

TOTAL = 39/50
78%



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. [FV2]**
- (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.**
- (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.**^[FV3]

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**^[FV4] **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.* [FV5]

(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?

(a) A pre-pack cannot be used if the debtor wishes to reject executory contracts. [FV7]

(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 ^[FV8] 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.**
- (b) The debtor-in-possession must establish that the transaction is in the best interests of the estate as a whole. ^[FV9]**
- (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 permits a creditor holding a claim against the debtor and simultaneously owing money to the debtor to net out the two (or more) obligations.

Setoff rights are not always permitted because setoff rights can improve the position of the creditor as compared to other unsecured creditors who are not owed money by the debtor^[FV11] because it decreases its obligations to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the unsecured claim.

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 lien granted by a court that is senior or equal to a pre-petition lien on estate property to secure post-petition financing. In order to be granted, the debtor must demonstrate that financing cannot be obtained on any other terms (i.e. DIP financing **will**^[FV12] only be advanced with priming lien and there are no other options) and that the interest of the secured creditors being primed is adequately protected.*

Question 2.3 [2 marks]

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

An act taken in violation of the automatic stay (even if taken without notice of the filing of the petition) constitutes contempt of court and is void or voidable (depending on the circuit in which the bankruptcy is pending due to a circuit split on the issue).

Imposition of contempt sanctions against the stay violator may (i) include payment of the [FV13] debtors' attorneys' fees, (ii) require the violator to take affirmative acts to undo the effect of its violation and (iii) imposition of a fine (which where the court is concerned that the violator may not act promptly, might include a daily fine to be paid inot the court until the relevant 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 reorganisation:

[FV14]

(i) an unimpaired class (including one whose acceleration of debt has been reversed) is deemed to accept the plan;

(ii) a class that will receive nothing is deemed to reject the plan; and

(iii) an impaired designated class of creditors is permitted to vote on the plan. A class is impaired unless, as to every claim or interest in the class, the plan leaves the holder's "legal, equitable, and contractual rights unaltered".

A given class of creditors approves 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 of the plan (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? [FV15]

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

(a) A preference claim

(b) A preference claim, an actual fraudulent conveyances and constructive fraudulent conveyances.

(c) An actual fraudulent conveyances.

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.

The Bankruptcy Court has limited jurisdiction to enter final orders other than if they are sufficiently related to "core" bankruptcy issues/proceedings [1a18]. *Section 157 of 28 USC contains a non-exhaustive list of what might constitute a core proceedings. Some examples listed are - (A) matters concerning the administration of the estate, (H) proceedings to determine, avoid or recover preferences, (I) determinations as to the discharge ability of particular debts, (L) confirmations of plans. The Bankruptcy Court may only hear non-core proceedings if they are sufficiently related to bankruptcy proceedings but it cannot make a final determination in respect of those).*

In general, appeals from Bankruptcy Court decisions are heard by the district court [1a19] *for the district in which they sit. In certain circuits bankruptcy appeals are heard by a Bankruptcy Appellate Panel* [1a20], *convened from the judges of the bankruptcy Court within the circuit. In those circuits, a party has the option to request that the appeal be heard by the district court instead.*

If the ruling was a non-core proceeding (i.e. not constitutionally final) or the bankruptcy court otherwise did not have authority to enter a final order, the district court or BAP reviews de novo (i.e. reviewing a decision of another court anew) all findings of fact and conclusions of law to which a party has objected. [1a21] *The order of a district court or BAP is reviewed by a circuit court of appeal de novo as to conclusions of law and for abuse of discretion for finding of fact.*

Question 3.2 [1a22] [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?

A foreign representative in chapter 15 may not use avoidance powers [1a23] *provided by the Bankruptcy Court (ss 1521(a)(7) ch 11 USC).*

Equivalent relief would require the debtor commencing proceedings under chapter 7 or chapter 11 prior to involvement of the foreign representative.

Alternatively, the foreign representative can commence plenary proceedings under the Bankruptcy Code after ch 15 recognition. However, in such circumstances, the scope will be limited to the debtor's US assets and will be coordinated with the foreign proceeding.

Question 3.3 [4 marks]

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

One should review:

- *the Federal rules of Bankruptcy Rules - these govern the bankruptcy proceedings;*
- *the Federal rules of Civil Procedure - these relate to litigation of disputed issues in contested matters;*
- *the local rules of procedure of the relevant Bankruptcy Court, and*
- *the relevant Judge's personal practices - these are available on the website of the relevant Bankruptcy Court.*

Question 3.4 [5 marks]

What fiduciary duties do directors of Delaware corporations owe and to whom are the duties owed in the ordinary course of business? To whom are duties owed when the corporation is potentially or actually insolvent?

