



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]

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Questions 1.1. - 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only ONE answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

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Which of the following entities does not satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

- (a) A foreign domiciled company that pays a US attorney a retainer.
- (b) A company with several US bank accounts, but no physical presence in the United States.
- (c) A company with US patents, but no physical presence in the United States.
- (d) All of the above satisfy the minimum requirement for presence in the United States.**
- (e) None of the above satisfy the minimum requirement for presence in the United States.

Question 1.2

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

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

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

Question 1.3

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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

When does an automatic stay come into effect?

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

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Question 1.9

Which of the following regarding substantive consolidation is true?

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

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Question 1.10

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

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

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QUESTION 2 (direct questions) [10 marks]

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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 allows a creditor who holds a claim against the debtor and at the same time owes the debtor an amount to make an offset between these two (or more) obligations. The Bankruptcy Code, however, considers the setoff to be a preference that would violate the fairness among creditors subject to the bankruptcy proceeding, since this creditor would be in a more beneficial position in relation to other unsecured creditors, considering that the debtor would "pay" the claim in full to the setoff-creditor while other creditors of the same class would be subject to the payment provisions of the restructuring plan, which usually provides discounts when paying unsecured creditors.]

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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?

[The Bankruptcy Rules, the Federal Rules of Civil Procedure, the local rules of the bankruptcy court and the judge's personal practices. In addition, it is worth consulting with a local practitioner for advice on unwritten local practices.]

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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?

[Section 1129(b)(2) of the Bankruptcy Code sets forth the absolute priority rule, by which it is established that each category of claims must receive full payment before proceeding to the payment of the next category. Deviation from the principle is allowed only with the consent of affected creditors, except in the case of a procedure under chapter 7, which requires that the statutory priorities be followed to the letter.]

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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?

[If the debtor is unable to obtain DIP financing by the other means provided by law, which enjoy priority, the court may authorize as a last resort a priming lien, which would be a senior or equal or a pre-petition lien on real estate property to secure DIP

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financing. To be granted, the debtor must demonstrate that the interest of the secured creditor being primed is protected from the diminution in value of his collateral or that he has consented.]

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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 of assets by the debtor made moments before the filing of the petition that initiated the bankruptcy proceeding. Through this negotiation, the recipient-creditor received more than he would receive in a chapter 7 liquidation. If this is the case, the property has to return to the estate. The elements of a preference claim are (1) transfer of funds, property or an interest in property from the property of the debtor securing a lien, (2) for the benefit of a creditor, (3) by reason of a pre-existing debt that the debtor held before such transfer was executed. Finally, there is no need of a showing of fault, since juridical transaction can be avoided as constructive fraudulent conveyances, which does not require a showing of fraudulent intent].

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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?

[Bankruptcy Courts are entities created by federal law, especially by the 1978 Bankruptcy Code. Therefore, they are different from the Federal Courts created by Article III of the US Constitution. The Bankruptcy Code distinguishes between core and non-core matters and authorizes bankruptcy judges to deal only with core proceedings (28 U.S. Code § 157). With respect to a motion or pleading that brings a non-core matter, the bankruptcy code may even consider it if it is related to the bankruptcy proceeding, but it cannot grant a final decision, which is the responsibility of the District Court. Therefore, Bankruptcy Courts have jurisdiction and power to give final decisions exclusively on core matters.

The central point of debate on the topic, therefore, is to distinguish whether a matter is core or non-core. In 2011, the US Supreme Court, in the case *Stern v. Marshall*, granted a decision considered controversial by practitioners in the area of insolvency, when it held that the bankruptcy court, even in core proceedings, could not give final decisions that invaded the jurisdiction delimited by Article III of the US Constitution. In the case, a bankruptcy court issued the first judgment, awarding USD 400 million to the debtor. The decision was appealed to the district court. The jury verdict in the state court came before the district court decision, which ratified the bankruptcy court's decision. The US Supreme Court held that the final decision of the bankruptcy court was unconstitutional under Article III because it overruled state law. More recently, insolvency laws have been implemented requiring litigants to state in their petitions whether they consent to the issuance of final orders by the bankruptcy court as well as

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allowing the district court to treat as a proposed findings of fact and conclusions of law, when on an Appeal a district court determines that the bankruptcy court did not have jurisdiction to enter judgment.]

