



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

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

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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 is a right allowing a creditor that has a claim against a debtor but who also simultaneously owes money to that debtor to conduct a netting exercise between those two (or more) claims, leaving one "consolidated" claim. That right to setoff is exempt from the Bankruptcy Code — meaning that setoff transactions can not be avoided as preferences (provided certain relevant conditions are met).*

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*However, setoff is not permitted in many circumstances — in order to curtail the effect that it may have on other unsecured creditors of the relevant debtor who do not have claims against the debtor (meaning that there is no netting of their claims). If it were unlimited, the right of setoff could routinely and materially decrease the position of those other unsecured creditors by reducing the total obligations to the debtor's estate.*

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*Therefore, setoff is not permitted in circumstances where the creditor's claim against the estate is allowed, where the creditor's claim against the estate was acquired after the petition or in the 90 days prior to the petition (if the debtor was insolvent at that time), where the creditor's obligation arose in the 90 days prior to the petition (if the debtor was insolvent at that time for the purposes of exercising setoff rights), and where the creditor would improve its position by exercising the right to setoff (as compared to its position had that right been exercised 90 days prior to the petition).*

**Question 2.2** [2 marks]

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

*When preparing for a filing for a bankruptcy court, the following rules should be reviewed and adhered to:*

- *the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), which govern procedures for bankruptcy proceedings;*
- *the Federal Rules of Civil Procedure, which are often incorporated by reference in the Bankruptcy Rules and which govern civil proceedings in the United States district courts;*
- *the local rules of the relevant bankruptcy court, which will differ from court to court; and*
- *the personal practices of the relevant judge, which will be available on the relevant bankruptcy court's website.*

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Commented [H(21)]: Correct, 1/2 mark

There may also be local practices in certain courts or geographical areas that are unwritten; a local practitioner should be consulted in relation to any further rules and/or requirements.

**Question 2.3** [2 marks]

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

The absolute priority rule is a protective rule that gives certain employee costs administrative priority in liquidations proceedings pursuant to chapter 7 of the US Bankruptcy Code and prohibits certain employee costs from receiving treatment under a plan of reorganization that is worse than that treatment would otherwise have been in a hypothetical chapter 7 liquidation.

The employee costs referred to above are, principally, employees' unpaid salaries and contributions to employees' benefits plans arising in the 180 days that precede the petition date or the business ceasing.

The absolute priority rule may be deviated from in chapter 11 proceedings (but not chapter 7 proceedings, in which the absolute priority rule and corresponding order of statutory priorities must be strictly adhered to) where a more senior creditor agrees to receive less than the rule would otherwise require, in circumstances where distribution of such funds to lower priority creditors is necessary to obtain their approval of the plan of reorganization.

The absolute priority rule does not apply in proceedings pursuant to Subchapter V of chapter 11 of the US Bankruptcy Code.

**Question 2.4** [2 marks]

**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 on estate property that is senior or equal to a lien that exists from the period pre-petition. Priming liens may be granted by the court in order for a debtor to secure post-petition financing (and thereby prevent more negative outcomes for the debtor and its creditors). In chapter 7 proceedings, where a priming lien has been granted for post-petition financing that financing will have a greater priority (in relation to the relevant collateral) than financing given by pre-petition secured lenders.

This framework serves as encouragement for existing lenders to extend further credit to the debtor (to avoid the risk of their existing collateral becoming subject to a priming lien). Existing unsecured or undersecured creditors of the debtor may be able

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to improve their position by "rolling up" (i.e., refinancing existing unsecured or undersecured claims into the facility that is the subject of the priming lien), if approved by the court.

In order for a court to grant a priming lien, the debtor must demonstrate to the court that the interests of the secured creditor due to receive the benefit of the proposed priming are sufficiently protected (i.e., in relation to the assets that are due to be subject to the proposed priming) and that the debtor has not been able to secure any other post-petition financing (i.e., priming liens are a last resort for a debtor in need of financing).

