



### **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 23/50

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

Commented [A&O2]: Total marks 5/10

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]: Incorrect, the correct response is (c)

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]: Incorrect, the correct response is (d)

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**

Commented [A&O6]: Correct, 1 mark

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**

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

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**

Commented [A&O8]: Correct, 1 mark

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.

**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]: Correct, 1 mark

**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 .

Commented [A&O12]: Incorrect, the correct response is (b)

- (c) Entrusting the management of US assets to the foreign representative.
- (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 7/10

**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?

[The minimum requirement to be a debtor under any chapter of the Bankruptcy Code is the presence of the debtor or its place of business **or any of its assets in United States**. However there are certain categories of debtor who can qualify to be as debtor either under Chapter 7 or 11 of the Bankruptcy Code. Like Stockbrokers and Commodity Brokers will qualify only for Chapter 7 whereas certain entities like financial companies and railroads will qualify only for Chapter 11 proceedings.]

**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?

[Executory Contract is a contract where there are **unperformed material obligations on both side of the parties or contract wherein both the parties have continuing obligations to perform**. E.g; Real Estate Contracts, Business Contracts etc.]

**Commented [A&O18]:** Correct, ½ mark, and the nature of these obligation is such 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?

[Priming Lien is a lien where a **lender is considered primed when they are surpassed by another lender with respect to their priority status regarding the collateral of a secured loan primarily because of existence of liens or other restrictions placed on the collateral in question**.]

**Commented [A&O21]:** Correct, 1 mark

A Debtor In Possession Financing [DIP Financing] can be granted when **the debtor is unable to obtain any other type of financing (unsecured loans on an administrative priority basis or non-priming DIPs) and either the holders of existing liens (the primed lenders) consent or the debtor can demonstrate such secured creditors are adequately protected from the diminution in value of their collateral as a result of the priming lien.**

**Commented [A&O22]:** Correct, ½ mark

**Commented [A&O23]:** Correct, ½ mark

**Question 2.4 [maximum 2 marks]**

**Commented [A&O24]:** Total marks 1.5/2

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?

[While voting on a plan of reorganisation:

- **An unimpaired class of creditors is deemed to accept the plan**

**Commented [A&O25]:** Correct, ½ mark

- Class of creditors that will receive nothing is deemed to have rejected the plan.
- Class of creditors holding at least 2/3<sup>rd</sup> of value of claims in the class is permitted to vote on the plan.
- For a class of creditors to accept a plan voting in favour by simple majority of the creditors in class holding at least 2/3<sup>rd</sup> of value of claims in the class is required.

**Commented [A&O26]:** Correct, ½ mark

**Commented [A&O27]:** Incorrect, creditors whose claims are impaired but will receive something under the plan are entitled to vote.

**Commented [A&O28]:** Correct, ½ mark

**Question 2.5 [maximum 3 marks]**

**Commented [A&O29]:** Total marks 1/3

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

[The automatic stay under Chapter 11 proceeding prevents creditors from taking any action to possess or exercise control over property of the corporate debtor or of the estate located anywhere in any part of the world. This moratorium applies globally and includes property located outside of the United States as well.]

**Commented [A&O30]:** Correct, ½ mark, also it comes into effect on filing the petition whereas a stay comes into effect in chapter 15 on an application for interim relief, automatically on recognition of a foreign main proceeding or discretionarily on recognition of a foreign non-main proceeding

[Whereas the automatic stay under Chapter 15 proceedings is limited only to the property of the corporate debtor located in the United States. Here the moratorium applies only on the debtor's assets located within the territorial jurisdiction of the United States while promoting consistency with similar statutes enacted in foreign jurisdictions.]

**Commented [A&O31]:** Correct, ½ mark

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

**Commented [A&O32]:** Total marks 6/15

**Question 3.1 [maximum 3 marks]**

**Commented [A&O33]:** Total marks 1.5/3

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 of directors of Delaware Corporations are Duty of Care and Duty of Loyalty. By duty of care it implies making informed and deliberative decisions about the company whereas by duty of loyalty it means acting of directors in an independent and transparent manner while handling the interest of the stakeholders of the company. In the ordinary course of business these duties are owed towards the company who work towards the maximisation of its stakeholder's interest.]

