



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 48/50

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

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

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)]: Incorrect, the correct response is (d)

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

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

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.*

Question 1.9

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

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.*

Question 1.10

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

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.**

QUESTION 2 (direct questions) [10 marks]

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

Question 2.1 (1 mark)

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

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

Setoff is the situation where a creditor who has a claim against the debtor, but who also owes money to the debtor, is allowed to offset the mutual debts and therefore claim only for the net position. Setoff is restricted in US bankruptcy law and is not permitted in many circumstances. This is because the rights of a creditor can be improved as against other unsecured creditors in a setoff situation. In particular, if the creditor owes more to the debtor than the debtor owes to the creditor, and is permitted to setoff, it will have essentially recovered 100 per cent of the debt that it is owed by the debtor, whereas other unsecured creditors in the debtor's estate may only recover a proportion of their debts.

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

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

Question 2.2 [2 marks]

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

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

When preparing a filing for a bankruptcy court, you should review:

- *US Bankruptcy Code (title 11 of the United States Code), which is federal law;*
- *any applicable non-bankruptcy law of the particular state, as long as it is not in conflict with the US Bankruptcy Code;*
- *Federal Rules of Bankruptcy Procedure, which often includes by reference the Federal Rules of Civil Procedure;*
- *the local rules of procedure for the particular bankruptcy court the filing is being made to; and*
- *the particular judge's personal practices.*

Commented [H(18)]: Also correct

Commented [H(19)]: Correct, 1/2 mark

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

Commented [H(21)]: Correct, 1/2 mark

Commented [H(22)]: Correct, 1/2 mark

Question 2.3 [2 marks]

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

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

The absolute priority rule applies to both Chapter 7 liquidations and Chapter 11 reorganisations.

In a Chapter 7 liquidation, there is an order of priority for the payment of each category of creditors when distributions are made to creditors. The absolute priority rule requires that payment in full must be made to each category of creditors before the next category will receive any payment at all. It is not possible to deviate from the absolute priority rule in a Chapter 7 liquidation.

Commented [H(24)]: Correct, 1 mark

In a **Chapter 11 plan of reorganisation**, the absolute priority rule requires that no creditor or class of creditors can receive any less under the plan of reorganisation than it would have received pursuant to a liquidation in accordance with Chapter 7. **The rule can be deviated from if the affected creditors consent.** For example, particular employee expenses, especially unpaid salaries and contributions to employee benefits plans for the 180 days preceding the petition date, can receive no worse treatment under a plan of reorganisation than they would have received in a Chapter 7 bankruptcy unless the employees consent. In addition, the absolute priority rule does not apply to the modified Chapter 11 proceedings for companies with debts below a certain level, which was US\$7,500,000 until March 2022 and is awaiting the signature on legislation to make this level permanent.

Commented [H(25)]: Correct, 1/2 mark

Commented [H(26)]: Correct, 1/2 mark

Question 2.4 [2 marks]

Commented [H(27)]: Total marks 2/2

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

DIP financing is "debtor in possession" financing. Going through a Chapter 11 reorganisation process is very expensive for a debtor, as it must pay legal costs, the costs of other advisers, and its ongoing business expenses. In order to increase the chances of the debtor successfully restructuring its business, the Bankruptcy Code gives lenders and other parties motivation to extend credit to the debtor. There are four methods by which the debtor can obtain financing. A "priming lien" is one of those four options.

If it can be shown to the court that financing is unable to be obtained on any other terms, the approval of the court can be sought to grant a priming lien. A priming lien is senior or equal to a pre-petition lien on property within the debtor's estate and is used to secure financing following the petition. The debtor must establish before the court that the interest of the secured creditor who is being primed (ie the secured creditor whose security is affected by the priming lien) is adequately protected. The risk that secured creditors face in having the property that their security interest is over be the subject of a priming lien often incentivises them to extend further credit to the debtor.

Commented [H(28)]: Correct, 1/2 mark

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

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

Question 2.5 [3 marks]

Commented [H(31)]: 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?

The Bankruptcy Code provides the trustee in bankruptcy or the debtor in possession with certain causes of action to recover property that was transferred within a particular period of time before the petition was commenced. A preference is an example of such a cause of action.

