



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]: 28 out of 50 = 56%

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

Commented [DB2]: 5 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]: 7.5 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?

The two alternative qualifications render a corporation eligible to be a debtor in a US Chapter 7 or 11 proceedings are:

1. Presence of debtor's or corporation's property;
2. Debtor's 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 US Bankruptcy Code does not define "executory contract", but most courts have adopted this definition: "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Contracts where performance remains due on both sides are executory. In re Columbia Gas Sys., Inc., 50 F.3d 233 (3d Cir. 1995) (settlement agreement may be an executory contract). **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 lien securing a post-petition credit extension that is senior or equal to a lien already attached to some or all of the debtor's property. A priming DIP financing is only available as a last resort when the debtor is unable to obtain any other type of financing (unsecured loans on an administrative priority basis or non-priming DIPs) and either the holders of existing liens (the primed lenders) consent or the debtor can demonstrate such 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?

- i) A class that is unimpaired by a plan is deemed to accept it.
- ii) Any class whose members are to receive nothing under a plan is deemed to reject the plan. Classes of claims and equity interests that will not receive any distribution under the plan of reorganization are deemed to have rejected the plan of reorganization and, therefore, do not vote.

- iii) "Impaired" classes get to vote on the plan. Essentially, if a plan alters the rights of a party in any way (negatively or positively), that party is considered impaired and can vote. (§ 1124)

In order for a plan to be confirmed, an affirmative vote of at least two-thirds in dollar amount of claims and more than one-half in number of the creditors in a class that submit votes is required for the acceptance of the plan of reorganization by that class. For equity interest holders, the affirmative vote of holders holding at least two-thirds in amount of the equity interests in a class is required from the class voting on the plan of reorganization. **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?

In Chapter 15, the automatic stay and any relief granted by the bankruptcy court apply only with respect to the debtor's property within the territorial limits of the United States; Chapter 11 is intended to provide extraterritorial relief as to a debtor's assets wherever located. (In both cases, however, the bankruptcy court is constrained by the limits of personal jurisdiction. In addition, the extraterritorial effect of a US court order will depend on the jurisdiction in which it is sought to be enforced.) While a Chapter 11 debtor has access to the full range of avoidance powers, a foreign representative in a Chapter 15 case may not bring preference or fraudulent conveyance claims under the US Bankruptcy Code, only under non-bankruptcy law.

It is to be noted that chapter 15 does not initiate a bankruptcy case and does not create an estate. It is a proceeding filed by a foreign representative intended to obtain U.S. recognition of a foreign insolvency proceeding.⁵ Because an estate is not created, the court's in rem jurisdiction is limited to the United States. Further, the purposes of chapter 15 are to protect the debtor's assets within the territorial jurisdiction of the United States while promoting consistency with similar statutes enacted in foreign jurisdictions.⁶ A global automatic stay would supplant, rather than not support, the main foreign insolvency proceeding by providing global relief that could otherwise not have been achieved in the foreign jurisdiction. **Timing? 1 mark**

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

Commented [DB4]: 8.5 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?

Under Delaware law, directors owe fiduciary duties to a corporation's shareholders. A director's fiduciary duties include both a duty of care and a duty of loyalty. The duty of care requires, among other things, that directors keep themselves reasonably informed when making decisions on behalf of the corporation. The duty of loyalty requires a director to act in good faith and in a manner it reasonably believes to be in the best interests of the corporation and its stockholders, and to avoid engaging in acts of self-dealing. When a company became insolvent, the duties of directors shifted from the company's shareholders to the company's creditors. The Delaware Supreme Court in 2007 in *Gheewalla* held its creditors take the place of the shareholders as the residual beneficiaries of an increase in value [of the corporation.] "[t]he corporation's insolvency 'makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value. **Not a clear answer! 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.

Bankruptcy courts are divided into (1) core and (2) non-core. If the matter is a core proceeding, then the bankruptcy judge is authorized to enter a final judgment on the merits, reviewable by the district court under the “clearly erroneous” standard. However, if the bankruptcy judge determines that a matter is not a core proceeding or otherwise related to a bankruptcy case, the judge is only authorized to submit proposed findings of fact and conclusions of law to the district court. Only district judges may enter final orders or judgments in non-core proceedings after reviewing the bankruptcy’s findings and conclusions de novo. In *Ritzen Group Inc. v. Jackson Masonry LLC*, the Supreme Court unanimously held that a bankruptcy court’s order denying relief from the automatic stay constitutes a final order, and thus that order may—and must—immediately be appealed if so desired. In an appeal from district court review of a bankruptcy court order, the circuit court of appeals independently reviews the bankruptcy court’s order without deference to the district court’s determination. Currently, there are bankruptcy appellate panels in the First, Second, Sixth, Eighth, Ninth and Tenth Circuits. When a district court or circuit court reviews a decision of a bankruptcy court, it reviews the factual findings for clear error and its legal conclusions de novo.

