



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 10/10

Questions 1.1. - 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only ONE answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1

Commented [H(3): Correct, 1 mark

Which of the following entities does not satisfy the minimum presence requirement to be a debtor under any chapter of the Bankruptcy Code?

- (a) A foreign domiciled company that pays a US attorney a retainer.
- (b) A company with several US bank accounts, but no physical presence in the United States.
- (c) A company with US patents, but no physical presence in the United States.
- (d) All of the above satisfy the minimum requirement for presence in the United States.
- (e) None of the above satisfy the minimum requirement for presence in the United States.

Question 1.2

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ABC Corp is an industrial manufacturing company that is filing for bankruptcy. Which of the following could not be considered a party in interest?

- (a) A neighboring landowner to ABC Corp's manufacturing plant.
- (b) An environmental advocacy group that opposes ABC Corp's operations.
- (c) The landlord of ABC Corp's corporate office.

- (d) *People who live several miles downstream from ABC Corp's manufacturing plant and have been exposed to the plant's toxic waste.*
- (e) *The US Internal Revenue Service.*

Question 1.3

Commented [H(5)]: Correct, 1 mark

Which of the following contracts to which ABC Corp is a party is executory and may be assigned without counterparty consent?

- (a) A lease on a manufacturing plant that contains a provision that requires landlord approval of any assignment.**
- (b) *An employment contract between ABC Corp and a former employee, requiring the company to provide health insurance through the end of the current year.*
- (c) *A 10-year software licensing agreement with XYZ Corp that is three years into performance.*
- (d) *A lease on office space that ended the prior year, but for which ABC Corp still owes past rent.*
- (e) *None of the above are executory and may be assigned without counterparty consent.*

Question 1.4

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

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)

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

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

Setoff is the situation where the debt owed by the debtor to the creditor is setoff by the debt owed by the creditor to the debtor. As setoff rights may provide the position of the creditor vis-à-vis unsecured creditors, it is often not permitted in situations such as where the creditor's claim against the estate is disallowed.

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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 practice of the judge before whom the filing is made.

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

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Question 2.3 [2 marks]

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

The absolute priority rule necessitates that payment in full be made to each category of claims before the next category of claims receives anything. It can be deviated from with the consent of affected creditors in a Chapter 11 plan, but not in Chapter 7, where the statutory priorities need to be adhered to.

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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 a lien on property senior to, or with the same priority as, existing liens on the same property. The grant of a priming lien for DIP financing is only available as a last resort when the debtor is unable to obtain any other type of financing (eg, unsecured loans on an administrative priority basis or non-priming DIPs) and either the holders of existing liens consent or the debtor can demonstrate such secured creditors are adequately protected from the diminution in value of their collateral as a result of the priming lien.

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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 within the suspect period prior to the petition date (ie, 90 days for transfers to third parties and one year for transfers to insiders) 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. The elements of a preference claim are: (a) a transfer of an interest of the debtor in property; (b) to or for the benefit of a creditor; (c) for or on account of an antecedent debt owed by the debtor before such a transfer was made; (d) which is made while the debtor was insolvent; (e) during the suspect period; and (f) that enables the creditor to receive more than it would have in a Chapter 7 liquidation. There is no need to show any fault of either the debtor or the recipient in connection with the payment having been made.

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

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

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

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Question 3.1 [3 marks]

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Describe the circumstances in which a bankruptcy court may enter a final order, who reviews appeals from bankruptcy court orders and how are non-final orders reviewed?

Final orders are orders which dispose of all issues such that nothing further needs to be decided, while non-final orders resolve only some issues or claims. A bankruptcy court may enter a final order on a discrete dispute (*Bullard v Blue Hills Bank* 135 S Ct 1686 (2015)). An appeal may be filed against a final order as of right, and the appeals from bankruptcy court decisions are heard by the district court for the district in which they sit or in some circuits, by a Bankruptcy Appellate Panel comprising judges of the bankruptcy courts within the circuits. Non-final orders may only be reviewed with the leave of the appellate court.

