

TOTAL = 40/50
80%



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^[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.

^[FV4]
(c) An insolvency professional appointed by the court overseeing the foreign proceeding.

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

(e) All of the above.

Question 1.5

Which of the following regarding executory contracts is false?

- (a) *A court will generally defer to a debtor's business judgment regarding whether to assume or reject an executory contract.*
- (b) Executory contracts are clearly defined by the Bankruptcy Code.**
- (c) *In the most common formulation, executory contracts are defined as those where both sides to a contract have material unperformed obligations.* [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.*
- (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.** [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 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 process.

[FV10]

(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 [INS 111] *is whereby parties offset mutual debts, leading to a reduction in the amounts owed. In an insolvency scenario, offset is usually not permitted because it allows the creditor to improve its position when compared to other unsecured creditors, and directly impacts the debtor's estate, because it reduces the amounts realised.*

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 where a party provides post-petition financing, which is granted priority over existing liens or security.

The court will only grant a priming lien if funding cannot be obtained by any other means. The debtor must also demonstrate that the interests of the secured creditor being primed is [FV12] *protected.*

Question 2.3 [2 marks]

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

Any action taken that violated the stay is a contempt of Court and is void or voidable.

Parties in interest can seek relief from the stay to validate an action that would otherwise be voidable. Failure to do this could:

- i) result in the violator having to pay the debtor's legal fees and may be liable for the damages; and [FV13]*
- ii) where the court is concerned that the violator of the automatic stay may not act quickly, the court can impose coercive contempt sanctions.*

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?

When constituting a plan of reorganization, claims of creditors or interests must be designated into classes. A class is either an impaired class or an unimpaired class. A class is considered to be unimpaired if the reorganization plan leaves the classes "legal, equitable, and contractual rights unaltered". Unimpaired classes are deemed to accept the reorganization plan.

If the classes rights are altered by the reorganization plan, the class is considered an impaired class. Only impaired classes are permitted to vote on the plan. A class approves [FV14] the plan if a simple majority of the creditors, holding at least two-thirds of the value of the claims in the class, vote in favour.

A class that received nothing from the reorganization plan is deemed to reject the plan.

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?***

See below answers with the same bulleting:

- a) A constructive fraudulent conveyance relates to a transfer whereby the debtor receives less consideration than they should have for the property. A constructive fraudulent conveyance claim applied to transfers made on account of a particular antecedent debt. [FV15]***

- b) *A preference claim is a cause of action where a debtor makes a payment to or transfers property within a certain period of time before the bankruptcy petition, and enables the receiving party to receive more than they would have in a Chapter 7 bankruptcy proceeding. Preference claims requires the debtor be presumed or proven to be insolvent at the time of the transfer.*
- c) *A fraudulence conveyance is where the debtor transferred property with the "actual intent to hinder, delay, or defraud any entity to which the debtor was or became...indebted". A fraudulent conveyance claim requires the debtor to be proven to have intended to frustrate creditor recoveries.*

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 bankruptcy court may enter into a final order in "core" bankruptcy proceedings (i.e. where the matter directly relates to the bankruptcy case and is within the jurisdiction of the bankruptcy court [1a18]. These "core" proceedings are described in section 157 of the Bankruptcy Code.

The Bankruptcy court can also enter into a final order if the parties involved in the bankruptcy proceeding consents to the court entering into the final order [1a19].

Appeals from bankruptcy courts are heard by the relevant district court [1a20] in which the bankruptcy court is located. However, in certain federal judicial circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Panel [1a21], which is a specialized body consisting of bankruptcy judges from within the circuit.

Final orders entered into by the Bankruptcy Court must be reviewed by the district court in which they sit [1a22].

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?

A foreign representative in chapter 15 proceedings does not have access to avoidance powers [1a24] (i.e. avoidance of preferences and fraudulent conveyances) as would be available under the Bankruptcy code.

