



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 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**

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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

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*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

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*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

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*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

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*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

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*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

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*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]

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**Question 2.1** (1 mark)

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

*Setoff occurs where a creditor is also indebted to the debtor, and therefore nets off the two positions to achieve a total net liability. Because setoff can artificially improve the position of one creditor over others in the same class (i.e. by having the obligation decreased by the full amount owing by the debtor rather than what the debtor would pay on an unsecured claim), it is not permitted in various instances.*

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**Question 2.2** [2 marks]

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

*When preparing a Bankruptcy Court filing, one should review the Federal Rules of Bankruptcy Procedure (also known as the Bankruptcy Rules), the Federal Rules of Civil Procedure, the relevant Bankruptcy Court's local rules and the personal practices of the particular judge.*

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**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 each category of claims in a chapter 7 bankruptcy must be paid in full before the next category in the statutory waterfall can be paid.*

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*In a chapter 11 bankruptcy, the absolute priority rule means that a creditor cannot accept less than it would receive in a hypothetical chapter 7 bankruptcy over the debtor. It can, however, be deviated from by consent of the senior creditor, where payment of the funds in question to a junior class or creditor is necessary to have the reorganisation or liquidation plan approved.*

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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 a lien granted over an already-encumbered asset in the estate, where the priming lien (despite being later in time) ranks either senior to or equal to the pre-petition lien. This type of lien is used to secure DIP financing, but is only available where (i) financing cannot be obtained on more favourable terms to the estate (e.g.*

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unsecured lending or a junior-ranking lien) and where the debtor can show that the secured creditor who is being "primed" is adequately protected.

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Question 2.5 [3 marks]

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**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 out of the debtor's estate made during the relevant period (either 90 days for third parties, or one year for insiders) before the petition date.

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To prove a preference, the following elements must be shown: (i) a transfer of the debtor's interest in property; (ii) the transfer is to or for the benefit of a creditor; (iii) the transfer is for or on account of prior (antecedent/pre-existing) debt owed by the debtor; (iv) the transfer is made while the debtor is insolvent (which is rebuttably presumed in the 90 days prior to the petition date); (v) the transfer is made during the "suspect period", which is 90 days before the petition date for transfers to third parties or one year for transfers to insiders; and (vi) as a result of the preference, the creditor received more than it would have in a chapter 7 liquidation, i.e. the creditor's position is improved by way of the transfer.

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A showing of fault by either party is not required, because the return of a preference is aimed at ensuring equality of creditors and preventing competition between creditors to obtain repayment from the debtor first.

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

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Question 3.1 [3 marks]

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**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?**

Prior to 2011, the position was that the Bankruptcy Court could grant final orders in respect of core matters only. Core matters are defined in the Bankruptcy Code and include matters such as the administration of the estate, proceedings relating to preferences, motions regarding the automatic stay, and confirmations of plans. Bankruptcy Courts may not enter final orders in respect of non-core proceedings, although they may hear those proceedings and make proposed findings of fact and conclusions of law to the District Court where the non-core proceeding in question is "sufficiently related" to the main bankruptcy proceeding.

Following the Supreme Court ruling in *Stern v Marshall*, the position is somewhat more complex: in that decision, the Supreme Court held that even in the case of core issues the Bankruptcy Court cannot issue a final order in respect of a state law claim. The Bankruptcy Rules and subsequent Court decisions mean that the position is now that



the Bankruptcy Court can issue final orders in respect of core matters only by way of report and recommendation to the District Court (as is the case for non-core matters) or where the parties consent to final relief being granted.

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Commented [H(39)]: Correct, 1/2 mark, there are also core matters that the bankruptcy court can adjudicate, such as a challenge to a petition

Appeals from bankruptcy court matters are heard by either the District Court for the district in which the Bankruptcy Court sits or, in the First, Sixth, Eighth, Ninth and Tenth Circuits, by way of a Bankruptcy Appellate Panel or BAP, consisting of judges from the bankruptcy courts within that circuit.

