INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
IN INTERNATIONAL INSOLVENCY LAW

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

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

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

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

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.

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The marker has flagged various instances of plagiarism and marks have been deducted accordingly. Please be reminded of the instructions pertaining to plagiarism contained in the Course Handbook as well as in the assessment itself.

Course Leader

Total marks 32/50
Note plagiarism in responses to questions 2.4, 2.5, 3.1, 3.2, 3.3, 3.4, 4.1, 4.2 and 4.3

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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 contact 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]: Incorrect, the correct response is (b)

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

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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

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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

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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]: Incorrect, the correct response is (c)

Which of the following regarding substantive consolidation is true?

(a) It respects the boundaries of corporate separateness.

(b) It is the treatment of two or more creditors as a single creditor to simplify the claims process.

(c) If a creditor can show it extended credit on the basis of corporate separateness, it has a valid objection to substantive consolidation.

(d) Substantive consolidation is commonly used to resolve bankruptcies of corporate groups.

(e) Authority for substantive consolidation comes from the Bankruptcy Code.

Question 1.10

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

(a) The location of the headquarters.

(b) The location of primary assets.

(c) The location of the majority of the affected creditors in the request for relief.

(d) The jurisdiction whose law will apply to most disputes.

(e) All of the above.

QUESTION 2 (direct questions) [10 marks]

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Question 2.1 (1 mark)

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

Setoff permits a creditor holding a claim against the debtor and simultaneously owing money to the debtor to net out the two (or more) obligations. The right of setoff ... allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A. The justification for permitting setoff is based on notions of fairness.

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- the creditor's claim against the estate is disallowed
- claim against the estate was acquired post-petition or in the 90 days prior to the petition
- creditor's obligation to the debtor was incurred in the 90 days prior to the petition

Generally, courts have only disallowed otherwise valid setoff in two categories of cases: (a) where the creditor committed an inequitable, illegal, or fraudulent act, or the setoff is against public policy, b) where the setoff would significantly harm or destroy the debtor's ability to reorganize.

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Question 2.2 [2 marks]

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

ANS:

We should review the Bankruptcy Rules, Federal Rules of Civil Procedure, local Rules of the Bankruptcy court and also the judges' personal practices. We can even consult with a local practitioner for advice in respect to the unwritten local practices followed.
The bankruptcy process is complex and relies on legal concepts like the "automatic stay," "discharge," "exemptions," and "assume."

Question 2.3 [2 marks]

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

ANS:

Some employee expenses, mainly for unpaid salaries and contributions to employee benefits plans for the 180 days prior to the petition date or cessation of business, are given administrative priority under chapter 7. Under the **absolute priority rule** can receive equitable treatment under a plan of reorganization comparable to that they would have received in a chapter 7 liquidation unless they consent.

The absolute priority rule requires that payment in full must be made to each category of claims before the next category receives anything. In a chapter 11 plan, deviation from the absolute priority rule is permitted with the consent of affected creditors, but deviation is not permitted in chapter 7, where the statutory priorities must be strictly followed.

Compliance with the absolute priority rule – no creditor or class of creditors may receive less under a plan of reorganization than it would under a hypothetical chapter 7 liquidation, in which the claims would be paid in accordance with statutorily required priorities, without consent of the affected creditor.

In a chapter 11 plan, however, a more senior creditor may consent to receiving less than the absolute priority rule would require if distribution of the funds to lower priority claimants is necessary to obtain their approval of the plan.

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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?

ANS:

Being a debtor in a US chapter 11 bankruptcy is very expensive. To maximize the chances of a successful reorganization, the Bankruptcy Code provides incentives to lenders and counterparties to extend credit to the debtor. This is commonly referred to as **debtor in possession (DIP) financing**. There are four alternative ways the estate may obtain creditor incur debt, in order of escalating protections.

If financing cannot be obtained on any other terms, the court may grant a **priming lien** that is senior or equal to a pre-petition lien on estate property to secure post-petition financing. Here the debtor also must demonstrate that the interest of the secured creditor being primed is adequately protected.

A lender is considered primed when they are surpassed by another lender with respect to their priority status regarding the collateral of a secured loan. This situation is also known as lien priming, because there are usually liens or other restrictions placed on the collateral in question.

Pre-petition creditors also may be able to improve their position by "rolling up" – refinancing pre-petition debt that was unsecured or under secured into the facility granted the priming lien.

