



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 36/50

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

Commented [H(2)]: Total marks 6/10

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)]: Incorrect, the correct response is (a)

*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)]: Incorrect, the correct response is (e)

*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)]: 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)]: Incorrect, the correct response is (d)

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]

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

**Question 2.1** (1 mark)

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

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

Setoff allows a creditor who holds a claim and owes money to a debtor to net out the claim and the owed amount. This can improve the position of a creditor compared to other unsecured creditors who are not owed money by the debtor. This is because it decreases its obligation to the estate by the full amount owed to the debtor rather than the lesser amount the debtor would pay on the unsecured claim.

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

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

**Question 2.2** [2 marks]

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

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

Review the Bankruptcy Rules, Federal Rules of Civil Procedure. You should also review the local rules of the bankruptcy court because they tend to contain the local practices and the judge's preferred ways, but it can modify deadlines for filings and responses. If there is a bankruptcy in a jurisdiction you don't practice, you should consult with a local practitioner for advice on common unwritten local procedures.

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

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

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

Commented [H(21)]: Correct, 1/2 mark, note these are usually on each judge's webpage, not in the local rules

**Question 2.3** [2 marks]

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

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

The absolute priority rule requires that payment must be made in full to each category of claims before the next category receives anything. In the first 90 days of a chapter 11 the proposed plan can cause deviation if affected creditors consent, this may cram down certain creditors. In this case absolute priority rule does not apply. Deviation is not permitted in chapter 7 because statutory priorities must be strictly followed.

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

Commented [H(24)]: this is not a requirement

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

Commented [H(26)]: Correct, 1/2 mark

**Question 2.4** [2 marks]

Commented [H(27)]: Total marks 2/2

**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 gives priority in collateral over the pre-petition secured lenders. They will do this by "rolling up" and refinancing pre-petition debt that was unsecured or undersecured. This will be granted by the court if any other financing cannot be obtained. The debtor must also show that the interest of the secured creditor being prime is adequately protected.

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

Commented [H(29)]: This is not the only circumstance in which priming debt may be incurred

Commented [H(30)]: Correct, 1/2 mark

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

**Question 2.5** [3 marks]

Commented [H(32)]: Total marks 3/3

**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 when there has been a transfer of the debtor's property that was made in a suspect period before the petition date. This must be returned to the estate if it exceeded the amount the recipient would receive in a chapter 7.

The elements are that:

- The debtor transferred property to or for the benefit of the creditor
- The transfer was made on account of a debtor's pre-existing debt to the creditor
- The debtor was insolvent at the time of the transfer
- The transfer was made 90 prior to bankruptcy filing or one year if the creditor is an insider
- The creditor obtained more than they would under Chapter 7

There is no need to show any fault by the debtor or creditor and the recipient creditor suffers no penalty other than return of the transfer.

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

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

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

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

Commented [H(37)]: Correct, 1/2 mark

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

Commented [H(38)]: Total marks 12.5/15

#### 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?**

Commented [H(39)]: Total marks 1/3

Final orders dispose all issues leaving nothing further to be decided, they may be appealed. Appeals from bankruptcy court decisions are heard by the district court but in certain circuits they are heard by a Bankruptcy Appellate Panel ("BAP"). The order of the BAP or district court is reviewed by a circuit court of appeal as to conclusions of law and for abuse of discretion for findings of facts.

Commented [H(40)]: A bankruptcy court has constitutional authority to enter a final order on a challenge to a petition or on another core matter with consent of the parties. An order for which it does not have authority to enter a final order is treated as a report and recommendation / proposed findings of fact and conclusions of law

Commented [H(41)]: Correct, 1/2 mark

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

Commented [H(43)]: Total marks 3/3

#### 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?**

The provisions of the Bankruptcy Code that automatically apply are:

- There is 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.

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

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

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

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

On a discretionary basis the following relief may be granted:

- Authorization of discovery of the debtor's assets and affairs as per Rule 2004 of the Federal Rules of Bankruptcy Procedure
- Entrust the administration of the debtor's US assets to the foreign representative or other person
- Extension of provisional relief
- Any other relief that is needed to protect the assets of the debtor or the interests of creditors

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

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

Commented [H(50)]: Also correct



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.

These duties are owed to the corporation and its shareholders not the creditors. Their duty remains to the company and shareholders in the case of insolvency.

