



SUMMATIVE (FORMAL) ASSESSMENT (RESIT SEPTEMBER 2022): MODULE 3A

THE INSOLVENCY SYSTEM OF THE UNITED STATES

This is the **summative (formal) resit assessment** for **Module 3A** of this course. Please read the instructions 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: **[studentID.assessment3Aresit]**. An example would be something along the following lines: 202223-336.assessment3Aresit. **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 "student ID" with the student ID 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. This assessment must be returned to David.Burdette@insol.org by e-mail no later than **23:00 (11 pm) BST (GMT +1) on Monday 26 September 2022**. When returning the assessment by e-mail, your e-mail must 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. Prior to being populated with your answers, this assessment consists of **9 pages**.

ANSWER ALL THE QUESTIONS

Commented [DB1]: 39 out of 50 = 78%

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

Which of the following entities **does not** satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

- (a) A foreign domiciled company that pays a US attorney a retainer.
- (b) A company with several US bank accounts, but no physical presence in the United States.
- (c) A company with US patents, but no physical presence in the United States.
- (d) All of the above satisfy the minimum requirement for presence in the United States.
- (e) None of the above satisfy the minimum requirement for presence in the United States.

Question 1.2

ABC Corp is an industrial manufacturing company that is filing for bankruptcy. Which of the following **could not** be considered a party in interest?

- (a) A neighboring landowner to ABC Corp's manufacturing plant.
- (b) An environmental advocacy group that opposes ABC Corp's operations. Yes
- (c) The landlord of ABC Corp's corporate office.
- (d) People who live several miles downstream from ABC Corp's manufacturing plant and have been exposed to the plant's toxic waste.
- (e) The US Internal Revenue Service.

Question 1.3

Which of the following contracts to which ABC Corp is a party is executory and may be assigned without counterparty consent?

- (a) A lease on a manufacturing plant that contains a provision that requires landlord approval of any assignment. **Yes**
- (b) An employment contract between ABC Corp and a former employee, requiring the company to provide health insurance through the end of the current year.
- (c) A 10-year software licensing agreement with XYZ Corp that is three years into performance.
- (d) A lease on office space that ended the prior year, but for which ABC Corp still owes past rent.
- (e) None of the above are executory and may be assigned without counterparty consent.

Question 1.4

Which of the following conditions **must** be true about a reorganization plan for a court to confirm it under Chapter 11 proceedings?

- (a) Have a possibility of success, even if it relies on speculative or improbable events to be capable of execution.
- (b) **The plan is not likely to be followed by liquidation. Yes**
- (c) All impaired classes must accept the plan.
- (d) All of the above.
- (e) None of the above.

Question 1.5

Which of the following about cramdowns, is **false**?

- (a) The plan of reorganization must be fair and equitable to all impaired classes.
- (b) Differential treatment of different classes is permitted if there is a reasonable, good faith basis for doing so and such treatment is required for the plan of reorganization to be successful.
- (c) Class definition is often a battleground when a debtor tries to cramdown classes.

(d) Dissenting creditors are permitted to challenge the classification of a creditor supporting the cramdown.

(e) If one insider creditor approves of the plan of reorganization, all other impaired classes may be crammed down. **Yes**

Question 1.6

Which of the following about 363 sales is **false**?

(a) A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.

(b) The debtor in possession must establish that the transaction is in the best interests of the estate as a whole.

(c) In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale. **Yes**

(d) Debtors must carry out a robust marketing process for the sale.

(e) A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.

Question 1.7

Which of the following is true of both an actual fraudulent conveyance and a constructive fraudulent conveyance?

(a) The debtor must have had an actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted.

(b) Both require at least circumstantial evidence of the fraudulent intent.

(c) The debtor must have been insolvent at the time of transaction.

(d) In addition to provisions in the Bankruptcy Code, the debtor or the trustee may invoke applicable state or foreign fraudulent conveyance laws. **Yes**

(e) All of the above are true.

Question 1.8

When does an automatic stay come into effect?

