



SUMMATIVE (FORMAL) ASSESSMENT: MODULE 3A

THE INSOLVENCY SYSTEM OF THE UNITED STATES

***This is the*** summative (formal) assessment ***for*** Module 3A ***of this course and is compulsory for all candidates who*** selected this module as one of their compulsory modules from Module 3. ***Please read instruction 6.1 on the next page very carefully.***

***If you selected this module as*** one of your elective modules, ***please read instruction 6.2 on the next page very carefully.***

The mark awarded for this assessment will determine your final mark for Module 3A. ***In order to pass this module, you need to obtain a mark of 50% or more for this assessment.***

## INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT

Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.

1. **You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.**
2. **All assessments must be submitted electronically in MS Word format, using a standard A4 size page and a 11-point Arial font. This document has been set up with these parameters - please do not change the document settings in any way. DO NOT submit your assessment in PDF format as it will be returned to you unmarked.**
3. **No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).**
4. **You must save this document using the following format: [studentID.assessment3A]. An example would be something along the following lines: 202223-336.assessment3A. Please also include the filename as a footer to each page of the assessment (this has been pre-populated for you, merely replace the words "student number" with the student number allocated to you). Do not include your name or any other identifying words in your file name. Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. **Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
- 6.1 **If you selected Module 3A as one of your compulsory modules (see the e-mail that was sent to you when your place on the course was confirmed), the final time and date for the submission of this assessment is 23:00 (11 pm) GMT on 1 March 2023. The assessment submission portal will close at 23:00 (11 pm) GMT on 1 March 2023. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.**
- 6.2 **If you selected Module 3A as one of your elective modules (see the e-mail that was sent to you when your place on the course was confirmed), you have a choice as to when you may submit this assessment. You may either submit the assessment by 23:00 (11 pm) GMT on 1 March 2023 or by 23:00 (11 pm) BST (GMT +1) on 31 July 2023. If you elect to submit by 1 March 2023, you may not**

submit the assessment again by 31 July 2023 (for example, in order to achieve a higher mark).

7. Prior to being populated with your answers, this assessment consists of 9 pages.

**ANSWER ALL THE QUESTIONS**

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**QUESTION 1** (multiple-choice questions) [10 marks in total]

Commented [H(2): Total marks 8/10

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

*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

*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

*Which of the following about cramdowns, is false?*

Commented [H(5)]: Incorrect, the correct response is (a)

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

Commented [H(7)]: Correct, 1 mark

- (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)]: Incorrect, the correct response is (c)

*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

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

*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)

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

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

*Setoff is where a creditor has a claim against a debtor whilst simultaneously owing the debtor monies and applies to have these two amounts netted off. It is not permitted in many circumstances because it could result in the creditor improving their position relative to other unsecured creditors by reducing the amount available to the latter.*

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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 Bankruptcy Rules, the Federal Rules of Civil Procedure, the local rules of the bankruptcy court and the judge's personal practices. One must also understand the unwritten local practices.*

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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?**

*It requires that no creditor or class of creditors may receive less under a plan of reorganization that it would under a Chapter 7 liquidation, in which the claims would be paid in accordance with statutorily required priorities, without consent of the affected creditor. This can be deviated from in a Chapter 11 plan where a more senior creditor may consent to receive less than the absolute priority rule would require if distribution of the funds to lower priority claims is necessary to obtain approval of the plan.*

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

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

**Question 2.4** [2 marks]

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**What is a "priming lien" and what requirements must be met for such a lien to be granted to secure DIP financing?**

*A priming lien is where the court grants a lien on an estate that is senior to or equal to a pre-petition lien on an estate property to secure post-petition financing. It is granted when financing cannot be obtained any other way. The debtor must demonstrate that the interest of the secured creditor being primed is adequately protected.*

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

**Question 2.5** [3 marks]

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

A preference is a transfer of the debtor's property made in a suspect period before the petition date that must be returned to the estate if the amount exceeds the amount the recipient would have received in a chapter 7 liquidation had the transfer not been made. There is no need to show fault in order to prove the preference, rather the elements are:

