



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 46.5/50

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

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 allows a creditor who has a claim against a debtor, and who also owes money to the same debtor, to net out the two or more obligations. Setoff can improve the position of the creditor as opposed to other unsecured creditors who are not owed money by the debtor – it decreases the obligation to the estate by the full amount owed by the debtor rather than the difference (the lesser amount) the debtor would have to pay on the unsecured claim.

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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 bankruptcy court's local rules. It is also important to know of the judge's personal practices.

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Commented [H(21)]: 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 rule requires that payment in full must be made to each category of claims before the next category receives anything. A corollary of this rule is that no creditor or class of creditors may receive less under a plan of reorganisation than it would under a hypothetical Chapter 7 liquidation (where the claims are paid in accordance with statutorily required priorities, without the affected creditor's consent).

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Under a Chapter 11 plan, the absolute priority rule can be deviated from with the consent of the affected creditors. For example, a senior creditor could consent to receiving less than their entitlement under the absolute priority rule if distribution of funds to lower priority claimants is necessary to obtain their approval of the plan. The absolute priority rule cannot be deviated from in Chapter 7 – the statutory priorities must be strictly followed.

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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?

This is a lien that is senior or equal to a pre-petition lien on estate property. The debtor must show that the interest of the secured creditor which is being primed is adequately protected. A priming lien is usually granted by the court as a last resort, where the debtor is unable to obtain any other type of financing.

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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 – this property will have to 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.

These are the elements of a preference claim:

- There must be a transfer of an interest of the debtor in property
- This transfer must have been to or for the benefit of the creditor
- This transfer must be for or on account of an antecedent debt owed by the debtor before such transfer was made
- This transfer must have been made during the suspect period, while the debtor was insolvent.
- The transfer enables the creditor to receive more than it would have in a Chapter 7 liquidation.

The showing of fault, by either the debtor or creditor, is not required.

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?

A bankruptcy court may enter a final order in core proceedings – but the US Supreme Court has held, in *Stern v Marshall*, that even in core proceedings, a bankruptcy court cannot issue final orders that invade Article III jurisdiction.

A bankruptcy court may exercise a district court's delegated authority to enter a final order on a motion challenging a petition. A bankruptcy court can also, in determining a core proceeding, issue final orders with parties' consent.

Appeals from bankruptcy court decisions are heard by the district court for the particular district in which they sit. In some circuits, bankruptcy appeals are heard by a Bankruptcy Appellate Panel ("BAP") – in these circuits, the party can request that the appeal be heard by the district court instead.

From either the district court or BAP, there is a further avenue of appeal to the circuit court of appeals. An appeal from the bankruptcy court can go directly to the court of appeals if the bankruptcy or district court certifies that: a) the appeal raises a point of law for which there is no controlling decision of the circuit or Supreme Court, or there are conflicting decisions which need to be resolved or b) that immediate appeal may advance the progress of the case.

A *de novo* review is undertaken for non-final orders – the district court or BAP reviews *de novo* all findings of fact and conclusions of law to which a party has objected.

Question 3.2 [3 marks]

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

These are the provisions of the Bankruptcy Code which automatically apply to the debtor's property within the territorial jurisdiction of the United States (11 U.S. Code § 1520):

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

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Commented [H(38)]: Correct, 1/2 mark

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- a. Sections 361 and 362 apply with respect to the debtor and property of the debtor that is within the territorial jurisdiction of the US
- b. Sections 363, 549, and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the US to the same extent that the sections would apply to property of an estate
- c. Unless the court orders otherwise, the foreign representative may operate the debtor's business and may exercise the rights and powers of a trustee under and to the extent provided by sections 363 and 552.
- d. Section 552 also applies to the debtor's property that is within the territorial jurisdiction of the US.

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

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These are the discretionary reliefs which may be granted for either the foreign main or non-main proceedings:

- a. Authorization of discovery regarding the debtor's assets and affairs
- b. Entrusting administration of the debtor's US assets to the foreign representative or other person
- c. Extension of provisional relief
- d. Any other relief necessary to effectuate the purposes of Chapter 15 and to protect the assets of the debtor or the creditor's interests.

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

Commented [H(49)]: 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 corporation's best interest. They also owe a duty of care in educated decision-making.

The directors owe their duties to the corporation and its shareholders. They do not owe their duties to creditors even when the corporation is potentially or actually insolvent.

The rule protecting directors from liability for errors of judgment is the business judgment rule.