(a) **Immediately on the filing of any plenary petition.** **Yes**

(b) On the filing of a voluntary petition but not on the filing of an involuntary petition.

- (c) Once the court reviews the petition and grants the stay.
- (d) Once the petitioner announces their intention to file for bankruptcy publicly.
- (e) Once a plan of reorganization is confirmed.

Question 1.9

Which of the following regarding substantive consolidation is **true**?

- (a) It respects the boundaries of corporate separateness.
- (b) It is the treatment of two or more creditors as a single creditor to simplify the claims process.
- (c) If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation. **Yes**
- (d) Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.
- (e) Authority for substantive consolidation comes from the Bankruptcy Code.

Question 1.10

Which of the following are relevant factors in determining a debtor's center of main interests (COMI) in the recognition stage of a Chapter 15 bankruptcy case?

- (a) The location of the headquarters.
- (b) The location of primary assets.
- (c) The location of the majority of the affected creditors in the request for relief.
- (d) The jurisdiction whose law will apply to most disputes.
- (e) **All of the above.** **Yes**

QUESTION 2 (direct questions) [10 marks]

Commented [DB3]: 9 out of 10

Question 2.1 (1 mark) 1 mark

What is setoff and why is it not permitted in many circumstances?

[Setoff is a right that allows a creditor having a claim against a debtor, and who also owes money to such debtor to deduct such obligations. The exercise of this right is not permitted in certain circumstances because it places such creditor in an improved condition in comparison to other unsecured creditors, since it reduces the obligation to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the unsecured claim.]

Question 2.2 [2 marks] 2 marks

What rules should you review when preparing a filing for a bankruptcy court?

[Federal Rules of Bankruptcy, Federal Civil Procedure Rules, local rules of procedure for the specific bankruptcy courts and the judge's personal practice should be reviewed. In addition, one should consult local practitioners in an unfamiliar jurisdiction for advice on the unwritten local practices.]

Question 2.3 [2 marks] 2 marks

What does the absolute priority rule require and when can it be deviated from?

[The rule requires that full payment should be made to each category of claims before the next category receives anything. Deviation is permitted in a Chapter 11 plan with the consent of affected creditors, unlike in Chapter 7 where deviation is not permitted, and statutory priorities must be followed.]

Question 2.4 [2 marks] 1 mark

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 a lien on the debtor's estate to secure the post-petition financing that is senior or equal to a pre-petition lien. For such lien to be granted the debtor must have explored the other three alternatives (including unsecured debts or credit in the ordinary course of business, or unsecured debts or credit outside the ordinary course of business with court approval) and show that it has been unable to secure sufficient funding to pay for the post-petition business expenses.]

Question 2.5 [3 marks] 3 marks

What is a preference? What are the elements of a preference claim that need to be proved? Is a showing of fault, by either the debtor or creditor, required?

[Preference is a transfer of the debtor's property made within the suspect period which is 90 days prior to the petition date, that must be returned to the estate if it exceeds the amount the recipient would have received in a chapter 7 liquidation, had the transfer not been made. For a preference claim, the elements that needs to be proved are that:

1. there was a transfer of an interest in the property of the debtor.
2. the transfer was to or for the benefit of the creditor.
3. the transfer was made on account of an antecedent debt owed by the debtor.
4. the transfer was made while the debtor was insolvent.
5. the transfer was made during the suspect period.
6. the transfer enables the creditor to receive more than it would have in a Chapter 7 liquidation.

It is pertinent to note however, that proof of fault of either the debtor or creditor is not required, and the creditor suffers no penalty other than returning the transfer and possibly prejudgment interest from the date of the transfer.]

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

Commented [DB4]: 14 out of 15

Question 3.1 [3 marks] 3 marks

Describe the circumstances in which a bankruptcy court may enter a final order, who reviews appeals from bankruptcy court orders and how are non-final orders reviewed?

[Bankruptcy courts can issue final order over core proceedings, that do not invade jurisdiction of courts created under Article III of the Constitution. For core proceedings that bankruptcy courts lack constitutional authority, they can issue a report and recommendation for the review of district courts in the same manner as non-core proceedings, or with the consent of the parties, issue final orders.

