



### **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**.

**Commented [DB1]:** Please read and comply with the instructions.

**ANSWER ALL THE QUESTIONS**

Commented [A&O2]: Total marks 29.5/50

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

Commented [A&O3]: Total marks 7/10

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&O4]: 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&O5]: Correct, 1 mark

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&O6]: 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**

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&O7]: Correct, 1 mark

Commented [A&O8]: Incorrect, the correct response is (d)

Commented [A&O9]: 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&O10]: 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&O11]: 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&O12]: 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&O13]: 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&O14]:** Total marks 5.25/10

**Question 2.1 [maximum 1 mark]**

**Commented [A&O15]:** Total marks 0/1

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

In Chapter 7 proceedings, railroads, insurance companies, banks and other financial institutions are not eligible to be debtors.

**Commented [A&O16]:** A debtor must be incorporated (have a place of business) in or have assets in the US.

In Chapter 11 proceedings, by contrast, railroads and certain types of financial institutions are eligible to be debtors, but stockbrokers and commodity brokers which may be chapter 7 debtors are not eligible to be chapter 11 debtors.

**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 with unperformed obligations on both sides. For example, in a construction contract between a debtor and a builder, if at the petition date, construction and payment are only partially complete, the contract is executory. If construction was complete, but the debtor had not made final payment, the contract would not be considered as executory.

**Commented [A&O18]:** Correct, ½ mark, also the obligations must be 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 1.5/2

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 securing post-petition financing that is senior or equal to a lien already attached to estate property. In order for such a lien to be granted, the debtor must demonstrate that the interest of the 'primed' secured creditor is adequately protected.

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

**Commented [A&O22]:** Correct, ½ mark, also the debtor must show financing is not available without a priming lien

**Question 2.4 [maximum 2 marks]**

**Commented [A&O23]:** Total marks 1.25/2

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?

An unimpaired class of creditor is deemed to accept the reorganization plan. A class that will receive nothing is deemed to reject the reorganization plan. Only the impaired class(es) has the right to vote on the plan.

**Commented [A&O24]:** Correct, ½ mark

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

**Commented [A&O26]:** Partially correct, ¼ mark, the class must be both impaired and receiving something under the plan. A class of creditors accepts the plan if a majority of the creditors in the class, holding at least 2/3rds the value of claims in the class, votes in favor

**Question 2.5 [maximum 3 marks]**

**Commented [A&O27]:** Total marks 1/3

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

In Chapter 11 proceedings, the automatic stay is extremely broad and applies to the debtor's property anywhere in the world. By contrast, in Chapter 15 proceedings, the automatic stay only applies with respect to the debtor's property within the territorial limits of the United States.

**Commented [A&O28]:** Correct, ½ mark, in chapter 11, the stay comes into effect on filing of the petition, whereas in chapter 15, it comes into effect automatically on recognition of a foreign main proceeding or discretionarily on an application for interim relief or recognition of a foreign non-main proceeding.

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

**Commented [A&O29]:** Correct, ½ mark

**Question 3.1 [maximum 3 marks]**

**Commented [A&O30]:** Total marks 10.5/15

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&O31]:** Total marks 3/3

Directors of Delaware corporations owe a duty of loyalty to the corporation's best interest and a duty of care in educated decision making.

**Commented [A&O32]:** Correct, ½ mark

**Commented [A&O33]:** Correct, ½ mark

Directors of Delaware corporations owe their duties to the corporation and its shareholders in the ordinary course of business. When the corporation is potentially or actually insolvent, this position does not change and directors still owe their duties to its shareholders, not to creditors. In comparison to the jurisdiction of England and Wales, there is no concept of wrongful trading, and the Delaware Supreme Court has decided that directors do not owe any duty to creditors, even when a corporation is operating in the zone of insolvency or is actually insolvent.

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

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

**Commented [A&O36]:** Correct, ½ mark

**Commented [A&O37]:** Correct, ½ mark

**Question 3.2 [maximum 3 marks]**

**Commented [A&O38]:** Total marks 2.5/3

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.

A bankruptcy court may enter a final order on a motion that challenges the validity of a bankruptcy petition. In the case of Executive Benefits, the US Supreme Court held that bankruptcy judges may determine a core proceeding over which they lack constitutional authority by issuing a report and recommendation for review by a district court.