Distributions in chapter 7 are made to holders of allowed unsecured claims in accordance with a detailed list of priorities, but such distributions are made only after satisfaction of secured claims from their respective collateral. If a priming lien was granted for post-petition financing, that financing will have priority in collateral over the pre-petition secured lenders.

As with a good faith purchaser at a 363 sale, a good faith DIP lender is protected from the effects

of a reversal of a DIP financing order on appeal.

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?

ANS:

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Course Leader

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Course Leader

The idea behind is that it is not fair when a troubled company selectively prefers to pay only certain creditors in the slide into bankruptcy. Some creditors might get most or all of what they are owed, while other creditors might get nothing. The purpose of Section 547 is two-fold: (1) it discourages aggressive creditors from racing to the courthouse to sue a faltering debtor; and (2) it promotes fairness and equality by evening the distribution of whatever money is left under supervision of the Bankruptcy Court.

Commented [H(33]: Copied from this blog post: https://hh-law.com/insights/blog/bankruptcy-preference-claims-three-words-you-dont-want-to-hear/

Preference payment is:

- Payment made on an antecedent debt (meaning a debt incurred before the time of payment);
- Payment made while the debtor was insolvent (a company can be insolvent before it files for bankruptcy);

- Payment made to a noninsider creditor, within 90 days of the filing of bankruptcy (when the creditor is an "insider" of the debtor-owners, relatives, officers, directors, and similar persons and entities-the time period increases from 90 days to one year);

- Payment made that allows the creditor to receive more than it would have received had the payment not been made in advance of, but paid through the bankruptcy proceeding.

Commented [H(34]: Correct, 1 mark, there is no intent requirement for the debtor or creditor be

The elements of a preference claim are:

- (1) A transfer of an interest of the debtor in property.

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The transfer may be of funds, property or an interest in property – that is, the granting of a lien. Transfer of property in which the debtor does not have an interest, such as property held as agent for another, cannot be a preference.

- (2) To or for the benefit of a creditor.

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If the recipient was not a creditor of the debtor prior to the transfer, the transfer cannot be a preference.

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- (3) For or on account of an antecedent debt owed by the debtor before such transfer was made.

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Preferences only arise where the debtor is paying a creditor for a pre-existing debt.

There are several statutory defenses to a preference suit. Three of those defenses are particularly applicable to business transactions.

- First, money paid by the debtor in a "contemporaneous exchange for new value" may not be avoided as a preference. If the payment is for something new and not an old debt, it may not need to be repaid by the creditor.
- Second, payments made "in the ordinary course of business" and "according to ordinary business terms" may not be avoided. If a customer orders 1,000 bags every month and always pays in 30 days, and those terms are typical for the industry, then any payments of that type within the 90-day preference window are probably defensible.
- Third, a "subsequent transfer of new value" may offset or negate the obligation to repay an already-made preference payment.

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

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Question 3.1 [3 marks]

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

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Course Leader

ANS: Bankruptcy courts were not part of the original federal court system, but were created by legislation under power granted to Congress by Article I of the US Constitution.

At the outset of each motion or pleading, parties must state whether the matter at issue is core or non-core, so that the bankruptcy court can determine the scope of its jurisdiction and power to render a final order or judgment.

After the 1984 amendments of the Bankruptcy Code, the bankruptcy courts' jurisdiction to resolve issues presented in core proceedings seemed well established. Intense focus was placed on the core / non-core distinction.

In 2011, however, the US Supreme Court held, in *Stern v Marshall*,[34] that even in core proceedings, a bankruptcy court cannot issue final orders that invade Article III jurisdiction.

§ 157 provides that a counterclaim is a core proceeding as to which a bankruptcy court can issue a final order, the US Supreme Court held that the bankruptcy court's issuance of a final order over a state law claim was unconstitutional under Article III. Thus, the jury verdict was the first final judgment and was conclusive of the issues.

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A bankruptcy court may exercise a district court's delegated authority to enter a final order on a motion challenging the validity of a petition. The US Supreme Court has held that bankruptcy judges may determine a core proceeding over which they lack constitutional authority by issuing a report and recommendation for review by the district court,(*Ins*

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Agency v Arkinson, 134 S. Ct. 2165 (2014).) the same procedure as in non- core proceedings, or, with the consent of the parties, may issue final orders. (*Wellness Int'l Network, Ltd. v. Sharif*, 135 S Ct 1932 (2015))

Bankruptcy court orders can be appealed by not only the litigants involved, but also can be appealed by other persons who are adversely affected by the ruling have a standing to appeal.

