



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 32.5/50

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]: 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]: 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]: 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 .
- (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 7.25/10

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 two alternative qualifications (which are required by the Bankruptcy Code) are:

(a) that the debtor has a presence or place of business in the US; or

Commented [A&O15]: Correct, ½ mark

(b) that the debtor has assets in the US (which can be met by paying a retainer to a US attorney).

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 where each counterparty to that contract has material obligations under that contract which it has yet to perform. An example of an executory contract is a construction contract where the building hasn't been fully constructed and the payments owed to the builder haven't been fully paid.

Commented [A&O18]: Correct, 1 mark

Commented [A&O19]: Correct, ½ mark, they must be of such significance that failure to perform would be a material breach

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 a lien granted to secure post-petition financing where the debtor isn't able to obtain financing except by offering that lien. The priming lien gives the creditor providing the post-petition financing a senior or pari passu lien to any pre-petition lien. The debtor needs to show the court that the interest of the creditor providing the post-petition financing is adequately protected.

Commented [A&O21]: Correct, ½ mark

Commented [A&O22]: Correct, 1 mark

Commented [A&O23]: Correct, ½ mark

Question 2.4 [maximum 2 marks]

Commented [A&O24]: Total marks 1.75/2

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?

(i) The class(es) of creditors which are deemed to accept the plan are the unimpaired class(es).

Commented [A&O25]: Correct, ½ mark

(ii) The class(es) of creditors which are deemed to reject the plan are the class(es) of creditors that will receive nothing under the plan, and

Commented [A&O26]: Correct, ½ mark

(iii) Only impaired classes of creditors can vote on the plan of reorganisation. An impaired creditor is one whose contractual rights are altered by the plan of reorganisation.

Commented [A&O27]: Partially correct, ¼ minutes, the class must be both impaired and receiving something under the plan.

For a class of creditors to accept the plan it must:

- constitute a simple majority of the creditors in that class;
- it must hold two-thirds of the value of the claims in that class; and
- it must vote in favour of the plan.

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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 in chapter 15 proceedings applies to a debtor's property situated within the US whereas the automatic stay in chapter 11 proceedings applies to a debtor's property wherever it is situated and not merely in the US.

Commented [A&O30]: Correct, ½ mark also it comes into effect automatically on recognition of a foreign main proceeding, discretionarily on recognition of a foreign nonmain proceeding or on an application for interim relief.

Commented [A&O31]: Correct, ½ mark, also it comes into effect on the filing of a petition

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

Commented [A&O32]: Total marks 12.25/15

Question 3.1 [maximum 3 marks]

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

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?

The directors of Delaware corporations owe:

- (a) a fiduciary duty of loyalty to the corporation's best interest; and
- (b) a duty of care in educated decision-making.

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Commented [A&O35]: Correct, ½ mark

That having been said, there is protection for directors from liability for errors in judgment in the form of the business judgment rule (which provides that directors will be presumed to have acted in good faith and on the basis of reasonable information). The presumption can of course be rebutted.

Both in the ordinary course of business and when the corporation is potentially or actually insolvent, a director owes his or her duties to the corporation and its shareholders but not to its shareholders. The Delaware Supreme Court has been clear in its decisions that directors do not owe duties to creditor even when the corporation is insolvent or close to being insolvent.

Commented [A&O36]: Correct, ½ mark

Commented [A&O37]: Correct, ½ mark

Commented [A&O38]: Correct, ½ mark

Commented [A&O39]: Correct, ½ mark

Question 3.2 [maximum 3 marks]

Commented [A&O40]: Total marks 2.75/3

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.

Bankruptcy courts were created by legislation as opposed to by Article III of the US Constitution. As such, the jurisdiction of bankruptcy judges to issue final orders is limited to entering final orders on core bankruptcy issues.

Commented [A&O41]: Partially correct, ¼ mark, other than with respect to the validity of the petition, consent of the parties is required

Parties to the case in their pleadings must stipulate whether a particular matter is core or non-core as that enables the bankruptcy court to ascertain the scope of its jurisdiction and in particular whether it can give a final order.

District courts have exclusive jurisdiction to determine a petition commencing bankruptcy proceedings. A bankruptcy court can exercise the delegated authority from a district court and give a final order in a case where the validity of the petition commencing the bankruptcy proceeding is challenged.

Commented [A&O42]: Correct, ½ mark

It is important to note that final orders can be appealed as a matter of right whereas non-final orders can only be appealed by seeking leave of the appellate court.

