



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 47.5/50

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

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

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

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

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

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.

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

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.

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

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.

Commented [H(12)]: Correct, 1 mark

QUESTION 2 (direct questions) [10 marks]

Commented [H(13)]: Total marks 10/10

Question 2.1 (1 mark)

Commented [H(14)]: Total marks 1/1

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

Setoff permits a creditor, who simultaneously holds a claim against a debtor and owes money to the debtor to net out the obligations against one another. Setoff is not permitted in a number of circumstances because it can improve the position of a creditor as compared to other unsecured creditors who are not owed money by the debtor. This is because setoff decreases the obligation the creditor owes to the estate by the full amount owed by the debtor, rather than the lesser amount the debtor would pay on the unsecured claim.

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

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

Question 2.2 [2 marks]

Commented [H(17)]: Total marks 2/2

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 considered:

- *the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), which govern procedure in bankruptcy proceedings;*
- *the Federal Rules of Civil Procedure, including in relation to litigation of disputed issues in contested or adverse proceedings, incorporated by reference into the Bankruptcy Rules;*
- *the circuit within which the proceeding is being heard, and the specific federal law that arises in that circuit;*
- *the local rules of procedure of each bankruptcy court; and*
- *the personal practices issued by each judge, sometimes referred to as Chambers Procedures.*

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

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

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

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

Question 2.3 [2 marks]

Commented [H(22)]: Total marks 2/2

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

The absolute priority rule requires the claims of a class of creditors to be paid in full prior to the satisfaction of any claim of any creditors in a subordinated or junior class. In chapter 7 proceedings, this rule cannot be deviated from. This means that no creditor or a class of creditors may receive less under a reorganisation plan than it would in a chapter 7 liquidation, within which the claims of such creditors would be paid in accordance with statutory priorities. In chapter 11 proceedings, deviation from the rule of absolute priority is permitted with the consent of affected creditors. For example, senior creditors may consent to receiving less than would be received in accordance with the absolute priority rule in order to secure approval of a chapter 11

Commented [H(23)]: Correct, 1 mark

Commented [H(24)]: Correct, 1/2 mark

Commented [H(25)]: Correct, 1/2 mark

plan from junior creditors (who would otherwise receive less under the absolute priority rule).

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?

Debtor in possession financing (“DIP Financing”) is permitted under the Bankruptcy Code in order to provide incentives to lenders to extend credit to the debtor. DIP Financing can be obtained in various ways but is usually dependent upon whether the debtor’s estate has any unencumbered assets or encumbered assets with sufficient equity value to support a junior lien of debt.

A priming lien is a form of DIP Financing, typically available where this is not possible to obtain alternative forms of DIP Financing. A court may grant a ‘priming lien’ that is senior or equal to a pre-petition lien on the debtor’s estate. In order to obtain the post-petition financing, the debtor is required to demonstrate that the interests of the secured creditor being primed are adequately protected. The risk of being primed often incentivised existing creditors to extend further credit to the debtor. It also provides junior creditors with an opportunity to ‘roll-up’ their position by refinancing previous unsecured debtor into a new priming lien. Before granting approval to a ‘roll-up’ the court will assess whether any other source of funds that does not contain a ‘roll-up’ provision exist and whether substantial credit is being made available to the debtor to justify the ‘roll-up’.

Question 2.5 [3 marks]

What is a preference? What are the elements of a preference claim that need to be proved? Is a showing of fault, by either the debtor or creditor, required?

The elements of a preference claim are as follows:

- a) a transfer of an interest of the debtor in property;
- b) to or for the benefit of a creditor (the “recipient creditor”);
- c) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- d) made when the debtor is insolvent; and
- e) made during the suspect period;
- f) that enables the creditor to receive more than it would have in a chapter 7 liquidation.

