



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 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**

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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

*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

*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

*Which of the following about cramdowns, is false?*

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

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

- (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

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Which of the following is true of both an actual fraudulent conveyance and a constructive fraudulent conveyance?

- (a) *The debtor must have had an actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted.*
- (b) *Both require at least circumstantial evidence of the fraudulent intent.*
- (c) *The debtor must have been insolvent at the time of transaction.*
- (d) *In addition to provisions in the Bankruptcy Code, the debtor or the trustee may invoke applicable state or foreign fraudulent conveyance laws.*
- (e) *All of the above are true.*

Question 1.8

When does an automatic stay come into effect?

- (a) Immediately on the filing of any plenary petition.
- (b) On the filing of a voluntary petition but not on the filing of an involuntary petition.
- (c) Once the court reviews the petition and grants the stay.
- (d) Once the petitioner announces their intention to file for bankruptcy publicly.
- (e) Once a plan of reorganization is confirmed.

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Question 1.9

Which of the following regarding substantive consolidation is true?

- (a) It respects the boundaries of corporate separateness.
- (b) It is the treatment of two or more creditors as a single creditor to simplify the claims process.
- (c) If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.
- (d) Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.
- (e) Authority for substantive consolidation comes from the Bankruptcy Code.

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Question 1.10

Which of the following are relevant factors in determining a debtor's center of main interests (COMI) in the recognition stage of a Chapter 15 bankruptcy case?

- (a) The location of the headquarters.
- (b) The location of primary assets.
- (c) The location of the majority of the affected creditors in the request for relief.
- (d) The jurisdiction whose law will apply to most disputes.
- (e) All of the above.

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**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?**

*Setoff is where a creditor and the debtor each owe funds to the other and the sum is 'netted off'. It is not allowed in many circumstances because it can result in the bettering of the affected creditor's position when compared to other creditors in the same class who did not owe the debtor money. It can also reduce recoveries to the estate.*

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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?**

*Those preparing a filing for bankruptcy court should consider the implication of the information shared within the required schedules of creditors, assets and liabilities and whether the dissemination of this information could infringe data privacy laws or other contractual confidentiality obligations. The US Trustee is able to provide the filing party with advice in this regard.*

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

**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 requires that no creditor or class of creditors may receive less under a plan of reorganization than it would under a hypothetical chapter 7 liquidation, in which the claims would be paid only once full payment had been made to superior classes, without consent of the affected creditor. In a chapter 11 plan, deviation is allowed (no deviations in chapter 7 liquidations) with creditor consent. Such as a more senior creditor consenting to receive less than the absolute priority rule would require if distribution of the funds to lower priority claimants is necessary to obtain their approval of the plan.*

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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 is security given in consideration for post-commencement financing that is senior to or equal to a pre-petition lien on estate property. The debtor must demonstrate that the interest of the primed creditor is adequately protected.*

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**Commented [H(25):** Correct, 1/2 mark, also the debtor 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:

1. A transfer of an interest of the debtor in property;
2. To or for the benefit of a creditor;
3. For or on account of an antecedent debt owed by the debtor;
4. Made while the debtor was insolvent (presumed insolvency for the 90 days immediately prior to the petition);
5. Made during a suspect period (90 days for third parties, 1 year for insiders);
6. That enables the creditor to receive more than it would have in a chapter 7 liquidation.

Importantly **no showing of fault is required** and the only penalty is the return of the property to the estate (plus potential pre-judgment interest from the date of 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?**

The bankruptcy courts may only enter final orders for 'core' matters. A non-exhaustive list of 'core' matters is provided in the referral statute. 'Core' matters are those that are not subject to Article III of the US Constitution which relate specifically to Bankruptcy rather than wider contractual and statutory rights which are 'non-core' matters.

Appeals against orders made by the Bankruptcy court are usually heard by the corresponding District Court (DC) or the Bankruptcy Appellate Board (BAP) in some circuits. A further right of appeal exists from the District Court or the BAP to the Circuit Court of Appeals. Appeals from the Bankruptcy Court can in certain circumstances be made directly to the Circuit Court of Appeals.

Non-Final orders are either orders made by the Bankruptcy Court over 'core' matters where the entire dispute was not resolved, or where an order was made over 'non-core' matters or where the parties had not consented to the jurisdiction of the Bankruptcy Court. In these scenarios the orders are reviewed by the DC or BAP.