- 1) a transfer of an interest of the debtor of the property
- 2) to or for the benefit of a creditor
- 3) for or on account of an antecedent debt owed by the debtor before such transfer was made.
- 4) made while the debtor was insolvent
- 5) made during the suspect period
- 6) that enables the creditor to receive more than it would in a 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?**

An order that is constitutionally final because the bankruptcy court had authority to enter it is not final for purposes of appeal if it does not resolve the entire issue in dispute. Conversely, an order that resolves an entire dispute and therefore would be final for purposes of appeal may not be final in the constitutional sense if the parties have not consented to the bankruptcy court's jurisdiction.

In general appeals from bankruptcy court decisions are heard by the district court for the district in which they sit. In certain circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Panel (BAP), convened from the judges of the bankruptcy courts within the circuit. From the district court or BAP, there is a further appeal of right to the circuit court of appeals.

If the ruling below was in a core proceeding over which the bankruptcy court had authority to enter a final order, the district court or BAP reviews conclusions of law de novo and reviews findings of fact for abuse of discretion, recognizing that the bankruptcy court had greater opportunity to weight the evidence. If the ruling was in a non-core proceeding or the bankruptcy court otherwise did not have the authority to enter a final order, the district court or BAP reviews de novo all findings of fact and conclusions of law to which a party has objected. The order of a district court or BAP is reviewed by a circuit court of appeal de novo as to conclusions of law and abuse of discretion for findings of fact.

**Question 3.2** [3 marks]

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Commented [H(38)]: Correct, 1/2 mark, also the bankruptcy court may enter final judgment on core matters created by the Bankruptcy Code, such as a challenge to a petition.

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

Commented [H(40)]: Correct, 1/2 mark

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**What provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the United States upon recognition of a foreign main proceeding? What relief may be granted on a discretionary basis for either foreign main or non-main proceedings?**

Upon recognition of a foreign main proceeding the following provisions apply:

- Automatic stay;
- Operation of the debtor's business in the ordinary course by the foreign representative;
- Sale, transfer or use of property outside the ordinary course;
- Avoidance of post-petition transfers and post-petition perfection of security interests.

Upon recognition of either a foreign main or non-main proceeding, the following may be granted on a discretionary basis:

- Authorization of discovery regarding the debtor's assets and affairs;
- Entrusting administration of the debtor's US assets to the foreign representative or other person;
- Extension of provisional relief;
- Any other relief "necessary to effectuate the purposes of [chapter 15] and to protect the assets of the debtor or the interests of the creditor".

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 owe a fiduciary duty of loyalty to the corporation's best interest and a duty of care in educated decision-making, but are protected from liability for errors of judgement by the business judgement rule. Director's duties are owed to the corporation and its shareholders, not to the creditors, even in circumstances where the corporation is potentially insolvent and therefore the shareholders stand to receive nothing in bankruptcy.

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.**

To qualify as a petitioning creditor, the creditor must have a claim against the debtor that is:

1. Non-contingent
- A contingent claim is one that depends on the occurrence of a future event.

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Commented [H(44)]: Correct, 1/2 mark

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

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

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Commented [H(56)]: Correct, 1/2 mark

- A debt that is unmatured (because the payment is due in the future) is not contingent if all requirements for liability, other than the passage of time has occurred.
- 2. **Not the subject of a bona fide dispute as to liability or amount**
- 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 subjective belief that the debt is not owed or the amount claimed is incorrect is not sufficient.
- If a portion of the amount claimed is disputed, the creditor cannot use the undisputed portion to reach the monetary threshold required in the next bullet, but a dispute as to one claim does not disqualify application of other, undisputed claims held by the same creditor to meet petitioning creditor requirements.
- 3. **Unsecured or undersecured, separately or in the aggregate with all other petitioning creditor's claims, in the amount of at least USD16,750.**

The creditor must allege that the debtor is either not generally paying on time or that within 120 days before filing a petition, a custodian or was appointed or took possession.