A preference is a transfer of property that is owned by the debtor to a creditor, where the transfer occurs within a particular period of time (the "suspect period") before the petition date. The property must be returned to the debtor's estate if it exceeds the amount that the transferee would have received in a liquidation under Chapter 7 if the transfer of property had not been made.

There is no requirement to show any fault by either the debtor or the creditor who received the property.

Commented [H(32)]: Correct, 1 mark

Commented [H(33)]: Correct, 1/2 mark

The elements of a preference claim that need to be proved are (section 547 of the Bankruptcy Code):

1. There was a transfer of an interest in property belonging to the debtor, for example, real estate, tangible assets, funds, or an interest in property such as granting a lien or other security over property.
2. The transfer was made to a creditor, or was made for the creditor's benefit.
3. The transfer was made in order to repay in whole or in part a debt owed by the debtor to the creditor before the transfer was made.
4. The transfer was made while the debtor was insolvent. There is a presumption that the debtor is insolvent on and during the period of 90 days before the petition date for the purposes of determining a preference claim.
5. The transfer was made during the "suspect period", which is 90 days before the date of the petition where the transfer is made to a third party, and one year before the petition date where the transfer is made to an "insider". An "insider" (section 101(31) of the Bankruptcy Code) is a corporate debtor's officers, directors, controlling persons, general partner, affiliates, and insiders of affiliates and an individual debtor's relatives, partnership in which the debtor is a general partner, or corporation in which the debtor is a director, officer or person in control.
6. The creditor receives more from the transfer than it would have if the debtor were to enter into a Chapter 7 liquidation.

Commented [H(34)]: Correct, 1/2 mark

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

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

If the transfer is made and there is a simultaneous exchange of value, and the debtor receives new value, the transfer is not a preference.

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

Commented [H(37)]: Total marks 14/15

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?

Commented [H(38)]: Total marks 2.5/3

The US bankruptcy court is a special federal court created by legislation (the 1978 Bankruptcy Code, as amended in 1984) as opposed to by Article III of the US Constitution. This means that the bankruptcy court has limited jurisdiction to enter a final order, save for on core bankruptcy matters.

The legislation that granted jurisdiction over bankruptcy proceedings to district courts and permitted district courts to refer those proceedings to the district's bankruptcy courts (sections 157 and 1334 of 28 USC) created a distinction between "core" and "non-core" issues (section 157 of 28 USC). Bankruptcy courts are allowed to hear and grant final orders in core matters only. Core matters include (but are not limited to) (section 157(b)(2) of 28 USC):

- 1. matters concerning the administration of the estate;*
- 2. allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a reorganisation plan under Chapter 11;*
- 3. counterclaims by the estate against creditors filing claims against the estate;*
- 4. orders relating to obtaining credit;*
- 5. orders to turn over property of the estate;*
- 6. proceedings to determine, avoid or recover preference claims;*
- 7. motions to terminate, annul, or modify the automatic stay;*
- 8. proceedings to determine, avoid or recover fraudulent conveyances;*
- 9. determinations on discharging particular debts;*
- 10. objections to discharges;*
- 11. determinations of the validity, extent or priority of liens;*
- 12. confirmation of reorganisation plans;*
- 13. orders approving the use or leasing of property;*
- 14. orders approving the sale of property;*
- 15. other proceedings affecting the liquidation of the assets of the estate, or the adjustment of the debtor-creditor or the equity security holder relationship; and*
- 16. recognition of foreign proceedings under Chapter 15.*

Review of Non-Final Orders

If the issue is "non-core", the bankruptcy court may hear the proceeding, but cannot make a final order. It has to submit its proposed findings of fact and conclusions on the law to the district court for the district court to make a final decision. This is the process by which a non-final order is reviewed.

*In the 2011 case of *Stern v Marshall* (546 US 462 (2011)) before the US Supreme Court, it was held that the bankruptcy court cannot issue a final order (even in core proceedings) that would be contrary to jurisdiction under Article III. In that case it was decided that the bankruptcy court could not issue a final order where there was a parallel claim under state law, as it was unconstitutional pursuant to Article III.*

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

The US Supreme Court and subsequent amendments to the Bankruptcy Rules have given further guidance on this point. A bankruptcy court may determine a core proceeding where it lacks jurisdiction under Article III by issuing a report and a recommendation for the district court to review. This is the same review procedure as in non-core proceedings. alternatively, the parties may consent for the bankruptcy court to issue a final order.

