

TOTAL = 33.25/50
66.5%
Rounded up = 67%



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.

(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.

[FV2]

(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 [FV3] 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. [FV4]

(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.*

(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.* [FV7]

(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).**^[FV8]
- (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.

[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 is a legal mechanism that allows a debtor to balance mutual debts with a creditor by offsetting claims, resulting in a net credit or a net obligation¹. This institute allows entities that owe money to each other to cancel their mutual debts, paying only the balance of the largest debt. Setoff is subject to specific rules under the U.S. Bankruptcy Code (Section 553) and is not permitted in many circumstances mainly to ensure fair treatment of all creditors [FV11] and to maintain the orderly process of debtor's estate liquidation or reorganization.]

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 type of security granted to new creditors (typically debtor-in-possession, or DIP financing providers) that gives them a first-priority position over existing liens or security interests over a debtor's assets in a bankruptcy scenario². This concept is most associated with Chapter 11 bankruptcy proceedings.]

¹ "The right of setoff ... allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'" Citizens Bank of Maryland v. Strumpf, 116 S. Ct. 286, 289 (1995) (quoting Studley v. Boylston Nat'l Bank, 229 U.S. 523, 528 (1913)), Samuel R. Maizel for the Civil Resource Manual, <https://www.justice.gov/jm/civil-resource-manual-65-setoff-and-recoupment-bankruptcy>, last access 29.02.24.

² According to Keneth Ayotte, "the most aggressive approach in the Bankruptcy Code to create liquidity for the debtor is the § 364(d) priming lien. This allows a new DIP lender to take a first-priority lien against collateral that

The granting of a “priming lien” to secure DIP financing is subject to specific requirements under the U.S. Bankruptcy Code, specifically under Section 364, and include:

- **adequate protection:** existing secured lenders must be provided with “adequate protection”^[FV12] for the loss of their priority;
- **court approval;**
- **no other financing available:** the debtor must generally show that it was unable to obtain unsecured credit or credit with a junior lien and that the credit with a priming lien is necessary to preserve the value of the estate;
- **best interest of the Estate:** the DIP financing, including the priming lien, must be in the best interest of the bankruptcy estate, meaning it should promote the chances of a successful reorganization or maximize the value of the estate for the benefit of all stakeholders.]

Question 2.3 [2 marks]

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

[Violating the automatic suspension can have serious consequences, including mostly:

- **Contempt of Court** the party who violates the automatic stay may be found in contempt of court and this may include fines and the requirement to pay legal fees, costs or damages caused by the violation;^[FV13]
- **Liability for Damages:** the infringing party may be held liable for actual damages caused by the breach, including costs and attorneys' fees. If the violation is found to be willful, the debtor may be entitled to punitive damages.

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 a Chapter 11 bankruptcy, when voting on a plan of reorganization:

(i) deemed to accept the plan: creditors with credits (claims) that are not impaired under the plan. Under the U.S. Bankruptcy Code, an unimpaired claim is one that will

is subject to an existing security interest without permission of the secured lender being primed.” in *Bankruptcy Law as a Liquidity Provider*, <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=5782&context=uclrev>, last access 29.02.04.

be paid in full, or will receive its legal, equitable, and contractual rights under the plan, thus not materially altering the rights of the claim holder;

(ii) deemed to reject the plan: classes of creditors that are not receiving any property under the plan, i.e., they are impaired and will receive nothing, are deemed to reject the plan;

(iii) permitted to vote on the plan: impaired classes of creditors are allowed to vote on the plan. An impaired class correspond to those who will not receive full payment of its claims or whose legal, equitable, and contractual rights are being modified.

For a class of creditors to accept a plan, two conditions must be met, number (at least two-[FV14]thirds in amount of the claims of the class that are voted must vote in favor of the plan) and count (more) than one-half of the number of allowed claims that are voted must vote in favor of the plan. This is known as the "dual majority" voting requirement.]

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) preference: under the U.S. Bankruptcy Code, specifically 11 U.S.C. § 547, a preference is a transfer made by the debtor to a creditor, for an antecedent (previously incurred) debt, made while the debtor was insolvent, within 90 days before the bankruptcy filing (or one year if the creditor was an insider), that enables the creditor to receive more than they would have received in a Chapter 7 liquidation.

