



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

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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

Commented [H(8)]: Correct, 1 mark

Which of the following about 363 sales is false?

- (a) *A good faith purchaser at a 363 sale may retain the property notwithstanding a subsequent reversal of court approval for the sale on appeal.*
- (b) *The debtor in possession must establish that the transaction is in the best interests of the estate as a whole.*
- (c) ***In chapter 15 proceedings, a foreign court's approval alone suffices for a 363 sale.***
- (d) *Debtors must carry out a robust marketing process for the sale.*
- (e) *A creditor's lien on assets sold in a 363 sale attaches to the proceeds of the sale.*

Question 1.7

Commented [H(9)]: Correct, 1 mark

Which of the following is true of both an actual fraudulent conveyance and a constructive fraudulent conveyance?

- (a) *The debtor must have had an actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted.*
- (b) *Both require at least circumstantial evidence of the fraudulent intent.*
- (c) *The debtor must have been insolvent at the time of transaction.*
- (d) ***In addition to provisions in the Bankruptcy Code, the debtor or the trustee may invoke applicable state or foreign fraudulent conveyance laws.***
- (e) *All of the above are true.*

Question 1.8

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

When does an automatic stay come into effect?

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

Question 1.9

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

Which of the following regarding substantive consolidation is true?

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

Question 1.10

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

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

QUESTION 2 (direct questions) [10 marks]

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Question 2.1 (1 mark)

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

Setoff involves the 'netting' of mutual debts between the creditor and the debtor. It "permits a creditor holding a claim against a debtor and simultaneously owing money to the debtor to net out the two... obligations" (Guidance Text at para 5.7.4).

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It is not permitted in many circumstances (see § 553) as it can improve the position of the creditor seeking to rely on the set-off relative to other unsecured creditors. This, for instance, may arise when a creditor is able to set-off a larger amount than he would receive when the debtor's assets are distributed amongst creditors of his level of priority, decreasing the obligation to the estate by the full amount owed by the debtor.

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Question 2.2 [2 marks]

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

- The Federal Rules of Bankruptcy Procedure
- The Federal Rules of Civil Procedure
- The local rules of the bankruptcy court
- The judge's personal practices

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Question 2.3 [2 marks]

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

The absolute priority rule provides that "payment in full must be made to each category before the next category receives anything" (Guidance Text at p 48). It may be deviated from in Chapter 11 reorganisations (for instance, in Subchapter V proceedings) where consent of affected creditors is obtained.

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Question 2.4 [2 marks]

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

A priming lien refers to "[a] lien on property senior to, or with the same priority as, existing liens on the same property" (DIP Financing: Overview by Practical Law Bankruptcy & Restructuring and Practical Law Finance (Thomson Reuters))

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A priming lien is fairly 'onerous' on other creditors and, as such, appears to be granted only as a last resort by the courts where the debtor is unable to obtain financing on other terms such as:

- Unsecured debt/credit in the ordinary course of business;
- Unsecured debt/credit outside the ordinary course of business with court approval; and
- Court of authorisation of (i) unsecured debt having priority ahead of all administrative expenses; (ii) secured debt with a lien on unencumbered estate property; and/or (iii) secured debt with a junior lien on encumbered estate property.

The debtor must demonstrate that the interest of the secured creditor being primed is adequately protected.

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?

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 it exceeds the amount the recipient would have received in a chapter 7 liquidation had the transfer not been made" (Guidance Notes p 50; 11 USC § 547). The purpose of the law is to preserve the estate and prevent a race by creditors to collect from the debtor.

The elements are as follows:

- A transfer of an interest of the debtor in property...
- To or for the benefit of the creditor...
- For or on account of an antecedent debt owed by the debtor before such transfer was made ...
- Made while the debtor was insolvent...
- Made during the suspect period (of 90 days prior to the petition date; save if the transferee is an insider to which the period is one year prior to the petition date)...
- That enables the creditor to receive more than it would have in a chapter 7 liquidation

It is not necessary for fault to be shown.

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?

