



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 39/50

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)]: 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

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.

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

Question 1.9

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.

Commented [H(11)]: The correct response is (c), but I cannot give you the mark because two answers are selected

Question 1.10

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.

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

QUESTION 2 (direct questions) [10 marks]

Commented [H(13)]: Total marks 9/10

Question 2.1 (1 mark)

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

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

When a creditor is owed money by the debtor (\$2000), while concurrently owing money to the debtor (\$1000 - perhaps from another purchase order, project, rebate), in theory the two (or more) balances can be applied to one equation, thus leaving only one net debtor or creditor (in our simple instance, \$1000 owed to the creditor by the debtor) in that counterparty dynamic.

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

Setoff may improve a particular creditor's position when compared to other creditors of the debtor (via setoff, the creditor will have received 100 cents on the dollar for its claim - a far cry from what otherwise might be distributed, had it been one of many unsecured creditors in a cash-strapped bankruptcy estate). As such, it may not be permitted and the matter litigated.

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

Exceptions include commodity and security contracts - the macroeconomic public good derived from properly functioning financial markets overrides microeconomic creditor v. debtor insolvency scenarios.

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?

I would review the judge's personal preferences, practices and required procedures (oftentimes available online / posted by judicial clerks); local rules of the bankruptcy court are also helpful (as is consulting another attorney(s) who frequent that particular jurisdiction). Lastly, Federal Rules of Civil Procedure and Bankruptcy Rules should always be part of any pre-filing review.

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

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 all claims of a class of creditors who oppose a reorganization plan (dissenting class of creditors) to be paid in full. Also, in a Chapter 7 context, payment in full must be made to each category of claims before the subsequent category receives any distributions. In a Chapter 11 proceeding, acquiescence of affected creditors allows for deviations from the Absolute Priority Rule; not so in a Chapter 7 proceeding (strict statutory modus operandi).

Commented [H(23)]: Incorrect, the dissenting class can be impaired

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

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

The relatively recent addition to the Bankruptcy Code, Subchapter V (2019), provides an exception to the Absolute Priority Rule and allows for a cram down of dissenting

creditors without the consent of at least one impaired class; the owner / debtor can retain their equity without having necessarily paid all creditors in full. Alas, 100% of projected disposable income over the next 36 - 60 months will need to be applied towards payments (Chapter 13 on steroids).

Question 2.4 [2 marks]

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

Priming lien is a lien senior to pre-existing pre-petition liens of the bankruptcy estate property. It is offered as the ultimate incentive of last resort to induce prospective Debtor-In-Possession lenders to grant a new credit lifeline to the financially troubled debtor. There are several prior escalating inducements that must be considered before granting a priming lien. They include administrative status for extension of new unsecured credit (ordinary and non-ordinary - with court approval - course of business), allowing new unsecured debt to jump the capital stack ahead of administrative expenses, or encumbrance of previously free and clear properties by a proposed lender. When those steps do not yield a willing creditor, a priming lien may have to come into play. Pre-existing creditors might be incentivized to throw more new money into the pot, lest their (initially senior) interests become primed down by the emergence of a de novo DIP lender.

Commented [H(26)]: Total marks 1.5/2

Commented [H(27)]: Correct, 1 mark

Commented [H(28)]: Correct, 1/2 mark, also the interests of secured creditors must be 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?

Preference is a transfer of property that occurred during a "suspect" (90 days pre-petition) period before the commencement of bankruptcy proceedings. If the value received by the creditor / recipient of said transfer exceeds what the creditor would have gotten in a Chapter 7 liquidation proceeding, the preference should be remitted back to the bankruptcy estate (unless the Trustee settles the preference litigation vis-à-vis the recipient for mutually agreed upon value, which occurs very frequently). The alleged transfer must have been associated with payment towards a pre-existing debt and for the benefit of a creditor. Prepayments towards goods and services (which bring forth "new value" defences) are not preferences, nor are contemporaneous exchanges of value.

