



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]: 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?

[Alternate qualifications that can make a corporation eligible to be a debtor in a US chapter 7 or 11 proceeding are:

1. If the corporation owns a property in the United States.
2. If the 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?

[Statute does not define what makes a contract executory. The meaning of executory contracts is derived from the case laws. Generally, a contract is said to be executory if there are material unperformed obligations on both the sides which result in **material** breach of the contract. Example of executory contract would be when the debtor has entered into a contract of supply of raw material and on the petition date, it is only partly complete and payment of the remaining part has not been received.] **1 mark**

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?

[Priming lien is created senior or equal to the existing lien. The priming lien is created on estate property to secure post-petition financing. Such financier if giver super-priority over the other existing claims. The requirements to be met are:

1. When financing could not be obtained on easier terms
2. Consent of secured creditors who is being primed is taken
3. Interests of secured creditors are 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?

- [(i) Any class that is unimpaired by a plan are deemed to accept the plan.
(ii) Any class whose members are to receive nothing under the plan are deemed to reject the plan

(iii) Any class whose rights have been impaired are permitted to vote on the plan.
A simple majority of the creditors in a class holding at least 2/3rd value of claims in the class vote in favour is required for a class to accept 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?

[In Chapter 11 proceedings the automatic stay applies with respect to debtor 's property worldwide and in Chapter 15 proceedings the automatic stay applies with respect to properties within the territorial limits. The automatic stay in Chapter 15 proceedings is subject to a carveout to permit the filing of a plenary US bankruptcy proceeding even after the recognition of a foreign proceeding.]

Timing? 1.5 marks

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

Commented [DB4]: 14 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?

[The duties that the directors of Delaware corporations owe are duty of care, which requires a director to be informed and indulge in deliberative decision-making based on all the material information that is reasonably available and duty of loyalty, which requires a director to act in best interests of the corporation and the shareholders.

In ordinary course of business, directors owe their duty to the corporation and shareholders. When the corporation is potentially insolvent, still directors owe their duty to the corporation and its shareholders and not creditors. Supreme Court in North Am Catholic Educational Programming Foundation, Inc v Gheewalla, 930 A.2d 92, 103 stated that directors do not owe any fiduciary duty to creditors even when the corporation is 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.

[The US Supreme Court in Wellness Int'l Network, Ltd. v. Sharif, 135 S Ct 1932 stated 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 they may issue the final orders. The Bankruptcy rules have implemented these rulings by requiring 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.

Generally, 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).

Only final orders are 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 that it was not a final order (In re Lendvest Mortgage, Inc., 42 F.3d 1181, 1183 (9th Cir. 1994)). Therefore, it follows that non-final orders are not reviewed.]

3 marks

Question 3.3 [maximum 4 marks]

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

Particulars	Preference	Fraudulent Conveyance	Constructive Fraudulent Conveyance
Elements	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.	A transfer or obligation with actual intent to hinder, delay or defraud any entity to which the debtor has become indebted.	Transaction in which debtor received less than the reasonably equivalent value
Suspect Period	90 days prior to petition in case of third parties and one year in case of insiders	Two years prior to the petition date	Two years prior to the petition date

4 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?

[Determination of foreign main or foreign non-main proceedings is done by establishing the Debtor's COMI (Center of Main Interests). COMI is a little alien to US Law since US law relies on the "nerve centre test" which factors in 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 location of headquarters, management, primary assets, creditors or jurisdiction whose law will apply to most disputes.

The relevant date in assessing COMI is the Chapter 15 petition date, rather than the date on which a foreign insolvency proceeding is commenced with respect to the debtor. The place of debtor's COMI is for foreign main proceeding and where debtor has establishment, where debtor carries out non-transitory economic activity prior to commencement of proceedings

under Chapter 15, the insolvency proceeding is recognised as foreign non-main proceeding.]
Requirements?

4 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?

- [(i) DOJ investigation will not be stayed as it is exempted from the automatic stay being a criminal proceeding.
- (ii) Securities class action litigation will stay. It falls under the scope of the stay being pre-petition litigation.
- (iii) A lease is an interest in a property and thus, these will be able to avail of the 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) Lenders will 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 nature of its business Rental Corporation does not own property, the lenders would likely file a motion to lift the automatic stay.]

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?

[The Bankruptcy Code provides protection to lessor via executory contracts. When there are material unperformed obligations on both sides, the debtor has to make decisions about assumption and assignment or rejection of executory contracts within 120 days of the petition date, further extendable by 90 days with the approval of the lessor. If the debtor chooses:

- (i) Rejection: it provides the lessor an unsecured pre-petition claim in damages
- (ii) Assume: debtor to cure the lessor's defaults and give lessor sufficient assurances for future performance.
- (iii) Assume and assign: Third party to whom it is assigned to give lessor adequate assurances for future performance]

Not a complete answer – 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?

[363 sale is free and clear of creditors interests and a good faith purchaser can retain the property and the debtor can transfer its interests in key contracts that are required to operate the business. Section 65 provides that licensees of patents and copyrights owned by the debtor are protected such that their licenses may not be terminated in connection with the sale of the intellectual property without their consent.

In the following case, Paint Corporation would be able to avail of the 363 sale. However, since it is a regulatory investigation, the US Environmental Protection Agency's action would continue even after filing for bankruptcy. Home Corporation is anyway not interested in the contaminated property. So Home Corporation can leave the property out of the 363 sale.

That leaves the proprietary and patented recipes and the distribution contracts, which Paint Corporation can sell under Section 363. These assets can fetch a higher value because the Home Corporation will be able to continue operating the business in its own factory during the proceedings.]

Your answer could have been more specific about the environmental claim and the fact that the purchaser can purchase free of the environmental claim. – 1 mark.

*** End of Assessment ***