Directors of Delaware corporations (which is the pre-eminent US jurisdiction for corporate law) owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care in educated decision-making, but are protected from liability for errors of judgment by the business judgment rule. Under this rule, the board of directors is presumed (rebuttable) to have acted in good faith on the basis of reasonable information. This can be rebutted only if the majority of the board in fact were not reasonably informed or did not honestly believe that their decision was in the corporations best interest or were not acting in good faith.

Directors owe their duties to the corporation and its shareholders, not to creditors. This does not change in circumstances where a corporation is potentially insolvent.

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

Question 4.1 [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?

If iWork files for either chapter 11 or chapter 7, the lessor of office space may have the following protections under the Bankruptcy Code:

*(1) The rent on the leased office spaces should continue to be payable if iWork continues to occupy these as an administrative expense and thereby as a priority of payment^[1a38]. This may depend on circumstances, as held in the *In re Pier 1 Imports Inc* judgment*

(2) If the leases are deemed executory contracts, the lessor may still be protected from iWork rejecting the leases if iWork continues to occupy the lessors' office space. In such circumstances, it may be deemed that iWork has assumed the contract under the proceedings, even if it later purports to reject the lease^[1a39].

(3) The automatic stay may be lifted for the office space if the lessors requests this. In such circumstance, the lessor would seek to argue that it has faced a lack of adequate protectoin^[1a40] of its interest in the property and would need to prove that the value of the office spaces may decline during the course of proceedings, resulting in the lessor making less than full recovery.

(4) iWork may also be evicted from the office spaces (as non-residential property) if the lease expires. This would be permitted as an exception to the automatic stay.

Question 4.2 ^[1a41] [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.

In order to be recognised as either a foreign main or foreign non-main proceedings under chapter 15, the foreign representative must establish that:

(1) it is empowered to act by the proceeding. In this case, the foreign representative of Skin Luxe would need to show that it is empowered to act by the English Court following sanctioning of the Scheme;

(2) the scheme of arrangement would fall within the scope of 'foreign proceedings' as defined under the Bankruptcy Code, specifically as a "collective judicial or administrative proceeding in a foreign country...under the law relating to insolvency

or adjustment of debt in which proceeding of the asset and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation". It is well established that an English scheme of arrangement would meet this criteria, and on the facts, it can be argued that the Scheme is for the purpose of "adjustment of debt"; and

(3) the proceedings would not need to be manifestly contrary to US public policy. In practice, this would be rarely applicable, and unlikely to be relevant in this scenarios, based on the facts.

On the basis of the above, it is likely that SL's scheme would be granted recognition under chapter 15.

The next question would be whether this would be construed as a foreign main proceeding (receive among other things, automatic recognition) or a foreign non-main proceeding. The determination would be based on whether it can be established that Skin Luxe's COMI is in England.

A debtor's COMI is presumed to be its place of incorporation (in this case France), but this is rebuttable.^[1a42] There would need to be further evidence provided including where Skin Luxe is headquartered, where management is located^[1a43], where SL's primary assets are located and location of majority of SL's creditors. Given the bonds are English law governed and SL operates in (and possibly has assets in), among other cities, London, there may be an argument that COMI is in England. If that can be proven, SL's scheme would be granted recognition as a foreign main proceeding.

If COMI cannot be established in the UK, then recognition may still be granted as a foreign non-main proceeding^[1a44] but the scope of reliefs thereunder would be more limited. If automatic relief will be required (e.g. there are opposing creditors in the US), the foreign representative may seek to take steps to shift the principal place of business of the debtor to England.

Question 4.3^[1a45] [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) DOJ investigation - if Speculation Inc (SI) was successfully granted a chapter 11 proceeding, an automatic stay would be enforceable from the date of the petition^[1a46]. However, the DOJ investigation (being a regulatory investigation) would likely qualify as a statutory exception to the automatic stay^[1a47]. As such, the chapter 11 proceedings would have no effect on the DOJ investigation.

(ii) The Margin Loan would likely be considered a securities contract, which also qualifies as a statutory exception to the effects of the automatic stay.^[1a48] As such, the chapter 11 proceedings would not have an effect on the default and the Margin Loan lenders could accelerate subject to their contract.

(iii) The leaseholder might be able to continue to receive rent under the lease as an administrative expense if SI continues to occupy the office space. The automatic stay will however prevent the leaseholder from appropriating the space, unless the lease has expired or the lessor can successfully request a lift of the stay on the basis of lack of adequate protection.^[1a49] If SI continues to occupy the premises, the lease may be deemed assumed as part of the proceedings.

(iv) The employee's litigation would be classed as a pre-petition claim and therefore the would be covered by the automatic stay^[1a50].

*** End of Assessment ***