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The granting of a priming lien may be opposed by other lenders who retain the benefit of collateral in relation to the proposed priming lien collateral if, for instance, the debtor has other unsecured property that could become the collateral in relation to the priming or if those other lenders are prepared to offer post-petition financing on better terms.

**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?**

Preferences are the subject of a cause of action that may be brought by the trustee or the debtor in possession in order to recover the property of the debtor's estate from pre-petition transferees.

A preference is a transaction consisting of the transfer of the debtor's property to a creditor of the debtor, in a suspect period before the date of the petition, that must be returned to the debtor's estate if the consideration received by the creditor would have been surpassed (in the event that the transfer had not been made) by consideration that would have been received for the same transaction in a chapter 7 liquidation.

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In short, a preference is an avoidable transaction that may be capable of being reversed (subject to the requirements set out below being met). The reversal of such transactions is intended to prevent creditors in similar positions to the transferee(s) from being prejudiced by the transaction(s) (by virtue of the overall pool of the debtor's assets available to creditors being reduced) and to promote collective insolvency proceedings (rather than individual creditors aiming to make better recoveries by pursuing the debtor's assets at an earlier stage than others). In that sense, the doctrine of preferences is a spiritual successor the Roman law *Actio pauliana*.

Where a preference is avoided (and the transaction reversed), the transferee will retain the benefit of an unsecured claim in the debtor's estate, in the amount of the value returned to that estate.

The elements of a preference claim that must be proven are as follows:

- there must be a **transfer of the debtor's interest in the relevant property** (i.e., the debtor must have had an interest in the property transferred, rather than a role as agent in relation to the property), which can include the granting of a lien;
- the transfer must be **to, or for the benefit of, a creditor who was a creditor of the debtor prior to the transaction;**
- the transfer must be **for, or on account of, an antecedent debt** owed by the debtor to the creditor and existing before the transfer was made;
- the transfer must have been made while the debtor was insolvent. For preference purposes, it is presumed that the debtor was insolvent on and during the 90 days preceding the petition date. A creditor may provide evidence to rebut that presumption and, ultimately, it is for the trustee or debtor to prove that at the time of the transfer the trustee or the debtor was insolvent on a balance sheet basis;
- the transfer was made during the suspect period (being 90 days prior to the petition date for unconnected third parties and one year prior to the petition date for insider parties (including, if a corporate, the debtor's officers, directors, controlling persons, general partner, and similar) - albeit there is no presumption that the debtor was insolvent in the period between one year prior to the petition date and 90 days prior to the petition date); and
- the transfer allowed the creditor to receive more than it would have otherwise in a chapter 7 liquidation (which may require expert evidence to be adduced in order to demonstrate the value that may have been achieved for a creditor in a chapter 7 liquidation).

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There is **no need to show any fault, in relation to the payment having been made, on the part of either the debtor or the recipient of the transfer.** Accordingly, there are no consequences for the transferee other than the reversal of the transfer (save, in certain situations, for interest from the date of the transfer).

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Certain defences may be available to the relevant creditor, including (but not limited to): where the debtor simultaneously gave new value to the debtor; where the transfer consisted of payments in the debtor's ordinary course of business; where a statutory lien was created / came into effect; where the creditor reclaimed goods belonging to it within prescribed time periods; and where the transactions related to margin payments on derivative financial products or other safe harbors apply. The defences listed above relate to transactions where the debtor is a corporate and may not all be applicable in cases where the debtor is a non-corporate.

**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?**

The US has specific federal courts devoted to bankruptcy matters, which are outside the scope of Article III of the US Constitution (unlike other federal courts including trial-level district courts, regional courts of appeal, and the US Supreme Court). As a consequence, the US bankruptcy courts have limited jurisdiction to enter final orders, other than on core bankruptcy issues.

Wherever a motion or pleading begins in a US bankruptcy court, the parties must confirm whether the matter at issue is a 'core' or 'non-core' matter; bankruptcy judges are only permitted to hear and determine 'core' proceedings (a non-exhaustive list of which is set out in statute). For non-core issues, the judge may make recommendations to the district court (which may be appealed by the parties) for their judgment.

