



**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: **[studentID.assessment3A]**. An example would be something along the following lines: 202223-336.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 “student number” 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 2023**. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2023. 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 2023** or by **23:00 (11 pm) BST (GMT +1) on 31 July 2023**. If you elect to submit by 1 March 2023, you **may not** submit the assessment again by 31 July 2023 (for example, in order to achieve a higher mark).
7. Prior to being populated with your answers, this assessment consists of **9 pages**.

### **ANSWER ALL THE QUESTIONS**

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

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**

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Commented [H(2)]: Total marks 9/10

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.

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**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.**
- (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.

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**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.
- (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.

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**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.**
- (c) All impaired classes must accept the plan.
- (d) All of the above.
- (e) None of the above.

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**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.**

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**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.**
- (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.

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**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.
- (e) All of the above are true.

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**Question 1.8**

**When** does an automatic stay come into effect?

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

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**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.
- (d) Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.
- (e) Authority for substantive consolidation comes from the Bankruptcy Code.

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**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.

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(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.

**QUESTION 2 (direct questions) [10 marks]**

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**Question 2.1 (1 mark)**

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

Setoff rights typically may be used where two persons are mutually indebted, the debts may be set off against each other. In a bankruptcy context, setoff rights enable a creditor to reduce its debt owed by the debtor from that creditor's existing claim, where those rights arose from a separate transaction. Certain requirements exist for a creditor to exercise an existing setoff right: that is, (1) mutuality; (2) the correct timing (the creditor's claim must only have arisen prepetition); and (3) the parties must stand in the same capacity (the nature of their relationship cannot change). However, setoffs are not permitted in many circumstances: in principle, this is because a creditor exercising its setoff rights may be in a better position of that creditor as against those of others — either similarly situated, or just plain unsecured. As a result, there are restrictions on when setoffs may be permitted (for instance, if the creditor's claim is entirely disallowed from the get-go, permitting that claim to be setoff through assets technically in the estate would unfairly hurt other creditors). Other times that setoffs are not permitted include if the creditor's claim falls within the preference period (90 days prior to the petition at the time the debtor was insolvency), or if the claim itself was created for the eventual purpose of exercising setoff rights.

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Commented [H(16)]: Correct, 1/2 mark

**Question 2.2 [2 marks]**

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

When preparing a bankruptcy petition, the Federal Rules of Bankruptcy Procedure provide crucial information that must be included in the petition. The schedules listed in the FRBP include lists such as assets and creditors, income and expenditures, executory contracts, and unexpired leases, etc. Other resources include the local rules of the bankruptcy court where the filing is taking place, and the particular judge's personal practices.

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Commented [H(20)]: Correct, 1/2 mark

**Question 2.3 [2 marks]**

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

Under the absolute priority rule, a plan must require that each category of claims is paid in full before a lower-ranked category can receive any recoveries. The practical effect of this rule may be seen, for example, in the treatment of equity holders, who are typically wiped out because they may not remain owners until and unless general unsecured creditors are paid in full. A Chapter 11 plan may deviate from this rule, as long as affected creditors (i.e. higher-ranked creditors) provide their consent.

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**Question 2.4 [2 marks]**

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What is a "priming lien" and what requirements must be met for such a lien to be granted to secure DIP financing?

A priming lien is a kind of court-granted debtor-in-possession financing, where the provider will carry at least an equal (or senior) rank on the estate property in question. This lien, which may be granted under § 364(d), effectively “primes” an existing lien on the property. However, a priming lien may be granted only if the debtor can show that the lending creditor will be adequately protected. Other requirements include that financing cannot be obtained on any other terms (for example, unsecured debt in the ordinary course of business).

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### Question 2.5 [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?

A preference, dealt with under § 547 of the Code, is a prepetition transfer made by the debtor, which allowed/allows one creditor to receive more money or value through the proceedings than another creditor who is similarly situated, or more than the creditor would have received in a liquidation scenario if the transfer hadn't been made. A preference claim has six elements: (1) a transfer of an interest of the debtor in property must have been made; (2) to or for the benefit of the creditor; (3) on account of or for some antecedent debt which was owed before the transfer was made; (4) during a “suspect period” of 90 days prior to the petition date; (5) while the debtor was insolvent and; (6) with the ultimate result of the creditor receiving more than it would have in a liquidation scenario (for example, in comparison to what other creditors in its position would have received). No showing of fault, either by debtor or creditor, is required in a preference avoidance action.