An appeal of a bankruptcy court decision is usually heard by the district court (which is situated in the same district as the bankruptcy court). While that is usually the case, in some circuits bankruptcy appeals are heard by the Bankruptcy Appellate Panel (which is formed by judges from the bankruptcy courts in that circuit). There is another right of appeal to the circuit court of appeals.

Commented [A&O43]: Correct, ½ mark

Commented [A&O44]: Correct, ½ mark

In the event that a ruling was a non-final order, the district court or Bankruptcy Appellate Panel would review all factual findings and conclusions of law which a party has objected to de novo.

Commented [A&O45]: Correct, 1 mark

Question 3.3 [maximum 4 marks]

Commented [A&O46]: Total marks 3/4

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

For a preference claim the following elements need to be made out:

(a) the debtor transfers an interest in property;

(b) that transfer is for the benefit of one or more of its creditors;

Commented [A&O47]: Correct, ½ mark

(c) the transfer was made by the debtor in relation to a debt that pre-dated the transfer;

Commented [A&O48]: Correct, ½ mark

(d) that transfer was made at the time the debtor was insolvent or in the suspect period (i.e. 90 days prior to the petition date); and

Commented [A&O49]: Correct, ½ mark

(e) the transfer would mean that the creditor would receive more than it otherwise would in the event of a chapter 7 liquidation.

Commented [A&O50]: Incorrect, the transfer must be both in a suspect period (90 days for 3rd parties and 1 year for insiders) and while the debtor is insolvent (which is presumed in the 90 days pre-petition)

A fraudulent conveyance is different to a preference in that it is made out when a debtor has transferred property or incurred an obligation and in doing so intends to hinder, defraud or otherwise delay its obligations to another entity to which it was or became indebted to. Intent can be established circumstantially and the following are some of (but not all of) the indicia of such intent:

Commented [A&O51]: Correct, ½ mark; the look back period for fraudulent conveyances is 2 years

(a) the transfer to or assumption of an obligation in relation to an insider;

(b) possession or control of property remains with the debtor following the transfer; and

(c) following such transfer or assumption of an obligation, the debtor becomes insolvent.

Commented [A&O52]: Correct, ½ mark

A constructive fraudulent conveyance is different in that its essence is that the debtor obtained in return less than the equivalent amount of the value in exchange for the relevant transfer or the assumption of the relevant obligation and one of the following factors (among others) was present:

(a) at the time of the transfer or assumption the debtor was either insolvent or would as a result of such transfer or assumption of the obligation become insolvent; or

Commented [A&O53]: Correct, ½ mark

(b) the debtor either believed or intended that it was incurring debt obligations beyond its ability to discharge those debt obligations on their maturity/

Question 3.4 [maximum 5 marks]

Commented [A&O54]: Total marks 3.5/5

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

For completeness, the reason why the distinction between a foreign proceeding being a main or non-main proceeding under chapter 15 is important is that this determines the scope of the relief that a debtor can get once recognition is granted.

Even though a debtor's center of main interests ("COMI") is a concept that didn't originate in the US, it is the concept that is used to determine whether the proceedings are the foreign main proceedings or foreign non-main proceedings. Under US law, traditionally COMI wasn't used for this purpose but instead the following concepts were used:

(a) where a debtor's domicile was;

(b) where a debtor's principal place of business is; and

(c) where the location of a debtor's assets are.

There is a rebuttable presumption that a debtor's COMI is the jurisdiction of its incorporation. There are various other factors in determining COMI and these include:

Commented [A&O55]: Correct, ½ mark. Also, COMI is evaluated as of the date of the US proceedings and should be ascertainable by creditors and third parties on the basis of objective evidence

(a) the location of the debtor's headquarters;

(b) where the debtor's management is situated;

(c) where the debtor's main assets are located;

(d) where most of the debtor's creditors are based or where the bulk of the creditors who will be impacted by the relief being sought are located; and

(e) the country whose laws will apply to the bulk of the disputes.

Commented [A&O56]: Correct, 1 mark

Therefore, proceedings:

(a) in the jurisdiction where the debtor's COMI is will be the foreign main proceedings; and

Commented [A&O57]: Correct, 1 mark

(b) in a jurisdiction other than where the debtor's COMI is provided the debtor had an establishment there prior to the commencement of the chapter 15 proceedings will be the

Commented [A&O58]: Correct, 1 mark

foreign non-main proceedings. An establishment is a place where a debtor undertakes non-transitory economic activity.