A bankruptcy court may make final orders in relation to 'core' matters (having established the scope of its jurisdiction and power to do so). That ability is curtailed pursuant to case law which has clarified that, even in core proceedings, a bankruptcy court is not able to issue a final order that has the effect of impinging upon jurisdiction pursuant to Article III.

Appeals from bankruptcy court orders are reviewed by the district court for the district in which the bankruptcy court is (although in some cases may be heard by a Bankruptcy Appellate Panel convened from local judges). From there, there is a further right of appeal to the circuit court of appeals.

If the relevant ruling of the bankruptcy court relates to a final order over which the appropriate authority existed in a core proceeding, the district court or Bankruptcy Appellate panel will review conclusions as to law and findings of fact to confirm that the bankruptcy court's discretion has not been abused. In non-core proceedings, the district court or Bankruptcy Appellate panel will review points in relation to which a party has objected. From there, a circuit court of appeal will conduct any further review as to conclusions of law and in relation to the abuse of discretion as to findings of fact.

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?**

The US has adopted the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law") pursuant to chapter 15 of the US Bankruptcy Code. In doing so, the US created

Commented [H(38)]: Correct, 1 mark, this also applies to core proceedings where the bankruptcy court does not have authority to enter a final order

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*a new type of US bankruptcy proceeding: previously, bankruptcy proceedings had all been plenary proceeding pursuant to which the US exercised (or purported to exercise) worldwide jurisdiction or authority in relation to the entirety of the debtor and its estate; the implementation of the Model Law introduced ancillary bankruptcy proceedings as a new concept, pursuant to which the US does not exercise (or purport to exercise) jurisdiction or authority in relation to the entirety of the debtor and its estate.*

*Pursuant to the US's adoption of the Model Law, foreign proceedings may be formally recognised by the US bankruptcy court as either "foreign main proceedings" (being proceedings in a foreign jurisdiction where the debtor has its centre of main interests (COMI)) or "foreign non-main proceedings" (being proceedings in a foreign jurisdiction where the debtor does not have its COMI).*

*Upon the US bankruptcy court's recognition of a foreign main proceeding, the following provisions of the US Bankruptcy Code apply within the territorial jurisdiction of the US:*

- *the automatic stay;*
- *the foreign representative in relation to the proceedings takes control of the operation of the debtor's business in its ordinary activities;*
- *the sale, transfer or use of property outside the ordinary course of the debtor's business; and*
- *the avoidance of transfers and perfection of security interests that occur post-petition.*

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*By contrast, for foreign non-main proceedings those elements of relief may be granted by the US bankruptcy court (on a discretionary basis).*

*Following the US bankruptcy court's granting of recognition of foreign proceedings (whether those foreign proceedings are main or non-main), it may grant the following relief (also on a discretionary basis):*

- *for the authorisation of discovery in relation to the assets and affairs of the debtor;*
- *for the entrusting of the US assets of the debtor to the relevant foreign representative or other delegate;*
- *for the extension of any of the relief referred to above; and/or*
- *for any other relief necessary to comply with the purposes of the Model Law (as enacted in chapter 15 of the US Bankruptcy Code) and to protect the debtor's assets or the creditors' interests.*

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*Wherever discretionary relief is sought in a foreign non-main proceeding, the US bankruptcy court must be satisfied that it is appropriate, as a matter of US law, for the relevant assets of the debtor to be controlled and handled in that foreign non-main proceeding.*

*The relief listed above is not exhaustive; the US bankruptcy court may also provide assistance to the foreign proceedings / foreign representative pursuant to the US Bankruptcy Code or any other US law that is consistent with the Model Law's values and principle of comity.*