Directors are protected from liability of errors of judgment by the *business judgment rule*. Under this rule directors are presumed to have acted in good faith on the basis of reasonable information. It can be rebutted only if most of the board were not reasonably informed and did not believe their decision was in the corporation's best interest or were not acting in good faith. Directors may be exculpated by a company's certificate of incorporation from liability for breach of duty of care

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

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

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

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

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

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 that is:

- Non-contingent. A contingent claim is one that depends on the occurrence of a future event. A debt that is unmatured is not contingent if all requirements for liability other than the passage of time have occurred.
- 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. If the debtor believes that the debt is not owed or the amount claimed is incorrect, it is not sufficient. If the portion of the amount claimed is disputed the creditor cannot use the undisputed portion to reach the monetary threshold of USD 16,750. A dispute as to one claim does not disqualify application of other, undisputed claims that are held by the same creditor to meet petitioning creditor requirements.
- Unsecured or undersecured, separately or in the aggregate with all other petitioning creditors' claims totalling to at USD 16,750

Commented [H(56)]: Total marks 4.5/5

Commented [H(57)]: The creditor must also allege that the debtor is insolvent or that "within 120 days before the filing of this 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."

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

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

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

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

Question 4.1 [5 marks]

**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,**

Commented [H(64)]: Total marks 7.5/10

Commented [H(65)]: Total marks 3.5/5

**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?**

- i. Chapter 11 proceedings do not prevent the DOJ from investigating them. They can still be liable if they are found to be guilty of insider trading. This would be considered a criminal offence. The stay is subject to certain statutory exceptions such as criminal proceedings.
- ii. Due to the automatic stay, it will prevent the broker from taking the shares as collateral, however they can still be liable. In a chapter 11 it may be likely the Speculation Inc will try to rectify that default with its broker in their proposed plan.
- iii. Delinquent lease. The automatic stay that is granted once Chapter 11 proceedings commenced it would prevent the landlord from seeking repayment.
- iv. Once Chapter 11 is commenced the automatic stay will stay all litigation against the company preventing the employment discrimination lawsuit from continuing. In many past Chapter 11 cases companies who had big lawsuits pending having been accused of using Chapter 11 to avoid these lawsuits.

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

Commented [H(67)]: Incorrect, a margin loan is a securities contract and benefits from an exception to the automatic stay

Commented [H(68)]: Correct, 1 mark

Commented [H(69)]: Partially correct, 1/2 mark, the landlord cannot commence non-bankruptcy proceedings to recover rent or to evict Speculation Inc.

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

**Question 4.2 [5 marks]**

Commented [H(71)]: Total marks 1/5

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

An English scheme of arrangement will be recognised in the US bankruptcy court since there funding is governed by English law. The requirements for recognition only require, that a 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. It does not need to resemble a US bankruptcy.

To decide if this case will be a foreign main or non-main proceeding a COMI test will have to be performed. The factors that need to be considered for COMI are:

- location of headquarters
- location of management
- location of primary of assets
- location of a majority of debtor's creditors or majority of the creditors to be affected by the relief; and
- jurisdiction whose law will apply to most disputes

The company's main headquarters and headquarters are located in France. This will provide a strong case for France to be the COMI and making the English proceedings non-main. The company's funding is governed by English law with the bank loan and Eurobonds. Considering the restructuring of the debt would be focused on the funding governed by English law it provides the case for the scheme to be a foreign main proceeding.

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

It is likely that the English proceedings will be a foreign non-main due to it not having its registered office located in England although there are significant business dealings that occur and the contracts are governed by English law.

Commented [H(73)]: Incorrect, this is likely not sufficient to overcome France as the COMI and as the COMI is not in England, recognition as foreign main proceedings would be inappropriate

Commented [H(74)]: Incorrect, the retail store in England would satisfy the requirement of an establishment for foreign non-main recognition

**Question 4.3** [5 marks]

Commented [H(75)]: Total marks 3/5

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

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

Yes, it is an executory contract as the 10 year period has not passed and neither party have fully completed their obligations.

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

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

GameMart can transfer the license. However, the patents that the toys are covered by are protected so that the licenses cannot be terminated in connection with the sale of the intellectual property. There is however case law for and against the transferring licences with patents.

Commented [H(77)]: Incorrect, consent of the patent holder is required under substantive non-bankruptcy law

Commented [H(78)]: This is not relevant here because the licensee (GameMart) is in bankruptcy, not the patent owner (ToyCo)

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

The factory lease is assignable not needing the consent of Land Corp. GameMart's ability to assign contracts increases due to the nullification of ipso facto clauses that would allow for the termination or alteration of the rights in the contract. This is due to the debtor filing for bankruptcy.

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

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

\* End of Assessment \*