The foreign representative may choose to commence a **plenary proceeding**^[1a25] such as chapter 7 or chapter 11 under the Bankruptcy code, after recognition of the foreign proceeding under Chapter 15. This would then allow the foreign representative access to the avoidance powers under the Bankruptcy code. However in these circumstances the scope of the plenary proceeding will be limited to the US assets.

Question 3.3^[1a26] [4 marks]

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

When preparing for a filing for a bankruptcy court in the US, the following should be reviewed:

- i) The US Bankruptcy Code. This is a federal law governing bankruptcy proceedings in the US.
- ii) The **Federal Rules of Bankruptcy Procedure**^[1a27]. This governs the procedural rules in bankruptcy proceedings, and provides guidance on
- iii) The **local rules of the bankruptcy court**^[1a28];
- iv) The **bankruptcy forms which are required to be filed**;
- v) The **judges personal practices**^[1a29].

Question 3.4^[1a30] [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 a fiduciary duty of **loyalty**^[1a31] to the corporation's best interest and a duty of **care**^[1a32] in decision making and duty of good faith but are protected from liability. The duties are owed to the **corporation**^[1a33] and its **shareholders**^[1a34], and not to the corporation's creditors.

Directors duties being owed to the corporation and shareholders does not change even in circumstances where the corporation is potentially or actually insolvent^[1a35]. Directors of Delaware corporations are not required to cease its operations or commence bankruptcy proceedings when the corporation is unable to pay its debts due. This was echoed in *See Trenwick Am Litig Trust v Ernst & Young, LLP* where the court ruled that "Delaware law imposes no absolute obligation on the board of the company that is unable to pay its bills to cease operations".

This means that, unlike in other countries, the concept of "wrongful trading" or "deepening insolvency" (i.e. when the corporation is continuing to trade when the directors ought to have known that the corporation was insolvent and should have commenced insolvency proceedings) is non-existent in Delaware.

QUESTION 4^[1a36] (fact-based application-type question) [15 marks in total]

Question 4.1 [1a37] [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?

Both Chapter 7 and Chapter 11 bankruptcy cases benefit from the worldwide automatic stay, allowing for breathing room whilst the debtor negotiates with creditors, realizes assets or formulates a reorganization plan.

The Bankruptcy code also provides protections for executory contracts. A contract is said to be an executory contract if there are unperformed obligations on both sides. An unexpired lease is an example of a executory contract, as both the landlord and the tenant still has obligations under the lease. As the iWork leases have not yet expired, they are executory contracts.

In order to benefit from these protections, iWork will need to enter into a Chapter 7 or Chapter 11 bankruptcy proceeding. IWork then has the choice to:

- i) Reject the lease, resulting in the debtor (i.e. iWork) having considered to have breached the contract, and amounts outstanding to the landlord will constitute an unsecured pre-petition claim.* [1a38]
- ii) Assume the contract, resulting in iWork having to pay all outstanding amounts due to the landlord and providing assurance to the landlord that it can meet its future payment obligations. However, if iWork later rejects the lease, the post-petition damages will be payable as an expense of iWork's estate.* [1a39]
- iii) Assume and assign the contract to a third party. The third party must however give the landlord assurance that it can meet the lease obligations.*

The bankruptcy code also provides timelines for executory contracts. In Chapter 7 bankruptcy proceedings, the trustee has 60 days after the petition date to decide whether the executory contract will be assumed, assigned or rejected.

In a chapter 11 bankruptcy case, the debtor has until the confirmation of its reorganization plan to choose whether to reject, assume or assign (as set out above) the executory contract. However, a counterparty can elect to put a deadline on the decision. Where unexpired leases of non-residential property is the case as with iWork, the debtor has 120 days of the order for relief to decide whether the unexpired lease will be assumed, assigned or rejected. [1a40]

An additional benefit to iWork is that the Bankruptcy Code prevents the enforcement of ipso facto clauses as a result of bankruptcy. This would prevent iWork's landlords

from terminating the lease agreements as a result of bankruptcy (if set out on the lease), whilst iWork decides what to do with the leases.