Not a well-structured answer but most points covered. 3 marks

Question 3.3 [maximum 4 marks]

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

- Constructive fraudulent conveyance is an unfair transfer, although it may lack actual intent. It occurs when creditors receive less than they have a right to under the law.
- Fraudulent Conveyances: Once a transfer has been deemed fraudulent, the trustee may recover the property, or the value of the property, and make it part of the bankruptcy estate. They may do so from either the immediate recipient or from anyone else to whom the property was subsequently transferred. One exception to this general rule, however, is the case of the “bona fide purchaser”. The bona fide purchaser is one who acted in good faith to purchase the property without notice of the outstanding rights of others to the property. The bona fide purchaser may retain the property. Another exception is made in a case where valuable improvements to the property have been made. In this case, those that made the improvements to the property are given a lien on the property, securing the improvements they made. Finally, if the law places no other restrictions on the transfer, and the property was purchased for some value in good faith, in other words, with no knowledge of the fraudulent intent, the person receiving the transferred property may be allowed to retain the property or regain the value they paid for it in the settling of the estate.
- To recover a preference payment, the debtor-in-possession (DIP) or trustee for the debtor’s bankruptcy estate must prove all of these elements (Payment made on an antecedent debt (meaning a debt incurred before the time of payment); Payment made while the debtor was insolvent (a company can be insolvent before it files for bankruptcy); Payment made to a noninsider creditor, within 90 days of the filing of bankruptcy (when the creditor is an “insider” of the debtor—owners, relatives, officers, directors, and similar persons and entities—the time period increases from 90 days to one year); Payment made that allows the creditor to receive more than it would have

received had the payment not been made in advance of, but paid through the bankruptcy proceeding). If it can, then the payment is "avoided" and must be returned, unless a defense applies. Preferential payments are avoidable even if there is no dispute as to the goods sold or the services rendered. Return of money may be demanded even if there was never any intent to make or accept a preferential payment. **If the recipient was not a creditor of the debtor prior to the transfer then recovery can be made in fraudulent conveyance but not under Preference.**

You did not really answer the question! 1.5 marks. The correct answer was:

[To be a preference, a payment must have been made to a creditor (1/2 mark) on an antecedent debt (1/2 mark), whereas any transfer of an interest of the debtor in property can be an actual or constructive fraudulent conveyance (1 mark).

The suspect period for preferences is 1 year for transfers to insiders (1/2 mark) and 90 days for transfers to others (1/2 mark). The look-back period for actual and constructive fraudulent conveyances is 2 years (1 mark)

To be a preference, the payment must be made while the debtor is insolvent (1/2 mark), whereas insolvency is not required for actual and constructive fraudulent conveyances (though may be an element considered in establishing such claims) (1 mark). Actual fraudulent conveyance is the only one of these claims that requires wrongful intent (1/2 mark).]

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?

Main proceeding

Chapter 15 does not define COMI, and the interpretation of this phrase has already been the subject of litigation in the US. Chapter 15 does provide that there is a presumption that a debtor's COMI is in the country of its registered office, but this presumption is rebuttable.

Chapter 15 permits the US bankruptcy courts to consider the interpretation of similar statutes adopted by foreign jurisdictions and the UNCITRAL's guide to enactment of the Model Law in construing Chapter 15, including with respect to determining the COMI. The UNCITRAL guide indicates that the phrase "centre of main interests" has its origins in the EU's regulations on cross-border insolvencies.

In *In re Tri-Continental Exchange Ltd.*, 349 B.R. 627 (Bankr. E.D. Calif. 2006), the US bankruptcy court had to determine whether a particular foreign proceeding was main or non-main. Noting that Chapter 15 did not define COMI, the court examined the definition in the EU regulations. The US court observed that the EU defined COMI as "the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties". Adopting this rule, the US court then found that the proceeding in the country where the debtor had its principal office and primary concentration of employees was the COMI of the debtor.

