



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 41/50

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

Commented [H(4): Correct, 1 mark

ABC Corp is an industrial manufacturing company that is filing for bankruptcy. Which of the following could not be considered a party in interest?

- (a) A neighboring landowner to ABC Corp's manufacturing plant.
- (b) An environmental advocacy group that opposes ABC Corp's operations.**
- (c) The landlord of ABC Corp's corporate office.

- (d) *People who live several miles downstream from ABC Corp's manufacturing plant and have been exposed to the plant's toxic waste.*
- (e) *The US Internal Revenue Service.*

Question 1.3

Commented [H(5)]: Correct, 1 mark

Which of the following contracts to which ABC Corp is a party is executory and may be assigned without counterparty consent?

- (a) **A lease on a manufacturing plant that contains a provision that requires landlord approval of any assignment.**
- (b) *An employment contract between ABC Corp and a former employee, requiring the company to provide health insurance through the end of the current year.*
- (c) *A 10-year software licensing agreement with XYZ Corp that is three years into performance.*
- (d) *A lease on office space that ended the prior year, but for which ABC Corp still owes past rent.*
- (e) *None of the above are executory and may be assigned without counterparty consent.*

Question 1.4

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

Which of the following conditions must be true about a reorganization plan for a court to confirm it under Chapter 11 proceedings?

- (a) *Have a possibility of success, even if it relies on speculative or improbable events to be capable of execution.*
- (b) **The plan is not likely to be followed by liquidation.**
- (c) *All impaired classes must accept the plan.*
- (d) *All of the above.*
- (e) *None of the above.*

Question 1.5

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

Which of the following about cramdowns, is false?

- (a) *The plan of reorganization must be fair and equitable to all impaired classes.*
- (b) *Differential treatment of different classes is permitted if there is a reasonable, good faith basis for doing so and such treatment is required for the plan of reorganization to be successful.*
- (c) *Class definition is often a battleground when a debtor tries to cramdown classes.*
- (d) *Dissenting creditors are permitted to challenge the classification of a creditor supporting the cramdown.*
- (e) ***If one insider creditor approves of the plan of reorganization, all other impaired classes may be crammed down.***

Question 1.6

Commented [H(8)]: Correct, 1 mark

Which of the following about 363 sales is false?

- (a) *A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.*
- (b) *The debtor in possession must establish that the transaction is in the best interests of the estate as a whole.*
- (c) ***In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale.***
- (d) *Debtors must carry out a robust marketing process for the sale.*
- (e) *A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.*

Question 1.7

Commented [H(9)]: 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

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 8/10

Question 2.1 (1 mark)

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

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

In a situation where a creditor has a (valid) claim against a debtor and has monies owed to the same debtor, the creditor may be able to net out (setoff) the two exposures assuming their claim is valid, and the netting off did not take place within 90 days prior to the petition being filed.

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

Because the setoff enhances a creditor's position relative to the wider pool of creditors, in the US context, it is not permitted in the 90 days prior to the petition date, unless the creditor can prove that the debtor was not insolvent. There are some exceptions to this restriction, presumably to ensure uninterrupted function of the financial markets.

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

Question 2.2 [2 marks]

Commented [H(17)]: Total marks 1.5/2

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

Since I have not had direct exposure to US bankruptcy courts, in the first instance I would reach out to local counsel to advise me on the necessary procedures. In the background I would consult the Bankruptcy Rules and the Federal Rules of Civil Procedure. Finally, depending on the actual jurisdiction (i.e., state where the case is going to be heard) I would also reference local state's bankruptcy court rules and the background of the relevant judge, similar to the process Kirkland & Ellis and Jones Day undertook prior to the bankruptcy of Caesar's Entertainment, when jurisdiction (Delaware vs. Illinois) was being debated.

Commented [H(18)]: Correct, 1/2 mark

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

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

Commented [H(21)]: Specifically, you should look at the judge's practices posted on the bankruptcy court's website

Question 2.3 [2 marks]

Commented [H(22)]: Total marks 1/2

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

Absolute priority rule relates to certain employee expenses (e.g., unpaid salaries and contributions to the employee benefits plan 180 days prior to the petition date or cessation of business). Specifically, employees cannot be made worse off under a reorganisation (Chapter 11) than they would be under a Chapter 7 proceeding, unless they consent to such terms. In a Chapter 7 liquidation, employees are given administrative priority relative to general unsecured creditors.

Commented [H(23)]: Partially correct, 1/2 mark, the absolute priority rule applies to all claims. Employee claims are one of a number of priority claim categories, each of which must be satisfied before a junior creditor class may receive anything.

