



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

Commented [H(1)]: Total marks 38/50

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

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

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

Commented [H(3)]: Correct, 1 mark

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

Commented [H(4)]: Correct, 1 mark

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.*

Question 1.3

Commented [H(5)]: Correct, 1 mark

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.*

Question 1.4

Commented [H(6)]: Correct, 1 mark

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.*

Question 1.5

Commented [H(7)]: Correct, 1 mark

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.*

Question 1.6

Commented [H(8)]: Correct, 1 mark

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.*

Question 1.7

Commented [H(9)]: Correct, 1 mark

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.*

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.

Commented [H(10)]: Correct, 1 mark

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.

Commented [H(11)]: Correct, 1 mark

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.

Commented [H(12)]: Correct, 1 mark

QUESTION 2 (direct questions) [10 marks]

Commented [H(13): Total marks 8.5/10

Question 2.1 (1 mark)

Commented [H(14): Total marks 1/1

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

Set off is when a creditor of the insolvent estate is owed money from the debtor, but also owes money to the debtor simultaneously, and is permitted to cancel out the credit against the debt, or a portion thereof, by setting one amount off against the other. It is not always permitted because if the creditor would not, in the ordinary bankruptcy process, fully recover the debt it is owed but they have been permitted to set off that debt in full, they are financially better off than any other creditor in the same class without any potential set off claim.

Commented [H(15): Correct, 1/2 mark

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

Question 2.2 [2 marks]

Commented [H(17): Total marks 1/2

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

The Federal Rules of Bankruptcy Procedure together with the local rules and procedure of the relevant court in which you are filing.

Commented [H(18): Correct, 1/2 mark, you should also review the Federal Rules of Civil Procedure because they are incorporated by reference in the Bankruptcy Rules

Commented [H(19): Correct, 1/2 mark, you should also review the judge's personal practices

Question 2.3 [2 marks]

Commented [H(20): Total marks 2/2

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

The absolute priority rule requires that each category of claim (fixed by way of statutory priorities) is fully paid out before the next category receive anything. This can be departed from in Chapter 11 proceedings with the consent of those creditors who are affected by such a deviation.

Commented [H(21): Correct, 1 mark

Commented [H(22): Correct, 1 mark

Question 2.4 [2 marks]

Commented [H(23): Total marks 1.5/2

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 lien that is senior or equal to a pre-petition lien on estate property, which is granted post-petition to secure financing. It must be shown that financing cannot be secured on any other terms in order for it to be granted.

Commented [H(24): Correct, 1 mark

Commented [H(25): Correct, 1/2 mark, also the interests of secured creditors must be adequately protected

Question 2.5 [3 marks]

Commented [H(26): Total marks 3/3

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 is a transfer of the debtor's property to a creditor during a specified period before the filing of a petition (referred to as the suspect period), which exceeds the sum that the given creditor would have been entitled to in a chapter 7 liquidation without such a transfer having been made.

Commented [H(27)]: Correct, 1 mark

In order to successfully reverse such a preferential transfer there is no need to show any fault by either the debtor or the creditor. The elements of a preference claim that need to be proved are:

Commented [H(28)]: Correct, 1 mark

- 1. a transfer was made of the debtor's interest in property;**
- 2. the transfer was for the benefit of a creditor; and**
- 3. it was made in settlement, or part payment, of an antecedent debt, owed by the debtor before the transfer was made.**

Commented [H(29)]: Correct, 1/2 mark

Commented [H(30)]: Correct, 1/2 mark

Commented [H(31)]: Correct, 1/2 mark

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

Commented [H(32)]: Total marks 12.5/15

Question 3.1 [3 marks]

Commented [H(33)]: Total marks 1/3

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?

A bankruptcy court may enter a final order only if it relates to a core bankruptcy issue, providing such order does not invade the Article III jurisdiction. A final order must dispose of all issues, leaving nothing further to be determined by the court.

Commented [H(34)]: Partially correct, 1/2 mark, this is correct only if the matter is a challenge to the petition or the parties consent

Any such final order is usually reviewed, upon appeal, by the district court within the district in which the bankruptcy court made the final order. In some circuits, however, such appeals are reviewed by a Bankruptcy Appellate Panel. In rare circumstances an appeal may go directly to the Court of Appeal instead.

