

TOTAL = 33/50
66%



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.

Commented [FV3]: 1, correct

(e) None of the above (options (a) to (d)) satisfy the minimum requirement for presence in the United States.

Question 1.4

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

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

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

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

Commented [FV4]: 1, correct

(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.**

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?

Commented [FV6]: 1, correct

(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.*

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?

Commented [FV10]: 1, correct

- (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.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 (1 mark)

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

Setoff exists when there are at the same time debts between one entity to the other and vice versa. In the ordinary course of business, two claims could be annulled (setoff) if the amount is the same. If the amount differs, there would be only the outstanding balance in favor of one party.

In bankruptcy setting, the creditor has a claim towards a debtor and the debtor has a claim against this creditor. Usually in bankruptcy this is not permitted, as the creditor who would potentially invoke setoff would be better off in comparison to other creditors. This would entitle this creditor to be in a better position than other creditors, as it could invoke its full claim against the insolvent debtor, while the other creditors most likely will collect only a part of their claim, in accordance with their insolvency class conditions of payment.

Commented [FV11]: 1, correct

In USA the setoff in bankruptcy is not allowed if 1) the creditor claim was acquired post petition or 90 days before the petition, 2) if the creditors obligation to the debtor has arisen in the 90 days prior to the petition, when the debtor was insolvent, 3) the creditor improves its position in comparison to the situation that the setoff is performed 90 days prior to the petition, 4) the creditor claim is disallowed. There are, however, the exemptions from such rules.

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?

Debtor in possession - DIP is related not only to possibilities with a rescue of the insolvent debtor, but also with various costs which will occur during reorganization (Chapter 11). These costs involve the financing of an ordinary course of business, legal fees, accountants, tax advisors, appraisal of the value of the properties and similar. Therefore, it might be crucial that DIP secures further funding opportunities.

DIP financing may be secured by suppliers (later payment deadlines), new loans by financial institutions such as banks. One of the possibilities for new financing is a priming lien, which takes place usually where there are no other possibilities for obtaining new funds. The priming lien is approved by the court and it is senior or equal lien to lien that exist before the commencement of insolvency proceedings.

Question 2.3 [2 marks]

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

Automatic stay protects the debtor from individual actions of creditors - the enforcement against debtor's property, litigation for pre-petition claims, possession or control over the property, enforcing a lien, letters for collection of claims, setoff of pre-petition claims and claims of the debtor against such creditor.

Relief against the automatic stay may be decided by the court only after the hearing (on creditor's request, when the property is not secured enough if the petition was filed with the aim to delay collection of debts and in several other situations.

If the acts are taken contrary to the stay (in violation of the stay) these actions are void or voidable. A party in interest may try to lift the stay (asking to court to lift the stay) in order to make prior actions violating the stay in effect. If this is not achieved, the party which violated the stay can be sanctioned to pay the attorney fees and to perform actions which would annule the violation of the 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?

The class of creditors which will receive the full collection of their claims are deemed to accept the plan. Class is considered impaired if the creditor receives full payment with delay. However, if the creditor receives reimbursement for damages for the late payment it is considered unimpaired and thus does not need to accept the plan, while it is deemed that such class has accepted the plan.

Commented [FV12]: 1.5. Full credit not given because answer does not note that priming is not available unless prepetition secured creditors are adequately protected.

Commented [FV13]: 2, correct

Commented [FV14]: 1.5 Full credit not given because answer does not note that a class votes to accept a plan if at least a majority holding 2/3 in value vote in favor of the plan

The class which does not receive anything from the plan is deemed to reject the plan.

Only impaired class is permitted to vote on the plan.

It is necessary to have at least one impaired class (without counting the insiders) to accept the plan, while the other classes then can be subject to cramdown.

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?

*The preference of the creditor is deemed to exist in case the payment of the insolvent debtor is executed on account of antecedent debt (among other pre-requisites). For example, if there is an immediate exchange of values (sale of property and immediate receipt of the counter-value, this is not a voidable payment *per se*). However, if the new value is provided by such creditor, then this will not be deemed as a voidable preference of the creditor (defense against the argument that the payment was preference).*

(b) Which cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer?

Avoidance of preference can be made with success if the debtor was insolvent (one of preconditions). The burden of proof that the debtor was insolvent at the time of the transfer is on a debtor and its trustee. The debtor is presumed to be insolvent on the petition day and 90 days prior to the petition.

For the avoidance of fraudulent conveyances, one of the badges of fraudulent transfer is insolvency of the debtor at the time of the transfer.

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

For actual fraudulent conveyances it is necessary to prove that the debtor intended to hinder, delay defraud an entity to which the debtor became indebted.

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

Question 3.1 [3 marks]

Commented [FV15]: 3, correct

Commented [la16]: 10/15 marks

Commented [la17]: 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.

Bankruptcy courts jurisdiction in which they can enter a final order relates to core bankruptcy issues. Example of such core cases are administration of the bankruptcy estate, allowance of claims, orders regarding the obtaining of credit, orders for turn over of property, motions to terminate automatic stay (there is a non-exhaustive list (para 157 USC). However, even in core proceedings the US Supreme Court held a position that bankruptcy court cannot issue final order which would invade Article III jurisdiction (state law claim, in Stern v. Marshall case).

The final bankruptcy court orders may always be appealed and are reviewed by the district court, i.e. the same district where the bankruptcy court was in charge of the case. However, in some areas, there is a second instance Bankruptcy Appellate Panel who reviews the appeal, if the parties do not request that appeal is reviewed by the district court. There is also a possibility of further appeal to the circuit court of appeals.