There is a rebuttable presumption that the debtor is insolvent on and 90 days prior to the petition date. The suspect period is 90 days prior to the petition date for third parties and one year prior to the petition date for insiders. Insiders include any officer, director, controlling person, general partner, partnership affiliates and insiders of

Commented [H(26)]: Total marks 2/2

Commented [H(27)]: Correct, 1/2 mark

Commented [H(28)]: Correct, 1 mark

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

Commented [H(30)]: Total marks 3/3

Commented [H(31)]: Correct, 1/2 mark

Commented [H(32)]: Correct, 1/2 mark

Commented [H(33)]: Correct, 1/2 mark

Commented [H(34)]: Correct, 1/2 mark

Commented [H(35)]: Correct, 1/2 mark

affiliates of the debtor. From the period between 91 days to one year prior to the petition date there is no presumption of insolvency.

The transfer is only an avoidable preference if it results in the recipient creditor receiving more value than it would otherwise receive in a chapter 7 liquidation had the transfer not occurred.

Once the transfer is 'restored' (i.e. returned to the debtor's estate), the recipient creditor holds an unsecured claim equal to the value returned to the debtor's estate.

There is no need to show any fault of either party and the recipient creditor is not penalised. The purpose of preference avoidance is to equalise treatment among creditors in the same class and disincentive value destruction of a distressed debtor, for example where creditors asset strip a debtor's estate.

Commented [H(36)]: Correct, 1/2 mark

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

Commented [H(37)]: Total marks 14.5/15

Question 3.1 [3 marks]

Commented [H(38)]: Total marks 2.5/3

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 federal court system, established under Article III of the US Constitution, consists of trial-level district courts, regional courts of appeal known as 'circuits' and the US Supreme Court. The bankruptcy courts were not part of the original federal court system but established by federal legislation, specifically the 1978 Bankruptcy Code. As a result, bankruptcy judges are appointed by courts of appeal (rather than the president); do not have lifetime tenure; and have limited jurisdiction to enter final orders on non-core bankruptcy issues.

A final order is a final judgement that resolves all issues in dispute. The 1978 Bankruptcy Code distinguishes between 'core' and 'non-core' proceedings. Parties must distinguish in their pleadings whether the matter at issue is 'core' or 'non-core' in order for the bankruptcy court to determine the scope of its jurisdiction and the power to render a final order. A non-exhaustive list of 'core' proceedings includes, for example, (i) matters concerning the administration of the estate; (ii) orders to turn over property to the state; (iii) proceedings to determine, avoid, or recover preferences; and (iv) counterclaims by the estate against persons filing claims against the estate. A bankruptcy court may hear non-core proceedings if they are sufficiently related to a bankruptcy proceeding. It is permitted to make a final order over non-core proceedings (subject to *Stern v Marshall*) but may only issue proposed findings of fact and conclusions of law for non-core proceedings.

In 2011, the US Supreme Court held in *Stern v Marshall* that the bankruptcy court's issuance of a final order over a state law claim was unconstitutional under Article III. However, a bankruptcy court may exercise a district court's delegated authority to enter a final order on a motion challenging the validity of a petition because of a

district court's exclusive jurisdiction to adjudicate a petition commencing bankruptcy proceedings. In *Executive Benefits Ins Agency v Arkison*, the US Supreme Court held that bankruptcy judges may determine core proceedings over which they lack constitutional authority by issuing a report and recommendation for review by the district court (i.e. the same procedure as in non-core proceedings) or may issue final orders with the consent of the parties. As a result, the Bankruptcy Rules now require parties to state in pleadings whether the consent to the entry of final orders or judgment by the bankruptcy court. If parties do not comply with this requirement, the court may deem the party to have consented to its exercise of jurisdiction.

Commented [H(39)]: Correct, 1/2 mark

Commented [H(40)]: Correct, 1 mark

Commented [H(41)]: The bankruptcy court may enter a final order with the consent of the parties.

Appeals from bankruptcy court decisions are generally heard by the district court for the district in which the bankruptcy court sits. However, the First, Sixth, Ninth and Tenth Circuits have elected to establish Bankruptcy Appellate Panels, although parties may request that the appeal be heard by a district court instead. Following the district court or Bankruptcy Appellate Panel, there is a second appeal right to the circuit's court of appeal. Where an appeal raises a question of law as to the which there is no controlling decision of the circuit of the US Supreme Court; required resolving conflicting controlling decisions; or an immediate appeal may materially advance the progress of a case, an appeal from the bankruptcy court may be directed to the court of appeals.