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

Commented [A&O59]: Total marks 7/15

Question 4.1 [maximum 5 marks]

Commented [A&O60]: Total marks 3/5

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?

The effect of a chapter 11 petition being filed by Rental Corporation is as follows:

Commented [A&O61]: This would cause the stay to come into effect

(a) on the DOJ investigation, there would be no effect as the automatic stay is subject to regulatory investigations. The reason for this is that on balance protecting the public is more important than protecting the debtor. This makes sense and particularly in light of the fact that Rental Corporation is a publicly-traded company.

Commented [A&O62]: Correct, 1 mark

(b) on the securities class action litigation, the automatic stay would prevent the continuation of this action during the period of the stay.

Commented [A&O63]: Correct, 1 mark

(c) on the delinquent leases:

Commented [A&O64]: Because the leases did not terminate on their own terms prior to the bankruptcy, the lessors are stayed from pursuing eviction proceedings

The debtor can either:

- reject the leases, which means that the debtor will have breached the leases just before the petition date. This would give the counterparty a claim in damages which is an unsecured claim;

- assume the leases, but in order for the debtor to do so it needs to pay to the counterparty the outstanding amounts and assure the counterparty that it will adhere to the leases going forward; or

- assume and assign the leases, which essentially means that the debtor assigns the leases to a third party transferee. The lessor will want assurances from that third party transferee that it will adhere to its obligations under those leases.

(d) on the credit facility, the automatic stay would prevent any attempt to collect amounts owed, enforcement of any lien securing the credit facility or any set-off.

Commented [A&O65]: Correct, 1 mark

Question 4.2 [maximum 5 marks]

Commented [A&O66]: Total marks 1/5

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

The Bankruptcy Code provides the following protection to the lessors of the office space to Rental Corporation:

(a) the lessors can request that the automatic stay be lifted so that they can take actions that they would otherwise be prohibited from taking due to the automatic stay. The basis upon which the lessors could ask for the automatic stay to be lifted is that there isn't adequate protection on an interest in the estate's property and that the value of that property may fall during the chapter 11 proceedings which could mean the lessors make less than a full recovery;

(b) Typically in chapter 11 proceedings, the debtor can decide whether to assume and assign or reject executory contracts up until the confirmation of its reorganisation plan. However, there is an exception with respect to unexpired leases of commercial properties where that decision needs to be made within 120 days of the order for relief. If Rental Corporation would like to extend that period within which it has to make a decision, it needs to obtain the consent of the lessors. The fact that the lessor have to consent to such an extension gives them some leverage; and

(c) In the event that the chapter 11 proceeding is converted to a chapter 7, the lessor will be fairly highly ranked in terms of the classes of unsecured claims given that its claims arise from a non-residential lease of real property and in the event that the lease was assumed and rejected within two years of the assumption by Rental Corporation.

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 sale under section 363 of the Bankruptcy Code can address these issues because:

(a) it would enable Paint Corporation to transfer its interests in the distribution contracts to Home Corporation notwithstanding the need to obtain consent from the home improvement stores;

(b) notwithstanding the fact that the US Environmental Protection Agency (the EPA) may levy a fine or penalty on Paint Corporation, section 363(f) allows an asset (in this case Paint Corporation's business (including the potentially contaminated property)) to be sold (in this case to Home Corporation) free and clear of the EPA's interest provided that court approval is obtained; and

(c) given that Home Corporation is a good faith purchaser, it may retain the business and assets that it has purchased from Paint Corporation even if the court approval sanctioning the sale of the business is subsequently reversed (see section 363(m)).

Commented [A&O67]: Correct, 1 mark, also this is subject to a 90 day extension for cause prior to needing lessor consent. Rental Corporation must pay rent as an administrative expense for the period prior to rejection of a lease. Administrative priority treatment for 2 years of rental payments for leases that are assumed and subsequently rejected. Lessors have a claim in the bankruptcy for unpaid pre-petition rent.

Commented [A&O68]: Total marks 3/5

Commented [A&O69]: Correct, 1 mark

Commented [A&O70]: Correct, 1 mark, though note that Home Corp doesn't want to buy the property and 363 lets it buy less than all of the assets of Paint Corp, and this may result in a higher price than if the business is sold outside of bankruptcy

Commented [A&O71]: Correct, 1 mark

*** End of Assessment ***