Commented [H(38)]: Bankruptcy courts may enter final orders on certain core matters that are created by the Bankruptcy Code, such as a challenge to a petition, or when the parties consent. A constitutionally non-final order is treated by the district court as a report and recommendation.

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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?

By 11 U.S. Code § 1520, sections 361, 362, 363, 549 and 552 apply on the recognition of a foreign main proceeding. Upon the recognition of a foreign main proceeding, there is an automatic stay of creditor action against the property of the debtor within the territorial jurisdiction. On a discretionary basis, pursuant to 11 U.S. Code § 1521, the bankruptcy court may on application of the foreign representative: (a) stay the commencement or continuation of an individual action or proceeding concerning the debtor's assets, rights, obligations or liabilities to the extent they have not been stayed

Commented [H(42)]: Correct, 1 mark. this entitles creditors to adequate protection

Commented [H(43)]: Correct, 1/2 mark, this authorizes sales of assets outside the ordinary course

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

under section 1520(a); (b) stay the execution against the debtor's assets to the extent it has not been stayed under section 1520(a); (c) suspend the right to transfer, encumber or otherwise dispose of any assets of the debtor to the extent this right has not been suspended under section 1520(a); (d) provide for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities; (e) entrusting the administration or realisation of all or part of the debtor's assets within the territorial jurisdiction of the United States to the foreign representative or another person, including an examiner, authorized by the court; (f) extending relief granted under section 1519(a); and (g) granting any additional relief that may be available to a trustee, except for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a) of the Bankruptcy Code.

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

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

Question 3.3 [4 marks]

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

Directors owe a fiduciary duty of loyalty to the Delaware corporation's best interest and a duty of care in decision-making. When the corporation is potentially or actually insolvent, such duties remain owed to the corporation and its shareholders, not to creditors. The business judgment rule protects directors from liability for errors of judgment - it presumes that the board of directors acted in good faith on the basis of reasonable information.

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

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

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

Question 3.4 [5 marks]

Commented [H(53)]: Total marks 5/5

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

Assuming that the debtor is an eligible debtor (*ie*, involuntary proceedings cannot be commenced under chapters other than 7 and 11 and the debtor is not a farmer, family farmer or not-for-profit organisation), the following requirements must be fulfilled to qualify as a petitioning creditor in an involuntary proceeding:

- (a) The claim against the debtor must be non-contingent. In other words, it does not depend on the occurrence of a future event.
- (b) The claim must not be the subject of 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 against the existence or quantum of the debt is not sufficient to amount to a bona fide dispute.
- (c) The claim must be in the amount of at least USD 16,750 (periodically increased due to inflation), either unsecured or undersecured or separately or in the aggregate with all other petitioning creditors' claims.

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

Commented [H(57)]: Correct, 1/2 mark

Commented [H(58)]: Correct, 1/2 mark

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

The involuntary petition form requires that the petitioning creditors allege either that the debtor is generally not paying its debts as they fall due, unless they are the subject of a bona fide dispute as to liability or amount, or that within 120 days before the filing of the petition, a custodian (other than trustee, receiver, or agent) was appointed or took possession (11 U.S. Code §303).

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

Commented [H(61)]: Total marks 10/15

Question 4.1 [5 marks]

Commented [H(62)]: Total marks 4/5

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?

The effect of a Chapter 11 petition being filed by Speculation Inc is an automatic stay of: (a) the commencement or continuation of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the filing of the petition, or to recover a claim against the debtor that arose before the filing of the petition; (b) the enforcement of a judgment obtained before the commencement of the case; (c) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate; (d) any act to create, perfect, or enforce any lien against property of the estate; (e) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the filing of the petition; (f) any act to collect, assess, or recover a claim against the debtor that arose before the filing of the petition; (g) the setoff of any debt owing to the debtor that arose before the filing of the petition against any claim against the debtor; and (h) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title (11 U.S. Code §362).

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

For the situations listed, the effect of the filing of the petition is as follows:

(i) DOJ investigation

The filing of the petition will not affect the DOJ investigations as these are criminal investigations.