Commented [H(42)]: Correct, 1/2 mark

Commented [H(43)]: Correct, 1/2 mark

Where the bankruptcy court did not have authority to enter a final order, the district court of Bankruptcy Appellate Panel reviews each findings of fact and conclusions of law which a party has objected to. In reviewing an order of a district court or Bankruptcy Appellate Panel, the court of appeal reviews conclusions of law and abuse of discretion for findings of fact.

Question 3.2 [3 marks]

Commented [H(44)]: Total marks 3/3

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, pursuant to section 1520 of Bankruptcy Code, the following relief may be granted with respect to the debtor and the debtor's property within the territorial jurisdiction of the US:

- an automatic stay against creditor action;
- operation of the debtor's business in the ordinary course by the foreign representative;
- sale, transfer or use of property outside the ordinary course; and
- avoidance of post-petition transfers and post-petition perfection of security interests.

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

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

Commented [H(47)]: Correct, 1/2 mark

Commented [H(48)]: Correct, 1/2 mark

The relief in (a) to (d) above may be granted on a discretionary basis following recognition of a foreign non-main proceeding.

In addition to the relief in (a) to (d) above, the following additional relief may be granted on a discretionary basis pursuant to section 1521 of the Bankruptcy Code:

- a) *the authorisation of discovery regarding the debtor's assets and affairs;*
- b) *entrusting the administration of the debtor's US assets to the foreign representative or other person;*
- c) *the extension of provisional relief; and*
- d) *any other relief "necessary to effectuate the purposes of chapter 15 and to protect the assets of the debtor or the interests of creditors".*

Commented [H(49)]: Correct, 1/2 mark

Commented [H(50)]: Correct, 1/2 mark

Pursuant to section 1521 (c) of the Bankruptcy Code, in determining whether to grant discretionary relief in a foreign non-main proceeding, the bankruptcy court must be satisfied that that it is appropriate under US law for the assets in question to be administered in the foreign non-main proceeding.

Further, pursuant to section 1522 (c) of the Bankruptcy Code a bankruptcy court may modify or terminate the discretionary relief granted pursuant to Pursuant to section 1521, provided the interests of the creditors and other interest entities, including the debtor, are sufficiently protected. A bankruptcy court also have the discretion, pursuant to section 1522 (b) of the Bankruptcy Code, to subject discretionary relief to conditions it considers appropriate, including for example, requiring security to be given or a bond to be filed.

Pursuant to section 1507 (b) of the Bankruptcy Code, subject to certain limitations, a bankruptcy court may provide other assistance pursuant to either the Bankruptcy Code or other statute in accordance with the principles of comity and the values of the Bankruptcy Code.

Question 3.3 [4 marks]

Commented [H(51)]: Total marks 4/4

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

Directors of a Delaware corporation owe a fiduciary duty of loyalty to the corporation's best interests; and a duty of care in educated decision-making. These duties are owed to the corporation and its shareholders at all times (including in circumstances where the corporation is potentially insolvency).

Commented [H(52)]: Correct, 1 mark

Commented [H(53)]: Correct, 1 mark

Commented [H(54)]: Correct, 1 mark

*In contrast to other jurisdictions, the Delaware Supreme Court has confirmed that no duty is owed to the corporation's creditors at any time, including where a corporation may be operating 'in the zone of insolvency' (*North Am Catholic Educational Programming Foundation, Inc v Gheewalla*). As a result, individual creditors of an insolvent corporation have no direct claim for breach of fiduciary duty against corporate directors. Therefore, there is no concept of wrongful trading or deepening insolvency under US law.*

Absent of gross negligence, the business judgment rule protects directors from liability for errors of judgment. Under the business judgment rule, there is a rebuttable presumption that directors acted in good faith on the basis of reasonable information.