If the order was in a core proceeding over which the bankruptcy court had authority to enter a final order, the DC or BAP reviews conclusions of law *de novo* and reviews findings of fact for abuse of discretion. If the order was in a non-core proceeding or the bankruptcy court otherwise did not have authority to enter a final order, the DC or BAP

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Commented [H(34)]: Total marks 2.5/3

Commented [H(35)]: Incorrect, there is an overlap between core matters and Article III jurisdiction, such as resolution of claims. The bankruptcy court may resolve core matters created by the Bankruptcy Code, such as challenges to a petition.

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Commented [H(37)]: Correct, 1/2 mark

Commented [H(38)]: Correct, 1/2 mark



reviews *de novo* all findings of fact and conclusions of law to which a party has objected. The order of a district court or BAP is reviewed by a circuit court of appeal *de novo* as to conclusions of law and for abuse of discretion for findings of fact.

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Question 3.2 [3 marks]

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**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 of the Bankruptcy Code automatically apply to the debtor:

- Automatic stay;
- The ability to operate the debtor's business by the foreign representative in the ordinary course;
- Sale, transfer or use of property outside of the ordinary course; and
- Avoidance of post-petition transfers and perfections of security interests.

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

Discretionary relief for foreign non-main proceedings and main proceedings includes:

- Any of the above;
- Authorisation of discovery regarding the debtor's assets and affairs;
- Administration of the debtor's US assets to the foreign representative or other person (subject to court approval in certain circumstances);
- Extension of any provisional relief granted; and
- Any other relief "necessary to effectuate the purposes of the Bankruptcy Code and to protect the assets of the debtor and interests of its creditors".

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

Question 3.3 [4 marks]

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**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 fiduciary duties of loyalty to the corporation's best interest and a duty of care to undertake 'educated decision-making'. Duties are owed to the corporation and its shareholders, not its creditors.

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

In circumstances where the corporation is potentially or actually insolvent are unchanged. The Delaware Supreme Court has been clear in upholding this principle.

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Directors are further protected from liability for errors in judgement by the 'Business Judgement Rule'. This rule states that directors are presumed to have acted in good

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*faith on the basis of reasonable information. This presumption is rebuttable if it can be shown that the majority of the board were not reasonably informed, were not acting in good faith or did not honestly believe their actions were in the best interests of the corporation.*

*The Business Judgement Rule does not apply where a transaction is approved by a board majority that is not disinterested and independent or where a controlling shareholder is on both sides of the transaction. In this scenario, the transaction will be void unless the entire fairness standard is satisfied.*

**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.**

**Petitioning creditors must have claims that are not contingent and not subject to bona fide dispute.**

**Contingent claims are those which only crystallise after a future event such as a default event. A petitioning creditor's claim must therefore be crystallised at the point of filing the petition. It is important to note that a debt that is unmaturing and will crystallise after nothing other than the passage of time can be considered 'non-contingent'.**

**Petitioning creditors' claims must also be free from bona fide dispute with the debtor. A claim will be viewed as 'disputed' if there is an objectively reasonable basis for the dispute as a matter of fact or law. It is important to note that a dispute as to one claim does not invalidate other undisputed claims from the same creditor.**

**Finally, petitioning creditors' claims must total at least \$16,750 to qualify.**

**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?**

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

**Commented [H(56):** Correct, 1/2 mark

**Commented [H(57):** Correct, 1/2 mark, also the claims must be unsecured or undersecured and the petitioners must allege that the debtor is not paying its debts or a custodian has been appointed over its assets

**Commented [H(58):** Total marks 11/15

**Commented [H(59):** Total marks 5/5

The first effect of Speculation Inc's petition being filed is the enforcement of a worldwide automatic stay which is extremely broad in scope and would prevent various actions that the company's creditors and other interested parties may wish to take or continue.

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#### 1) DOJ Investigation.

The DOJ's investigation into potential insider trading will be able to continue. As their investigation is not affecting the status quo of the estate's property the continuation of their investigation is not likely to violate the stay inadvertently, regulatory investigations are also a recognised exception to the stay. However the DOJ representatives may wish to petition the Bankruptcy court to lift the stay should they wish to take affirmative action against the estate that would affect the assets position of the company such as suspending the shares owned or removing them from the company's custody. The DOJ representatives may also consider requesting that the US Trustee consider appointing a private trustee over the bankruptcy so Speculation Inc's Board cannot continue to manage the business as a debtor in possession if their concerns are serious enough to warrant a showing of good cause.

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#### 2) Margin Loan Default.