Bankruptcy orders which are not final are those which are defined as interlocutory orders. They resolve only part of the issues stemming from the bankruptcy case. Such orders can be appealed only if the appellate court approves such possibility to lodge an appeal.

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?

The foreign representative does not have the right on avoidance actions which are provided by the Bankruptcy Code, which include the avoidance of preferences and fraudulent conveyances. However, a foreign representative is entitled to use other, non-bankruptcy avoidance powers related to pre-petition claims. This can be done on the basis of other non-bankruptcy US law or in accordance with the applicable foreign law.

Question 3.3 [4 marks]

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

In addition to bankruptcy rules from United States Code, Chapter 11, and case law, the following needs to be considered when preparing the filing: Federal Rules of Bankruptcy Procedure (Bankruptcy Rules) and Federal Rules of Civil Procedure, which are invoked by the Bankruptcy Rules. Moreover, a local set of rules is to be regarded, while each bankruptcy court has its own rules of procedure. Bankruptcy judges have

Commented [la18]: Specifically, the Bankruptcy Court can only enter a final order if the core proceeding is specific to the Bankruptcy Code, like a challenge to a petition, or the parties consent.

Commented [la19]: Non-final orders are treated by the reviewing court as a report and recommendation.

Commented [la20]: Correct, 1/2 mark

Commented [la21]: Correct, 1/2 mark

Commented [la22]: 2/3 marks

Commented [la23]: Correct, 1 mark

Commented [la24]: Correct, 1 mark; alternatively, the foreign representative can commence a plenary proceeding under chapter 7 or 11

Commented [la25]: 4/4 marks

Commented [la26]: Correct, 1 mark

Commented [la27]: Correct, 1 mark

Commented [la28]: Correct, 1 mark

their own practices, which are updated and can be found on bankruptcy court websites.

Commented [la29]: Correct, 1 mark

Question 3.4 [5 marks]

Commented [la30]: 3/5 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?

Fiduciary duties of directors are owed in Delaware to the company shareholders and to the corporation itself. These rules apply also in the vicinity of insolvency. Therefore, there is no shift in duties to whom they are owed when the debtor is in the zone of insolvency and duties are not owed to creditors.

Commented [la31]: The principal duties are loyalty and care.

Commented [la32]: Correct, 1 mark

Commented [la33]: Correct, 1 mark

Commented [la34]: Correct, 1 mark

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

Commented [la35]: 6/15 marks

Question 4.1 [5 marks]

Commented [la36]: 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?

Insolvent Tenant may decide to assume or to reject the executory contracts and unexpired lease. However, during the time that such decision takes place, the tenant is obliged to make timely payments to the Landlord. In addition, if the Tenant decides to assume the contract, it needs to compensate the damages to the Landlord, i.e. to put the Landlord into the position in which it would have been if the insolvency did not occur (provision of cure or adequate assurance including the assurance that its future obligations will be performed).

Commented [la37]: The debtor has a 120 day deadline (in chapter 11) which may be extended by a maximum of 90 days for cause. Any further extensions require landlord consent.

Commented [la38]: Correct, 1 mark; the landlord also has an unsecured claim for unpaid pre-petition rent and, if the debtor assumes and then rejects the lease, the landlord has an administrative priority claim for 2 years' rent.

Question 4.2 [5 marks]

Commented [la39]: 2/5 marks

Skin Luxe is incorporated and has a principal place of business in France where it develops and manufactures high end skincare products. Skin Luxe sells its skin care products through its own boutiques in many international cities, including Paris, Las Vegas, London and Hong Kong. Skin Luxe's English law-governed bonds are due to mature in one year, but it is unable to repay or refinance them. Skin Luxe is considering using an English scheme of arrangement to restructure the bonds.

Discuss whether the English scheme of arrangement could be granted recognition under US chapter 15 as a foreign main or foreign non-main proceeding.

Skin Luxe has its principal place of business in France, which means this would be considered as its COMI. English Schemes of Arrangement can be recognized in the USA as the collective proceedings (judicial or administrative in nature), it regulates the

Commented [la40]: Correct, 1 mark; also France is assumed to be the COMI on the basis of incorporation.

adjustment of debt or insolvency, assets and affairs are subject to control or supervision, and they have the purpose of reorganization. Having in mind that the debtor's COMI is France, such proceedings (schemes of arrangement) will be recognized as non-main foreign insolvency proceedings.

Commented [la41]: Correct, 1 mark, because only the jurisdiction of the COMI can be a foreign main proceeding and the boutique in London constitutes the establishment required for foreign non-main proceedings.

Question 4.3 [5 marks]

Commented [la42]: 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?

Chapter 11 petition would have the following consequences:

- (i) **DOJ investigation - petition would not have stay effect on investigation. This is one of the statutory exceptions to the automatic stay;**
- (ii) **Margin loan default - it will be covered under the automatic stay; therefore, the broker will be treated as other similar creditors in respective creditor class. The margin loan default does not amount to swap agreement, to financial repo agreement or commodity, forward or security contract;**
- (iii) **Delinquent lease - the claim which amounts to prepetition period will fall under respective creditor class, but the unpaid lease in the post-petition period will be administrative expense if the debtor continues to occupy the premises;**
- (iv) **Employment discrimination lawsuit - if it has been commenced prepetition, it cannot be continued, as the automatic stay includes the stay on litigation proceedings.**

Commented [la43]: Correct, 1 mark

Commented [la44]: Incorrect, a margin loan is a securities contract exempt from the automatic stay.

Commented [la45]: The automatic stay that comes into effect on the filing of the petition bars the landlord from pursuing eviction proceedings on account of the unpaid rent.

Commented [la46]: Correct, 1 mark

* End of Assessment *