Commented [H(40)]: Correct, 1/2 mark. The bankruptcy court also can enter a final order on a challenge to a petition.

Appeals

Appeals from the decisions of bankruptcy courts are normally heard by the district court in the district in which the bankruptcy court sits. However, there are certain circuits where appeals from the decisions of bankruptcy courts are heard by a Bankruptcy Appellate Panel ("BAP"). A BAP is made up of judges who sit in the bankruptcy courts within the circuit. However, a party has the ability to request the appeal be heard by the district court instead of the BAP.

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

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

After the district court or BAP has heard the appeal from the bankruptcy court, there is a further right of appeal to the circuit court of appeals. It is also possible, but only in very rare circumstances, that an appeal can go directly from a bankruptcy court to the circuit court of appeals. This is only where (section 158(d) of 28 USC) the appeal raises a question of law where there is no decision of the circuit or the US Supreme Court, there are conflicting decisions that require to be resolved, or the case will be advanced materially if the appeal is made immediately.

Question 3.2 [3 marks]

Commented [H(43)]: 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?

Chapter 15 of the Bankruptcy Code applies to the recognition of foreign proceedings. Section 1520 of the Bankruptcy Code provides that upon recognition of a foreign main proceeding:

1. Sections 361 and 362 of the Bankruptcy Code **apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States.** These sections provide for an automatic stay against the commencement or continuation of proceedings against the debtor or other enforcement against the debtor's property. This is subject to section 1520(c), which provides that a foreign representative or an entity may file a petition commencing a case under this title, or the right of any party to file claims or take other proper actions in such a case.
2. Sections 363, 549 and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same

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

extent that the sections would apply to property of an estate. This means that the foreign representative can use, sell or lease property outside the ordinary course of business after receiving court approval in accordance with section 363. He/she can avoid post-petition transactions (unauthorised transfers of property that occur after the commencement of the case) pursuant to section 549 and can avoid post-petition perfection of security interests under section 552.

Commented [H(45)]: Correct, 1/2 mark

Commented [H(46)]: Correct, 1/2 mark

3. Unless otherwise ordered, the foreign representative may operate the debtor's business and may exercise the rights and powers of a trustee under and to the extent provided by sections 363 and 552.

Commented [H(47)]: Correct, 1/2 mark

4. Section 552 applies to property of the debtor that is within the territorial jurisdiction of the United States.

Section 1521 of the Bankruptcy Code provides that upon the recognition of a foreign proceeding, whether main or non-main, the court has discretion to grant any appropriate relief including:

1. staying actions or proceedings concerning the debtor's assets and execution against the debtor's assets to the extent they are not already stayed under section 1520;
2. suspending the right to transfer or otherwise dispose of the debtor's assets to the extent this is not already suspended under section 1520;
3. the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities;
4. entrusting the administration or realisation of all or part of the debtor's assets within the territorial jurisdiction of the United States to the foreign representative or another person;
5. extending any provisional relief granted under section 1519; and
6. granting any additional relief that might be available to a trustee in bankruptcy, except for relief available under sections 522, 544, 545, 547, 548, 550 and 724(a).

Commented [H(48)]: Correct, 1/2 mark

Commented [H(49)]: Correct, 1/2 mark

Question 3.3 [4 marks]

Commented [H(50)]: 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?

In the ordinary course of business, directors of a Delaware corporation owe a fiduciary duty of loyalty to act in the corporation's best interests, as well as a duty of care to make educated decisions.

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

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

*The duties owed by directors of a Delaware corporation are owed to the corporation and its shareholders. When the corporation is potentially or actually insolvent those duties are still owed to the corporation and its shareholders. The directors never owe their duties to creditors, even when the company is "operating in the zone of insolvency" or actually insolvent (*North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92, 103 (Del 2007)). There is no concept of "wrongful trading" or "deepening insolvency" under US insolvency law.*

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

However, directors are protected from liability for errors of judgement by the "business judgement rule". Under this rule, it is presumed that the board of directors were acting in good faith and on the basis of reasonable information. The presumption can be rebutted if it can be shown that a majority of the board of directors were not in fact reasonably informed, did not honestly believe that their decision was in the corporation's best interests, or were not acting in good faith. If the presumption is not rebutted, the directors cannot be liable for their actions without it being shown that there was gross negligence.