Commented [H(35)]: Correct, 1/2 mark

Commented [H(36)]: Correct, 1/2 mark

Non-final orders are reviewed by the district court or a Bankruptcy Appellate Panel, depending on the system in place in the relevant district, but leave is required by the relevant court in order to pursue any such appeal.

Commented [H(37)]: This refers to non-finality for purposes of appeal, but orders that are not final for constitutional purposes are treated as a report or recommendation.

Question 3.2 [3 marks]

Commented [H(38)]: Total marks 3/3

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?

An automatic stay takes effect in relation to the debtor's property within the jurisdiction of the US upon recognition of foreign main proceedings. Upon recognition a representative of foreign main proceedings also becomes entitled to operate the debtor's business in the ordinary course, to sell, transfer or use property outside of the

Commented [H(39)]: Correct, 1/2 mark

Commented [H(40)]: Correct, 1/2 mark

ordinary course of business and to avoid post-petition transfers and post-petition perfection of security interests.

Commented [H(41)]: Correct, 1/2 mark

Commented [H(42)]: Correct, 1/2 mark

The same relief is available in foreign non-main proceedings but it is not automatic, it is at the discretion of the relevant court. In addition, in foreign non-main proceedings, and foreign main proceedings, at the discretion of the relevant court relief may be granted authorizing discovery relating to the debtor's assets and affairs, entrusting administration of the debtor's assets to the foreign representative (or to another person), there may be an extension of provisional relief, and the court can consider any other relief necessary to effectuate the purpose of chapter 15 and to protect the assets of the debtor or the interests of a creditor.

Commented [H(43)]: Correct, 1/2 mark

Commented [H(44)]: Correct, 1/2 mark

Commented [H(45)]: also correct

Question 3.3 [4 marks]

Commented [H(46)]: Total marks 4/4

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?

Unusually directors of a Delaware corporation never owe a duty to the creditors, even in the event of actual or potential insolvency. In the ordinary course of business directors owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care of care in educated decision making. As such the duties are owed to the corporation and to the shareholders. Such duties continue in the event of insolvency or circumstances where the corporation is potentially insolvent.

Commented [H(47)]: Correct, 1 mark

Commented [H(48)]: Correct, 1 mark

Commented [H(49)]: Correct, 1 mark

Directors of Delaware corporations additionally benefit from the business judgement rule which protects them from liability arising from errors of judgement in certain circumstances. Under this rule the board of directors (providing they are independent and disinterested in the relevant transaction) are presumed to have acted on the basis of reasonable information and to have acted at all times in good faith. The rule can only be rebutted if it can be shown that the majority of the board were not in fact reasonably informed, did not act in good faith or did not honestly believe that their decision was in the best interests of the corporation. This presumption also does not apply where there is a controlling shareholder on both sides of the relevant transaction.

Commented [H(50)]: Correct, 1 mark

Question 3.4 [5 marks]

Commented [H(51)]: Total marks 4.5/5

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 given creditor's claim must be non-contingent. This means that it cannot be dependent upon the occurrence of any future events in order for the debt to arise. The timing of payment does not make it contingent i.e. if the payment deadline for the debt has not

Commented [H(52)]: Correct, 1 mark

Commented [H(53)]: Correct, 1/2 mark

yet been reached but all but all other requirements for liability have been met, the creditor's claim will not be considered to be contingent.

The creditor's claim must also not be the subject of a *bona fide* dispute, either as to whether there is any liability owed by the debtor or as to the amount owed by the debtor. The test for whether there is a *bona fide* dispute relating to the creditor's claim is objective, not subjective. As such it would have to be shown that there was an objectively reasonable basis to dispute the creditor's claim in order for them to be disqualified from acting as a petitioning creditor on this basis.

Commented [H(54)]: Correct, 1 mark

Commented [H(55)]: Correct, 1/2 mark

The creditor's claim must be an unsecured claim, or an under secured claim, in the amount of at least USD 16,750. This can be met by the single petitioning creditor alone if there are fewer than 12 creditors, or this sum can be made up by a group of petitioning creditors (at least three) if there are more than 12 creditors to the debtor's estate. Where any of the petitioning creditors debts are disputed, they cannot rely on the undisputed amount of that said debt to reach this threshold. However, if they have multiple debts, some disputed, some not, the disputed debt will not impact on the amount taken into account for the undisputed debts.