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

(ii) Margin loan default

As the broker is a secured creditor of Speculation Inc, the filing of the petition stays any action that may be brought by the broker to obtain the moneys due from the margin loan default.

Commented [H(65)]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay, so the broker may liquidate the collateral.

(iii) Delinquent lease

For Speculation Inc falling behind on rent payments, the landlord is barred from bringing an action to claim rental arrears because of the stay on proceedings and/or claim that arose before the filing of the petition (see 11 U.S. Code §362(a)(1)). However, assuming that this pertains to a nonresidential real property, there may be an exception to any act by a lessor to the debtor where its lease has terminated by its expiration before the filing of the petition or during the petition to obtain possession of such property (see 11 U.S. Code §362(b)(10)).

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

(iv) Employment discrimination lawsuit

As the employment discrimination lawsuit was brought by the employee herself, it may not fall within the exception to the stay in 11 USC § 362(b)(4) where the stay does not apply to "the commencement or continuation of an action or proceeding by a governmental unit" to enforce its "police and regulatory power". The present situation is therefore unlike the one considered 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, 2018), where the Equal Employment Opportunity Commission brought the claim as part of its regulatory prerogative to safeguard public policy and welfare.

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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 could be recognised by a US bankruptcy court pursuant to 11 USC § 101(23), which defines a "foreign proceeding" broadly 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". Although it may be refused recognition on the basis that it would be manifestly contrary to US public policy, the circumstances in which this occurs is narrow. Whether it would be characterised as a foreign main or non-main proceeding turns on whether the proceedings were commenced in the debtor's centre of main interest ("COMI") - if that is answered in the affirmative then it would be foreign main proceedings. On these facts, it appears that the COMI of Stella SA is France - an English scheme of arrangement would therefore be a foreign non-main proceeding.

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

Commented [H(70)]: Correct, 1 mark, the other factors would be unlikely to overcome the presumption in favor of the jurisdiction of incorporation.

Commented [H(71)]: Correct, 1 mark, the retail store in England would be the necessary establishment

Commented [H(72)]: Total marks 3/5

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?

A contract is executory if there are material unperformed obligations on both sides, such that the failure of either party to complete performance would constitute a material breach excusing performance of the other. The license agreement to manufacture Xblox is an executory contract, and remains valid and enforceable until the debtor rejects the agreement.

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

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

Yes. Although ToyCo is a potential creditor of GameMart for any unpaid monthly royalties and termination fees pursuant to the license agreement, GameMart can transfer the Xblox by way of a 363 sale with court approval. This furthers the legislative intent of Chapter 11, which was enacted to permit a debtor in possession to continue to operate its business in the ordinary course while carrying out an organisational and/or financial restructuring. However, if the Xblox license constitutes substantially all of GameMart's assets, then ToyCo may object that the transaction amounts to a sub rosa plan - court approval for the 363 sale may be withheld if the sale thwarts plans of reorganisation by causing the ultimate allocation of value to be a forgone conclusion. That said, such an objection is seldom successful.

Commented [H(74)]: Incorrect, the consent of the patent owner is required because of substantive IP law.

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

*Notwithstanding the anti-assignment clause in the lease, it appears that so long as outstanding defaults are cured, the unexpired factory lease may be assigned to the buyer of the factory lease without Land Corp's consent. 11 U.S. Code §363(f) allows a debtor in possession (ie, GameMart) to sell property of the estate "free and clear of any interest in such property," and the factory lease is an "interest in such property." However, the law is not particularly clear on this point - for the line of cases in the 18th to 19th century, it seemed that where the sale (and assignment) of the lease to another was against a covenant, the courts have been reluctant to find a breach of the covenant where the assignment was not voluntary, but by operation of the law (see for eg, *Durand & Co v Howard & Co* 216 Fed 585). It remains open to Land Corp to argue that this 363 sale was not involuntary per se, and therefore GameMart should not be allowed to transfer the lease without its consent.*

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

* End of Assessment *