

TOTAL = 38.5/50
77%



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.

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 [FV1]: 0, correct answer is C

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

Commented [FV2]: 1, correct

(e) A non-profit organization that advocates for companies like Car Corp to be held responsible for climate change

Question 1.3

Which of the following entities does not satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

(a) A foreign domiciled company that pays a US attorney a retainer.

(b) A company with several US bank accounts, but no physical presence in the United States.

(c) A company with US patents, but no physical presence in the United States.

(d) Options (a) to (c) above satisfy the minimum requirement for presence in the United States.

Commented [FV3]: 1, correct

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

Question 1.4

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

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

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

Commented [FV4]: 1, correct

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

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

(e) All of the above.

Question 1.5

Which of the following regarding executory contracts is false?

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

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

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

Commented [FV5]: 1, correct

(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.

Commented [FV6]: 1, correct

(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]: 1, correct

Question 1.9

Which of the following about 363 sales is false?

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

Commented [FV9]: 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?

Setoff allows a creditor with a claim against a debtor and simultaneously owing money to the debtor to net off the two (or more) obligations.

Commented [FV11]: 1, correct

In many circumstances setoff is not permitted because setoff rights can improve the position of a creditor compared to other unsecured creditors who are not owed money by the debtor.

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?

In certain circumstances the court may grant a priming lien to secure post-petition financing - a lien senior or equal to a pre-petition liens on estate property.

Commented [FV12]: 1.5. Full credit not given because answer did not use the term adequately protected, which is defined in the Bankruptcy Code.

The debtor must demonstrate that it cannot obtain DIP financing by any other means and that the interest of the secured creditor being primed is sufficiently protected.

Question 2.3 [2 marks]

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

A violation of the automatic stay, without obtaining relief, constitutes contempt of court and is void or voidable.

This can result in the contempt sanctions being imposed against the violator, which can include:

- (i) Payment of the debtors' attorneys' fees;*
- (ii) Requiring the violator to take affirmative acts to undo the effect of its violation; and*
- (iii) Daily fines to be paid to the court until the stay violation has been rectified.*

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?

In voting on a plan of reorganization:

- (i) The unimpaired class of creditors are deemed to accept the plan;*
- (ii) The class of creditors that will receive nothing is deemed to reject the plan; and*
- (iii) Only the impaired classes of creditors are permitted to vote on the plan.*

A given class of creditors accepts a plan if a simple majority of the creditors in the class, holding at least two-thirds of the value of claims in the class, vote in favour. Or, for equity interests, if two-thirds in amount of interests vote in favour.

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) Constructive fraudulent conveyance*
- (b) Preference*
- (c) Actual fraudulent conveyance*

Commented [FV13]: 2, correct

Commented [FV14]: 2, correct

Commented [FV15]: 2, the correct answer for a is also preference.

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

Commented [la16]: 11/15 marks

Question 3.1 [3 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 judges have limited jurisdiction to enter **final orders** other than on core bankruptcy issues.*

Commented [la18]: Specifically, the Bankruptcy Court can enter a final judgment in a core proceeding that is exclusive to the Bankruptcy Code (e.g., a challenge to a petition) or where the parties consent.

Section 157 of the US Bankruptcy Code provides guidance on the types of matters that bankruptcy courts have authority to hear and determine. It distinguishes between "core" and "non-core" proceedings. Core proceedings are considered those central to the bankruptcy case. Non-core proceedings are matters related to, but not limited to, a bankruptcy case.

*Generally, appeals from bankruptcy court orders are heard by the **district court** for the district in which they sit. In certain circuits, bankruptcy appeals are heard by a **Bankruptcy Appellate Panel**, convened from the judges of the bankruptcy courts within the circuit.*

Commented [la19]: Correct, 1/2 mark

Commented [la20]: Correct, 1/2 mark

*Orders that are not constitutionally final in bankruptcy proceedings are reviewed by **district courts**.*

Commented [la21]: The non-final orders are reviewed as a report and recommendation.

Question 3.2 [3 marks]

Commented [la22]: 2/3 marks

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

*Chapter 15 excludes from the rights granted to foreign representatives the use of **avoidance powers** provided by the Bankruptcy Code.*

Commented [la23]: Correct, 1 mark

A foreign representative can only invoke the Bankruptcy Code avoidance powers in proceedings such as:

(i) **Chapter 7; or**

(ii) **Chapter 11.**

Commented [la24]: Correct, 1 mark; alternatively the foreign representative can pursue equivalent claims under US or foreign law

A way in which a foreign representative can obtain equivalent relief is to commence plenary proceedings under the Bankruptcy Code (such as chapters 7 or 11) after recognition of the foreign proceeding under chapter 15 to obtain avoidance powers.

Question 3.3 [4 marks]

Commented [la25]: 4/4 marks

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

The following rules should be reviewed when preparing a filing for a bankruptcy court:

- (i) the Bankruptcy Rules;
- (ii) the Federal Rules of Civil Procedure;
- (iii) the local rules of the bankruptcy court; and
- (iv) the judge's personal practices.

Commented [la26]: Correct, 1 mark

Commented [la27]: Correct, 1 mark

Commented [la28]: Correct, 1 mark

Commented [la29]: Correct, 1 mark

Consultation with local practitioners is advised for those not familiar with practicing in the jurisdiction, as there may be certain unwritten local practices.

Question 3.4 [5 marks]

Commented [la30]: 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?

In the ordinary course of business, directors have a fiduciary duty to act in the best interests of the corporation and a duty of care in educated decision-making. Directors are protected from liability for errors of judgment by the business judgment rule.