Commented [H(24)]: Correct, 1/2 mark

According to section 507 (a) of the US Bankruptcy Code:

- (4) wages, salaries or commissions (including vacation, severance and sick leave pay); and*
- (5) contributions to employee benefit plans*

would be considered priority claims, to be settled immediately after domestic support obligations, "super-priority" claims, administrative expenses and claims arising in involuntary bankruptcy cases.¹

As mentioned earlier, the absolute priority rule can be deviated from if the employees consent, and this would normally happen if they were provided with adequate incentives (e.g., termination in their current role and a new employment agreement under revised terms that aligns their compensation better with the company's long term performance).

Question 2.4 [2 marks]

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

Broadly speaking a bankruptcy estate will have secured and unsecured creditors. Priming refers to using estate assets that have already been secured to a creditor, to raise additional funds in the form of DIP financing. Rationale for such a transaction is that the debtor is unable to either generate liquidity (internally) or find alternative sources of funding, and therefore to maximize the overall value of the bankruptcy estate (by not disrupting operations or forcing the debtor to enter into Chapter 7 proceedings) it is preferable to "prime" already secured assets, providing that the secured creditor is not made worse off and is adequately protected.

Considering that the DIP funder generally sits at the top of the waterfall ahead of pre-petition creditors (secured and unsecured), this provides an incentive to existing creditors to extend DIP financing and potentially improve their overall recoveries (depending on how the DIP loan is structured). This is referred to as a "roll-up" (i.e., a creditor combining pre and post-petition exposure to the debtor), and is subject to court approval, taking into consideration other financing options (that exclude the roll-up) and the quantum of new debt being provided.

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?

If a creditor were to receive debtor's assets during the "suspect" period prior to the bankruptcy petition, and in doing so improve their overall recoveries compared to a liquidation under chapter 7, this would be considered a preference. Suspect period varies depending on the nature of the creditor and their relationship to the debtor. In case of an independent third party suspect period is 90 days, while for debtor-related parties (aka insiders) that time frame is extended up to 12 months.

¹ Kevin M. Lewis, *Making it a Priority: What Happens to Employee Claims When a Business Declares Bankruptcy?* (Congressional Research Service, 16 April 2019)

Commented [H(25)]: Total marks 1.5/2

Commented [H(26)]: Partially correct, 1/2 mark, specifically the new lien is of equal or greater seniority to the existing lien

Commented [H(27)]: Correct, 1/2 mark

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

Commented [H(29)]: Total marks 3/3

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

Main point to prove is that the creditor would have received less in a chapter 7 liquidation, and as a result was given preferential treatment relative to other creditors. In situations where the business continues to operate (i.e., chapter 11), this type of counterfactual is challenging to prove. There are additional considerations including if the transfer of debtor's assets was made at a time when the debtor was insolvent and whether it relates to a historical debt (prior to the time of the transfer).

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

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

Finally, neither party (creditor nor debtor) needs to have been proved to be at fault, which means that the transaction gets reversed (assuming creditor still has possession of the transferred assets and is itself solvent). It is common practice in emerging markets for an all-out asset grab to take place prior to the debtor declaring bankruptcy, with the debtor generally prioritizing local creditors (or those creditors who are most likely to pursue debtor's management in their home country). Presumably in the US, this treatment of preferences disincentivizes such action and maximizes value for the estate.

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

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

Commented [H(34)]: Total marks 14.5/15

Question 3.1 [3 marks]

Commented [H(35)]: Total marks 2.5/3

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?

Bankruptcy courts were not established under Article III of the US Constitution, and their decisions are therefore subordinated to federal courts as evidenced most recently by the US Supreme Court ruling in the case of *Stern v Marshall*². In this particular case, the final order issued by the bankruptcy court was deemed to be unconstitutional under Article III since there was a parallel proceeding happening in a state court, with the jury eventually ruling in favour of the claimant. Therefore, bankruptcy court orders can only be considered final if they relate to core proceedings, and if the final order does not conflict with the ruling of a state court. Core proceedings include matters relating to the administration of the estate, allowance or disallowance of claims against the estate, counterclaims by the estate, orders in relation to obtaining credit and matters relating to preferences, amongst others.

Commented [H(36)]: The bankruptcy court cannot enter final judgment on core proceedings that overlap with Article III jurisdiction (such as resolution of claims and counterclaims), but enter final judgment on matters created by the Bankruptcy Code, such as resolution of a challenge to a petition.

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

In order to avoid complications, Bankruptcy Rules now require litigants to specify in their pleadings whether they consent to the jurisdiction of the bankruptcy court (i.e., is the court's order to be considered final and binding on them). Otherwise the relevant district court will have the authority to rule on the jurisdiction of the bankruptcy court, and if it is determined that the jurisdiction is lacking, district court will treat the bankruptcy court's order as a proposed finding and a conclusion of law. A final bankruptcy order may still be appealed (even if the bankruptcy court had the necessary authority) if it does not resolve the entire dispute.

