



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

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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

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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

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

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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.*

Correct, 1 mark

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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]

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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 is the act of netting out the debts of an unsecured creditor and a debtor, where such debts are simultaneously owed by each party to the other. The rights of setoff is exempted under the Bankruptcy Code as such rights can improve a creditor's position as compared to other unsecured creditors who are not owed money by the debtor. This is because it decreases the debtor's obligation to the estate by the full amount owed, rather than the lesser amount the debtor would pay on the unsecured claim. In other words, it permits the creditor to obtain more than what it would have obtained on the debt owed, had the matter proceeded to liquidation and distributions are made.

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Question 2.2 [2 marks]

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

The various rules to review include the Federal Rules of Bankruptcy Procedure which incorporates the Federal Rules of Civil Procedure, the local rules of the bankruptcy court and the Judge's personal practices. The latter two are available on the website of the bankruptcy court.

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Question 2.3 [2 marks]

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

The absolute priority rule states that full payment must be made to each category of claims under the prescribed statutorily required priorities before the next category receives anything. Deviation from the rule is only permitted in a chapter 11 reorganisation procedure with the consent of the creditors affected. But deviation is not permitted in a chapter 7 liquidation.

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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 refers to a lien on property senior to, or with the same priority as, existing liens on the same property. A priming lien is usually granted when the debtor is unable to obtain financing from lenders and counterparties in any other way in order to finance a chapter 11 bankruptcy proceeding. Such other methods include the debtor in possession incurring unsecured debt or other unsecured credit in the

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Commented [H(28): Correct, 1/2 mark. Also, the interest of secured creditors being primed must be adequately protected.

ordinary course of business, outside the ordinary course of business (with court approval after notice and a hearing), and where the foregoing two approaches are not open, (a) unsecured debt having priority ahead of all other administrative expenses; (b) secured debt with a lien on unencumbered estate property; and (c) secured debt with a junior lien on encumbered estate property.

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 is a transfer of the debtor's property made in a suspect period before the petition date that must be returned to the estate if that transfer exceeds the amount the recipient would have received in a chapter 7 liquidation, had the transfer not been made.

The elements are: (a) a transfer of an interest of the debtor in property; (b) to or for the benefit of a creditor; (c) for or on account of an antecedent debt owed by the debtor before such transfer was made; (d) the transfer was made while the debtor was insolvent; (e) the transfer was made during the suspect period, either 90 days prior to petition date in the case of third parties and one year for insiders; (f) the transfer enables the creditor to receive more than it would have in a chapter 7 liquidation.

There is no need to show any fault of either the debtor or the recipient in connection with the transfer.

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

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?

A bankruptcy court may enter a final order where the proceeding is a core proceeding over which the bankruptcy court has the authority to enter a final order. This authority may be conferred by law or by consent of the parties.

Appeals from bankruptcy courts are reviewed by the district court for the district in which they sit. In some circuits, however, a bankruptcy appeal may be heard by a Bankruptcy Appellate Panel ("BAP") convened by the judges of the bankruptcy courts within the circuit.

Where non-final orders originating from non-core proceedings are concerned, the bankruptcy court's proposals of findings of fact and conclusions of law are reviewed by the district court and the BAP *de novo*.

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Commented [H(37): Specifically, when the issue is a challenge to a petition.

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

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

Commented [H(41): Correct, 1 mark, this is also the case for core proceedings where the bankruptcy court does not have authority to enter a final order.

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 recognition of a foreign main proceeding, the following provisions apply to the debtor's property within the territorial jurisdiction of the United States: (a) an automatic stay; (b) operation of the debtor's business in the ordinary course by the foreign representative; (c) the sale, transfer or use of property outside the ordinary course of business; and (d) the avoidance of post-petition transfers and post-petition perfection of security interests.

For either a foreign main or non-main proceeding, in addition to the abovementioned reliefs, the following reliefs may also be granted: (a) authorization of discovery regarding the debtor's assets and affairs; (b) entrusting the administration of the debtor's US assets to the foreign representative or other persons; and (c) extension of provisional relief.

