



### **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]: 37 out of 50 = 74%

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

Commented [DB2]: 9 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?

[Answer:

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.]

Incorporation? 0.5 marks

**Question 2.2 [maximum 2 marks]**

What is an executory contract?

[Answer:

The code does not define "Executory Contracts", but most of the courts have adopted the definitions arise from case laws. In the most common term, also called as Countryman Test, a contract under which the obligation of both the parties are so far unperformed that then failure of either to complete performance would constitute a material breach excusing the performance of other. For example, if a debtor is a party to a supply contract with a manufacturing company and if either party fails to perform their part of obligation, then it will become an executory contract. In case, one party performs and other party fails then contract would not be executory.] 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?

[Answer:

Priming lien is a type of post-bankruptcy commencement financing. In case, the debtor is unable to obtain credit facility or possibility of obtaining financing will depend on whether the estate has any unencumbered assets or encumbered assets with sufficient equity value to support a junior lien. Then, a court may grant a priming lien, which creates a senior or equal lien in the estate property to secure post-petition financing. The debtor has to make sure that the interest of secured creditor will not get impacted due to the creation of priming lien.

The requirements to be met are:

1. Priming lien can be granted only when any other source or any other term of financing is not available.
2. The foremost requirement is that the interest of secured creditors need to be protected adequately.] 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?

[Answer:

In Voting on a plan of reorganisation:

1. A class that is unimpaired by a plan is deemed to accept it.
2. Any class whose members receives nothing under the plan is deemed to reject the plan.
3. Only impaired classes have the right to vote on the plan.

In order for a plan to be confirmed, an affirmative voting of at least 2/3<sup>rd</sup> in dollar amount of claim and more than 1/2 in numbers of the creditors in a class that submits votes is required for the acceptance of the plan for reorganisation by that class. For equity interest holders, the affirmative vote of holders holding at least 2/3<sup>rd</sup> in amount of the equity interest in a class is required from the class voting on the plan of reorganisation.] **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?

[Answer:

The automatic stay provides a period of time in which all judgments, collection activities, foreclosures, and repossessions of property are suspended and may not be pursued by the creditors on any debt or claim that arose before the filing of the bankruptcy petition. As with cases under other chapters of the Bankruptcy Code, a stay of creditor actions against the chapter 11 debtor automatically goes into effect when the bankruptcy petition is filed. The stay provides a breathing spell for the debtor, during which negotiations and planning can take place to try to resolve the difficulties in the debtor's financial situation. Under chapter 11 proceeding automatic stay prevents creditors from taking any action to possess or exercise control over property of the debtor or of the estate, wherever located and by whomever held.

Whereas the automatic stay application in a chapter 15 proceeding is limited to property located in the United States or within the territorial limits of the United States. Also, the stay comes into effect automatically on recognition of a foreign main proceeding and discretionarily on an application for interim relief or recognition of a foreign non-main proceeding, whereas the chapter 11 stay comes into effect on filing the petition. **3 marks**

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

Commented [DB4]: 12.5 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?

[Answer:

Under Delaware law, Directors of Delaware corporation owes fiduciary duties to a Corporation's shareholders. The fiduciary duties of the director's include:

1. Duty of care: It requires that director should keep themselves reasonably informed when making decisions on behalf of the corporation.
2. Duty of loyalty: It 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.

Generally, in case the company is solvent, Directors owe duties to the corporation and shareholders of a corporation, but not to its creditors. However, the duty of a director expanded to include a company's creditors when a company operated in the so-called "zone of insolvency."

In *Gheewalla*, the court affirmed the dismissal of breach of fiduciary claims against the directors of a Delaware corporation asserted by a creditor of the company. In reaching its decision, the court first held that when a company is in the zone of insolvency, a creditor does not have standing to assert a direct fiduciary duty claim against a director. The court rejected the holdings of several lower Delaware court decisions which stood for the proposition that directors of a Delaware corporation have direct duties to creditors when operating in the zone of insolvency, and held that, when a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change. Directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.] **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.

[Answer:

Bankruptcy courts are divided into:

1. Core; and
2. Non-core.

The US Supreme Court has held that Bankruptcy judges may determine a core proceeding over which they have no constitutional authority by issuing a report and a recommendation for review by the district court or with the consent of the parties, may issue final orders, also bankruptcy courts do have authority to finally resolve certain core proceedings. However, if the bankruptcy judge determines that a matter is Non-core 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 general, appeals from Bankruptcy Courts are heard by the district court for the district in which they sit. However, in certain circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Tribunal (BAP). 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.] **3 marks**



**Question 3.3 [maximum 4 marks]**

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

[Answer:

- 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 non-insider 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.]

Satisfactory answer, although a bit long – 3 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?

[Answer:

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.

**What factors are taken into consideration when analysing COMI?**

#### Foreign Non-main Proceeding

Establishment. An "establishment" is defined in section 1502(2) as "any place of operations where the debtor carries out a non-transitory 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.]

**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?

[Answer:

An automatic stay arises automatically on the petition date.

- i) DOJ investigation, since it is a criminal proceeding, 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) 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 judice. Even pre-existing litigation against the debtor is subject to the stay. **No**
- iii) Delinquent leases will be hit by the automatic stay as any attempt to collect pre-petition claims (including demand letters, calls) are stayed.
- iv) Credit facility, the automatic stay will protect the debtor from collection efforts by creditors in the post-petition period. the stay would come into effect on the filing of the petition. 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?

[Answer:

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! 1 mark**

The answer was:

Rental Corporation only has 120 days to decide whether to assume or reject the leases. (1 mark) This period can be extended by 90 days for cause, but not further without lessor consent (1 mark).

Rental Corporation must pay rent as an administrative expense for the period prior to rejection of a lease. (1 mark) [but note Covid exception to this has developed in practice]

Administrative priority treatment for 2 years of rental payments for leases that are assumed and subsequently rejected. (1 mark)

Lessors have a claim in the bankruptcy for unpaid pre-petition rent. (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?

[Answer:

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. **You have not dealt specifically with the environmental 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.]

**This answer looks very much the same as candidate's 410's answer!**

**1 mark**

**\* End of Assessment \***