

**TOTAL = 33.5/60**  
**67%**



**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[1]

### 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. [2]
- (c) Yes, if other creditors owed at least USD 5,775 join in the petition.
- (d) No, because Parts Inc does not know whether Car Corp is insolvent.
- (e) No, because Parts Inc is not a US company.

#### Question 1.2

Answer this question with reference to the set of facts set out in question 1.1 above: Which of the following is likely to be a **party in interest** in the bankruptcy of Car Corp?

- (a) A shareholder in Parts Inc, to which Car Corp is indebted.
- (b) A journalist writing about Car Corp's bankruptcy.
- (c) A shareholder in Investment Corp, Car Corp's parent company.
- (d) A retired employee of Car Corp who receives payments from the company's pension plan. [3]

- (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.[4]

(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.[5]
- (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. [6]
- (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.
- (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. [7]
- (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.
- (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 [8] 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.
- [9] (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).

### 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.
- [10] (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.

### 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[11] 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.

### QUESTION 2 (direct questions) [10 marks]

#### Question 2.1 (1 mark)

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

“Setoff” or “Offsetting” permits creditors holding a claim against the debtor, and while at the same time owing money to the debtor, to net out the two (or more) obligations. It allows a[12] debtor to reduce or abolish a debt owed to a creditor. Setoff is not permitted in many circumstances as setoff rights can improve the position of the creditor as compared to other unsecured creditors who are not owed money by the debtor as it decreases the obligation to the estate. By not permitting setoff, the interests of the creditors are safeguarded and ensures equitable distribution of assets among them.

#### 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 four ways in which a debtor may obtain creditor incurred debt. For example, the costs associated with Chapter 11 bankruptcy can be very high due to normal business operating expenses as well as the various legal and advisory fees associated with the successful restructuring of an entity. Therefore, the Bankruptcy Code under Section 364 provides incentives to lenders and associated parties to extend credit to the debtor. This concept is known as debtor in possession financing, a priming lien is senior or equal to pre-petition lien on estate property to secure post-petition financing. This form of financing[13] likewise received claim priority, also known as ‘Super Priority’. Section 364 also lays out the two main requirements for such a lien to be granted as mentioned below:

1. The debtor-in-possession must prove that it was unable to obtain financing without offering a priming lien as an incentive

2. The debtor must then prove that the interests of the existing lenders being primed are adequately protected

**Question 2.3 [2 marks]**

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

An automatic stay comes into effect immediately upon the filing of a plenary petition. Its main objective is to provide the debtor breathing room to formulate a restructuring plan, negotiate with creditors and realise the value of assets for the subsequent distribution to creditors. One consequence of violating the automatic stay, whether the party is aware of the stay or not, is being held in the contempt of court. For example, if a creditor continues contacting the debtor with collection notices or attempting to repossess collateral properties when a stay is granted, they can be held in contempt of court which can result in fines and sanctions and [14] be enforced by the court.

Another consequence of a violation of the automatic stay can be in the form of litigation. If a debtor takes legal action against a creditor for violating a stay, if successful, the debtor may be entitled to damages and the creditor can be ordered to pay the legal fees associated with the enforcement of the automatic stay.

**Question 2.4 [2 marks]**

In voting on a plan of reorganization, which class(es) of creditors are (i) deemed to accept the plan, (ii) deemed to reject the plan and (iii) permitted to vote on the plan? What vote is necessary for a class of creditors to accept a plan?

- (i) An unimpaired class (including one whose acceleration of debt has been reversed) [15]
- (ii) Impaired class
- (iii) A simple majority vote of the creditors class holding at least two-thirds of the value of claims in the class

**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) This cause of action is seen as a preference action as noted in section 547(b)(2) of the Bankruptcy Code which states that the transfer made by the debtor within 90 days of



the bankruptcy be for or on account of an antecedent debt owed by the [16] Debtor before such transfer was made.

- (b) The cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer is a constructive fraudulent conveyance as a debtor received less than good value in exchange for a transfer or incurrence of obligation at the time of being insolvent. As shown under section 547(b)(1) of the Bankruptcy Code.
- (c) This cause of action relates to an actual fraudulent transfer under section 548(a)(1)(A) of the Bankruptcy Code.

