



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 45.5/50

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

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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

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

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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

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

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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 allows a creditor who has a claim against the debtor but who also owes money to the debtor to net out the competing obligations. It is generally not permitted as it would improve the position of the creditor by comparison to other unsecured creditors and decrease their obligation to the estate by the full amount owed rather than the lesser amount the debtor would presumably have to pay on the unsecured claim.

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

Question 2.2 [2 marks]

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

The Federal Rules of Bankruptcy Procedure. In addition, each bankruptcy court has their own local rules of procedure and each judge also issues personal practices which are updated from time to time so practitioners should make sure to check these also.

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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 dictates that no party should be treated less favourably under a Chapter 11 reorganisation than they would otherwise be treated under a chapter 7 liquidation unless they specifically consent to such less favourable treatment. This might happen, for example, where a creditor agrees to receive less in order to ensure the plan is approved by another class of creditors. However, the absolute priority rule does not apply to subchapter V of chapter 11, which added to the Bankruptcy Code by the Small Business Reorganization Act of 2019 in order to create a new regime for businesses with debts below a statutory threshold.

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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 allows the bankruptcy estate raise funds where funding may otherwise be unavailable by granting the lender / financier a lien that will be senior (or at least equal to) to any pre-petition lien or security on the property of the of the estate. If the bankruptcy court grants a priming lien the debtor must be able to demonstrate that the interest of the secured creditor whose interest 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 occurs where there is a transfer of the debtor's property in the period immediately preceding the petition. If that transfer exceeds the amount otherwise receivable by the creditor in a chapter 7 liquidation, then it must be returned to the estate. There does not need to be any fault on behalf of either the debtor or the recipient and the recipient will not suffer any penalty beyond having to return the transfer (and interest if applicable). One must prove the below elements in respect of a preference:

- Transfer of property in which debtor has interest;
- To the benefit of a creditor;
- Payment must be for an existing debt;
- Payment made when debtor was insolvent (rebuttable presumption of insolvency 90 days before filing of petition);
- Transfer made during 'suspect period' being 90 days in ordinary course and 1 year in respect of transactions with connected parties; and
- Results in recipient creditor being better off than would otherwise be in chapter 7 liquidation.

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?

As bankruptcy courts derive from a standalone federal statute (1978 Bankruptcy Code) and not Article III of the US Constitution, the US Supreme Court has found they cannot make final orders in many cases given they are unable to invoke the jurisdiction granted under Article III. To overcome this, 28 USC section 157 introduced the concept of 'core' and 'non-core' matters with bankruptcy judges only permitted to determine 'core' proceedings which are those that relate directly to the administration of the bankruptcy estate including claims by or against it or regarding estate property, the automatic stay, recognition proceedings etc. However, the Supreme Court decision in *Stern -v- Marshall* called into question whether bankruptcy judges can issue final orders even in 'core' proceedings and now the situation is similar to 'non-core' proceedings whereby they can issue a recommendation for review by the District Court judge to implement or, pursuant to the Bankruptcy Rules, the parties can proactively consent to the entry of final orders by the bankruptcy judge.

As regards appeals, final orders can be appealed as of right but leave from the appellate court is required for interlocutory orders. However, the US Supreme Court has recognised that bankruptcy court orders which not are not necessarily final but resolve a discreet issue can be treated as final purpose of an appeal. Appeals from bankruptcy court decisions are heard by district court in the relevant district unless there is Bankruptcy Appellate Panel established in that circuit (although parties have an option to request the district court hear the appeal instead of the Bankruptcy Appellate Panel).

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

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Commented [H(36)]: Specifically, the bankruptcy court can enter final orders on core matters created by the Bankruptcy Code, such as a challenge to a petition

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main proceeding? What relief may be granted on a discretionary basis for either foreign main or non-main proceedings?