Ultimately, the abovementioned list of discretionary reliefs is not exhaustive, and the court may provide additional assistance under the Bankruptcy Code or other US law consistent with the principle of comity and the values underlying the Bankruptcy Code

Question 3.3 [4 marks]

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

In the ordinary course of business, a director owes a fiduciary duty of loyalty to act in the company's best interest and also owes a duty of care in making business decisions. These duties are owed to the company and its shareholder.

These duties are owed to the company and its shareholders even when the company is potentially insolvent. Thus, under Delaware law, the Delaware Supreme Court in *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92, 103 (Del 2007) held that these duties are not owed to creditors.

The business judgment rule protects directors from liability for errors of judgment. Under this rule, the director is presumed to have acted in good faith on the basis of reasonable information. Unless it is rebutted, the directors will not be liable in the absence of gross negligence.

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Question 3.4 [5 marks]

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

The following elements (and their accompanying descriptions) must be met before a creditor's claim qualifies as a petitioning creditor:

- (a) The claim must be non-contingent. This means that the claim must be not one that depends on the occurrence of a future event.
- (b) The claim must not be subjected to a bona fide dispute as to liability. A bona fide dispute arises if there is an objectively reasonable basis for a dispute as a matter of fact or law.
- (c) The claim must be unsecured or under-secured, separately or in the aggregate with all other petitioning creditors' claims, in the amount of at least USD 16,750.
- (d) The petitioning creditor must show that the debtor is generally not paying its debts as they become due. Alternatively, the petitioning creditor must show that within 120 days before filing of the petition, a custodian (other than a trustee, receiver or an agent appointed or authorised 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.

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

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?

The starting position is that, following the filing of a Chapter 11 petition, there would be a worldwide automatic stay of all proceedings (see s 362 of the Bankruptcy Code). The scope of the stay is extremely broad and it applies to any interference with the

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property of the estate anywhere in the world. However, the automatic stay is subject to statutory exceptions.

- (i) *With respect to the DOJ investigation, the automatic stay will not bar any regulatory and possibly criminal proceedings. Given the nature of the DOJ investigation as constituting a securities-related regulatory investigation, it is likely that the investigation will be unhindered.*
- (ii) *With respect to the margin loan default, the broker will not be able to collect on the margin loan either by way of a letter of demand or a margin call. However, depending on the precise nature of the contract or agreement between the broker and Speculation Inc, it could be that the debt owed under the margin call falls under one of the statutory exceptions such as a security contract or financial repo contract exception under s 362 of the Bankruptcy Code). However, given that the shares that Speculation Inc has traded are held as collateral, this means that the broker has a security interest in the shares and is therefore a secured creditor of Speculation Inc.*
- (iii) *With respect to the delinquent lease, although the rental arrears constitute debt that the landlord is entitled to sue on, the automatic stay will bar the landlord from taking action to enforce the lease and claim on the rent. The landlord will, however, be classified as an unsecured creditor. Further, the stay does not bar the landlord from evicting Speculation Inc from the property, assuming the lease has expired.*
- (iv) *It is likely that the stay will affect the employment discrimination lawsuit. This is because the nature of the suit possibly falls under pre-petition claims made by a claimant against Speculation Inc. Even if the nature of the suit is to ask for declaratory relief in respect of employment discrimination, in so far as the liquidators' conduct of the suit on behalf of Speculation Inc requires the application of the company's resources to defend the claim, and this would lead to a change in the status quo of the estate's property (see *City of Chicago v Fulton*, 529 US 140 (2021)). However, should the lawsuit be concluded prior to the filing of the pre-petition claim, then any attempt by the successful claimants to enforce their judgment debt against Speculation Inc will be barred by the stay.*

Question 4.2 [5 marks]

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

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Commented [H(66)]: Partially correct, 1/2 mark, the margin loan is a securities contract so the broker could liquidate the collateral due to an exception from the automatic stay

Commented [H(67)]: Correct, 1 mark, here the lease has not expired so eviction is barred by the automatic stay

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

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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?