Generally, the district court in the district where the bankruptcy court sits, review appeals from bankruptcy courts order. In certain circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Panel (BAP), and appeals may go directly to the Court of Appeal where the ground for appeal raises a question of law or immediate appeal may materially advance the progress of the case.]

Question 3.2 [3 marks] 3 marks

What provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the United States upon recognition of a foreign main proceeding? What relief may be granted on a discretionary basis for either foreign main or non-main proceedings?

[The following provisions in the Bankruptcy Code automatically apply to the debtor's property:

1. automatic stay.
2. operation of the debtor's business in the ordinary course by the foreign representative.
3. sale, transfer or use of property outside the ordinary course.
4. avoidance of post-petition transfers and post-petition perfection of security interests.

Discretionary reliefs dependent on whether the proceedings are foreign main or non-main are as follows:

1. authorisation of discovery on the debtors' assets and affairs.
2. entrusting administration of the debtor's US assets to the foreign representative or other person.
3. extension of provisional relief.
4. any other relief necessary to effectuate the purposes of Chapter 15 and to protect the assets of the debtors or the interest of the creditors.]

Question 3.3 [4 marks] 4 marks

What duties do directors owe to a Delaware corporation in the ordinary course of business? To whom are these duties owed when the corporation is potentially or actually insolvent? What rule protects directors from liability for errors of judgment?

[Directors owe fiduciary duty of loyalty to act in the best interest of the corporation, as well as a duty of care in educated decision-making. Where the corporation is potentially or actually insolvent the duties are still owed to the corporation and shareholders, not to creditors.

As director liability in Delaware is limited, directors are protected from liability for errors of judgment by the business judgment rule. Under the business judgment rule, there is a rebuttable presumption that directors have acted in good faith on basis of reasonable information.]

Question 3.4 [5 marks] 4 marks

List and describe the requirements that a creditor's claim must fulfill in order to qualify as a petitioning creditor in an involuntary proceeding.

[In order to qualify as a petitioning creditor in an involuntary proceeding, the creditor's claim must be:

1. Non-contingent- the claim must not be determined on the occurrence of a future event. In the case of a debt that is matured, it would be non-contingent if all the

requirements for the debtor to incur liability has occurred, except the passage of time.

2. Not be the subject of *bona fide* dispute on liability or amount- The existence or otherwise of a *bona fide* dispute is an objective test of if there is a reasonable basis for dispute to arise as a matter of fact or law. The debtor's subjective belief that the amount claimed is incorrect or that the debt is not owed is not sufficient.
3. Undersecured or unsecured, separately or in the aggregate with the petitioning creditor's claim in the amount of at least USD16,750.]

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

Commented [DB5]: 7 out of 15

Question 4.1 [5 marks] 2 marks

Speculation Inc is engaged in day-trading stocks from leased office space with two employees. It funds its trading through a margin loan from its broker, where the shares it purchases are held as collateral. For a while, Speculation Inc was very successful in trading, and the US Department of Justice (DOJ) has announced an investigation into whether its success was due to illegally trading on insider information. More recently, Speculation Inc has had serious trading losses, causing its broker to declare a default on the margin loan. It also has fallen behind on its rent and been sued by a former employee alleging she was fired due to gender bias.

What would be the effect of a Chapter 11 petition being filed by Speculation Inc on each of the (i) DOJ investigation, (ii) margin loan default; (iii) delinquent lease and (iv) employment discrimination lawsuit?

[The filing of the Chapter 11 petition would have the effect as follows: **automatic stay?**

- i. DOJ investigation: The DOJ investigation can still continue with the Chapter 11 petition being filed. Regulatory investigations are not covered by automatic stay on proceedings. **yes**
- ii. Margin loan default- the filing of the voluntary petition would impose a statutory automatic stay that would protect the property of Speculation Inc. from any creditor enforcement action by the broker. **No**
- iii. Delinquent lease: The landlord's right to evict debtor company from the property as a result of non-payment of lease is not affected by the petition filing.
- iv. Employment discrimination lawsuit: Commencement of criminal actions are not debarred by the filing of the petition.]