Commented [H(56)]: Correct, 1 mark

Commented [H(57)]: Correct, 1/2 mark, also the petitioning creditors must allege that the debtor is not generally paying its debts or that "within 120 days before the filing of this petition, a custodian, other than a trustee, receiver, or an agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession."

Where a claim is under secured, the secured portion of the debt cannot be relied upon to meet the required threshold.

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

Commented [H(58)]: Total marks 7/15

Question 4.1 [5 marks]

Commented [H(59)]: Total marks 2/5

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?

DOJ Investigation

Regulatory investigations are not affected by the automatic stay and as such the DOJ investigation can continue without interference.

Commented [H(60)]: Correct, 1 mark, and note that the filing of the petition would bring the automatic stay into effect.

Margin Loan Default

The broker would be a secured creditor up to the value of the shares which it holds as collateral. For any debt beyond that amount the broker would be an unsecured creditor. To the extent of its secured debt the broker would have relatively little involvement in the Chapter 11 process but any restructuring plan could have the effect of forcing the broker to accept altered terms on the said debt.

Commented [H(61): Incorrect, a margin loan is a securities contract and its close out is permitted under an exception to the automatic stay

Delinquent Lease

Although there is a debt owed to the landlord, the lease of the non-residential property would still be an executory contract because, unless the lease is at an end there are obligations outstanding on both sides; the debtor to pay the future rents and the landlord to continue to provide the office space.

Commented [H(62): The automatic stay would bar eviction proceedings for non-payment of rent because the lease did not expire pre-petition.

As such the debtor in possession would have 120 days from the date of any order for relief to make a decision whether assume, assume and assign, or reject the non-residential lease. If it is assumed the rent payments from the date of the petition will likely be treated as an administrative expense and as such paid as a priority. The overdue rent accruing prior to filing will, however, be an unsecured creditor claim.

Employment Discrimination

As this is a contested lawsuit it will be subject to the automatic stay and leave of the court will be required to continue the matter. If such leave is granted the claim will still be treated as a contingent creditor claim.

Commented [H(63): Correct, 1 mark

Question 4.2 [5 marks]

Commented [H(64): Total marks 0/5

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 can be recognized by a US bankruptcy court under Chapter 15. However, in determining whether foreign proceedings are main or non-main the court will have regard to where the company's centre of main interest is.

As the incorporation and headquarters are both in Paris the court may consider that any French proceedings would in fact be the foreign main proceedings. However, the court will also consider where Stella's primary assets are, the location of the majority of Stella's creditors, or the majority of those creditors that will be affected by the relief

being sought by the foreign representative and also the jurisdiction which will apply to most disputes.

As Stella's funding is governed by English law, and presumably as such the majority of creditor claims will be governed by English law the court may well consider the English proceedings as the main proceedings.

Question 4.3 [5 marks]

ToyCo is an American toy company that has created a popular line of folding robot toys called Xblox. The toys are covered by several US patents. Currently, GameMart Inc (GameMart) has a 10-year exclusive license to manufacture Xblox 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 Xblox 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 Xblox an executory contract?

Yes, because there are material unperformed obligations on both sides.

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

Non-bankruptcy law dictates that as regards intellectual property, a licensor cannot be compelled to accept performance of the obligations under the licence from a transferee. As such the transfer of the Xblox license as part of a 363 sale would require ToyCo's consent.

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

The lease is an executory contract as there are material unperformed obligations on both sides. Even though it expressly forbids assignment under the terms of the lease, the Bankruptcy Code provides that any contractual prohibitions on assignment cannot be enforced once a bankruptcy process has commenced. There are certain exceptions but commercial leases are not one of them. As such GameMart can transfer the factory lease without Land Corp's consent.

Commented [H(65)]: Incorrect, these would be insufficient to displace the presumption that the place of incorporation is the COMI, particularly given that it is also the headquarters of the debtor. Therefore proceedings in England cannot be recognized as foreign main proceedings. They can be recognized as foreign non-main proceedings, assuming that there is an establishment (such as a retail store) in England.

Commented [H(66)]: Total marks 5/5

Commented [H(67)]: Correct, 1 mark

Commented [H(68)]: Correct, 1 mark

Commented [H(69)]: Correct, 1 mark

Commented [H(70)]: Correct, 1 mark

Commented [H(71)]: Correct, 1 mark

* End of Assessment *