



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: **[student number.assessment3A]**. An example would be something along the following lines: 202021IFU-314.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 “studentnumber” 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 2021**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2021. 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 2021** or by **23:00 (11 pm) BST on 31 July 2021**. If you elect to submit by 1 March 2021, you **may not** submit the assessment again by 31 July 2021 (for example, in order to achieve a higher mark).
7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

Commented [A&O1]: Total marks 27.5/50

QUESTION 1 (multiple-choice questions) [10 marks in total]

Commented [A&O2]: Total marks 6/10

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

Commented [A&O3]: Correct, 1 mark

FabCo, based in Utah, owes SupplyCo, based in Mexico, US\$10,000 on a past-due invoice. May SupplyCo file an involuntary petition to place FabCo into chapter 11 bankruptcy proceedings?

- (a) Yes.
- (b) Yes, if FabCo has fewer than 12 non-contingent, non-insider creditors.
- (c) Yes, if other creditors owed at least US\$5,775 join in the petition.**
- (d) No, because SupplyCo doesn't know whether FabCo is insolvent.
- (e) No, because SupplyCo is not a US company.

Question 1.2

Commented [A&O4]: Incorrect, the correct response is (b)

Which of the following is a *mandatory*, rather than *discretionary*, basis to deny recognition of a foreign judgment under state law based on one of the Uniform Acts?

- (a) The foreign judgment is subject to appeal in the foreign country.**
- (b) The foreign judgment is an injunction.
- (c) The foreign judgment was issued by a court, contrary to the parties' agreement to arbitrate.
- (d) The defendant did not have sufficient notice of the foreign proceeding to put on a defense.
- (e) The foreign judgment is inconsistent with another final judgment on the same subject matter.

Question 1.3

Commented [A&O5]: Correct, 1 mark

Which of the following is likely to be a party in interest in the bankruptcy of XYZ Corp?

- (a) A shareholder in ABC Corp, to which XYZ Corp is substantially indebted.
- (b) A journalist writing about XYZ Corp's bankruptcy.
- (c) A shareholder in MNO Corp, which owns all of XYZ Corp's shares.

(d) A retired employee of XYZ Corp who receives payments from the company's pension plan.

(e) A non-profit organization that advocates for companies like XYZ Corp to be held responsible for climate change.

Question 1.4

If a debtor rejects an executory trademark license agreement under which it licenses a trademark to its counterparty, which of the following is true:

(a) The counterparty must immediately stop using the trademark.

(b) The counterparty can continue using the trademark for the remaining period of the license.

(c) The counterparty has a claim for damages for breach of contract.

(d) Both (a) and (c).

(e) Both (b) and (c).

Question 1.5

In which of the following circumstances may a counterparty enforce a contractual *ipso facto* clause?

(a) The contract would obligate the counterparty to extend a loan to the debtor.

(b) The contract is a lease of real property.

(c) The clause is triggered by the bankruptcy filing of a third party, not the debtor.

(d) Both (a) and (c).

(e) *Ipso facto* clauses are never enforceable against a debtor.

Question 1.6

What does a chapter 11 debtor have exclusivity to propose for the first 120 days of proceedings?

(a) Avoidance actions.

(b) A plan of reorganization.

(c) DIP financing.

(d) Lifting the automatic stay.

(e) Formation of an equity committee.

Commented [A&O6]: Incorrect, the correct response is (e)

Commented [A&O7]: Incorrect, the correct response is (d)

Commented [A&O8]: Correct, 1 mark

Question 1.7

Which of the following is **not** a requirement to confirm a “cramdown” plan?

- (a) Acceptance of the plan by all classes of secured creditors.
- (b) Acceptance of the plan by at least one class of impaired, non-insider creditors.
- (c) The plan is fair and equitable to dissenting classes of creditors.
- (d) The plan does not discriminate unfairly against dissenting classes of creditors.
- (e) The dissenting creditors receive no less than they would under a liquidation scenario.

Commented [A&O9]: Correct, 1 mark

Question 1.8

When may distributions to creditors diverge from the absolute priority rule?