There is no need to show any fault by either the debtor or the creditor.

Commented [H(29)]: Total marks 2.5/3

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

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

Commented [H(32)]: Correct, 1/2 mark, also the transfer must be of the debtor's interest in property

Commented [H(33)]: Correct, 1/2 mark

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

Question 3.1 [3 marks]

Commented [H(34)]: Total marks 14/15

Commented [H(35)]: Total marks 2.5/3

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?

Bankruptcy proceedings by nature deal with distressed scenarios, be it of the individual or corporate entity variety. Said scenarios are often chaotic and messy. Given that bankruptcy proceedings are the nexus of many separate controversies, the Supreme Court (via *Bullard vs. Blue Hills Bank*, 575 US 496) has held that bankruptcy courts can enter a final (for appeals purposes) order resolving a particular discreet dispute.

Bankruptcy Appellate Panels in the 1st, 6th, 8th, 9th- 10th circuits hear appeals from Bankruptcy Courts from those circuits; parties can request district court appeals instead. In other circuits, appeals will be heard by a randomly assigned district judge from where that bankruptcy court sits.

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

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

Standard of review branches out depending on whether the ruling in question was in a core (administration of the estate, claims, orders pertaining to obtaining credit, automatic stay, fraudulent conveyance, debt dischargeability, plan confirmation, recognition of foreign proceedings, to name a few) or non-core proceeding. Bankruptcy judges can only hear a core proceeding. In such a scenario, district court or Bankruptcy Appellate Panel reviews the Conclusions of Law anew (de novo), while reviewing Findings of Fact for abuse of discretion. The presumption is that the Bankruptcy Court has had greater opportunity to weigh the evidence in the matter. In a non-core scenario, the district court or Bankruptcy Appellate Panel reviews de novo any Findings of Fact and / or Conclusions of Law to which a party has objected. In case of subsequent appeal further up the judiciary ladder, Circuit Court of Appeals reviews de novo Conclusions of Law of a given appealed order, while examining for abuse of discretion within the Findings of Fact.

Commented [H(38)]: Partially correct, 1/2 mark, the bankruptcy court can adjudicate a challenge to a petition or another core proceeding with consent of the parties

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

Question 3.2 [3 marks]

Commented [H(40)]: Total marks 3/3

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?

Recognition of a foreign main proceeding will result in the automatic stay of all creditor actions within territorial United States. Furthermore, foreign representative may continue (ordinary course of business) to operate the debtor's business and sell / transfer property outside the ordinary course of business. Post-petition transfers and security interests may be avoided.

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

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

Commented [H(43)]: Correct, 1/2 mark

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

Discretionary relief may include actions to protect the assets of debtor and standing of creditors, commencement of discovery into the debtor's affairs and allowing the foreign representative to become an administrator of the debtor's US-based assets.

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

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

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 when it comes to corporate best interests, as well as duty of care in prudent decision making. Business judgment rule protects the directors from errors in judgment due to its presumption of directors' good faith on the basis of reasonable information.

The directors' duties are only owed to the corporation and its shareholders and not to creditors, even if the corporation may be (or is) insolvent.

Commented [H(47): Total marks 4/4

Commented [H(48): Correct, 1 mark

Commented [H(49): Correct, 1 mark

Commented [H(50): Correct, 1 mark

Commented [H(51): 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.

The creditor's claim must be non-contingent (not dependent on the hypothetical occurrence of a future event - a prospect of a debtor default that may take place but has not), not subject to a bona fide dispute as to the debtor's liability or amount, and be unsecured or undersecured (ideally by itself, but if not then at least in combination with other creditor claims) by at least \$16,750. Also, the petitioning creditors need to allege a debtor's insolvency (inability to stay current on obligations as they become due) and / or that early stages of taking possession of debtor's property by secured creditors have begun.