There is a distinction between final and Interlocutory orders. Final orders are those that dispose of all issues, leaving nothing further to be decided, whereas interlocutory orders resolve only some issues or claims. Final orders may be appealed as of right, whereas interlocutory orders may be appealed only with leave of the appellate court.

The US Supreme Court has held that a bankruptcy order resolving a discrete issue is a final order. *Bullard v Blue Hills Bank*, 135 S Ct 1686 (2015).

An order that is constitutionally final because the bankruptcy court had authority to enter it is not final for purposes of appeal if it does not resolve the entire issue in dispute. On the other hand, an order that resolves an entire dispute and therefore would be final for purposes of appeal may not be final in the constitutional sense if the parties have not consented to the bankruptcy court's jurisdiction.

In general, appeals from bankruptcy court decisions are heard by the district court for the district in which they sit.[42] In certain circuits,[43] however, bankruptcy appeals are heard by a Bankruptcy Appellate Panel (BAP),

From the district court or BAP, there is a further appeal of right to the circuit court of appeals.

where the bankruptcy court or district court certifies that either that the appeal raises a question of law to which there is no controlling decision of the circuit or the US Supreme Court, or requires resolving conflicting controlling decisions, an appeal from a bankruptcy court may go directly to the court of appeals.

For Review: If the ruling below was in a core proceeding over which the bankruptcy court had authority ,whether by law or by consent of the parties, to enter a final order, the district court or BAP reviews conclusions of law *de novo* and reviews findings of fact.

If the ruling was in a noncore proceeding or the bankruptcy court otherwise did not have authority to enter a final order, the district court or BAP reviews *de novo* all findings of fact and conclusions of law to which a party has objected. The order of a district court or BAP is reviewed by a circuit court of appeal *de novo* as to conclusions of law and for abuse of discretion for findings of fact.

Question 3.2 [3 marks]

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Course Leader

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?

ANS:

Upon recognition of a foreign main proceeding, certain provisions of the Bankruptcy Code automatically apply to the debtor's property within the territorial jurisdiction of the United States.

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Upon recognition of either a foreign main or non-main proceeding, the foreign representative is granted the right to intervene in any US state or federal court proceedings to which the debtor is a party.

The automatic stay in a ch. 15 proceeding is subject to a permit ,to filing of a plenary US bankruptcy proceeding even after the recognition of a foreign proceeding.

Upon recognition of a foreign Non-main proceeding, any of the following relief may be granted on a discretionary basis :

- 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.

The following recognition, either foreign Main or foreign Non- main, the following relief also may be granted on a discretionary basis:

- (1) authorization of discovery regarding the debtor's assets and affairs;
- (2) entrusting administration of the debtor's US assets to the foreign representative or other person;
- (3) extension of provisional relief;
- (4) any other relief "necessary to effectuate the purposes of chapter 15, and to protect the assets of the debtor or the interests of creditors."

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The power to operate the debtor's business in the ordinary course and the power to sell outside the ordinary course are subject to court approval, which come into effect upon recognition of a foreign main proceeding. This does not authorize the foreign representative to return funds collected in the US proceeding to the foreign proceeding for distribution.

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The grant of such relief is discretionary and requires the foreign representative to show that "the interests of creditors in the United States are sufficiently protected.

A court may provide additional assistance under the Bankruptcy Code

or other US law consistent with the principle of comity and the values underlying the Bankruptcy Code.

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1)just treatment of all holders of claims in the debtor's property

(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding

(3) prevention of preferential or fraudulent dispositions of property of the debtor

(4) distribution of proceeds of the debtor's property substantially in accordance with the order prescribed

(5) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

The Article 23, Model Law does not prescribe which powers should be granted, but indicates, in bracketed text, the types of actions to avoid or otherwise render ineffective acts detrimental to creditors that are available in this State to a person or body administering a reorganization or liquidation.

A foreign representative can only invoke the Bankruptcy Code avoidance powers in a plenary proceeding such as chapter 7 or 11.