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Non-final orders are reviewed by way of consideration of both the facts and the law *de novo* by the District Court or BAP as appropriate.

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?**

When a foreign main proceeding is recognised pursuant to Chapter 15, the following provisions automatically apply to the debtor's property within the US: (i) the automatic stay, (ii) the ability of the foreign representative to operate the debtor's business in the ordinary course, (iii) the avoidance of post-petition transfers and perfections of security interests, and (iv) the ability of the foreign representative to sell, transfer or use the debtor's property outside of the ordinary course of its business.

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

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

For foreign non-main proceedings, any of the above can also be made applicable at the Court's discretion on application by the foreign representative.

For both foreign main and non-main proceedings, the foreign representative gains the right to intervene in federal or state court action in which the debtor is a party, when the proceeding is recognised.

For both main and non-main proceedings, the Court can also grant discretionary relief relating to (i) authorisation of discovery concerning the debtor's assets and affairs, (ii) entitling the foreign representative or another person to administer the debtor's US assets, (iii) extending any of the provisional relief granted upon filing of the petition, or (iv) another other relief necessary to give effect to Chapter 15 and protect the debtor's assets or creditors' interests.

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Commented [H(48)]: 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?**

Directors of a Delaware corporation owe a **fiduciary duty of loyalty to the corporation's best interests**, as well as a **duty of care in educated decision-making**.

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

These duties are owed to the corporation itself and its shareholders, and not to the creditors even when the corporation is actually or potentially insolvent. This is different from many other common-law jurisdictions where the directors' duties are owed to creditors when the company is insolvent or of dubious solvency.

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Directors enjoy protection pursuant to the **"business judgment rule"**, which states that the directors as a whole (i.e. the board) are presumed to have acted in good faith and on the basis of reasonable information in making business decisions. It should be noted that the business judgment rule does not apply where the board approved transactions in respect of which the majority of the board is not disinterested and independent. It also does not apply where a controlling shareholder is involved in both sides of the particular transaction.

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**Question 3.4 [5 marks]**

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**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 for a creditor to qualify as a petitioning creditor in an involuntary bankruptcy proceeding, its claim must meet all of the following requirements.

First, **the claim must be non-contingent**. This means that the claim is not subject to the occurrence of a specified event e.g. the breach of an obligation by a third party (as is usually the case for claims against guarantors). However, a claim that is "contingent" only on the passage of time (that is, an unmaturing but otherwise non-contingent claim) is regarded as non-contingent provided that the only outstanding requirement is the effluxion of time.

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Second, **the claim must not be the subject of a bona fide dispute as to liability or quantum**. This requirement would not be met (i.e. there would be a bona fide dispute) where there is an **objectively reasonable basis to dispute the claim either in fact or in law**. A subjective belief is insufficient for this purpose. If a claim is disputed in part, the undisputed part does not count towards the monetary threshold; however, one creditor can of course hold disputed and undisputed claims and a dispute about one claim would not automatically mean a dispute about all claims.

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Third, **the claim must be either unsecured entirely, or under-secured, in the specified sum**. This can be alone, or in aggregate with other claims held by other petitioning

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creditors. The sum is current US\$16,750, and is adjusted periodically based on inflation.

**Commented [H(60):** Correct, 1/2 mark, also the petitioners must allege the debtor is failing to pay debts as they come due or has had a custodian appointed over its assets

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

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**Question 4.1** [5 marks]

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

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

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

**The filing of a Chapter 11 petition would bring into effect an automatic stay in respect of various types of proceedings, aimed at allowing the debtor breathing space to either liquidate or reorganise its business. However, the automatic stay is subject to several exceptions.**

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**The DOJ investigation, as a regulatory investigation, is specifically excluded from the ambit of the automatic stay pursuant to 11 USC §362. Accordingly, the DOJ is entitled to continue its investigation after the filing of a Chapter 11 petition.**