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

Furthermore, directors of a Delaware corporation can be exonerated from liability for breach of the duty of care by a corporation's certificate of incorporation, but not for breach of the fiduciary duty of loyalty.

The business judgement rule does not apply to circumstances where a transaction is approved by the board, and the majority of the board are interested in the transaction or not independent, or where a controlling shareholder is on both sides of the transaction. In those situations, the transaction is void unless the entire fairness standard is shown to be satisfied.

Question 3.4 [5 marks]

Commented [H(55)]: 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.

An involuntary proceeding may be commenced by a creditor under either Chapter 7 or Chapter 11 of the US Bankruptcy Code (section 303). In accordance with section 303, an involuntary proceeding may not be commenced against a farmer, a family farmer, or a corporation that is not a moneyed, business or commercial corporation.

Commented [H(56)]: The creditor also must allege that the debtor is not paying debts as they come due or that a custodian has been appointed over the debtor's assets

To qualify as a petitioning creditor under section 303, the creditor's claim against the debtor must:

1. not be contingent as to liability;
2. not be the subject of a bona fide dispute as to liability or amount; and
3. be unsecured, or only partially secured, separately or in the aggregate value of at least US\$16,750 with all other petitioning creditor's claims.

Commented [H(57)]: Correct, 1 mark

Commented [H(58)]: Correct, 1 mark

Commented [H(59)]: Correct, 1 mark

Commented [H(60)]: Correct, 1/2 mark

As to the first requirement, the creditor's claim must not be contingent, which means that it must not be subject to the occurrence of a future event. For example, if A enters into a contract for services to be provided by B and there is a provision that an additional amount will be paid by A if B's services help A obtain a specific contract with C, B's claim against A for the additional amount is contingent on the future event of A obtaining the contract with C. A debt that is not yet due because the date of payment is due in the future is not classed as a contingent debt, if all the requirements for payment save the particular date have been satisfied.

Commented [H(61)]: Correct, 1/2 mark

For the second requirement, there is a bona fide dispute as to liability where there is an objectively reasonable basis for the debt to be disputed as a matter of either fact or law. It is not enough simply for the debtor to believe that the debt is not actually owed, or that the amount claimed is not correct. If part of the amount that is claimed is disputed, it is not possible for the creditor to use the undisputed part to meet the US\$16,750 threshold, but this does not prevent the creditor from using other undisputed claims to qualify as a petitioning creditor.

Commented [H(62)]: Correct, 1/2 mark

The number of qualifying petitioning creditors that are required for an involuntary proceeding to be commenced depends on the total number of qualifying creditors the debtor has who are not "insiders". In accordance with section 303, if the debtor has less than 12 such creditors, only one is required to file the petition. If the debtor has more than 12 such creditors, at least three are required to file the petition.

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

Commented [H(63)]: Total marks 15/15

Question 4.1 [5 marks]

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

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?

Section 362(a) of the Bankruptcy Code provides for a global automatic stay immediately upon the filing of the Chapter 11 petition by Speculation Inc. This means that in general the commencement or continuation of proceedings and the enforcement of pre-filing judgments is prohibited as soon as the petition is filed.

Commented [H(65)]: Correct, 1 mark

Section 362(a) is subject to the exceptions provided in section 362(b). In relation to the matters at (i) to (iv):

(i) Section 362(a) does not expressly list investigations into criminal offences as matters that are subject to a stay. Furthermore, section 362(b)(1) provides that there is no stay on the commencement or continuation of a criminal action or proceeding against the debtor. For these reasons, the filing of the Chapter 11 petition will not have any effect on the DOJ investigation, which will be able to continue and if the DOJ considers that illegal trading on insider information has occurred, there will be no bar to it prosecuting Speculation Inc simply by reason that Speculation Inc has filed for Chapter 11.

