

TOTAL = 46/50  
92%



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.**

Question 1.4

**Who may serve as a foreign representative to seek recognition of a foreign proceeding under chapter 15?**

**(a) An officer of the debtor if it is a debtor-in-possession in the foreign proceeding.**

**(b) The board of directors of the debtor if it is a debtor-in-possession in the foreign proceeding.**

**(c) An insolvency professional appointed by the court overseeing the foreign proceeding.**

**(d) An insolvency professional appointed by a creditor where the foreign proceeding is an involuntary receivership.**

**(e) All of the above.**

Question 1.5

**Which of the following regarding executory contracts is false?**

Commented [FV3]: 1, correct

Commented [FV4]: 1, correct

(a) *A court will generally defer to a debtor's business judgment regarding whether to assume or reject an executory contract.*

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

Commented [FV5]: 1, correct

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

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

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

Question 1.6

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

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

Commented [FV6]: 1, correct

(b) *Acceptance of the plan by at least one class of impaired, non-insider creditors.*

**(c) Acceptance of the plan by all classes of secured creditors.**

(d) *That the plan does not discriminate unfairly against dissenting classes of creditors.*

(e) *That the dissenting creditors receive no less than they would under a liquidation scenario.*

Question 1.7

*Which of the following statements about "pre-packs" is false?*

**(a) A pre-pack cannot be used if the debtor wishes to reject executory contracts.**

Commented [FV7]: 1, correct

(b) *Creditors must have sufficient information about the debtor and the plan to make an informed voting decision.*

(c) *A pre-pack debtor may spend as little as a single day in bankruptcy.*

(d) *The proposed plan of reorganization is submitted to the bankruptcy court together with the voluntary petition.*

(e) *Creditors' commitment to vote in favor of the plan may be memorialized in a restructuring support agreement.*

Question 1.8

*If a debtor rejects an executory trademark license agreement under which the debtor licenses its trademark to a manufacturer, which of the following is true:*

- (a) The manufacturer has a claim for damages for breach of contract.*
- (b) The manufacturer must immediately stop using the trademark.*
- (c) The manufacturer can continue using the trademark for the remaining period of the license.*
- (d) Both options (a) and (b).***
- (e) Both options (a) and (c).*

Commented [FV8]: 0, correct answer is E

Question 1.9

*Which of the following about 363 sales is false?*

- (a) A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.*
- (b) The debtor-in-possession must establish that the transaction is in the best interests of the estate as a whole.*
- (c) In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale.***
- (d) Debtors must carry out a robust marketing process for the sale.*
- (e) A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.*

Commented [FV9]: 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 is when a creditor has the right or option to apply the full or partial amount owed by the debtor against the amount owed by the creditor to the debtor i.e., in simple terms it allows the creditor to net off the amount owed to it against the amount owed by it. (There are various types of set-off including contractual and statutory)*

*It is not permitted in circumstances when<sup>1</sup>:*

- *the creditor's claim against the estate is disallowed*
- *the creditors' claim against the estate was acquired post-petition or in the 90 days prior to the petition when the debtor was presumed insolvent (unless rebutted by the creditor) thereby preventing the acquisition of debts or obligations by a party who has the intention of applying set-off*
- *in the 90 days prior to the petition when it is presumed the debtor was insolvent (unless rebutted by the creditor, the creditor incurred the obligation to the debtor for the purpose of applying set-off.*
- *the creditor who exercises set-off improves its position in a manner that would not have been the case had it set-off the amounts 90 days prior to the petition.*

Commented [FV11]: 1, correct

*The reasoning why it is not permitted in many circumstances is because it has the effect of benefitting the (unsecured) creditor who sets-off the amount it owes to the debtor potentially to the detriment of the other (unsecured) creditors. It has its claim against the debtor by the set-off but also it diminishes the assets (which may include the debt*

<sup>1</sup> Foundation Certificate in International Insolvency Law, "Module 3A Guidance Text Insolvency System of the United States 2023/2024" (INSOL) pg. 59

recoverable from the creditor) available for distribution to the other creditors. The debts owed to the debtor are recoverable in full whereas the claims of the creditors of the debtors are only partially settled.

