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**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**.

6.1If 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 2023**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2023. 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 2023** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2023**. If you elect to submit by 1 March 2023, you **may not** submit the assessment again by 31 July 2023 (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**

Which of the following entities **does not** satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

1. A foreign domiciled company that pays a US attorney a retainer.
2. A company with several US bank accounts, but no physical presence in the United States.
3. A company with US patents, but no physical presence in the United States.
4. All of the above satisfy the minimum requirement for presence in the United States.
5. None of the above satisfy the minimum requirement for presence in the United States.

**Question 1.2**

ABC Corp is an industrial manufacturing company that is filing for bankruptcy. Which of the following **could not** be considered a party in interest?

(a) A neighboring landowner to ABC Corp’s manufacturing plant.

(b) An environmental advocacy group that opposes ABC Corp’s operations.

(c) The landlord of ABC Corp’s corporate office.

(d) People who live several miles downstream from ABC Corp’s manufacturing plant and have been exposed to the plant’s toxic waste.

(e) The US Internal Revenue Service.

**Question 1.3**

Which of the following contracts to which ABC Corp is a party is executory and may be assigned without counterparty consent?

1. A lease on a manufacturing plant that contains a provision that requires landlord approval of any assignment.
2. An employment contact between ABC Corp and a former employee, requiring the company to provide health insurance through the end of the current year.
3. A 10-year software licensing agreement with XYZ Corp that is three years into performance.
4. A lease on office space that ended the prior year, but for which ABC Corp still owes past rent.
5. None of the above are executory and may be assigned without counterparty consent.

**Question 1.4**

Which of the following conditions **must** be true about a reorganization plan for a court to confirm it under Chapter 11 proceedings?

1. Have a possibility of success, even if it relies on speculative or improbable events to be capable of execution.
2. The plan is not likely to be followed by liquidation.
3. All impaired classes must accept the plan.
4. All of the above.
5. None of the above.

**Question 1.5**

Which of the following about cramdowns, is **false**?

1. The plan of reorganization must be fair and equitable to all impaired classes.
2. Differential treatment of different classes is permitted if there is a reasonable, good faith basis for doing so and such treatment is required for the plan of reorganization to be successful.
3. Class definition is often a battleground when a debtor tries to cramdown classes.
4. Dissenting creditors are permitted to challenge the classification of a creditor supporting the cramdown.
5. If one insider creditor approves of the plan of reorganization, all other impaired classes may be crammed down.

**Question 1.6**

Which of the following about 363 sales is **false**?

1. A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.
2. The debtor in possession must establish that the transaction is in the best interests of the estate as a whole.
3. In chapter 15 proceedings, a foreign court’s approval alone suffices for a 363 sale.
4. Debtors must carry out a robust marketing process for the sale.
5. A creditor’s lien on assets sold in a 363 sale attaches to the proceeds of the sale.

**Question 1.7**

Which of the following is true of both an actual fraudulent conveyance and a constructive fraudulent conveyance?

1. The debtor must have had an actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted.
2. Both require at least circumstantial evidence of the fraudulent intent.
3. The debtor must have been insolvent at the time of transaction.
4. In addition to provisions in the Bankruptcy Code, the debtor or the trustee may invoke applicable state or foreign fraudulent conveyance laws.
5. All of the above are true.

**Question 1.8**

**When** does an automatic stay come into effect?

1. Immediately on the filing of any plenary petition.
2. On the filing of a voluntary petition but not on the filing of an involuntary petition.
3. Once the court reviews the petition and grants the stay.
4. Once the petitioner announces their intention to file for bankruptcy publicly.
5. Once a plan of reorganization is confirmed.

**Question 1.9**

Which of the following regarding substantive consolidation is **true**?

1. It respects the boundaries of corporate separateness.
2. It is the treatment of two or more creditors as a single creditor to simplify the claims process.
3. If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.
4. Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.
5. Authority for substantive consolidation comes from the Bankruptcy Code.

**Question 1.10**

Which of the following are relevant factors in determining a debtor’s center of main interests (COMI) in the recognition stage of a Chapter 15 bankruptcy case?

1. The location of the headquarters.
2. The location of primary assets.
3. The location of the majority of the affected creditors in the request for relief.
4. The jurisdiction whose law will apply to most disputes.
5. All of the above.