The filing of the chapter 11 would result in immediate application of the automatic stay. (1 mark).

The DOJ investigation would not be affected because it is a criminal investigation that is exempt from the automatic stay. (1 mark)

Foreclosure on the collateral securing the margin loan would not be stayed because a margin loan is a securities contract exempt from the automatic stay. (1 mark)

Any action by the landlord to recover unpaid rent or evict Speculation Inc. would be subject to the automatic stay because the lease had not expired at the end of the term, but rather were simply in payment default. (1 mark)

The filing of the petition would stay the employment discrimination action. (1 mark)

Question 4.2 [5 marks] 1 mark

Stella SA (Stella) is an international cosmetics company incorporated in France, with its headquarters in Paris. Stella's products are made in Italy and shipped to its retail stores in Europe (including England), Asia, and North America. Stella's funding comes from a bank loan and Eurobonds, both of which are governed by English law. Stella's retail sales have suffered due to pandemic-related closures and it is considering options to restructure its debt. One option is to use an English scheme of arrangement with respect to the Eurobonds. Could the English scheme of arrangement be recognized by a US bankruptcy court under Chapter 15, and would such recognition be as a foreign main or non-main proceeding?

[The English scheme of arrangement could be recognised by the US bankruptcy court, except where it would contravene US public policy.

In determining whether the recognition would be foreign main or non-main proceeding, the court would need to consider if the action is commenced at the debtors' centre of main interest ("COMI"). For an analysis of COMI, courts would consider objective evidence on:]

- a. The location of the headquarters- in this case it is Paris, and it is also a city in country of incorporation. **ok**
- b. The location of primary assets-in the above scenario the products are made in Italy, therefore, the primary assets are likely to be located there/
- c. The location of the majority of the affected creditors in the request for relief-in this situation no information was provided about the location of the creditor. However, it has agreed to be subject to English law.
- d. The jurisdiction whose law will apply to most disputes- English law

Since the law that would apply to the disputes is English law and Stella SA carried out economic activity in England, the US bankruptcy courts would recognise it as a foreign main proceeding

Stella's COMI is France because that's where it is incorporated and has headquartered (1 mark); the connections with other jurisdictions are not sufficient to overcome the presumption that its jurisdiction of incorporation is its COMI (1 mark). Because the English proceedings are not in Stella's COMI jurisdiction, there cannot be foreign main recognition (1 mark). The English proceedings can be recognized as foreign non-main (1 mark), assuming that one of the retail stores is in England and constitutes an establishment (1 mark).

Question 4.3 [5 marks] 4 marks

ToyCo is an American toy company that has created a popular line of folding robot toys called Xbox. The toys are covered by several US patents. Currently, GameMart Inc (GameMart) has a 10-year exclusive license to manufacture Xbox and pays ToyCo monthly royalties. GameMart operates a factory in California that it leases from Land Corp on a longer term lease with seven years to go; the lease prohibits assignment without Land Corp's consent. The Xbox toys are selling well, but GameMart's other toy lines are doing poorly, so it is considering a Chapter 11 bankruptcy. Answer the following questions:

(i) Is the license to manufacture Xbox an executory contract?

[Yes, it is. The use of the license as well as the royalties have not been fully completed.] **Yes**
1 mark

(ii) Can GameMart transfer the Xbox license as part of 363 sale without ToyCo's consent? Why or why not?

[GameMart cannot transfer the Xbox License as part of 363 sale without the consent of ToyCo, because the license is a protected intellectual property right.] **Yes 2 marks**

(iii) Can GameMart transfer the factory lease as part of 363 sale without Land Corp's consent? Why or why not?

[GameMart can transfer the factory lease as part of 363 sale without the consent of Land Corp, because even though consent requirement provided in the lease, the lease is used in the ordinary course of business.] Not quite the right answer **1 mark**

*** End of Assessment ***