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 one of the four options under the Bankruptcy Code for a debtor in Chapter 11 bankruptcy to source debtor in possession funding (DIP Financing)<sup>2</sup> post-petition. It is a lien that is senior or equal to any lien over property of the estate that was in place prior to the petition. DIP financing is financing for working capital for the debtor in possession under chapter 11 bankruptcy.*

*It is the final option available in the event the debtor is unable to secure financing on other terms. Like other options the provision of financing with a priming lien is intended improve the chances for reorganization of the debtor. The ability to obtain financing is normally critical to be able to successfully restructure an organization as it allows an organization to continue to operate with minimal disruption which provides confidence in the viability of the company (once restructured)<sup>3</sup>. There is an associated risk to the secured creditor with a pre-petition lien even though protections are afforded to the secured creditor when the court determines whether the priming lien should be granted.*

*The requirements that must be met for a priming lien to be granted are stringent and are that the debtor:*

- *must be in a Chapter 11 bankruptcy.*
- *has been unable to secure financing on any other terms (so it has not been able to source unsecured debt or unsecured credit in the ordinary course of business (without court approval) or unsecured debt or unsecured credit in the ordinary course of business (with court approval) or source (with the authorization of the court) unsecured debt with priority over administrative expenses/secured debt with a lien of unencumbered state property/secured debt with a junior lien on encumbered property.*
- *demonstrates to the court granting the priming lien that there is adequate protection of the secured creditor being primed.*

*A priming lien offers the highest level of security and in practice it is the majority of DIP financing<sup>4</sup>.*

<sup>2</sup> DIP financing is an incentive for lenders and counterparties to provide extension of credit to a debtor in Chapter 11 bankruptcy under the Bankruptcy Code. The rationale is that it enables the debtor to finance the bankruptcy process and thereby improve the chances of the reorganization.

<sup>3</sup> Bo Xie, ‘Comparative Insolvency Law’ The Pre-Pack Approach in Corporate Rescue’, Edward Elgar (2016) pg 197

<sup>4</sup> *Ibid*, pg 199

Commented [FV12]: 2, correct



Question 2.3 [2 marks]

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

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

1. *that such an action is considered to be a contempt of court and the violator may receive contempt sanctions. Contempt sanctions could include:*
  - *the settlement of the attorney fees of the debtor,*
  - *affirmative acts to undo the effect that have changed the *status quo*,*
  - *daily fines imposed until the violation is rectified (coercive contempt sanctions)*
2. *any action may be void or voidable, whether it is void or voidable will be dependent upon the circuit in which the bankruptcy is before.*

Commented [FV13]: 2, correct

*The purpose of an automatic stay is to protect the property of the estate to ensure the orderly conduct of the bankruptcy including the realization of the assets that is for the benefit of the body of creditors, not individual creditors, in order for the settlement of claims of creditors in the legislated priority in due course. It prevents creditors from taking enforcement action against the debtor for claims arising prior to the petition. Further to provides "breathing space" to allow for the development of a reorganization plan as well as negotiation with creditors.*

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?**

*Class(es) of creditors*

- i) *Deemed to accept the plan are:*
  - a. *the unimpaired class(es) i.e. those creditors in a class in which the plan does not alter their legal, equitable or contractual rights, or the class(es) of creditors deemed unimpaired i.e. those creditors whose claims are cured of monetary default and compensated for damages by the plan i.e. creditors whose acceleration of debt has been reversed.*
- ii) *Deemed to reject the plan is the class of creditors who will receive nothing.*
- iii) *Permitted to vote on the plan are the impaired class(es) i.e. those creditors who are not unimpaired or creditors whose acceleration of debt has been reversed.*

