

TOTAL = 34.5/50
69%



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. [FV1]**
- (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. |**

[FV2]

- (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?

- (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.** |
- [FV5]
(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.* |
- [FV6]
(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? [FV7]

- (a) **A pre-pack cannot be used if the debtor wishes to reject executory contracts.**
- (b) *Creditors must have sufficient information about the debtor and the plan to make an informed voting decision.*
- (c) *A pre-pack debtor may spend as little as a single day in bankruptcy.*
- (d) *The proposed plan of reorganization is submitted to the bankruptcy court together with the voluntary petition.*
- (e) *Creditors' commitment to vote in favor of the plan may be memorialized in a restructuring support agreement.*

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.*** [FV8]
- (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.*** |
- [FV9] ***(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 valid objection to substantive consolidation.**
- [FV10] (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 enables a creditor holding a claim against the debtor and, at the same time, owing money to the debtor to net out the multiple obligations.¹ Given that setoff rights may improve [FV11] the creditor's position as compared to other unsecured creditors, setoff is not allowed in a number of circumstances.²

Question 2.2 [2 marks]

What is a "priming lien" and what requirements must be met for such a lien to be granted to secure DIP financing?

A priming lien is a court-granted lien that is equal or senior to a pre-petition lien on estate property, and it is granted in order to secure post-petition financing.³ The requirements for a priming lien are that financing cannot be obtained via any other terms and that the debtor [FV12] has demonstrated that there is adequate protection for the interest of the secured creditor which is being primed.⁴

Question 2.3 [2 marks]

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

¹ Module 3A Guidance Text, p 59.

² Ibid

³ Ibid, p 30.

⁴ Ibid.

Contempt sanctions could be imposed against the violator, including (and not limited to), paying the fees of the debtor's attorneys.⁵ Furthermore, the violator may be required to take [FV13] affirmative actions to undo the result of its violation.⁶

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 is deemed to accept the plan.**
- (ii) A class that will receive nothing is deemed to reject the plan.**
- (iii) Only impaired classes may vote on the plan.**

If there is a simple majority of creditors in a class that vote in favour of the plan then that [FV14] class of creditors accepts the plan, the majority of creditors, however, must hold a minimum of two thirds of the value of the claims in the class (or, in the context of equity interests, if two-thirds in amount of interests vote in favour).⁷

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?**

A preference claim.⁸

- (b) Which cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer? [FV15]**

A constructive fraudulent conveyance claim.⁹

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

An actual fraudulent Conveyance claim.¹⁰

⁵ Ibid, 26.

⁶ Ibid.

⁷ Ibid, 40.

⁸ Ibid, 51-52.

⁹ Ibid, 58.

¹⁰ Ibid, 57

QUESTION 3 [1a16] (essay-type questions) [15 marks in total]

Question 3.1 [1a17] [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 final order under the Constitution [1a18] *is one that disposes of all issues, with nothing left to be decided, in contrast to an interlocutory order, which resolves only some of the issues.*¹¹ *The distinction is relevant in that *inter alia* a final order may be appealed as of right, in contrast to an interlocutory order, which may only be appealed with the leave of the appellate court.*¹² *The same legal position applies in bankruptcy, save that orders which extend the period of exclusivity for proposing a plan are also appealable as of right.*¹³ *Moreover, as per *Bullard v Blue Hills Bank*, 135 S Ct 1686 (2015), and acknowledging that bankruptcy proceedings involve “an aggregation of individual controversies,” the US Supreme Court has decided that a bankruptcy order resolving a discrete dispute is, for appeals purposes, a final order.*¹⁴

An order that is constitutionally final, on the basis that the bankruptcy court had authority to enter it, will not be, for the purpose of an appeal, final if the order did not resolve all of the issue in dispute, whereas an order resolving all of a dispute (which, thus, would be final for appeals purposes), may not be final, constitutionally speaking, if the parties did not give their consent to the jurisdiction of the bankruptcy court.¹⁵

Generally speaking, appeals from decisions of the bankruptcy court are heard by the district court [1a19] *for the same district in which the bankruptcy court sits, albeit that in certain circuits such appeals are heard by a Bankruptcy Appellate Panel* [1a20] *(BAP), comprised of judges of the bankruptcy courts within the circuit.*¹⁶ *In turn, a further right of appeal exists (if the initial order was appealable as of right) to the circuit court of appeals.*

Question 3.2 [1a21] [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?

¹¹ Ibid, 19.

¹² Ibid.

¹³ Ibid 20.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.