### **QUESTION 3 [17] (essay-type questions) [15 marks in total]**

#### **Question 3.1 [18] [3 marks]**

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

A circumstance where a bankruptcy court may enter a final order consistent with the US Constitution, specifically under Article III has been formulated through the Supreme Courts revisions made to the 1978 Bankruptcy Code as they deemed those jurisdictional provisions to be unconstitutional. New jurisdictional provisions, such as the referral statute, created the distinction between “core” and “non-core” matters. In non-core proceedings, as per 28 U.S. code section 157(b)(c) a bankruptcy judge may hear a non-core proceeding and submit their proposed findings of fact and conclusions of law to the district court where a final order will be made. In this scenario, the district court takes the bankruptcy judges proposed findings and conclusion into account which may well be consistent with their own conclusion. When any final judgement shall be entered into by the district court, stakeholders have the right to protest for the courts final decision. In core proceedings, the US Supreme Court has determined that bankruptcy judges may determine a core proceeding over which they lack constitutional authority by issuing a report and recommendations for review by the district court to hand down final orders. [19]

In terms of the review of appeals from Bankruptcy court orders, these would be conducted by the district court for that district. Bankruptcy appeals are heard by a Bankruptcy Appellate Panel (BAP) [20]. From there, appeals are reviewed by circuit courts. When orders are not constitutionally final (meaning the parties have not consented to the Bankruptcy court's jurisdiction) De novo reviews are conducted.

#### **Question 3.2 [21] [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?

The provisions that may not be invoked by a foreign representative under a Chapter 15 proceeding are those which relate to domestic bankruptcy cases. For example in relation to avoidance powers [22], Chapter 15 expressly excludes the substantive powers that are usually given under the law of the US courts, for example the ability to avoid preferential or fraudulent

transfers. Foreign representatives are unable to use such powers and can only invoke the Bankruptcy Code avoidance powers in a plenary proceeding such as a separate Chapter 7 or Chapter 11 Trustee filing.<sup>[23]</sup> Additionally, unlike chapter 7 and chapter 11 proceedings, foreign representatives have no powers to take control of the entity, a right when can be provided under the domestic insolvency laws.

Upon recognition of a chapter 15 proceeding, the equivalent relief a foreign representative can seek would be dependent on the type of foreign proceeding, i.e. foreign main or foreign non-main, foreign main proceedings would be able to seek automatic relief provisions provided the proceedings are in the COMI of the debtor, whereas foreign non-main proceedings would be granted discretionary relief and the debtor merely needs to justify an establishment in this jurisdiction.

Equivalent relief can be by way of automatic relief extended to the foreign representative providing protection against assets located in the jurisdiction against creditors. In addition, relief can be granted through the authorization of discovery regarding the debtor's assets and affairs.

### Question 3.3<sup>[24]</sup> [4 marks]

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

In principle, bankruptcy proceedings are governed by the Federal Rules of Bankruptcy Procedure<sup>[25]</sup>, known as the Bankruptcy Rules. One should also review the Federal Rules of Civil Procedure,<sup>[26]</sup> specifically in relation to litigation of disputed issues in contested matters or adversary proceedings.

Furthermore, before filing it is recommended for one to familiarize themselves with the relevant forms required for filing and their requirements. These forms differ depending on the type of filing and the Chapters under the Bankruptcy Code they relate they relate to which are available on the United States Courts website. Categories include:

- (a) Bankruptcy Forms
- (b) Individual Debtors
- (c) Non-Individual Debtors
- (d) Means Test Forms
- (e) Appellate Forms
- (f) Meeting of Creditors Notices
- (g) Small Business Forms

Additionally, it is important to be aware of local rules of procedures<sup>[27]</sup> and judge issued personal practices<sup>[28]</sup> that are available on the Bankruptcy court website which may differ depending on the Bankruptcy court one is filing in. In addition to the modifications to deadlines and filing and responding to pleadings, local rule and practices cover the preferred working procedures of the judges.

### Question 3.4<sup>[29]</sup> [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 directors of Delaware corporations owe a fiducial duty of **loyalty [30]** to the corporation's best interests, including the decision to act or not to act on an independent basis with the main objective to ensure their actions are beneficial for the company and its stakeholders. They have a responsibility to ensure the board were properly informed of decisions and that they have acted in the company's best interests. In addition, another basic fiduciary duty is a duty of **care [31]** in educated, deliberate decision-making. These include the subsidiary duties of good faith oversight and disclosure.

It is noted that the director's duties are not owed to creditors and are only owed to the **corporation [32]** and its **shareholders [33]**. **When the company is experiencing financial difficulties potentially rendering the entity insolvent, the Delaware Supreme Court has ousted any requirement for the directors to act in the best interest or to provide assistance to the corporations creditors [34]** as supported by the decision in *North Am Catholic Educational Programming Foundation, Inc v Gheewalla, 930 A.2d 92, 103 (Del 2007)*. With the above in mind, there is not notion of wrongful trading or deepening insolvency see *Trenwick AM Litig Trust v Ernst & Yong, LLP 906 A.2d 168 (Del Ch 2006)*.