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

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### Question 3.1 [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?

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The circumstances around which a bankruptcy court may enter a final order will typically see situations that dispose of all issues, with no pending decision to be made. Where, for example, a “discrete dispute” is resolved, such an order would likely be considered a final order. An order, for example, that denies relief on an automatic stay with no other pending issues surrounding the denial of that stay would likely be considered final (and thereby immediately appealable). Similarly, where a bankruptcy court is adjudicating over core bankruptcy proceedings, such orders would likely be final orders. In contrast, while bankruptcy courts can hear non-core issues (for example, issues relating to the bankruptcy but those that are not part of the core proceedings of the bankruptcy process), a court may choose not to issue a final order on these non-core issues (though litigants might choose to consent to a bankruptcy court entering a final order on a non-core matter as well). From a policy standpoint, bankruptcy courts are of limited jurisdiction, which is why such a distinction is made.

Commented [H(37)]: These refer to finality for appellate purposes rather than constitutional finality

Commented [H(38)]: Incorrect, the bankruptcy court may enter constitutionally final orders on core matters only if it concerns allowance of the petition or with the consent of the parties

Appeals from bankruptcy court decisions will be heard by the United States District Court of the district that the bankruptcy court sits in, unless that court is in a circuit that instead has a “Bankruptcy Appellate Panel” (BAP). In such circuits (for example, the First, Sixth, Ninth and Tenth Circuits), a party may choose to have their appeal heard either by the relevant district court, or by the BAP, which is comprised of judges from bankruptcy court within that circuit. The final layer of appeal (assuming the case is not appealed further and granted a writ of certiorari by the Supreme Court) sits at the Circuit Court of Appeals level (like, for example, the Second Circuit Court of Appeals). At times, an appeal from the bankruptcy court may go right up to the circuit court if that issue raises a question of law where no controlling decision (either of the Supreme Court or that Circuit) already exists, or if the issue requires dealing with conflicting controlling decisions, or if an appeal could materially advance the case. The circuit court has discretion to accept a case that is being appealed directly from the bankruptcy court level. The standard of review applied by a district

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court or BAP on conclusions of law is *de novo* while findings of fact are reviewed on an abuse of discretion standard.

Final orders may be appealed generally. However, **non-final orders, also referred to as interlocutory orders, may only be appealed with permission from the appellate court.** Interlocutory appeals that are up for hearing on the appellate level could still permit the party to obtain a stay (pending appeal) from the bankruptcy court, as long as such a party is able to show its likelihood of winning on the appeal issues/possibility of facing imminent harm without a stay and failing to do so could result in a fruitless appeal overall. Lastly, after the *Stern v. Marshall* Supreme Court case, the Federal Bankruptcy Rules now require litigants to state in their pleadings whether they consent or do not consent to a bankruptcy court entering a final order, and to consent to a district court to treat a bankruptcy order as proposed findings of fact and conclusions of law.

### Question 3.2 [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?

Upon the recognition of a **foreign main proceeding**, several provisions of the Bankruptcy Code are **automatically applied** to a debtor's property within the territorial jurisdiction of the U.S (see generally 11 U.S.C § 1520). These include the imposition of an **automatic stay** under 11 U.S.C. § 1520(c) and the ability for a foreign representative to intervene in US-based proceedings that the debtor is a party to in accordance with 11 U.S.C. § 1524. Other rules with that automatically apply include those dealing with the foreign representative's ability to **operate the debtor's business in the ordinary course**, the foreign representative's ability to **sell, transfer, or use property outside the ordinary course** with the requisite court approval (to the extent that the relevant provisions apply to the property of an estate), and the foreign representative's ability to **avoid and clawback post-petition transfers or perfection of security interests**.

Other types of relief are available, but only on a **discretionary basis**, though such reliefs may be granted following the recognition of either a foreign main or foreign non-main proceeding (see generally 11 U.S.C § 1520). The relief of this nature, which is subject to court approval, includes allowing **discovery into the debtor's assets and affairs**, or entrusting either the foreign representative or another person to **administer the debtor's US-based assets**, or extending provisional reliefs and other reliefs that may be necessary to ultimately effective the goals and purposes of Chapter 15, as well as any relief needed to protect the assets of the debtor or the interests of its creditors. Indeed, other requirements exist when a court is considering granting (on a discretionary basis) reliefs for foreign main or non-main proceedings: not only must the bankruptcy court be satisfied that it is permissible under US law for the assets in question to comprise and be administered in the foreign main proceeding, but the court must also make its relief contingent on the relevant interested parties to have their interests protected.