In addition, appeals from a bankruptcy court decision are reviewed by the district court to which the bankruptcy court that issued the order is attached. In certain circuits, bankruptcy appeals are directed to the Bankruptcy Appellate Panel (BAP), made up of judges from the bankruptcy courts of that particular circuit. In circuits where there is a BAP, the party may choose between the district court and the BAP. Finally, from the decision of the district court or the BAP there is one last right to appeal, this time to the circuit court of appeals. In specific circumstances, the appeal may go directly to the circuit court of appeals, in the case where (i) the appeal raises an issue that was not on the docket of that circuit or the US Supreme Court, or the issue requires that the conflict of controlling decisions be resolved; (ii) or when the direct forwarding of the appeal would further the progress of the case. Once the appeal is directly forwarded, the court of appeals will have discretion whether or not to confirm the direct forwarding of the appeal. Finally, non final orders can be reviewed by interlocutory appeals, which will submit to the court only the specific point addressed in the interlocutory order.]

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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?

[Upon recognition of a foreign main proceeding the following provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the United States: (a) automatic stay; (b) operation of the debtor's business in the ordinary course by the foreign representative; sale, (c) transfer or use of property outside the ordinary course; (d) avoidance of post-petition transfers and post-petition perfection of security interests.]

In terms of relief that may be granted on a discretionary basis for both foreign main or non-main proceedings there are: (a) authorization of discovery regarding the debtor's assets and affairs; (b) entrusting administration of the debtor's US assets to the foreign representative or other person; (c) extension of provisional relief; (d) any other relief necessary to effectuate the purposes of chapter 15 and to protect the assets of the debtor or the interests of the creditors. This list is not exhaustive and the court may authorize other forms of relief under the Bankruptcy Code or Other US Law based on the principle of comity and the values inherent in the Bankruptcy Code.]

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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, under the law of Delaware, owe a fiduciary duty of loyalty to the best interests of the company and a duty to conduct decision making with the utmost care in the ordinary course of business.]

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The fiduciary duties of the directors are owed by them to the company and its shareholders but not to the company's creditors, even in circumstances where the company is in financial distress or on the verge of insolvency. This issue has already been expressly decided by the Delaware Supreme Court in the case law named North Am Catholic Educational Programming Foundation, Inc v Gheewalla, 930 A.2d 92, 103 (Del 2007).

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The business judgment rule protects directors from liability for error of judgment. This rule provides that the board of directors enjoys a presumption of having acted in good faith based on the information that was available to it at the time of making the decision. This presumption can be rebutted only by (i) showing that a majority of the board was actually ill-informed or (ii) that they acted without a good faith belief that such action would be in the best interests of the company, or (iii) that they were acting in bad faith. Therefore, without evidence of negligence by the directors, they cannot be held liable for the company's debts.]

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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.

[To appear as a petitioning creditor in an involuntary proceeding the creditor must have a claim against the debtor that is: (1) Non-contingent, that is, a determinate title, which does not depend on the occurrence of a future and uncertain event for the perfection of the obligation to occur; as well as which is already past due before the filing of the insolvency proceeding; (2) that it is not subject to bona fide dispute as to liability or amount, meaning that there is no dispute as a matter of fact or law to dispute the claim, for example with the debtor believing that he does not owe the amount or that he owes a different amount (noting that if the dispute over the amount owed is partial, the creditor may not take advantage of the portion that is not under dispute to qualify as a petitioning creditor); (3) that the unsecured or undersecured claim reaches an amount of at least USD 16,750 (this amount is periodically adjusted for inflation), which amount may be reached separately by one claim or in sum with the claims of all the other petitioning creditors. In addition, in the event of an involuntary proceeding, the petitioning creditor must allege either that the debtor is not paying its debts or that a custodian has been appointed within the last 120 days before the filing of the petition to enforce a lien against the property of the debtor, which does not represent the entire assets of the debtor.]

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

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Question 4.1 [5 marks]

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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?

[Speculation Inc's filing of a Chapter 11 petition is a voluntary proceeding, since the debtor started it on its own initiative. As a consequence, the voluntary petition takes immediate effect and imposes the statutory automatic stay. First, the worldwide automatic stay (11 USC, § 301(b)) will be in effect and will provide Speculation Inc with a deadline to file its plan of reorganization (must be filed within the exclusivity period of 120 days from the order for relief - petition date in this specific case).