**Commented [A&O34]:** Correct, ½ mark

**Commented [A&O35]:** Correct, ½ mark

**Commented [A&O36]:** Correct, ½ mark, they also owe their duties to shareholders

Delaware Law holds that the duties of the directors will remain intact irrespective of the fact whether the corporation is solvent or insolvent. However when the corporation is potentially or actually insolvent then directors owe their duties towards the shareholders and creditors of the corporation.]

**Commented [A&O37]:** Incorrect, the duties are always owed to the corporation and shareholders, never to creditors.

**Question 3.2 [maximum 3 marks]**

**Commented [A&O38]:** Total marks 1/3

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

[US Bankruptcy Court may on its own motion or all the parties concerned timely motion may pass final order when a decision has been entered that end the litigation on the merits and leaves nothing for the court to do but execute the judgment.]

**Commented [A&O39]:** As a matter of constitutional authority, a bankruptcy court may enter final orders on challenges to petition or on core matters with consent of the parties. When it does not have authority to enter a final order, its decision may be a report and recommendation (finding of facts and conclusions of law) to the district court.

The appeals from US Bankruptcy Court are heard by the district courts set up in the respective jurisdiction or by Bankruptcy Appellate Panel.

Commented [A&O40]: Correct, ½ mark

Commented [A&O41]: Correct, ½ mark

Non-Final Orders may be reviewed only after obtaining the permission of Appellate Court. ]

**Question 3.3 [maximum 4 marks]**

Commented [A&O42]: Total marks 1/4

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

[A **Preference Claim** is a claim that prioritises a creditor over the similarly situated creditor or disincentives one creditor with the similarly situated creditor during a suspected period before the petition date. Such claims intend to provide unbiased benefit to a particular creditor or class of creditor.

Commented [A&O43]: Correct, ½ mark, the payment must be on account of an antecedent debt, during a suspect period (90 days or 1 year), when the debtor is insolvent.

A **Fraudulent Conveyance** is a transaction wherein the corporate debtor has made a transfer or incurred an obligation with intent to defraud any creditor or class of creditor. Such transactions are entered either with an insider or incurred nearly before or after the substantial debt or value of consideration received for such transaction by debtor was not at arm's length price.

Commented [A&O44]: Correct, ½ mark, the lookback period is 2 years for fraudulent conveyances

A **Constructive Fraudulent Conveyance** is a transaction incurred by the corporate debtor wherein the consideration received by debtor pursuant to the transaction is considerably low than the reasonable value and consequently debtor become insolvent or was insolvent during transaction or transaction was made for some undue advantage for some insider/related party of the debtor.]

**Question 3.4 [maximum 5 marks]**

Commented [A&O45]: Total marks 2.5/5

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

[Filing of an insolvency proceeding under Chapter 15 happens only when foreign representative of corporate debtors files for such application. The stay under Chapter 15 proceeding is announced only upon the recognition of a proceeding as foreign main or non-main proceeding.

A US Bankruptcy Court determines a foreign proceeding as a foreign main proceeding if the proceeding has been initiated in corporate debtor's Centre of Main Interest i.e if the proceeding has been initiated in a jurisdiction where debtor's principal place of business/headquarters/management is located or jurisdiction in which majority of creditors of debtors resides.

Commented [A&O46]: Correct, 1 mark, the COMI is evaluated as of the date of commencement of the US proceeding

Commented [A&O47]: Correct, ½ mark, the debtor's jurisdiction of incorporation is presumed to be its COMI, but this may be rebutted and should be ascertainable by creditors and third parties on objective evidence

Whereas if proceeding has been initiated at any place apart from the debtor's centre of main interest then such proceeding will be termed as foreign non-main proceeding. On the basis of determination of a proceeding as a main or non-main proceeding, the relief available to the debtor will be ascertained.]

