



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 [DB1]: 38 out of 50 = 76% Good mark!

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

Commented [DB2]: 8 out of 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

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

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

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.

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.

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.

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.

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.

(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 [DB3]: 9.5 out of 10

Question 2.1 [maximum 1 mark]

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

A corporation that has a place of business or property in the US is eligible to be a debtor for the purposes of Chapter 7 or 11. A corporation organized under section 25A of the Federal Reserve Act may be a debtor under Chapter 7 or 11. 0.5 marks

Question 2.2 [maximum 2 marks]

What is an executory contract?

The Countryman definition is the most notable definition of an executory contract and it defines an executory contract as a contract under which the obligations of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach and excuse the performance of the other. 2 marks

Question 2.3 [maximum 2 marks]

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 on the estate property of a debtor that is granted by a debtor, with the authorisation of the bankruptcy court, to a lender in consideration of that lender granting debtor in possession financing to the debtor. A priming lien may have seniority over existing liens on the estate property or at the very least has the same priority as existing liens on the estate property. Priming liens are a last resort mechanism authorised by the bankruptcy court in circumstances where the debtor has not been able to secure any other type of financing. The debtor must demonstrate to the court that secured creditors are adequately protected from the diminution in value of their collateral as a result of the priming lien. 2 marks

Question 2.4 [maximum 2 marks]

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?

Responses to (i) – (iii) are as follows -

- (i) Unimpaired classes of creditors are deemed to have accepted a plan of reorganization;
- (ii) A class of creditors who receive nothing under the plan of reorganisation are deemed to have rejected the plan.
- (iii) The impaired creditors are permitted to vote on a plan of reorganisation.

A class of creditors approves a plan of reorganisation if a simple majority of the creditors in the class, holding (i) at least two-thirds of the value of claims in the class or (ii) two-thirds of the equity interests, vote in favour of the plan. 2 marks

Question 2.5 [maximum 3 marks]

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

The automatic stay available in chapter 15 proceeding is only granted where a foreign proceeding has been recognised as foreign main proceeding after the hearing of a chapter 15 petition for recognition. The automatic stay prevents any enforcement action, or the start or continuation of other legal proceedings against the debtor within the US.

On the other hand, when a petition is filed commencing chapter 11 proceedings an automatic stay comes into effect that prevents any enforcement action or the start or continuation of other legal proceedings against the debtor worldwide. 3 marks

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

Commented [DB4]: 12 out of 15

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?

Directors of Delaware corporations owe the following fiduciary duties to the corporation and its shareholders –

- (i) a duty of loyalty to the corporation's best interests; and
- (ii) a duty of care in educated decision making.

In circumstances where a corporation is potentially or actually insolvent, the directors continue to owe the fiduciary duties mentioned previously to the corporation and its shareholders. In *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla* - 930 A.2d 92 (Del. 2007), the Delaware Supreme Court rejected the claim that directors of corporations owe fiduciary duties to creditors where a company is in the zone of insolvency or actually insolvent. 3 marks

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.

A bankruptcy court may enter a final order in a core proceeding. In this context, core proceedings are those that concern issues that arise under the U.S. Bankruptcy Code.

Generally, appeals from decision of bankruptcy courts are heard by the district court of the relevant district. However, the first, sixth, eighth, ninth and tenth circuits have elected to have bankruptcy appeals heard by a Bankruptcy Appellate Panel comprising judges of bankruptcy courts from within the relevant circuit.

If the non-final order was made in a core proceeding, the district court or the BAP reviews conclusions of law de novo and reviews findings of fact for abuse of discretion. If the non-final order was made in a non-core proceeding, the district court or the BAP reviews de novo both the findings of fact and the conclusions of law which has been objected to. 3 marks

Question 3.3 [maximum 4 marks]

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

The basis of claims for the recovery of preferences is to ensure, in the context of insolvency, that one creditor is not treated more favourably than other creditors of the debtor. On the other hand, claims for fraudulent conveyances and constructive fraudulent conveyances are based on preserving and recovering the assets of a debtor for the benefit of its general body of creditors.

