



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

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

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**

Commented [H(1)]: Total marks 25.5/50

Commented [H(2)]: Total marks 7/10

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

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.

Commented [H(3)]: Correct, 1 mark

Question 1.2

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.

Commented [H(4)]: Correct, 1 mark

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.

Commented [H(5)]: Incorrect, the correct response is (a)

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.

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

Question 1.5

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.**

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

Question 1.6

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.

Commented [H(8)]: Incorrect, the correct response is (c)

Question 1.7

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.

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.

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.

Commented [H(9)]: Incorrect, the correct response is (d)

Commented [H(10)]: Correct, 1 mark

Commented [H(11)]: Correct, 1 mark

(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(12): Total marks 8/10

Question 2.1 (1 mark)

Commented [H(13): Total marks 1/1

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

ANSWER:

Set off is the process whereby a creditor of an estate is also the debtor of an estate. The set off occurs when the creditor sets off its debt against its claim against the estate this is known as contra accounting. This is not permitted as it gives the creditor an unfair/ undue preference over other creditors. Set off is not permitted in the following circumstances: where the claim was against the estate; where the claim was acquired post-liquidation or within the 90 days prior to the insolvency; or in any period during the 90 days prior to insolvency where it can be proven that the debtor was insolvent.

Commented [H(14): Correct, 1/2 mark

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

Question 2.2 [2 marks]

Commented [H(16): Total marks 2/2

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

ANSWER:

Before submitting an application before the bankruptcy court one should familiarize themselves with the current bankruptcy rules as well as the federal rules on civil procedure. One should also study the local rules and practice directives of the bankruptcy court as well as the judges personal directives. It is advisable that a local practitioner be consulted, should you not regularly practice in the area.

Commented [H(17): Correct, 1/2 mark

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

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

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

Question 2.3 [2 marks]

Commented [H(21): Total marks 1/2

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

ANSWER:

In terms of the absolute priority rule an employee is granted absolute priority for unpaid salaries and employee benefit contributions due in the 180 day period prior to petition or ceasing. Hence such employees may not receive worst treatment under any reorganization program then they would in a chapter 7 liquidation. This may only be deviated from on the express consent of the employees concerned.

Commented [H(22): Partially correct, 1/2 mark, the absolute priority rule applies to all categories of claims, not just employees

Commented [H(23): Correct, 1/2 mark, also this can only happen in a chapter 11 plan

Question 2.4 [2 marks]

Commented [H(24): 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?

ANSWER:

A priming lien is senior or equal to a pre-petition lien over estate property and is used to secure post-petition financing. In order for such a lien to be granted it must be demonstrated that the interest of the secured creditor that will be primed in terms of the priming lien are sufficiently protected.

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

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?

Commented [H(26)]: Correct, 1/2 mark, also the debtor must show the financing is not available without the priming lien

Commented [H(27)]: Total marks 2.5/3

ANSWER:

A preference can be defined as the alienation of the debtors property made in a tumultuous period prior to the petition date. It is designed to prefer one creditor over the other. Once a preference has been proven by showing that the debtor received a better dividend than it would be entitled to, in terms of a chapter 7 liquidation, such excess amount would need to be returned. There is no need to prove any fault or guilt on either party, merely the need to prove an increased dividend.

Commented [H(28)]: Correct, 2 marks, the recipient must be a creditor on a pre-existing debt

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

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?

Commented [H(30)]: Total marks 6.5/15

Commented [H(31)]: Total marks 1/3

ANSWER:

The bankruptcy court may enter a final order if the facts point to the necessity thereof and that the litigants have consented in their pleadings to the entry of a final order or judgment. It is important to note that should either of the litigants do not comply with the requirement the court may *mero meto* assume that the party has consented to its jurisdiction. With regard to appeals from the bankruptcy court are heard by the bankruptcy appellate panel which comprises of judges of the bankruptcy court within the circuit where the court a quo is based.

Commented [H(32)]: Correct, 1/2 mark, the bankruptcy court can also enter final orders on certain core matters, such as a challenge to the petition

Commented [H(33)]: Correct, 1/2 mark, this is only true in certain circuits, in other circuits a district court will hear the appeal. If the order is not constitutionally final, the district court treats it as a report and recommendation.

Question 3.2 [3 marks]

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

Commented [H(34)]: Total marks 0.5/3

ANSWER:

Section 363 automatically applies to the assets of a debtor with regard to relief the court has a discretion to deny recognition of the foreign judgment if it can be proven that the foreign court had no jurisdiction, the judgment was fraudulently obtained, the order offends public policy or conflicts with other absolute judgments or that any other dispute resolution forums had been agreed to.

