

**TOTAL = 35.5/50**  
**71%**



**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 States.**<sup>[FV3]</sup>
- (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.**<sup>[FV4]</sup>
- (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.* [FV5]

**(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.*

(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.*** [FV8]
- (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 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 <sup>[FV10]</sup> valid objection to substantive consolidation.**
- (c) **It is the treatment of two or more creditors as a single creditor to simplify the claims process.**
- (d) **Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.**
- (e) **Authority for substantive consolidation comes from the Bankruptcy Code.**

QUESTION 2 (direct questions) [10 marks]

Question 2.1 (1 mark)

**What is setoff and why is it not permitted in many circumstances?**

*Setoff permits a creditor with a claim against a debtor company who also owes the debtor company money to set off / net out the two (or more) obligations.*

*Given setoff rights can improve a creditor's position in the bankruptcy as compared to other unsecured creditors, it is not allowed in a number of circumstances, for example, where the creditor's claim against the estate is disallowed, the creditor's claim against the estate <sup>was</sup><sub>[FV11]</sub> acquired post-petition or in the 90 days prior to the petition when the debtor was insolvent, the creditor's obligation to the debtor was incurred in the 90 days prior to the petition at a time when the debtor was insolvent for the purposes of exercising set off rights.*

*This is because the right of setoff decreases the setoff creditor's obligation to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the unsecured claim.*

Question 2.2 [2 marks]

**What is a "priming lien" and what requirements must be met for such a lien to be granted to secure DIP financing?**

*A priming lien is a lien on property senior to, or with the same priority as, existing liens <sup>on</sup><sub>[FV12]</sub> the same property which may be granted by the court to secure post-petition financing.*



*A priming lien is typically only available as a last resort where financing cannot be obtained on any other terms.*

Question 2.3 [2 marks]

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

*Any act taken in violation of the automatic stay (even if taken without notice of the petition) constitutes contempt of court and is void or voidable depending on the circuit before which the bankruptcy is pending. Failure to obtain relief from the stay may result in the imposition of contempt sanctions against the party violating it which may include paying the debtor's attorneys' fees and requiring the violator to take steps to undo the violation. Where the court is concerned that the violator will not act promptly, it may impose a daily fine to be paid into court until the violation has been rectified.*

Question 2.4 [2 marks]

*In voting on a plan of reorganization, which class(es) of creditors are (i) deemed to accept the plan, (ii) deemed to reject the plan and (iii) permitted to vote on the plan? What vote is necessary for a class of creditors to accept a plan?*

*An unimpaired class of creditors is deemed to accept the plan and a class that will receive nothing is deemed to reject the plan.*

*A plan will be approved by a given class of creditors if a simple majority of the creditors in that class holding at least two thirds of the value of the claims vote in favour of the plan (for equity interests, the threshold is two-thirds in amount of interests vote in favour).*

Question 2.5 [3 marks]

**Answer the following questions about preferences, actual fraudulent conveyances and constructive fraudulent conveyances:**

- (a) Which cause of action applies only to transfers made on account of antecedent debt?**
- (b) Which cause of action requires that the debtor be presumed or proven to have been insolvent at the time of the transfer?**
- (c) Which cause of action requires that the debtor be proven to have intended to frustrate creditors' recoveries?**

*(a) A preference only applies to transfers made on account of an antecedent debt as they only arise where a debtor is paying a creditor a pre-existing debt.*

*(b) A constructive fraudulent conveyance is proven by showing that the debtor received<sup>[FV15]</sup> less than reasonably equivalent value in exchange for a transfer or incurrence of obligation and that the debtor was insolvent at the time or became insolvent as a result of the transaction.*

*(c) An actual fraudulent conveyance requires that the debtor is proven to have made the transfer or incurred an obligation with an intent to hinder, delay or defraud creditors.*

**QUESTION 3<sup>[1a16]</sup> (essay-type questions) [15 marks in total]**

**Question 3.1<sup>[1a17]</sup> [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.**

*District courts have exclusive jurisdiction to adjudicate a petition commencing bankruptcy proceedings therefore therefore a bankruptcy court may only exercise a district court's delegated authority to enter a final order on a motion challenging the validity of a petition<sup>[1a18]</sup>. The bankruptcy court may determine a core proceeding over which they do not have constitutional authority by issuing a report and recommendation for review by the district court<sup>[1a19]</sup> or, with the consent of the parties, they may issue final orders<sup>[1a20]</sup>. In effect, bankruptcy courts may not make final orders where they have no jurisdiction over the proceedings, for example, where they would be purporting to make final orders over state laws or where the parties have consented that the bankruptcy courts may make final orders.*