A foreign representative may wish to commence plenary proceedings to obtain access to the Bankruptcy Code's avoiding powers where relief under other applicable law is unsatisfactory.

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Question 3.3 [4 marks]

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Course Leader

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?

ANS:

Delaware, is the pre-eminent US jurisdiction for corporate law. US director liability is more limited than elsewhere. As of 2018, over two-thirds of all Fortune 500 companies, and 1.3 million companies total, are incorporated in Delaware. Many other US states have modeled their corporate laws on Delaware's legislation.

Directors of Delaware corporations are subject to the fiduciary duties of *care* and *loyalty* (which include the subsidiary duties of *good faith*, *oversight* and *disclosure*).

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- **Duty of care.** *Care* requires informed, deliberative decision making based on all material information reasonably available.

- **Duty of loyalty.** *Loyalty* requires acting (including deciding not to act) on a disinterested and independent basis, in good faith, with an honest belief that the action is in the best interests of the company and its stockholders.

• This does not preclude directors from considering the interests of other constituencies in determining what is in the company's and stockholders' best interest.

Commented [H(62]: Copied from https://www.skadden.com/insights/publications/2020/02/directors-fiduciary-duties

Directors owe a fiduciary duty of loyalty to the corporation's best interest. Also they owe a duty of care in educated decision-making, but are protected from liability for errors of judgment by the **business judgment rule**. Under this rule, the board of directors is presumed to have acted in good faith on the basis of reasonable information.

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However this presumption can be rebutted by showing that a majority of the board in fact were not reasonably informed. It was not believed that their decision was in the corporation's best interest, or were not acting in good faith. The directors will not be liable in the absence of a showing of gross negligence, unless presumption is rebutted. Directors may be exculpated by a corporation's certificate of incorporation from liability for breach of the duty of care.

In general, courts applying Delaware law and evaluating board decisions will, in the first instance, apply the *business judgment rule* (BJR).

* **Rebuttable presumption.** The BJR is a rebuttable presumption that in making decisions directors act in accord with their fiduciary duties.

***Burden on plaintiff.** To rebut the presumption, a plaintiff has the burden of presenting evidence that directors were at least grossly negligent in not becoming adequately informed or were motivated by interests other than those of the company's stockholders as a whole (or acted in bad faith by consciously disregarding a known duty).

***Effect of failure to rebut.** If the BJR is not rebutted, Delaware courts will not second-guess a board judgment unless found to be not rational.

* **Nonrational decisions.** To make that finding, a court must conclude that the board's decision cannot be attributed to any rational business purpose related to the company.

The business judgment rule does not apply where a transaction is approved by a board majority that is not disinterested and independent or a controlling shareholder is on both sides of the transaction. In such circumstances, the transaction will be void unless the **entire fairness standard** is satisfied.

Certain Delaware Protections Permitted for Directors

Delaware law contains provisions that assist directors in satisfying their fiduciary duties, in defending against claims of breach of duty and in avoiding certain consequences of a breach.

- **Reliance on company records and others.**

- **Exculpation of certain personal liability for monetary damages.** Delaware corporations may include in their certificates of incorporation (COI) an exculpation provision for the benefit of directors.

- **Indemnification and expense advancement.** Delaware corporations may indemnify directors and advance their expenses (pursuant to COI, bylaw or agreement), when directors are or are threatened to be made parties to a range of proceedings, subject to specified limitations.

- **D&O liability insurance.** Delaware permits its corporations to purchase directors' and officers' liability insurance

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Directors' duties are owed to the corporation and its shareholders, not to creditors.

Even in circumstances where the corporation is potentially insolvent. Therefore the shareholders stand to receive nothing in bankruptcy.

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In *North Am Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92, 103 (Del 2007)

The Delaware Supreme Court has put to rest any suggestion that directors owe duties to creditors when a company is operating "in the zone of insolvency", or is actually insolvent.

Thus, there is no equivalent under US law of the concept of "wrongful trading" or "deepening insolvency". As held in *TrenwickAmLitigTrustvErnst&Young,LLP*,906A.2d168(DelCh2006:

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Delaware law imposes no absolute obligation on the board of a company that is unable to pay its bills to cease operations and to liquidate. Even when the company is insolvent, the board may pursue, in good faith, strategies to maximize the value of the firm.

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.

ANS: Creditors may commence an **involuntary** proceeding against an eligible debtor under either chapter 7 or chapter 11.