(b) constructive fraudulent conveyance: according to 11 U.S.C. § 548(a)(1)(B), a transfer-[FV15] may be considered constructively fraudulent if the debtor did not receive reasonably equivalent value in exchange for the transfer and was insolvent at the time or became insolvent as a result of the transfer.

(c) actual fraudulent conveyance: under 11 U.S.C. § 548(a)(1)(A), a transfer made with actual intent to defraud creditors can be avoided, regardless of whether the debtor received reasonably equivalent value or whether the debtor was insolvent at the time of the transfer.]

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.

[In the United States, a bankruptcy court may issue a final order consistent with the Constitution when it is acting within its statutory authority as defined by Congress and when it meets the requirements of Article III of the U.S. Constitution, which governs the judicial power of federal courts.]

Circumstances for a final order include i. cases involving "core proceedings," which are matters at the center of the bankruptcy process, such as the administration of the bankruptcy estate, allowance of claims against the estate, and determinations of adversary proceedings which are based on bankruptcy laws [1a18], and ii. matters where both parties have consented to the bankruptcy court's jurisdiction and the entry of final orders or judgments [1a19].

Appeals from bankruptcy court orders are typically reviewed by a. the district courts [1a20] within the federal judiciary where the bankruptcy case was filed; b. the bankruptcy appellate panels [1a21] (where available), which are made up of bankruptcy judges from the same circuit or c. directly by the U.S. Courts of Appeals if the appeal involves a question of law and all parties agree or if it meets other specific criteria for direct appeal.

Orders that are not constitutionally final, which generally involve "non-core" proceedings or those that do not arise under Title 11 (Bankruptcy Code), are reviewed on an "interlocutory" basis and require leave of the court to be appealed. [1a22]

The Supreme Court, as the highest court in the U.S., can also review decisions of the Courts of Appeals or, on certain occasions, may take direct appeals from the district courts in matters of significant legal importance.]

Question 3.2 [1a23] [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?

[In a Chapter 15 proceeding a foreign representative may not invoke certain provisions of the Bankruptcy Code that are typically reserved for domestic bankruptcy cases under other chapters such as 7 or 11. For example, the foreign representative cannot file a plan of reorganization or liquidation as in a Chapter 11 case and he may not use

certain **avoidance powers**^[1a24] that a trustee may have in a domestic bankruptcy case, such as preferences or fraudulent conveyances, without initiating an ancillary case.

To obtain **equivalent relief**^[1a25], a foreign representative in a Chapter 15 proceeding can i. request recognition of foreign proceedings, so that certain protections such as the automatic stay may be extended to the foreign debtor's assets that are within the jurisdiction of the United States, or ii. seek injunctive relief to protect the assets of the debtor or the interests of the creditors in the U.S.

Question 3.3^[1a26] [4 marks]

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

[When preparing a filing for a bankruptcy court one should review several sets of rules and regulations, especially the US Bankruptcy Code, **Federal Rules of Bankruptcy Procedure**^[1a27], **local bankruptcy rules**^[1a28], case law and the applicable state law. Reviewing these rules will ensure that filing is accurate and effective.]

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 two recent decisions, Delaware Supreme Court addressed issues relating to the duties of directors³.

Directors of Delaware corporations owe fiduciary duties of **care**^[1a30] and **loyalty**^[1a31] to the **corporation**^[1a32] and its **shareholders**^[1a33] in the ordinary course of business. The duty of care requires directors to make informed and deliberate decisions by adequately informing themselves of all material information reasonably available to them before making a business decision. The duty of loyalty mandates that directors act in good faith and with the honest belief that their actions are in the company's best interest, without personal conflicts of interest.

When a corporation is solvent, these duties are owed to the corporation and its shareholders. However, when a corporation is in the "zone of insolvency" or has become insolvent, the directors' fiduciary duties expand to include creditors of the corporation. This does not create a direct duty to creditors, but it means that the directors must consider the interests of the creditors in their decision-making because the creditors become the residual interest holders⁴.