For the English Scheme of Arrangement ("Scheme") to be recognised by a US bankruptcy court under Chapter 15, the Scheme must fall within the meaning of a foreign proceeding under the Bankruptcy Code ("Code"). The Code defines a "foreign proceeding" as a "collective judicial or administrative proceeding in a foreign country ... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation." The definition is broad, and would most likely encompass the Scheme. This is because such the Scheme would involve Stella's creditors and is therefore a collective administrative proceeding; it would most likely be commenced under the relevant insolvency legislation in England; be subjected to the supervision of the English courts; and is commenced for the purposes of reorganising and restructuring Stella's debt.

Turning to the next issue as to the nature of the proceeding recognised by the US bankruptcy court, whether an insolvency proceeding is recognised as a foreign main or non-main proceeding turns on whether the proceeding is commenced in the debtor's centre of main interests ("COMI").

The starting position is that the debtor's COMI is presumed to be its place of incorporation. On the facts, given that Stella is incorporated in France, France is presumed to be Stella's COMI.

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The next question is whether this presumed COMI has been displaced on the facts. In undertaking this inquiry, the relevant factors in the analysis include, amongst others, the location of the primary assets, the location of a majority of the debtor's creditors or a majority of the creditors that will be affected by the relief requested by the foreign representative, and the jurisdiction whose law will apply to most disputes. On the facts, Stella's funding comes from financing instruments which are governed by English law. English law is thus the governing law of the debt obligation, and presumably, the jurisdiction whose law will apply to most disputes arising from the debt obligation. However, given that Stella's products are made in Italy, presumably, most of Stella's assets including its plant, property and equipment will be located in Italy. Further, it is unclear where most of Stella's creditors are located. While its headquarters are located in France, its manufacturing operations are located in Italy. It is therefore likely, in the absence of further evidence, that Stella's creditors (including employees, suppliers and financiers) are located in these jurisdictions.

Given that the evidence does not clearly point to one jurisdiction that would displace the presumed COMI being located in France, it remains that the COMI is likely to be located in France, and hence the Scheme, being an insolvency process occurring in England, would most likely be recognised as a foreign non-main proceeding.

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Commented [H(72)]: Correct, 1 mark, foreign main recognition would not be appropriate because England is not the COMI

A final point to note is, where the proceeding is likely recognised as a foreign non-main proceeding, the recognition can only be successful if the debtor has an establishment in the jurisdiction where it carries out non-transitory economic activity prior to its insolvency (*In re Bear Stearns High-Grade Structured Credit Strategies Master Fund*, 374 BR 122 (Bankr SDNY 2007)). On the facts, Stella does operate retail stores in England distributing its products. This should suffice as constituting an establishment for the purposes of recognition of the Scheme as a foreign non-main proceeding.

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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 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?

A contract is executory if there are material unperformed obligations on both sides. In the present case, the license has a 10-year duration and GameMart is contractually obliged to pay ToyCo monthly royalty for the duration of this license, which has yet to conclude. Accordingly, payment is only partially complete, and the contract is thus executory.

Commented [H(75)]: Partially correct, 1/2 mark, ToyCo also has an ongoing obligation not to license the property to others to maintain exclusivity, so there are obligations on both sides.

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

It is unlikely that GameMart can transfer the Xbox licence without ToyCo's consent. This is because the license is an exclusive license, and thus may contain restrictions enforceable under intellectual property licensing law giving ToyCo a right not to accept performance from the transferee of the license in the absence of consent from ToyCo.

Commented [H(76)]: Incorrect, the consent requirement arises from IP law--any contractual restriction is not applicable in bankruptcy.

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

The factory lease is an executory contract as a substantial part of the obligation has yet to be completed. The factory lease is assignable without consent, notwithstanding a provision requiring the landlord's approval. T Correct, 1 mark.

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

*** End of Assessment ***