Commented [FV14]: 2, correct

*The vote necessary for a class of creditors to accept a plan is a "simple majority of the creditors in the class and holding two thirds of the value of claims in the class"<sup>5</sup>.*

<sup>5</sup> Foundation Certificate in International Insolvency Law, "Module 3A Guidance Text Insolvency System of the United States 2023/2024" (INSOL) pg. 40

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) *The cause of action that applies only to transfers made on account of antecedent debt is a preference. The requirement is that there must be a pre-existing debt with a creditor that the debtor is paying. There needs to be a time delay between the creation of the debt and the payment by the debtor (It cannot be a simultaneous exchange).*

*Transfer made on account is one element of a preference under US law. The other four are transfer of an interest of the debtor in property; to or for the benefit of a creditor; made while the debtor was insolvent; made during the suspect time and that enables the creditor to receive more than it would in a chapter 7 liquidation)<sup>6</sup>.*

b) **The cause of action that requires the debtor be presumed or proven to have been insolvent at the time of transfer is**

a. *a preference - ninety days prior to the petition the debtor is presumed to insolvent for the purposes of determining a preference (where this is challenged by a creditor then the debtor or trustee must prove balance sheet insolvency).*

b. *constructive fraudulent conveyance - if the debtor was insolvent as the time of transfer (or as a result of the transfer) there may be a cause of action for recovery if the debtor value received for the incurrence of an obligation to transfer of an asset was unreasonably below the value of that exchanged.*

c) **The cause of action that requires the debtor be proven to have intended to frustrate creditors' recoveries is an actual fraudulent conveyance. Intent may be circumstantial. The cause of action would be with respect to *inter alia*<sup>7</sup>:**

<sup>6</sup> Foundation Certificate in International Insolvency Law, "Module 3A Guidance Text Insolvency System of the United States 2023/2024" (INSOL) pg. 51-53

<sup>7</sup> Foundation Certificate in International Insolvency Law, "Module 3A Guidance Text Insolvency System of the United States 2023/2024" (INSOL) pg. 57-58

**Commented [FV15]:** 2.5. The answer to b is preference. A constructive fraudulent conveyance does not require insolvency. It may be brought where debtor has unreasonably small capita. Partial credit given for b.

- *Transfer/obligation made to an insider*
- *Retention of possession or control of the property after the transfer*
- *Transfer/obligation was disclosed or concealed*
- *Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with a suit*
- *Transfer of substantially all of the debtor's assets*
- *Absconding of the debtor*
- *Removal or concealment of the assets by the debtor*
- *Value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred*
- *The debtor was insolvent or became insolvent shortly after the transfer was made or obligation was incurred*
- *The transfer occurred before or shortly after a substantial debt was incurred, and*
- *The debtor transfers the essential assets of the business to a lienor that transferred the assets to an insider of the debt.*

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

Commented [la16]: 15/15 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.**

- i) *The circumstances in which a bankruptcy court may enter a final order consistent with the US Constitution are limited and generally only on core bankruptcy issues. This is because bankruptcy courts are not created by Article III of the US Constitution so are not part of the federal system but legislatively created by powers granted to congress. Following the decisions of the US Supreme Court this prevents judges not appointed under Article III from exercising jurisdiction over matters subject to Article III. This Core bankruptcy issues, per statute 11 USC §157(b)(2), include *inter alia**
- *Matters concerning the administration of the estate*
  - *Counterclaims by the estate against person filing claims in the estate*
  - *Orders in respect of obtaining credit*
  - *Objections to discharges*
  - *Confirmation of plans*
  - *Determinations of the validity, extent or priority of liens*
  - *Recognition of foreign proceedings and other matters under chapter 15 of title 11.*

*It also includes the ability to issue a final order on motion challenging a petition's validity but any final order cannot invade Article III jurisdiction<sup>8</sup>. They can issue final orders with the consent of the parties<sup>9</sup>.*

Commented [la18]: Correct, 1/2 mark

Commented [la19]: Correct, 1/2 mark

*If the bankruptcy court hears non-core matters any proposed findings of fact and conclusions of law are submitted to the district court for a final decision (assuming interested parties do not object).*