In any case, these discretionary reliefs need not be exhaustive if a court finds that other additional assistance under the Bankruptcy Code is needed and justified under principles of international comity (as long as doing so does not contradict public policy or the values upon which the Bankruptcy Code is founded).

### Question 3.3 [4 marks]

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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?

In the ordinary course of business, directors of Delaware corporations owe the corporation a “**duty of loyalty**” and a “**duty of care.**” The duty of loyalty requires that directors put the corporation’s interests ahead of their own, and act without any conflicts of interest. The duty of care differs from the duty of loyalty, in that it requires a director to have behaved with a requisite level of care that a reasonable person in similar circumstances would have used.

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Commented [H(51)]: Correct, 1 mark

The rule protecting directors from liability for errors of judgment is known as the “**business judgment rule,**” under which a director will presumably have acted in good faith, based on the reasonable information they had at the time. The idea of the business judgment rule is to give deference to directors’ decisions and presume that they acted in with the genuine belief that their action would be in the best interests of the corporation and its shareholders. Taking forward this policy, the business judgment rule is not applicable where a board majority is not disinterested (that is, they have their own interests involved) and an independent or controlling shareholder sits on either side — because in this case, there is reason to doubt the drivers behind that board or directors’ point of view.

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Outside of bankruptcy, there is little doubt as to whom the duties of loyalty and care are owed: the corporation. What happens, then, when we ask whether these duties change when a corporation could be or is insolvent? Does a director’s duty of care and loyalty shift from the corporation to the corporation’s creditors? The answer is no: in *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, the Delaware Supreme Court noted that **even if a company is actually insolvent or operating in the “zone of insolvency,” individual creditors do not have the right** to “assert direct claims for breach of fiduciary duty” against the corporate directors. That is, even if a corporation is in the zone of insolvency, its directors **must owe their duties of loyalty and care to the corporation and its shareholders — not the creditors.** On a practical level, this would preclude creditors of an insolvent company from bringing claims against directors themselves, though creditors are still very much able to bring a derivative claim *on behalf of the insolvent corporation* — just not a direct one.

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#### Question 3.4 [5 marks]

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

A creditor seeking to involuntarily initiate Chapter 7 or Chapter 11 proceedings against a debtor must meet certain requirements.

*First*, as to the claim itself, the creditor’s claim must be **non-contingent** (meaning the claim cannot be contingent on an event that will happen in a future, except for unmatured debts). *Second*, as to the creditor’s claim must also **not be the subject of a bona fide dispute on the liability or amount**; that is, if a debtor’s subjective believe is that they do not own this creditor the claim or if the debtor believes the claim is incorrect, then such a claim will be found to be subject to a *bona fide* despite. *Third*, the creditor’s claim — whether **unsecured or undersecured or in the aggregate with other petitioning creditors’ claims** — must be at least **USD 16,750 (subject to inflation)**. If the claim(s) total less than the minimum of USD 16,750, an involuntary petition may not be filed. Importantly, if part of the claim is disputed, the disputed amount cannot be computed in the total to meet this threshold (though the disputed portion of one creditor does not disqualify the otherwise valid, non-contingent claims of other

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filing creditors). *Fourth*, the creditor or collective group of creditors filing the involuntary petition must actually allege that the debtor is not paying their debts as they become due (unless the claims are subject to some *bona fide* dispute, or unless within 120 days prior to the petition date a trustee or agent or person in a similar role was authorized to obtain charge over the property in order to enforce a lien).

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Based on the above rules, it is also important to note that if a debtor has over 12 or more non-contingent, non-insider creditors, at least three qualifying creditors must petition together. If, however, a debtor has less than 12 creditors, even the petition of one creditor is sufficient for the involuntary petition to be filed.

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

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##### Question 4.1 [5 marks]

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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?

(i) **DOJ Investigation.** The DOJ investigation will not cease upon the execution of the automatic stay under § 362 upon filing a Chapter 11 petition. This is because the stay itself is subject to several statutory exceptions, of which one is "regulatory investigations" — such as the DOJ investigation (see section 362(b)(26)).