As discussed above, the worldwide automatic stay will be in effect, however another recognised exception to the stay is the ability to exercise rights under a commodity, forward or security contract. Financial repo contracts are also exceptions to the stay. The broker may therefore be able to continue with their recovery attempts. These exceptions are in place in recognition of the fact that freezing or terminating certain financial contracts will have a wider potentially harmful effect on the financial market.

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#### 3) Delinquent lease.

In contrast to the previous class of stakeholders, the stay will stop the landlord from repossessing the leasehold premises as a result of the unpaid rent (unless the lease had expired prior to the petition being filed). The delinquent lease, if a portion of the term remains could be capable of being an executory contract. Therefore as an asset of the company, Speculation Inc could look to sell the lease as part of a s.363 sale free and clear of liabilities. Therefore the lease could be sold to a third party and the landlord would have a new tenant with no ability to claim the missed rent from them. The landlord's claim for the unpaid rent would remain with the estate as a creditor claim.

Commented [H(63)]: Correct, 1 mark

#### 4) Employment Discrimination lawsuit.

It is likely that the employment discrimination lawsuit would be affected by the stay, unless it becomes a criminal matter. In terms of amounts potentially owed to the employees for unpaid salaries or contributions to their benefit plans for the 180 days prior to the petition, the claimants would need to be in no worse a position had the company entered Chapter 7 liquidation unless they consent to a different outcome.

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Question 4.2 [5 marks]

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***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?***

*Should Stella enter an English scheme of arrangement its English representatives would be able to apply for recognition in the US under Chapter 15. The advantage of doing this would be to seek to impose a stay on any assets of the debtor within the United States. In order for this to be achieved, the English proceedings need to be recognised as foreign proceedings. A foreign proceeding is defined by the Bankruptcy Code 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 reorganisation or liquidation." The English scheme of arrangement would clearly fit these requirements.*

*The issue is then as to whether the English scheme of arrangement is a foreign 'main' proceeding to not. This requires analysis of Sella's COMI. Given the facts above, it is not clear that Stella's COMI would in fact be in the UK. A rebuttable presumption exist that the COMI is where the company was incorporated - in this case France. Whilst the following are not conclusive, the bankruptcy court will consider the location of Stella's headquarters and management (both in France), the location of the primary assets (Italy where the products are made and potentially in warehouses and stores around the world) and the jurisdiction whose law will apply to most disputes (this is likely to be the UK because of the bank loan and Eurobonds). However a key test is also where the creditors of the company believe the company to be based - this could be anywhere given the global nature of the brand. However if the brand marketed itself as a 'French' cosmetics company or 'Italian made' this may sway the Court. Given the above, further evidence will be needed to determine Stella's COMI. However it is important to note that for Chapter 15 purposes the COMI will be determined upon petition to the Bankruptcy Court in the US not from the date of the commencement of the foreign proceedings. The COMI could therefore shift from England to the US or elsewhere in the run up to the petition. Whilst this may be done to take advantage of the US' Chapter 15 rules, the Court can refuse recognition where they find the COMI has been manipulated in bad faith.*

*Whether the proceedings are classified as 'foreign-main' or not, the Bankruptcy court can, at is discretion grant relief to the foreign representatives which would be beneficial.*

**Commented [H(66)]:** Specifically, a foreign main proceeding is in the jurisdiction of the debtor's COMI, and a foreign non-main proceeding is in a jurisdiction that is not the COMI and where there is an establishment (which the retail store in England would be).

**Commented [H(67)]:** Correct, 1 mark, the other factors are unlikely to overcome this presumption given the headquarters are also in France.

**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?**

**The license to manufacture Xblox is capable of being an executory contract because there are obligations on both sides - ToyCo to provide the license for 10 years and GameMart to pay ToyCo royalties.**

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

**GameMart cannot transfer the Xblox license without ToyCo's consent because the transfer involves consideration of substantive non-bankruptcy laws - intellectual property law in this case. ToyCo is not obliged to accept performance by a transferee without giving consent.**

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Commented [H(71): Correct, 1 mark

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

**GameMart's lease is an executory contract because further performance is required on both sides - provision of the site and payment of the rent. The clauses in the lease that prohibit transfer without Land Corp's consent are not enforceable post-petition and therefore the factory lease can be transferred. However because this is a transaction not in the ordinary course of business GameMart must establish that it is proposing the transaction in its business judgement and that the transaction is in the interests of the estate as a whole.**

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Commented [H(73): Correct, 1 mark

\* End of Assessment \*