



### **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]: 32.5 out of 50 = 65%

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

Commented [DB2]: 7 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]: 7 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?

[Following are two alternative qualifications that render a corporation eligible to be a debtor in a US Chapter 7 or 11 proceeding are as follows:

1. The qualification to be a debtor under the Bankruptcy Code can arise because the Corporation owned property in the United States, and/or
2. In case a debtor corporation has a domicile or a place of business in the United States.]

0.5 marks

**Question 2.2 [maximum 2 marks]**

What is an executory contract?

[The term "executory contract" has not under the Statute, however, an understanding of the same can be derived from case laws. In the simplest sense, a contract is said to be executory if there exists a material unperformed obligation(s) on the part of both the sides to the contract. Example: A contract where a debtor enters into a software development agreement with a developer, as on date of entering the contract, both parties are yet to discharge their obligations under the contract, and therefore the contract is can termed as an executory contract.] 1.5 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?

[The term "priming lien" means that a lien is created on a property senior to, or with the same priority as, existing liens on the same property. It is usually given a higher priority over pre-bankruptcy secured creditors and a claim with super-priority over administrative expenses over all the other claims. The requirements to be fulfilled are:

1. That financing could not be obtained on any other terms,
2. Consent of the secured creditors who are being primed,
3. That the interest of the secured creditor is being adequately protected] 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?

[In voting on a plan of reorganization,

- (i) Deemed to accept the plan: Any class that is unimpaired by the plan.
- (ii) Deemed to reject the plan: Any class whose members who might receive anything under the plan.
- (iii) Permitted to vote on the plan: Any class whose rights have been impaired have the right to vote on the plan.
- (iv) Necessary vote for a class of creditors to accept a plan: If a simple majority of the creditors in the class, holding at least 2/3rds of the value of claims in the class vote in favour.]

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 under Chapter 15 applies with respect to the Debtor's property within the territorial limits of the United States, whereas under Chapter 11, the stay provided is even on extraterritorial limits & the automatic stay under a chapter 15 proceeding is subject to a carveout to permit the filing of a plenary US bankruptcy proceeding even after the recognition of a foreign proceeding.] **Timing? 1 mark**

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

**Commented [DB4]:** 12.5 marks 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?

[Following are the fiduciary duties that directors of Delaware Corporations owe are:

1. Duty of care: This requires a director to care to be informed and indulge in deliberative decision-making based on all the material information that is reasonably available.
  2. Duty of loyalty: This requires the director to show integrity and act on an independent basis, and in good faith with an honest belief that the action is in the best interests of the company and its stockholders. This would not preclude directors from considering the interests of other constituencies in determining the interests of the company and shareholder's best interest.
- A. On a corporation being solvent, the director's fiduciary duty is towards the shareholders only.
- B. On the brink of insolvency, the director's fiduciary duty still remains towards the shareholders, as laid down in the Delaware Supreme Court in North American Catholic Educational Programming v. Gheewalla (Del. Supr. 2007).
- C. On actual insolvency, whether on balance sheet basis or cash flow basis. The board's fiduciary duty shifts from the shareholders to all of the corporation's claimants. However, claimants include both creditors as well as the shareholders. Thus, the directors must continue to make decisions based on what according to them would be in the best interests of the corporation but keeping in consideration the interests of the creditors as well as shareholders. In the matter of '*In re Gheewalla*', it was ruled by the Delaware Supreme Court that once a corporation is insolvent, a creditor obtains standing to assert *derivative* claims on behalf of the corporation for directors' breaches of fiduciary duties to the residual claimants.] **2 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.

[The US Supreme Court had held that Bankruptcy judges have the authority to determine a core proceeding over which they have no constitutional authority by issuing a report and making a recommendation for review by the district court or with the consent of the parties, then may issue final orders. The same was held in the case of *Wellness Int'l Network, Ltd. v. Sharif*, 135 S Ct 1932 (2015). The Bankruptcy rules have implemented these rulings by mandating the litigants to state in their pleadings as to whether or not they consent to the entry of final orders or judgment by the Bankruptcy Court.

In general, appeals from Bankruptcy Courts are usually heard by the respective District court. However, in certain circuits, bankruptcy appeals can be heard by a Bankruptcy Appellate Tribunal (BAP).

The orders which are final in nature can be reviewed. For instance, where the district court's order remands a final order back to the Bankruptcy Court for "further significant proceedings on merits", it was held on account of non-final order (In re Lendvest Mortgage, Inc., 42 F.3d 1181, 1183 (9th Cir. 1994)). Thus, it follows that non-final orders are not reviewed.]