A foreign representative is not entitled to use the avoidance powers^[1a22] of the bankruptcy code, as per US Title 11, Chapter 15, § 1521(a)(7): *“Upon recognition of a foreign proceeding... the court may, at the request of the foreign representative, grant any appropriate relief, including... granting any additional relief that may be available to a trustee, except for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a)”* (emphasis added).

Two means for obtaining equivalent relief are for the foreign representative (FR) to do so via a plenary proceeding^[1a23] in the event that:

1. The proceeding was already commenced by the creditor(s) or debtor, prior to the FR’s recognition; or
2. FR commences the plenary proceeding after the Chapter 15 recognition.¹⁷

Question 3.3^[1a24] [4 marks]

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

- Most obviously, the Bankruptcy Rules^[1a25];
- Federal Rules of Civil Procedure^[1a26];
- Any local rules of the bankruptcy court^[1a27]; and
- The judge’s personal practices^[1a28].¹⁸

Question 3.4^[1a29] [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 of Delaware corporations owe fiduciary duties to their corporation^[1a30] and its shareholders^[1a31], consisting of the duty of loyalty^[1a32] to the best interests of the corporation and a duty of care^[1a33] in respect of educated decision-making.¹⁹ Such duties remain during insolvency, but are not owed to creditors^[1a34]. As per the ruling of the Supreme Court of Delaware in *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...”.²⁰

QUESTION 4^[1a35] (fact-based application-type question) [15 marks in total]

¹⁷ Ibid, 66.

¹⁸ Ibid 7-8, 73.

¹⁹ Ibid, p 60.

²⁰ Ibid.

Question 4.1 [1a36] [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?

- ***There is a general, worldwide automatic stay,²¹ that would prevent the landlord from evicting iWork Ltd, unless the lease between iWork and the landlord has already expired;²²***
- ***In the event that the lease is unexpired, and obligations are still owed by iWork Ltd and the landlord to each other etc, such that the lease is an executory contract, and in the context of a Chapter 7 case, iWork can Reject, Assume or 'Assume and Assign' the lease;***
- ***iWork's decision (on assumption, assignment or rejection) about the unexpired lease (which is obviously non-residential property) can be made within 120 days of the order for final relief, rather than within 60 days of the petition date^{1a37};²³***
- ***The election decision regarding the lease is also insulated with significant legal tests for challenge, i.e. the Court can only interfere with the decision if it is not a reasonable exercise of business judgment or was not made in good faith;²⁴***
- ***The Bankruptcy Code also provides protection in that assignment can take place despite any contractual restriction on assignment;²⁵ and***
- ***Similarly, ipso facto clauses are nullified.²⁶***

Question 4.2 [1a38] [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.

²¹ Ibid, 8.

²² Ibid, 23.

²³ Ibid 31.

²⁴ Ibid.

²⁵ Ibid 32.

²⁶ Ibid 33.

Yes. A foreign representative would need to lodge a petition for recognition of the scheme of arrangement (SOA) as a foreign proceeding under Chapter 15. Whether the SOA is recognised as a foreign non-main proceeding (FNMP) or foreign main proceeding (FMP) is contingent upon whether the US Court determines the centre of most interest (COMI) to be in England or elsewhere (a FMP is where the COMI is located: 11 USC, § 1517(b)(1)). As per 11 USC, § 1516(c), the COMI is presumed to be located at the place of the debtor's incorporation^[la39], such that, on the facts, the SOA would be *presumed not* to be a FMP, given that France is the place of Skin Luxe's incorporation and principal place of business. That being said, the presumption is rebuttable, and one could argue that because the bonds are English-law governed the COMI is in England^[la40], such that the SOA is in fact a FMP.²⁷ In any event, the SOA could be a FNMP given that Skin Luxe has its own boutique in England, which is most likely an establishment^[la41] (11 USC, § 1517(b)(2)), given that a boutique selling products is plainly a "place of operations where the debtor carries out a non-transitory economic activity" (11 USC, § 1502(2)). The place of establishment would thus enable recognition of the SOA as a FNMP: § 1517(b)(2).

Question 4.3^[la42] [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) Chapter 11 proceedings would not affect the DOJ investigation, given that an exception to the general stay includes regulatory investigations.^[la43]²⁸**
- (ii) ^[la44]**
- (iii) The automatic stay would apply to stop the landlord taking affirmative steps in respect of the lease, i.e. repossessing the property (provided the lease has not yet expired)^[la45].²⁹**
- (iv) The employment litigation would be caught by the general stay.^[la46]**

*** End of Assessment ***

²⁷ See Ibid, p 63, footnote 202, i.e. *In re SPhinx, Ltd*, 351 BR 103, 117 (Bankr SDNY 2006)

²⁸ Ibid, 23

²⁹ Ibid, 22-23.