- (a) In a chapter 7 proceeding with consent of the affected senior creditor.
- (b) In a chapter 7 proceeding with consent of the affected junior creditor.
- (c) In a chapter 11 proceeding with consent of the affected senior creditor.
- (d) In a chapter 11 proceeding with consent of the affected junior creditor.
- (e) The absolute priority rule cannot be deviated from.

Commented [A&O10]: Correct, 1 mark

Question 1.9

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.
- (d) An insolvency professional appointed by a creditor where the foreign proceeding is an involuntary receivership.
- (e) All of the above.

Commented [A&O11]: Incorrect, the correct response is (e)

Question 1.10

Which of the following is *not* available as relief in a chapter 15 proceeding?

- (a) Sale of US property free and clear pursuant to section 363.
- (b) Prosecution of avoidance actions pursuant to section 544 .
- (c) Entrusting the management of US assets to the foreign representative.

Commented [A&O12]: Correct, 1 mark

(d) Application of the automatic stay under section 362 to the debtor's interests in US property.

(e) Discovery about the debtor's assets.

QUESTION 2 (direct questions) [10 marks]

Commented [A&O13]: Total marks 6.5/10

Question 2.1 [maximum 1 mark]

Commented [A&O14]: Total marks 1/1

What two alternative qualifications render a corporation eligible to be a debtor in a US chapter 7 or 11 proceeding?

A corporation is eligible to be a debtor in a US chapter 7 or 11 proceeding is that the presence of the debtor or its place of business or any of its assets in the United States.

Commented [A&O15]: Correct, ½ mark

Commented [A&O16]: Correct, ½ mark

Question 2.2 [maximum 2 marks]

Commented [A&O17]: Total marks 1.5/2

What is an executory contract?

An executory contract is a contract that had material unperformed obligations on both side of the party. If either side of the party had accomplished his obligation in the contract, it is not an executory contract. If the debtor had not made its final payment while the construction has complete, the contract was not executory.

Commented [A&O18]: Correct, ½ mark, and they such significant obligations that failure to perform would be a material breach.

Commented [A&O19]: Correct, 1 mark

Question 2.3 [maximum 2 marks]

Commented [A&O20]: Total marks 2/2

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 senior or equal to a pre-petition lien on estate property to secure post-petition financing.

Commented [A&O21]: Correct, 1 mark

To meet for such a lien to be granted to secure debtor in possession financing, the debtor must demonstrate that the debtor is unable to obtain credit otherwise and that the existing lienholder's interest in its collateral is adequately protected notwithstanding the grant of the priming lien under Bankruptcy Code 364(d)(1).

Commented [A&O22]: Correct, ½ mark

Commented [A&O23]: Correct, ½ mark

Question 2.4 [maximum 2 marks]

Commented [A&O24]: Total marks 1/2

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

In voting on a plan of reorganization, the unimpaired class is deemed to accept the plan while the impaired class that receive nothing is deemed to reject the plan. All holders of the claims can vote. At least one impaired class (not counting the insiders) must have voted to accept the plan.

Commented [A&O25]: Correct, ½ mark

Commented [A&O26]: Correct, ½ mark

Commented [A&O27]: Incorrect, only impaired claims that receive something under the plan can vote. A class accepts the plan when a majority of creditors, holding 2/3rds of the claims by value, votes in favor.

Question 2.5 [maximum 3 marks]

Commented [A&O28]: Total marks 1/3

How does the automatic stay available in chapter 15 proceedings differ from that available in chapter 11 proceedings?

Under Chapter 11 proceedings, an estate is created consisting of all of the debtor's property interests as of the petition date. Hence, the automatic stay available in chapter 11 proceedings comes into effect immediately on the filing of any plenary petition which allows to negotiate with creditors and realize the assets orderly to settle the creditor's claim. Such stay applies to all property of estate in the world, not only United States.

The automatic stay available in Chapter 15 proceedings excludes the rights granted to foreign representatives the use of avoidance powers provided by the Bankruptcy Code. Hence, the foreign representative can only invoke the Bankruptcy Code avoidance powers in a Chapter 11 proceedings. Upon the recognition of the foreign main proceedings, the automatic stay in Chapter 15 proceedings only applies to the debtor's property within the territorial jurisdiction of the United States.