An automatic stay will be granted only upon the petition for recognition of foreign main proceeding being granted (not on the filing the petition) and will be limited to the property of the debtor within the USA. Other provision of the Bankruptcy Code which will apply to debtor's property within the USA after recognition are that their US business can be operated by the foreign representative, the foreign representative can oversee the sale or transfer of property which is outside of the ordinary course and can seek to avoid post-petition transfers or granting of security. These provisions will apply on a discretionary basis upon the recognition of a foreign non-main proceeding. In addition, under 11 USC, section 1521 the following relief can be granted on a discretionary basis upon recognition of either a foreign main or non-main proceeding: discovery over the debtor's affairs, the appointing the foreign representative (or someone else) to administer the debtor's US assets, extending any provisional relief or any other relief necessary to protect the assets of the debtor and the interests of the creditor.

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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?

In the ordinary course of business, Delaware directors owe a fiduciary duty of loyalty to act in the corporation's best interest as well as a duty of care to make educated, well-informed decisions. However, they are protected from liability for errors of judgment by the business judgment rule which assumes that directors act in good faith and on the basis of reasonable information. This presumption is rebuttable but only it can be proven a majority of the board were not reasonably informed, did not believe the action was in the company's best interest, or were not acting in good faith. If the presumption is not rebutted, the directors will only be held liable where it can be proven there was gross negligence. However, the business judgment rule does not apply in conflict situations where there is a lack of independence. Such conflict transactions must satisfy the entire fairness standard to be valid. In addition, the directors in a Delaware corporation owe their duties to the shareholders and not the creditors, even where the corporation is in the 'zone of insolvency'. This has been endorsed by the Delaware Supreme Court in North Am Catholic Educational Programming Foundation, Inc v Gheewalla, [930 A.2d 92, 103 (Del 2007)].

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

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

Commented [H(52)]: Correct, 1/2 mark, the duties are also owed to the corporation itself

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 to qualify as a petitioning creditor and initiate an involuntary proceeding against a debtor under either chapter 7 or chapter 11, the minimum number of creditors required to bring the proceedings will depend on the amount of creditors the Company has. The amount of creditors required is dependent on the amount non-contingent, non-insider creditors the debtor has. If the debtor has fewer than 12 such creditors, only one is required. If there are more than 12 of these creditors, at least 3 of them must join in filing the petition.

In order to be a qualifying creditor the claim must be actually owing and non-contingent - that is an obligation is actually owed which is not dependant on some future event occurring (such

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as a guarantee which can only be called upon if the primary obligor doesn't repay). In addition, the debt must not be the subject of a bona fide dispute in respect of either the liability or the amount of the debt. The test here is an objective one and for a bona fide dispute there must be an objectively reasonable basis to dispute the debt. Finally, the creditor or creditors must be unsecured or inadequately secured in an amount of at least US\$16,750. This threshold sum is reviewed and increased with inflation periodically. If any part of a claim is disputed then it is not possible to use this claim (even if some of it is not disputed) to overcome this threshold amount. In order to present an involuntary petition, the petitioning creditor(s) must also be of the belief that the debtor is unable to pay its debts as they become due (unless such debt is the subject of a bona fide dispute) or, alternatively, within the 120 days prior to the filing of the petition, a trustee, receiver or other agent was appointed to take possession of the majority of the debtor's property.

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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?

- (i) AS the DOJ investigation is criminal in nature, it will not be subject to the automatic stay on the filing of the company's petition. However, given the ongoing and publicly announced investigation, the DOJ may be uncomfortable with Speculation Inc undergoing a DIP chapter 11 process under the supervision of their existing management team. It is possible that the DOJ could liaise with the US Trustee (who are overseen by the DOJ) in order to have a private trustee appointed to the company to oversee the process and to ensure that the DOJ maintain oversight.
- (ii) The shares that Speculation Inc purchases are held as collateral by its broker who then declares a default and presumably seeks to enforce this collateral. Were Speculation Inc to enter chapter 11, It initially appears that as an interest in the shares purchased by the debtor would be passed to the broker in respect of an antecedent debt (the margin loan presumably having already been made), at a point when the debtor was insolvent and during the suspect period (being 90 days before the petition), and that the broker would end up being in a better position than it would otherwise be in a chapter 7 liquidation, it could constitute a preference and be avoidable. However, 11 USD sections 546(e)-(g) and (j) provide a safe harbour for securities and commodities contracts which margin payments and so it seems the margin loan default would be not be avoidable following the filing of the petition.