**Commented [A&O39]:** Correct, ½ mark, also can rule on a core proceeding with consent of the party

**Commented [A&O40]:** Correct, 1 mark

Bankruptcy court orders can be appealed by both the litigants involved in the issue and those adversely affected by the ruling. Generally, appeals from bankruptcy court decisions are heard by the district court for the district in which they sit. However, in particular circuits, bankruptcy appeals can be heard by a Bankruptcy Appellate Panel (BAP), comprised of the judges sitting at the bankruptcy courts within the circuit. In the circuits in which the BAPs operate, a party has the option to request that the appeal be heard by a district court or BAP.

**Commented [A&O41]:** Correct, ½ mark

**Commented [A&O42]:** Correct, ½ mark

On appeal, if the ruling below was in a core proceeding which the bankruptcy court had authority over, in order to enter into a final order, the district court or BAP reviews conclusions of law de novo and reviews findings of fact. By contrast, if the ruling below was in a noncore proceeding or the bankruptcy court did not have authority to enter a final order, the district court or BAP reviews de novo all findings of fact and conclusions of law which have been objected by a party. The order of a district court or BAP is then reviewed by a circuit court of appeal.

**Question 3.3 [maximum 4 marks]**

**Commented [A&O43]:** Total marks 1/4

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

#### Preferences

Claims for the recovery of preferences are usually aimed at transactions immediately prior to bankruptcy, whereby a transfer of the debtor's estate has been made in a suspect period before the petition date. If the amount transferred exceeds the amount the recipient would have received in a chapter 7 liquidation (had the transfer not been made), the transfer sum or other consideration transferred must be returned to the estate. Notably, due to the balance of competing principles and values such as the protection of secured parties and the encouragement of lending to distressed businesses, creditors have a number of defences that may allow them to keep pre-petition transfers that occurred during the suspect period.

**Commented [A&O44]:** The transfer must be to a creditor on account of an antecedent debt while the debtor is insolvent, whereas any transfer to any party may be a fraudulent conveyance and insolvency is not a necessary element.

**Commented [A&O45]:** The suspect period is 90 days for third parties and 1 year for insiders.

#### Fraudulent Conveyance

Claims for the recovery of fraudulent conveyances are aimed at other transactions within a two year period prior to the petition date where it is proven that the debtor showed fraudulent intent. Intent may be proven circumstantially by reference to a wide range of 'badges of fraud' developed in state law relating to fraudulent transfers.

**Commented [A&O46]:** Correct, ½ mark, this period also applies to constructive fraudulent conveyances

**Commented [A&O47]:** Correct, ½ mark

#### Constructive Fraudulent Conveyance

Claims for the recovery of constructive fraudulent conveyances are aimed at transactions where the debtor received consideration less than equivalent value for a transfer or incurrence of obligation whereby the debtor was either:

- Insolvent at the time of the transaction or became insolvent as a result of the transaction
- Unreasonably undercapitalized for the business or transactions it was engaged in (or planned to engage in)
- Intended to or believed they would incur debts beyond their ability to pay on maturity
- The transfer was made to or for the benefit of an insider, or the debtor incurred an obligation under an employment contract with an insider outside the ordinary course of business.

In order to bring a claim for the recovery of constructive fraudulent conveyance, fraudulent intent does not have to be shown.

The differences highlighted above are provisions contained in the Bankruptcy Code. In addition to these provisions, other applicable non-bankruptcy laws may be invoked which may have longer look back periods (e.g. in New York, there is a look back period of six years from transfer or two years from discovery) and may not be subject to extraterritoriality limitations.

#### Question 3.4 [maximum 5 marks]

**Commented [A&O48]:** Total marks 4/5

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

A US bankruptcy court determines whether a foreign proceeding is a main proceeding by determining whether or not the main proceeding was commenced in the debtor's centre of main interests (COMI). A debtor's COMI is presumed to be in its place of incorporation but this is rebuttable.

**Commented [A&O49]:** Specifically, a foreign main proceeding is one pending in the debtor's COMI

**Commented [A&O50]:** Correct, ½ mark



As per the case of Morning Mist, the court should determine the debtor's COMI on the basis of objective evidence. A debtor's COMI can be ascertained by analysis of its creditors or other third parties.

Commented [A&O51]: Correct, ½ mark

As per the case of Re SPhiX, Ltd, in order to determine where the COMI is located, the court will analyse the location of the debtor's headquarters, the location of the debtor's management, the location of the debtor's primary assets and the location of the majority of the debtor's creditors or the location of the majority of creditors that will be affected by the relief sought by the foreign representative. In addition, the court will also analyse the location of the legal jurisdiction that will apply to most disputes.