Involuntary Bankruptcy Petition requirements

Each petitioning creditor must hold a claim against the debtor that is neither contingent as to liability or the subject of a bona fide dispute, and. the claims must aggregate at least $16750(periodically increased) more than the value of any liens held with respect to the debtor's property.

Commented [H(68]: Correct, 1 mark, the claim cannot depend on the occurrence of a future event

Commented [H(69]: Correct, 1 mark, the test is whether there is an objective basis in fact or law to dispute the debt

Commented [H(70]: Correct, 1/2 mark

In re: Forever Green Athletic Fields, Inc.(2015), held that an involuntary bankruptcy petition filed under 11 U.S.C. §303 may be dismissed for being filed in bad faith even though the petitioning creditors met all of the required criteria for filing the petition. If the court dismisses an involuntary petition after a determination that it was filed in bad faith, the court may impose sanctions on the petitioning creditors. This provision forms the basis for the decision in *Forever Green*.

Requirement: The number of petitioning creditors required depends on how many non-contingent, non-insider creditors the debtor has — if it has fewer than 12 such creditors, only one is required to file an involuntary petition; if it has 12 or more such creditors, at least three qualifying creditors must join in the petition.

The involuntary petition form requires the petitioning creditors to allege either that the debtor is generally not paying its debts as they become 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 this petition.

Commented [H(71]: Correct, 1/2 mark

To qualify as a petitioning creditor, the creditor must have a claim against the debtor that is:

- Non-contingent
- Not the subject of *bona fide* dispute as to liability or amount :

  the debtor's subjective belief that the debt is not owed or the amount claimed is incorrect.

  If a portion of the amount claimed is disputed, the creditor cannot use the undisputed portion to reach the monetary threshold required

- All other petitioning creditors' claims, Unsecured or under secured, separately or in the aggregate in the amount of at least USD 16,750 (this amount is periodically increased due to inflation)

Commented [H(72]: Correct, 1 mark

- (a) An involuntary case may be commenced only under chapter 7 or 11 of this title, and only against a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such case is commenced.
  (b) An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—

  (1)
- by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount, or an indenture trustee representing such a holder.

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, 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?

ANS:

Chapter 11 of the US Bankruptcy Code's debtor-friendly rehabilitation regime. Its success and popularity have led other national legislatures to adopt some of its key features in their domestic insolvency regimes. Among those features are the automatic stay, powers to sell assets free and clear, avoid pre-petition transactions, and reject unprofitable contracts, and the adjustment of debts through a plan of reorganization.

- Continue business operations by the debtor in possession in ordinary course of business unless a trustee is appointed.
- The debtor discloses information, including assets, liabilities, and executory contracts.
- The debtor negotiates with creditors (and potentially with non-creditors interested in purchasing assets or financing its bankruptcy and / or post-bankruptcy operations) to develop a plan of reorganization.
- The plan of reorganization is voted upon by creditors and must be confirmed by the court.
- US trustee can be appointed by DOJ to oversee the detailed transactions ,financial transactions, books of accounts and such other documents can be disclosed.

Loan default can be financed upon negotiating with the broker(DIP) as his shares are held by the broker as collateral. The valuation of the shares can help Speculation .inc in getting further finance as DIP financing .

If financing cannot be obtained on any other terms, the court may grant a **priming lien** that is senior or equal to a pre-petition lien on estate property to secure post-petition financing.

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Commented [H(74]: Total marks 1/5

Updated: 0 marks

Course Leader

Commented [H(75]: Copied from Guidance Text

Commented [H(76]: Incorrect, the US Trustee and the trustee appointed in bankruptcy are difference parties. The DOJ investigation would not be stayed by the automatic stay upon the filing of the petition.

Commented [H(77]: Incorrect, this is a securities contract that is exempt from the automatic stay so the broker can sell the collateral

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

The lease of the office space is assignable during the reorganisation plan.

As regards the employment discrimination law suit shall be stayed upon automatic stay till the Bankruptcy proceedings conclude.

Question 4.2 [5 marks]

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?

ANS:
Chapter 15 is a new chapter added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. It is the U.S. domestic adoption of the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law ("UNCITRAL") in 1997, and it replaces section 304 of the Bankruptcy Code. Because of the UNCITRAL source for chapter 15, the U.S. interpretation must be coordinated with the interpretation given by other countries that have adopted it as internal law to promote a uniform and coordinated legal regime for cross-border insolvency cases.