The lookback period for the recovery of preferences is 90 days in the case of transfers made to third parties and 1 year in the case of transfer made to insiders. Whereas the lookback periods for both fraudulent conveyances and constructive fraudulent conveyances is 2 years.

Once it is established that a transfer is a preference, the transfer must be returned. In the case of fraudulent conveyances and constructive fraudulent conveyances, if the recipient acted in good faith and the transfer was made for fair value, the recipient may retain the property. 2 marks

Question 3.4 [maximum 5 marks]

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

The US bankruptcy court determines whether a foreign proceeding will be recognised as a main proceeding or a non-main proceeding by considering whether the jurisdiction in which the foreign proceedings were commenced is the debtor's centre of main interest (COMI). COMI is a concept used in the UNCITRAL Model Law on Cross-Border Insolvency (Model Law). Chapter 15 adopted the Model Law. The term COMI is not defined in the Model Law and is not defined in Chapter 15. However, it is widely held that a debtor's COMI is generally the place where the debtor conducts the administration of his interests on a regular basis as ascertainable by third parties. There is a rebuttable presumption that a debtor's COMI is the location of its registered office. The Bankruptcy Courts will consider the following factors in determining the debtor's COMI –

- (i) location of headquarters;
- (ii) location of management;
- (iii) location of primary assets;
- (iv) location of the majority of debtor's creditors or a majority of creditors that will be affected by the relief sought by the foreign representative; and
- (v) the jurisdiction whose laws will apply to most disputes.

If the foreign proceeding is not a main proceeding, in order to determine whether it is a non-main proceeding under Chapter 15 the court will assess whether the debtor has an establishment in the jurisdiction in which the foreign proceedings were commenced. For this

purpose, an establishment is a place where the debtor carries out non-transitory economic activity. 4 marks

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

Commented [DB5]: 8.5 out of 15

Question 4.1 [maximum 5 marks]

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

- (i) The filing of a petition for Chapter 11 proceedings will not have any effect on the DOJ investigation as criminal proceedings are an exception to the worldwide stay which automatically takes effect on the filing of a petition for Chapter 11 proceedings.
- (ii) The filing of a petition for Chapter 11 proceedings will automatically stay the securities class action litigation;
- (iii) The delinquent leases are executory contracts. Rental corporation has 120 days from the date of the order for relief to decide whether to assume or reject the leases. If the RC rejects leases, then the lessor in each instance would be a creditor on a claim for unpaid rents and damages for termination of the lease. To assume the delinquent leases, RC would need to cure the defaults and seek approval from the Bankruptcy court.
- (iv) The credit facility may be terminated by the lender, if it contains an ipso facto clause, as contracts to make a loan, or extend other debt financing or financial accommodations are exceptions to the general rule that ipso facto clauses are unenforceable.

3 marks

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?

Lessors of Rental Corporation have the following protections –

- (i) RC has 120 days from the date of the order for relief to assume or reject the various leases; extension of 90 days?
- (ii) If RC rejects the leases, the demised property must be vacated and returned to the respective lessors. The lessors would have an unsecured claim for unpaid rent and a claim for breach of lease.

- (iii) If RC assumes the leases, it must cure any defaults and provide assurance of future payments. Rent payments will become an administrative expense which is a high priority claim against the estate.

3 marks

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?

If Paint Corporation were to file Chapter 11 proceedings, section 363 of the Bankruptcy Code would address its concerns in the following way –

- Per section 363 (c) of the Bankruptcy Code, a debtor is permitted to sell its property in the ordinary course of business without court approval, which facilitates continued and uninterrupted business operations. Therefore, Paint Corporation can ensure the continued operation of its business to maximise value on a sale of the business.
- Also, under 363 of the Bankruptcy Code, Paint Corporation can assign interests in the various distribution contracts to Paint Corporation the consent of the other parties to the various distribution contracts, even in circumstances where such contracts contain restrictions on assignments or purport to terminate on a bankruptcy filing.

2.5 marks

*** End of Assessment ***