Commented [A&O52]: Correct, 1 mark

Following developments in the US courts, including the Bear Sterns case that COMI is assessed at the date of the US petition, rather than at the commencement of the foreign proceedings, a process has been developed whereby the COMI of a debtor is shifted through the conduct of the foreign proceedings whereby assets of a debtor and/or the debtor's management are moved to a different country/jurisdiction for a period of time prior to the filing of a chapter 15 petition. This practice has attracted criticism and proposals for the Bankruptcy Code to be amended have been put forward by the National Bankruptcy Council to allow the assessment of COMI to take place at the commencement of the foreign proceedings.

Commented [A&O53]: Correct, 1 mark

As for non-main proceedings, this is recognized where there are proceedings taking place in a jurisdiction outside of the debtor's COMI where the debtor has an establishment in that jurisdiction prior to the commencement of chapter 15 proceedings. An establishment is defined as "a place where it carried out non-transitory economic activity".

Commented [A&O54]: Correct, 1 mark

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

Commented [A&O55]: Total marks 7/15

##### Question 4.1 [maximum 5 marks]

Commented [A&O56]: 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?

##### *The DOJ Investigation*

The DOJ Investigation would be covered under the statutory exceptions of the Chapter 11 worldwide automatic stay. As such, the chapter 11 petition would have no impact on the DOJ Investigation and it would be able to continue as normal.

Commented [A&O57]: Correct, 1 mark

##### *The securities class action litigation*

Chapter 11 proceedings initiate a worldwide automatic stay. The Bankruptcy Code specifically prohibits litigation on pre-petition claims. As the securities class action was filed pre-petition, this litigation would be stayed as a result of the chapter 11 proceedings.

Commented [A&O58]: Correct, 1 mark

Commented [A&O59]: Correct, 1 mark

##### *The delinquent leases*

Commented [A&O60]: Because the leases were not terminated pre-petition, the lessors would be stayed from pursuing eviction proceedings

The lease of office space is an executory contract and can be assigned without consent. On the presentation of a chapter 11 petition, the debtor can elect to either reject the contract, assume the contract or assume and assign the contract. In a chapter 11 case, the debtor has until the confirmation of its reorganization plan to make the election but a deadline can be imposed by the bankruptcy court.

#### *The credit facility*

The worldwide stay imposed by the chapter 11 petition would mean that creditors could not enforce their rights under the facility to recoup property/assets from the debtor. However, if an unconditional guarantee was granted under the facility agreement to the lender, the lender would be able to pursue repayment from the guarantor.

**Commented [A&O61]:** Correct, 1 mark

#### **Question 4.2 [maximum 5 marks]**

**Commented [A&O62]:** 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 was amended by the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act whereby a deadline was implemented for the assumption or rejection of non-residential property. In addition, the Act limited the extension of the exclusivity period for proposing a reorganization plan under chapter 11 proceedings. Further, the Act also requires courts to hold more status conferences to manage the progress of cases. The extent to which protection is actually offered to lessors of office space is limited, however, as the market appears to have shifted away from full chapter 11 reorganizations towards liquidations for lease dependent corporations. Given the shift to remote working over the last 18 months, it is likely that this shift towards liquidations will be exacerbated.

**Commented [A&O63]:** Correct, ½ mark, specifically 120 day deadline, subject to a 90 day extension for cause, but any further extension requires lessor consent. Also, 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.

#### **Question 4.3 [maximum 5 marks]**

**Commented [A&O64]:** Total marks 2/5

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 section 363 sale is a preferable option for Home Corporation as an out of court sale would require the consolidation of creditor claims relating to any interests they have in the estate of Paint Corporation. By contrast, a section 363 sale allows Paint Corporation to sell its business/assets free and clear of creditor interests with court approval.

**Commented [A&O65]:** Correct, 1 mark, specifically Home Corp could buy only the assets it wants and leave the contaminated property and related claims behind. This could generate a higher price than a sale outside of bankruptcy. Paint Corp could be sure the sale could not be overturned on appeal.

A section 363 sale allows for the practice of an auction with a 'stalking horse' bidder which would benefit Home Corporation. Paint Corporation would be able to market its business and invite interested parties (including Home Corporation) to conduct due diligence which would lead to the negotiation of sale documents with Home Corporation. Home Corporation would be able to negotiate to purchase the assets of Paint Corporation, excluding any potentially contaminated property. The debtor is also able to transfer its interest in the distribution contracts required to operate the business as the distribution contracts can be rejected during the period of either 60 days of the petition date (chapter 7) or until the date a chapter 11 reorganisation is finalized.

**Commented [A&O66]:** Correct, 1 mark, though it would need to assume and assign, not reject.

**\* End of Assessment \***