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Commented [H(63)]: Correct, 1 mark

(ii) **Margin loan default.** Once a Chapter 11 petition has filed, the automatic stay is immediately imposed and as such, any collection efforts (including acceleration or sending a default notice) that the broker could be making must also cease. Moreover, the broker will become likely become a secured creditor (since the margin loan is secured by shares that Speculation bought). It is critical for the broker to file its claim by the claims bar date, assuming Speculation also follows appropriate notice procedures. The Chapter 11 process itself will deal with the loan, as well as compute in default interest, etc. To this end, any secured creditor like the broker will be put into a class of similarly situated creditors.

Commented [H(64)]: Incorrect, the margin loan is a securities contract exempt from the automatic stay

(iii) **Delinquent lease.** A Chapter 11 petition likely does not nullify any leases that have already been defaulted on. However, the leases do become executory contracts and may be renegotiated (or assumed/accepted/rejected), but if the debtor continues to occupy the leased office space, then it will appear that Speculation has accepted the lease. If the lease has not expired as such, the decision will be made as to what to do about the lease within a 120-day window starting on the petition date. The lease amount will be factored into the ultimate payment waterfall, and it will be decided whether the lease sum comprises an administrative payment or not. Finally, if the leases have any *ipso facto* clauses, these will likely not be enforceable and the leases themselves may need to be provided as schedules

Commented [H(65)]: Because the rent is past due but the lease is not expired, the landlord could not evict Speculation Inc. or bring an action outside the bankruptcy for recovery of the rent

- (iv) **Employment discrimination.** The automatic stay covers any litigation pre-petition claims, which would encompass the employment discrimination suit filed on by the former employee. The employee could choose to seek approval from the bankruptcy court to pursue the litigation in parallel, or if needed, file a motion or pleadings.

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#### Question 4.2 [5 marks]

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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?

An English scheme of arrangement would most likely be recognized by a US Bankruptcy Court under Chapter 15, and at the time of recognition, a US bankruptcy court would likely find the scheme of arrangement to be a foreign non-main proceeding. However, in this essay, I also make a competing argument for why an English scheme of arrangement could be, in this scenario, a foreign main-proceeding as well.

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A foreign main proceeding is found when a debtor's "centre of main interests" (COMI) or place of incorporation is in a location. COMI is not a defined term under the UNCITRAL Model Law of Cross Border Insolvency, and so determining a debtor's COMI is a fact-based inquiry. Indeed, the two aforementioned factors — headquarters location and location of incorporation — are not dispositive for a finding of whether a restructuring in another jurisdiction is a foreign main proceeding. Instead, generally speaking, several factors (as seen in *In re Sphinx*) under Chapter 15 case law speak to whether an insolvency proceeding from another jurisdiction constitutes a foreign main proceeding or not. These factors include the location of the company's primary assets, the location of the company's management, the location of a majority of the debtor's creditor (or those affected by the relief requested by the foreign representative), or the jurisdiction whose law will apply to most disputes.

In contrast, a foreign *non-main* proceeding is found where a debtor has an *establishment* in a jurisdiction. The threshold for a debtor to show they have an establishment in a jurisdiction is lower than what is required to show the COMI: for one, a debtor needs only to carry out non-transitory economic activities with human means and goods or services. Stella at least has an establishment in Italy (as that is where its products are manufactured), and also has its Asia, Europe, and North America locations (where the company has retail stores).

In the case of Stella's presence, the company is headquartered and incorporated in Paris. Taking a common or plain reading of what we assume COMI to be, this makes it clear that France would be Stella's COMI. If we were to ask what Stella's nerve centre or principal place of business is, France seems like the obvious choice because that's where the debtor's headquarters lie. Presumably, that's where the debtor's management likely also sits, though we are not told of this fact. In most jurisdictions, the determination of a debtor's COMI tends to revolve around a company's headquarters and place of incorporation, which in this case, would be France. If a bankruptcy court were to find that France is where Stella's COMI is (and as a result, potential insolvency proceedings in France would be declared the foreign main proceedings), the English scheme of arrangement would likely be found to be the foreign non-main proceedings. Indeed, its presence in England is also sufficient to meet the

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**threshold of an establishment.** Not only does Stella have stores in England, which adequately meets the non-transitory standard of an establishment, but Stella's primary debt documents (as discussed further below) are also governed by English law. While the England might be too tenuous a jurisdiction to find the existence of a COMI, Stella most certainly has at least an establishment in the country.