Good answer 3 marks

**Question 3.3 [maximum 4 marks]**

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

Theme	Preferences	Fraudulent Conveyance	Constructive Fraudulent Conveyance
<b>Ingredients</b>	It can be proved by showing that there was a transfer of an interest of the debtor in property to or for the benefit of a creditor on account of an antecedent debt owed by the debtor before such a transfer was made and such a transfer was made while the debtor was insolvent.	(1) The transfer within one year of bankruptcy (2) There has been actual intent to hinder or to delay or to defraud	(1) The transfer within one year of bankruptcy (2) It was made for less than reasonable equivalent value.
<b>Lookback period</b>	The look back period or the suspect period for transfers to third parties is ninety days before petition date and for insiders of the Corporate Debtor, the look back period is usually longer since this would prevent those with greater knowledge of the Debtor's financial condition from benefitting	A possibility can exist where there is a longer look back period – ranging from 6 years from transfer or two years from discovery	A possibility can exist where there can be a longer look back period – ranging from 6 years from transfer or two years from discovery



from asset stripping of the transactions before the 90-day preference period

<b>Defences applicable if any</b>	(1) There are ordinary course payments, (2) Purchase-money security interests, (3) Net result rule (4) After-acquired accounts and inventory, etc.	-	-
<b>Applicability of local laws</b>	-	There is an applicability of non-bankruptcy laws such as a state foreign fraudulent conveyance law	There is an applicability of non-bankruptcy laws such as a state foreign fraudulent conveyance law
<b>Regarding extraterritoriality limitations</b>	There is growing debate on this area. Judgments exist in favour of both sides – extension and non-extension of extraterritoriality limitations. Eg. <i>Accord Hosking v. TPG Capital Mgmt.</i> and see <i>Spizz v. Goldfarb Seligman &amp; Co.</i>	May not be subject to extraterritoriality limitations	May not be subject to extraterritoriality limitations

]

4 marks – good answer if longer than required

**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 determination of foreign main or foreign non-main proceedings is done by establishing the Debtor’s COMI (Center of Main Interests). COMI is comparatively new to the U.S. Law as the U.S. law relies on the “nerve centre test” which is based on the concepts of domicile, principal place of business and location of assets. In the absence of any contrary evidence, the debtor’s registered office or habitual residence in case of an individual is presumed to be the Debtor’s COMI. A debtor’s COMI may also be determined by factoring in:

- (1) Location of Headquarters
- (2) Location of Management,
- (3) Location of Primary assets,
- (4) Location of most debtor’s creditors or most of the creditors that will be affected by the relief requested by the foreign representative
- (5) Jurisdiction whose law will apply to most disputes.

The relevant date in assessing COMI is under the Chapter 15 petition date rather than the date on which a foreign insolvency proceeding is commenced with respect to the debtor. Any proceeding other than a Debtor’s COMI naturally can be recognised as a foreign non-main proceeding only if the debtor had an establishment in the jurisdiction, a place where it

carried out non-transitory economic activity which is prior to commencement of proceedings under Chapter 15.] **3.5 marks**

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

Commented [DB5]: 6 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?

[The effect of a chapter 11 petition being filed by Rental Corporation

- (i) *the DOJ investigation*: This will proceed unimpeded since it is a criminal proceeding and therefore, an excepted from the automatic stay.
- (ii) *the securities class action litigation*: This will be most likely stayed under § 362 of the Bankruptcy Code, the small uncertainty arising from the fact that the bankruptcy petition was filed after the filing of the class action suit.
- (iii) *the delinquent leases*: As a lease is an interest in a property and thus, may avail an automatic stay by forming a part of the debtor's estate. The lessors will not be able to attempt direct collection of the rent arrears from the debtor.
- (iv) *the credit facility*: The lender(s) shall be prevented from acting against the default on the quarterly payment. If any lien has been created to extend the facility, it will be unenforceable. Since by the nature of its business Rental Corporation does not own property, the lender(s) would likely file a lift-stay motion.] **4 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?

[Following protecting the Bankruptcy Code provide to lessors of office space to Rental Corporation:

- i)The protection from assignment of leases to third parties after the court's permission to avoid an increase in the debtor's liabilities and the lessors' losses.
- ii)The lessors may seek a 'relief from stay' motion on the ground of lack of adequate protection. This may either result in lifting of the stay or the lessors receiving an indubitable equivalent of the claim value. The debtor would also have to show a reasonable prospect of reorganizing within a reasonable time frame.]

**Time frames? Priorities? 1 mark**

**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?

[In case the Paint Corporation enters Chapter 11 proceedings, it would be able to avail of the under § 363 sale. However, since this is a regulatory investigation, the U.S. Environmental Protection Agency's action would continue even after filing for bankruptcy. As the Home Corporation is not interested in the contaminated property.

This leaves the proprietary and patented recipes and the distribution contracts which Paint Corporation may sell under § 363. The recipes of the paint can be sold under § 363 after establishing that it is a transaction proposed in its judgment sense. The sale may be done through an auction where Home Corporation would be the stalking horse bidder. The distribution contracts can be assumed and assigned to Home Corporation under § 365(f).] **You missed the point of this question – you should have dealt with the purchaser's ability to purchase free and clear of environmental claims. 1 mark**

**\* End of Assessment \***