Commented [H(52): Total marks 4.5/5

Commented [H(53): Correct, 1 mark

Commented [H(54): Correct, 1/2 mark

Commented [H(55): Correct, 1 mark, also the test for a bona fide dispute is objective, not subjective

Commented [H(56): Correct, 1 mark

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

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

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

Commented [H(59): Total marks 10/15

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, 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.

Commented [H(60): Total marks 3/5

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 petition would have no effect on the DOJ investigation, as that would fall into the category of criminal (or at the very least regulatory) investigation. Ditto for the margin loan default, as shares utilized as collateral would fall into the category of exercising collateral rights on a security (shares) contract and also fall into the category of safe harbour protections associated with commodity / security contracts; the public good of maintaining the well-being of financial markets trumps micro considerations. The employment discrimination lawsuit is a pending legal case and an automatic stay would be enforced against it, thus buying the debtor time.

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

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

Commented [H(63)]: Correct, 1 mark, also the landlord would be barred from pursuing eviction and the stay would come into effect on the filing of the petition

Question 4.2 [5 marks]

Commented [H(64)]: Total marks 3/5

Stella SA (Stella) is a 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?

English scheme of arrangement is often a much more flexible alternative to other jurisdictions. It can be used as a mechanism to creatively conjure up a wide range of restructuring solutions, such as debt for equity swaps, injection of new capital on terms beneficial to the debtor, re-amortization of repayment terms, etc. Alas, there needs to be a sufficient connection between the foreign company and England for the English court to allow it. Given that Stella's products are available for retail in England and its capital structure (bank loan and Eurobonds) is based on English law, I believe the English scheme would be applicable in this case, given the sufficiency of connections to England.

It would be a foreign non-main proceeding. Stella's Center of Main Interests (COMI) arguably is located in France, whereas the English scheme of arrangement would attempt to utilize the English connection (where Stella has had non-transitory economic activity presence).

Commented [H(65)]: Correct, 1 mark

Commented [H(66)]: Correct, 1 mark, the connections with other jurisdictions would not be enough to overcome the presumption of COMI in the place of incorporation, and proceedings not in the place of COMI cannot be foreign main proceedings

Commented [H(67)]: Correct, 1 mark, the store in England would qualify

Question 4.3 [5 marks]

Commented [H(68)]: Total marks 4/5

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 Xbox 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 Xbox toys are selling well, but GameMart's other toy lines are doing poorly, so it is considering a Chapter 11 bankruptcy. Answer the following questions:

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

Yes, as there are unperformed obligations on both counterparty sides. GameMart (licensee) owes ToyCo (licensor) monthly royalties for the duration of the contract, while ToyCo (in all likelihood) has contingent duties of its own - continued advertising and marketing support, possible copyright infringement indemnification (GameMart is merely a manufacturer of a design created by ToyCo) of the Xbox product. In fact, the sole contractual obligation of ToyCo can be that of forbearance of granting a manufacturing license to another producer / GameMart's competitor - Fenix Cattle Co v. Silver, 625 F.2d 290, 292.

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

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

Generally speaking, the answer would be affirmative (and relates to answer III below) - bankruptcy courts tend to support solutions that maximize value for the bankruptcy estate, non-consent vetos of counterparties be damned. In that sense, perhaps "yes". However, the license may be considered intellectual property and the scope of licensed rights and the assignability of the licensing contract under applicable non-bankruptcy law can also come into play. In that sense, perhaps "no". Section 365(n) offers a gamut of angles and pitfalls.

Commented [H(70)]: Correct, 1 mark, the right to manufacture a patented product is an IP license

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

Yes, the lease can be transferred notwithstanding the landlord veto power incorporated within it, courtesy of 11 USC 365(f). Counterparty consent is seldom required, as the Bankruptcy Court is loath to enforce restrictions that would preclude a debtor from achieving a higher monetization value vis-à-vis if said restrictive covenants were enforced to the letter. The landlord may and likely will attempt to secure adequate assurances of future performance from the new third-party lease assignee.

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

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

* End of Assessment *