The presumption is rebuttable by proving:

- a) a majority of the board were not reasonably informed;
- b) a majority of the board did not reasonably believe that their decision was in the corporation's best interest; or
- c) a majority of the board were not acting in good faith.

The rule does not apply where:

- a) a majority of the board is not independent;
- b) a majority of the board is not disinterested (i.e. have an interest in the transaction); or
- c) where a controlling shareholder is present on both sides of the transaction.

If any of the circumstances in (a) to (c) above are present, the transaction will be void unless the entire fairness standard is satisfied. This onerous standard shifts the burden of proof to the directors to demonstrate that the transaction was entirely fair to the corporation and shareholders (including the price and structure of the transaction).

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 to qualify as a petitioning creditor in an involuntary proceeding, the creditor must have a claim against the debtor that fulfils the following requirements:

- a) non-contingent;
- b) not the subject of bona fide dispute as to liability or amount;
- c) unsecured or under secured, separately or in aggregate with all other petitioning creditors' claims, in an amount of at least USD 16,750; and
- d) the creditor is generally not paying its debts as they become due or, that within 120 days of the petition date, a custodian (other than a trustee, receiver, or an agent appointed or authorised to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property) was appointed or took possession.

A non-contingent claim is a claim that is not dependent upon the occurrence of a future event. For example, a debt that is due and owing is typically non-contingent. However, a guarantee is a contingent claim as is required the guaranteed obligation to be in default; and for the guarantee to be called upon.

A bona fide dispute exists if there is an objectively reasonable basis for a dispute as a matter of fact or law. The debtor's mere objection that the debt is not owed or the

Commented [H(55)]: Correct, 1 mark

Commented [H(56)]: Total marks 5/5

Commented [H(57)]: Correct, 1 mark

Commented [H(58)]: Correct, 1 mark

Commented [H(59)]: Correct, 1 mark

Commented [H(60)]: Correct, 1/2 mark

Commented [H(61)]: Correct, 1/2 mark

Commented [H(62)]: Correct, 1/2 mark

Commented [H(63)]: Correct, 1/2 mark

amount claimed by the creditor is incorrect is insufficient to claim a bona fide dispute exists.

A bona fide disputed claim is carved out of the required threshold in its entirety. For example, where a portion of the disputed amount claimed is undisputed, a creditor cannot use the undisputed portion to reach the requisite threshold. However, if the creditor has multiple claims against the debtor, a dispute in respect to one claim does not disqualify undisputed claims held by the same creditor from meeting the petitioning creditor requirements.

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

Commented [H(64): Total marks 13/15]

Question 4.1 [5 marks]

Commented [H(65): Total marks 3/5]

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

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

A chapter 11 petition filed by Speculation Inc (the "debtor") would be a voluntary proceeding. The date that the petition was filed is the "petition date". In chapter 11 proceedings, the debtor may remain 'in possession' and continue to operate in the ordinary course of business, reorganise or liquidate. On and from the petition date, the debtor also enjoys certain debtor-friendly aspects.

- i. It is presumed that the DOJ's investigation commenced prior to the petition date. From the petition date, a worldwide automatic stay of any proceeding against the debtor or its property is imposed in order to provide the debtor with a breathing space within which to propose a reorganisation plan. However, the automatic stay is subject to certain statutory exceptions, including regulatory investigations. Therefore the DOJ's investigation into insider trading would be entitled to continue.**
- ii. The margin is a pre-petition date claim and the broker is a secured creditor, as the margin loan is secured via the shares the broker purchases. The automatic stay discussed above protects the property of the debtor's estate from creditor enforcement actions with respect to pre-petition date claims. Any act to obtain possession or control of the property of the debtor's estate is expressly**

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

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

Commented [H(68): The margin loan is a securities contract that is exempt from the automatic stay, so the broker could liquidate the collateral.

prohibited. Any legal transfer of ownership of the shares from the debtor to the broker would be void. Further, any attempt to collection on the pre-petition claim by the debtor, for example the issue of demand notice or acceleration notice, would constitute contempt of court.