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

² 564 US 462 (2011)

Appeals are heard either by the district court or the Bankruptcy Appellate Panel (BAP) comprising judges from the circuit's bankruptcy courts. The parties also have the option for further appeal with the circuit court of appeals. In a situation where the order being appealed was made by a bankruptcy court that had the necessary authority (i.e., core proceeding with no competing state court rulings), the conclusions / findings will be reviewed by either the BAP or the district court. Alternatively, BAP and the district court review afresh (de novo) all objectionable conclusions / findings.

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

Question 3.2 [3 marks]

Commented [H(41)]: Total marks 3/3

What provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the United States upon recognition of a foreign main proceeding? What relief may be granted on a discretionary basis for either foreign main or non-main proceedings?

Once a foreign main proceeding has been recognized in the United States, debtor's property is subject to an automatic stay (section 362) and can also be transferred, sold or used outside the ordinary course of business (section 363). In addition, a foreign insolvency professional / representative can operate the debtor's business (section 363 and 552) and take actions to void post-petition asset transfers and perfection of security interests (section 549).

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

Commented [H(43)]: Correct, 1/2 mark

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

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

Furthermore, the court may grant additional relief on a discretionary basis with respect to the discovery of debtor's affairs and any other relief "necessary to effectuate the purpose of chapter 15 and protect the assets of the debtor or the interests of creditors". However, considering that this type of relief is discretionary (i.e., can be revoked) in the case of foreign non-main proceedings, makes foreign main proceedings more attractive from a protection standpoint.

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

Question 3.3 [4 marks]

Commented [H(48)]: Total marks 4/4

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

Based on the information provided, it would seem that relative to UK's Companies Act 2006 / Chapter 2 (s170 - s180), director duties and liability under Delaware corporate law is more limited. First of all directors' duties are always owed to the corporation and its shareholders (and never to the creditors!), since the zone of insolvency does not exist in Delaware case law. Second, directors owe a fiduciary duty of loyalty and a duty of care in educated decision making. Finally, the directors are protected from liability by the business judgement rule in situations where errors in judgement have resulted in an unfavourable outcome for the company and its shareholders. The only way this "shield" can be pierced is if it can be proven that the directors were not reasonably informed in their decision making, were not acting in good faith and did not honestly believe that the decision was in the corporation's best interest.

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

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

Commented [H(52)]: 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.

In order to qualify as a petitioning creditor in an involuntary proceeding, the unsecured (or undersecured) creditor must have a claim that is non-contingent, not subject to a bona-fide dispute and is in excess of US\$16,750.

For a claim to be considered non-contingent it needs to have crystallized and cannot be dependent on future events. The claim also needs to be based on fact and/or law, and in that sense not subject to a dispute. To the extent that a portion of the non-contingent claim is disputed, it disqualifies that specific claim in its entirety from being used to meet the monetary threshold of US\$16,750. However, the same creditor can use other claims (providing they are neither disputed nor contingent) to meet the necessary criteria. Finally, in an insolvency petition the creditor also needs to prove that the debtor is either cash flow insolvent or that within 120 days prior to the filing of the petition a custodian was appointed.

In addition to the abovementioned constraints, there are also limitations in terms of what type of debtor can be subject to an involuntary proceeding (e.g., farmers and not-for-profit corporations are exempted) and how many creditors are required to file the petition.

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?

Typically upon the filing of the petition for Chapter 11, a debtor would benefit from a worldwide automatic stay that would help preserve the value of the estate for the creditors. However there are several exceptions (where the stay does not apply) that are relevant in this case:

Commented [H(53)]: Total marks 5/5

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

Commented [H(55)]: Correct, 1 mark

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

Commented [H(57)]: Correct, 1/2 mark

Commented [H(58)]: Correct, 1/2 mark

Commented [H(59)]: Correct, 1/2 mark

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

Commented [H(61)]: Total marks 8.5/10

Commented [H(62)]: Total marks 4.5/5

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

- a) Regulatory investigations; and
- b) Exercise of rights under financial contracts such as swaps, forwards and repos.

To that extent, the DOJ investigation into Speculation Inc's affairs would not be stayed, and neither would its broker's ability to net-off any losses related to the margin loan default against the shares held as collateral. However, if Speculation Inc does not have sufficient assets (i.e., value of shares held by the broker is not sufficient to cover the margin-loan position), the broker will become an unsecured creditor of Speculation Inc.