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

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

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

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

Commented [H(62)]: Total marks 9.5/15

Question 4.1 [5 marks]

Commented [H(63)]: Total marks 3.5/5

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

- Effects on DOJ investigation: The Chapter 11 automatic stay is unfortunately exempt from regulatory investigations - hence the DOJ investigation would proceed not be impacted. Should the investigation proceed to criminal proceedings these too would continued and not be impacted by the stay.**
- The exercise of rights under a financial repo contract would not be impacted by the Chapter 11 stay and the broker could continue to exercise its contractual rights such as sell its underlying security of the margin loan contract.**
- The lease agreement would be impacted by the Chapter 11 stay and would further be considered an executory contract in which the debtor could**

Commented [H(64)]: The filing of the petition would bring this into effect.

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Commented [H(67)]: Correct, 1/2 mark, the landlord will not be able to evict or commence proceedings for back rent

determine whether to 1) reject 2) assume or 3) assume and assign the contract. In this instance since the debtor still occupies the leased-space the debtor may be deemed to have assumed the lease based on its conduct.

- iv) **The debtor would be protected by the stay from any pre-petition litigation that impacts its property or results in such a claim.**

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**Question 4.2 [5 marks]**

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

*Yes the English scheme of arrangement can be recognized by a US bankruptcy court under Chapter 15. The 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. However a point of contention that may arise is the characterization of proceedings as either foreign main or foreign non-main, as this determines the scope of relief available to the debtor following recognition. Foreign main proceedings are those that are commenced in the debtor's center of main interests. COMI is a foreign concept to US law, the latter uses the concepts of domicile, principal place of business and location of assets in determining jurisdiction and venue. A debtor's COMI is presumed to be in its place of incorporation, but this is rebuttable. My view is that the proceedings could be considered foreign main proceedings if the UK formed the location of the majority of the debtor's creditors being the bank loans and Eurobonds as well as the law (UK) whose jurisdiction would apply to most disputes.*

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

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

Commented [H(72)]: Incorrect, note that there are likely to be trade creditors in the various jurisdictions in which Stella operates and therefore the presumption of France as COMI is unlikely to be rebutted. Recognition as foreign non-main proceeding is appropriate because the retail store in England satisfies the establishment requirement.

**Question 4.3 [5 marks]**

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**ToyCo is an American toy company that has created a popular line of folding robot toys called Xblox. The toys are covered by several US patents. Currently, GameMart Inc (GameMart) has a 10-year exclusive license to manufacture Xblox and pays ToyCo monthly royalties. GameMart operates a factory in California that it leases from Land Corp on a longer term lease with seven years to go; the lease prohibits assignment without Land Corp's consent. The Xblox toys are selling well, but GameMart's other toy lines are doing poorly, so it is considering a Chapter 11 bankruptcy. Answer the following questions:**

(i) **Is the license to manufacture Xbox an executory contract?**

*It is an executory contract as there will be material unperformed obligations by GameMart to produce toys and pay the royalties for whatever remaining period is left under the 10-year license agreement.*

**Commented [H(74):** Correct, 1 mark, ToyCo also is required to maintain exclusivity of the license.

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

*GameMart cannot transfer the license without ToyCo's consent. Although Bankruptcy law abrogates contractual restrictions on assignment to enable a debtor to achieve a higher value for its assets, intellectual property licensing law is considered substantive non-bankruptcy law that provides that the counterparty cannot be compelled to accept performance from a transferee. Because the prohibition is phrased as either prohibiting either assumption or assignment some courts have concluded that a debtor may not assume an executory contract that it would not be permitted to assign.*

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

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

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

*GameMart can transfer the lease without Land Corp's consent notwithstanding the landlord approval provision. However a 363 sale is not possible since GameMart does not own the property.*

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

**Commented [H(78):** Incorrect, the sale would consist of the rights GameMart has to transfer--363 sales are not limited to real estate and may be of contract rights.

\* End of Assessment \*