



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 36/50

**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)]: 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)]: Incorrect, the correct response is (c)

*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 7.5/10

**Question 2.1** (1 mark)

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

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

When a creditor holds a claim against a debtor and simultaneously owes the debtor an obligation, such creditor nets out the obligations. Set-off is not permitted in many circumstances as it can improve the position of the creditor, in comparison to unsecured creditors not owed money by the debtor, as it reduces the obligation to the estate by the full amount owed by the debtor rather than the lesser amount the debtor would pay on the unsecured claim.

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

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

**Question 2.2** [2 marks]

**Commented [H(17):** Total marks 0/2

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

The rules one should review when preparing a filing for a bankruptcy court include;

- Filing schedules such as lists of assets which includes all property, executory contracts, unexpired leases of real and personal property and liabilities,
- List of creditors,
- Estimated funds in the debtor's possession.

**Commented [H(18):** You should review the Federal Rules of Bankruptcy Procedure, the Federal Rules of Civil Procedure, the local rules of the bankruptcy court and the judge's personal practices

**Question 2.3** [2 marks]

**Commented [H(19):** Total marks 2/2

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

The rule requires that full payment must be made to each group of claims before the next group receives payment. It can be deviated from under a Chapter 11 plan with the consent of affected creditors.

**Commented [H(20):** Correct, 1 mark

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

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

**Question 2.4** [2 marks]

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

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

It is a lien equal or more superior to other liens over a debtor's property that existed before the bankruptcy petition. It is used to obtain financing after a bankruptcy petition.

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

In order to be granted the lien, the debtor must show that the interests of the secured creditor being primed is adequately protected.

**Commented [H(25):** Correct, 1/2 mark, the debtor also must show that financing is not available without the priming lien

**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 the act of transferring a debtor's property during the suspect period to a recipient, the effect of which the recipient receives more than they would have been entitled to under a Chapter 7 liquidation had the transfer not been made.

The elements of a preference that need to be proved are;

- A transfer of the interest of the debtor in the property;
- For the benefit of a creditor;
- For a debt owed by the debtor before the transfer was made;
- The transfer having been effected while the debtor was insolvent;
- The transfer of the property was made during the suspect period;
- By virtue of the transfer the creditor was able to receive more than it would have under a chapter 7 liquidation.

It is not necessary to show default by either the debtor or creditor.

**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?**

The bankruptcy court may enter a final order when exercising a District Court's delegated authority. A final order may also be entered with the consent of the parties.

District Courts review appeals from bankruptcy court orders. Non-final orders are reviewed through the issuance of a report by the bankruptcy court Judges and recommendation for review by the District Court.

**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?**

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

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

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

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

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

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

**Commented [H(32):** Total marks 10/15

**Commented [H(33):** Total marks 2/3

**Commented [H(34):** Specifically, the bankruptcy court has authority to resolve a challenge to a petition or other matters outside Article III jurisdiction.

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

**Commented [H(36):** Correct, 1/2 mark, also in some circuits appeals are heard by a Bankruptcy Appellate Panel

**Commented [H(37):** Correct, 1 mark

**Commented [H(38):** Total marks 1.5/3



The Bankruptcy Code allows a United States Court to grant an automatic stay upon the petition for the recognition of a foreign main proceeding.<sup>1</sup> The discretionary relief available following recognition of foreign main or non-main proceedings includes,<sup>2</sup>

- Authorisation of discovery of the debtor's assets and affairs;
- Entrusting administration of the debtor's US assets to the Foreign Representative or other person;
- Extension of provisional relief.

**Commented [H(39):** This is available as provisional relief following the filing of the petition, but the question asks for what automatically comes into effect when recognition is granted.

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

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

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

### 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, directors owe to a Delaware Corporation the following duties;

- A fiduciary duty of loyalty to the Corporation's best interest;
- A duty of care in educated decision making.

**Commented [H(43):** Total marks 4/4

**Commented [H(44):** Correct, 1 mark

**Commented [H(45):** Correct, 1 mark

The duties are owed to the Corporation and its shareholders even when the Corporation is potentially and factually insolvent.

**Commented [H(46):** Correct, 1 mark

The **business judgement** rule protects directors from liability for errors of judgment as there is a rebuttable presumption that the board of directors acted in good faith on the basis of reasonable information.

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

### 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.**

To qualify as a petitioning creditor the following requirements must be fulfilled;

- The creditor must have a claim against the debtor that does not rely on the occurrence of a future event.
- The claim should not be the subject of a *bona fide* dispute on the liability or amount.

