



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 33.5/50

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

Commented [H(2)]: Total marks 8/10

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

*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]

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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 a principle that allows a creditor with a claim against the debtor and who at the same time also owes money to the debtor to net out the two or more obligations. Setoff is not permitted because it improves the position of the creditors to the disadvantage of other unsecured creditors who are not owed money by the debtor.]

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

Question 2.2 [2 marks]

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

[Bankruptcy proceedings are regulated by the Federal Rules of Bankruptcy Procedure hereinafter called the "Bankruptcy Rules". The Bankruptcy Rules often incorporate by reference to the Federal Rules of Civil Procedure with respect to litigation of issues in dispute. The other Rules to be considered or reviewed when preparing a filing for a bankruptcy court are the local rules applicable to each Bankruptcy Court and also the personal practices or Practice Directions issued by each Judge.]

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

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

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

Question 2.3 [2 marks]

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

[The absolute priority rule entails that payment in full must be made to each class of claims before the next class of claims receives anything. It is important to note that Chapter 11 of the Bankruptcy Code provides for deviation from the absolute priority rule provided there is consent of the affected creditors.]

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

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 lien is simply a right which entitles a person or a party to hold on the property or assets in his or possession pending payment of a debt owed. However, a priming lien can be defined as a lien on property that is senior or equal to a pre-petition lien on the asset or estate to secure post-petition financing. For such a lien to be granted the

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debtor must show that the interest of the secured subject of priming lien is adequately protected.]

Commented [H(28)]: Correct, 1/2 mark, also the debtor must show that debt is not available without the priming lien

Question 2.5 [3 marks]

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**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?**

[According to Laura R Hall, the author of Module 3A Guidance Text, Insolvency System of the United States on page 50, "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 it exceeds the amount the recipient would have received in a chapter 7 liquidation had the transfer not been made." The Author of the Module further lists the following elements of a preference on pages 51 to 52;

Commented [H(30)]: Correct, 1 mark, also there is no requirement to show fault

1. "A transfer of the Debtor's interest in the property.
2. For the benefit of a creditor
3. For or on account of an antecedent debt owed by the Debtor before such transfer was made
4. Made while the debtor was insolvent
5. Made during the suspect period
6. That enables the creditor to receive more than it would have in a chapter 7 liquidation" ]

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Commented [H(32)]: Correct, 1/2 mark

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

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

Commented [H(34)]: Total marks 12.5/15

Question 3.1 [3 marks]

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**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?**

[It is important from the outset to state that Bankruptcy Courts are not creatures of Article III of the US Constitution and the Judges who preside over these Courts are not Article III judges. Therefore, Bankruptcy Courts are created under Article I of the US Constitution and federal legislation, the 1978 Bankruptcy Code to be precise. Since Bankruptcy Court Judges are not appointed under Article III of the US Constitution it therefore follows that they have no jurisdiction over Article III matters. Thus, the Bankruptcy Court has jurisdiction to enter a final order in core matters only and in non core matters its jurisdiction is limited only to hearing the matter if the matter is sufficiently related to a bankruptcy proceeding and thereafter submit the proposed findings of fact and conclusions of law to the district court for final order. The appeals are reviewed by the District Court for the district in which the Bankruptcy court sits. ]

Commented [H(36)]: Partially correct, 1/2 mark, the court has jurisdiction in certain core matters like a challenge to a petition, and for other matters requires the consent of the parties

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Commented [H(38)]: Correct, 1/2 mark, also in some circuits appeals go to a Bankruptcy Appellate Panel



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?**

[ According to the Author of Module 3A Guidance Text, Insolvency System of the United States on pages 63 to 64, the provisions of the Bankruptcy Code that applies upon recognition of a foreign proceeding are;

1. "Automatic Stay
2. Operation of the debtor's business in the ordinary course by the foreign representative
3. Sale, transfer or use of property outside the ordinary course
4. Avoidance of post-petition transfers and post-petition perfection of security interests.

On the other hand the Court may grant the following discretionary reliefs for either foreign main or non-main proceedings,

1. Authorization of discovery regarding the debtor's assets and affairs
2. Entrusting administration of the debtor's US assets to the foreign representative or other persons
3. Extension of provisional relief
4. Any other relief necessary to effectuate the purposes of Chapter 15 and to protect the assets of the debtor or the interests of creditors." ]

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?**

[Directors as agents of the corporation owe a fiduciary duty of loyalty to the corporation's best interest and also a duty of care in decision making. The preceding duties are owed to the corporation and its shareholders even in instances where the corporation is potentially or actually insolvent. The business judgment rule insulates the Directors from liability for errors of judgment. Under the aforesaid rule, the Board of Directors are presumed to have acted in good faith on the basis of reason information. It is important to note that this presumption can be rebutted only by showing that a majority of the Board in fact were not reasonably informed, did not honestly believe that their decision was in the best interest of the corporation or were not acting in good faith.]