Commented [la20]: Correct, 1 mark

Commented [la21]: Actually, the district court will only consider the portions of the bankruptcy court's order that are objected to

- ii) *The appeals of the bankruptcy court orders are generally reviewed by the district court for the district to which they sit and will be reviewed by a randomly assigned judge.*

Commented [la22]: Correct, 1/2 mark

*For the First, Sixth, Eighth, Ninth and Tenth Circuits decisions are reviewed by a Bankruptcy Appellate Pane (BAP), which is a panel of bankruptcy judges within the circuit. There is an option, however, in these circuits for the appeal to be heard by the district court.*

Commented [la23]: Correct, 1/2 mark

*In circumstances where the initial order that permitted an appeal of right the further appeal of right would be to the circuit court of appeals. It is possible in certain circumstances, included in where an appeal may advance the case, for the appeal to be made directly to the court of appeals but this is discretionary and not an automatic right. It is necessary in these circumstances for the bankruptcy court or the district court to certify one of two things<sup>10</sup>:*

- (a) *the appeal raises a question of law and there is no controlling decision by the US Supreme Court or the circuit, or there are conflicting controlling decisions that need to be resolved,*

*or*

- (b) *by affecting an immediate appeal the case would be advanced (materially).*

- iii) *Order that are not constitutionally final are reviewed by the district court or BAP. This is a de novo review of all conclusions of law and findings of fact that have been objected to.*

*Interlocutory orders (i.e. orders that only partially resolve the issues or claims) may only be appealed with the leave of the appellate court.*

**Question 3.2 [3 marks]**

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<sup>8</sup> Following *Stern v Marshall* 564 US 463 (2011).

<sup>9</sup> *Wellness Int'l Network Ltd. V Sharif*, 135 S Ct 1932 (2015).

<sup>10</sup> Foundation Certificate in International Insolvency Law, "Module 3A Guidance Text Insolvency System of the United States 2023/2024" (INSOL) pg. 20

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

The provision of the Bankruptcy Code that may not be invoked by a foreign representative in a chapter proceeding are the use of the avoidance powers with respect to preferences and fraudulent conveyances.

Commented [la25]: Correct, 1 mark

The two ways a foreign representative can obtain equivalent relief are to:

1. invoke the Bankruptcy Code avoidance powers in a plenary proceeding. A foreign representative may commence an involuntary chapter 7 or chapter 11 petition against the debtor. This would be under chapter 7 or chapter 11 of the Bankruptcy Code. Both of these codes grant avoidance powers with respect to preferences and fraudulent conveyances.
2. avoid pre-petition transactions under other applicable foreign or US law<sup>11</sup>.

Commented [la26]: Correct, 1 mark

Commented [la27]: Correct, 1 mark

**Question 3.3 [4 marks]**

Commented [la28]: 4/4 marks

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

The rules that should be reviewed when preparing a filing for a bankruptcy court include

- US Bankruptcy Code (title 11 of the United States Code)
- the Federal Rules of Bankruptcy Procedure (Bankruptcy Rules),
- Federal Rules of Civil Procedure
- Bankruptcy court local rules or procedure
- Most recent update of the judge's personal practices (available on the website of the bankruptcy court) paying attention to the deadlines (including for filing and responding to pleadings).

Commented [la29]: Correct, 1 mark

Commented [la30]: Correct, 1 mark

Commented [la31]: Correct, 1 mark

Commented [la32]: Correct, 1 mark

One should also check if there is a form for the bankruptcy filing that necessarily needs to be used (<http://www.uscourts.gov/forms/bankruptcy-forms>).

The local court rules should be considered carefully if there is a choice of forum option as interpretation of the Bankruptcy Code differs by circuit<sup>12</sup>.

For a corporate debtor under chapter 7 or 11 the list of schedules that necessarily need to be filed includes details of real and personal property, secured creditors, unsecured creditors, executory contracts and unexpired leases and co-debtors. A chapter 11 case should also include the list of the 20 largest non-insider creditors.