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 Chapter 15 proceedings, recognition of foreign proceedings will be granted as long as the foreign proceeding is (as defined in the Bankruptcy Code) “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”.

The US bankruptcy court will recognize foreign main proceedings, where those proceedings have been commenced in the debtor’s center of main interest (“COMI”).^[1a42] *Where proceedings are not commenced in the debtors COMI, but rather a jurisdiction where the debtor has an establishment, the US bankruptcy court will recognize those proceedings as foreign non-main proceedings.*^[1a43]

Noting the above, the US court should recognize the English scheme of Arrangement, however the main consideration would be whether Skin Luxe applies for recognition of foreign main or foreign non-main, as this determines the scope of the relief that is available.

Based on the facts above, it appears that Skin Luxe’s COMI is most likely to be considered to be in France, as that is i) where its incorporated, ii) where its principal place of business is, and iii) where it manufactures its products, suggesting that the majority of its assets/products are located there.^[1a44]

However, there could be an argument that Skin Luxe’s COMI is in England, as Skin Luxe’s bonds are governed by English law suggesting that this was where the financing for the bonds took place. Furthermore, if the majority of Skin Luxe’s creditors are also located in England, this would support COMI being in England.

In order for Skin Luxe to apply for recognition of the English scheme of arrangement as a foreign non-main proceeding, the foreign representative would need to prove that Skin Luxe has an “establishment” in England^[1a45]*(i.e. a place where the debtor*

carries out non-transitory economic activities). Skin Luxe sells its products through its own boutiques in international cities, one of these being London and so has an establishment in England.^[1a46] However, Skin Luxe may need to demonstrate that the English scheme relates to its establishment in England.^[1a47]

To summarize, based on the available facts, Skin Luxe should apply for recognition of the English scheme of arrangement as foreign non main proceedings. There is also an argument for Skin Luxe to apply for recognition of the proceedings as foreign main proceedings, however further information is required in order to decide whether this will be appropriate.

Question 4.3 ^[1a48] [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?

Speculation Inc filing for Chapter 11 bankruptcy would have different effects on different issues it is experiencing.

- i. **DOJ investigation:** *Whilst companies who file for Chapter 11 bankruptcy benefit from a worldwide automatic stay immediately upon the filing of the petition^[1a49], there are some limitations to the stay. The automatic stay is subject to statutory exceptions, one of which being regulatory investigations. The DOJ investigation into Speculation Inc would likely be allowed to continue, however its likely that the DOJ will need to communicate with the bankruptcy court in order to take any further legal actions which could be detrimental to the bankruptcy proceedings or put stakeholders in a worse position.* ^[1a50]
- ii. **Margin loan default** ^[1a51] : *Chapter 11 proceedings is a plan of "reorganization", allowing the debtor to restructure its debts. The effect of Speculation Inc's Chapter 11 proceedings on the margin loan default is dependent on how this debt is treated in the reorganization plan. The plan may cramdown on this loan default, allowing Speculation Inc to continue*

with its business without paying its creditors in full. Spectrum Inc could also try to negotiate better terms to the margin loan default through the plan.

- iii. *Delinquent lease^[1a52]: the delinquent lease will constitute an executory contract, and as the executory contract is in relation to a non-residential property, Spectrum Inc will have 120 days to decide whether to reject, assume or assign the lease. If there is an ipso facto clause on the lease agreement, this will be nullified as a result of the Chapter 11 proceedings.*
- iv. *Civil lawsuit: the worldwide automatic stay prevents the continuation/commencement of most civil lawsuits against the debtor and its assets, as the outcome of civil lawsuits could result in a fine/damages owed by the debtor which could have a negative monetary impact to the estate. The employment discrimination lawsuit could therefore not be continued whilst the debtor is in Chapter 11 bankruptcy^[1a53].*

*** End of Assessment ***