In conclusion, the duties of directors for Delaware corporations change minimally in relation to what they consist (Duty of Care, Duty of Loyalty and Duty of Good Faith) and to who they owe them to (the corporation and the shareholders), regardless of the determination of solvency. While the "Zone of Insolvency" can bring heightened scrutiny to directors, it is imperative the decisions being made are preformed carefully and logically in light of creditor pressures.

#### **QUESTION 4 [35] (fact-based application-type question) [15 marks in total]**

##### **Question 4.1 [36] [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?

As iWork is experiencing financial difficulties by way of being unable to meet their contractual obligations under their lease agreement through unpaid rent, they are likely to look to bankruptcy proceedings for assistance. As per the US Bankruptcy Code Section 362, Chapter 3, when an insolvency petition is filed an automatic stay comes into effect immediately to prevent creditors from trying to collect debts or starting/continuing legal proceedings. While a stay can offer protection to the debtor, in this case a stay can be subject to certain statutory exceptions, including eviction of a debtor-tenant from non-residential property where the lease has expired.

Additionally, protections can be afforded to the lessor through a *lift stay* or relief from stay motion.[37] Section 365 of the Bankruptcy Code on executory contracts and unexpired leases lays out the framework applicable for this situation and how provisions can work to protect the Lessor and the debtors at the same time. For example, upon filing the petition the tenant has 120 days to make up their mind on how to proceed[38]. These options are to assume the lease which provides security to the lessors as not only would they need to cure the unpaid rents, but they would also be required to fulfill their tenancy obligations going forwards.

Another option is to assume and assign the lease, depending on the lease agreement, the tenant could assign the lease to a third party and have them take over the tenancy, again returning rent to the lessor. Lastly, the tenant has the option to reject the lease, which means the tenant is in further violation of the lease agreement and need to leave the premise. This option provides protection for the lessor as they would also be able to possibly seek rejection damages pursuant to section 365 of the Bankruptcy Code[39].

#### **Question 4.2 [40][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.

Yes, an English scheme of arrangement can be granted recognition under US chapter 15. However, there are certain requirements which must be met, that I have laid out below.

An English scheme of arrangement can be characterized as a creditor approved and court sanctioned scheme and allows a company to restructure and reorganize its creditor's rights (in this case bond holders). The process for establishing an English scheme of arrangement requires a creditor approved plan which is submitted to the court. Initially a strategy is presented to different classes of creditors. For a plan to be approved a vote takes place, and at least 50% in number constituting 75% in value of each relevant class of creditor must vote on the scheme. Once approved by the court, it becomes binding on all creditors of each class.

Now the company has received a sanction order in relation to the scheme, it can apply to the US courts for chapter 15 recognition under section 1515 of the Bankruptcy Code as a foreign proceeding. In this case the foreign representative would be applying for recognition of foreign main proceedings due to the fact that the COMI is located in the UK[41]. The justification for this is the fact that English law-governed bonds are located in the UK which classifies it as the location of the primary assets. With the filing of the application for recognition comes automatic relief under section 1519 of the Bankruptcy Code. Once recognized, the foreign representative has the right to request further relief to facilitate the successful restructuring of the bonds.

### Question 4.3[42] [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?

If a chapter 11 petition was to be filed by speculation Inc, the main effect that this would have in relation to the DOJ investigation would be that the bankruptcy proceedings do not stop the investigations and does not protect the entity from potential criminal charges[43]. Additionally, the company may not be able to adequately defend itself against the investigations as their resources would be involved in the chapter 11 proceedings.

Regarding the broker declaring a default on the margin loan, a chapter 11 petition filing would halt all actions against the debtor under the automatic stay provisions provided upon filing.[44] This means the broker would no longer be able to enforce its debt. During this time the debtor can look to restructure the debt through negotiations with the broker or a potential repayment plan which could eventually result in the debtor avoiding liquidation.

Similar to the rights afforded to the debtor in relation to the broker looking to enforce its debt, upon the filing of a chapter 11 proceeding, an automatic stay will come into effect [45]which temporarily prevents the landlord from taking action against the debtor[46]. The debtor can use this time to reject the lease, assign the lease to a third party or assume the lease, cure any outstanding debt and renegotiate a new lease agreement.

Lastly, a chapter 11 petition filing would also benefit from the automatic stay provisions when dealing with any pending legal lawsuits such as the employment discriminations lawsuit.[47]The lawsuit would be paused and the former employee would be encouraged to file a proof of claim in the bankruptcy proceedings which would be dealt as part of the chapter 11 proceedings.

In conclusion, while the filing of a chapter 11 petition can provide the company some breathing space in relation to the enforcement from debts and pending civil and criminal investigations, the entity may have to stretch its resources in an attempt to deal with these facts and if successful negotiations and settlements are unable to be reached, the entity is at risk of entering into full blown liquidation.

**\* End of Assessment \***