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

Commented [H(65)]: The US Trustee's Office doesn't control the appointment of bankruptcy trustees--they may propose a candidate, but the bankruptcy court has the final say

Commented [H(66)]: Correct, 1 mark

- (iii) The lease of the company's office space is an executory contract so, in normal circumstances, the debtor must elect whether to assume, assign or reject the contract at any point before the a reorganisation in confirmed. However, 11 USC section 365(d)(4) provides that decisions regarding unexpired leases relating to non-residential property must be made within 120 days of the petition being granted (although it can be extended by 120 days with the consent of the lessor). This means that the trustee or DIP would have to make a decision of whether to reject, assume or to assign the lease within 120 days of the order granting the chapter 11 application.
- (iv) As soon as the petition is filed there will be an automatic stay on all proceedings involving the Speculation Inc. This means that the employment discrimination lawsuit will be stayed and, should the employee want to pursue it regardless of the chapter 11 proceedings, it would have to bring a motion.

Commented [H(67)]: The landlord would be barred from pursuing eviction or past-due rent.

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

Question 4.2 [5 marks]

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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?

Were Stella to enter a scheme of arrangement in the UK, it is likely that said scheme would qualify as a foreign proceeding under chapter 15 as the purpose of the scheme is to reorganise the debts of the company and present a restructuring which would enable the continued survival of the company. As Stella ships products to England and has bank and Eurobond funding which is governed by English law, it also seems clear that the it would be deemed to have an 'establishment' in England under 11 USC section 1502 as it carries out 'non-transitory economic activity' there. It therefore appears that the application for recognition would succeed. However, the next question is whether the scheme would be recognised as a foreign main or foreign non-main proceeding. We must therefore determine where Stalla's COMI is. Although there is no strict test to determine a debtor's COMI, there is a rebuttable presumption under 11 USC section 1516(c) that its COMI will be its place of incorporation. Other factors which will be taken into account when determining COMI are the location of a debtor's assets and creditors, its headquarters and where its management is carried out. As Stella is a French incorporated company with its headquarters also in France, there would be a presumption that its COMI is also France which, in this instance, I do not think would be rebuttable. Accordingly, the English governed scheme would be capable of recognition under chapter 15 but would likely be recognised as a foreign non-main proceeding.

Commented [H(70)]: Correct, 1 mark, the retail store satisfies the establishment requirement

Commented [H(71)]: Correct, 1 mark

Commented [H(72)]: Correct, 1 mark, as COMI is not in England, foreign main recognition is not available.

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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 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?

Although the contract to manufacture Xbox is executory as there are ongoing obligations owed by both parties to the contract, 11 USC section 365(c) provides that the counterparty to certain types of contracts cannot be forced to accept performance by a transferee and therefore requires the counterparty to certain types of contracts to consent to any assignment. It appears that as the contract with ToyCo covers US patents and the licencing intellectual property, counterparty consent would be required were GameMart to assign the contract. However, some circuits, including California (9th Circuit) have also determined that a debtor is not permitted to assume an executory contract it would not otherwise be permitted to assign (applying the hypothetical test). This would mean that GameMart may not be able to assume and continue producing Xbox without Tyco's consent.

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

As indicated above, although the Xbox licence is an executory contract and would ordinarily be capable of being freely assigned so that the bankruptcy estate could realise value for the asset, because it concerns intellectual property rights, counterparty consent would be required under 11 USC section 365(c) were GameMart to seek to assign the contract to a transferee by way of a 363 sale.

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Commented [H(77)]: Correct, 1 mark

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

Despite the lease with Land Corp prohibiting assignment, the lease would be deemed an executory contract allowing the debtor to ordinarily elect whether to assume, assign or reject the contract at any point before the a reorganisation in confirmed. However, 11 USC section 365(d)(4) provides that decisions regarding unexpired leases relating to non-residential property (which would apply to CameMart's lease with Land Corp) must be made within 120 days of the petition being granted (although it can be extended by 120 days with the consent of the lessor). This means that GameMart would have to make a decision on whether to reject, assume or to assign the lease within 120 days of the order granting the chapter 11 application and could choose to assign the lease without Land Corp's consent in spite of the prohibition on assignment in the lease.

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* End of Assessment *