Commented [H(64)]: Correct, 1 mark, though not the automatic stay is immediately effective on an involuntary petition as well

Furthermore, upon filing of a plenary bankruptcy proceeding, an "estate" is formed consisting of all the debtor's assets at the petition date. With this, all assets of the debtor, anywhere in the world, are protected. In particular the Bankruptcy Code throughout the automatic stay provision prohibits: (i) litigation on pre-petition claims; (ii) enforcement of pre-petition judgment against the debtor or property of the estate; (iii) any act to obtain possession or control of property of the estate; (iv) creation, perfection or enforcement of a lien against property of the estate on account of a pre-petition claim; (v) any attempt to collect on pre-petition claims; (vi) setoff of any pre-petition debt against any pre-petition claim.

However, the automatic stay is subject to some statutory exceptions, and among the exceptions are regulatory investigations. Therefore, the DOJ investigation will continue against Speculation Inc.

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In turn, the margin loan default would be considered a non-contingent claim that would be subject to the effects of the restructuring plan to be submitted by Speculation, Inc.

Commented [H(66)]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay, so the broker can liquidate the collateral.

The delinquent lease is a contract not yet matured and subject to a special Chapter 11 regime, so Speculation should indicate it as an "unexpired lease of real property". This point is an exception, since decisions on unexpired leases of non-residential property must be made within 120 days of the order for relief.

Commented [H(67)]: Specifically, the landlord is barred from commencing proceedings for eviction or past-due rent

Finally, regarding the employment discrimination lawsuit, it will be stayed due to the Chapter 11 petition filing, in accordance with the title 11 U.S. Code § 362(a)(1): Except as provided in subsection (b) of this section, a petition filed under section 301, 302,

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

or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of— the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title.]

Question 4.2 [5 marks]

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?

[The foreign representative of the “English scheme of arrangement” could file a petition for recognition of the foreign proceeding before a US bankruptcy court under Chapter 15. To assess whether the foreign proceedings would be recognized as a main or non-main proceeding one would have to analyze where the center of main interests (COMI) of the company is located. Under the US Bankruptcy Code, the debtor’s COMI is presumed to be the place of incorporation of the company, a presumption that is rebuttable (11 USC, § 1516(c)). However, there are other factors that are relevant when determining the COMI, such as: location of headquarters; location of management; location of primary assets; location of a majority of debtor’s creditors or a majority of the creditors that will be affected by the relief requested by the foreign representative; jurisdiction whose law will apply to most disputes.

In this scenario, considering that Stella SA is incorporated in France, with its headquarters in Paris, the tendency would be that only a French insolvency proceeding recognized before the US bankruptcy court would be recognized as a main-foreign proceeding, especially taking into account that the company is incorporated in France, with its headquarters and potential place of management in Paris. In this case, Stella would only have one retail store in England, which would be defined as an establishment under the provisions of the Chapter 15, and the English scheme of arrangement would be recognized as a foreign non-main proceeding. However, considering that Stella S.A. is financed through bank loans and Eurobonds, being that both of which are governed by English law, it is possible that the English Court would be the jurisdiction most often sought by the creditors to resolve disputes regarding the restructuring of Stella S.A.’s debt. Taking this into consideration, the English

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Commented [H(71)]: Correct, 1 mark, the other COMI factors are unlikely to overcome the presumption

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scheme of arrangement could also be recognized as a foreign main proceeding under Chapter 15.]

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?

[Yes, intellectual property licenses based on US patents are typically deemed to be executory contracts.]

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

[No, GameMart - the debtor licensee - is prohibited to assume or assign this executory contract, because pursuant to section 365 (c) (1) of the Bankruptcy Code a debtor may not assume or assign an executory contract or unexpired if "applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties". In this specific case, the US law on intellectual property can be considered an applicable law, which restricts the assignment of the license granted to GameMart, even if it is non-exclusive license, without the Licensor's consent.]

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

[Yes, because section 365(f) of the Bankruptcy Code, notwithstanding a lessor approval provision, overrides the necessity of approval of the lessor to transfer the factory lease as part of 363 sale. The referral section 365(f) provides: except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.]

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Commented [H(75): Correct, 1/2 mark. specifically one party is obliged to maintain exclusivity and not sue for infringement, and the other party has to pay royalties

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*** End of Assessment ***