



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 33.25/50

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

Commented [A&O2]: Total marks 8/10

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]: Correct, 1 mark

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 7.75/10

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?

For a corporation to be eligible to be a debtor in a US chapter 7 or 11 proceeding, the corporation should have a presence, place of business or any asset (which can include intangible) in the US.

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?

There is no statutory definition of an executory contract. Instead, a definition is based on an amalgamation of various case precedents. On this basis, an executory contract is one where material obligations within that contract have not been performed as yet by both or more parties (not just one party) to the contract.

Commented [A&O18]: Correct, ½ mark, specifically they must be such as would constitute a material breach of contract if not performed

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 security interest, given to a creditor providing debtor-in-possession financing to a debtor undergoing chapter 11 bankruptcy, over the estate or assets of a debtor, on a senior ranking or pari passu basis to other secured creditors with pre-existing security interests over the same estate or assets of the debtor. A priming lien is granted by a court and will depend on whether the estate has any unencumbered assets – failing which the court considers that financing cannot be obtained by the debtor without a priming lien.

Commented [A&O21]: Correct, 1 mark

Commented [A&O22]: Correct, ½ mark, also the court must find that interests of the primed secured creditors are adequately protected

Question 2.4 [maximum 2 marks]

Commented [A&O23]: 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?

A plan of reorganization is approved by creditors (holding in aggregate at least two-thirds of value in claims against the debtor) in a simple majority vote of creditors. In this context, (i) the unimpaired class is deemed to accept the plan; (ii) the class of creditors that receive nothing under the plan are deemed to reject the plan; and (iii) the impaired class of creditors are permitted to vote on the plan.

Commented [A&O24]: Correct, ½ mark

Commented [A&O25]: Correct, ½ mark

Commented [A&O26]: Correct, ½ mark

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

Question 2.5 [maximum 3 marks]

Commented [A&O28]: Total marks 2/3

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

A stay is automatic once a chapter 11 proceeding is filed whereas stays are not automatic in chapter 15 proceedings, as they are only granted after the foreign main proceedings are granted recognition by the court, and in any case are limited in reach to the debtors' assets that are in the US. Chapter 15 proceedings also empower a court to grant interim stays while the recognition of a foreign main proceeding is pending which is a feature that is not available, nor necessary in chapter 11 proceedings.

Commented [A&O29]: Correct, ½ mark

Commented [A&O30]: Partially correct, ½ mark, the stay can also come into effect in chapter 15 recognition of non-main proceedings on a discretionary basis

Commented [A&O31]: Correct, ½ mark, whereas chapter 11 stay has worldwide effect

Commented [A&O32]: Correct, ½ mark

Commented [A&O33]: Total marks 9.5/15

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

Question 3.1 [maximum 3 marks]

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?

In the case of Delaware corporations, directors have a fiduciary duty to act in the best interests of the corporation, to owe their loyalty to the corporation and a duty of care to take decisions on the basis of reasonable information available to them. These duties are owed to the corporation's shareholders and the corporation itself but not to creditors. This position does not change including when the corporation is near insolvency, or even when it is insolvent.

Commented [A&O34]: Total marks 3/3

Commented [A&O35]: Correct, ½ mark

Commented [A&O36]: Correct, ½ mark

Commented [A&O37]: Correct, ½ mark

Commented [A&O38]: Correct, ½ mark

Commented [A&O39]: Correct, ½ mark

Commented [A&O40]: Correct, ½ mark

Commented [A&O41]: Total marks 1/3

Question 3.2 [maximum 3 marks]

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.

The US Supreme Court held in *Bullard v Blue Hills Bank* that a bankruptcy court may enter a final order on the basis that it resolves a discrete dispute (rather than disposing of all issues, as would be the case in non-bankruptcy proceedings) and that such a final order is then appealable.

Commented [A&O42]: As a matter of constitutional authority, the bankruptcy court has power to resolve a challenge to a petition or a core matter with consent of the parties.

Bankruptcy court appeals are heard by district courts however, appeals can also be heard by a Bankruptcy Appellate Panel, depending on the circuit in question. Any further appeal would be to the relevant and applicable circuit court of appeals. Only sparingly would an appeal be a court of appeals directly (assuming the court of appeals agrees to accept), namely when the bankruptcy or district court is of the view that a unique question of law needs resolving, or that an appeal would significantly progress the case.

Commented [A&O43]: Correct, ½ mark

Commented [A&O44]: Correct, ½ mark

For non-final orders, it is likely that a district court or Bankruptcy Appellate Panel would review both factual matters and interpretations of law, which form the basis of the appeal on a fresh basis.

Commented [A&O45]: Incorrect, a non-final order is treated as a report and recommendation which is reviewed to the extent objected to by the parties

Question 3.3 [maximum 4 marks]

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

Commented [A&O46]: Total marks 3.5/4

Claims for avoidance of preferences runs for a period of 90 days prior to the date of petition (during which period a presumption of insolvency applies) or for 1 year for insiders of the debtor. In contrast, fraudulent conveyance runs for a period of 2 years prior to the date of petition.

Commented [A&O47]: Correct, ½ mark

Commented [A&O48]: Correct, ½ mark

Commented [A&O49]: Correct, 1 mark

In the case of avoiding a transfer for preference, the person receiving the transfer should be a creditor of the debtor at the time. If the person was not a creditor at the time, the transfer may be recoverable as a fraudulent conveyance instead.