*In general, appeals from the bankruptcy court are heard by the district court for the district in which they sit. However, in certain circuits (the First, Sixth, Eighth, Ninth and Tenth Circuits), bankruptcy appeals are heard by a Bankruptcy Appellate Panel (BAP made up from bankruptcy judges from that circuit. From the district court or the BAP, there is a further right of appeal (assuming the initial order is appealable) to the circuit court of appeals.<sup>[1a21]</sup>*

*If the order was not constitutionally final (in that the ruling was in a noncore proceeding or the bankruptcy court did not otherwise have the authority to enter a final order), the district court or BAP would review all findings of fact and law that have been challenged de novo. The order of a district court or BAP is then reviewed by a circuit court of appeal de novo as to conclusions of law and for abuse of discretion for findings of fact.*

**Question 3.2<sup>[1a22]</sup> [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?**

*Chapter 15 does not allow a foreign representative to use the avoidance powers in the Bankruptcy Code. [1a23] This has been widely but not universally interpreted only to apply to the use of the Bankruptcy Code's powers of avoiding preferences and fraudulent conveyances but does not bar a foreign representative from seeking to avoid pre-petition transactions under other applicable US or foreign law [1a24].*

*However, a foreign representative may invoke the avoidance powers in the Bankruptcy Code in a plenary proceeding such as chapter 7 or 11 [1a25]. In some circumstances, such proceedings were commenced by a creditor or debtor prior to the foreign representative becoming appointed. In other circumstances (though more rarely), the foreign representative may choose to commence plenary proceedings under the Bankruptcy Code after it has gained Chapter 15 recognition. In such circumstances, the scope of the plenary proceedings would be limited to the debtor's US assets and would need to be coordinated with the foreign proceedings. This step is usually only taken where relief under other applicable law is unsatisfactory, such as where limitation periods have expired or applicable law does not permit claims for constructive fraudulent conveyances.*

**Question 3.3 [1a26] [4 marks]**

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

*You will need to review the Bankruptcy Rules [1a27], the Federal Rules of Civil Procedure [1a28], and the local rules of the bankruptcy court [1a29]. Each judge will also issue personal practices [1a30] which are periodically updated and published on the bankruptcy court's website.*

*There may also be relevant case law which will need to be considered, having regard to the circuit in which the matter is being heard.*

**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 a Delaware company owe a duty of loyalty [1a32] to the corporation's best interest and a duty of care [1a33] in educated decision making. However, directors are protected from liability by the business judgment rule which raises a rebuttable presumption that the board of directors acted in good faith and on the basis of reasonable information. This presumption may only be rebutted by showing that a*

*majority of the board of directors were not reasonably informed, did not honestly believe that their decision was made in the best interests of the company or were not acting in good faith. Where it is not possible to rebut the presumption, the directors will not be liable without showing gross negligence.*

*Furthermore, the directors may be exculpated from liability for a breach of duty of care by a corporation's certificate of incorporation. However, they cannot be exculpated for a breach of loyalty.*

*Directors' duties are owed to the corporation [1a34] and to its shareholders [1a35]. This is the case even where the corporation is potentially insolvent [1a36] and the shareholders stand to receive nothing in the bankruptcy. Indeed the Delaware Supreme Court found in North Am Catholic Educational Programming Foundation, Inc v Gheewalla, 930 A.2d 92, 103 (Del 2007) that "individual creditors of an insolvent corporation have no right to assert claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of insolvent corporations."*

*There is accordingly no equivalent of "wrongful trading". As held Trenwick Am Litig Trust v Ernst & Young, LLP, 906A.2d 168 (Del Ch 2006) "Delaware law imposes no obligation on the board of a company that is unable to pay its bills to cease operations and to liquidate. Even where the company is insolvent, the board may pursue ion good faith strategies to maximize the value of the firm."*