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**The bank's position in respect of the margin loan default would depend on the type of relief it seeks. To the extent that it sought to commence an ordinary civil suit against Speculation Inc. for sums owed under the loan, that would be stayed by virtue of the automatic stay. However, should the bank elect to exercise its rights in respect of the collateral (share) it holds, then it is free to do so as the exercise of rights under a security contract is specifically excluded from the ambit of the stay (again, pursuant to 11 USC §362).**

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**In respect of the delinquent lease, the position will also depend on the specific circumstances: given that the lease is non-residential in nature, if its term has expired then the lessor is free to continue proceedings to evict Speculation Inc., as evictions of this nature are excluded from the stay. However, if the term has not expired (such that the lease constitutes an executory contract in Speculation Inc's estate), the lessor will not be entitled to sue for back rent or other sums owed by virtue of the stay.**

**Commented [H(66):** Correct, 1/2 mark, as the lease has not expired, the landlord cannot seek eviction

Finally, in relation to the discrimination lawsuit, employees are afforded no special exceptions from the automatic stay, so the employee's claim would be stayed from the moment of filing of the Chapter 11 petition.

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Question 4.2 [5 marks]

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**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?**

Pursuant to Chapter 15, a foreign proceeding is defined as "a collective judicial or administrative proceeding in a foreign country,... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purposes of reorganization or liquidation". A scheme of arrangement at English law, as a collective proceeding before the English High Court under UK insolvency law aimed at restructuring the debt of the debtor, meets these elements and accordingly the scheme of arrangement would be recognised as a foreign proceeding pursuant to Chapter 15.

The determination of whether the scheme of arrangement is a foreign main or foreign non-main proceeding will depend on Stella's COMI: if Stella's COMI is England, the scheme of arrangement will be a foreign main proceeding since it is commenced in Stella's COMI jurisdiction. If however, Stella's COMI is not England, then the scheme of arrangement is a foreign non-main proceeding.

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A debtor's COMI is presumed to be its place of incorporation, and accordingly Stella's COMI will be presumed to be France. However, this presumption is rebuttable taking into account the location of its headquarters, its management, its primary assets, its majority creditors and the jurisdiction whose law will apply to most disputes.

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Stella's headquarters are in Paris (which supports its COMI being France), but its creditors (the Bank and Eurobond issuer) are based in England and English law applies to its debt. However, given there may be other claims arising in Italy (where its main operations are) or elsewhere in Europe (where it sells its products), this is not the only area in which claims could arise.

In light of the evidence as a whole, there is unlikely to be sufficient evidence to rebut the presumption that France is its COMI, meaning the scheme of arrangement would stand to be a foreign non-main proceeding.

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*In order to be a foreign non-main proceeding, the debtor must have an establishment in the relevant country, meaning that it conducts non-transitory economic activity there. Securing finance and selling products are non-transitory economic activities, so Stella plainly has an establishment in England, allowing the English proceedings to be recognised as foreign non-main proceedings pursuant to Chapter 15.*

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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 an executory contract, because there are material un-performed obligations on both sides.*

Commented [H(75)]: Correct, 1 mark

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

*Despite the fact that the Xblox license is an executory contract (which would usually entitle GameMart as debtor to transfer it pursuant to a 363 sale without consent), licenses involving patents and trademarks enjoy special protection pursuant to the Bankruptcy Code. Thus, GameMart would not be able to transfer the Xblox license without Toyco's consent. This is because the no-bankruptcy law relevant to patents provides that a party cannot be compelled to accept performance by a transferee.*

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

*The lease is an executory contract given that there are material non-performed obligations on both sides. Thus, despite the anti-assignment provision in the lease, GameMart is free to elect to assume and assign the lease, and can do so without Land Corp's consent as lessor. There are no special provisions relative to the assignment of leases in this regard like there are for, for example intellectual property.*

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Commented [H(79)]: Correct, 1 mark

**\* End of Assessment \***