The purpose of Chapter 15, and the Model Law on which it is based, is to provide effective mechanisms for dealing with insolvency cases involving debtors, assets, claimants, and other parties of interest involving more than one country. This general purpose is realized through five objectives specified in the statute: (1) to promote cooperation between the United States courts and parties of interest and the courts and other competent authorities of foreign countries involved in cross-border insolvency cases; (2) to establish greater legal certainty for trade and investment; (3) to provide for the fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested entities, including the debtor; (4) to afford protection and maximization of the value of the debtor's assets; and (5) to facilitate the rescue of financially troubled businesses, thereby protecting investment and preserving employment. 11 U.S.C. § 1501.

Chapter 15 was primarily designed to promote the fair and efficient administration of cross-border insolvencies; however, **it can be used to recognize foreign proceedings under not only insolvency laws but also laws (such as schemes of arrangement) relating to the adjustment of debts.(Thomas cook 2019 &Matalan)**

Commented [H(78]: The automatic stay bars the landlord from commencing eviction proceedings

Commented [H(79]: Correct, 1 mark

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An ancillary case is commenced under chapter 15 by a "foreign representative" filing a petition for recognition of a "foreign proceeding." (1) 11 U.S.C. § 1504. Chapter 15 gives the foreign representative the right of direct access to U.S. courts for this purpose. 11 U.S.C. § 1509. The petition must be accompanied by documents showing the existence of the foreign proceeding and the appointment and authority of the foreign representative. 11 U.S.C. § 1515. After notice and a hearing, the court is authorized to issue an order recognizing the foreign proceeding as either a "foreign main proceeding" (a proceeding pending in a country where the debtor's center of main interests are located) or a "foreign non-main proceeding" (a proceeding pending in a country where the debtor has an establishment, (2) but not its center of main interests). 11 U.S.C. § 1517

Immediately upon the recognition of a foreign main proceeding, the automatic stay and selected other provisions of the Bankruptcy Code take effect within the United States. 11 U.S.C. § 1520.

The foreign representative is also authorized to operate the debtor's business in the ordinary course. Id. The U.S. court is authorized to issue preliminary relief as soon as the petition for recognition is filed. 11 U.S.C. § 1519.

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If a full bankruptcy case is initiated by a foreign representative (when there is a foreign main proceeding pending in another country say UK in this case), bankruptcy court jurisdiction is generally limited to the debtor's assets that are located in the United States. 11 U.S.C. § 1528. The limitation promotes cooperation with the foreign main proceeding by limiting the assets subject to U.S. jurisdiction, so as not to interfere with the foreign main proceeding.

One of the most important goals of chapter 15 is to promote cooperation and communication between U.S. courts and parties of interest with foreign courts and parties of interest in cross-border cases. This goal is accomplished by, among other things, explicitly charging the court and estate representatives to "cooperate to the maximum extent possible" with foreign courts and foreign representatives and authorizing direct communication between the court and authorized estate representatives and the foreign courts and foreign representatives.

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Also, upon recognition of either a foreign main or non-main proceeding, the foreign representative is granted the right to intervene in any US state or federal court proceedings to which the debtor is a party. 11 USC, § 1524.

A foreign representative may seek dismissal of US plenary proceedings against a foreign debtor only if the foreign proceeding is recognized under ch 15 and the court concludes that the purposes of ch 15 would be best served by dismissal.

The requirements of recognition are minimal: the 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 by the proceeding.

A foreign proceeding need not resemble a US bankruptcy case to be recognized .

Upon recognition of a foreign non-main proceeding, the relief may be granted on a discretionary basis. The bankruptcy court must be satisfied that it is appropriate under US law for the assets in question to be administered in the foreign non main proceeding.

Proceedings in a jurisdiction other than the debtor's COMI can be recognized as foreign non-main proceedings only if the debtor had an **establishment** in the jurisdiction – a place where it carried out non-transitory economic activity – prior to the commencement of chapter 15 proceedings.

As a result of the *Bear Sterns* case, and the conclusion of most US courts that COMI is to be assessed as of the date of the US petition, not the commencement of foreign proceedings.It has been seen a process has been developed of shifting COMI through the conduct of the foreign proceedings themselves.