³ "The Fiduciary Duties of Directors of Troubled U.S. Companies: Emerging Clarity", Davis Polk and Wardell, chapter 2, p. 6-10, in IGL TO: CORPORATE RECOVERY AND INSOLVENCY 2008, www.iclg.co.uk.

⁴ "(...) when the corporation is insolvent, "its creditors take the place of the shareholders as the residual beneficiaries of any increase in its value." Id. The primary object of the directors' duties remains the same, however - it is the corporation.", *op. cit*, p. 7.

It is important to note that Delaware courts have clarified that the directors do not owe a fiduciary duty directly to creditors but instead continue to owe their duties to the corporation for the benefit of its residual claimants, which, in the context of insolvency, are the creditors. [1a34] Directors must navigate these shifting duties carefully to avoid breaches that could lead to personal liability.]

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

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?

[The Bankruptcy Code provides several protections for lessors of nonresidential real property, such as office space, when a tenant, such as iWork Ltd., files for bankruptcy. These protections include:

- assumption or rejection of unexpired leases: under Section 365 of the Bankruptcy Code, the debtor must either assume or reject unexpired leases within a certain period [1a37]. If iWork Ltd. were to file for bankruptcy, it would have to decide whether to assume (and continue) or reject (and terminate) its office space leases;*
- adequate assurance of future performance [1a38]: If iWork Ltd. decides to assume a lease, it must provide adequate assurance of future performance to the lessor and this means it must prove to the bankruptcy court that it will be able to fulfill the lease terms going forward;*
- timely payment for post-petition rent: [1a39] from the date of the bankruptcy filing, the tenant is generally required to continue paying rent under the lease terms and failure to do so may be grounds for the lessor to request relief from the automatic stay to evict the tenant; and*
- relief from the automatic stay: if the debtor has defaulted on a lease, a lessor can seek relief from the automatic stay for cause, such as lack of adequate protection [1a40], or if it is not in the best interest of the estate.]*

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.

[Chapter 15 allows a foreign representative to commence a bankruptcy case in the U.S. by filing a petition for recognition of a foreign proceeding.

To be recognized as a foreign main proceeding, the foreign proceeding must be pending in the country where the debtor has the COMI.^[1a42] For Skin Luxe, if its COMI is determined to be in France, where it is incorporated and has its principal place of business, then the English scheme of arrangement might be recognized as a foreign main proceeding.^[1a43]

If the COMI is not in England but the scheme of arrangement is related to the debtor's assets or affairs in England, it may still be possible for the scheme to be recognized as a foreign non-main proceeding. A foreign non-main proceeding is one that is pending in a country where the debtor has an establishment, defined as any place of operations where the debtor carries out non-transitory economic activity.^[1a44]

In both cases, the scheme of arrangement must meet the criteria of being a collective judicial or administrative proceeding, including a proceeding under a law relating to insolvency, in which the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization, liquidation, or debt adjustment.

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?

[If I understood the question properly, filing a Chapter 11 bankruptcy petition has several immediate effects due to the imposition of the automatic stay.^[1a46] The filing would affect each of the issues facing Speculation Inc as it follows:

(i) DOJ Investigation: the automatic stay generally does not stop criminal proceedings, including investigations by the DOJ. In these terms, the investigation into potential insider trading would likely continue unaffected by the Chapter 11 filing.^[1a47]

(ii) *margin loan default: the automatic stay would halt any actions by the broker to collect on the margin loan or to liquidate the collateral share*^[1a48]s;

(iii) *delinquent lease: the filing would stay any pending eviction proceedings or collection efforts for the back rent.*^[1a49] *Speculation Inc would then have the opportunity to assume or reject the unexpired lease and would have to provide adequate assurance of future performance if it wants to assume the lease;*

(iv) *employment discrimination lawsuit: the automatic stay would also apply to the employment discrimination lawsuit*^[1a50]*and the former employee would be stayed from continuing the lawsuit in civil court without seeking relief from the automatic stay.*

*** End of Assessment ***