Question 3.4 [5 marks]

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

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

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

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

Commented [H(51)]: Total marks 3.5/5

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

[It is a requirement in involuntary petitions for a creditor to allege either that the debtor is generally not paying its debts as they become due or that within 120 days before the filing of a 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. The other requirements that must be satisfied by a petitioning creditor in involuntary proceedings are as follows;

1. The creditor must have a claim against the debtor that is non-contingent. According to the author of Module 3A on page 11, "A contingent claim is one that depends on the occurrence of a future event. For example, a claim under a guarantee is typically contingent on the occurrence of a default under the guaranteed obligation. A debt that is unmatured (because the payment is due in the future) is not contingent if all requirements for liability, other than the passage of time, have occurred."

2. The claim must not be subject of bona fide dispute as to liability or amount ]

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

Question 4.1 [5 marks]

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

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

[Chapter 11 petitions are reorganization petitions and are regarded as the centrepiece of the US Bankruptcy Code's debtor friendly rehabilitation regime and chapter 11 proceedings come with certain benefits such as automatic stay from the date when the petition is filed, continued business operations by the debtor among other benefits. In the context of the question at hand, chapter 11 proceedings will not have any effect on DOJ investigations due to public policy considerations. However, the petition will trigger an automatic margin loan default and delinquent lease but without any effect on employment discrimination lawsuit.]

Commented [H(52)]: Correct, 1/2 mark

Commented [H(53)]: The claim must be unsecured or undersecured and must alone or with other petitioning creditors' claims total \$16,750

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

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Commented [H(56)]: Correct, 1 mark, the test is whether there is an objective basis for dispute in law or fact

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Commented [H(58)]: Total marks 2/5

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

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

Commented [H(61)]: Incorrect, a default has already been declared, but the margin loan a securities contract so liquidation of collateral is not barred by the automatic stay

Commented [H(62)]: Incorrect, the automatic stay will bar an action to recover rent or evict Speculation Inc. and will stay the employment litigation.

Question 4.2 [5 marks]

***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?***

*[Chapter 15 proceedings are Cross Board insolvency proceedings which mirror the provisions of the UNCITRAL Model Law nearly word for word. It is vital to note that Chapter 15 proceedings are ancillary as opposed to plenary proceeding in cases where the US has no jurisdiction or authority over the entire estate but only provides assistance to the foreign proceedings pertaining to the Debtor. Since chapter 15 proceedings are aimed at rendering assistance to the foreign proceedings, reciprocity of treatment is not a requirement; therefore US Courts will recognize proceedings in countries that would not recognize the US proceedings. In view of the preceding, the English scheme of arrangement will be recognized by a US bankruptcy court under Chapter 15. The proceeding would be recognized as foreign main proceeding on the basis that Stella has assets in the US.]*

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?***

*[A contract is regarded as executory contract if there are material unperformed obligations on both sides. On the basis of the foregoing and considering the fact that the licence to manufacture Xblox is for a period of 10 years and ToyCo pays monthly royalties it is safe to say that the licence to manufacture Xblox is an executory contract.]*

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Commented [H(64): Incorrect, the relevant test is whether the proceedings in England are in the location of the debtor's COMI. Based on the debtor's place of incorporation and the facts here, the presumption that Stella's COMI is in France is not overcome. Because Stella's COMI is not in England, the proceedings there cannot be recognized as foreign main proceedings. They can be recognized as foreign non-main proceedings because the retail store in England constitutes an establishment.

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Commented [H(66): Correct, 1 mark, specifically GameMart pays royalties and ToyCo is obligated not to license the IP to anyone else

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

*[GameMart is not the owner of the patents as such it cannot transfer the Xbox license as part of 363 sale on the ground that Licensees of patents and copyrights owned by the debtor are protected such that their licenses cannot be terminated in connection with the sale of the intellectual property without their consent.]*

**Commented [H(67)]:** Incorrect, the protection of licenses only applies in when the owner of the patent is the debtor. Here, the licenses could not be transfer without consent because non-bankruptcy law provides that the patent owner has the right to refuse performance by another.

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

*[A lease is a contract that creates interest in land. It is discernable from the facts of the question at hand that the lease between GameMart and Land Corp's has a restriction on transfer of interest in the lease without the consent of Land corp's. The preceding notwithstanding GameMart can transfer the factory lease as part of 363 sale without the Land Corp's consent on the ground that such transfer is permissible under the 363 sale.]*

**Commented [H(68)]:** Correct, 1 mark, specifically the contractual restriction would be unenforceable in bankruptcy.

\* End of Assessment \*