Commented [la31]: Correct, 1 mark

Commented [la32]: Correct, 1 mark

If an entity is potentially or actually insolvent, directors of Delaware corporations owe duties to the corporation and its shareholders, not to creditors - is even these circumstances where the shareholders stand to receive nothing in a bankruptcy scenario.

Commented [la33]: Correct, 1 mark

Commented [la34]: Correct, 1 mark

Commented [la35]: Correct, 1 mark

Specifically, the Delaware Supreme Court deem that directors owe duties to creditors when a company is close to insolvency or actually insolvent. Under US law there is no equivalent concept of "wrongful trading".

Commented [la36]: I think you may have used the wrong word because this suggests the Supreme Court found that they do owe duties to the creditors.

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

Commented [la37]: 10/15 marks

Question 4.1 [5 marks]

Commented [la38]: 2/5 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?

iWork Ltd has failed to pay rent on some of its office space leases.

First, we should consider whether these constitute "unexpired leases". Section 365 of the US Bankruptcy Code provides guidance on unexpired leases and executory contracts - "unexpired lease" means a lease to which the debtor is a party to which performance remains due to some extent on both sides."

Performance remains due from iWork Ltd (the lessee) in that it has not paid rent. Assuming that there is still time remaining on the lease (i.e., a performance remaining from the lessor), the leases are unexpired leases.

Given these are office buildings, we can assume that these are non-residential real property - an important distinction in the US Bankruptcy Code.

We have not been told if there are proceedings on foot, but if there are:

- (i) In a chapter 7 case, the trustee must make decisions about assumption and assignment or rejection of the unexpired leases within 60 days of the petition date. Given Chapter 7 cases are to liquidate, the leases will likely be rejected.
- (ii) In a chapter 11 case the debtor has 120 days from the date of the bankruptcy filing to make decisions about assumption and assignment or rejection of the unexpired leases of non-residential real property. While this period can be extended by the court for cause, any subsequent extension requires the consent of the lessor, giving landlords of commercial premises substantial leverage.

Section 363 of the Bankruptcy Code also entitles lessors to adequate protection. If iWork Ltd sought to continue to use or sell the leased property during the bankruptcy case, the lessors are entitled to adequate protection - ensuring that the lessor's interests are safeguarded.

A worldwide automatic stay comes into effect immediately on the filing of any plenary petition. The automatic stay may be lifted on creditor (e.g., lessor) request to permit otherwise prohibited creditor actions in certain circumstances.

Question 4.2 [5 marks]

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

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

When foreign proceedings are opened in the jurisdiction of a debtor's COMI, these are referred to as "foreign main proceedings".

Commented [la39]: The debtor must pay post-petition rent as an administrative priority until it rejects the lease, the landlord has an unsecured claim for pre-petition unpaid rent, and if the debtor assumes and then rejects the lease, the landlord has an administrative priority claim for 2 years' rent.

Commented [la40]: Correct, 1 mark

Commented [la41]: Correct, 1 mark

Commented [la42]: 5/5 marks

Commented [la43]: Correct, 1 mark

When foreign proceedings are opened in the jurisdiction that is not the debtor's COMI but is a jurisdiction that the debtor has an establishment (a place where a debtor carries out a non-transitory economic activity) in, these are referred to as "foreign non-main proceeding".

Commented [la44]: Correct, 1 mark

We must assess whether England is Skin Luxe's COMI or whether Skin Luxe only has an establishment in England.

Based on the limited information available, I consider that COMI is most likely in France due to this being the location of:

- (i) Its "principal place of business" - likely where its headquarters and management are;
- (ii) Where it develops and manufactures its products, implying this is where intellectual property and PPE are; and
- (iii) Its incorporation - likely where the registered office and books and records are situated.

Commented [la45]: Correct, 1 mark

Commented [la46]: Correct, 1 mark, correct, this gives rise to a presumption of COMI

It should be noted however that there are possible indicators that COMI is in England. Its bonds are English law-governed indicating that England is the location where financing was organized. It also operates a boutique out of London. I would however consider that the locations of the boutiques more closely meet the definition of an establishment.

Commented [la47]: Correct, 1 mark

If we assume that Skin Luxe has an establishment in England, then the recognition proceedings in the US would be foreign non-main proceedings. Post recognition relief will only be granted to foreign representatives in foreign non-main proceedings under Article 21 if the proceedings do not interfere with the administration of another insolvency proceeding, in particular foreign main proceedings.

If we assume that COMI is in England, then the recognition proceedings in the US would be foreign main proceedings. The US has adopted the Model Law and therefore assuming that certain requirements are met, the recognition application will be granted.

Question 4.3 [5 marks]

Commented [la48]: 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?

- (i) **A worldwide automatic stay would come into effect immediately on filing the Chapter 11 petition. However, the stay is subject to certain exceptions including regulatory investigations and criminal proceedings. If the DOJ uncovered evidence of criminal activity, criminal proceedings could commence as this would be a statutory exemption to the stay.**
- (ii) **The automatic stay will give Speculation Inc breathing space to continue operating and work with the broker (and other creditors) to propose a plan of reorganization to adjust its debts.**
- (iii) **Speculation Inc has 120 days from the date of the bankruptcy filing to make decisions about assumption and assignment or rejection of the delinquent / unexpired lease of non-residential real property. While this period can be extended by the court for cause, any subsequent extension requires the consent of the lessor, giving landlords of commercial premises substantial leverage.**
- (iv) **The worldwide stay would apply to the employment discrimination lawsuit if it is a civil case.**

Commented [la49]: Correct, 1 mark

Commented [la50]: Correct, 1 mark

Commented [la51]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay so the broker can sell the shares even after the petition is filed.

Commented [la52]: The filing of the petition will prevent the landlord from seeking to evict Speculation Inc. on account of unpaid rent

Commented [la53]: Correct, 1 mark

*** End of Assessment ***