**QUESTION 2 (direct questions) [10 marks]**

**Question 2.1 (1 mark)**

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

A Setoff is a right allowing parties to net off debts owing to each other, wherein as a result, the parties will be liable to pay the remaining balance only.

Setoffs are not permitted in many circumstances as the amount that a debtor to the insolvency estate could otherwise net off may be much higher than the cents on the dollar claim that they will receive from the estate (which would put them on an uneven footing with other creditors).

**Question 2.2 [2 marks]**

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

You should review the:

* Federal Rules of Bankruptcy Procedure;
* Federal Rules of Civil Procedure; and
* Local rules of procedure of the Court that you are filing in.

As an aside, each judge's personal practices are updated from time to time, and regard should also be had to these practices.

**Question 2.3 [2 marks]**

What does the absolute priority rule require and when can it be deviated from?

The absolute priority rule requires the payment of certain categories of claims before certain lower categories of claims may receive or retain any value in satisfaction of their claims.

The absolute priority rule can be deviated from if a higher in priority creditor agrees to the revision.

**Question 2.4 [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 that is senior or equal to pre-petition liens on estate property and is used to secure post-petition financing.

The debtor must demonstrate that the interest of the secured creditor being primed is adequately protected in order for the lien to be granted.

**Question 2.5 [3 marks]**

What is a preference? What are the elements of a preference claim that need to be proved? Is a showing of fault, by either the debtor or creditor, required?

In summary, a preference occurs when a creditor receives a transfer of property in the suspect period prior to the filing of a petition for bankruptcy.

The elements to be proved are: (a) there is a transfer of an interest in debtor property, (b) to or for the benefit of a creditor, (c) payment is made to a creditor for a pre-existing debt, (d) payment made whilst debtor was insolvent, (e) payment made during suspect period, and (f) the creditor is better off than they would have been under a CH7 liquidation.

No fault, by either the debtor or creditor, is required.

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

**Question 3.1 [3 marks]**

Describe the circumstances in which a bankruptcy court may enter a final order, who reviews appeals from bankruptcy court orders and how are non-final orders reviewed?

Bankruptcy courts have limited jurisdiction to issue final orders. Bankruptcy courts may issue final orders on "*core*" bankruptcy issues, but not on "*non-core*" matters. The lists of core matters is defined in legislation.

Non-core matters may also only be heard if they are sufficiently related to the bankruptcy proceedings. Decisions on non-core matters are non-final. Proposed findings / non-final findings of fact and conclusions of law are submitted to the district court, for the district court's final decision.

Further, appeals from bankruptcy courts are also (usually) heard by the district court for the district in which they sit.

**Question 3.2 [3 marks]**

What provisions of the Bankruptcy Code automatically apply to the debtor’s property within the territorial jurisdiction of the United States upon recognition of a foreign main proceeding? What relief may be granted on a discretionary basis for either foreign main or non-main proceedings?

The stay only arises upon the recognition of a foreign main proceeding being granted and is limited to the property of the debtor with the territorial jurisdiction of the USA.

Upon recognition, the following provisions (inter alia) also apply: the foreign representative may operate the debtor's business and certain dispositions of property are voidable.

The following relief may also be granted on a discretionary basis for foreign non-main proceedings.

The following relief may also be granted on a discretionary basis for either foreign main or non-main proceedings:

* Discovery rights regarding the debtor's assets and affairs;
* Extensions of provisional relief; and/ or
* Any other relief necessary to effectuate the purposes of CH 15 and to protect the assets of the debtor or the interests of creditors.

**Question 3.3 [4 marks]**

What duties do directors owe to a Delaware corporation in the ordinary course of business? To whom are these duties owed when the corporation is potentially or actually insolvent? What rule protects directors from liability for errors of judgment?

Duties owed by directors in the ordinary course of business:

* Fiduciary duty of loyalty to the corporation's best interests; and
* Duty of care in educated decision-making.

According to the business judgment rule, the board will be presumed to have acted in good faith on the basis of reasonable information and thus will not have liability for otherwise breaching the above duties.

This presumption is rebutted if the majority of the board were not reasonably informed and did not honestly believe they were acting in the corporations best interests, or were not acting in good faith.

