



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 41.25/50

**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 9/10

**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 occurs where A owes B money, while at the same time, B owes A money. Setoff refers to A's debt to B being extinguished by the amount of B's debt to A. If setoff were permitted in B's insolvency proceedings, A would in effect recover the full amount of its debt from B (because A's debt would be offset by that full amount). This is not permitted in many circumstances because it places A in a better position than B's other unsecured creditors.*

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**Question 2.2** [2 marks]

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

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

*The first point of reference should be the Federal Rules of Bankruptcy Procedure. One should also have regard to the Federal Rules of Civil Procedure and the local rules of the bankruptcy court in which the filing will be made.*

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

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

Commented [H(20)]: Correct, 1/2 mark, also the judge's personal practices

**Question 2.3** [2 marks]

Commented [H(21)]: Total marks 2/2

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

*The absolute priority rule requires that one category of claims is paid in full before payment begins on the next category of claims. It can be deviated from in Chapter 11 proceedings, where the affected creditors (i.e., the creditors in relation to the first category of claims) consent to the deviation.*

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Commented [H(23)]: Correct, 1/2 mark

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

**Question 2.4** [2 marks]

Commented [H(25)]: 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?**

*A priming lien is a lien that is granted on encumbered property, but takes priority either senior or equal to that of the existing lien on the property. Such a lien will be granted if a debtor is able to show that it has been unable to obtain credit in the form of: (a) unsecured debt that is given administrative expense priority; (b) unsecured debt that is given priority ahead of administrative expenses; (c) secured debt with a lien on unencumbered property; or (d) secured debt with a junior lien on encumbered property. Thus, it will only be granted where a debtor's assets are insufficient to: (a) fully satisfy administrative expenses; and (b) accommodate a junior lien.*

Commented [H(26)]: Correct, 1 mark

Commented [H(27)]: Correct, 1/2 mark, also the interest of the secured creditor primed must be adequately protected

**Question 2.5** [3 marks]

Commented [H(28)]: Total marks 3/3

**What is a preference? What are the elements of a preference claim that need to be proved? Is a showing of fault, by either the debtor or creditor, required?**

A preference is a transfer from debtor to a creditor within a certain period prior to the petition that must be returned if it exceeds the amount that the creditor would obtain under Chapter 7 liquidation. There is no need to show fault on the part of either the debtor or the creditor. The elements of a preference claim are: (a) a transfer of an interest of the debtor in property - this could include a transfer of assets or a granting of security over assets; (b) for the benefit of a creditor; (c) for and on account of an antecedent debt - the transfer must be made in relation to a pre-existing debt from the debtor to the creditor, it cannot be a contemporaneous exchange of value (eg. a purchase of new goods from the creditor); (d) made while the debtor was insolvent; (e) made during the suspect period - 90 days before petition for non-insiders and 3 years before petition for insiders; and (f) that enables the creditor to receive more than it would have in a Chapter 7 liquidation.

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

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

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

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

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

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**Question 3.1** [3 marks]

Commented [H(35)]: Total marks 1.5/3

**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?**

A bankruptcy court may enter a final order in relation to a core matter it has jurisdiction over, either by law or by consent of parties. Appeals from bankruptcy court orders are typically heard by the district courts. In some circuits, it is a Bankruptcy Appellate Panel made up of judges from the bankruptcy court who reviews the appeal. For non-final orders, leave must be sought for an appeal to be brought. When they are reviewed by the appellate court, they are reviewed *de novo* in respect of all findings of fact and conclusions of law.

Commented [H(36)]: Correct, 1/2 mark, specifically it has authority over certain core matters that are established by the Bankruptcy Code, such as a challenge to a petition. When the bankruptcy court does not have constitutional authority to enter a final order, its ruling is treated as a report and recommendation by the district court.

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

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

**Question 3.2** [3 marks]

Commented [H(39)]: 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?**

Pursuant to section 1520 of the Bankruptcy Code, sections 361, 362 and 552 automatically apply. Pursuant to section 1521, the following relief may be granted on a discretionary basis for foreign proceedings: (a) a stay of proceedings; (b) stay of execution; (c) suspension of transfers; (d) examination of witnesses; (e) entrustment of the administration and realisation of the debtor's assets to the foreign representative;

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

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



(f) relief under s 1519(a); and (g) relief other than that under sections 522, 544, 545, 547, 548, 550 and 724(a).

Question 3.3 [4 marks]

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

Directors owe their corporation a fiduciary duty of loyalty which requires them to act in the best interests of their corporation and exercise reasonable care in decision making. Directors are protected from liability for errors of judgment by the "business judgment rule". This rule presumes that any act of the directors was done in good faith and with reasonable information. This presumption can then be rebutted by actual evidence that the directors acted in bad faith, did not genuinely believe that they were acting in the corporation's best interests or were not acting with reasonable information. Thus, by virtue of the business judgment rule, where the directors have acted reasonably, they will not be in breach of their duties simply because their actions turned out to be harmful to the company. These directors' duties are owed only to the corporation and its shareholders. They are not owed to creditors even where the corporation is potentially or actually insolvent.

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 creditor's claim must: (a) be non-contingent - this means that the claim must not depend on the occurrence of a future event, and the claim must be matured in the sense that all the requirements for it to arise, other than passage of time, have been met; (b) not be the subject of a bona fide dispute as to liability or amount - this means that there cannot be an objectively reasonable basis to dispute the claim as a matter of fact or law; and (c) the claim must amount to at least USD 16,750.

