

TOTAL = 42/50  
84%



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.** [FV1]
- (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.** [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<sup>[FV3]</sup> 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<sup>[FV4]</sup> 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.*
- (b) *Acceptance of the plan by at least one class of impaired, non-insider creditors.* [FV6]
- (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.**
- (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.*
- [FV7] (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.*** [FV8]
- (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.***
- (c) In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale.*** [FV9]
- (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.**
- (c) It is the treatment of two or more creditors as a single creditor to simplify the claims<sub>[FV10]</sub> 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 is a legal mechanism that allows a creditor holding a claim against a debtor and simultaneously owing money to that debtor to net out the relevant obligations.*

*Setoff rights are not permitted in a number of circumstances as they can improve the<sub>[FV11]</sub> position of the relevant creditor as compared to the 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?**

*A “priming lien” is a lien granted by the court that is senior or equal to a pre-petition lien on estate property. It is provided to secure post-petition financing.*

*For a priming lien to be granted, (i) it must be clear that the underlying DIP financing could not have been obtained on any other terms; and (ii) the debtor must demonstrate that the<sub>[FV12]</sub> interest of the secured creditor being primed is adequately protected.*

Question 2.3 [2 marks]

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

*Violation of an automatic stay may result in:*

- *The imposition of contempt sanctions against the stay violator, which may include payment of the debtors' attorneys' fees and requiring the violator to take affirmative acts to undo the effect of its violation; and/or*
- *Where the court is concerned that the violator may not act promptly, the imposition of coercive contempt sanctions, which could include a daily fine to be paid into the court until the relevant violation has been rectified.* [FV13]

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:*

- *An unimpaired class is deemed to accept the plan; and*
- *A class that will receive nothing is deemed to reject the plan.*

*Each designated class of creditors is permitted to vote on the plan.* [FV14]

*A given class of creditors approves the plan if a simple majority of the creditors in that class, holding at least 66.66% of the value of claims in the class, vote in favour of the plan (or for equity interests, if more than 66.6% in the 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?***

*A preference claim.*

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

*A preference claim.* [FV15]

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



*An actual fraudulent conveyance.*

**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 may enter a final order consistent with the US Constitution (and in particular Article III jurisdiction) by either issuing a report and recommendation for review and sanction by the district court [1a18], or with the consent of the relevant parties [1a19].*

*Generally, appeals from the bankruptcy court's decisions are heard by the district court [1a20] for the district in which they sit. In certain circuits, they are heard by a Bankruptcy Appellate Panel (BAP) [1a21]. There are then potential further appeal rights to the circuit court of appeals.*

*If the order is not constitutionally final, the district court or BAP reviews *de novo* all finding of fact and conclusions of law to which a party has objected.*

**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?**

*Avoidance powers [1a23] provided by the Bankruptcy Code cannot generally be invoked by a foreign representative in a Chapter 15 proceeding.*

*One way for such foreign representative to access such powers is by commencing plenary proceedings (e.g. chapter 7 or 11). Avoidance powers under the Bankruptcy Code will then be available in respect of actions relating to the debtor's US assets [1a24].*

*An alternative approach to obtain equivalent relief would be for the foreign representative to bring equivalent avoidance action(s) under the applicable law of the jurisdiction where the main proceedings are taking place [1a25].*

**Question 3.3** [1a26] [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:*

- **The Federal Rules of Bankruptcy Procedure** [1a27] - these govern procedure in bankruptcy proceedings;
- **The Federal Rules of Civil Procedure** [1a28] - these particularly relate to litigation of disputed issues in contested matters/adversary proceedings; and
- **The local rules of procedure** [1a29] of each Bankruptcy Court; and
- **Personal practices** [1a30] issued by each judge (which are periodically updated and available on the website of the relevant Bankruptcy Court).

**Question 3.4** [1a31] [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 owe their fiduciary duties to the corporation [1a32] and its shareholders [1a33] (and not to creditors).*

*Those duties include duties of loyalty [1a34] to the corporation's best interest and a duty of care [1a35] in educated decision making.*

*The directors' duties remain owing to the corporation and its shareholder when the corporation is potentially or actually insolvent [1a36].*

**QUESTION 4** [1a37] (fact-based application-type question) [15 marks in total]

**Question 4.1** [1a38] [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 Ltd was to enter into a bankruptcy proceeding (e.g. Chapter 11) as a result of its failure to pay rent, the Bankruptcy Code would provide various protection(s) to the relevant lessors, including the following:*