**Question 3.3 [4 marks]**

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

*Directors of Delaware corporations owe limited duties (in comparison to many other jurisdictions). Chief amongst their duties owed during the ordinary course of business are a **fiduciary duty of loyalty** to the corporation's best interest (which requires the directors to put the interests of the company and its shareholders before any of the directors' personal interests) and a **duty of care** in educated decision-making (which requires the directors to make informed, deliberative decisions on the basis of all material information that is reasonably available to them).*

*When a corporation is potentially insolvent, its directors owe their duties to the corporation and its shareholders (but not to creditors) - notwithstanding that the shareholders may not receive any distribution from the debtor's estate if it does become bankrupt. In fact, in relevant case law the Delaware Supreme Court has clarified that no duties are owed to creditors by directors even where the debtor is actually insolvent (and remain owing to the debtor and its shareholders).*

*Directors are protected from incurring personal liability for their errors of judgment by the so-called 'business judgment rule', pursuant to which the board of directors is presumed to have acted, when taking decisions, in good faith on the basis of reasonable information. It is possible for that presumption to be rebutted by demonstrating that a majority of the board were not reasonably informed, did not honestly believe that the decision(s) they took was/were in the best interests of the debtor, and/or were not acting in good faith.*

*Failing a rebuttal of the presumption above, directors will not incur personal liability except in cases where they have been grossly negligent. It is also possible for a debtor's certificate of incorporation to preclude directors from incurring liability for a breach of the duty of care, albeit that is not possible for breaches of the fiduciary duty of loyalty.*

*In circumstances where a transaction is approved either by a board majority that is not disinterested and independent or where a controlling shareholder is on both sides of the relevant transaction, the business judgment rule is not applicable. In those cases, the relevant transaction will be deemed void unless it can be demonstrated that the*

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challenged act/transaction was entirely fair to the relevant debtor and shareholders (known as the 'entire fairness standard').

**Question 3.4** [5 marks]

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

*In order for a creditor's claim to support a creditor qualifying as a petitioning creditor, the claim must meet the following criteria:*

- *the claim must be unsecured or undersecured, whether separately or together with other claims, in an amount of at least USD 16,750 (subject to that figure being increased periodically);*
- *the claim must be non-contingent; it must not depend on the occurrence of an event that will or may happen in the future (for instance, a guarantee is typically a contingent claim because it is a secondary liability parasitic upon the occurrence of a default pursuant to the guarantee obligation). As an exception, if a debt has not matured (because the payment is due at a time in the future) but all other requirements as to the debtor's liability have been satisfied, then the need to await the passage of time will not cause a claim to be regarded as contingent;*
- *the claim must not be the subject of a bona fide dispute as to the liability itself or as to the quantum of the liability:*
  - *if, in relation to the liability itself, there is an objectively reasonable basis for a dispute (either as a matter of fact or a matter of law) then the claim will not support the creditor being a petitioning creditor. It is not sufficient for the debtor to have a subject belief that the debt is not owed, nor for the amount claimed to be incorrect; and*
  - *if, in relation to the quantum of the liability, the creditor's claim is disputed (whether in whole or in part) then that disputed amount of the claim cannot be applied in order to meet the criterion in the first bullet point above.*

*A petitioning creditor must also allege, in the involuntary petition form, that (i) the debtor is, generally speaking, not paying its debts as they fall due (unless those debts are the subject of a bona fide dispute as to liability or quantum, as outlined above) or (ii) within 120 days before the petition is filed, a custodian was appointed or took possession in relation to the debtor (other than a trustee, receiver, or an agent appointed to take control of less than substantially all of the debtor's property) for the purpose of enforcing a lien against such property).*

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

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Question 4.1 [5 marks]

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

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

*Upon the filing of a plenary petition (such as a Chapter 11 petition), there is an immediate and automatic stay on all actions as against the debtor (subject to certain exceptions).*

*The automatic stay is broad: it is applicable worldwide and applies to any interference with the property in the debtor's estate, subject to certain exceptions (for policy reasons and to protect the interests of creditors and other stakeholders).*

*In relation to (i) the DOJ investigation: the automatic stay would not apply because regulatory investigations are a statutory exception to the automatic stay.*