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**

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

Commented [H(48)]: Correct, 1 mark

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

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

Commented [H(51)]: Total marks 3.25/5

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

Commented [H(53)]: Correct, 1/2 mark

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

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

Commented [H(56)]: Partially correct, 1/4 mark, alternatively multiple creditors' claims can collectively satisfy this requirement. Also, the claims must be unsecured or undersecured and the creditor must allege that the debtor is generally not paying its debts or has had a custodian appointed over its assets.

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Commented [H(58)]: Total marks 3.5/5

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?

Upon the filing of any plenary petition (including a Chapter 11 petition), a worldwide stay pursuant to section 362 comes into effect.

- (i) The DOJ investigation would be able to continue without interruption. This is because the s 362 stay does not operate as a stay against the continuation of investigation by a securities regulatory organisation (s 362(b)(25)). The DOJ investigation relates to potential breaches of security regulations by Speculation Inc, and is therefore unaffected by the stay.
- (ii) The broker will not be able to enforce the margin loan default on the shares that it holds as collateral. This is pursuant to s 362(a)(5). Further, the broker will not be able to recover the margin loan default by commencing proceedings against Speculation Inc, because this is prohibited by s 362(a)(1). That said, there is an exception for securities contracts contained in s 362(b)(6) that could apply to the broker. If its contract with Speculation Inc constitutes a "security agreement", it could be able to exercise any contractual rights pursuant to that contract to offset or net out the margin loan default. However, more information would be necessary to determine if this exception applies.
- (iii) The landlord will not be able to commence proceedings to recover the rental arrears pursuant to s 362(a)(1). However, they would not be prevented from evicting Speculation Inc if the terms of the rental agreement allow them to do so.
- (iv) The suit against Speculation Inc would constitute a judicial proceeding against Speculation Inc, and therefore its continuation would be stayed pursuant to s 362(a)(1). If the suit has already concluded and judgment has been given in the employee's favour, she will not be able to enforce the judgment pursuant to s 362(a)(2).

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

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

Commented [H(61)]: Partially correct, 1/2 mark, a margin loan is a securities contract so this exception does apply

Commented [H(62)]: Incorrect, if the lease has not expired, eviction is barred by the automatic stay

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

Question 4.2 [5 marks]

Commented [H(64)]: Total marks 4/5

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?**

*Under Chapter 15, the English scheme of arrangement can be recognised as long as it constitutes "a collective judicial or administrative proceeding in a foreign country ... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation", and an application for recognition is brought in the US by someone empowered to act in the English scheme. The English scheme certainly constitutes a foreign proceeding and therefore it will be recognised unless it is contrary to US public policy (which does not appear to be the case). There is also a further requirement, that Stella has an establishment in the UK, given my conclusion that the English scheme is likely to be recognised as a foreign non-main proceeding. On the facts, Stella's retail stores in England will satisfy this requirement.*

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

*The English scheme is like to be recognised as a foreign non-main proceeding. Pursuant to s 1516, France will be presumed to be Stella's COMI because that is where Stella has its registered office. This presumption can be rebutted by evidence showing that Stella's COMI is in fact in England instead. The COMI of an entity is determined by a variety of factors, including the location of its headquarters, the location of its management, the location of its primary assets, the location of a majority of its creditors and the jurisdiction whose law will apply to most disputes: *In re SPhinX LTD*, 2006 Bankr. LEXIS 2078. A COMI must also be readily ascertainable by creditors and third parties on the basis of objective evidence. In this case, Stella does not have its headquarters in England, nor does it appear that its management is located there. I recognise that Stella's funding, which appears to be the main source of its debt, comes from Eurobonds which are governed by English law. However, this does not seem to be enough to displace France as Stella's COMI.*

Commented [H(66)]: Correct, 1 mark, recognition as foreign main would require that Stella's COMI was in England

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

**Question 4.3 [5 marks]**

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

**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:**

Commented [H(69)]: Total marks 3/5

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

*An executory contract is one whereby there are material unperformed obligations on both sides such that the failure of either to complete performance would constitute a material breach excusing performance of the other. In this case, GameMart pays ToyCo*

on a monthly basis (as opposed to one lump sum at the beginning of the license). This means, for the remainder of the 10-year license period, there are unperformed obligations on both the licensee's and the licensor's sides, and the license is therefore executory.

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

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

It depends on intellectual property law. Pursuant to s 365(c)(1), an executory contract cannot be assigned where applicable law excuses a party from accepting assignment, and that party does not consent. In this case, the applicable law would be intellectual property law. Intellectual property law dictates that the license of a trademark may not be assigned without the consent of the licensor because it provides that the licensor cannot be compelled to accept performance from a party other than the licensee: *In re Trump Entertainment Resorts, Inc*, 526 BR 116. Even if such a rule applies to patents, the next question is whether the rule will be one that parties are free to contract around. If it is (like with trademarks), the terms of the license will then become relevant. For example, if the license contains a provision prohibiting GameMart from sublicensing or assigning its rights to others, it will be clear that parties did not intend to depart from the default rule. While such terms are themselves unenforceable in bankruptcy due to s 365(f)(1), they are relevant in this case because of intellectual property law and s 365(c)(1).

Commented [H(71)]: The same rule applies to patents, so ToyCo's consent is required.

To conclude, therefore, GameMart can transfer the Xbox license without ToyCo's consent so long as doing so is not prohibited by intellectual property law.

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

Yes, it may do so. While there is a specific provision stating that it may not, s 365(f)(1) provides that a debtor may assign an executory contract notwithstanding any provision restricting such assignment. Upon the transfer, the assignee will have to provide Land Corp adequate assurance of future performance.

Commented [H(72)]: Correct, 1 mark

Commented [H(73)]: Correct, 1 mark

\* End of Assessment \*