**Commented [H(48):** Total marks 2.5/5

**Commented [H(49):** Correct, 1/2 mark, it must not be contingent

**Commented [H(50):** Correct, 1 mark, the test for a bona fide dispute is whether there is an objective basis in fact or law to dispute liability or amount

<sup>1</sup> S.1520(a) (1). Bankruptcy Code.

<sup>2</sup> 11 USC, S.1521.

- The claim must be unsecured or under secured separately as an average with all other petitioning creditors' claims in the minimum amount of USD 16, 750 duly adjusted according to inflation.
- The creditors must allege either,
  - a. The debtor is generally not paying his debts as they become due or;
  - b. Within 120 days before the filing of the petition a custodian other than a trustee, receiver or duly authorized appointed agent to take charge of less than substantially all of the property of the debtor so as to enforce a lien against such property was appointed or took possession.<sup>3</sup>

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

Commented [H(52)]: Incorrect, it is separately or in total, not in average

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

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

Commented [H(54)]: Total marks 10.5/15

##### Question 4.1 [5 marks]

Commented [H(55)]: Total marks 3/5

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

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

##### DOJ INVESTIGATION

A Chapter 11 petition would not suspend the investigation of DOJ on Speculation Inc as DOJ is a regulatory body and therefore exempt from the world wide automatic stay effective under the Chapter 11 petition.

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

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

##### MARGIN LOAN DEFAULT.

The worldwide stay applies to the loan from the broker who is a creditor in the estate. The stock broker after filing the claim is entitled to participate in the restructuring plan.

Commented [H(58)]: Incorrect, the margin contract is a securities contract that is exempt from the effect of the automatic stay

##### DELINQUENT LEASE.

The stay does not apply to a debtor tenant occupying rented commercial premises. The effect is that Speculation Inc can be evicted from the leased office space.

Commented [H(59)]: Incorrect, because the lease has not expired, the stay bars the commencement of eviction proceedings.

##### EMPLOYMENT DISCRIMINATION LAW SUIT.

The moratorium would apply to a former employee's law suit as it occurred before the petition was filed. The employee's suit would be suspended if no decision by the Court was pronounced before the petition was filed. The employee therefore has an unsecured claim for damages.

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

<sup>33</sup> 11 USC, 303.

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?***

The US courts have adopted a *Universalist* approach to bankruptcy cases with an international dimension. Under Chapter 15 a British scheme of arrangement falls under the definition of a foreign proceeding which is defined as a "collective judicial or administrative proceeding in a foreign country under a law relating to insolvency or adjustment of debt in which proceedings the assets and affairs of the debtor are subject to control or supervision by a foreign court for the purposes of reorganization or liquidation".<sup>4</sup>

One of the purposes of Chapter 15 which adopted the UNCITRAL Model Law on Cross-Border Insolvency is to facilitate the cooperation between courts and parties to insolvency proceedings in the US and foreign countries.

From the above facts Stella's COMI would determine whether the US would recognize the English scheme of arrangement as a foreign main or non-main proceeding. The factors considered when determining COMI include the location of the Head Quarters and the location of the primary assets. Stella's headquarters are in Paris. The products are located in Italy and shipped to retail stores all over Europe including England. England is therefore not Stella's COMI as neither the headquarters nor a majority of the company's assets are located in England. Recognition of the English scheme of arrangement in the US by the US courts would be categorized under a foreign non-main proceeding.

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:***

<sup>4</sup> S. 101 (23).

Commented [H(61)]: Total marks 3/5

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

Commented [H(63)]: Correct, 1 mark, also there is a presumption that Stella's COMI is in France where it is incorporated.

Commented [H(64)]: Correct, 1 mark, also the retail store in England qualifies as the establishment necessary for recognition of a foreign non-main proceeding

Commented [H(65)]: Total marks 4.5/5

**(i) Is the license to manufacture Xbox an executory contract?**

The license to manufacture Xbox is an executory contract as GameMart has an obligation to manufacture the Xbox and pay ToyCo monthly royalties while ToyCo over the remaining period cannot unilaterally terminate the manufacturing license.

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

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

GameMart cannot transfer the Xbox license as part of a 363 sale without ToyCo's consent as licenses are not transferable without the licensor's consent.<sup>5</sup> ToyCo's consent is therefore required as the holder of the license.

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

Commented [H(68)]: Partially correct, 1/2 mark, consent is required as a matter of IP law, whereas section 365(n) applies where the patent owner is the debtor

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

GameMart can transfer the factory lease as part of the 363 sale without Land Corp's consent notwithstanding the prohibition of assignment without Land Corp's consent.<sup>6</sup> This is to ensure continuity of business for GameMart so it remains a viable entity.

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

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

\* End of Assessment \*

<sup>5</sup> Bankruptcy code s.365 (n).

<sup>6</sup> S. 365 (c) and (e).