It would be sensible also to gain an understanding of local practice by consulting (and likely engaging) a local practitioner.

<sup>11</sup> *In re Condor Ins Ltd* 601 F.3d 319 (5<sup>th</sup> Cir 2010).

<sup>12</sup> Foundation Certificate in International Insolvency Law, "Module 3A Guidance Text Insolvency System of the United States 2023/2024" (INSOL) pg. 14

US case law should also be reviewed both with respect to the US Bankruptcy Code, in the circuit in which the intended filing will be made but also potentially leading judgements in other circuits (which are persuasive) for contentious matters. Also cases relating to non-bankruptcy matters that may be affected by the filing should be reviewed.

In relation to a chapter 15 proceeding the case law applicable to the Model Law of Cross Border Insolvency.

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?**

The fiduciary duties of directors of Delaware corporations is more limited than in the other states in the US (and in other countries). Directors of Delaware corporations owe a fiduciary duty "of loyalty to the corporation's best interest" and "of care in educated decision making"<sup>13</sup>. They are protected by error of judgement by the business judgement rule (i.e. the board has acted in good faith on the basis of reasonable information).

In the ordinary course of business the duties are owed to corporation and to the shareholders of the corporation. This remains the case even when the company is potentially insolvent or actually insolvent.

*Per Trenwich Am Litig Trust v Ernst & Young, LLP 906 A.2d 168 (Del Ch 2006)*

*"Delaware law imposes no absolute obligation on the board of a company that is unable to pay its bills to cease operations and to liquidate. Even when the company is insolvent, the board may pursue, in good faith the strategies to maximize the values of the firm".*

The directors do not have a fiduciary duty to the creditors in these circumstances (contrary to other jurisdictions which allow for claims against directors for wrongful or reckless trading).

*Per North AM Catholic Educational Programming Foundation Inc v Gheewalla, 930 A.2d 92, 103 (del 2007)*

*"(I)ndividual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation..."*

<sup>13</sup> Foundation Certificate in International Insolvency Law, "Module 3A Guidance Text Insolvency System of the United States 2023/2024" (INSOL) pg. 60

Commented [la33]: 5/5 marks

Commented [la34]: Correct, 1 mark

Commented [la35]: Correct, 1 mark

Commented [la36]: Correct, 1 mark

Commented [la37]: Correct, 1 mark

Commented [la38]: Correct, 1 mark

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

Commented [la39]: 13.5/15 marks

**Question 4.1** [5 marks]

Commented [la40]: 4/5 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 protections afforded to the lessor vary according to the which Chapter iWorks Limited may be placed in. For those leases that are still in effect when the bankruptcy order is made, so would be determined to be executory contracts, the Bankruptcy Code offers certainty as to the time period that the trustee or debtor has to make the decision with respect to executory contract. If iWorks is placed under chapter 7 then the decision must be made to assume or assign or reject the contract within 60 days from the date of the petition.*

*In terms of chapter 11 a decision would need to be made with respect to any unexpired leases of the office spaces (which are non-residential property) within 120 days of the order for relief<sup>14</sup>. An extension (to 90 days for cause) can be granted but the lessor needs to provide consent. In chapter 11 while iWorks may continue to lease the offices it could only sell the lease with court approval.*

Commented [la41]: Correct, 1 mark

Commented [la42]: Correct, 1 mark

*If the lease are rejected then iWorks would be deemed to have breached the contract and the lessor has an unsecured claim for pre-petition damages. If iWorks continues with it and then later rejects it the claim for damages would be a cost of administration. If the contract is assigned then the Lessor will have a new (hopefully) better tenant. Although the lease may be assigned without the Lessor approval (notwithstanding any provisions in the contract to that effect). If the lease continues the rent is paid as a cost of administration.*

Commented [la43]: Correct, 1 mark

Commented [la44]: Correct, 1 mark, also there is an administrative priority claim for post-petition rent