Commented [A&O29]: Correct, ½ mark. The stay can also come into effect in chapter 15 on a request for interim relief or on a discretionary basis on recognition of a foreign non-main proceeding. By contrast, the stay comes into effect in chapter 11 on filing of the petition.

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

Commented [A&O30]: Correct, ½ mark, by contrast, the stay in chapter 11 has worldwide effect.

Question 3.1 [maximum 3 marks]

Commented [A&O31]: Total marks 10/15

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?

Commented [A&O32]: Total marks 3/3

Directors of Delaware corporations owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care in educated decision-making. In the ordinary course of business, the directors' duties are owed to the corporation and its shareholders. Even when the corporation is potentially or actually insolvent, the directors owe duties to the corporation and its shareholders, not to creditors.

Commented [A&O33]: Correct, ½ mark

Commented [A&O34]: Correct, ½ mark

Commented [A&O35]: Correct, ½ mark

Commented [A&O36]: Correct, ½ mark

Commented [A&O37]: Correct, ½ mark

Commented [A&O38]: Correct, ½ mark

Question 3.2 [maximum 3 marks]

Commented [A&O39]: Total marks 1.5/3

Describe the circumstances in which a bankruptcy court may enter a final order, who reviews appeals from bankruptcy court orders (Section 5.3.5.3?) and how non-final orders are reviewed.

The Bankruptcy court can only hear and enter a final order for core proceedings. At the outset of each motion or pleading, parties must state whether the issue is core or non-core as the bankruptcy court can only determine the scope of its jurisdiction and power to enter a final order or judgment.

Commented [A&O40]: Partially correct, ½ mark, it may enter a final order on a challenge to the petition or on a core matter with consent of the parties. A non-final order is treated as a report and recommendation.

Generally, the district court for the district in which they sit reviews appeals from bankruptcy court orders. However, in certain circuits, a Bankruptcy Appellate Panel which was convened from the judges of the Bankruptcy court within the circuit could also review appeals from bankruptcy court orders. In very rare circumstances that the bankruptcy court or district court certifies that the appeal raises a question of law or requires resolving conflicting controlling decision or it may materially advance the progress of the case, the court of appeals may review the bankruptcy court order if she accepts the case.

Commented [A&O41]: Correct, ½ mark

Commented [A&O42]: Correct, ½ mark

Question 3.3 [maximum 4 marks]

Commented [A&O43]: Total marks .5/4

Describe how claims for recovery of preferences, fraudulent conveyance and constructive fraudulent conveyance differ.

For the claims for recovery of preferences, the creditors must return the debtor's property to the Bankruptcy estate if it exceeds the amount the recipient would have received in a chapter 7 liquidation as if the transfer had not been made unless the creditor to show the requirements of the defense, such as ordinary course of business, new value created or contemporaneous exchange, have been met.

For fraudulent conveyance where the debtor is proven the transfer with actual intent to hinder, delay or defraud any entity, the debtor might face liability under a money judgment, settlement, penalty arising from violation of state or laws. The bankruptcy trustee could recover the property transferred fraudulently for the benefit of all of the creditors of the debtor. Some courts have ruled that, because the fraudulent transfer laws are remedial, rather than punitive, recovery should be limited to the amount necessary to satisfy creditor claims, thereby preventing a windfall. However, other courts, including two circuit courts of appeal, have ruled that the amount a trustee can recover is not capped at the aggregate amount of unsecured claims against the estate.

For constructive fraudulent conveyance, the recipient may retain the property received or enforce the obligation created if it took for value and in good faith. If a transfer is avoided under section 548, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property.

Question 3.4 [maximum 5 marks]

How does a US bankruptcy court determine whether a foreign proceeding is a main or non-main proceeding under chapter 15?

To determine whether a foreign proceeding is a foreign main or foreign non-main proceeding under chapter 15, the debtor's center of main interests ("COMI") would be considered. Proceedings in a jurisdiction other than the debtor's COMI where the debtor had an establishment in the jurisdiction which carried out non-transitory economic activity, can be recognized as foreign non-main proceedings while proceedings in a jurisdiction of the debtor's COMI can be recognized as foreign main proceedings.