Similarly, in *In re SPhinX, Ltd.*, 351 B.R. 103 (Bankr. S.D.N.Y. 2006), the US bankruptcy court embraced the decision and reasoning by the Irish Supreme Court in *EuroFoods*, and held that the presumption that a debtor's COMI is in the location of its registered office may be rebutted "particularly in the case of a 'letterbox' company not carrying out any business in the territory of the [country] in which its registered office is situated". Using this reasoning, the bankruptcy court found that a hedge fund registered in the Cayman Islands actually had its COMI in the

US because most of its assets were located in the US and the debtor conducted most of its business in the US.

Foreign Nonmain Proceeding

Establishment. An “establishment” is defined in section 1502(2) as “any place of operations where the debtor carries out a nontransitory economic activity.” Unlike with the determination of COMI, there is no statutory presumption regarding the determination of whether a foreign debtor has an establishment in any particular location. The debtor’s foreign representative bears the burden of demonstrating that the debtor has an establishment in a particular jurisdiction.

You did not answer what was being asked! Timing? Factors to be taken into consideration? 2 marks

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

Commented [DB5]: 7 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?

An automatic stay arises automatically on the petition date.

- i) the DOJ investigation is an exception to automatic stay, Section 362(b)(4) excepts from the automatic stay an action by a governmental unit to enforce its police or regulatory power.
- ii) the securities class action litigation will also be an exception to automatic stay as securities contracts are also an exception and the litigation can continue despite Chapter 11 is sub judge. **No**
- iii) the delinquent leases will be hit by the automatic stay as any attempt to collect pre petition claims (including demand letters, calls) are stayed.
- iv) the credit facility- The automatic stay will protect the debtor from collection efforts by creditors in the post-petition period. It is one of the primary reasons why debtors file for bankruptcy.

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?

The automatic stay prevents the lessor from taking actions against the lessee on account of the lessee’s pre-petition claim, including setting off any cash security deposit against unpaid pre-petition amounts due under the lease. In addition, the lessor’s pre-petition claim for unpaid amounts due under the lease will be treated as a secured claim to the extent the lessor holds collateral (such as a cash security deposit), and a general unsecured claim to the extent the amount due from the lessee exceeds the value of the collateral that the lessor holds. Lessors

may convince the bankruptcy court to lift the automatic stay to simply permit them to set off their cash security deposits against unpaid pre-petition amounts due under their leases. This is because lessors have a secured claim for unpaid amounts due to the extent of their cash security deposits. Accordingly, to the extent the security deposit would cover unpaid amounts under the lease, allowing the lessors to set off the security deposit would not harm other creditors or the bankruptcy estate. In addition, if the lessee fails to make its post-petition lease payments to the lessor, the lessor will likely have a strong basis to request that the bankruptcy court lift the automatic stay to permit the lessor to pursue eviction proceedings.

You did not answer the question! Timings? Claims? 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?

Section 363(b) authorizes a bankruptcy trustee or chapter 11 debtor-in-possession ("DIP") to use, sell, or lease estate property other than in the ordinary course of business only after court approval. To obtain such approval, a trustee or DIP must first provide notice to stakeholders and an opportunity for a hearing. The court will generally approve a sale of estate property under section 363(b) if the trustee or DIP offers a "good business reason" for the sale. *See In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983); *accord Matter of VCR I, L.L.C.*, 922 F.3d 323, 326 (5th Cir. 2019); *In re Nine W. Holdings, Inc.*, 588 B.R. 678, 686 (Bankr. S.D.N.Y. 2018)..

How Sec 363 will address the issue:
A 363 sale commissioned by the bankruptcy court benefits all the parties involved. Debtors who do not want to go through a reorganization benefit from the opportunity to maximize the returns from selling their assets through a competitive bidding process. Purchasers get an opportunity to buy assets at a bargain price with the approval of the court and without worrying about a reversal of the sale, as long as the auction is conducted correctly and the court rules that the sale was done in good faith. Purchasers also benefit by obtaining ownership of assets that are free and clear of lien or claim.

In the present case since Home Corporation is interested in taking over Paint Corporation and Paint Corporation wants to exit the business, a sale under Section 366(b) will benefit both the parties.

Once again you have not really answered the question! 2 marks.

The answer was:

Under a section 363 sale, Home Corporation could purchase Paint Corporation assets free and clear of any environmental claim (1 mark). Home Corporation would also have the certainty of knowing that its purchase could not be overturned on appeal (1 mark).

In a 363 sale, the purchaser could take less than all of Paint Corporation's assets and liabilities (1 mark); this could generate a higher price for payment of clean-up costs than if the business was sold as a whole outside of bankruptcy (1 mark).

A 363 sale combined with the debtor's power to assume and assign executory contracts would allow Home Corporation to take over the distribution contracts without counterparty consent. (1 mark)

*** End of Assessment ***