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A bankruptcy court may enter a final order when the proceeding is a 'core proceeding' (28 USC § 157); though it appears from the authority of *Stern v Marshall* that even in core proceedings a bankruptcy court cannot issue final orders that invade Article III jurisdiction. The bankruptcy court may also enter into final order with the consent of parties (*Wellness International Network Ltd v Sharif*)

Commented [H(38)]: The bankruptcy court can enter a final order on a core matter that is created by the Bankruptcy Code such as a challenge to a petition.

Who reviews appeals: The district court of the district the bankruptcy court is situated in reviews the appeal.

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

In the First, Sixth, Eighth, Ninth and Tenth Circuits, Bankruptcy Appellate Panels ("BAP"), convened from judges of the bankruptcy courts within the circuit, may also review an appeal.

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How non-final orders are reviewed: Non-final orders (presumably made in noncore proceedings or where the bankruptcy court had no authority to enter a final order) are reviewed *de novo* in relation to all findings of fact and law by the BAP or district court.

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Question 3.2 [3 marks]

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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?

The provisions of the Bankruptcy Code that automatically apply are (see 11 USC § 1520):

- an 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.

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For either a foreign main or non-main proceeding, in addition to the abovementioned reliefs, the following reliefs may be granted (11 USC § 1521):

- authorization of discovery regarding the debtor's assets and affairs;
- entrusting the administration of the debtor's US assets to the foreign representative or other persons;
- extension of provisional relief; and
- any other relief necessary to effectuate the purposes of chapter 15 and to protect the assets of the debtor or the interests of creditors.

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

The abovementioned list of discretionary reliefs is not exhaustive, and the court may provide additional assistance under the Bankruptcy Code (see 11 USC § 1507;

"Additional Assistance") or other US law consistent with the principle of comity and the values underlying the Bankruptcy Code (Guidance Text at p 64).

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?

Duties owed: Directors owe a **fiduciary duty of loyalty to the corporation's best interest** and a **duty of care in educate decision-making**.

Owed to whom (when potentially or actually insolvent): These duties remain owed to the corporation and the interest of shareholders even when the corporation is potentially or acutally insolvent (*North Am Catholic Educational Programming Foundation, Inc v Gheewalla*).

Rule that protects directors from liability for errors of judgment: The **business judgment rule**, which provides that the board of directors is presumed to have acted in good faith on the basis of reasonable information. This presumption, however, may be rebutted with evidence showing that a majority of the board was not reasonably informed, did not honestly believe that their decision was in the corporation's best interest, or were not acting in good faith.

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.

Requirements:

- The claim must be non-contingent, *ie*, it must be not one that depends on the occurrence of a future event such as a guarantee which is contingent on the occurrence of default.
- The claim must not be subjected to a *bona fide* dispute as to liability/quantum. A *bona fide* dispute arises if there is an objectively reasonable basis for a dispute as a matter of fact or law.
- The claim must be unsecured or under-secured, separately or in the aggregate with all other petitioning creditors' claims, in the amount of at least USD 16,750.
- The petitioning creditor must allege either that: (i) the debtor is generally not paying its debts as they become due; or (ii) that within 120 days before filing of the petition, 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

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debtor for the purpose of enforcing a lien against such property) was appointed or took possession.

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

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Question 4.1 [5 marks]

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

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

Pursuant to 11 USC § 362, a worldwide automatic stay comes into effect upon the filing of the petition. This is the default position unless otherwise stated in the following scenarios:

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DOJ Investigation: Regulatory investigations and criminal proceedings are not barred by the stay. It is likely that the filing of the petition and the stay cannot impede the DOJ investigations.

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Margin Loan Default: The broker is a secured creditor of Speculation Inc (with the shares purchased by Speculation Inc held as collateral), and any action to collect the debts may be stayed. However, this position also greatly depends on the characterisation of the contract, as the exercise of rights under a security contract does not fall within the scope of the stay (or, more accurately, is a statutory exception to the stay).

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Delinquent Lease: The landlord may have a claim in rental arrears, but the automatic stay bars the landlord from taking action to enforce the lease and claim on the rent. The stay does not prohibit the landlord from evicting Speculation Inc from the property where the lease has expired.