Automatic Stay

- *Eviction of a debtor-tenant from non-residential property where the lease has expired is permitted under the automatic stay (treated as an exception) - as such the debtor cannot remain in the property indefinitely.*
- *The automatic stay may be lifted on request by a lessor to permit otherwise prohibited creditor actions [1a39] (in respect of the relevant property). This would*

*be applicable where the relevant lessor faced a lack of adequate protection of its interest in the property, where the value of the property may decline during the course of proceedings and result in the interested party making less than a full recovery.*

#### Executory Contracts

- *Leases of commercial property could be considered executory contracts (therefore granting the debtor the power to assume/reject the lease). In a Chapter 11 case, the debtor has until the confirmation of its plan or reorganisation to make this election. Commercial property leases are an exception to this rule, insofar as decisions relating to unexpired leases of non-residential property are required to be made within 120 days of the order for relief (providing more certainty / protection to lessors).* [1a40]
- *In certain circumstances, a debtor may be deemed to have assumed a contract based on its conduct, including where a debtor continues to occupy leased commercial premises despite purporting to reject the lease.* [1a41]

#### Priority of Payment

- *Lessors benefit from various protections in respect of the unsecured creditor waterfall:*
  - *Rent on real estate that a debtor continues to occupy is usually paid on an ongoing basis post-petition as an administrative expenses; and*
  - *Where a non-residential lease of real property is assumed and subsequently rejected, the relevant lessor will benefit from a high-priority claim for two years of lease payments from the later of the date of rejection of the lease or turnover of the property.*

#### Question 4.2 [1a42] [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 satisfy the relevant requirements of recognition under Chapter 15, the foreign representative must establish that the English court (or administrative)***

*proceeding with respect to the debtor is pending and that the foreign representative is empowered to act by the proceeding. The scheme may be granted recognition assuming it constitutes:*

*"a collective judicial or administrative proceeding in a foreign country... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation"*

*It is well established that an English scheme of arrangement, in principle, meets this criteria and accordingly may be granted recognition under US Chapter 15.*

*Whether the English scheme of arrangement is granted recognition as a foreign main or foreign non-main proceeding will primarily depend on the location of Skin Luxe's COMI. Foreign main proceedings are those that are commenced in the debtor's COMI. [1a43] COMI is a concept foreign to US law, which typically considers concepts of domicile and location of assets. A debtor's COMI is presumed to be its place of incorporation (i.e. in the case of Skin Luxe, France), though this is rebuttable [1a44].*

*The Bear Stearns case established that COMI is to be assessed as of the date of the US petition, not the commencement of foreign proceedings (this has encouraged the development of the practice of COMI shifting)*

*The following factors would suggest that the debtor's COMI is in England, and therefore that the proceedings should be recognised as foreign main:*

- *Sells its skin care products in London (and is therefore likely to have assets in England)*
- *Bonds are governed by English law*

*The following factors would suggest that the debtor's COMI is outside England [1a45], and therefore that the proceedings should be recognised as foreign non-main:*

- *It is incorporated and has its principal place of business in France*
- *Also sells its skin care products in a number of cities outside of England (and is therefore likely to have assets in those countries)*

*On the basis of the above, it seems likely that the proceedings will be recognised as foreign non-main [1a46], though the debtor could further COMI shift to England by e.g. changing its principal place of business to England (resulting in recognition as foreign main proceedings).*

**Question 4.3** [1a47] [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?**

**The Chapter 11 petition filing would affect these matters as follows:**

#### The DOJ Investigation

**An automatic stay of proceedings against the debtor or its property will be enforceable from the date of the Chapter 11 petition.<sup>[1a48]</sup> However, that stay is subject to certain statutory exceptions, including regulatory investigations. It is therefore likely that the Chapter 11 proceedings have no effect on the DOJ investigation<sup>[1a49]</sup>.**

#### The Margin Loan Default

**The margin loan will likely be considered a securities contract. Execution of securities contracts is excepted from the automatic stay. The proceedings will therefore have no effect on the default.<sup>[1a50]</sup>**

#### The Delinquent Lease

**If the lease has expired, the landlord can evict the debtor. If not the landlord will have no claim against pre-petition amounts owed but could claim rent should the debtor continue to occupy the property post-petition (as an expense of the proceeding)<sup>[1a51]</sup>.**

#### The Employment Discrimination Lawsuit

**The employee's claim would be stayed - it does not fit within any statutory or other exemption.<sup>[1a52]</sup>**

**\* End of Assessment \***