

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. [A1]**
- (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. [A2]**

- (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.**
- [A3]
- (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.**
- [A4]
- (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.* [A5]
- (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.* [A6]
- (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.**
- (b) *Creditors must have sufficient information about the debtor and the plan to make an* [A7] *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.**^[A8]
- (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).**
- (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^[A9] the estate as a whole.**
- (c) In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale.**
- (d) Debtors must carry out a robust marketing process for the sale.**
- (e) A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.**

Question 1.10

Which of the following regarding substantive consolidation is true?

- (a) *It respects the boundaries of corporate separateness.*
- (b) *If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.*^[A10]
- (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 which nets claims owed against claims owing. Setoff is not^[A11] *always available because it could put a creditor of a company in a better position than others who are not also debtors of the company.*

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?

This court-granted lien, which may be provided to secure DIP financing, will be senior or equal to a pre-petition lien on the property of the debtor’s estate.

^[A12]

To grant a priming lien, the debtor has to demonstrate the primed secured creditor’s interests are adequately protected and that no other terms were available to get the DIP financing.

Question 2.3 [2 marks]

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

1. *Contempt sanctions against the violator of the stay (e.g. requiring the violator to take affirmative acts to undo the effect of its violation and pay the debtor’s legal fees)*^[A13]

2. *Coercive contempt sanctions (e.g. daily fine paid into the court until rectified) if the court considers the violator might not act quickly*

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?

Unimpaired class - deemed to accept the plan [A14]

Class not receiving anything under the plan - deemed to reject the plan

Each designated class - permitted to vote

To accept a plan, creditor class needs approval of simple majority holding at least 66.66% of the value of the claims in that class. In the case of equity interests, requires > 66.66% in the amount of interests to 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?***

This is 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?*** [A15]

This is also a preference claim

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

This is actual fraudulent conveyance

QUESTION 3 [A16] (essay-type questions) [15 marks in total]

Question 3.1 [A17] [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.

It could do so by issuing a report and recommendation for review / sanction by the relevant district court^[A18] or otherwise if it has the consent of the relevant parties^[A19].

Appeals are reviewed by the relevant district court^[A20] (or, if relevant, a Bankruptcy Appellate Panel^[A21]). There may also be additional appeal rights to the circuit court of appeals.

Orders that are not constitutionally final are reviewed de novo by the district court or Bankruptcy Appellate Panel (as applicable).

Question 3.2^[A22] [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?

The Bankruptcy Code avoidance powers^[A23] usually are not available to foreign representatives in Chapter 15. Instead, the foreign representative could:

- 1. commence plenary proceedings under Chapter 7 or Chapter 11^[A24] etc so they can access avoidance powers in respect of actions relating to the debtor's assets in the US; or*
- 2. initiate avoidance actions in the jurisdiction of the main proceedings (if available^[A25]).*

Question 3.3^[A26] [4 marks]

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

The Federal Rules of Bankruptcy Procedure^[A27] pertain to the procedure to be followed in bankruptcy proceedings. Re the conduct of litigation in contested matters or adversarial proceedings, the Federal Rules of Civil Procedure^[A28] are also relevant.

Consideration should be given to each Bankruptcy Court's local rules of procedure^[A29] and also personal practice of the relevant Bankruptcy Court judge(s)^[A30].

Question 3.4^[A31] [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?

Fiduciary duties (including duties of loyalty^[A32] to the corporation's best interest and a duty of care^[A33] re educated decisionmaking) are owed to the corporation^[A34] in the ordinary course of business. This is the case even when the corporation is potentially or actually insolvent.

[A35]

QUESTION 4 [A36] (fact-based application-type question) [15 marks in total]

Question 4.1 [A37] [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 goes into Chapter 11, until the confirmation of its plan or reorganisation, it can generally opt to assume or reject executory contracts. In the case of unexpired leases of non-residential property, however, iWork would have to make the decision within 120 days of the order of relief which is a stronger position for lessors. [A38] Additionally, if it remains in the property despite having purported to reject the lease, it could be found that it has actually assumed the leases by conduct. [A39]

Re priority of payments, the lessors would also have a strong position under the unsecured creditor waterfall as rent on occupied property is typically paid on an ongoing basis as an administrative expense [A40]. If iWork assumes the leases (by conduct or otherwise) but subsequently rejects them, the lessors get high priority claims for two years of lease payments from the later of the date of rejection or turnover of the property [A41].

Otherwise, the lessors would still be able to evict iWork once the lease expires as this falls within the exception to the automatic stay. The lessors could also apply to lift the automatic stay to allow for otherwise prohibited creditor actions if, amongst others, they had inadequate protection of their interest in the property or the value could decline during the proceedings such that they could make less than a full recovery.

Question 4.2 [A42] [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.

To receive recognition under Chapter 15 in the U.S., a foreign representative needs to demonstrate that there is an ongoing English court (or administrative) proceeding pending with respect to the debtor and that they are empowered to act by this

proceeding. Recognition is contingent upon the proceeding being a "collective judicial or administrative proceeding in a foreign country... under a law relating to insolvency or adjustment of debt" where the debtor's assets and affairs are managed or overseen by a foreign court for the purpose of reorganisation or liquidation. English schemes of arrangement generally fulfill these conditions and are capable of recognition under Chapter 15.

The determination of whether an English scheme of arrangement is recognized as a foreign main or non-main proceeding largely depends on the debtor's center of main interests (COMI)^[A43]. There is a rebuttable presumption of COMI in the debtor's place of incorporation (i.e. France for Skin Luxe)^[A44]. Although COMI is a concept which is foreign to US law, the Bear Stearns case provided guidance that COMI should be evaluated at the time of the Chapter 15 petition filing in the U.S., not when foreign proceedings commenced. Bearing this in mind, the fact that Skin Luxe sells skincare products in London and its financial instruments (i.e. bonds) are English law governed are indicative of an English COMI. However, its incorporation in France and the fact that its main operations are in France and it sells skincare outside the UK are suggestive that Skin Luxe's COMI is not in the UK^[A45]. This means the proceedings will more likely be "foreign non-main proceedings"^[A46] but the debtor could (and it is becoming increasingly popular to) COMI shift.

Question 4.3 ^[A47][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?

Although the initiation of Chapter 11 proceedings will trigger an automatic stay^[A48], this is subject to certain statutory exclusions including regulatory investigations and securities contracts. There is therefore likely no effect on the DOJ investigation^[A49] or margin loan default.^[A50]

With respect to the delinquent lease, the treatment of the delinquent lease depends on its status at the time of the petition. If the lease term has ended, the landlord can proceed with eviction. Otherwise, while claims for pre-petition lease arrears are barred, the landlord may claim rent for any period post-petition if the debtor remains

in the property, treating it as an administrative expense of the bankruptcy proceedings.^[A51]

Finally, with respect to the employment discrimination lawsuit, claims arising from an employment discrimination lawsuit against the debtor are subject to the automatic stay, as they do not fall under any specific exemption. Therefore, such litigation is paused by the Chapter 11 filing.^[A52]

*** End of Assessment ***