Commented [A&O50]: Correct, ½ mark, also the transfer must be on account of an antecedent debt

Commented [A&O51]: Correct, ½ mark

Under section 548, a fraudulent conveyance involves a transfer by the debtor "with the actual intent to...defraud any entity to which the debtor was or became...indebted". This intent may be demonstrated a number of ways, as exemplified by various case law on fraud. In a constructive fraudulent conveyance, no actual fraudulent intent is required as all that needs to be demonstrated is that the debtor received less than the equivalent in value in a transfer, along with one other requirement as laid out in section 548.

Commented [A&O52]: Correct, ½ mark

Question 3.4 [maximum 5 marks]

Commented [A&O53]: Total marks 2/5

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

For the purposes of chapter 15, a US bankruptcy court determines a foreign proceeding as either main or non-main proceeding on the basis of the debtor's center of main interests, which may be established in a variety of ways, such as jurisdiction of incorporation (the main presumption), place of headquarters, where its assets are primarily based or where most of its affected creditors are located.

Commented [A&O54]: Specifically, a main proceeding is one in the jurisdiction of the debtor's COMI, whereas a non-main proceeding is in a jurisdiction that is not the debtor's COMI but where the debtor has an establishment. Also, COMI is evaluated as of the date of commencement of the US proceedings.

Commented [A&O55]: Correct, ½ mark

In any case, the determination of a debtor's center of main interests should be objectively ascertainable. Equally, a debtor's center of main interest can also be rejected on the basis that a US court considers mala fide intention was involved in manipulating the center of main interest, such as under the circumstances following the conclusion of the *Bear Stearns* case.

Commented [A&O56]: Correct, 1 mark

Commented [A&O57]: Correct, ½ mark

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

Commented [A&O58]: Total marks 8/15

Question 4.1 [maximum 5 marks]

Commented [A&O59]: Total marks 5/5

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 a chapter 11 petition being filed by Rental Corporation, an automatic stay becomes effective therefore

Commented [A&O60]: Correct, 1 mark

(i) the DOJ investigation would continue as is because the automatic stay that comes into place under chapter 11 does not apply to regulatory investigations as led by the DOJ;

Commented [A&O61]: Correct, 1 mark

(ii) the securities class action litigation would be stayed pursuant to the automatic stay put in place, as the securities class action litigation appears to be a pre-petition claim;

Commented [A&O62]: Correct, 1 mark

(iii) the delinquent leases represent possible creditor claims by the applicable lessors, and therefore the automatic stay would apply to termination of the leases which would result in possession or control of Rental Corporation's property, since to do otherwise would cause irreparable harm to the estate of a business based on sub-leasing property to clients while the leases have not expired; and

Commented [A&O63]: Correct, 1 mark

(iv) the credit facility also represents a possible creditor claim by the applicable lenders, and therefore the automatic stay would apply to repayments under the credit facility, while the claims of all creditors are compiled and ranked according to their priority.

Commented [A&O64]: Correct, 1 mark

Question 4.2 [maximum 5 marks]

Commented [A&O65]: Total marks 0/5

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 lessors can apply to have the automatic stay lifted through a lift-stay or relief from stay motion on one of the following grounds:

Commented [A&O66]: Rental Corporation only has 120 days to decide whether to assume or reject the leases. This period can be extended by 90 days for cause, but not further without 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.

(i) Rental Corporation has no equity in the leased properties and therefore they are irrelevant for the reorganization (subject to the outcome of a valuation report), unless the debtor is able to show that the reorganization can be undertaken in enough time to avoid the need for the stay to be lifted;

(ii) the lessor arguing that there is insufficient protection of its interest in the leased properties since their value may decline during the bankruptcy proceedings, and therefore the lessor recovering less than full recovery (again subject to a valuation report), unless the debtor is able to show that the property is of value that may be lost to the business, which should be protected against by the lessor submitting something of equivalent value; or

(iii) the property remains subject to the stay despite 90 days having passed without a reorganization plan, nor has Rental Corporation made any payments on the delinquent leases.

Question 4.3 [maximum 5 marks]

Commented [A&O67]: Total marks 3/5

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 sale under section 363 of the Bankruptcy Code enables Paint Corporation to sell its business under court approval to a strategic purchaser such as Home Corporation. Through section 363, Home Corporation would be able to continue operating the business in the ordinary course, while the bankruptcy proceedings continued, and which could result in high purchase price for Paint Corporation's business, as compared to a sale outside of section 363.

A particular reason for the high purchase price is that a section 363 sale is free and clear of creditor interests (such as the claim that could arise from the investigation being led by the Environmental Protection Agency), and even more so because Home Corporation could potentially keep the valuable portion of Paint Corporation's business (on the basis that it is a good faith purchaser), if the sale were to be overturned on appeal.

Commented [A&O68]: Correct, 1 mark, Home Corp could buy less than all of Paint Corp's assets since it doesn't want the property and it may be willing to pay more than might be paid if someone had to take the contaminated property

In order to facilitate the sale of the business to Home Corporation, Paint Corporation can look into assigning the distribution contracts, if they are deemed as executory contracts (which appears likely as obligations may be outstanding on the side of both Paint Corporation and the relevant home improvement stores), on the basis that Home Corporation provides sufficient assurances that it would continue to perform under the distribution contracts assigned to it.

Commented [A&O69]: Correct, 1 mark

The sale to Home Corporation is also likely to be effective as it may satisfy the two prong test for sale of the business in the ordinary course of business, as Home Corporation may appeal to both the vertical (creditor expectations) and horizontal (similar business to Paint Corporation) dimensions.

Commented [A&O70]: Correct, 1 mark

*** End of Assessment ***