Commented [H(64)]: Correct, 1 mark

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

As far as the delinquent lease is concerned, it would depend on the status of the lease. If the lease had expired, automatic stay would not be applicable and the landlord could potentially evict Speculation Inc. However, if the lease still had some time to run (i.e., it would be considered an executory contract since both sides still have important performance remaining), then the debtor would have the choice to either reject the contract (making the landlord a pre-petition unsecured creditor), assume the contract (by curing defaults and giving assurances of future performance) or assume and assign to a third party. Given the liquidity position of Speculation Inc it is unlikely to want to assume the contract, and considering the DOJ investigation it is even less likely that a third party would be willing to step in its shoes as a tenant.

Commented [H(66)]: Partially correct, 1/2 mark, here the lease has not expired so eviction is barred

Finally, the employment discrimination lawsuit will also be stayed on the filing of Chapter 11 given it is a civil action.

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

Question 4.2 [5 marks]

Commented [H(68)]: Total marks 1/5

Stella SA (Stella) is a an international cosmetics company incorporated in France, with its headquarters in Paris. Stella's products are made in Italy and shipped to its retail stores in Europe (including England), Asia, and North America. Stella's funding comes from a bank loan and Eurobonds, both of which are governed by English law. Stella's retail sales have suffered due to pandemic-related closures and it is considering options to restructure its debt. One option is to use an English scheme of arrangement with respect to the Eurobonds. Could the English scheme of arrangement be recognized by a US bankruptcy court under Chapter 15, and would such recognition be as a foreign main or non-main proceeding?

An English scheme of arrangement would qualify as a "collective juridical 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."³ Furthermore, there is precedent of English schemes being granted recognition in the past.

³ 11 USC, section 101(23)

In determining whether this is going to be a foreign main or a non-main proceeding, the following would have to be taken into account:

- a) Location of Stella's HQ (France);
- b) Location of Management (France);
- c) Location of primary assets (Europe/UK, Asia and North America);
- d) Location of majority of creditors (not clear);
- e) Jurisdiction whose law will apply to most disputes (most likely English Law).⁴

Given that Stella has presence and assets in the UK (i.e., its retail stores), and considering that it could be argued that "most" disputes will be governed by English Law (if "most" means by value - assuming its debt is sizeable relative to other potential liabilities and is the main cause of "dispute"), then it would appear that Stella's Chapter 15 filing could be considered as a foreign main proceeding. To be 100% certain we would probably need to review Stella's most significant contracts, in particular ADR clauses that would specify the mechanism and governing law for such matters.

In an alternative scenario, if it came to light that Stella's UK operations were negligible, and that most contract disputes were governed by laws other than English Law, then Stella's Chapter 15 application would be qualified as 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:

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

The license is an executory contract⁵. In addition, case background suggests that the license still has a period of time that it needs to run (potentially up to 10 years), with both parties having to perform a service (e.g., quality control for ToyCo and contractual payments for GameMart).

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

⁴ 11 USC, section 1516(c)

⁵ 11 USC, section 365

Commented [H(69): It is unlikely that these factors would overcome the presumption that Stella's COMI is in France where it is incorporated.

Commented [H(70): Correct, 1 mark, the retail store in England would be the necessary establishment for non-main recognition

Commented [H(71): Total marks 3/5

Commented [H(72): Correct, 1 mark, the licensor is also obligated to maintain the exclusivity of the license

Under section 363 (f) of the US Bankruptcy Code, a trustee (of GameMart) may sell / transfer the property free and clear of any interest subject to a number of conditions being met, one of them being the consent of the party whose contractual rights are being transferred (i.e., ToyCo in our case). Therefore, GameMart cannot transfer the Xbox license without ToyCo's consent as part of a 363 sale.

Commented [H(73): Correct, 1 mark, but for the wrong reason, substantive IP law, not the Bankruptcy Code, makes the owner's consent necessary

Presumably ToyCo would want to ensure that the party that the Xbox license is being transferred to has the capacity (operational and financial) to maintain the quality and standards needed to protect the ToyCo brand, but also to meet the necessary payments contracted by GameMart.

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

Considering the lease has seven years to run, it would be considered as an executory contract, and therefore subject to section 365 of the US Bankruptcy Code. Under section 365 (c), the trustee of the debtor may not assign the unexpired lease (irrespective of whether the lease permits assignment or not) if the relevant laws prohibit or excuse LandLease from providing services to anyone other than the debtor, and LandLease does not consent to such assumption or assignment to a third party.

Commented [H(74): Correct, 1 mark, however consent is not required because the contractual requirement of consent is not enforceable in bankruptcy and there is no substantive law of leasing that requires consent to be granted

* End of Assessment *