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There is a reasonable argument to show that England could be the COMI as well: other relevant factors in the COMI analysis hold in this case, because not only are Stella's bank creditor is based in England, but also because its Eurobonds are governed under English law. This answer also presumes that Stella's only creditors comprise the bondholders of the Eurobonds and its UK-based bank lender. The presence of a debtor's creditors affected by the relief in a specific jurisdiction, as well as the fact that the jurisdiction's law will apply to many disputes, are important additional factors to the COMI analysis and a generous reading may actually find that these factors are sufficient to find England as a foreign main proceeding. However, in comparing this presence to the fact that both Stella's incorporation AND headquarters are in France, the likelihood that England could be deemed a foreign main proceeding is diminished. **France is the stronger choice for a foreign main proceeding finding, and an English scheme of arrangement is most likely going to be a foreign non-main proceeding.**

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As to recognition itself, I cannot see under these facts why recognition would be denied. Denials of recognition occur in rare circumstances, such as the unique situation in the *Bear Stearns* case where the court suspected COMI manipulation or where a proceeding is manifestly contrary to US public policy. However, in general, absent such considerations, proceedings usually do receive recognition under Chapter 15 and in this case, particularly since we don't know of any changes around the date of the petition that would change the COMI/establishment analysis, **recognition would most likely be granted.**

#### Question 4.3 [5 marks]

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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?

A contract is executory if the obligations of both parties are significantly unperformed, such that if either party failed to perform there would be a material breach. The obligations must remain outstanding, and not substantially or fully performed. In this case, unless the 10-year exclusive license contract is almost substantially fulfilled (and similarly, unless GameMart owes ToyCo no more monthly royalties), we can assume the license to manufacture Xbox is an executory contract. Licenses could be compared to leases, in that both a licensee and licensor have duties — either to utilize the license in question and pay royalties, or to fulfil the exclusivity promise in this case. Here, the central aspect of the executory contract is that GameMart is manufacturing the Xbox, and not simply making payments to ToyCo.

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

While GameMart may be able to assume the Xbox license agreement, selling the license (i.e. transferring it to a third-party buyer) without ToyCo's consent is likely not

permitted. Even though a debtor in bankruptcy may choose to assume and assign contracts such that the debtor's rights are transferred to a third party, counterparty consent is required if the contract pertains — as it does in this case — to substantive non-bankruptcy rights. Under certain applicable federal or state laws, agreements to license trademarks, copyrighted and patented material, or other intellectual property may not be assigned without the counterparty's explicit consent.

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Notably, a separate layer of analysis of § 365(c) — the part of executory contracts that require a transferability inquiry — requires delving into the hypothetical and actual tests, which are common law tests utilized to determine whether a debtor can assume the contract to begin with (before even deciding whether the contract can be assigned). Under the hypothetical test. That is, it is possible GameMart couldn't even assume the license agreement to begin with, let alone assign it. Under the hypothetical test, courts have found that a debtor cannot assume an executory contract that it wouldn't later be able to assign without consent. Taking our facts and the hypothetical test, it's possible that GameMart would be precluded from assuming the license agreement in bankruptcy and continue performing on it because a ToyCo's consent would be required since we are dealing with the license of a third-party's intellectual property. Under the actual test, however, courts only bring up a question of assignment — that is, a debtor cannot assume a contract ONLY where the restructuring would result a non-debtor (i.e. licensor) from accepting a third party to whom the license was transferred. This question, however, focuses only on whether ToyCo's consent is required: and since we are dealing with the license of intellectual property, it is likely that ToyCo's consent is needed.

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

GameMart likely may transfer the factory lease as part of a 363 sale without Land Corp's consent, as long as the lease was properly assumed. That is, the lease must have been assumed 120 days after the petition date or the GameMart's conduct must have shown that it continued to occupy the factory and as such, assumed the contract despite any indications of rejecting the lease. And as long as the transferee or assignee is able to provide Land Corp with adequate assurances of their ability to perform the contract and pay the lease, the lease should be transferrable. Contracts that cannot be assigned tend to focus on loan or financial accommodation contracts, federal government contracts, or intellectual property law contracts (such as trademark law, franchise and dealer contracts, or distributorship agreements). However, a lease does not fall into this category and on a policy front, the Bankruptcy Code precludes contractual restrictions (including *ipso facto* clauses) from obstructing a debtor's chance to maximize value. As such, the lease can be assignable without consent, notwithstanding the Land Corp approval clause.

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**\* End of Assessment \***