The debtor's COMI should be ascertainable by its creditors or other third parties on the basis of objective evidence which is presumed to be its place of incorporation. However, relevant factors include the location of headquarters, location of management, location of primary assets, location of a majority of debtor's creditors, location of the books and records, the location where financing of GSC was organized or authorized, jurisdiction whose law will apply to most disputes.

In the Bear Stearns case, the US bankruptcy court held that the place of incorporation, Cayman Islands could not be the COMI while COMI is to be assessed as of the date of the US petition.

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

Question 4.1 [maximum 5 marks]

Rental Corporation is a publicly-traded company that leases office space from office building owners and sublets the space to small businesses. It has recently announced that it is being investigated by the US Department of Justice Fraud Division (DOJ) regarding allegedly

Commented [A&O44]: Partially correct, ½ mark. A preference is a payment to a creditor on account of antecedent debt during a suspect period (90 days or 1 year pre-petition) when the debtor was insolvent.

Commented [A&O45]: Correct, ½ mark. The lookback period for fraudulent conveyances is 2 years. The counterparty need not have been a creditor, and the debtor need not have been insolvent (but this may be a factor).

Commented [A&O46]: Total marks 5/5

Commented [A&O47]: Correct, 1 mark

Commented [A&O48]: Correct, 1 mark

Commented [A&O49]: Correct, ½ mark

Commented [A&O50]: Correct, ½ mark

Commented [A&O51]: Correct, 1 mark

Commented [A&O52]: Correct, 1 mark

Commented [A&O53]: Total marks 5/15

Commented [A&O54]: Total marks 3/5

fraudulent misstatements of revenues; shortly after the announcement, a securities class action litigation was filed against Rental Corporation in New York federal court. Due to the increase in the numbers of businesses operating remotely, Rental Corporation has suffered a decline in revenues. As a result, it has failed to pay rent on some of its office space leases and it has just defaulted on its quarterly payment on its credit facility. What would be the effect of a chapter 11 petition being filed by Rental Corporation on each of (i) the DOJ investigation, (ii) the securities class action litigation; (iii) the delinquent leases and (iv) the credit facility?

If Rental Corporation filed chapter 11 petition, the effect of DOJ investigation, securities class action litigation, delinquent leases and credit facility would be illustrated as follows:-

(i) the DOJ investigation

The filing of a petition, however, does not operate as a stay for certain types of actions listed under Section 362(b) of the Bankruptcy Codes. Though Rental Corporation filed a chapter 11 petition, the filing of such petition does not operate as a stay for the commencement or continuation of a criminal action or proceeding against Rental Corporation of its fraudulent misstatements of revenue (which was a criminal investigation) under Section 362(b)(1) of the Bankruptcy Codes.

(ii) the securities class action litigation

A securities class action is a lawsuit filed by investors who bought or sold a company's publicly traded securities and suffered economic injury as a result of violations of the securities laws. A securities class action against Rental Corporation is generally subject to the Bankruptcy Code's automatic stay, which typically halts litigation against Rental Corporation upon its filing for bankruptcy. However, such automatic stay may be lifted upon creditor's request under Section 362(d) of the Bankruptcy Code. Any judgment or settlement in a securities class action against Rental Corporation would be an unsecured claim, and any recovery by shareholders from the bankruptcy estate would be subordinate to recovery by the company's more senior creditors. Undeniably, the recovery of the investors would be small and less than a full recovery.

(iii) the delinquent leases

The Rental Corporation has failed to pay rent on some of its office space leases. Upon the filing of the chapter 11 petition, unexpired leases become property of the bankruptcy estate. This allows Rental Corporation to decide whether to assume the lease, or reject the lease. Rental Corporation must make their election within 120 days of the bankruptcy filing. If assumed, the lease remains in effect and Rental Corporation must pay the defaults and give the landlord sufficient assurances of its future performance under Section 365(b)(1) of the Bankruptcy Codes. If rejected, Rental Corporation is automatically deemed in breach of the agreement which allows the landlord to terminate the lease while the landlord was given an unsecured pre-petition claim in damages under Section 365(g)(1) of the Bankruptcy Codes.

(iv) the credit facility

The Rental Corporation has just defaulted on its quarterly payment on its credit facility. However, since Rental Corporation filed a chapter 11 petition, the automatic stay provides a period of time in which all judgments, collection activities, foreclosures, and repossessions of property are suspended and may not be pursued by the creditors on any pre-petition claim that arose before the filing of the bankruptcy petition.

