English scheme is recognizable and will be recognized as foreign non-main proceedings.*

Firstly, it is indubitable that an English scheme is a “foreign proceeding” within the meaning of the Model Law and Chapter 15, being a collective judicially administered proceeding in a foreign country under a law relating to insolvency or adjustment of debt...”

Secondly, while the facts are sparse, it is likely that the company’s England operations will be considered an “establishment” even if not a COMI, given its boutiques in London. Thus, the English scheme has no difficulty being recognized as a foreign non-main proceeding, on application of the English scheme manager.

While it is difficult (based on given facts) to argue that the English scheme is a foreign main proceeding given that the COMI appears to be in France instead, there is no real practical significance given decisions, especially in SDNY, that suggests that the scope of relief available whether in main or non-main proceedings is broadly similar.

There is no question of the recognition being contrary to US public policy. Indeed, the recognition promotes comity and is aligned with the spirit and purpose of Chapter 15. There is also no indication that the reliefs sought upon recognition will in any way be contrary to US public policy.

To the extent that the bonds are governed by English law, there may be a question of the Gibbs principle interfering with the efficacy of the restructuring. The facts are not sufficient to determine if this will be a real obstacle.

**Question 4.3** [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?**

On the filing of a Chapter 11 petition, a worldwide automatic stay immediately comes into effect. The scope of this stay is extremely broad and prevents interference with Speculation Inc’s estate anywhere in the world, including litigation on pre-petition claims.

Commented [la42]: Correct, 1 mark

Commented [la43]: Correct, 1 mark. The foreign proceedings cannot be recognized as main because they are not in the jurisdiction of the debtor’s COMI.

Commented [la44]: Correct, 1 mark, also this is consistent with the presumption that the COMI is in the jurisdiction of incorporation

Commented [la45]: 3.5/5 marks

Commented [la46]: Correct, 1 mark

*The DOJ investigation has not yet culminated in litigation. Nevertheless, it is a recognised statutory exception to the stay, both in its form as a regulatory investigation and as criminal proceedings (assuming that charges are brought). It may thus proceed notwithstanding the filing.*

**Commented [la47]:** Correct, 1 mark

*For the margin loan default, it is likely that the mere declaration of default will not offend the stay. However, any action to collect owing from the default, being litigation to collect on pre-petition claim, will likely not be permissible. It is possible and indeed likely, however, for the broker to seek relief from the stay on the basis that the equity collateral is highly volatile and likely to suffer in valuation the longer the Chapter 11 proceeds, and that given this volatility there is inadequate protection for the broker.*

**Commented [la48]:** Incorrect, the margin loan is a securities contract that is exempt from the automatic stay so the broker can sell the shares.

*In relation to the delinquent lease, litigation for the recovery of rent will likely be prohibited by the automatic stay. However, once the duration of the lease expires, then the eviction of Speculation Inc from the property, which is non-residential property, falls within one of the recognised exceptions to the stay and is thus not prohibited by the stay.*

**Commented [la49]:** Partially correct, 1/2 mark, but the lease would have to have expired prior to the bankruptcy for the debtor to be evicted.

*For the employment discrimination lawsuit, this is not the subject of a statutory exception and is thus likely to be prohibited by the stay.*

**Commented [la50]:** Correct, 1 mark

\* End of Assessment \*