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Employment discrimination lawsuit: This is likely to depend on whether the employment discrimination lawsuit may be characterised within one of the exceptions in 11 USC § 362. For instance, in *EEOC (Equal Employment Opportunity Commission) v. Tim Shepard M.D., PA d/b/a Shepherd Healthcare, 17-CV-02569 (N.D. Tex. Oct. 11,*

Commented [H(69)]: Very interesting--here, the suit is brought by a private party, not the EEOC, so it would be subject to the stay.

2018), a discrimination suit was filed prior to the filing of a petition (albeit under Chapter 7 of the Bankruptcy Code). It was successfully argued by the EEOC that the suit fell within 11 USC § 362(b)(4) (that the stay does not apply to “the commencement or continuation of an action or proceeding by a governmental unit ... to enforce such governmental unit’s ... police and regulatory power”), though this was also premised on the court’s finding that the EEOC was not seeking nor protecting a pecuniary interest in the bankruptcy estate.

The Court found that the EEOC’s primary purpose for bringing the claim was to protect public policy and welfare, and thus not subject to the stay. Whether the employment discrimination lawsuit falls within the ambit of the stay may, therefore, depend on such arguments in relation to the purpose of the suit amongst other things.

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?

On whether the English scheme of arrangement (“SOA”) may be recognised:

The SOA may be recognised so long as Stella can establish that a foreign court or administrative proceeding with respect to Stella is pending and that the foreign representative is empowered to act by the proceedings. 11 USC § 101(23) provides that such “foreign proceeding” “means a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, 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.”

These requirements are likely to be met under the SOA since the SOA is an administrative proceeding in England and under English insolvency law, where the asset of Stella (the Eurobonds) are subject to control by the English court for the purpose of reorganisation.

Foreign main or non-main

Whether an insolvency proceeding is recognised as a foreign main or non-main proceeding under Chapter 15 turns on whether the proceeding is commenced in the debtor's centre of main interests ("COMI").

Reference may be made to the "presumptions concerning recognition" in this regard, i.e. 11 USC § 1516(c) which provides that: "[i]n the absence of evidence to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the center of the debtor's main interests." In the present context, France (Stella's registered office) is presumed to be the COMI.

This presumption may be rebutted on an overall analysis of the following features:

- The location of Stella's headquarters and/or management; → This appears to be France.
- The location of Stella's primary assets; → Stella's products are made in Italy. It may therefore have significant assets there (in terms of plant and product). It does also ship globally, however, so it is not clear where its primary assets truly lie.
- The location of the majority of Stella's creditors; and
- The jurisdiction whose law will apply to most disputes (*In re Sphinx Ltd*). → This appears to be English law since it is the governing law of the debt obligations.

On the present state of the facts, there does not appear to be sufficient evidence to rebut the presumption that France is the COMI. Given that the SOA is commenced in England, this would mean it would be recognised as a foreign main proceeding. Proceedings in a jurisdiction other than the COMI can be recognised as a foreign non-main proceeding only if the debtor had an establishment in the jurisdiction prior to the commencement of Chapter 15 Proceedings (11 USC § 1502(2)). This is a requirement likely to be met given the presence of its stores in England.

Question 4.3 [5 marks]

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

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

An executory contract is defined as one where there remains outstanding and material obligations on both parties to the agreement. As such, the license to manufacture

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

Commented [H(73)]: Incorrect, because COMI is not in England, foreign main recognition is not available.

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Xbox is executory: ToyCo grants consent to GameMart to manufacture using ToyCo's patents, while GameMart pays ToyCo royalties.

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

No, it cannot (despite it being an executory contract). In a 363 sale, counterparty consent is required where non-bankruptcy law (such as intellectual property licensing law) provides that the counterparty cannot be compelled to accept performance from a transferee.

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

Yes. The lease is an executory contract (with some years remaining on the lease and, presumably, lease payments being furnished by GameMart) and may be transferred without Land Corp's consent. The Bankruptcy Code abrogates contractual restrictions on assignment to enable debtors to achieve a higher value for its assets.

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

However, this will also depend on whether the requirements in 11 USC § 365 are met.

For instance, 11 USC § 365(c) provides that:

"... (c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1)

(A)

applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B)

such party does not consent to such assumption or assignment; or

(2)

such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor; or

(3)

such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief."

*** End of Assessment ***