Commented [H(66)]: Correct, 1 mark

(ii) Section 362(a) would on the face of it prohibit the broker from enforcing its security, so the broker is unable to sell the shares that it holds as collateral for the margin loan. However, section 362(a) is subject to section 362(b) and sub-section 362(b)(6) provides that a broker may still exercise any contractual right under any security agreement or arrangement forming part of or related to any securities contract. This means that the broker would be able to rely on any provisions in the agreement with Speculation Inc. regarding the enforcement of its security over the shares it holds as collateral.

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

(iii) Pursuant to section 362(a), a landlord is prohibited from commencing any claim against a debtor for unpaid rent. There are no relevant exceptions to this in subsection (b). This means that any claim against Speculation Inc for non-payment of rent cannot be commenced or continued upon the filing of Chapter 11 proceedings. If the lease expires during the period of the Chapter 11 case, the landlord may proceed to obtain possession of the property back from Speculation Inc under section 362(b)(10). However, the landlord is not able to claim against Speculation Inc for unpaid rent while the stay is in place.

Commented [H(68)]: Correct, 1 mark, eviction proceedings are stayed so long as the lease has not expired

(iv) Section 362(a)(1) provides for a stay on the continuation of any judicial, administrative, or other action or proceeding against a debtor. This means that the employee discrimination lawsuit against Speculation Inc is automatically stayed upon the filing of the Chapter 11 petition. There are no relevant exceptions to this in subsection (b).

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

It is possible for the landlord and the former employee to apply under section 362(d) for an order lifting the stay in specified circumstances, through a lift-stay or motion for a relief from stay. These specific situations include:

- 1. where the creditor can show that a property interest belonging to the debtor's estate will not be adequately protected during the course of the proceedings and the value may decline and result in the interested party making less than a full recovery;*
- 2. where the debtor has no equitable interest in the property and the property is not a necessary part of its restructuring;*
- 3. the debtor's sole asset is one piece of real estate secured to the relevant creditor, and the debtor has not filed a plan within 90 days, or made monthly payments and the stay should be lifted to enable the creditor to foreclose or pursue other remedies; and*
- 4. the creditor's security is real estate and the debtor's filing for Chapter 11 is found to be part of a scheme to delay, hinder or defraud creditors to transfer all or part of the interest in real property, or make multiple bankruptcy filings affecting the real estate.*

In addition, the court can also make rulings to protect the interest of a creditor in property, or to lift the stay to enable a limitation period to be complied with. In this situation, the landlord is more likely than the former employee to be able to obtain such an order, if it can show that the value of the property may decline during the course of the proceedings, and it will be able to show that Speculation Inc, as a mere lessee, has no equity in the property and the property cannot form part of its reorganisation.

Question 4.2 [5 marks]

Commented [H(70)]: Total marks 5/5

Stella SA (Stella) is a 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?

Chapter 15 of the US Bankruptcy Code adopts the UNCITRAL Model Law on Cross-Border Insolvency, and is almost identical to the Model Law. Chapter 15 does not

require any reciprocity of recognition in order for foreign proceedings to be recognised in the United States.

Section 1515 of the Bankruptcy Code states that a foreign representative applies for recognition of a foreign proceeding. A "foreign proceeding" is defined in section 101(23) as "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of a debt in which proceedings the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation".

An English law scheme of arrangement under Part 26 of the English Companies Act 2006 is a compromise or arrangement between a company and its members or creditors (or any class of them)¹ and can be used as a way of effecting a solvent reorganisation of a company or group structure. In accordance with section 899 of the English Companies Act 2006, court sanction of the scheme or compromise is required. This means that an English law scheme of arrangement is a proceeding subject to control by a foreign court for the purpose of reorganisation and would fall within the definition in section 101(23) of a foreign proceeding. Therefore an English scheme of arrangement can be recognised by a US bankruptcy court under Chapter 15.

The only exception to recognition is under section 1506, if the action of recognising the scheme of arrangement would be manifestly contrary to US public policy. On these facts, this does not appear likely.

In accordance with section 1517(b) and the definitions in section 1502(4) and (5), a foreign proceeding is to be recognised as a foreign main proceeding if it is pending in the country where the debtor has the centre of its main interests, or as a foreign non-main proceeding if the debtor has an establishment within the meaning of section 1502 in the foreign country where the proceeding is pending.