Commented [H(35)]: Correct, 1/2 mark, the automatic stay, operating the debtor's business in the ordinary course, and avoidance of post-petition transfers automatically apply. Discretionary relief include discovery of the debtor's assets and affairs, entrusting administration of US assets, extension of provisional relief and any other relief necessary to serve the purposes of chapter 15 and protect the debtor's assets and creditors' interests

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?

Commented [H(36)]: Total marks 2/4

ANSWER:

Duties are owed to the corporation and its shareholders, it is pertinent to note that directors do not owe a duty to creditors even when insolvency is on the horizon. Directors are protected from liability for poor decision making and errors of judgment by the business judgment rule.

Commented [H(37): Correct, 1 mark, specifically the duties are of loyalty and care

Commented [H(38): Correct, 1 mark

Question 3.4 [5 marks]

Commented [H(39): Total marks 3/5

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

ANSWER:

In order for a creditor to become a petitioning creditor the creditors claim must be 1- non-contingent, 2- must not be the subject of any justifiable dispute as to quantum or merit and lastly the claim must either be secured or unsecured. The claim must further be either separately or in aggregate of an amount no less than USD 16750,00.

Commented [H(40): Correct, 1 mark, it must not depend on the occurrence of a future event

Commented [H(41): Correct, 1 mark, this is an objective test as to bases in fact and law

Commented [H(42): Partially correct, 1/2 mark it must unsecured or undersecured, a fully secured creditor cannot petition for an involuntary bankruptcy

Commented [H(43): Correct, 1/2 mark, also the creditor must allege that the debtor is not paying its debts or has had a custodian appointed over its assets

Commented [H(44): Total marks 4/15

Commented [H(45): Total marks 2/5

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?

ANSWER:

The chapter 11 petition would not affect the department of justice's investigation, nor the employment discrimination suit. It would however provide it with the opportunity to benefit from a moratorium whilst the company prepares and rearranges its financing. It is pertinent to note that no award against the company in terms of the discrimination lawsuit may be executed upon whilst the company is in chapter 11.

Commented [H(46): Correct, 1 mark

Commented [H(47): Incorrect, this is a private civil litigation that would be stayed.

Commented [H(48): Correct, 1 mark, also the stay will prohibit an action by the landlord for rent or eviction. The margin loan is a securities contract exempt from the automatic stay so the broker could liquidate the collateral.

Commented [H(49): Total marks 0/5

Question 4.2 [5 marks]

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

ANSWER:

In terms of chapter 15 the recognition would depend on the COMI which is a relatively unknown term in American insolvency proceedings but pivots on the location of the companies registered office or headquarters where its assets are primarily located, the management team are primarily located and the location of the majority of the general body of creditors that are affected, jurisdiction is also to be looked at. As the Euro bonds on the face of it appear to be the biggest creditor and may very well be based in England the English courts appear to have jurisdiction. I therefore submit that the recognition in terms of Chapter 15 would be that of a foreign main proceeding. The arrangement of the English courts is not automatically recognized and application under Chapter 15 by the English administrator must be filed.

Commented [H(50): COMI is presumed to be in France where Stella is incorporated. The other factors are unlikely to overcome the presumption. As COMI is not in England, foreign main recognition is not appropriate. Recognition as foreign non-main is available because the retail store in England constitutes the necessary establishment.

Question 4.3 [5 marks]

Commented [H(51): Total marks 2/5

ToyCo is an American toy company that has created a popular line of folding robot toys called Xbox. The toys are covered by several US patents. Currently, GameMart Inc (GameMart) has a 10-year exclusive license to manufacture Xbox 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 Xbox 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 Xbox an executory contract?

ANSWER:

Yes

Commented [H(52): Correct, 1 mark, both parties have ongoing duties: to pay royalties and to maintain exclusivity

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

ANSWER:

Yes they can transfer the contact as this is another debtor friendly feature of the bankruptcy code and is designed to assist the company in need.

Commented [H(53): Incorrect, consent is required as a matter of IP law

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

ANSWER:

Yes, they can sell the lease as part of a 363 sale as it is an asset of the company. However, adequate protection must be given to the lessor.

Commented [H(54): Correct, 1 mark, the provision requiring landlord consent would not be effective in bankruptcy

*** End of Assessment ***