*In relation to (ii) the margin loan default: the automatic stay would not apply because the exercise of any rights under commodity, forward, security, and financial repo contracts is a statutory exception to the automatic stay.*

*In relation to (iii) the delinquent lease: assuming that the lease has not expired (which we may gather from rental payments being owing), the automatic stay would apply.*

*In relation to (iv) the employment discrimination lawsuit: if US employment discrimination lawsuits are criminal proceedings then the automatic stay would not apply, because those are a statutory exception to the automatic stay. If they are not criminal proceedings, the automatic stay would apply.*

Question 4.2 [5 marks]

*Stella SA (Stella) is an international cosmetics company incorporated in France, with its headquarters in Paris. Stella's products are made in Italy and shipped to its retail stores in Europe (including England), Asia, and North America. Stella's funding comes from a bank loan and Eurobonds, both of which are governed by English law. Stella's retail sales have suffered due to pandemic-related closures and it is considering*

Commented [H(63)]: Total marks 5/5

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

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

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

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

Commented [H(68)]: Correct, 1 mark, these are private, civil suits

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

**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?**

*Upon an application to a US bankruptcy court pursuant to Chapter 15 of the US Bankruptcy Code, by a foreign representative of Stella, for recognition of foreign proceedings, the US bankruptcy court may consider granting a recognition order.*

*There are limited requirements for recognition to be granted. The relevant foreign representative of Stella's scheme of arrangement would need to establish, to the satisfaction of the US bankruptcy court, that the scheme of arrangement was in progress and that the foreign representative was empowered to act in relation to the scheme of arrangement.*

*An English law scheme of arrangement is a proceeding capable of being recognized pursuant to Chapter 15, as a collective judicial proceeding in a foreign country - subject to it not being manifestly contrary to US public policy (which is an exception with a narrow scope).*

*Foreign proceedings are granted recognition either as foreign main proceedings or foreign non-main proceedings. The determinative factor is the jurisdiction of the debtor's COMI, which is presumed to be in the debtor's jurisdiction of incorporation (albeit that presumption is rebuttable).*

*Accordingly, Stella's COMI would be presumed to be in France. Other relevant factors for determining Stella's COMI are the location of its headquarters (France), management, primary assets (various jurisdictions including France), and creditors (various jurisdictions), as well as the jurisdiction whose law will apply to most disputes (various jurisdictions including England, in relation to the bank loan and Eurobonds).*

*In the absence of any more decisive factors, that fact pattern is unlikely to be sufficient to consider that Stella's COMI is in England (rather, it would likely remain in France). As a result, the English law scheme of arrangement would be recognised (if at all) as foreign non-main proceedings.*

*As a consequence, the US bankruptcy court would order discretionary relief applicable to foreign non-main proceedings.*

**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**

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

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

Commented [H(72)]: Correct, 1 mark, as England is not the COMI, foreign main recognition is not available and the retail store in England constitutes the necessary establishment for foreign non-main recognition.

Commented [H(73)]: Total marks 3/5



**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?**

**Yes, because there are material unperformed obligations in relation to both parties (continuation of the licence and payment of royalties).**

**Commented [H(74):** Correct, 1 mark

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

**No, because licensees (such as ToyCo, in this instance) of intellectual property owned by a debtor (GameMart, in this instance) are protected in such a way that their licenses may not be terminated pursuant to the sale of the intellectual property unless the licensee consents.**

**Commented [H(75):** Correct, 1 mark, but this is the incorrect reason--this question is about assignment of the license, not termination.

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

**Yes, provided that GameMart is able to establish that the transfer is being proposed in its business judgment and that the transaction is in the best interests of the estate as a whole. This assumes that GameMart's transfer of the lease is not part of its ordinary course of business. The transfer may be subject to regulatory scrutiny.**

**Commented [H(76):** Correct, 1 mark. the landlord consent requirement is inapplicable in bankruptcy court

\* End of Assessment \*