- iii. The debtor is in rent arrears. The landlord to the lease is an unsecured creditor. If the lease has expired, the landlord would be entitled to evict the debtor from the non-residential property under the statutory exception to the automatic stay. Otherwise, the landlord will be prevented from taking any action to collection the rent arrears, which constitutes a pre-petition date claim.
- iv. The employee's claim against the debtor would be unsecured. Capped amounts (per employee) of claims for wages and benefits due within 180 days before the earlier of the debtor's cessation of business or petition date rank the debtor's administrative expenses and expenses incurred in the ordinary course of business. The employees claim as unsecured would also rank behind the claims of secured creditors.

Commented [H(69)]: Correct, 1 mark

Commented [H(70)]: The pre-petition employment litigation would be stayed.

Question 4.2 [5 marks]

Commented [H(71)]: Total marks 5/5

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

The requirements of recognition are minimal. Pursuant to section 101(23) of the Bankruptcy Code, Stella's foreign representative must establish that a foreign court or administrative proceeding with respect to the debtor is pending and that the foreign representative is empowered to act by the proceeding.

Pursuant to section 1010(23) of the Bankruptcy Code, a foreign proceeding is defined 'as a collective judicial or administrative proceeding in a foreign country... under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation.' An English scheme of arrangement has been, and a US bankruptcy court in respect of Stella's English scheme of arrangement relating to the Eurobonds would be, granted recognition under chapter 15 pursuant to this definition. A bankruptcy court may refuse to grant recognition where such recognition would be manifestly contrary to US public policy. However, this exception is very narrow and more likely applicable to specific assistance granted rather than the mere act of recognition.

The characterisation of a foreign proceeding as either a foreign main proceeding or a foreign non-main proceeding has an impact on the scope of relief available to Stella following recognition under chapter 15.

A foreign main proceeding is a foreign proceeding commenced in a debtor's centre of main interest (COMI). There is a rebuttable presumption that a debtor's COMI is its place of incorporation. Other factors to consider when determining a debtor's COMI include the location of the debtor's headquarters; the location of management; the location of primary assets; the 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; and the jurisdiction whose law will apply to most disputes. Pursuant to the presumption under section 1516(c) of the Bankruptcy Code, Stella's COMI would be France, being its place of incorporation with its headquarters also in Paris. On this basis, the English scheme of arrangement would unlikely be classed as a foreign main proceeding.

Commented [H(72)]: Correct, 1 mark

Commented [H(73)]: Correct, 1 mark

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

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

A foreign proceeding will be a foreign non-main proceeding if a debtor has an establishment in the jurisdiction prior to the commencement of chapter 15 proceedings (i.e. the petition date). An establishment is a place where the debtor carries out non-transitory economic activity. Stella has retail stores in England, which is sufficient to objectively evidence an establishment. Therefore, it is likely the English scheme of arrangement would be classed as a foreign non-main proceeding.

Commented [H(76)]: Correct, 1 mark

Question 4.3 [5 marks]

Commented [H(77)]: Total marks 5/5

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, the license to manufacture is an executory contract. A contract is executory if there are material unperformed obligations on both sides.

Commented [H(78)]: Correct, 1 mark

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

The Bankruptcy Code abrogates contractual provisions that restrict assignment or assumption, in order to enable the debtor to achieve a higher value for its assets than if such provisions were enforced. However, a counterparty's consent is required where

substantive non-bankruptcy law provides that a counterparty cannot be compelled to accept performance from a transferee. In Trump Entertainment Resorts, Inc, the bankruptcy court held that federal trademark law "generally banks assignment of trademark licenses absent the licensor's consent." Therefore, ToyCo's consent would be required to transfer the license as part of a 363 sale.

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

Commented [H(80)]: Correct, 1 mark

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

Notwithstanding any non-assignment provision in the lease, it may be transferred as part of a 363 sale without Land Corp's consent as it is unexpired (with 7 years remaining). If GameMart was in rent arrears, any outstanding default would need to be cured.

Commented [H(81)]: Correct, 1 mark

Commented [H(82)]: Correct, 1 mark

* End of Assessment *