The facts set out in the case in hand mentions that the cosmetic products are made in Italy and shipped to its retail stores in Europe (including England), Asia, and North America.
The recognition for the foreign proceeding will be under head of Non main proceeding as the COMI of Stella shall not be considered in the us. It does have business transactions taking place by supplying products to retail stores. Considering it to be an establishment in the US. (An establishment is a place of operations where the debtor carries out a long term economic activity)
English scheme of arrangement may be recognized by a US bankruptcy court under Chapter 15.

A "foreign proceeding" is a "judicial or administrative proceeding in a foreign country ... under a law relating to insolvency or adjustment of debt in which proceeding the [debtor's assets and affairs] are subject to control or supervision by a foreign court for the purpose of reorganization or liquidation." 11 U.S.C. § 101(23).

A "foreign representative" the person or entity authorized in the foreign proceeding "to administer the reorganization or liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding may seek recognition in the US under chapter 15.

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Commented [H(85]: Incorrect, the proper analysis is whether England is Stella's COMI because that's where the foreign proceeding is pending

Commented [H(86]: Incorrect, the establishment is required to be in England, where the foreign proceeding is.

Question 4.3 [5 marks]

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Updated: 0 marks

Course Leader

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?

What makes a contract executory is not defined by statute, but has been given meaning through case law. A contract is said to be executory if there are material unperformed obligations on both sides.

Executory refers to something ,generally a contract that has not yet been fully performed or completed and is therefore considered imperfect or unassured until its full execution. Anything executory is *started* and not yet finished, or is in the process of being completed in order to take full effect at a future time.

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The manufacture of Xblox licence to Game Mart is an executory contract.

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An executory contract is an ongoing agreement between two parties who are responsible for completing certain obligations over a set period of time. They are written agreements that ensure each party is clear about their own and the other's responsibilities.

An example of an executory contract is an apartment lease. The lessee is expected to continue to pay and the lessor is expected to continue to care for the property until the end date in the contract.

Intellectual property licenses are typically considered to be executory contracts.

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

ANS:

Normally, a licensor must consent to the licensee's assumption or assignment. Most courts consider law outside of Bankruptcy Law and hold that if a licensor can prohibit its license from being assigned to another party, then the licensor may withhold its consent from the licensee either assigning or even assuming the license. The practical effect of these decisions is that licensees filing for bankruptcy could lose their licenses at the licensor's discretion.

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Bankruptcy courts generally attempt to maximize the value of executory contracts of firms involved with Chapter 11 or Chapter 7 bankruptcy. These contracts include intellectual property licenses e.g. The franchise agreement is not assignable because it includes a licence of Brand Name trademarks and trademark licenses are not assignable without licensor consent.

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In re Trump Entertainment Resorts, Inc, 526 BR 116 (Bankr D Del 2015) ("Federal trademark law generally bans assignment of trademark licenses absent the licensor's consent.") The United States Bankruptcy Court for the District of Delaware recently held that the Trademark Licence Agreement between Trump AC Casino Marks, LLC(Trump AC) and Trump Entertainment Resorts, Inc and certain of its affiliates (Trump Entertainment) was not assignable without Trump AC's consent.

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

ANS:

Notwithstanding the landlord approval provision, the lease of the office space is assignable without consent.

The right conferred by a leasehold upon the lessee "readily may be understood as an 'interest' in the property" within the meaning of section 363(f).

With Spanish Peaks and Qualitech steel two circuits have now ruled that a leasehold interest may be extinguished in a free-and-clear sale of property under section 363(f).

Non-residential leases and executory contracts are governed by section 365 of the Bankruptcy Code. The sale of an executory contract or lease must comply with the requirements of section 365 for its assignment to proposed purchaser.

Non-residential leases and executory contracts can provide considerable value to an asset sale as a buyer can often pick and choose those contracts that are most favorable to it.

Some courts have found that section 365 is the exclusive remedy available to a debtor in an unexpired leasehold situation. In *Precision Industries, Inc. v. Qualitech Steel* the Seventh Circuit Court of Appeals held a different view. *Precision* decision has stripped such lessees of the statutory protections afforded to them by Congress in section 365(h). Debtors are more likely to employ the use of section 363 of the Bankruptcy Code to eliminate unwanted leaseholds.

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Commented [H(93]: Correct, 1 mark

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*** End of Assessment ***