Further, there are no duties owed when the corporation is potentially or actually insolvent. That is, there is no duty even when the company is in the "*zone of insolvency*", or actually insolvent. There is no "*insolvent trading*" provision in the USA.

**Question 3.4 [5 marks]**

List and describe the requirements that a creditor’s claim must fulfill in order to qualify as a petitioning creditor in an involuntary proceeding.

Creditor may commence under either CH 7 or 11.

To qualify as a petitioning creditor must be show that the claim against the debtor is:

* Non-contingent, that is a claim that does not depend on the occurrence of future events. For example:
  + a guarantee where there has been no underlying default would not suffice; and
  + an unmatured debt where the payment is due in the future is not contingent if all requirements for liability except the passing of time have occurred.
* Not the subject of a *bona fide* dispute as to liability or amount. For example:
  + It needs to be shown that it is objectively reasonable to say there is no debt as a matter of fact or law; and
  + The debtor's subjective belief that the debt is not owed or is claimed is not sufficient.
* The amount is not *de minimis*. Presently, the amount for the petition must be greater than USD 16,750; and
* An allegation must be made that the debtor is not paying its debts as they become due.

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

**Question 4.1 [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 been sued 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 the (i) DOJ investigation, (ii) margin loan default; (iii) delinquent lease and (iv) employment discrimination lawsuit?

Effect of filing a Chapter 11 petition by Speculation Inc on each of the:

1. **DOJ investigation**

Filing a CH 11 petition will not automatically stop the DOJ investigation into whether Speculation Inc's success was due to illegally trading on insider information. The DOJ may continue its investigation, even if the company is in bankruptcy.

1. **Margin loan default**

In most cases there is an automatic worldwide stay following the filing of a petition. Subject to any specific rule, the margin call would therefore likely be stayed – particularly as this is a CH 11 filing.

1. **Delinquent lease**

Claims for rent would be stayed (unenforceable). The Lessor would be required to put in a proof of debt if the company ultimately goes into CH 7.

1. **Employment discrimination lawsuit**

There will be a stay on this lawsuit.

**Question 4.2 [5 marks]**

Stella SA (Stella) is a an international cosmetics company incorporated in France, with its headquarters in Paris. Stella’s products are made in Italy and shipped to its retail stores in Europe (including England), Asia, and North America. Stella’s funding comes from a bank loan and Eurobonds, both of which are governed by English law. Stella’s retail sales have suffered due to pandemic-related closures and it is considering options to restructure its debt. One option is to use an English scheme of arrangement with respect to the Eurobonds. Could the English scheme of arrangement be recognized by a US bankruptcy court under Chapter 15, and would such recognition be as a foreign main or non-main proceeding?

An English scheme of arrangement with respect to the Eurobonds will be granted recognition under CH 15.

However, the COMI of the business is unlikely to be the United Kingdom.

The following factors militate to France being the COMI, Stella is:

* incorporated in France; and
* headquartered in Paris.

Further, the location of the business assets seems to indicate that Italy should be the COMI.

Therefore, on balance, the COMI will not be the United Kingdom, and the proceedings will be recognized as non-main proceedings in the United States.

**Question 4.3 [5 marks]**

ToyCo is an American toy company that has created a popular line of folding robot toys called Xblox. The toys are covered by several US patents. Currently, GameMart Inc (GameMart) has a 10-year exclusive license to manufacture Xblox and pays ToyCo monthly royalties. GameMart operates a factory in California that it leases from Land Corp on a longer term lease with seven years to go; the lease prohibits assignment without Land Corp’s consent. The Xblox toys are selling well, but GameMart’s other toy lines are doing poorly, so it is considering a Chapter 11 bankruptcy. Answer the following questions:

(i) Is the license to manufacture Xblox an executory contract?

There are material unperformed obligations on either side, as such the license to manufacture Xblox is an executory contract.

(ii) Can GameMart transfer the Xblox license as part of 363 sale without ToyCo’s consent? Why or why not?

As a general rule, yes.

However, there is IP at play, and thus it may be that the assignment will not be allowed unless ToyCo consents.

In any event, ToyCo must likely give adequate assurances of future performance.

(iii) Can GameMart transfer the factory lease as part of 363 sale without Land Corp’s consent? Why or why not?

Yes, the lease will be assignable.

**\* End of Assessment \***