*Should there be an intention to sell the leases as part of a reorganization under chapter 11 in the ordinary course of business then it would be necessary to consider the "vertical" and "horizontal" dimension tests to see if it such a sale would be considered to be in the ordinary course (the vertical test being the expectations of a hypothetical creditor of the debtor and the vertical being how businesses are conducted by other companies similar to iWorks<sup>15</sup>).*

*For any expired leases, the lessor would be able to evict iWorks where it has not paid its rent because the automatic stay is excepted<sup>16</sup>.*

<sup>14</sup> 11 USC, § 365(d)(4).

<sup>15</sup> Foundation Certificate in International Insolvency Law, "Module 3A Guidance Text Insolvency System of the United States 2023/2024" (INSOL) pg. 27

<sup>16</sup> 11 USC, § 362(b)

*The lessors have further protection under the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). BAPCPA prescribes deadlines for assuming or rejecting commercial leases.*

*One protection, should iWorks Limited make a voluntary petition, is that the details of unexpired leases must be included in the petition and are therefore known.*

*If iWorks enters chapter 7 bankruptcy the deposit amount payable as an unsecured claim is capped. Any rental due for offices still occupied by the debtor after the petition should be paid as an administrative expense.*

*For purposes of this answer it is assumed that the covid pandemic is over and the covid provisions introduced with respect to leases do not apply..*

**Question 4.2** [5 marks]

Commented [la45]: 5/5 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 would meet the definition of a foreign proceeding as defined by the Bankruptcy Code ("a collective judicial or administrative proceeding in 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 submitted to control or supervision by a foreign court, for the purpose of reorganization or liquidation<sup>17</sup>").*

*The foreign representative of Skin Luxe would need to file a petition under chapter 15 for recognition.*

*In order to grant recognition it would be necessary for the foreign representative to present evidence that the scheme of arrangement is pending and that the foreign representative is empowered to act. (A foreign representative would need to be appointed in terms of the scheme).*

*The scheme of arrangement is likely to be granted as a foreign non-main proceeding. Foreign non-main proceedings can only be opened where there is an establishment. Under Article 2(e) an establishment is "any place of operations where the debtor*

Commented [la46]: Correct, 1 mark

Commented [la47]: Correct, 1 mark

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<sup>17</sup> 11 USC, §101(23)



carries out non-transitory economic activity with human means and assets or services'. A boutique would meet the requirements for an establishment<sup>18</sup> as it is a place where non-transitory economic activity is carried out. The premises are presumably owned by Skin Luxe or at least leased and it has employees selling the products.

A foreign main proceeding would be those proceedings commenced in Skin Luxe's center of main interest (COMI). While the US (Chapter 15) does not explicitly incorporate the concept of the COMI it is guided by it<sup>19</sup> and there is corresponding case law<sup>20</sup>. It generally presumed to be the place of incorporation in the US as these meet the criteria that determine the COMI under Model Law which are it is the central place of administration and creditors can ascertain same.

Commented [la48]: Correct, 1 mark

Commented [la49]: Correct, 1 mark

Given the presumption is that this is the place of its incorporation i.e. France and therefore the English scheme of arrangement would be the non-main proceeding as the boutique in London would be considered an establishment.

This presumption, however, may be rebuttable and a case may be made that England is the COMI. The bonds are governed by English law and the scheme of arrangement is under English law as such the laws of England are the laws applicable to any disputes arising in terms of the notes. However, this may not be sufficient as other factors also determine the COMI - location of headquarters, management, primary assets and majority of creditors (including those affected by the scheme)<sup>21</sup>. Given the principal place of business is France and the skin products are manufactured there it is assumed that the headquarters, management, and primary assets are in France. There is insufficient information provided to determine where the majority of creditors are located but given it is bonds being restructured there is some evidence that the debt of those creditors is governed by English Law.