Under this rule, directors are presumed to have acted in good faith on the basis of reasonable information. This presumption can be rebutted by showing that a majority of the board was, in fact, not reasonably informed and did not honestly believe that their decision was in the corporation's best interest, or were not acting in good faith.

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

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

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

Question 3.4 [5 marks]

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

These are the requirements:

1. The creditor must have a claim against the debtor that is:
 - a. Non-contingent – this means a claim which is not dependent on the occurrence of a future event.
 - b. Not the subject of a bona fide dispute as to liability or amount – there must be no objectively reasonable basis for a dispute as a matter of fact or law.
 - c. 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 (this amount is periodically increased due to inflation).

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

Commented [H(59)]: Correct, 1/2 mark

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

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

2. The petitioner must also allege that the debtor is generally not paying its debts as they become due or that within 120 days before filing of the petition, a custodian (other than a trustee, receiver, or an agent appointed or authorized 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.

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

Commented [H(63)]: Total marks 11.5/15

Question 4.1 [5 marks]

Commented [H(64)]: 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 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?

When a Chapter 11 petition is filed, a worldwide automatic stay comes into effect. These are the effects the stay would have on the aforementioned factors:

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- **DOJ Investigation:** The Chapter 11 petition has no effect. Exceptions to the stay cover criminal proceedings and regulatory investigations.
- **Margin loan default:** The broker cannot seize control of the Speculation Inc shares which have been used as collateral. The Bankruptcy Code prohibits any act to obtain possession or control of property of the estate.
- **Delinquent Lease:** The Bankruptcy Code prohibits any attempts to collect on rent owed pre-petition (including through letters of demand or calls).
- **Employment discrimination lawsuit:** This will be stayed. The Bankruptcy Code prohibits litigation on pre-petition claims.

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

Commented [H(67)]: Incorrect, the margin loan is a securities contract that is exempt from the automatic stay, so the broker may liquidate the collateral.

Commented [H(68)]: Correct, 1/2 mark, it also prohibits eviction

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

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?

I think that the English scheme of arrangement could be recognised by a US bankruptcy court under Chapter 15. Recognition requirements are minimal – all that must be shown is that there is a foreign court or administrative proceeding with respect to the debtor that is pending and that the foreign representative is empowered to act by the proceeding.

In this case, any such recognition would be as a foreign non-main proceeding. I proceed on the assumption that there is no attempt to shift Stella's COMI from the time court proceedings are commenced in the UK to sanction the scheme of arrangement proceedings, and the commencement of recognition proceedings in the US.

There is a rebuttable presumption that a debtor's COMI is its place of incorporation. From this, it follows that Stella's COMI is in France where it has its headquarters.

Stella only has stores in the UK – if proceedings (ie, an application to sanction a scheme of arrangement) are taken out in the UK, then those proceedings would be considered as foreign non-main proceedings. Stella only has an establishment in UK (which was a place where Stella carried out non-transitory economic activity through the sale of goods in its shops in the UK).

This affects the reliefs which may be granted upon recognition of the UK proceedings as foreign non-main proceedings. Reliefs such as a stay or avoidance of post-petition transfers will only be granted on a discretionary basis.

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

Commented [H(72)]: Correct, 1 mark, the connections with other jurisdictions are not sufficient to overcome the presumption. Because the English proceedings are not in Stella's COMI, foreign main recognition is not available.

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

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 Xblox an executory contract?

An executory contract is one where there are material, unperformed obligations on both sides. The license to manufacture Xblox is an executory contract – there are material, unperformed obligations on both sides. On Gamemart's part, it must pay ToyCo monthly royalties. On ToyCo's part, it must continue to allow Gamemart to continue to utilise its patents to manufacture the Xblox.

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

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

GameMart cannot transfer the Xblox license as part of the 363 sale without ToyCo's consent. Generally, the Bankruptcy Code abrogates contractual restrictions on assignment so as to allow the debtor to achieve a higher value for its assets than if such provisions were enforced – that said, counter-party consent is required in cases where substantive non-bankruptcy law, such as intellectual property licensing law (pertinently in this case) provides that the counter-party cannot be compelled to accept performance from a transferee.

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Commented [H(77)]: 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 should be able to transfer the factory lease as part of 363 sale without Land Corp's consent. The Bankruptcy Code abrogates contractual restrictions on assignment. This allows debtors such as GameMart to achieve a higher value for its assets than if such provisions were enforced.

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*** End of Assessment ***