**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?***

*The leases would be considered executory contracts so the debtor would have the right to assume, reject or assume and assign the leases. The trustee in chapter 7 proceedings or the debtor in chapter 11 proceedings are required to make a decision on the leases within 120 days of the order for relief. [1a39] This period can be extended for cause but any subsequent extension requires the consent of the landlord which would give the landlords substantial leverage. [1a40]*

*If the trustee/debtor rejects the leases, the lease is deemed to have been breached immediately before the petition date, giving the landlords an unsecured pre-petition claim in damages.*

*If the trustee/debtor assumes the leases, it must cure all defaults and give the landlords sufficient assurances of future performance (ie that it will pay any outstanding rent and that it is capable of meeting future rental payments).*

*If the trustee/debtor assumes and assigns the contract, it would transfer the debtor's rights under the lease to a third party. The new lessee would have to give the landlords adequate assurances of future performance. The landlord's consent would not be needed.*

**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.***

*To determine whether an English scheme of arrangement would be recognized as a foreign main or foreign non-main proceedings, Skin Luxe's centre of main interest ("COMI") must first be determined. COMI is a concept derived from the Model Law and should be ascertainable by creditors or other third parties on the basis of objective evidence. A debtor's COMI is presumed to be its place of incorporation [1a42] but this presumption is rebuttable and relevant factors determining the COMI of a debtor include the location of its headquarters, the location of its management, location of primary assets, the location of the debtor's creditors or majority of creditors that will be affected by the relief, the jurisdiction whose law will likely apply to most disputes.*

*Here, we are told that Skin Luxe is incorporated in France, such that a rebuttable presumption arises that France will be its COMI. This is supported by the fact that its principal place of business is France and that appears to be where its operations are situated. We are told that it sells products in France, the United Kingdom, the United States and in Hong Kong, though there may be other international cities which may be relevant. We are not told where the majority of its creditors are, nor where its principal assets are located, though we are told that it is the restructuring of its English law governed bonds by an English scheme of arrangement which will be the subject matter of the recognition application. This could arguably mean that England is the jurisdiction whose laws will apply to most disputes (at least as they relate to the restructuring of the English-law governed bonds) though it is not clear whether this would shift the COMI from France to the United Kingdom.*

*However, the requirements for recognition are fairly minimal but the level of assistance will depend upon whether the proceedings are foreign main proceedings or foreign non-main proceedings. Here, it would appear that an English scheme of arrangement would be a foreign non-main proceeding<sup>[1a43]</sup>.*

*Recognition requires that the foreign representative must establish that a foreign court or administrative proceeding with respect to the debtor is pending and that the foreign representative is empowered to act by the proceedings. A foreign proceeding is defined by the Bankruptcy Code as "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 are subject to control or supervision by the foreign court for the purpose of reorganization or liquidation". Given the breadth of the definition, it has been interpreted to include English schemes of arrangement.*

*An English scheme of arrangement fits into this definition because it is a court supervised process by which the debtor's debt obligations and the creditors' rights in relation thereto can be restructured.*

*If the English scheme of arrangement is recognized as a foreign non-main proceeding, the foreign representative may be granted the same relief as is available to foreign main proceedings (such as the automatic stay, the foreign representative's ability to operate the debtor's business in the ordinary course in the United States, and the sale, transfer or use of property outside of the ordinary course) but only upon a discretionary basis - this relief is not automatic. There is also other discretionary relief available such as provisional relief, authorizing discovery of the debtor's assets and affairs and any other relief "necessary to effectuate the purposes of [chapter 15] and to protect the assets of the debtor or the interests of creditors.*

**Question 4.3** <sup>[1a44]</sup> [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 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 worldwide automatic stay does not apply to regulatory investigations so the filing of a chapter 11 petition<sup>[1a45]</sup> would not have any effect on the DOJ investigation<sup>[1a46]</sup>, ie it would not stay the investigation.*

*The broker would have no rights to collect the outstanding liabilities under the margin loan after the petition has been filed as it would be caught by the automatic stay<sup>[1a47]</sup>.*

*We are not told whether the lease has expired as well as being delinquent. If it has expired, Speculation Inc cannot be evicted from its office space<sup>[1a48]</sup>. If it has not expired, the debtor would have the right to assume, reject or assign the lease - it being an executory contract.*

*Given that that the employment discrimination claim was issued prior to any petition being filed, this will be stayed pursuant to the automatic stay<sup>[1a49]</sup>.*

**\* End of Assessment \***