Commented [la50]: Correct, 1 mark

#### Question 4.3 [5 marks]

Commented [la51]: 4.5/5 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?**

<sup>18</sup> 11 USC, §1502(2)

<sup>19</sup> See LC Ho 'Proving COMI: Seeking Recognition Under Ch 15 of the US Bankruptcy Code' (2007) 22 JIBFL 636.

<sup>20</sup> *In re Sphinx* (SDNY Case No 06-11760)

<sup>21</sup> *In re SPinX, Ltd*, 351 BR 103, 117 (Bankr SDNY 2006)

A chapter 11 petition being filed by Speculation would be voluntary filing. Upon filing the petition Speculation obtains an automatic (worldwide) stay protecting it from creditors' individual debt-collection action. Following the filing of the petition the Debtor in Possession (DIP) has 120 days of exclusivity to propose a reorganization plan. After that time or if the DIP plan is not accepted then a party in interest can file a plan.

Commented [la52]: Correct, 1 mark

i) **DOJ investigation**

Effect of chapter 11 petition would be Speculation Inc would be an automatic stay however this would not affect the DOJ investigation as it would be classified as a regulatory investigation<sup>22</sup>.

Commented [la53]: Correct, 1 mark

The DoJ would be considered a party in interest. Given the nature of the business, which is high risk, and the suggestion of insider trading it may be that the that the DOJ, as a party in interest may seek to appoint a trustee. Although to appoint a part in interest there is a high bar to establish it is necessary. If a trustee is appointed as opposed to the Debtor in Possession the trustee is afforded investigative powers.

ii) **Margin loan default**

Effect of chapter 11 petition would be Speculation Inc would be an automatic stay. It would need to be determined what are the security arrangements in place with the broker. The interests of secured creditors are safeguarded under chapter 11 by constraining DIP to sell, use of lease estate property to provide adequate protection of the secured creditor's interest.

The scope of the stay would prohibit the enforcement of any lien on the shares purchased by the broker on the margin loan.

However, the stay with respect to the trading of the shares may be exempted by virtue of being a forward contract as such by freezing the trading of the shares would prevent Speculation Inc being able to trade during the period when the development plan is being developed.

Commented [la54]: Partially correct, 1/2 mark, because it is a securities contract the broker is not barred by the automatic stay from liquidating the collateral

Given the questions arising with respect to insider trading any amount due in respect of the margin loan may be avoided as a preferential or fraudulent transfer.

iii) **Delinquent lease**

Speculation, being the DIP, is entitled to continue with the lease in the ordinary course of business.

Commented [la55]: Correct, 1 mark, it cannot be evicted

<sup>22</sup> 11 USC, § 362(b)

*Assuming the lease has not expired then a decision would need to be made with respect to any unexpired leases of the office spaces (which are non-residential property) within 120 days of the order for relief<sup>23</sup>. An extension (to 90 days for cause) can be granted but the lessor needs to provide consent.*

*Should DIP continue to lease the offices it could only sell the lease as part of the reorganization with court approval.*

*If DIP rejects the lease it would need incur an unsecured claim for pre-petition damages. If Speculation continues with it and then it would need to pay the rental and if it later rejects it the claim for damages would be a cost of administration. Speculation does have the option to assign the lease.*

*Should a 363 sale be undertaken in due course the lease could be transferred and the liability arising from the unpaid rental would not be transferred.*

iv) **Employment discrimination lawsuit**

*Effect of chapter 11 petition would be Speculation Inc would be an automatic stay and this affect pre-petition lawsuits. However, depending on the relevant US legislation, if the employment discrimination lawsuit falls outside of the of the bankruptcy court which it is assumed a lawsuit by the former employee due to gender discrimination would be then the lawsuit may proceed.*

*The former employee would still be able to submit a claim in the bankruptcy proceedings.*

**Commented [la56]:** Correct, 1 mark, the litigation would be stayed, but the bankruptcy court could lift the stay to permit the case to proceed in another court

**\* End of Assessment \***

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<sup>23</sup> 11 USC, § 365(d)(4).