There is no definition of centre of main interests in the US Bankruptcy Code. Pursuant to section 1516(c), there is a presumption in the absence of evidence to the contrary that a debtor's centre of main interests is its registered office. Other relevant factors for the centre of main interests will be the location of its headquarters, the location of the debtor's management team, the location of the debtor's main assets, the location of the majority of its creditors, and the jurisdiction whose law will apply to most disputes.

Section 1502(2) provides that "establishment" means any place of operations where the debtor carries out a non-transitory economic activity.

Based on the above information, Stella is incorporated in France and has its headquarters in Paris. This means there is a rebuttable presumption pursuant to section 1516(c) that Stella's centre of main interests is in France. While the bank loan

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

¹ Section 895(1) English Companies Act 2006.

and Eurobonds are governed by English law, and there are retail stores in England, the products are made in Italy and sold in retail stores in Europe, Asia and North America. This means Stella is likely to have creditors worldwide, not just in England. It is most likely that Stella's centre of main interests would be found to be France, given its headquarters are located there, as well as France being its jurisdiction of incorporation. This means that the English scheme of arrangement cannot be recognised as a foreign main proceeding.

Commented [H(72)]: Correct, 1 mark

Commented [H(73)]: Correct, 1 mark

As Stella has retail stores in England, this means that it does have a place of operations in England where it carries out non-transitory economic activity, in accordance with the definition of an establishment in section 1502(2). This means that Stella has an establishment in England and so the English scheme of arrangement would be recognised as a foreign non-main proceeding.

Commented [H(74)]: Correct, 1 mark

Commented [H(75)]: Correct, 1 mark

Question 4.3 [5 marks]

Commented [H(76)]: Total marks 5/5

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?**

The term "executory contract" is not defined in the Bankruptcy Code. An executory contract is a contract which has material obligations that have not yet been performed by both parties to it. In accordance with the "Countryman Test", a contract is executory if performance remains due to some extent on both sides, and the failure of either party to complete performance would be a material breach of the contract.²

The licence to manufacture Xblox is an executory contract because performance remains due on both sides. GameMart still has to manufacture Xblox and still has to pay ToyCo royalties for that right. ToyCo has a continuing obligation to not grant licences to third parties for the 10-year period because the licence is exclusive to GameMart.

Commented [H(77)]: Correct, 1 mark

Furthermore, section 365(n) of the Bankruptcy Code envisages that a licence for a right to intellectual property can be an executory contract because it provides that a trustee in bankruptcy can reject an executory contract under which the debtor is the licensor of a right to intellectual property. This section does not apply in this instance because

² <https://www.dechert.com/knowledge/onpoint/2022/8/a-modified-countryman-test-for-multi-party-executory-contracts.html>, accessed 26 February 2023.

GameMart, the debtor, is the licensee rather than the licensor, but it does demonstrate that licences for intellectual property rights are executory contracts.

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

GameMart is the licensee under the licence and the licence is an executory contract. A sale under section 363 is subject to the provisions of section 365 where the sale is made notwithstanding the terms of the contract (section 363(m)).

In accordance with section 365(c), the licence cannot be assigned without the consent of ToyCo. Section 365(c) provides that an executory contract cannot be assigned if applicable non-bankruptcy law would excuse ToyCo from accepting performance from an entity other than GameMart and ToyCo does not consent to the assignment. Intellectual property licensing laws in the United States would provide that ToyCo is not obliged to accept performance of the licence from a third party without its consent.

Commented [H(78)]: Correct, 1 mark

Commented [H(79)]: Correct, 1 mark

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

Again, the factory lease is an unexpired lease, and so section 363 is subject to section 365 (section 363(m)). Section 365(f) provides that notwithstanding a provision in an unexpired lease that prohibits or restricts assignment of the lease, the lease can be assigned, only if there is adequate assurance of future performance given by the assignee. This is subject to subsections 365(b) and (c), which make assignment subject to the applicable law and also provide for conditions where there has been a breach of the terms of the unexpired lease.

Commented [H(80)]: Correct, 1 mark

Under section 365(f), the factory lease can be transferred without Land Corp's consent, despite there being a clause prohibiting assignment without consent, on the assumption that there is no breach of lease.

Commented [H(81)]: Correct, 1 mark

* End of Assessment *