Commented [A&O48]: Correct, ½ mark

Commented [A&O49]: Partially correct, ½ mark, the debtor must have an establishment in that jurisdiction



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

Commented [A&O50]: Total marks 5/15

**Question 4.1 [maximum 5 marks]**

Commented [A&O51]: Total marks 4/5

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 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?

[Upon filing of petition under Chapter 11 of US Bankruptcy Code by Rental Corporation a worldwide automatic stay will come into effect that will protect the assets of the corporate debtor in any part of the world from any legal consequences till the time restructuring of Rental Corporation under Chapter 11 is in process. Upon analysing the facts of the case the effect of such stay will be as follows;

Commented [A&O52]: Correct, 1 mark

- **DOJ Investigation**- This investigation falls under the category of regulatory investigation which is outside the ambit of automatic stay. Hence the investigation will continue even if insolvency proceeding has been initiated.
- **Securities Class Action Litigation**- This will be stayed till the automatic stay is in force.
- **Delinquent Leases**- This will be outside the ambit of automatic stay available with Rental Corporation. Hence no moratorium in respect of delinquent lease.
- **Credit Facility**- This will be stayed till the automatic stay is in force.

Commented [A&O53]: Correct, 1 mark

Commented [A&O54]: Correct, 1 mark

Commented [A&O55]: Incorrect, because the leases were not terminated prior to the bankruptcy (only payment defaults had occurred), the stay bars eviction proceedings.

Commented [A&O56]: Correct, 1 mark

Commented [A&O57]: Total marks 1/5

**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?

[Protection available to the lessor of office space to Rental Corporation are as follows :

- Lessor may proceed for post-filing rent payments followed by the eventual assumption of the lease and curing of outstanding monetary defaults. In such circumstances, the lessors are ultimately benefits from the bankruptcy as the lessee theoretically emerges in better financial health.
- If lessee rejects the lease and surrenders the premises then lessors claim can be claimed either as an administrative expense claim for the use of the premises by lessee during the bankruptcy or as a lease rejection damages.
- Reorganisation Plan under Chapter 11 provides for payment in full for Administrative Expense Claims. However an administrative expense claim is not automatically measured by the contractual rent. If the lease was above market value then the debtor/creditors may object to an exceedingly large administrative claim by the lessor.]

Commented [A&O58]: The debtor have 120 days to decide whether to assume or reject the leases, subject to a 90 day extension for good cause, but no further objection without the consent of the lessors.

Commented [A&O59]: Correct, 1 mark, also there is an administrative priority claim for 2 years' rent if the debtor assumes and then rejects the leases

Commented [A&O60]: The lessors also have an unsecured claim for unpaid pre-petition rent

**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?

[There is no particular procedure prescribed under the US Bankruptcy Code to give effect to a sale under Section 363. However as per the facts of the case, Home Corporation is interested only in buying the business of Paint Corporation and not its contaminated property; therefore to give effect to the sale under Section 363 of the Bankruptcy Code; as a part of reorganisation plan Paint Corporation may propose to sell its contaminated property by way of an auction conducted with "Stalking Horse" Bidder pursuant to which the Paint Corporation will invite expression of interest from prospective buyer to purchase the property after conducting proper due diligence.

The buyer winning the bid will require court's approval so that no other buyer may bid for that property unless a higher price is being offered by the later buyer.

If a creditor is having secured interest over the contaminated property then such creditor may make credit bid for this property wherein the creditor will be required to pay an amount equivalent to the amount over and above the loan amount over which security is created.

Such a sale of contaminated property will be subject to court approval to ensure that the sale is made to an independent bidder and also at an arm length's price. ]

**\* End of Assessment \***

**Commented [A&O61]:** Total marks 0/5

**Commented [A&O62]:** Home Corp's purchase of assets would proceed under section 363 and by excluding the contaminated property, and having the assets free and clear of the environmental claim the debtor may get a higher sales price. The purchase could include the distribution contracts, even if the counterparties do not consent, and Home Corp would be protected from reversal on appeal.