Question 4.2 [maximum 5 marks]

Considering the facts set forth in Question 4.1, what protections does the Bankruptcy Code provide to lessors of office space to Rental Corporation?

Commented [A&O55]: The automatic stay would come into effect on the filing date.

Commented [A&O56]: Correct, 1 mark

Commented [A&O57]: Correct, 1 mark

Commented [A&O58]: The lessors would be barred from pursuing eviction proceedings because the leases had not terminated pre-petition.

Commented [A&O59]: Correct, 1 mark

Commented [A&O60]: Total marks 1/5

Considering the facts set forth in Question 4.1, Rental Corporation is automatically deemed in breach of the agreement if it rejected the lease which allows the landlord to terminate the lease while the landlord was given an unsecured pre-petition claim in damages. To protect the lessors, the landlord could also consider to apply for obtaining relief from the automatic stay. Since lack of adequate protection of the lessor where the value of the property may decline during the course of proceedings and result in the interested party making less than a full recovery, the lessor could apply a lift-stay to re-possess the property under Section 362(d) of the Bankruptcy Code.

Question 4.3 [maximum 5 marks]

Paint Corporation formulates house paint according to proprietary and patented recipes at its factory in the United States, which it sells to home improvement stores under a number of distribution contracts. The US Environmental Protection Agency is investigating whether Paint Corporation's operations are causing harmful chemicals to contaminate a nearby river. Paint Corporation is concerned it cannot afford the clean-up that may be required and is seeking to sell its business. Home Corporation is interested in buying the business, but does not want the potentially contaminated property (it can manufacture paint at its own factory) and is concerned about obtaining consent from all the home improvement stores to assign the distribution contracts. How would a sale under section 363 of the Bankruptcy Code address these issues?

A 363 Sale refers to the sale of an organization's assets under Section 363 of the US Bankruptcy Code. The sale enables debtors to fulfill their obligations to creditors by selling their assets in the ordinary course of business and using the funds collected to settle their debts. The good-faith purchasers of the assets benefit from the opportunity to acquire valuable assets that are free of liens, claims, or other encumbrances – often at discount prices.

However, in the distribution contracts between Paint Corporation and home improvement stores. Paint Corporation distributed the house paint with proprietary and patented recipes to home improvement stores. Depending to the specific provisions in the distribution contracts, licensee of patents and copyrights owned by Paint Corporation under Section 365(n) of the US Bankruptcy Code are protected assumed that the distribution contract was not merely distributing the paints, but also specifying to distribute the patented receipts paints.

Section 365(n) of the Bankruptcy Code applies to licenses of intellectual property which included patentable inventions and patent applications. Assumed the patented receipts paints manufactured by Paint Corporation was included as the patentable inventions covered by Section 365(n) of the Bankruptcy Code, it might serve as a barrier to the 363 Sale. Without negotiating a binding commitment directly with each home improvement stores, Home Corporation cannot determine with any certainty whether it will have control over the patented paints (i.e. intellectual property) to be accepted by the home improvement stores. Depending, however, upon the nature of the distribution contracts between Paint Corporation and home improvement stores, Home Corporation could include representations, warranties, contract schedule with indemnification clauses and out-clauses in the sale under Section 363 of the Bankruptcy Code.

*** End of Assessment ***

Commented [A&O61]: Giving you credit here for your answer in the prior question regarding the 120 day deadline to assume or reject the leases (1 mark). This period can be extended by 90 days for cause, but not further without lessor consent.

Commented [A&O62]: Rental Corp must pay rent as an administrative expense for the period prior to assuming or rejecting the leases and must pay 2 years rent as an administrative expense if it assumes and then rejects the leases. The lessors would have an unsecured claim for the unpaid pre-petition rent.

Commented [A&O63]: Total marks 1/5

Commented [A&O64]: Correct, 1 mark, Home Corporation could acquire only the assets it wants free and clear of the environmental claims, which may generate a higher price than outside of bankruptcy.

Commented [A&O65]: The distribution contracts could be assumed and assigned as executory contracts without counterparty consent.